RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

EIGHTY-FIFTH CONGRESS

SECOND SESSION

PURSUANT TO

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CONTENTS

CHRONOLOGICAL LIST OF WITNESSES

	Page
I. Employment Act objectives and the stabilization of prices	1
Baumol, William J., professor of economics, Princeton University	6
Grover W. Ensley, executive vice president, National Association of Mutual Savings Banks	6
Edwin G. Nourse, economic consultant, Washington, D. C.	8
Joseph Aschheim, assistant professor of political economy, The Johns Hopkins University	16
George L. Bach, dean, Graduate School of Industrial Administration, Carnegie Institute of Technology	18
Betty G. Fishman, lecturer in economics, West Virginia University	20
Leo Fishman, professor of economics and finance, West Virginia University	23
II. The measurement of price changes and price relationships	49
Kenneth J. Arrow, professor of economics and statistics, Stanford University	50
Martin J. Bailey, professor of economics, University of Chicago	51
H. E. Riley, Chief, Division of Prices and Cost of Living, Bureau of Labor Statistics, United States Department of Labor	53
Oris V. Wells, Administrator, Agricultural Marketing Service, United States Department of Agriculture	55
III. Past price behavior viewed in the context of cyclical and secular economic changes	91
Clarence H. Danhof, professor of economics, Tulane University	92
Bert G. Hickman, senior staff member, the Brookings Institution	93
Thor Hultgren, research staff, National Bureau of Economic Research, Inc	97
John W. Kendrick, associate professor of economics, the George Washington University	99
IV. Interrelationships among prices, demands, and costs	127
Milton Friedman, professor of economics, University of Chicago	127
Abba Lerner, professor of economics, The Johns Hopkins University	128
Ruth P. Mack, research staff, National Bureau of Economic Research, Inc	130
Gardner Patterson, professor of economics, Princeton University	131
Richard Ruggles, professor of economics, Yale University	134
Nancy D. Ruggles, Bureau of Economic Affairs, United Nations	127
J. Frederick Weston, professor of finance, University of California, Los Angeles	138
V. Interrelationships among prices, employment, output, incomes, and resources	243
Clark C. Bloom, professor of economics, State University of Iowa	244
George D. Bodenhorn, professor of economics, University of Chicago	245
Carl F. Christ, associate professor of economics, University of Chicago	247
Otto Eckstein, professor of economics, Harvard University	249
John P. Lewis, professor of business economics and public policy, Indiana University	250

	Page
VI. Private pricing policies: Their formulation and effects	285
Wroe Alderson, Alderson & Sessions, Inc., Philadelphia	285
Lawrence E. Fouraker, professor of economics, Pennsylvania State University	286
Stanley C. Hollander, associate professor of business administration, Michigan State University	287
Robert K. Lanzillotti, associate professor of economics, State College of Washington	288
Alfred R. Oxenfeldt, professor of marketing, Graduate School of Business, Columbia University	290
VII. Relationships between public policies, private pricing policies, price changes, and price relationships	321
Joel B. Dirlam, senior consultant, Boni, Watkins, Jason & Co., Inc	321
George E. Lent, visiting professor and director of research, The Amos Tuck School of Business Administration, Dartmouth College	323
Warren L. Smith, associate professor of economics, University of Michigan	324
Myron W. Watkins, vice president, Boni, Watkins, Jason & Co. Inc. (see Joel B. Dirlam)	321
Murray L. Weidenbaum, senior operations analyst, Convair division, General Dynamics Corp	326
Simon Whitney, Director, Bureau of Economics, Federal Trade Commission	328
VIII. Formulating public policies for economic stability and growth	361
Oswald H. Brownlee, professor of economics, University of Minnesota	362
Allan G. Gruchy, professor of economics, University of Maryland	363
Richard A. Musgrave, professor of economics, University of Michigan	365
Arthur Smithies, professor of economics, Harvard University	367
General summary	393
Gardner Ackley, professor and chairman, Department of Economics, University of Michigan	394
Neil H. Jacoby, dean, Graduate School of Business Administration, University of California, Los Angeles	396
Albert E. Rees, associate professor of economics, University of Chicago	400
Herbert Stein, director of research, Committee for Economic Development	402
Robert C. Turner, professor of business economics and public policy, Indiana University	403

STATEMENTS AND EXHIBITS

Ackley, Gardner, professor and chairman, Department of Economics, University of Michigan	394
Alderson, Wroe, Alderson & Sessions, Inc., Philadelphia, Pa	285
Arrow, Kenneth J., professor of economics and statistics, Stanford University	50
Aschheim, Joseph, assistant professor of political economy, The Johns Hopkins University	16
Bach, G. L., dean, Graduate School of Industrial Administration, Carnegie Institute of Technology	18
Bailey, Martin J., professor of economics, University of Chicago	51
Letter to Hon. Joseph C. O'Mahoney	88
Monthly prices of petroleum products, 1957	58
Bloom, Clark C., professor of economics, State University of Iowa	244
Bodenhorn, George D., professor of economics, University of Chicago	245
Brownlee, Oswald H., professor of economics, University of Minnesota	362
Christ, Carl F., associate professor of economics, University of Chicago	247
Danhof, Clarence H., professor of economics, Tulane University	92
Dirlam, Joel B., senior consultant, Boni, Watkins, Jason & Co., Inc	321
Eckstein, Otto, professor of economics, Harvard University	249

	Page
Ensley, Grover W., executive vice president, National Association of Mutual Savings Banks, read by Roderick H. Riley, executive director, committee staff	6
Fishman, Betty G., lecturer in economics, West Virginia University	20
Fishman, Leo, professor of economics and finance, West Virginia University	23
Fouraker, Lawrence E., professor of economics, Pennsylvania State University	286
Gruchy, Allan G., professor of economics, University of Maryland	363
Hickman, Bert G., senior staff member, The Brookings Institution	93
Hollander, Stanley C., associate professor of business administration, Michigan State University	287
Hultgren, Thor, research staff, National Bureau of Economic Research, Inc	97
Jacoby, Neil H., dean, Graduate School of Business Administration, University of California, Los Angeles	396
Kendrick, John W., associate professor of economics, George Washington University	99
Lanzillotti, Robert F., associate professor of economics, State College of Washington	288
Lent, George E., visiting professor and director of research, the Amos Tuck School of Business Administration, Dartmouth College	323
Lerner, Abba, professor of economics, The Johns Hopkins University	128
Lewis, John P. professor of business economics and public policy, Indiana University	250
Mack, Mrs. Ruth P., research staff, National Bureau of Economic Research	130
Musgrave, Richard A., professor of economics, University of Michigan	365
Nourse, Edwin G., economic consultant, Washington, D. C	8
Ideal and working concepts of full employment	9
Oxenfeldt, Alfred R., Graduate School of Business, Columbia University	290
Patterson, Gardner, professor of economics, Princeton University	131
Rees, Albert, associate professor of economics, University of Chicago	400
Riley, H. E., Chief, Division of Prices and Cost of Living, Bureau of Labor Statistics, United States Department of Labor	53
Chart presentation	72
Ruggles, Richard, professor of economics, Yale University	134
Smith, Warren L., associate professor of economics, University of Michigan	324
Smithies, Arthur, professor of economics, Harvard University	367
Stein, Herbert, Director of Research, Committee for Economic Development	402
Turner, Robert C., professor of business economics and public policy, Indiana University	403
Weidenbaum, Murray L., senior operations analyst, Convair division, General Dynamics Corp	326
Liberalization of depreciation allowances for Federal income tax purposes	356
Wells, Oris V., Administrator, Agricultural Marketing Service, United States Department of Agriculture	55
Numbers of farms by size of acreage group, acreage size of farm, land in farms, and farm output	83
Weston, Frederick, professor of finance, University of California, Los Angeles	138
Whitney, Simon, Director, Bureau of Economics, Federal Trade Commission	328

ADDITIONAL INFORMATION

The significance of the words "maximum employment" as used in the Employment Act of 1946	1
Council on Prices, Productivity, and Incomes, first report, London, Her Majesty's Office, 1958	163

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

MONDAY, MAY 12, 1958

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

The Committee met at 10:15 a. m., pursuant to notice, in room P-38, the Capitol, Hon. Wright Patman (chairman of the committee) presiding.

Present: Representatives Patman (presiding), Bolling, Reuss, Talle, and Kilburn, and Senator Hoblitzell.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk; and James W. Knowles, economist in charge.

The CHAIRMAN. The committee will come to order.

This study of the relationship of prices to economic stability and growth evolved from the problems associated with prices which have arisen during the past 10 years work of the Joint Economic Committee.

The Employment Act of 1946 grew out of the legislative debate of public and private policies which would promote full or maximum employment of the Nation's resources, human and material. It evolved in a period when the paramount problems of economic policy concerned readjustment from a wartime to a peacetime economy. It was thought that this transition might involve widespread and perhaps persistent unemployment.

Before I go on I should like to offer for the record a study prepared by the committee staff in April 1955 entitled "The Significance of the Words 'Maximum Employment' as Used in the Employment Act of 1946."

(The material referred to is as follows:)

THE SIGNIFICANCE OF THE WORDS "MAXIMUM EMPLOYMENT" AS USED IN THE EMPLOYMENT ACT OF 1946

Those who work with the Employment Act of 1946 are continually challenged by the necessity of giving some content to the words "maximum employment" as used in the act. The Federal Government, it will be remembered, working in cooperation with private sectors of the economy and the State and local government, has undertaken to utilize its resources within the framework of the free, competitive enterprise system, in pursuit of the parallel objectives (1) "of creating and maintaining * * * conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work"; and (2) "to promote maximum employment, production, and purchasing power."[1] In the end, we shall see that maximum employment envisaged as part of the second objective is substantially identical with the opportunity for employment set forth in the first objective.

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[1] Employment Act of 1946 as amended, sec. 2.

In the economic and political journals a considerable literature has developed dealing with the meaning of sustainable maximum employment and the conditions under which it may best be attained. We are not interested here in exploring this literature, but confine ourselves to the legislative history of the act to discover what supporters of the act may have had in mind in using the word "maximum" in this important context.

CONFERENCE OF THE TWO HOUSES SUBSTITUTES "MAXIMUM" FOR "FULL"

Perhaps the most striking thing is that neither the expression "maximum employment" nor any consideration of its meaning bulk large in the extensive discussions which make up the legislative history of the Employment Act. Throughout two volumes of congressional hearings consisting of over 1,200 pages each, before the House and Senate committees, the entire discussion is couched in terms of full employment. With minor exceptions noted in a later paragraph, the word "maximum" scarcely appears.

As often happens in the case of legislation of this sort, the key word "maximum" makes its first appearance in the bill as it came out of the conference reconciling differences between the two Houses. All that the conference report tells us on the subject is the cryptic statement: "The term 'full employment' is rejected, and the term 'maximum employment' is the objective to be promoted."[2]

Prof. Stephen Bailey, having personally interviewed most of the parties involved for his study of the story behind the Employment Act, tells us somewhat more. Throughout five conference sessions the term "full employment" was debated, he tells us, just as it had been a point of contention from the very beginning of the bill's long history. Bailey then continues:

"Almost impossible of unambiguous definition, the phrase had been challenged by Taft and Radcliffe in the Senate, and had been completely deleted from the House substitute. In conference, Whittington made it clear that under no circumstances would the phrase be admitted; and, although the Senate managers had made an initial concession by deleting the phrase, they attempted for bargaining purposes to reintroduce it. At long last, Senator Tobey came through with "maximum" to replace "full", and everyone seemed satisfied."[3]

Without detracting from the late Senator Tobey's place as a compromiser, it is only fair to note that in the House hearings more than 3 months earlier, Representative Judd, while questioning Secretary of Commerce Wallace, had spoken of a bill which would indicate to the people that "we are going to do our utmost to achieve maximum employment * * * it is our purpose to promote maximum employment, but not saying that we certainly assure it * * *."[4]

On the Senate side, one witness—James L. Donnelly, executive vice president, Illinois Manufacturers' Association—throughout his statement spoke of the objective of legislation as being that of assuring "maximum employment * * * through maximum production and distribution of goods and services through competitive private enterprise."[5]

LEADERS EXPLAIN THAT "MAXIMUM" AND "FULL" ARE SUBSTANTIALLY SYNONYMOUS

For an understanding of the legislative significance of the word "maximum" we must therefore look upon it as a last-minute substitute for the word "full."

When the conference report was considered before the House, it was apparent that the sponsors of the bill felt that the last-minute substitution of a new word did not materially alter the intentions nor the tenor of the hearings. Representative John W. McCormack, at that time House majority leader, said:

"As for the phraseology of the bill, it calls for 'maximum employment, production, and purchasing power.' If one looks up the definition of 'maximum' in the dictionary, among other things one finds that 'maximum' means 'the greatest quantity of value attainable in a given case: the highest point or degree.' So I

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[2] H. Rept. No. 1520: Declaring a National Policy on Employment, Production, and Purchasing Power, and For Other Purposes, Conference report to accompany S. 380, 79th Cong., 2d sess.

[3] Bailey, Stephen K., Congress Makes a Law (1950), p. 225.

[4] Hearings before the Committee on Expenditures in the Executive Departments, House of Representatives, 79th Cong., 1st sess., on H. R. 2202, Full Employment Act of 1945, pp. 882–883. Hereafter referred to as House hearings.

[5] Hearings before a subcommittee of the Committee on Banking and Currency, U. S. Senate, 79th Cong., 1st sess., on S. 380, Full Employment Act of 1945, p. 668. Hereafter referred to as Senate hearings.

believe that those who try to draw a distinction between maximum and full are drawing one that in fact does not and under the provisions of this bill will not exist." [6]

Representative Whittington, of Mississippi, who had been one of the House conferees, stated:

"The term 'full employment' is rejected. The conference agreement uses the term 'maximum employment.' In my judgment it is synonymous with the high levels of employment of the House bill. * * *" [7]

Also, in a similar vein, Representative Sabath, of Illinois, observed that:

"* * * While this bill does not call for full employment in those very words, it does call for maximum employment, which is tantamount to full employment, properly construed." [8]

In presenting the conference report to the Senate, Senator Barkley, chairman of the Senate conferees, citing section 2 of the bill containing the word "maximum," concluded:

"* * * we feel that we have gone as far as possible, and as far as we should be required to go in providing what may be called full employment." [9]

Since the terms "maximum" and "full" were apparently thought of as being used more or less interchangeably (even though "full" had been found objectionable), it is appropriate for us here to examine more closely the legislative history of the bill while the words "full employment" were still the prevailing language.

EITHER WORD WAS TO CONNOTE A GOAL RATHER THAN A GUARANTY

It seems clear from the legislative record that both "maximum employment" and the earlier expression "full employment" were thought of as goals rather than as guaranties. As such, they were better left as working concepts rather than precisely defined in the statute.

In answering his own question "Should full employment be defined?" Mr. Beardsley Ruml gave voice to this view:

"* * * Like other goals, it is clearly unattainable and it would lose its virtue if it were. The statement of the goal and our sincere efforts to attain it will make the reality much closer to the ideal than if the ideal had never been expressed. There is some doubt in my mind, therefore, whether it is necessary or even desirable to define precisely what we mean by 'full employment.' It is a concept that will change from decade to decade as our ideas with respect to the relation between work and freedom change. A definition can hardly have any substantial practical consequences as to what is recommended or legislated under the bill. Why not leave the term 'full employment,' like 'liberty' and 'justice,' to stand as a goal of democratic government, and to derive its specific content from the will of the people as expressed from period to period by their free institutions?" [10]

PRECISE QUANTIFICATION OF GOAL WAS EXPRESSLY AVOIDED

Throughout the committee hearings on the bills and the floor discussions on the conference report, no attempt was made to state quantitatively precisely what level or percentage rate of unemployment might be considered tolerable in the minds of those who pleaded for the full-employment objective. Senator O'Mahoney, one of the sponsors of the Senate bill, presented a chart designed to show the difference between the labor force and an idealized line intended to show what prosperous employment would have been during the years [1900–50]. One may read from the chart a difference of approximately 1.5 million as the average level of employment which would have prevailed had we had "a system which would have prevented depressions." [11] A statement prepared by the Department of Agriculture in 1945 and submitted by Secretary Clinton P. Anderson, giving a 5-year forward estimate for 1950, places total unemployment at 2 million under what was characterized in the statement as a full-employment economic model.[12] Several other witnesses casually mentioned

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[6] Congressional Record, vol. 92, pt. 1, 79th Cong., 2d sess., p. 983.
[7] Ibid., p. 985.
[8] Ibid., p. 983.
[9] Ibid., p. 1138.
[10] Senate hearings, pp. 398–399.
[11] Ibid., pp. 27–29.
[12] Ibid., p. 313.

unemployment figures of 4 or 5 percent as not unreasonable (for example, Chairman Manasco of the House Committee).[13]

As opposed to these rare and tentative quantifications, there were those who specifically rejected the suggestion that precise levels could or ought to be stated quantitatively. Secretary of Labor Schwellenbach was one of these. In his statement before the Senate subcommittee, he said:

"Much discussion has ensued concerning the meaning of the term 'full employment.' As I construe the term it means a condition in which all who are able and willing to work can find jobs under satisfactory conditions. * * * I specifically decline to speculate upon the number of jobs which must be made available if we are to have full employment. This for the reason that I believe that, now at the war's end, there are too many imponderables concerning which accurate conclusions cannot be reached to enable us at this point specifically to determine how many jobs are required. * * *"[14]

This reluctance to quantify the levels of full employment or tolerable levels of unemployment doubtless came in large part from the view expressed by Senator Taft that one ought not to be too definite on the basis of "shifting statistics and figures based so largely on opinion."[15] He pointed especially to the difficulties and uncertainties involved in estimating the labor force, the key figure in arriving at full or maximum employment. While "full employment" implies a job for every member of the work force, the "work force" itself is not a fixed group. It is subject to constant seasonal movements of persons in and out, to say nothing of changes in the number of those seeking work as economic conditions vary or as the incentives and disposition of given individuals to work may change.

OPPORTUNITY AND AVAILABILITY OF JOBS ARE THE OBJECTIVE

Almost invariably, such attempts as were made at defining "maximum employment" fell back upon the words of section 2 of the Employment Act itself to give meaning to the ideals and concepts of the act.

If we remember that the words "maximum employment" were, in the minds of most supporters of the act, substantially synonymous with "full employment," the definitions given in connection with the conference report by Representative Patman, sponsor of the original House bill, and by Senator Murray, a cosponsor of the original Senate bill, are in this connection especially significant and enlightening.

Mr. Patman told the House:

"* * * This conference report clearly outlines a duty and an obligation on the part of the Federal Government to do everything within its power to provide maximum employment, which I construe to be full employment, if possible * * *.

"* * * Instead of using the actual words 'full employment' the declaration uses the accepted definition of full employment, 'conditions under which there are afforded employment opportunities, including self-employment, for those able, willing, and seeking to work.' "[16]

At about the same time Senator Murray was explaining the conference report to the Senate in very similar language:

"* * * Instead of using the words 'full employment,' the bill uses the accepted definition of full employment. The specific language used is 'conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work.'

"This concept embraces the entire labor force. It is the substance of what is meant by the words 'full employment.' "[17]

In summarizing the legislative history of the act, one can only conclude that "maximum employment," as used in the act, was intended to be a conceptual ideal rather than a precise, mathematical goal. Perhaps some may find it helpful in understanding that ideal by phrasing the objective as one of promoting conditions of "minimum unemployment" rather than its complement, "maximum employment." While the difference may be no more than semantic, few thoughtful people will quarrel with the effort and hope of keeping involuntary unemployment at a minimum.

The objective under the act may be likened to that of a merchant who sets for himself the goal of attaining "maximum" profits. In such a case one may have

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[13] House hearings, p. 816.
[14] Senate hearings, p. 572.
[15] Ibid., p. 700.
[16] Congressional Record, op. cit., p. 981.
[17] Ibid., p. 1141.

in mind some vague impressionistic benchmarks such as last year's level, or the level of some peak year, or, even less precise but more challenging, that of getting the utmost out of one's productive capacity and resources. But the goal, however set, is constantly being redefined as scores of controllable and uncontrollable factors enter on the plus and minus side. Even after one has budgeted to achieve "maximum" levels of profits (or, in terms of the Employment Act, "maximum" employment), the goal is subject to constant reinterpretation. It is possible, indeed, for different individuals to assign different meanings to the words since they will differ in their concepts of the attainable and the proper.

Perhaps, therefore, as Mr. Patman suggested before the House of Representatives:

"* * * It is idle to argue, as many economists do [about levels of unemployment]. * * * if we can agree upon the principle that there must be sufficient opportunity somewhere in the economy for everyone who is willing and able to work." [18]

Or, as Senator Murray is quoted as having said:

"Our American system owes no man a living, but it does owe every man an opportunity to make a living." [19]

Finally, it is well to remember that, no matter how interpretations may differ, the expression "full employment" (or maximum employment), need not be too mysterious. As a representative of the National Association of Manufacturers told the House committee, it "has no hidden implications and merely summarizes the legitimate and attainable economic aspirations of a free people." [20]

ADMINISTRATIVE DETERMINATION OF NEEDED LEVELS CALLED FOR EACH YEAR

While the Employment Act, as basic, enduring statutory law, is general in its statement of goals, it is amply clear from the legislative history that supporters of the act did not intend its broad language to be empty phrases or the expression of a vague hope.

In section 3 of the act, following the declaration of policy, it is specifically provided that the President, at the beginning of each regular session of Congress, shall set forth the levels of employment, production, and purchasing power needed to carry out the policy thus broadly stated. The act does not require prediction. But it does call for the regular, annual, administrative determination of the levels of activity which will give concrete, specific, and timely meaning to the term "maximum." He shall, that is to say, estimate and set forth the levels of economic activity which will provide adequate job and self-employment opportunities for those seeking work during the ensuing year.

From the beginning, however, the Joint Economic Committee has had to be concerned with the problems of promoting the stability of the general price level and the need for combating inflation. In fact, the first hearings ever held by this committee—in June and July of 1947—were on current price developments and the problems of economic stabilization. Out of the experience of many previous occasions the design of the present investigation has been developed.

The committee's major goal is an objective and authoritative exploration of those general economic processes which involve prices, price relationships, costs, and price policies in the expectation that this will reveal ways in which public and private policies can contribute to the attainment of the objectives of the Employment Act.

The focus of the committee's interest is, as the title chosen for this study indicates, upon the relationship of prices to economic stability and growth. We recognize that prices and price policies can be studied from other points of view by other committees of the Congress concerned with the development of particular pieces of legislation, such as antitrust statutes.

In contrast to more particularistic or specialized points of view, this study focuses upon the ways in which the behavior of prices, the

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[18] Senate hearings, p. 60.
[19] House hearings, p. 852.
[20] Ibid., p. 547.

operation of the market mechanism, and private pricing policies are related to the rate at which the productive capacity of our economy grows and to stability of the rate at which this productive capacity is utilized. It aims at information which will be useful over the long run in the design of policies to carry out the Employment Act objectives, though, of course, we hope also that some contribution might be made to the immediate short-run problems we face in the current recession.

Some months ago 47 experts from universities and research organizations were requested to prepare papers on topics which the committee thought would be useful to it in its further deliberations. Each paper contributes to the overall study by approaching the relationship of prices ot economic stability and growth from a different viewpoint, reflecting also differences in training and background of the contributor. Topics and contributions were chosen not so much to find articles of agreement as to assemble parts which when fitted together would provide as complete a picture as possible of the general processes and policy decisions relevant to the committee's deliberations under the Employment Act. The papers which our contributors prepared were printed in a compendium which was released to the public May 6.

Today we begin the second phase of this study—a series of hearings, in the form of panel discussions, in which the contributors to the compendium will have an opportunity to develop more fully the issues and analyses presented in their papers, both through answers to questions from the members of the committee and through a discussion with fellow contributors.

We will proceed in these hearings in the order in which the papers appear in the compendium. At the start of each session, each member of the panel will be given about 5 minutes in which to summarize his paper, and we will hear these summaries without interruption. Upon completion of the opening statements, the committee will question the panel for the balance of the session. This part of the hearing will be very informal. We want all members of the panel to participate, commenting upon other papers in the compendium and on the questions of committee members.

Before introducing this morning's panel, I wish to state that Dr. William J. Baumol, of Princeton University, who submitted a paper for the compendium, is in England and therefore could not be present for the hearing.

Our first witness this morning was to have been one whom it would be a pleasure to welcome back to this committee's deliberations, Dr. Grover W. Ensley. He was formerly executive director of the committee staff. Unfortunately, he became ill over the weekend, so he cannot be with us this morning. His opening statement, summarizing his views, will be read by Mr. Roderick Riley, executive director of the committee staff.

STATEMENT OF GROVER W. ENSLEY, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS, READ BY RODERICK H. RILEY, EXECUTIVE DIRECTOR, COMMITTEE STAFF

Mr. RILEY. This is a summary prepared by Dr. Ensley of his paper, entitled "The Employment Act of 1946: The Dynamics of Public Economic Policy."

Twelve years ago, the Employment Act introduced into public policy the first explicit statement of objectives for the Nation's economy. The broadly phrased language expressing those objectives emphasizes maximum employment, production, and purchasing power, reflecting the early postwar fears that the economy might revert to the persistent unemployment and economic stagnation of the 1930's. Both the language of the act and the machinery it created, however, have proved to be adaptable to changing economic circumstances. By virtue of the major developments in the economy and the challenges imposed upon United States leadership in the cold war, the objectives of public economic policy are now quite generally expressed as achieving and maintaining growth and stability of a dynamic, free, private-enterprise economy, with minimum fluctuations in the price level.

Experience since 1955 has raised the question whether expansion of productive capacity, stability in the rate of resource use, and stability in the price level can be achieved simultaneously in a dynamic setting without the imposition of direct or special governmental controls. Are these objectives inconsistent? The answer is "Yes" only if public policy regards each of them in some rigid, absolute sense. Instead, it must be recognized that, in a high-employment economy, realization of gains with respect to any one objective well may limit gains which can be achieved with respect to any other. We must, therefore, continually effect compromises—in other words, redetermine and adjust priorities among objectives. These adjustments in no wise imply abandonment of any one goal.

Recent debate has centered on the contention that stability in the price level is inconsistent with stability in the rate at which we use our expanding productive capacity, so long as public policy continues to rely on general, instead of direct, controls. It is argued that some segments of business and labor can insulate themselves from market pressures and, therefore, from the impact of general fiscal and monetary restraints on total demand.

It is further maintained that general restraints sufficiently rigorous to break through this insulation will hold total demand to levels which will not support full employment. Accordingly, it is argued, we must accept either frequent and relatively severe interruption of economic growth and higher levels of unemployment as the cost of stability in the price level, or continual "moderate" inflation as the cost of a high and sustained rate of growth and full employment and production.

The validity of this argument is yet to be demonstrated. If it is correct, it implies that the Nation will accept with equanimity the continued control of a very small group over the value of our money and over the capability of policies suited to a free society to provide for continuing growth, stability, and dynamism. It seems to me that this argument does not so much demonstrate the incompatability of these public economic-policy objectives as the need for a more vigorous and effective antitrust policy.

Moreover, inflation can work no magic in helping us to attain objectives for which our resources are inadequate. It can serve merely to shift the claims to resources to the relatively strong—those enjoying monopoly powers—and away from the weak. Relying on inflation to provide such levels of employment and rates of growth as we deem desirable means that we are more willing to accept inflation's

haphazard and capricious distribution of sacrifices of claims to current output than the distribution of such sacrifices imposed by fiscal and monetary restraints provided through the due processes of representative government.

But, since the burdens of inflation necessarily will rest on the economically weak, agreeing to the necessity for a little bit of inflation—along the lines of the argument cited above—really means agreeing to more inflation in the future as the insularity of monopoly power groups becomes stronger.

Price-level stabilization, therefore, must be an important objective of public policy. Taking the steps required to make it a practicable objective also will enhance the dynamic qualities of the economy and the conditions for achieving a high rate of growth and stability in the rate of resource use.

As in the case of these latter objectives, precise specification of the objective of price-level stability is neither desirable nor possible. Our economic-stabilization objective, for example, does not rule out some fluctuation in the rate of resource use. By the same token, we cannot, as a practical matter, pursue absolute rigidity in the price level. What we seek is the best possible mix of all of our major economic-policy objectiveness. Our best hope for its attainment rests in the alertness and adaptability of those charged with responsibility for public economic policy.

The Chairman. Thank you, Mr. Riley, for reading Dr. Ensley's statement.

It is a pleasure to welcome back to the committee's deliberations one of America's most distinguished economists and the first chairman of the Council of Economic Advisers, Dr. Edwin G. Nourse.

Dr. Nourse, we will hear next from you.

STATEMENT OF EDWIN G. NOURSE, ECONOMIC CONSULTANT, WASHINGTON, D. C.

Mr. Nourse. It is a great pleasure, Mr. Chairman, to be here, particularly, as I comment in the opening part of my paper, because I feel so strongly that the hearings which you have set up here and are conducting now have not only great timeliness, but are admirable in the depth and scope of definition, as you read it in your opening statement this morning.

I might say, too, that I think Dr. Ensley's paper is an admirable statement of the issues. I find myself in very complete agreement with it.

In my paper, in the compendium, I point out that price relationships and price policies are inextricably included in the Employment Act's declaration of policy through its linking of maximum purchasing power to maximum employment and production.

I argue further that, by stipulating a setting of "free competitive enterprise," and "the assistance and cooperation of industry, agriculture, and labor," the act points the way to the attainment of growth and stability over the years through basic market adjustments among prices and incomes, rather than merely through offsetting governmental manipulations, monetary and fiscal.

By some historical documentation, I show that this interpretation of desired ends and suitable means has appeared rather consistently throughout the 12-year history of the act's administration. Its most forthright expression was found in the Economic Report of the President in January 1953:

Private enterprise, under our free system, bears the major responsibility for full employment. The role of responsible Government, while vital, is in a sense supplemental * * *. We must learn more about * * * private price and wage policies which may contribute most to a stable and growing economy.

All members of this panel express themselves as believing that inflation is a persistent threat to our attempt to attain maximum employment and production over time, and half of them would write a price stabilization or antiinflation mandate into the act.

I argue against such amendment on the ground that it would add more words of vague meaning and controversial interpretation without giving further practical guidance to policymakers. It would invite controversy over the meaning of the terms "inflation" and "price stability" and the degree of stability and of fullness of employment to be sought. We are already plagued by a tendency—even of some of the participants on this panel—to speak of full or maximum employment as 95 or 96 percent of "the labor force"—which is simply a figment of the statistician's definition and the enumerator's judgment.

Elsewhere I have examined the full-employment concept as an issue of alternatives, proportions, and priorities—choices not only between growth and stability but also between goods and leisure and between freedom and controls. Since I believe these distinctions are pertinent to your present inquiry, I would ask permission to file some excerpts from a paper on "Ideal and Working Concepts of Full Employment" (that I presented before the American Economic Association about a year ago) as a supplement to my present testimony.

The CHAIRMAN. Without objection, it is so ordered.

IDEAL AND WORKING CONCEPTS OF FULL EMPLOYMENT [1]

Edwin G. Nourse

A decade of experience under the Employment Act of 1946 has served to uncover many complexities that inhere in the mere concept of full employment—quite aside from the yet greater complications that beset the attempt actually to reach such goals as we may set up.[2] We need a concept that will be dynamic and at the same time realistic in that it views fullness of employment in perspective to the state of the arts—organizational as well as technological. It must recognize, but not accept as fixed, the institutions and the mores of our system of free enterprise and representative government. So oriented, it will envision goals high enough to gratify our sociopolitical aspirations but also be consonant with the limitations of means existing at any given time for their attainment. Thus my title links ideal with working concepts of full employment.

I. At the outset we should differentiate between an economic concept of full employment on the one hand and sociological and political concepts on the other hand—without either ignoring or disparaging the latter.

This is not to say that qualitative standards and sociological considerations have no relevance to the concept of fullness of employment opportunities in a progressive economy. It simply is to say that the formula "always more vacant jobs than unemployed men," whatever usefulness it may have had as a slogan

[1] Paper read at the annual meeting of the American Economic Association, Cleveland, Ohio, December 27, 1956.

[2] In the Review of Economics and Statistics (May 1956, p. 193) I presented a descriptive and historical account of the emergence of the full employment slogan and some of the issues of interpretation that have arisen in practice.

to stimulate discussion of positive employment policies, is much too rarefied to serve as a practical test of private business performance or of national employment policy.

This sociological approach has much in common with the political approach to the employment problem exemplified in the "full employment bill" introduced into our Congress in 1945 by Senator Murray, supported by three other Senators. Section 2 of S. 380 read:

"All Americans able to work and seeking work have the right to useful, remunerative, regular, and full-time employment, and it is the policy of the United States to assure the existence at all times of sufficient employment opportunities to enable all Americans who have finished their schooling and who do not have full-time housekeeping responsibilities freely to exercise this right."

In the press, in public hearings, and in congressional debate there was spontaneous and vigorous challenge to so vague but at the same time so ambitious a concept of the labor force for whose full and "remunerative" employment the Government should accept responsibility. It seemed to foreshadow a provident State whose political pressures would supersede commercial bargains and market incentives. The Employment Act as finally passed sought to shift the matter back to a more practical basis by defining the goal of Government policy as facilitation of an enterprise system that will "afford useful employment opportunities for those able, willing, and seeking to work." Emphasizing the shift from sentimental to operational criteria, the Congress established an apparatus of professional economic advisership in both the executive and the legislative branches of Government. It devolves on the economist, therefore, to furnish interpretations of the full-employment goal that will sublimate political pressures, temper reformist dreams, and combine industrial and commercial workability with the scientist's ideal of systematic progress.

II. The declaration of policy in the Employment Act does not specify full or even "maximum" employment as the single goal of national policy. There are in fact three broad objectives or criteria of action set forth, all of which have distinctly economic content: (1) employment opportunities for those able, willing, and seeking to work, (2) promotion of maximum employment, production, and purchasing power, (3) deference to "other needs and obligations and other considerations of national policy." But can the economist accept these three specifications as spelling out a consistent and tenable formulation of a full-employment ideal or adequate working rules for national employment policy? I think not. Our profession has further work to do toward conceptual clarification.

1. The phrase "those able, willing, and seeking to work" does not define a labor force for whose optimum utilization the Federal Government can, in good economic conscience, pledge itself to "utilize all its plans, functions, and resources." In the absence of objective criteria, the word "able" becomes practically meaningless. Whether a given person is, in a commercial or industrial sense, able to work is a decidedly relative matter. Able to work steadily or only intermittently? At the kinds of work for which demand presently exists, only with other skills, or without any particular skill, aptitude, or even teachability? Able to work as determined by a doctor's certificate or by a foreman's report? Under standard shop or office conditions or only with special facilities or treatment? Equally rich in ambiguity is the companion term "willing." It was inserted as a gesture of reassurance to those who feared the camel of authoritarianism might be getting his nose under the tent of free enterprise. But does it mean willing to work at such jobs as are available or only at the job of one's dreams? Willing to work on a time schedule dictated by employers' needs or by workers' convenience? Seeking is, of necessity, the criterion relied on by the Census Bureau in giving us a monthly estimate of involuntary unemployment. But "wanting" would be a more apt term for our purpose since it is a commonplace in the experience of all who have dealt with the unemployed to find not a few persons who want work—may even need it desperately—and who yet are not actively seeking a job because they have become convinced that the search is hopeless.

The plain fact is that the size of our labor force is statistically determinate only within the limits of quite categorical definitions. While there is a substantial hard core of fully competent and persistent breadwinners, it is completely surrounded by fringes of adolescents, casuals, housewives, and the aged or handicapped, who freely add themselves to or subtract themselves from the ranks of job seekers as circumstances change.

Probably more useful than any single norm to be striven for is a concept of "peril points" to be avoided, such as 2 percent unemployment as a warning of inflationary overemployment, overextension of credit, or overinvestment, and 4 or 5 percent as alerting prompt investigation of causes—whether the sort of disturbance that seems likely to "blow itself out" in due course or, contrariwise, to have a "snowballing" quality or reveal a geographical concentration that points to the need of specific local relief measures or such dispersion as suggests the resort to generally acting national policies.

2. Second among the Employment Act's directives we find "maximum employment, production, and purchasing power." Does this tripartite formula give the policymaker a clear and consistent criterion for measurement, for judgment, and for action? I think not. The terms are both ambiguous and ambivalent.

Besides uncertainty as to who shall be counted in the labor force, just discussed, there is complete obscurity as to how many days or total hours of work are called for. Economists have long accepted transitional or, more broadly, frictional unemployment as indigenous to and ineradicable from an economy of rapid technological progress, free enterprise, and free choices of both consumers and workers. Seasonal unemployment stems in part from the same causes, with weather as an important additional factor. Maximum employment in economically ideal terms would call not for the elimination of these categories of temporary idleness but for the fitting of fractional work years together into the largest practicable total and the use of as many marginal work capacities as possible rather than letting them run to waste as "unemployable." This raises the whole issue of work versus leisure, which will be discussed later when we consider alternatives. But first, are maximum employment, maximum production, and maximum purchasing power mutually compatible, complementary, or conflicting desiderata?

It seems clear that a policy that resulted in giving a job to everyone who might seek work or just be "willing" to work would put many on the payrolls who were submarginal under any standard of business management geared to maximum production—of wealth, that is, not merely volume of goods. It follows, then, as a matter of sheer economic logic that if aggregate demand for workers is raised to a level where there are "always more vacant jobs than unemployed men," marginal product will frequently be less than the cost of the last increments of labor—most of which must be paid for at standard wages, not a marginal price. Even under the conditions of mildly inflationary boom that we have witnessed over considerable areas of the economy during recent years, "scraping the bottom of the manpower barrel" has entailed expenses of recruitment, training, absenteeism, spoiled work, and lowered morale that have raised unit costs direct and indirect until they exceed the unit value of added product. Whether one looks at this as overemployment leading to inflation or as inflation leading to overemployment, it is clear that the choice of the economist as such between maximum employment and maximum production must fall to maximum production. It is an encouraging aspect of the economic thinking of our times as it bears on the effectuation of the Employment Act that the oversimplified goal of full or maximum employment is to so great an extent giving way to maximum production and the new formulation "economic growth." Yet more suitable is the expression economic progress that we at Brookings used.

Unlike the incompatibility between maximum employment and maximum production, the latter is entirely compatible with maximum purchasing power—if this is properly interpreted as power of consumers to command goods, not merely as a bigger flow of dollars through the market and government treasuries.

3. The third of our excerpts from the declaration of policy tacitly recognizes that sound interpretation of the Employment Act involves choices among alternatives which cannot be simultaneously maximized. It specifies that the maxima to be sought shall lie within the ambit of the country's "other needs and obligations and essential considerations of national policy." Besides this general caveat, there is the specific proviso that the full employment or maximum production goal is to be sought "in a manner calculated to promote free competitive enterprise." To elaborate and refine these sweeping phrases into meaningful and mutually consistent parts of our full employment philosophy and practice will demand answers in two of the most controversial areas of economic discussion today.

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First, as to free competitive enterprise: Each of these three words invokes value judgments. On the face of it, the use of the word free represents a codification into the act of our traditional rating of personal and group freedom above mere material enrichment. This is value judgment both political and sociological in nature, though it rests also on belief, both lay and professional, in the superior economic efficacy of free enterprise. But how free can strong and aggressive individuals or groups be left to pursue their private interests without the interests of workers and consumers suffering? In a modern industrial economy choices have to be made between degrees of freedom not only of employer groups to displace workers but also of labor groups to protect jobs if the ends of maximum production and consumer real purchasing power are to be served. The dilemma of freedom or control is provisionally resolved by a wide range of compromises. Traditionally, the American worker, urban and rural, has stoutly asserted that he would hold to freedom of choice as to whether, when, or how to work in lieu of larger labor income. However, both farmers and industrial workers have in many ways, but with uncertain degrees of finality, given up considerable areas of this pristine freedom for the tangible or imagined benefits of farm price supports, standard wage laws, and whatever controls are entailed in (*a*) voluntary union membership or (*b*) the strictures of union shop, closed shop, or hiring hall.

Similarly, can our profession supply either clear-cut criteria or compelling insights to guide our national choices between types of competition that tend to maximize productive employment and those that curtail it, or between private and public expressions of economic enterprise? The Employment Act challenges us to supply the policymaker both with formal ideals and with workable ad hoc approximations covering these issues.

Important as is this three-dimensional area of policy choices—among freedoms, forms of competition, and channels of enterprise—to our promotion of sustained maximum production, still more baffling ambiguity and ambivalence confront us in the act's qualification of the full employment goal by such phrases as "general welfare—needs and obligations (of the Federal Government)—and other considerations of national policy." Space does not permit even the outlining of the multifarious issues that are suggested by these broad phrases. But both economists and businessmen most often invoke them on one side or the other of the argument over fullness of employment vis-a-vis stability of the dollar. As a mere verbal matter, resolving this inflation issue might seem easy and obvious: follow policies of freer private and public spending to stimulate employment up to but not beyond the point where further pressure raises the index of prices rather than the production index. But such a criterion becomes distressingly amorphous once we look at its terms more closely. As already noted, the actual fullness of employment is objectively indeterminate—a matter of opinion of the policymaker, the interest-group spokesman, even the individual. Likewise the point at which price changes up and down in varying degrees become inflation with a capital "I" is indeterminate or relative to conflicting definitions of the term.

But even with both goalposts shrouded in fog, economists should have no great difficulty in deciding which team they are playing on. There has been a growing judgment in the economic thinking of our times—that is, times of postwar prosperity and continuing boom—that a persistent inflationary creep should be the consciously chosen alternative to intermittent or marginal nonuse of potential labor. It is argued that adequate growth of the economy cannot be attained except through the injection of "new money" each year. Proponents of such a view would keep this accelerator pedal pressed to the floorboards, reposing confidence in the brakes to hold in any emergency and trusting also that momentum will not carry the car off the road even when brakes are doing all that is physically possible. They expect the Congress to "fill 'er up" regularly and to reline the brakes whenever needed or install new ones of more powerful design, that is, "controls." In the other camp are those who rate inflationary dangers as greater and offsetting controls as ultimately self-defeating.

To this issue we shall return later, but by way of partial summary here: to review the complicated, and in many ways, obscure language of the Employment Act's policy declaration in the light of 10 years' experimental interpretation is to make one thing clear. Even an ideal concept of full employment is not a simple matter of counting noses of an objectively determined labor force and statistically measuring an "unemployment gap" between this roster and some glorified "Help wanted" column. And working concepts for the actual policymaker involve assumptions or hunches about most if not all the major areas of

economic theory. Some of the major issues to be encountered as we struggle for the best working programs in fast-changing situations can be most usefully envisaged in the context of short-run versus long-run concepts of full employment.

III. On the face of it, the time perspective of the Employment Act is short run. The apparatus of an annual economic report and program submitted by the President, its review by the Joint Economic Committee, and the submittal of this committee's report to the Congress focuses attention on present alternatives and a model for the current year's legislative action and the parallel programing of private business. Of necessity, the measurements of unemployment which the President and the joint committee take over from the various statistical bureaus must take as "given" such things as the character of the labor force, the state of the arts as this affects the functioning of labor in the productive process, and the whole institutional situation as it mediates incentives to work, contractual terms regulating the workweek and work year, and many others. But any adequate concept of the fullness of employment toward which we could wisely strive cannot, in a society such as ours, take those "givens" as given "for keeps."

This brings us to our second long-run issue—the choice, private and public, between work and leisure in a free society. If the economy were organized on a basis of self-employment, the individual could decide—by whim or by thoughtful calculus—when he would work and when he would knock off for either rest or recreation. He still is free to decide when he will seek work or quit his job. But the concept of optimum employment that we are evolving in our highly organized industrial society is formulated to an important extent through the institutions of unionism and the controls and the competitive practices of corporate and other employers. It is shaped also by the legislative and administrative actions of Government, notably social-security provisions. The economist's tools offer little to the individual in resolving his choices of alternatives between his kind of work and his kind of leisure. They offer rather more to the policy-making officials or committees of labor unions in evaluating the consequences of their group decisions in specific cases or the general pattern of organized labor's wage-and-hours philosophy, collective-bargaining strategy, and political pressures. But primarily the economist's analyses are pertinent to the issue of what division between work and leisure will maximize the economy's production of ultimate satisfactions for the total population—in other words, the best public policy as to work versus leisure.

In this broad area of labor-management negotiation and Government legislation, two issues are sharply defined as today looks forward toward tomorrow's employment goals. (1) Is our objective the filling of a quota of 2,000-hour jobs (that is, 8 hours times 5 days times 50 weeks), or shall we be satisfied with a full roster of workers for only 6 or 7 hours a day or perhaps a workweek of 4 days? The unions are increasingly lining up for a campaign for the shorter workweek and still longer vacations. (2) A second issue as between work and leisure concerns age at retirement. Shall we, through social-security rules and otherwise, set the end of the period for which employment is to be kept full at 62 years or 60 years or even 55 years? This brings us back to the discrepancy between "maximum employment" as mere number of jobs and "maximum production" as total volume of consumer satisfactions. A sound long-run concept of optimum fullness of employment demands careful and continuous study of the functional relationship between work and leisure over the whole lifetime of worker-consumers under changing conditions of technology and of longevity. Only two practical aspects of this complicated issue can be mentioned here.

The first is that leisure is not simply nonwork but is, to a considerable extent, alternative activity. This both adds to the supply of consumer goods and creates demand for production of goods and services for the commercial market. In a rich and highly productive society, many business enterprises are directed to supplying goods or services desired not for subsistence needs or refinements but for the filling or killing of leisure time. To paraphrase the old adage "one man's meat is another man's poison," we may say that some workers' leisure is other workers' livelihood. This is conspicuously illustrated in our flourishing amusement industries and in "tourism." But what may not be so well recognized is that expanded leisure leads to a growth of a great area of social productivity outside the statistically recorded market area. With the growth of the factory system, a great deal of direct want satisfaction moved out of the family circle into the ambit of the market. Now a more leisured working population is enlarging the social product far beyond what the commercial figures show—in a

vast "do-it-yourself movement." However much of home improvement or life enrichment is thereby produced, it eludes the computed of our gross national product. As between employment and leisure, the progress of technology, the processes of collective bargains and of legislative standard making keep nudging both employer and employee toward employment patterns that are both workable and acceptable (within the personal adjustments made through supplementary jobs, part-time work, and do-it-yourself activities).

A second complication in working out a long-run criterion of choice between work and leisure in our employment policies derives from the conflict between the group interest and the general interest. This is conspicuous in the drives for the shortening of the workweek, the work year, and the working lifetime already referred to. It is not altogether clear what use the unions expect their members to make of added leisure or what values they attach to such uses. Neither is it very clear where management calculates that the benefits and burdens will fall if they compensate for, or themselves, induce, this shortening by automation or other labor-saving devices. But that consequence to the group and to the economy or society are widely disparate is evident.[3] Even viewing ours as a laboristic economy, it should be clear or even axiomatic that the level of consumption for workers and their dependents as a whole cannot be raised as high in the long run, and under whatever technological condition emerges, with a shorter work year and working lifetime as it could with a longer work-input period. The heaviest impact of the loss would, I believe, fall on those now in the lower consumer levels of our population—and on backward nations whose advance we might aid most strongly and most comfortably in proportion as our own production was really maximized.

Much the same may be said of the fourth of our long-run interpretations of the full employment concept—the choice of fuller employment at the cost of a higher price index or a cheaper dollar. The matter has already been alluded to as a dilemma dimly envisaged in the policy declaration of the Employment Act as it juxtaposes full employment against "other needs and obligations." But it is, in my analysis, in fact the paramount issue or the comprehensive policy decision in which all segmental issued (ex noneconomic value judgments) must be comprehended. For the "economy" is an infinitely complex system of pecuniary relationships of costs, prices, incomes, spendings, savings, investments, and taxes, which both express and condition a physical process of making goods and rendering consumer services. The elusive and controversial terms inflation, stability, and deflation are the semantic symbols by which we seek to objectify the optimum condition of that process which national policy and program should promote and the dual dangers that it should strive to avoid. If, as I have argued, ideally full employment would be such as promotes continuous maximization of production and real purchasing power for the people, it cannot be attained in the face of any disturbance in the monetary mechanism that would be harmful to business activity and general spending and saving for capital formation.

Those who ignore or belittle inflation threats and who champion an extremely high employment goal at all times seem to me to deny the practical necessity of appreciable frictional or transitional unemployment which they themselves formally accept as a premise of business life in a highly dynamic industrial society. Underemployment on farms during the current basic readjustment of the industry, unemployment among highly immobile coal miner groups, and substantial idleness of automobile workers while some egregiously bad mistakes of management are being corrected afford cases in point, but of the second order of magnitude. It is in the longer and wider swings from boom to equilibrating correction that the major and really fundamental issue lies. It demands realistic recognition of a state of overemployment at the crest of an investment cycle that scrapes the bottom of the manpower barrel and stretches credit beyond the safe support of individual and institutional saving. It demands recognition of the inevitability of some increase in the volume of unemployment during the offsetting period of slower plant expansion and durable goods accumulation—a transition less severe in proportion as overinvestment and overemployment are avoided in the boom period. It is when we dream of economic perpetual motion and the miraculous elimination of these frictions rather than patient lubrication of the

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[3] For instance, under the pension provisions of some union contracts (and still more under prospective guarantees of an annual wage), it is to the advantage of the employer, when demand is brisk, to operate on an overtime basis rather than take more men on the payroll. This tends to create a very refractory unemployment situation for the more marginal workers—untouchable by the stimulative effect of an increase in aggregate demand.

transitions that we invite inflation or the impairment of the monetary mechanism whose smooth and dependable operation is a sine qua non of maximum long-run production or economic progress in a free-choice economy.

It is not enough for the advocates of high-pressure economics to argue that inflation can be kept in check by the use of general or spot controls. That is simply to declare a value judgment in favor of maximizing the number or jobs or the rate of economic expansion even at the cost of less freedom of economic choice by individuals or organized groups. Our freedom of individual choice has already been eroded at many points through concentration in the hands of policymaking officials of national bargaining unions and top executives of administered price corporations. It becomes all the more important that the degree of decentralization still remaining shall not be swallowed up in monolithic decisions of Government control agencies. It behooves these proponents of high-pressure economics, therefore, to abstain from such ambitious definitions of full employment or of business expansion as will engender a degree of inflation that will call for the imposition of controls on prices, wages, or investments.

Since the baleful effects of inflation and the insidious nature of its onset have been so amply demonstrated in a variety of circumstances and places in the past, and since the effective strength of the available arresters or correctors has never been really tested under strain, I cannot accept inflation as a way of life for the long run even though emergency measures of an inflationary character can be used both prudently and safely in the short run.[4] Equally eschewing doctrinaire full employment at whatever cost and an ever-balanced budget at whatever cost, we should make intensivity of labor utilization a contingent factor within our total technique of so administering our free economy as to move it consistently and persistently, even if not at an absolutely steady pace, toward maximum real income for the whole people.

By way of brief summary, I offer three general propositions:

1. Today's economic thinking about employment policy shows substantial movement away from such simple quantifications of the early 1940's as 60 million jobs or an unemployment gap in explicit numerical terms or as a sanctified percentage. Substitution of the concept "economic growth" moves in the right direction, but to specify that growth must be by annual increments of, say $20 billion in GNP or that no previous year is good enough is no more tenable than the earlier formulas "more jobs than unemployed men" or "jobs for all the people all the time."

2. Combining long-run ideals with short-run working programs places emphasis on qualitative analysis of the intensivity of labor utilization as one facet of a complex objective of sustained economic progress in which choices, priorities, and proportions must be carefully evaluated in their time perspective, seeking self-sustaining patterns of economic growth with only moderate changes of pace and with minimum resort to emergency interventions.

3. The sharpest issues of official and individual choice lie between consumer satisfactions (overall or by groups) (*a*) vis-a-vis freedom of action, (*b*) vis-a-vis leisure and its distribution and use, and (*c*) vis-a-vis stability of the monetary unit. Vis-a-vis rather than versus because the choices are not mutually exclusive but among various combining proportions under a rule of reason. In our free society of rising economic sophistication, what is a reasonable application of any of the several criteria is decided in considerable degree under the guidance of technical experts on the professional staffs in the administrative offices of business, labor, academic, and governmental agencies. It is inevitable that the practical judgments of even the best-trained economists shall be strongly suffused with subjective value judgments. If their professional training has been sufficiently broad, these value judgments will not derive from personal prejudice and naivete as to the adjacent areas of social science, but from some perceptiveness as to issues in these fields and collaboration with professionals in the sister disciplines. Fortunately, the years through which we are now passing give us

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[4] Alongside Jacob Viner's deprecation of "full employment at whatever cost" (QJE, August 1950) we may place the comment of Arthur Burns, made after he had for several years wrestled with the practical problems of interpreting the Employment Act: "In a high level economy such as ours, it is but a narrow road that separates recession from inflation. * * * If we are to advance firmly on that road, the Federal Government * * * alert to changing conditions must pursue monetary, fiscal, and housekeeping policies with skill and circumspection [to the end of balancing] reasonable fullness of employment with reasonable stability of prices." (Address before the Chamber of Commerce of the State of New York, New York City, October 6, 1955.)

an opportunity never before equaled for what are approximately the laboratory conditions needed for the deriving of scientific principles.

Mr. NOURSE. In specific answer to the question posed for this panel: "Under what conditions would stabilization of prices be inconsistent with the attainment of Employment Act objectives?" I would suggest the following: When the use of Government fiscal and monetary restraints was so drastic as to hold the price level steady in the face of private market institutions and practices in which price maintenance laws, nationwide escalation wage contracts, sacrosanct markup rules and rigid cost-accounting principles, and "parity" farm price supports are widespread and well entrenched.

There is no reason in economic logic, or, if you please, price mechanics, why our economy should not combine vigorous growth with such stability of the price level as would be reassuring to the businessman and the investor and equitable to the various groups in the society. But it would require the flexibilities of a truly competitive business structure and practices.

There you see I touch Mr. Ensley's theme again.

The greatest threat to the accomplishment of the objectives of the Employment Act is to be found in the rigidities or the built-in inflationary bias that we have allowed to creep in. This danger was admirably recognized in the first economic report of the present administration, as follows:

> The role of competitive markets is as basic to the proper functioning of our economic order as the secret ballot is to our political democracy. Government has vital responsibility in this area, immensely complicated by large aggregations of capital under single management and large organizations of labor. Government must nevertheless remain alert to the danger of monopoly, and continue to challenge any outcropping of monopoly power. It must practice vigilance constantly to preserve and strengthen competition.

Possibly the greatest service that this committee and the Congress as a whole could render at this juncture in our economic affairs would be to clarify the meaning of free competitive enterprise in this day of corporation and labor-union giants. With the degree of concentration of economic power that has grown up at these centers and the institutional structures that they now have, it is quite possible for the free competitive enterprise of their leaders to work against rather than toward the stabilizing of the economy in a strong growth trend. We need to reestablish conditions of price competition in place of power competition.

The CHAIRMAN. Thank you, Dr. Nourse.

Now, Dr. Joseph Aschheim, assistant professor of political economy, the Johns Hopkins University.

STATEMENT OF JOSEPH ASCHHEIM, ASSISTANT PROFESSOR OF POLITICAL ECONOMY, THE JOHNS HOPKINS UNIVERSITY

Mr. ASCHHEIM. Thank you, Mr. Chairman.

Widespread concern about postwar inflation in the United States contrasts with the absence of any reference to price-level stability in our basic guide to national economic policy, the Employment Act of 1946. The predominant economic views at the time of passage of the act explain the lack of mention of a price-level objective, but they do not permanently justify it.

Whether or not to continue the exclusion of a price-level objective from the Employment Act depends on at least two considerations. The first consideration is the extent of conflict between a stable price level and present Employment Act objectives of "maximum employment, production, and purchasing power." The second consideration is the relative importance of price-level stability and of maximum or full employment.

Turning to the extent of conflict between price-level stability and full employment, let us first take up the well-known definition provided by Lord Beveridge that full employment is "having always more vacant jobs than unemployed men." This definition of full employment clearly implies an excess of demand for labor. Since the demand for labor is derived from the demand for output, an excess of demand for labor means an excess of aggregate monetary demand. As well illustrated by conditions in the years 1945–48, and mid-1950–51, a general excess of demand results in inflation. Thus, if by full employment we mean an excess of demand for labor, full employment and price-level stability are, by definition, incompatible. Strict adherence to the Beveridge concept of full employment is therefore clearly seen to be tantamount to the doctrine of "full employment at any price" or, more precisely, "full employment at any price level."

At the opposite extreme, it is possible to define full employment in a totally different manner, namely, the maximum level of employment consistent with price-level stability. According to some economists, price-level stability in the postwar market structure of the American economy requires from 10 to 15 percent of the civilian labor force to be unemployed. If correct, such figures would, of course, render this second definition of full employment socially useless.

However, is mass unemployment of 10 to 15 percent really necessary for price-level stability? The evidence of the first two postwar recessions suggests otherwise. In 1949 unemployment averaged only 5½ percent and in 1954, 5 percent. Yet in both years prices fell: the Consumer Price Index declined, as well as the Wholesale Price Index. Incidentally, average hourly earnings of production workers in manufacturing industries rose by less than the secular increase in output per man-hour in both years. But the current recession, we are now told, does not fit the pattern of the previous two: in the face of declining employment, prices are still rising. Is this interpretation as valid as it appears to be? Any answer at this stage must, at best, be tentative. Nonetheless, I should like to point out that from September 1957 to March 1958, gross hourly earnings of production workers in manufacturing industries rose by less than 1 percent. Furthermore, during the same 6 months there was a slight decline in the wholesale price index of commodities other than farm products and foods. The rise in the wholesale price index of all commodities is clearly due to special circumstances in the agricultural sector of the economy, namely, the effect of unseasonably bad weather on fresh fruits and vegetables, and a reduction in livestock marketings. Thus, a closer scrutiny of economic data for the current recession, to my mind, bolsters rather than undermines the results of the two previous recessions: price-level stability does not require more than 5 percent unemployment.

We must now turn to our second major consideration, namely, the relative importance of price-level stability and of full employment.

Growing attention is being paid to the inequitable impact of a rising price level on the distribution of income and to the destabilizing effect of anticipating inflation. A further deleterious result of chronic inflation is the damage done to the quality of Government services. Being unable to raise salaries in competition with the private sector without substantial timelags, Government agencies are, in effect, compelled to lower their standards in hiring additional and replacement personnel. In like manner, being unable to obtain increased appropriations for expansion of essential physical facilities in the face of rising costs, Government must oftentimes resort to elimination or curtailment of such expansion programs, in this instance too, at the expense of the quality of the services being rendered. The stickiness of salary levels of teachers, scientists, military personnel, Foreign Service personnel, statisticians, accountants, and other Government employees, as well as the sluggishness in the upward adjustment of expenditures for school construction, new hospitals, improved civil defense facilities, additional public libraries, and a variety of other projects, result in reduced quality and curtailed efficiency of these vitally important services. In a period of acute international challenge, no person or institution could have a greater stake in preserving price-level stability than Government itself.

Because of the likely need for improvements of governmental services in several directions and because the conflict between price-level stability and present Employment Act objectives appears to me widely exaggerated, I suggest that incorporation of a stable price-level objective into the Employment Act is both timely and imperative. Failure to make this change in the act amounts to implicit admission that the Federal Government is prepared to acquiesce in chronic inflation.

The CHAIRMAN. Thank you, Mr. Aschheim.

Our next panelist is Dr. George L. Bach, dean of the graduate school of industrial administration, Carnegie Institute of Technology.

Mr. Bach, we are glad to have you, sir.

STATEMENT OF G. L. BACH, DEAN, GRADUATE SCHOOL OF INDUSTRIAL ADMINISTRATION, CARNEGIE INSTITUTE OF TECHNOLOGY

Mr. BACH. My task is to examine the impact of moderate, or "creeping," inflation on the American private enterprise economy, and to consider the significance of these findings for Government policy aimed at promoting stable economic growth. I shall summarize briefly here the findings which are spelled out at length in the paper I submitted on the impact of inflation, and then comment on the policy implications of the evidence.

The effects of inflation on the American economy over the past two decades, while much less disruptive and alarming than is often claimed, have been appreciable and inequitable. Perhaps more important, inflation appears to have had little of the stimulative effect on economic output and growth often claimed for it.

Very briefly, there is little evidence that inflation has either increased or decreased significantly total economic output in the United States over the last two decades. Equally, there is little clear-cut evidence that creeping inflation, in a society like ours, will either increase or decrease significantly the rate of economic growth.

While inflation has apparently not changed greatly the size of the economy's total real output, it has altered somewhat the sharing of that output—though to a lesser extent than is often argued. Over the period, the share of wages and salaries in the national income has increased substantially, mainly at the expense of unincorporated businesses, while the share of business corporations has remained roughly unchanged.

Thus, the common allegation that inflation transfers income from wages to profits has not been borne out. Instead, the income redistribution appears to have been increasingly toward the active sellers and income groups in the economy, at the expense of the more passive groups who have no prices to raise directly in the marketplace to protect themselves as inflation proceeds—retired persons, schoolteachers, Government employees.

Inflation has militated against Government services, especially at the State and local level. Since the public generally considers private spending more productive than governmental, public expenditures are raised only with a lag when inflation pushes up governmental costs faster than it does tax income. Only the Federal Government is reasonably protected by its heavy reliance on income taxes. Generally, the wage lag in Government has led to a growing undersupply of top-quality personnel in Government.

Substantial, continuing peacetime inflation in this country is likely to occur only as the result of two interacting factors: Widespread excess income claims by major economic groups who push up wages and prices faster than is consistent with a generally stable price level, and Government support of high-level production and employment through expansionary monetary-fiscal policy. Without this supporting Government action, the excess income claims of workers, businessmen, or farmers cannot produce continuing, substantial inflation.

Full Government acceptance of the responsibility to maintain high-level production and employment means that if major wages and commodity prices are pushed up faster than is consistent with high-level employment and a stable price level, the Government will bail out resulting unemployment and falling sales by expansionary monetary-fiscal policy. Such a policy, if fully relied on, will remove most of the incentive for sellers to refrain from continually seeking ever-larger income shares through higher wages and prices. We will be continually faced with the necessity of accepting inflation to maintain high-level employment.

Creeping Government-supported inflation does not solve the unemployment versus inflation dilemma which arises from excess-income claims. At best it only postpones the dilemma, and even temporary success becomes increasingly unlikely, even though the rate of inflation is repeatedly stepped upward. Indeed, it may become increasingly difficult to have full employment even with inflation, if inflation becomes increasingly accepted and expected. Unions, businesses, and farmers can readily increase their asking prices further next time around. If we could assure full employment by having a little inflation, few would hesitate to incur the inflation. But this is not the meaningful way to state the choice.

To avoid inflation with or without full employment, we must generate and preserve an economic climate where sellers expect Government policy to emphasize both high-level employment and rela-

tively stable prices. The solution to the unemployment or inflation dilemma is, as with many other dilemmas, not to choose one or the other painful alternative; rather, it is to take steps to avoid having the dilemma arise.

This reasoning leads me to support strongly inclusion of a statement in the Employment Act that reasonable stability of the consumer price level is one goal of governmental policy, along with the others now specified. Such an announcement would help warn sellers against overconfidently pricing themselves out of the market on the presumption of validating Government monetary-fiscal policy. Alone, the statement would surely not solve the inflation-full employment problem. But it would be a significant step in that direction, involving little or no cost.

The CHAIRMAN. Thank you, Mr. Bach.

Mrs. Betty Fishman, lecturer in economics, West Virginia University, is next.

We are glad to have you here, Mrs. Fishman.

STATEMENT OF BETTY G. FISHMAN, LECTURER IN ECONOMICS, WEST VIRGINIA UNIVERSITY

Mrs. FISHMAN. Mr. Chairman and members of the committee, the terms "stability" and "growth" have been used so frequently during the past few years in discussions of the Employment Act of 1946, that a goodly number of intelligent citizens may very well believe that these words were used in the act, to set forth its purpose. Actually, of course, this is not the case.

According to section 2 of the act:

> It is the continuing policy and responsibility of the Federal Government to use all practicable means * * * to promote maximum employment, production, and purchasing power.

The words "stability" and "growth," however, are not to be found in the Employment Act either separately or together.

The number of years which has elapsed since the passage of the Employment Act, together with the nature and diversity of the economic developments which have occurred during that time are sufficient to justify the conclusion that the language of the Employment Act is remarkably well suited to the general purpose of the act. That language is general enough to provide for flexibility in interpretation and also for the flexibility in action necessary if the act is to furnish a useful guide to economic policy in particular circumstances, the exact nature of which could not be foreseen at the time the act was passed.

Employment, production, and purchasing power are each highly significant concepts in assessing the adequacy with which the economy is functioning, and in determining what steps, if any, need be taken to improve its functioning. They are also concepts which are generally understood and defined in a similar fashion by economists and policymakers alike.

It may be pointed out that implicit in the language of the act is the belief that maximum employment, maximum production, and maximum purchasing power either are or can be made to be consistent with one another, and also with the objective of avoiding economic fluctuations or mitigating their effects. Whether or not this is actually so

under all circumstances may, of course, be questioned. But it is evident that principal emphasis in the act is placed on employment, and this emphasis could furnish a clue to policy makers in what otherwise might prove to be a perplexing situation.

Although the terms "stability" and "growth" have been used for some years now in discussions of the Employment Act both in and out of Government circles, those terms have not always been construed or applied in the same way, nor have they always been assigned the same degree of importance or priority.

Thus there have been times when stability has been emphasized and growth has received little if any attention. At other times growth has been emphasized and stability, at least overtly, has been substantially neglected. More recently it has been fairly common to link the two together and talk of economic stability and growth together.

In general in the years subsequent to 1946, concern about stability, and use of the term, increased together with signs of actual or impending recession or actual or impending inflation. Under such circumstances, stability was generally not defined clearly by those who used the term. It was, perhaps, obvious that they applied it in a negative rather than a positive fashion. In one set of circumstances it meant avoiding recession or at least avoiding a deepening of recession. In another set of circumstances it meant avoiding inflation or at least avoiding a heightening of inflation.

During some periods when neither recession nor inflation were present or imminent, attention shifted from stability, and then the term "growth" was used more frequently. This term, too, was rarely defined, but it was generally clear that it was held to be integrally related to increasing employment opportunities, and sometimes to increasing productivity, and/or a rising level of production as well.

Until quite recently, when both economic stability and growth were discussed in the same paper or in the same public statement, "stability" was frequently referred to as a suitable goal for short-run policy, and "growth" as a suitable goal for long-run policy. More recently, however, there has been increasing recognition of the fact that it is impossible to keep short-run and long-run considerations neatly enclosed in separate compartments in the formulation of public policy.

In the not-too-far-distant past, many economists might agree that the short run meant any period of time shorter than one complete business cycle. They might agree, also, that, in dealing with the short run, the matter of economic growth could be ignored with impunity, since the amount of growth in the short run was, generally, negligible. Today, however, a large and increasing number of economists in the United States realize that, when an economy as large as ours is growing at an average annual rate of 3½ percent, even a comparatively short cessation or interruption of economic growth will result in a large increase in unemployment.

In other words, we must run just to keep up with ourselves. If we proceed too slowly, we will still be faced with increasing unemployment. On the other hand, a sharp increase to a rate above that which can be maintained for a long period of time will result in an unhealthly inflationary situation which paves the way for future contraction or recession.

Thus, within the past few years, it has become increasingly common for public officials to link the words "stability" and "growth" together and to use them as one term in discussing the objectives of the Employment Act and the implementation of the act.

The two are conceived of as being closely interrelated—indeed, interdependent, for economic stability is thought of not in the dictionary sense of permanence or absence of change, but in the sense of minimum fluctuations around a growth trend. Growth, itself, is generally equated with the real increase in net national product. It is fairly easy to understand why the two words are so often linked together in this way. Each of them expresses one aspect of the type of economic process which is consistent with the stated objectives of the Employment Act and, indeed, necessary for achieving those objectives. Yet neither of them, by itself, is sufficient.

Such usage of the words "stability" and "growth" by public officials is probably in accord with prevailing opinion among reputable economists today. But is this usage really desirable?

Attention has already been called to the fact that the meaning generally ascribed to the word "stability" in current discussions of the Employment Act is very different from the dictionary meaning. It is different, too, from the meaning generally ascribed to the word only a few decades ago by both economists and policymakers. And it is certainly different from the meaning currently ascribed to "stability" by economists and policymakers when they discuss price stability.

In view of these facts, the current usage of the word "stability" in discussions of the general objectives of the Employment Act is bound to be confusing, at least occasionally.

In addition, if the type of growth which is desirable and consistent with the objectives of the act is a stable rate of growth, the use of the word "stability" in the term "stability and growth" is somewhat redundant. If the word "growth," by itself is considered inadequate to convey so complex a meaning, or if we wish to be more explicit on this score, might it not be preferable simply to make use of the expression "a steady rate of economic growth" or a "stable rate of economic growth" in our thinking and talking and writing, rather than "economic stability and growth"?

While growth does not insure stability unless the proper rate of growth is achieved and maintained, it is possible to determine theoretically a stable rate of growth for a free economy, under certain specified conditions. But is a stable rate of growth for the economy of the United States actually a realizable ideal?

Practically all economists today recognize that there is some relationship between economic fluctuations and economic growth. It is rather generally realized that economic growth does not proceed smoothly or evenly. During some periods growth is retarded. At times it may even stop or be reversed. During other periods, growth is accelerated, sometimes slightly, and sometimes considerably more than slightly.

The distinguished British economist, Harrod, although he does not believe the existence of cyclical fluctuations in the real world is caused solely by growth, has, nevertheless, demonstrated that an understanding of the growth process leads to the expectation that economic fluctuations of a cyclical nature will occur.

The late Joseph A. Schumpeter believed that there is an inherent causal relationship between economic growth and cyclical fluctuations, and that cyclical fluctuations are the mechanism through which growth occurs. Devoted followers of Schumpeter may, therefore, question whether it is possible to maintain growth without cyclical fluctuations, and whether any attempts to eliminate or even sharply reduce cyclical fluctuations may not result in economic stagnation, or, at least, in a long-run rate of growth much lower than that which might otherwise prevail.

Most economists in the United States today, however, do not subscribe to this point of view. A substantial number would probably agree that complete elimination of fluctuations—both cyclical and noncyclical—from the optimum rate of growth is impossible of achievement, at least in a free society, and that maintenance of a perfectly stable rate of economic growth in the United States for an extended period of time is, therefore, equally impossible—especially since the theoretical optimum, itself, may change from time to time.

They would probably also agree, however, that the concept of a stable rate of economic growth is a useful one, not only as a theoretical tool of analysis, but as a guide for policymakers, both in and out of the Government. It keeps us moving in the right direction, and, while we may never quite reach it, we can certainly reduce the magnitude of fluctuations in economic activity and move closer to the ideal of a stable rate of growth than we have yet come.

The CHAIRMAN. Thank you, Mrs. Fishman.

Next is Dr. Leo Fishman, professor of economics and finance, West Virginia University.

Glad to have you, sir.

STATEMENT OF LEO FISHMAN, PROFESSOR OF ECONOMICS AND FINANCE, WEST VIRGINIA UNIVERSITY

Mr. FISHMAN. Within the past 2 years, increasing attention has been given to the concept of price stability in discussions pertaining to the Employment Act of 1946. A number of economists and public officials have voiced the belief that stable prices are essential to the promotion and maintenance of maximum employment, production, and purchasing power. Some have even proposed that stable prices should formally be made a goal of public policy and that an explicit declaration to that effect should be incorporated in the Employment Act.

The Bush bill, introduced during the last session of Congress, was designed to amend the Employment Act in this fashion. Although the bill was not passed, there is still much sentiment in favor of such legislation.

Those who favor such legislation use the word "stability," not in the sense in which it is often used in current discussions of the general level of economic activity—that is, minimum fluctuations around the growth trend—but, rather, in the dictionary sense—that is, steadiness, absence of change, permanence.

They are concerned not with individual prices or price relationships, but rather with the general price level. Often, however, for reasons which are wholly or largely practical, rather than conceptual,

in nature, "the level of consumer prices" is accepted either explicitly or implicitly as a substitute for the "general price level."

The proposal that the Employment Act be amended to include price stability is generally based on two assumptions: (1) That, in the absence of effective preventive measures, a rising price level will be a basic characteristic of the American economy for many years to come; and (2) that effective implementation of the goal of price stability is, and always will be, consistent with the promotion and maintenance of maximum employment, production, and purchasing power. A third assumption, although frequently omitted, should really be included here; namely, that, from a technical and administrative point of view, stability of the price level constitutes a desirable goal of public policy.

The assumption that a rising price level is virtually certain to be a feature of the American economy for an indefinitely long time to come is in turn generally based on one or more of the following assumptions: (1) That the expansionary forces which have played so important a role in shaping economic conditions in the United States since the end of World War II will continue to play an equally important role in the future; (2) that, in the future, economic recessions will be relatively infrequent and, also, relatively short and mild, no more protracted or serious than the two relatively minor récessions of 1949 and 1954, for example; and (3) that the Federal Government will deal with future economic recessions swiftly and effectively.

The course of action pursued during the 1949 recession and that pursued during the 1954 recession are frequently cited in support of this point.

The future is, as ever, uncertain and, in the end, it may turn out that these assumptions were justified. Nevertheless, there are at present sound reasons to question the validity of each of these assumptions.

The principal forces making for economic expansion during the postwar period were (1) a huge backlog of pent-up demand for many types of consumer goods and capital goods, accompanied by a record volume of liquid savings held by both individuals and business firms; (2) a rapid rate of population growth; (3) a rapid rate of technological advance; and (4) a high level of public expenditures.

We cannot expect these forces to operate in similar fashion throughout a future of indefinite duration. The backlog of pent-up demand persisted in making its effects felt for longer than was originally anticipated, but it is now a thing of the past. The rate of population growth continues high. But one of the lessons of the past 15–20 years has been that the rate of population growth is less stable than we formerly supposed. It would be imprudent for us to base our current actions and plans on the expectation that the current rate of population increase will be maintained or will rise still further.

Technological advance, although certainly an important factor, is notoriously unstable. Research and development programs may continue to produce inventions in a steady stream. But inventions are not synonymous with technological advance. New inventions result in technological advance only when economic conditions favor their economic exploitation. Moreover, technological change does not necessarily result in a net addition to employment opportunities or to income. Only if the surrounding economic conditions are favorable do these results occur.

Government expenditures cannot be expected to rise as rapidly in the future as they have in the past 12 years, and it is not even certain that they will continue at their present level. Successful disarmament negotiations and/or a lessening of international tension would, undoubtedly, result in a reduction in national-security expenditures. And in a world that is so full of surprises, this may occur much sooner than any of us dare hope at the moment.

Even in the absence of successful disarmament negotiations and a lessening of international tension, national-security expenditures may decline if modern implements of warfare prove to be less expensive, in the aggregate, than the older implements they are displacing, and if they do not become obsolete so quickly.

State and local government expenditures will probably level off in the near future, and may even decline.

The same arguments just marshaled to support the view that we cannot expect the forces making for economic expansion during the postwar period to continue operating in the same fashion indefinitely may also be cited in questioning the validity of the assumption that future economic recessions will be relatively infrequent and, also, relatively short and mild.

Recent experience and our hopes for the future should not blind us to the fact that our basic economic institutions are still substantially the same as in the 1920's and the 1930's. The Federal Government acted wisely and well to help counter the relatively mild inventory recessions of 1949 and 1954.

We do not yet know, however, whether the Federal Government can act with the requisite speed and effectiveness in the face of an economic decline of a more serious character. Moreover, in any actual situation, it is no longer a question of what the political authorities can do, but what they will do. If a decline which theoretically could be arrested is not arrested because of conflicting views on what is to be done or when it should be done, the decline may possibly deteriorate into a genuine depression.

The second assumption of those who propose amending the Employment Act to include price stability as a goal of public policy is that effective implementation of the goal of price stability is, and always will be, consistent with the promotion and maintenance of maximum employment, production, and purchasing power. If this assumption is evaluated on the basis of either history or theory, however, it appears to be of questionable validity.

It is generally accepted that economic growth is necessary for the promotion and maintenance of maximum employement, production, and purchasing power. And the historical record reveals a remarkably close relation between economic growth and a rising price level.

Theoretical analysis suggests that the association of rising prices with economic expansion or growth in the past has not been fortuitous, and that a similar association may be expected in the future. Economic expansion or growth occurs when aggregate demand is strong in relation to current output and gives evidence of increasing further. These are the same conditions which provide the basis for rising prices.

These observations, however, should not be construed to mean that a rising price level is desirable under all circumstances, or that a

continuously rising price level is a necessary requisite for continuous economic growth.

The assumption that price stability constitutes a desirable goal of public policy from a technical and administrative point of view is seldom, if ever, explicitly stated by those who propose that the declaration of policy of the Employment Act be amended to include maintenance of a stable price level as one of the objectives of public policy. But this assumption must be accepted by anyone who seriously considers the proposed amendment necessary.

Here, again, however, past experience and theoretical considerations both give rise to several questions.

Since it does not appear likely that price stability will, under all circumstances which may arise in the future, be consistent with promotion and maintenance of maximum employment, production, and purchasing power, if price stability is added to the Employment Act, policymaking officials will sometimes be faced with the necessity of choosing between price stability and the other objectives of the act. This will tend to cause confusion and dissension, and may result in other undesirable consequences, as well.

If price stability is always granted priority, this will greatly limit the flexibility of action which it is desirable and presently possible for policymaking officials to exercise. It may seriously reduce our chances of realizing or approximating the optimum growth rate.

On the other hand, if the goal of price stability is not to be granted priority, except at the discretion of policymaking officials, or if price movements are merely to be one of a number of factors considered by policymaking officials in reaching decisions on public policy, why is it necessary to amend the Employment Act? Surely, price movements are already seriously studied and taken into account by those responsible for giving effect to the provisions of the Employment Act.

Actually, current developments, as well as those of the recent and more distant past, indicate that change or lack of change in the price level does not always constitute a very useful guide to policymakers who must decide what course of action to recommend or pursue.

Prices tend to lag behind changes in underlying conditions and are, therefore, frequently a tardy indicator of the need for action. Considered by themselves, they may even suggest the need for action of a type which is clearly inappropriate in the light of other economic indicators.

It seems pertinent also to raise the question of whether price stability constitutes a feasible goal of public policy. Is our current knowledge of economic theory, techniques of public policy, and the manner in which our economy functions and responds to policy decisions, sufficiently far advanced so that we can realize the goal of price stability?

The problem is further complicated by the fact that in a technical or statistical sense, there is no such thing as "the general price level." At present there is considerable support for using the BLS Consumer Price Index as an indicator of price movements for general policy purposes. Undoubtedly, this proposal has much to commend it from a political point of view. In the past, however, most economists and statisticians have leaned toward the view that the consumer price index is less useful than the wholesale price index for this purpose.

These technical and administrative considerations point to the same conclusion indicated by the arguments already presented: namely,

that it would be unwise to amend the Employment Act by adding price stability to the objectives presently included in the declaration of policy.

It is perhaps worth noting that several times in the past when congressional action has been proposed to make price stability the sole or chief goal of the policies and actions of the Federal Reserve Board, Federal Reserve officials have presented eloquent testimony in opposition to these proposals, and have made use of some—although not all—of the same arguments cited above.

One of the arguments most frequently cited by those who favor amending the Employment Act by adding price stability to the declaration of policy, is that even a slowly or moderately rising price level has uneven economic effects and that it has particularly undesirable effects on retired persons living on past savings, on recipients of pensions or annuities, and on other individuals with fixed incomes.

In arguing against the proposed amendments to the Employment Act, I do not wish to appear unmindful of the validity of this argument. I believe, however, that policymaking officials already have ample basis for adopting measures to restrain undesirable price rises. Rigid adherence to the goal of price stability might do more harm than good, even to the group it was intended to help.

It would seem preferable, therefore, not to rely on price stability for this purpose, but rather to devise new techniques more specifically directed toward the special problems of this group.

The CHAIRMAN. Thank you, Mr. Fishman.

The Chair would like to yield alternately between the majority and minority members, with the suggestion that each member be allowed 5 minutes in the first go-round to ask some questions.

After we have gone around once for 5 minutes each, the time will then be unlimited.

Mr. Bolling.

Mr. BOLLING. I will pass temporarily, Mr. Chairman.

The CHAIRMAN. Mr. Kilburn.

Representative KILBURN. I have been a little bit overcome here by all these economists.

It is kind of difficult to digest all of this material here, but I was interested in what was said. I presume that our goal here in this country, since we have gotten inventions and improvements and everything over the past hundred years or so, is to lower the people's working week. I would think it would be that. So if they produce as much for their working time in 3 or 4 days a week they can go to the movies the rest of the time. And I gather from your statement, sir, that is your goal too.

Mr. FISHMAN. I had not given specific consideration to the question of reducing the workweek.

Sometime in the future it maybe appropriate to do that.

Mr. KILBURN. I am not suggesting that. I mean the evolution. If we all invent things as we have done over the last hundred years to reduce work, why, eventually we will cut it down, I would think.

Mr. FISHMAN. Yes, I agree.

I think in the future there will be opportunity to reduce the workweek for the American labor force.

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Mr. KILBURN. I am not sure which one of you spoke about this, but I always had the hunch—and maybe I am wrong—that the steel companies or some other big companies get together with the labor leaders, and they say, "All right, we will give you the wage increase, and we will increase our prices."

I would like to have a comment on that.

The CHAIRMAN. Would you raise your voice a little bit, Mr. Kilburn.

Representative KILBURN. I think the big corporations, many of them, go to their union leaders or the union leaders come to them and say, "Listen, we want a wage increase. And all you have to do is raise your prices."

And they get together and they do it.

Mr. NOURSE. I do not read their statements in that way. It seems to me that they have come and said, "We must have our wages increased to increase the purchasing power of our people and the others indirectly. But if we are going to benefit, you should hold your prices down."

It seems to me that that has not been a package suggestion. They have pressed for higher returns. Management has found it possible to raise the prices.

Representative KILBURN. Well, I do not think—as far as I have seen anyway—that the margin of profit on these big corporations has grown any.

Mr. NOURSE. The labor people contend that it has.

Representative KILBURN. Well, I am just going by their yearly statement where they take a circle there and their margin of profit has stayed about the same.

And all they do is give a wage increase, and then they put that on the price, and they stay the same, and the wages go up. And all the people that are not in their union find that it is tough for them.

Mr. NOURSE. Well, that has been the inflationary wage-price spiral.

Representative KILBURN. That is right. And the people that are on pensions and all of that are out of luck.

That is all, Mr. Chairman.

The CHAIRMAN. Mr. Reuss.

Representative REUSS. The panel seemed to display some difference of opinion on one of the central questions, namely, whether the Employment Act of 1946 includes something like price stability as a goal; and if it doesn't, whether or not it is desirable that it should.

I must confess that my reading of the act has alway been this: that I assumed that the goal of maximum purchasing power was indeed a directive to achieve maximum price stability; and, therefore, I would question the need or desirability of an amendment, even assuming we address ourselves to the point raised by Mr. Fishman as to whether or not this is desirable.

I do not think it is.

What about that? Dr. Nourse, I believe, feels that the act, as presently drawn, does include the goal of price stability with equal, though no greater, emphasis than the goals of maximum employment and maximum production.

Is that correct, Dr. Nourse?

Mr. NOURSE. That seems to me the only tenable interpretation of those phrases.

It is my neighbors here, Dr. Aschheim and Dean Bach, who have argued against that. So they should probably respond to you.

Mr. Ensley and Mr. Fishman both took your side of the argument.

Representative REUSS. Yes. Mr. Aschheim and Mr. Bach.

Mr. ASCHHEIM. It seems to me that if you adhere strictly to the objectives stated in the Employment Act, namely, "maximum employment, production, and purchasing power," these would not be inconsistent with inflation. That is, as they are now stated, the Employment Act objectives are open to the interpretation that it is the obligation of the Federal Government to pursue them regardless of what happens to the price level.

It is because I am concerned about the possibility of interpreting the act in this way that I recommend incorporation of a stable price-level objective. With incorporation of this objective, it will be made entirely clear that maximum employment, production, and purchasing power are not to be pursued regardless of what happens to the price level.

Representative REUSS. I would certainly hope that the act would be interpreted to include inflation equally with underproduction and underemployment.

However, doesn't maximum purchasing power mean that? Doesn't maximum purchasing power mean that efforts should be made by the governmental authorities to see that purchasing power does not evaporate due to inflation? And purchasing power for the great body of people, including schoolteachers, Government workers, and fixed-income people?

Mr. BACH. It seems to me that Mr. Aschheim is providing an interpretation of the act that is seized upon by many people. The mere fact that there is so much discussion and disagreement about whether this price-level objective is included is significant.

May I speak to the technical point you raised, as to whether the language of the act does necessarily or reasonably imply price stability. I think it does not. I disagree with Dr. Nourse, although I respect his much greater wisdom and experience in this field than mine.

It seems to me that if we say maximum purchasing power, this is consistent with any level of prices, because in the inflationary process, incomes rise and prices rise. And after an inflation of, say, a hundred percent has taken place, the amount of purchasing power has not decreased if, in fact, incomes have risen by the same amount.

So, if we look at that that way, I think one can reasonably say that maximum purchasing power is a directive to provide maximum real output of goods and services. So viewed, the act does not provide any guidance on the problem of price stability.

As I argued before, it seems to me the real danger of inflation is that the Government will behave in a certain way in response to pressures of different groups for larger incomes. It is extremely important that the Government will be clearly on record that price stability is a part of its goal and not that this is a very vague and uncertain thing as to whether it is a part of its goal.

May I say one last word about this?

If, in fact, Dr. Nourse is right that price stability is implied and ought to be implied in the present act, I find it difficult to understand why we are so reluctant to put it in the present act and make it explicit.

It seems to me that public policy in a democracy should be stated as clearly as possible. Here is a case where if we are all agreed that price level is an important objective, it seems desirable that we should say so.

Representative REUSS. Of course, one reason to the contrary is that, if it really is in the act now, as Dr. Nourse thinks it is, and as I thought it was, then, if we should suddenly put it in now, it will imply that it was not in before. This will tend to excuse retroactively many sins of omission of the past, some of which, in my opinion, are continuing to the present day.

Mr. NOURSE. May I comment there, Mr. Chairman?

The CHAIRMAN. Certainly.

Mr. NOURSE. If I understood your position, Dean Bach, you read the act as maximum monetary purchasing power.

I read it—and read the whole legislative history of the act which brought it into being—as meaning maximum real consumer purchasing power.

Mr. BACH. No. I read it as you do, sir.

I thought I was directing myself to precisely that point, that maximum real purchasing power is consistent with a high or a low level of prices, since in inflation, incomes generally go up and down at about the same rate as prices do.

And my test of maximum purchasing power really is the goods and services being produced for consumption and for use in investment goods in any particular period.

Mr. NOURSE. If I can ask a second question?

I pointed to the difficulties of interpreting a thing like the Bush amendment. It seems to me that the Bush amendment as proposed in the last session would give all this uncertainty. But if the act were amended to include the two words I have inserted there, and read "real consumer purchasing power," would that accomplish the purposes which you think should be accomplished?

Mr. BACH. I am afraid Dr. Nourse and I are monopolizing the discussion.

The CHAIRMAN. Well, you may reply briefly.

Mr. BACH. I would like to see the statement made that price stability is an appropriate objective.

I would be glad to answer at more length later if the Chairman directs me.

The CHAIRMAN. Thank you.

Senator Hoblitzell?

Senator HOBLITZELL. I would like Dr. Nourse to elaborate on his last paragraph and clarify the meaning of "the free competitive enterprise system" with relation to monopoly. And I am referring to both on the part of corporations and labor.

Mr. NOURSE. That goes back to the argument in the first part of my paper and the same thing that is stressed in Mr. Ensley's paper of the "insulated position of certain persons who have no monopoly power in the strict sense, but have monopolistic power. If Senator O'Mahoney were here I am sure he would want to say "concentration of economic power."

It seems to me that through our institutions and our practices we have a great deal of built-in inflation in our system, and that that is the point which I think is most important for attack now.

Senator HOBLITZELL. Like automatic price increases?

Mr. NOURSE. Yes. I cited the nationwide 3-year automatic escalation contracts.

Representative KILBURN. Will you yield?

Senator HOBLITZELL. Yes.

Representative KILBURN. As I gathered from Mr. Reuss' question, you give a price increase and that increases purchasing power. And that takes care of the depression.

Representative REUSS. I am not sure I understand your question.

Representative KILBURN. You say that increased wages increase purchasing power. And that would take care of the depression.

If that is the case, let's double the wages, and they would be all fixed.

Representative REUSS. I do not know where you got that. I was simply saying that as I read "maximum purchasing power" this meant a stable dollar; this meant that prices should not be allowed to ascend very rapidly, because this would depart from the goal of maximum, well-distributed, purchasing power, which is the concept as I read it.

Representative KILBURN. I am just a little bit sick and tired of saying that to increase wages will take care of everything.

That is what I thought you were inferring.

Representative REUSS. I did not say that.

Senator HOBLITZELL. Dr. Fishman, in the latter part of your statement in relation to this, you mentioned ways of taking care of retired persons, and so on. What would you suggest?

Mr. FISHMAN. I do not wish to make any specific recommendations along those lines at present. But we have some legislation on the books today which is designed to help such people.

Our social security laws, for example, help them in some respects. We have been increasing the benefits provided by our social-security legislation so that retired persons have benefited from increased payments as prices rise.

My main concern, however, is that if a policy of price stability is pursued at the wrong time, it may have undesirable economic consequences which would create unemployment and wipe out liquid assets. This would do more harm to these particular groups than a policy of maintaining price stability.

Senator HOBLITZELL. That is all, Mr. Chairman.

The CHAIRMAN. I would like to raise two questions.

One is: Why have prices remained level, and even gone higher, in this recession, or depression, or whatever you want to call it, whereas, normally prices would go down?

What do you think has caused prices to remain high and fail to go down, and some of them even have gone higher?

What would you say on that question, Dr. Nourse?

Mr. NOURSE. Well, it seems to me that the increases of incomes for certain important and strategically placed groups, chiefly in the form of wages, has been causal. Then, too, as I suggested in my opening statement, management has clung to fixed pricing formulas and cost-accounting methods, in an attempt to recoup wage costs in their prices.

The CHAIRMAN. The built-in costs have compelled the prices to remain up? Is that your argument?

Mr. Nourse. Yes. And even though industrial pricemakers have made the point that they have had to have these wide margins of profit to make the plant improvements that will reduce their costs, now that those improved processes are in, they do not seem to find enough cost reduction that they can grant price reductions.

As I look at it, there is great rigidity in most manufacturing prices now. And the only place where the process, the classical process, of price reduction by competition is taking place is in the merchandising field. The great mail-order houses put out their new catalogs with substantial price reductions. Also, in the chainstores you have that same process taking place. But the cuts in the manufacturing area have been very small. And in many cases we have had increases and announcements of further increases to come.

The Chairman. We have always been told, Mr. Aschheim, that production is the best answer to inflation; that if we will just produce and produce, why, then, we will not have any inflation.

How do you reconcile that former belief with the present situation concerning automobiles, when we are greatly overproduced, and prices do not go down?

Mr. Aschheim. Well, I certainly admit that there is downward price rigidity in the industrial sector of the economy, and that with recessions such as the 1949 or 1954 recession, and even of the magnitude of the current one, it is not likely that we will get substantial price-level declines.

However, recognizing that is quite a far cry from the claiming that we need mass unemployment in the American economy to have price-level stability. I believe that this claim has gotten a great deal of attention and has been widely used as a basis for regarding it as undesirable to incorporate a stable price-level objective into the Employment Act.

In other words, it has been alleged that the conflict between price-level stability and full employment is so serious that we had better give up the price-stability objective. My own examination of the data leads me to minimize the conflict between these two goals and to suggest that in the absence of out-and-out inflationary demand conditions, such as are associated with or immediately follow wartime, this conflict is likely to be much less pronounced than it has been commonly thought to be.

Now, with reference to the remark by Congressman Reuss on the possible reflection of a newly added price-level objective upon past performance under the act, I believe we should be primarily concerned with future performance.

We know we have had considerable inflation since the passage of the Employment Act. Do we want this state of affairs to persist in the future? I am confident that we do not. If we do not, one way in which the Congress can make this idea clear to the administrators of the Employment Act, as well as to the public at large, is to incorporate a price-level objective into the Employment Act.

Representative Kilburn. I would like to say something about your question, which was a good one, I thought.

The Chairman. I don't want to take up too much time on it.

But one other question I want to raise before I yield to other members is this: Having gone through these OPA's and price-fixing,

and knowing all the problems in connection with them—and the ways of evasion, and the fears and apprehensions connected with them—I just wonder if there is a real deterrent to price reduction on the part of producers and manufacturers, because they are apprehensive or afraid that if they reduce prices, some emergency will possibly arise and the prices will be frozen there.

In other words, they would rather keep the prices up and give discounts, if necessary, but always maintain the price rather than run the risk that, if we were to get into an emergency and prices would be frozen, they would have them frozen at a lower level.

Do you see any corroboration of that viewpoint, Mr. Bach?

Mr. Bach. I do not feel competent to answer that, because it is basically a question about what goes on in the minds of manufacturers.

The Chairman. That is right. And talk among manufacturers.

Mr. Bach. I would only say that in my circle of acquaintance I have not heard that mentioned as a significant barrier to price reductions.

The Chairman. What about you, Mr. Fishman?

Mr. Fishman. I, too, am not technically competent to speak about the automobile industry. From a broader economic point of view, however, I think there are several possible explanations for the failure of automobile prices to decline in the face of a reduced demand for automobiles.

The point you made, Mr. Chairman, I think, is a valid one. It is easier to reduce prices than it is to raise prices. Should automobile prices decline at the present time, it might be difficult to raise them again in the near future.

There are several other factors which might help to explain this rather unusual situation.

In the first place, I think it indicates that price competition is not sufficiently keen in the automobile industry to produce a price decline.

Secondly, the firms in the automobile industry appear to be financially strong enough to absorb temporary losses.

And, finally, it indicates that the automobile industry is capable of reducing production to deal with a decline in demand without resorting to price declines.

The Chairman. Mr. Bolling?

Mr. Bolling. In the last few weeks there has been a good deal of publicity given to two facts that were stated by different people.

Mr. Allan Dulles recently indicated that to his knowledge the rate of growth in the Soviet Union on an annual basis had been substantially larger than that of the United States, and drew some implications from this.

Also fairly recently, the second panel of the Rockefeller Brothers Fund indicated that various reasons, including, at least by implication, the point Mr. Dulles was making, plus assuring the ability of the United States to perform the services that it had undertaken already at a reasonably comparable level, might make desirable a rate of growth of 5 percent on annual basis.

This substantially exceeds any historic long-run rate, and, I think, has been exceeded in this country only during World War I and World War II for any appreciable period of years.

My question, I think, is pertinent to this discussion.

Is it the opinion of the panel that, accepting for the moment for the sake of argument the implications of both these statements, it

would be possible for us to maintain reasonable price stability at a rate of growth of about 5 percent per annum?

I think that is the $64 question. I think that is what we are really talking about.

Mr. FISHMAN. I do not think it would be possible under present conditions.

It might be possible if the Government were willing to institute various types of administrative, financial, and fiscal controls in addition to the ones it now employs for that purpose.

Representative BOLLING. Would you mind suggesting the kind of controls that you have in mind in specific terms?

Mr. FISHMAN. Well, in the case of monetary policy, for example, I think it might be possible for the Federal Reserve Board to utilize selective controls to help in a situation of the type you describe.

Representative BOLLING. Consumer credit controls?

Mr. FISHMAN. Consumer credit controls and controls on new real estate construction would be appropriate. That type of selective control has seldom been used in this country except during wartime. In the face of sharp inflationary pressures, however, such controls would be appropriate and helpful.

There are other types of controls of a selective character which could also be used. Financial controls could be used to a larger extent than they have in recent years to stimulate production.

For example, during the inflationary period from 1955 to 1957, we had pockets of unemployment in many areas of the country. Had we been able to utilize the facilities and labor force from areas which suffered substantial amounts of unemployment, it would have been possible to increase total production and thereby contribute to a lessening of the inflationary pressures.

Representative BOLLING. This involves actually a diversion of activity from an area where there was lack of demand to an area where there was an excess of demand?

Mr. FISHMAN. I would conceive of such policies being used only where their use would result in a net expansion of output.

Representative BOLLING. I do not disagree with that. I did not make myself clear.

If there is an industry which is not finding an adequate demand for its product and this causes pockets of unemployment, the implication might be you would either technologically find ways to increase demand for that industry or divert those resources into an area where there is an excess demand.

That is what I tried to say.

Mr. FISHMAN. That is true.

Mr. BACH. I think the answer to the question might have sounded a little different 2 years ago, when we were fully employed or at a high level of employment, than it sounds now.

If I remember correctly, in a subcommittee of this committee, the Subcommittee on Tax Policy, several of us who testified at that time argued that it was possible to do what you are describing—to grow at a more rapid rate without inflation.

And this could be done in principle through a combination of monetary and fiscal policies that would simultaneously stimulate investment and saving and restrain consumption, while using aggregate fiscal policy to keep total demand and supply in balance. This

implies a shift of production in the direction of capital goods away from consumer goods, which, of course, is one of the ways we grow more rapidly.

Now, I think in principle there is no reason at all why that cannot be done with stable prices, beginning from a full employment situation.

Your $64 question implied beginning at this time, I suppose. And it is much more difficult now.

What we need to do now is not only shift the composition of output from consumer goods to investment goods to get your goal, but also to get everybody back to work, or to get many people back to work. I am not sure at all that the problem of getting people back to work now is entirely consistent with maintaining stable prices.

It seems to me, however, that we ought to bear in mind the fact that if we let ourselves get into these dilemmas, we are going to have to get out of them by making bad compromises all the time.

And this may well be some more demand which brings on some more inflation.

This is the general gist of my argument: that in order to attain your goal, which is a higher rate of growth without price inflation, you need to have a policy that makes it very clear at the outset that price stability is going to be one of our goals, and that it develops expectations in the economic world, that is, in the business world, in the labor world, in the agricultural world, that it is not going to be possible when times look a little bit lush, as they have over much of the postwar period, just to push up your asking prices and get away with it all the time.

Representative BOLLING. Do you think it could be accomplished by words rather than deeds? When you talk about a responsible fiscal policy, there seems to be some acceptance, some general acceptance, that crosses party and partisan lines, that we should have a countercyclical policy on the downside. But in my mind there seems to be some question as to whether that is acceptable fully on the up side.

It would seem to me that we could put any number of words we wanted to in the Employment Act, but until for the first time the Government—that being the administration and the Congress—had put together an action on the up side, that there would be very grave doubt in the minds of everybody from the professional economists to the businessman, what actually was meant. My point is that it would require more than words, although the words might be the beginning.

Mr. BACH. I think it does require more than words, but I think the words are important at the beginning.

It makes you sound pretty unpopular to talk about price stability today when there is unemployment of 5 or 5½ million.

Representative BOLLING. This is the best time, because some of the heat is out of the subject.

That is all, Mr. Chairman.

The CHAIRMAN. Dr. Talle.

Representative TALLE. Mr. Chairman, I shall forego questions at this time.

The CHAIRMAN. If you want to come in later, you may do so.

Senator Hoblitzell?

Senator HOBLITZELL. You made some statement about the production of automobiles. I do not think your question was answered adequately.

The CHAIRMAN. I wish you would pursue it.

Senator HOBLITZELL. Credit was a major item. And the overextension in 1955 enables us to sell millions of automobiles. Those people who bought those cars are still paying for them.

I happen to be a banker. And I learn my economics the hard way every day when I talk to people coming in to borrow money.

Industry has been financing itself more by debt financing than by risk capital. We are now in a period of decreasing production, and they still have that fixed cost of money they borrowed to pay for.

The individual was able to absorb the price increase in 1956 because they extended credit terms on new cars from 30 to 36 and 40 months, which, to me, was an unwise extension of credit. Now we are paying for that pushing of the market at that time through loose credit policies.

The CHAIRMAN. May I ask you a question, Senator?

Senator HOBLITZELL. Yes, sir.

The CHAIRMAN. Do you think many people deliberately go into debt rather than pay the cash when they have the cash so as to get the deduction on their income tax?

Senator HOBLITZELL. You mean business people or do you mean individuals?

The CHAIRMAN. Individuals.

Senator HOBLITZELL. Individuals do not.

The CHAIRMAN. The business people go into debt?

Senator HOBLITZELL. Most individuals take the 10 percent and go on. But business people look at it differently.

The CHAIRMAN. That does not enter into the installment question in any way?

Senator HOBLITZELL. I don't think it does.

The CHAIRMAN. The monthly payments on these cars—the average individual thinks only in terms of how much it is going to cost him per month. They don't always inquire about how many months?

Senator HOBLITZELL. No. They only think about how much it will cost them a month.

The CHAIRMAN. Mr. Reuss.

Representative REUSS. I would like to raise what seems to be an issue among the panel that really has not been fully explored. If I heard correctly, it is Mr. Leo Fishman against the field on the assumed incompatibility between maximum purchasing power and maximum employment.

In your statement particularly, Mr. Fishman, you talked about the fact that at various times in the past it is true that expanding production occurred at the same time as expanding purchasing power. Then you go on to point out that expanded purchasing power is frequently found in conjunction with higher prices—inflation.

It is certainly true that there have been many times when those things did concur. But can't you dredge up also examples of where they didn't?

How about Germany from 1949 to 1954?

How about this country in 1941 and 1942?

Of course you are going to say "Yes, but we had price ceilings or the beginning of price ceilings."

Mr. FISHMAN. Well, I agree there have been occasions when the country enjoyed a high level of prosperity at the same time that prices were steady. In general, I would support any move to stabilize prices at a time when employment is full or relatively full.

On the other hand, I would be opposed to amending the Employment Act to include price stability among the objectives, for I am not as convinced as some of my colleagues on the panel that prosperity is assured for the indefinite future.

I think there are signs that we may in the future be subject to economic recessions. In fact, we may experience something more severe than an economic recession. Prices will probably decline in such a situation. But whether or not they decline, it seems to me that the policies we would pursue to encourage an expansion of the general level of economic activity would also be policies which would permit prices to rise. Policies permitting a rise in the price level are not sound or necessary at all times. But there are times when a rising price level is integrally related to a rising level of economic activity. And Government officials would do well, I think, to leave themselves free to pursue policies which would permit the price level to rise under such circumstances.

Mr. REUSS. I am now going to ask some of your colleagues here for comments on that; and specifically, to ask whether any other member of the panel—and almost all the other members have stressed the need for the inclusion of some such goal as anti-inflation if it isn't in there now—really feels that the inclusion of such a goal on a specific basis would be inconsistent with the national authorities letting prices go up with equanimity after they had gone down for a while.

Mr. Aschheim?

Mr. ASCHHEIM. I hope it is in order for me to call attention to a statistical table and an analysis of its meaning in a paper by Dr. Otto Eckstein. This is found in the compendium on page 362, where several countries are examined with respect to the behavior of their rates of growth of output per decade and their rates of change of prices per decade.

In commenting on these data, Dr. Eckstein states on page 361:

> It can be seen that periods of rapid growth occurred with and without inflation and that periods of stagnation also saw a very wide range of price changes. Thus, as the long-run phenomenon, there is no historical association between growth and inflation.

Thus, a rising price level is not necessary for rapid economic growth.

I wish to go somewhat beyond this, however, and to point out that it is not only the rate of growth that matters but also the type of growth. That is, the pattern of investment matters, as well as the rate of investment.

And this is particularly relevant from the viewpoint of American economic growth, which is deemed necessary in terms of the current international competition with the Soviet Union.

Perhaps the most important form of investment that our economy has made historically and is likely to make in the future is investment in developing the human mind. The continued need for such investment means that there will have to be a substantial improvement

of various governmental services that are part of the educational process in the United States.

Such governmental services have suffered greatly in the postwar inflationary period.

This result has been part of a more general reduction of quality standards in the public sector of the economy. It is in terms of concern about the future quality of Government services that the goal of price-level stability becomes especially germane and important.

The CHAIRMAN. Senator Hoblitzell.

Senator HOBLITZELL. You commented on the decline of Government services. What are you referring to there specifically?

Mr. ASCHHEIM. I mean by that that schoolhouses are more crowded than they used to be; and State highways are more crowded than they used to be. Various Federal facilities are more crowded than they used to be.

The ratio of students to teachers has increased. In various areas public libraries have had to curtail services that they have provided.

Thus, inflation, even at the creeping rate that we have witnessed, has been most significant in bringing about the relative disadvantage at which the governmental sector has been placed in relation to the private sector of the economy.

Senator HOBLITZELL. You want the Government to do everything, then?

Mr. ASCHHEIM. I certainly do not. I want the Government to raise its standards of performance rather than to lower them.

Senator HOBLITZELL. Would you have that done on the Federal or local level?

Mr. ASCHHEIM. I think in the case of education, this is primarily at the local level. However, in the field of scientific research, and even in the field of economic research, the Federal Government has an important role to play in contributing to the development of higher educational standards.

Senator HOBLITZELL. I will buy the economic research study. That is good. But I am a little worried about the future.

Representative REUSS. Going back to the point raised by Mr. Fishman and commented upon by Mr. Aschheim, there does seem to be evidence on both sides of the question as to whether you have to have inflation at the same time that you have growth.

There certainly seems to be many periods when the two do not occur at the same time. However, I would like some more comment on another point raised by Mr. Fishman. He suggests: What if we have a pronounced deflation in this country, as we did from 1930 to 1932? Is it bad, then, for the Government to see prices go up afterward?

If so, we had better not rivet an ironclad "no-price-increase" plank into the platform.

I suggest there is an answer to this in the minds of some of the other panelists.

Mr. BACH. I do not think anyone wants to stabilize a depression, and this is a false way to view the issue. Those of us who feel that price stability is important, whether or not we think there should be a separate statement put in the act, I am sure could all agree that we want to see prices relatively stable at the beginning from a satisfactory level of prices and economic activity.

So I think if we let ourselves get into another 1933, at least I would be delighted to see prices go up if that is something we have to have to get the economy back on its feet.

The case for the price-stability objective, it seems to me, is one that begins with a relatively satisfactory level. So a serious drop from that level would, I think, imply the propriety of getting prices back up if a depression should come upon us.

Representative REUSS. Mrs. Fishman.

Mrs. FISHMAN. I would like to shift the question back to the period before the price decline occurred. If you amend the act to include price stability, then in applying this goal of price stability would you allow the price decline to occur in the first place?

But there are one or two other points I would like to bring up that I think are important in this connection also.

One point is that although we have all been talking about inflation, and using the word freely, we do not all mean the same thing by it. I think part of the difference in our points of view stems from that fact.

For example, Mr. Bach would define any price rise as inflation, whereas some other economists, including myself, would not define any price rise as inflation. We would consider a rise in the price level inflationary only if it is not accompanied or immediately followed by a rise in total output which is of at least equal significance. So we would not consider a modest price rise inflationary as long as the price rise is accompanied or immediately followed by a substantial increase in total production as some unemployed resources become active once more.

Anyone accepting that point of view would also subscribe to the idea which you expressed earlier, Mr. Reuss, that inflation is inconsistent with maximum purchasing power, although a rise in prices might not always be inconsistent with maximum purchasing power.

In other words, if a rise in prices occurs because of the setting into motion of forces which increase employment and production, you would get prices going up together with income, and it might very well be that incomes would rise more rapidly than prices in such a situation.

If that were so, maximum purchasing power would be consistent with rising prices.

On the other hand, in a truly inflationary situation, the rise in prices would not be accompanied or immediately followed by an increase in total production of at least equal significance. Inflation is necessarily inconsistent with maximum purchasing power, because an inflationary price rise cannot be accompanied by an equivalent, or more than equivalent, increase in income.

Mr. REUSS. If I may interrupt you there, are we all against that kind of inflation?

Mrs. FISHMAN. I certainly am. And, from what I know about Mr. Fishman's point of view, he certainly is against this, also. And that is why I go into this definition. I think it is a crucial point here.

I would also like to make a few comments about several other questions which were raised earlier. There was a question raised about the movement of prices at the present time; for example, why does the price level continue to go up?

This ties in with a point that was made in our papers. Price indexes are not always a good indicator of what is going on on the

economic front. And they are not always a good indicator of the type of economic policy which should be pursued. We know that prices tend to lag behind other indicators of economic activity. We know that the Consumer Price Index, in particular, tends to lag.

Right now we also know that a good part of the increase in the Consumer Price Index results from the increase in food prices, and that food prices have risen partly because of special weather conditions which existed this year. We see that most other components of the Consumer Price Index do not exhibit this same rise.

Should we attack this special situation by adopting general economic policies that would counteract this sort of thing? Obviously, there is no general economic policy which we can take to cope with the freeze that occurred in Florida last winter.

Now, I do think that the strength of the underlying forces, given sufficient time, would prevent price rises of this sort from going on indefinitely, although there are lags for institutional reasons which other people have mentioned.

There is another point which I think should also be brought out in this connection, and that is that the discounts which are being granted today do influence the Consumer Price Index.

The Bureau of Labor Statistics is quite sophisticated in this respect. They do not base the price of new cars on the quoted price. When discounts are given, this gets into the BLS index.

As a matter of fact, I understand that, a couple of years ago, they even started to send investigators around to discount houses to get prices of various electrical appliances, because they are aware of the fact that many sales of these appliances are made by discount houses, and the list price is not necessarily an accurate indication of the price which consumers are actually paying for these things.

The main point I would like to make, however, is that there is no implication in anything that either Mr. Fishman said or wrote or in anything that I said or wrote that price stability is inconsistent with economic growth, or that you have to have rising prices for economic growth.

But there is realization of the fact that we should not base our policy on wishful thinking. And there are some circumstances which, conceivably, may arise in the future in this country in which it would not be a good idea for us to adhere rigidly to the goal of price stability.

We feel there is already in the legislation as it now stands, and in other legislation, a sufficient basis for Federal officials to pursue the goal of reasonable price stability without incorporating in the Employment Act language which might make more rigid adherence to this goal seem necessary and desirable.

Mr. Nourse. Mr. Chairman, I am a little more than bothered by Mr. Bach's statement a few minutes ago that no one on this panel wants to stabilize recession. Of course, no one wants to freeze us into a recession position. But do his remarks mean that no one here wants to stabilize prices at the level that they now stand at this stage of the recession, but that all reasonable means under the Employment Act should be taken to resume prosperity by going back to the inflationary boom?

Now, personally, I would think that a sound line of policy, public and private, would be to permit some easing of prices from this level.

The cost of housing is one of the things which is interfering with the resumption of an active rate of building—1.2 million of housing starts, or whatever it might be, per year, or getting back onto the 6-million-car level, or something of the sort.

It would seem to me that the implication of what you were saying in response to Mr. Bolling's question was that you would use an aggressive, positive fiscal and monetary policy to get activity going and not worry about this price aspect of it, although you did say a cautious word or two at the end.

I wish Mr. Bach would clarify his position.

Mr. BACH. I thought I was responding to a question: "What would we feel about beginning a stabilization of the price index as part of our total policy in 1932 or 1933?"

I would not classify this as a recession; I would call that a bona-fide full-blast depression. I said I would not want to stabilize a depression.

Your statement is a much more modest one when you ask about a recession of, say, the present sort, and whether we feel that there is always a situation where we should not be concerned about rising prices and should, in fact, be prepared to let them slide off a little.

Well, I believe that the basic danger is the upward push of prices. And that is why I have been taking a rather strong stand on that direction.

Secondly, I would like to emphasize the main point I have been trying to make, which is that, whether you have prices rising or falling, at least within moderate degrees, does not seem to be the critical question as to whether we have full employment, less than full employment, rapid growth, or slow growth.

The evidence seems quite convincing to me that the degree of inflation within moderate range, or the degree of deflation within moderate range, does not play a critical role in this question.

Now, personally, I should be glad to see prices soften a little, say, from present levels. But I think the danger is so much the other way that I am perfectly willing to see put into the goals of the act a statement about price stability or to associate myself with you in your position that I take to be that the act already implies a considerable attention to reasonable consumed price developments.

Mr. NOURSE. Oh, absolutely; yes.

Mr. REUSS. Dr. Talle.

Representative TALLE. Thank you, Mr. Reuss.

I should like to refer to the last page of your statement, Dr. Nourse, and I will quote a sentence about 5 or 6 lines down:

> The greatest threat to the accomplishment of the objectives of the Employment Act is to be found in the rigidities or the built-in inflationary bias that we have allowed to creep in.

That is the end of my first quotation.

And that has to do with the greatest threat. Now, may I move down to the last paragraph where you state, and I quote:

> Possibly the greatest service that this committee or the Congress as a whole could render at this juncture in our economic affairs would be to clarify the meaning of free competitive enterprise in this day of corporation and labor-union giants.

And then I pick up your final sentence and I will quote that as follows:

We need to reestablish conditions of price competition in place of power competition.

I would like your comments on those significant statements, Dr. Nourse.

Mr. NOURSE. I am glad you find them significant, Mr. Talle. They are very much at the core of my thinking.

I believe that the rigidities I have referred to in different ways reflect the use of the power of large organizations, both labor and management, to protect themselves or to get in an insulated position in which they can take care of their own immediate interests by the raising of wages and the subsequent raising of prices and, through the elasticity of our monetary system and the positive philosophies of fiscal policy that we have now, to have such raises passed on to the consumer. We do not have a showdown on what are competitive relationships in these two large areas of capital use and labor use.

We have gone on from one of those situations to another and tried to make the farmer's position equally good by saying that when prices of what the farmer buys are raised, then we raise the support level for his products. When I say the greatest clarification would come from facing the question as to the difference between price competition, I have in mind the situation we have in the automobile industry at the present time, or in the Teamsters organization. Is either of them compatible with the flexibilities of a real competitive enterprise system? I am very skeptical that they are.

How are you going to get out of the present situation with both automatic and bargained wage increases and the leapfrogging price increases that accompany them?

We have had every attempt repudiated even to make a standstill agreement to reassure the business buyer or the consumer buyer that the price will not be more adverse in the future. Every one of those proposals has been turned back both by management and by labor.

So it seems to me that our philosophy of running our industrial system today is one of building inflation. And that concerns me very seriously. I suggested in my opening testimony at the Kefauver committee that one very small but very significant step toward attacking the price problem would be to declare a policy by the present Congress not to exempt any part of the community from the procompetition or antitrust or monopoly principle.

We have, under the Clayton Act—or we have interpreted the Clayton Act—I think misinterpreted it—as giving exemption both to farmers and to labor. I don't think we have a truly free competitive enterprise system backed up by congressional legislation if we accept that sort of an institutional situation. We need a positive declaration that they must all stand equal before the law.

Then we come to the question, Is there anything in the automobile situation which is inimical to price competition rather than power competition of each to be first among the low-priced three? Or, in case of the unions, Is the competition to see that the laboring man, that the laboring masses of the country are best served by full utilization of our resources? Is it, rather, a situation where this union must get at least as great a gain as the last union that bargained with

industry? That is what I mean by power competition, which I think you have both on the industrial and on the labor side.

Representative TALLE. May it not be possible, Dr. Nourse, that the built-in inflationary forces can gather so much strength and momentum that they will carry on upward even in the fact of declining economic activity?

Mr. NOURSE. That seems to be the present situation.

Senator HOBLITZELL. You mean escalator clauses and things like that in the wage contracts will automatically go up?

Representative TALLE. Yes.

Senator HOBLITZELL. For instance the automobile industry gets a 7 percent automatic increase each year because of so-called efficiency increases.

Representative TALLE. I think you have to put your finger on a very important point. I am not singling out any one factor. But I think you raised a very important point about the definition of free enterprise.

In theory that is thought of as a frictionless situation, a perfect situation, in theory.

Of course, it isn't perfect in actual life.

Mr. NOURSE. We have to redefine it in units large enough to be compatible with the character of our technology and our industrial structure. And so it is competition among companies large enough to get efficiency but not so large as to compromise competition.

Representative TALLE. What you are asking is that we look at free enterprise as it is now constituted and not confuse it with something that might have been in years past?

Mr. NOURSE. Yes.

Representative TALLE. I agree with you, Dr. Nourse. Thank you, Mr. Reuss.

Representative REUSS. On this joint, Dr. Nourse, particularly with relation to the automobile industry, the suggestion has been made by, among others, Professor Galbraith, I think, that it would be a useful way of stimulating price competition in industries like the automobile industry to require publicity for proposed price increases.

The other day in a hearing before the House Banking and Currency Committee I put that proposition to Walter Reuther, who was testifying, and asked him what he would think of such a proposition, particularly since publicity on certain price increases might have the effect of stiffening the back of the employer on a wage negotiation that they might then be engaged in with Mr. Reuther's United Automobile Workers. Mr. Reuther's answer was that he would be prepared to live within such an arrangement and to have the employer's back stiffened.

What do you think of a device like that as a means of groping for the solution you are after?

Mr. NOURSE. Well, I like it in this sense: That it seems to me to be a fresh facing of the issues of the price problem—applying our imagination to it and saying, now what is wrong in this situation? How does it defeat the purposes of a free-enterprise system and how could we, while preserving the efficiencies and recognizing the realities of the kind of world we live in, make needed and helpful changes? There you have something like the cooling-off period that we introduced on the labor side. I would not say that I have examined the

specific proposal enough to gage either its efficacy or its practicality, but I endorse every attempt to experiment and get all the technicians from both sides to analyze any honest proposal and I say, would it help without interfering with the practical operations in industry?

There are other aspects of the scope that can be brought within a single managerial organization. If we apply our imagination to this, we could attack the problem at that end.

I am not minimizing the importance of positive financing and monetary policies. I am stressing that those alone do not accomplish a solution when we have this sort of one-way rigidity in the industrial sector.

Mr. ASCHHEIM. If I may, perhaps, paraphrase Dr. Nourse's position, it seems that what he is suggesting is that we redefine free enterprise to make it require the absence of inflation.

Now, if that is the kind of definition of free enterprise which is to be incorporated into the Employment Act, there will clearly be no further need to specify price-level stability as an additional objective.

Mr. NOURSE. Well, I called attention to the fact that we have "free competitive enterprise" stipulated in the act. That is one of the qualifying phrases.

Mr. ASCHHEIM. As I understand it, you do want further elaborations on the meaning of this statement.

Mr. NOURSE. Somewhat unlike Dean Bach, I think I would be satisfied—would feel that we had the act in good actionable form if it said, "real consumer purchasing power."

I don't know whether Bach wants to demur again at that.

Mr. BACH. Shall we have our argument privately?

The CHAIRMAN. Mr. Fishman?

Mr. FISHMAN. Most of our comments today have been based on the assumption that we are in a period of inflation and that we face the prospect of continued inflation for an indefinite time to come. We seem to have lost sight of the fact that for the past 7 months the Nation has experienced declining economic activity and there is very little evidence that the decline is either being halted or being reversed.

It is quite possible that in the not so very far distant future we will view the problem of price stability not from the standpoint of possible future rises but from the standpoint of possible future declines.

Representative REUSS. Well, if we do face that—and maybe we are facing it now—don't you think that the way to worry about prices is not by taking primary action to keep them up but by working on the other two goals of the Employment Act—employment and production—and let prices take care of themselves?

Mr. FISHMAN. Under any circumstances it seems to me that the main concern of those who administer the Employment Act should be to assure maximum levels of employment and production and to follow a pricing policy which is most consistent with those objectives. Under certain conditions, a rising price level is inconsistent with maximum employment and production; but there are other times when that is not the case.

I think economists are in error when they assume that the basic long-term problem being faced by the United States is one of inflation. Only 15 or 20 years ago many economists insisted that the basic

long-term problem of this country was stagnation. Actually we seem to face alternating periods of inflation and stagnation; and a wise public policy should permit us to act freely to cope with either of those situations when they arise, rather than tie us down to a specific policy which is designed to cope with only one of those situations.

Representative REUSS. Does any member of the panel differ with the last observation that we certainly should not lose sight of the goals of maximum employment and maximum production?

Mr. BACH. I think we are all taking it entirely for granted and the discussion really hinges around whether that is enough by itself or whether we need something more to go with it.

Mr. NOURSE. Or to put it another way, whether you can even with a positive Government policy reactivate our economy with the cost of cars and the cost of houses and the cost of steel and the cost of wages going up according to the pattern that they have been following.

Senator HOBLITZELL. I am still confused.

Representative REUSS. Mr. Knowles, do you have any questions for the panel?

Mr. KNOWLES. I think I have a little chore that I might do for today's session, and that is to clarify the matter of price behavior in this current recession which has been the subject of some debate around the panel. The facts seem to point, at least through March, to the fact that the stability or rise in the price indexes is, of course, due to food and, in addition, at the retail level, to services; that nondurables other than food and durable products have been declining both at wholesale and at retail within the last 3 months—certainly since the January high, or the December high, as the case may be; that the rate of increase in services is slowing down; and that the performance of the price structure in this regard—except for the very special case of food—is not so tremendously different from the record in some other past recessions, if you examine some of the other papers here as well as past behavior of the price indexes.

So you cannot say from the record of the various papers that have been submitted here, or the price behavior submitted to us from the Government bureaus, that, except for food, the performance is unusual. And apparently there have been some other recessions in which the peculiar supply conditions in agriculture have resulted in the wholesale and even the consumer price index performing this way in a recession.

That is, the prices have been stable for price rising in a period of unemployment precisely because of this supply situation in agriculture. This should be part of the record. It also should be part of the record that the retail automobile prices under discussion were at a high in November and have been declining every month since, except one, and are now about 6 percent below the November level according to the BLS in March. Part of that decline is undoubtedly seasonal. There is usually a peak in November with the new model introduction and no discounts such as prevail in the preceding month. But I think it indicates that the price is far from as rigid as supposed.

I think we should keep in mind in discussing these price indexes that they are not seasonally corrected. Therefore, if you are talking about periods shorter than a year-to-year comparison, that is, trying to discern changes within a short period of a few months, you may in

fact be discussing what has happened because of the usual seasonal movements of supplies or demands or both. And this may have nothing to do with either the secular trend or the cycle either one. It may have nothing—or have very little—to do with the current economic situation or the long-term trend. So this is one very bad misfortune that we have, that this is the one kind of important index we have which is not seasonally adjusted in the official series; so we have no basis for judging whether movements are the usual seasonal ones or more or less than that.

We get back to another point that has been raised and I don't think quite completely settled. This is the question of whether the Employment Act now contains within its meaning price stability as one of its objectives. What I am wondering is: What does the phrase "maximum purchasing power" add to the statement of objectives of maximum employment and output if it does not imply stability of the general price level?

Because, if you assume—and I think my economic theory has not gotten so rusty that I am missing the point—if you assume for the moment that prices are not stable, then this phrase "maximum purchasing power" is redundant.

You have already said it in "maximum employment and output."

So I ask the question, if the maximum purchasing power does not mean stable prices, why is it in the act at all?

Mr. FISHMAN. I would like to hear what Mr. Bach has to say about that. I seem to recall a talk he gave before the American Economic Association a few years ago at Christmastime, in which he dealt with precisely that point, namely, how maximum purchasing power can be defined in a manner consistent with the expression "maximum employment and production."

Representative REUSS. Mr. Bach?

Mr. BACH. I am afraid I am merely going to repeat what I said before. But let me first disclaim any ability to read the mind of the Congressmen and Senators who voted on the act in 1946. I was in Washington at the time and followed it with great interest. But I confess to being a little confused at that point as to just what some people meant by some words. I agree with Mr. Knowles' general argument that one can make, I would say, a reasonably good case that this must be what was in the minds of the Congress when the legislation was passed. I would like at this moment, however, to retreat to an earlier point that I took. And that is, if there is as much confusion about what the words really do mean as there appears to be among this panel this morning—and I suggest it is a pretty good sample of professional and public opinion as to what those words do mean—then there is indeed some case left for clarifying this situation in some way.

If, in fact, we mean stability of the Consumer Price Index, why not say so and let the public know what you mean? If we don't mean this—and I think there is some legislative history that maybe Congress didn't mean that—this again seems to me to be a case where it is well to clarify the situation.

Mr. NOURSE. Have you drafted clarifying language which you think would be free of obscurity?

Mr. BACH. I am sure it is impossible to have language completely free of obscurity.

Representative REUSS. Well, the entire panel is certainly to be commended, and we are very grateful to it for its observations not only on what the Employment Act of 1946 in fact contains but what are valid directions of public policy for carrying out that set of goals which we all instinctively feel are its aims: the greatest possible approach to full employment, the greatest possible annual increase in production, and, finally, a price system which is responsive to consumers' wants and needs but avoids runaway characteristics.

I have defined this somewhat broadly to try to subsume the observations of the whole panel.

We are very grateful to you gentlemen.

The committee will now stand adjourned until tomorrow morning at 10 o'clock, in this room, when we will meet again to hear Mr. Arrow, Mr. Bailey, Mr. Riley, and Mr. Wells.

Thank you very much.

The committee is adjourned.

(Whereupon, at 12:15 p. m., the committee was recessed, to reconvene at 10 a. m., Tuesday, May 13, 1958.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

TUESDAY, MAY 13, 1958

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

The committee met at 10 a. m., pursuant to recess, in room P-38, the Capitol, Hon. Richard Bolling, presiding.

Present: Representatives Bolling, Reuss, and Talle, and Senators O'Mahoney and Hoblitzell.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk; and James W. Knowles, economist in charge.

Representative BOLLING. The committee will please come to order. Prior to making my opening statement for today, I would like unanimous consent granted to insert at the appropriate place in the record of yesterday's hearings, a memorandum by the Joint Economic Committee staff made in April of 1955, the title of which is "The Significance of the Words 'Maximum Employment' as used in the Employment Act of 1946." (See p. 1.)

Without objection, that will be ordered.

Today we turn our attention to the consideration of the problems involved in the measurement of price changes and price relationships. We are interested in surveying these technical matters in order to clarify our understanding and perhaps the public's, as to what price indexes can and do tell us about price changes.

Among the questions posed for this panel were:

How do changing technology, changing physical characteristics, changing uses of products and services, and so forth, affect the significance and usefulness of price comparisons between different time periods?

What is the distinction between relative price movements and changes in the price level?

What are the identifying characteristics of administered prices compared to competitive prices in today's markets and institutions?

What are the characteristics of a general price index which is adequate for economic policy purposes, and is more than one index needed?

When price level enters into decisions about policies to promote economic stability and growth, which of the indexes that we now have would be best as a measure of general price movements? And how can existing indexes be improved?

I want to thank all of the panelists for the fine papers contributed for this section of our study. We will follow our usual practice this morning. We will proceed in the order in which the papers appear

in the compendium. We will hear from each panelist without interruption for about 5 minutes, in which time he is to summarize his paper. Upon completion of the opening statements, the members of the committee will question the participants for the balance of the session. Of course, we will expect the participants to discuss the issues among themselves.

I hope this discussion will be very informal, and that, as I said, members of the panel will not hesitate to join in the discussion.

Our first panelist this morning is Dr. Kenneth Arrow, professor of economics and statistics at Stanford University.

Dr. Arrow, we are pleased to have you with us. You are recognized for 5 minutes.

Mr. Arrow. Thank you.

STATEMENT OF KENNETH J. ARROW, PROFESSOR OF ECONOMICS AND STATISTICS, STANFORD UNIVERSITY

Mr. Arrow. I have tried in my paper to set forth some of the underlying theoretical problems and possibilities for measuring price changes, particularly with reference to the cost of living. Along with most theorists, I take the position that an index number must be defined as a deflator which states the ratio between money incomes in different years needed to achieve the same level of satisfaction by the consumer.

The introduction of subjective measures such as satisfaction seems at first blush to be a major difficulty from the point of view of application, but in fact I think it will be seen as implicit in any method of measurement and attempts to avoid it usually lead quickly to absurdity. This is even more true in a situation where the objective factors—the commodities which enter into comparisons—are themselves changing in quality over time. The only thing which enables comparisons to be made is the assumption that we are dealing with a body of consumers with more or less stable wants.

Within this framework it is possible to make much more accurate measures of the cost-of-living price index by having a budget study yielding average consumption figures for different commodities at each income level. The pertinence of these data lies in two factors: (1) The individuals in different income brackets have different consumption patterns, and, therefore, they should in general have different cost-of-living index numbers; (2) in a period of rising incomes the behavior of people in upper brackets becomes a forecast of the consumption patterns of those of middle income brackets in the future. Annual budget studies may be thought of as rather expensive, but in days of active Government policy, even minor improvements in the accuracy of index numbers will, from a social point of view, repay additional costs of gathering data many times over. This is especially true, because annual budget studies have so many other values for both Government and business use, not to mention their use by the professional economist.

In comparisons involving extended periods of time, I join with, I think, the majority of index number theorists in holding to the position that a chained index number is superior to one involving fixed base-year weights. However, neither is perfect and more research certainly needs to be done in this area.

I would also like to argue that a combination of budget studies and chain-index numbers will considerably mitigate the technical difficulties involved in the production of new commodities over a period of time. Any of the difficulties associated with technological changes can be reduced by simply better use of the tools that have been sketched in this paper.

Representative BOLLING. Thank you, Dr. Arrow.

Next is Dr. Martin J. Bailey, professor of economics, University of Chicago.

Mr. BAILEY. Thank you.

STATEMENT OF MARTIN J. BAILEY, PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. BAILEY. The principal aim of the paper I submitted to this committee was to examine afresh the issues, both theoretical and practical, involved in the concept of administered prices.

In this context I am somewhat in the role of an ugly duckling, because the other members of the panel are mainly talking about index numbers.

In doing this it was necessary to stick to two limited objectives: To survey and summarize the conclusions that can be drawn from other people's work in this field, and to make a modest additional contribution to the facts and theory that have been brought to bear on it.

Unfortunately the research of other persons has not produced results sufficiently conclusive to cause general agreement on what the facts are about administered prices nor on their practical importance. In general, opinion is divided sharply between two groups: Those who think that administered prices or monopoly prices are widespread and extremely important in the private, unregulated sector of the economy, and those who think such prices are practically nonexistent or of no great importance in this sector.

My survey of the opinions and evidence has led me to find myself more and more firmly set in the second group.

It is my opinion that the subject of administered prices in the free or unregulated part of the economy is not of itself a proper concern of public policy nor a subject worthy of the attention of the Congress.

On the other hand, I am firmly convinced that monopoly as such is a proper concern of public policy, and I do not want to give any impression to the contrary. However, the proper focus of attention in these matters should be on measures to insure and promote competitive marketing of goods and services and the efficient use of resources. Some existing public policies which do not promote these ends are in need of reappraisal and reform.

Although the available factual data have many weaknesses, certain definite conclusions on the nature and importance of administered prices seem to me to be well supported by the evidence. I shall summarize these briefly.

1. If a seller is able to hold the price he actually charges unchanged for weeks or months at a time in the face of changing market conditions, he possesses a degree of monopoly power. His ability to do this means that his sales will not fluctuate violently and intolerably if he fails to "follow the market" as market conditions change, which

by itself means that he possesses some degree of monopoly power, or control over prices.

2. However, we should not judge whether administered prices (or list prices) are frequently not the prices actually charged. Discounts, allowances, and so on may fluctuate from day to day and may be the means by which sellers adjust to conditions in what is in fact a competitive market, while quoted prices give a contrary impression.

3. Oligopoly theory, and related theories, which purport to tell us what to expect in the pricing of a product whose market is controlled by a few sellers, are seriously defective in their logic and are of little help in guiding us on the facts of the matter. A seller will determine his price behavior not only according to what other sellers will do if he cuts his price, but what they very likely will do even if he doesn't.

The outcome can be discovered by the outsider only by studying the actual behavior of prices, net of discounts, allowances, and so on, not by studying what big business says about its pricing policies.

4. In two outstanding examples of what appears to be, or is widely believed to be, "oligopolistic pricing," namely steel and petroleum products, the evidence is conclusive that actual prices are sensitive to month-to-month changes in market conditions. The evidence certainly suggests—although it is not conclusive on this point, I have to admit—that their realized prices are competitive, determined by supply and demand as ordinarily understood, in every essential respect.

5. Studies of the major industrial products, taken industry by industry, have tended to show that the obviously differing degrees of price flexibility of different products are almost entirely explainable in terms of differences in the behavior of costs, without regard to concentration or monopoly.

6. Long-run monopolistic overpricing of commodities is not a widespread problem in our economy at the present time. The public is protected from this by two things: Competition, both potential and actual, on the one hand, and the antitrust laws on the other. The main areas where this is not true are sheltered areas, in which competition and the antitrust laws are not effective, due to errors of commission or omission by various levels of Government.

7. Administered prices, even if they were as prevalent as they superficially appear to be, would not be of serious concern in relation to the problem of full employment and stability. Contrary to what appears to be a widespread opinion, it has never been true that prices have been flexible enough to prevent recessions in output and employment. The main remedy for such recessions is an appropriate set of monetary and fiscal policies.

Apart from the adoption of such a set of policies, Government policy toward the private economy should be such as to promote maximum efficiency and to facilitate growth. This implies, among other things, that a thorough reform is needed in those areas where Government has a regulatory role—including patents and other restraints on entry—but that apart from prosecuting conspiracies under the antitrust laws it should avoid tinkering with the determination of individual prices. Where competition exists competition should be allowed to set prices.

I am not impressed, either, with the argument that under modern conditions full employment is inconsistent with price-level stability. There is little or no evidence to support the hypothesis that the eco-

nomic system has substantially more of an inflationary bias than it ever did, or that the maintenance of stable prices would produce unemployment.

The striking thing about the historical evidence is how similar present price and output movements are to those that have occurred in the past—notwithstanding the very definite evidence that wages have become less flexible, due, very likely, to the advent of unemployment compensation—in this context, I would like to refer especially to the historical summary in the paper presented to this committee by my senior colleague, Professor Friedman. This is not to say that wisely chosen, skillful policies by the monetary and fiscal authorities are unnecessary, but merely that, if employed, they may be expected to function with reasonable success.

Representative BOLLING. Thank you.

Next is Mr. H. E. Riley, Chief, Division of Prices and Cost of Living, Bureau of Labor Statistics, United States Department of Labor.

STATEMENT OF H. E. RILEY, CHIEF, DIVISION OF PRICES AND COST OF LIVING, BUREAU OF LABOR STATISTICS, UNITED STATES DEPARTMENT OF LABOR

Mr. RILEY. Thank you, Mr. Bolling.

The Consumer Price Index and the Whole Price Index of the Bureau of Labor Statistics are probably the most widely used price indicators in the world today. Both of these measures serve two broad areas of need: For general economic analysis and to guide policy decisions by government, business, and the public. Neither index can be completely satisfactory for both theoretical analyses and practical day-to-day decision making. In fact, price measures of any kind have certain inherent limitations which must be recognized in any application.

In recent years, the Consumer Price Index has become a household byword. Public concern over the cost of living has raised questions as to the meaning and accuracy of the Consumer Price Index. Some critics think the Consumer Price Index fails to show the true extent of price increases, while others suspect that it exaggerates increases or fails to reflect price reductions that are being made at the present time.

Much of the criticism of the Consumer Price Index stems from misunderstanding as to its meaning, and from attempts to use it in ways for which it is not suited. The popular term, "cost of living," illustrates one source of misunderstanding. When, in a period of rising prices, a housewife buys cheaper cuts of meat to stay within her food budget, the family's cost of living may remain stable, even though all meat prices are increasing. In this instance, the family has reduced its standard of living.

In another example, a family with a rising income may buy higher quality and more expensive commodities than it has been accustomed to using. Its cost of living rises because its standard of living has increased.

The Consumer Price Index is not designed to measure the effects of these changes in living standards. Instead, it isolates and measures the effects of only one factor in the cost of living, that is, price. This

is done by comparing prices from period to period for a fixed market basket of goods and services.

The current Consumer Price Index market basket represents, in effect, the average living standards of urban wage-earner and clerical-worker families in 1952, when the basic structure of the index was last revised. The content of the market basket, and the weighting structure, will be retained until the index is again revised, except for such substitutions or changes in specifications as are required when goods in the original list are replaced in the market by others.

As an index of "pure" price change, the Consumer Price Index is an appropriate device for wage escalation in long-term labor-management contracts. To the extent that it succeeds in meeting its objective, the index provides a measure of changes in the purchasing power of the wage dollar, unaffected by changes in the wage-earner's overall income status.

In time, of course, the goods and services offered in the market change to such an extent that many of the items originally in the basket are no longer available or have declined significantly in importance. New commodities become important in the family's consumption patterns.

Accordingly, the commodities and their weights should be reviewed and brought up to date periodically, in order that the index may have a realistic basis of goods and services.

If the index is revised at very frequent intervals, it takes on the nature of a cost-of-living rather than a price measure. This raises difficult problems in using it for contract escalation.

On the other hand, for obvious reasons, the market basket cannot remain unchanged indefinitely. The view is widely accepted that the index should be revised at regular intervals, and it is generally agreed that a decennial schedule is appropriate.

As the index was last revised in 1952, the adoption of a 10-year schedule would require immediate planning for a new survey of consumer expenditures, if data are to be obtained for a new revision, effective by the end of 1962. The Department of Labor is now giving attention to this problem.

The Wholesale Price Index differs fundamentally in many respects from the Consumer Price Index. In the first place, its scope specifically excludes sales to household consumers. The Wholesale Price Index includes commodities, but not services. The term "wholesale" in this instance refers to sales in large lots, not to prices paid or received by wholesalers, distributors, or jobbers. The index is based on monthly data for nearly 2,000 commodities, ranging from raw materials, such as grains, fibers, and iron ore, to finished products, such as canned foods, clothing, automobiles, and machine tools.

Although the Wholesale Price Index is used as a measure of general price trends, it is the detail underlying the total figure that has the widest usefulness. Individual item and group indexes are used in deflating components of the gross national product estimates. Segments of the index are incorporated in escalation provisions of long-term production contracts, commercial leases, and supply contracts.

For example, virtually all of the heavy electrical generating equipment is produced under contracts providing for escalation of the contract payments according to changes in the price indexes for selected materials and components.

There is a tendency to think of the Consumer and the Wholesale Price Indexes as two comparable measures of price movements at different levels in the economy. In a sense, of course, this is true.

But the assumption of similarity leads to erroneous conclusions regarding the relationship between the two. In the first place, the indexes do not measure prices of similar groups of commodities at two transaction levels.

The Wholesale Price Index includes raw materials. It also includes semifrabricated parts and components. On the other hand, the Consumer Price Index includes services, and its commodity content is limited to goods ready for consumption by households, the ultimate consumers. The manufacturer's price of a consumer good may parallel the retailer's price, but in the Wholesale Price Index that price change can be offset by movements in prices of things that never enter the consumer market. This means that comparison of the two indexes will not provide valid evidence of trends in price markups or margins.

Despite their limitations, the two Bureau of Labor Statistics price indexes are virtually indispensable. For lack of any better guide, they are frequently used in ways for which they are poorly fitted. As many participants in the hearings of the Joint Economic Committee emphasize, our increasingly complex economic system requires more and better measures of price movements. This is a need which must be met, if the system is to function most effectively.

Representative BOLLING. Thank you, Mr. Riley.

Next, Oris V. Wells, Administrator, Agricultural Marketing Service, United States Department of Agriculture.

Mr. WELLS. Thank you.

STATEMENT OF ORIS V. WELLS, ADMINISTRATOR, AGRICULTURAL MARKETING SERVICE, UNITED STATES DEPARTMENT OF AGRICULTURE

Mr. WELLS. The invitation for this appearance was quite generous: I was to concern myself with the general price level and nonagricultural phenomena only to the extent I so desired; I was not to feel mortgaged to any existing statistical measures simply because they were now provided for, and finally I was not to be overly concerned with theory; rather, I should so far as possible keep the discussion in terms of what appeared to be reasonably practical.

There are three comments I should like to make with respect to these terms of reference:

First: I am of course aware of and agree with the argument in favor of a stable "general price level." However, I do not know how to measure, at least in any precise way, the general, overall price level, nor do I think that any single measure, assuming we were to agree on one, would wholly serve the purposes which the committee has in mind.

That is, it never seemed to me in the twenties and early thirties that the Wholesale Price Index measured the general price level even though we often talked as if it did. Nor do I today accept the Consumers' Price Index, useful as it is, as a single sufficient measure of the overall concept. Further, except under pressure of great economic strain, and usually then also, it seems to me that many, often the most,

of our price problems have to do with differences in price and related economic developments as between different sectors of the economy.

Very simply, this means that we are as much interested in sector or partial price level measures as in the direction and magnitude of any total price movement.

Second: In discussing price and related economic measures for agriculture, it is difficult for me to start anywhere except with the measures now being used, along with our current recommendations for improvement.

Our farm statistics have gradually developed over quite a long time, they have been and are being used to evaluate programs and arrive at decisions; and the problem as I see it has to do with strengthening and improving our current measures, not with designing an entirely new set.

Third: Analysis of why prices behave as they do and the effects or implications of such behavior are as important as any set of price statistics. Prices or price indexes by themselves are purely neutral. They only tell in a predetermined way what has happened—not why nor whether it is good or bad, nor what should be done. So I conclude that we should never spend all our funds simply to collect, combine, and release statistics. Appropriate analyses must also be arranged for.

There is a good argument that the only really good index or aggregative measure is the one which has been designed to fit precisely and particularly the problem at hand. However, we must usually analyze actual situations and arrive at decisions on the basis of statistics collected in accordance with some earlier estimate of what might be useful.

In this connection, the statement which I supplied for the volume on price stability gives special attention to the following price measures relating to American agriculture:

1. The Index of Prices Received by Farmers: This index as now published by the USDA is a straightforward aggregative price index, calculated from the base 1910–14=100. There are no really difficult problems associated with this index although there are some improvements that would be desirable. The commodity mix has not changed so radically over the years as to raise serious questions as to comparability as between even widely separated periods and except for truck crops, some fruits, and tobacco, the accurate measurement of month-to-month changes is not too difficult.

2. Costs and margins measures: Changes in prices received by farmers are one of the main factors affecting the price of food at retail. However, what the housewife buys covers not only the price of the raw farm product but also all associated assembling, processing, transporting, and selling costs. Thus is it desirable to measure the costs and margins which intervene between farmers and consumers in order that food costs can be broken down into their component parts. Such calculations are essential to understanding changes in both farm prices and prices of food at retail.

3. The index of prices and cost rates paid by farmers: Commercial farming is a business operation with the farmer's net income depending in substantial part upon the level of prices and cost rates paid. Compared with the index of prices received by farmers, where the statistical problems are relatively simple, the maintenance and

improvement of this index presents some difficult, complex problems. The general mix of commodities and services used by farmers has materially changed over the years so that this index now covers three basically different periods as it extends back to 1910–14. The statistical problems which this raises could be most easily solved by shifting the base and weighting pattern for the index of prices and cost rates paid by farmers to a post-World War II period. More precise price observations and some increased coverage of commodity prices and cost rates are also needed.

4. Index of farm land values: Farm real estate accounts for about 70 percent of the value of farmers' nonfinancial assets, and changes in market values and rates of transfer are useful agricultural indicators. Consequently, we have developed an index of farm land values by States and the United States which is reported as of March 1, July 1, and November 1 each year.

Price policy is chiefly a means to an end and price indexes often fail to satisfactorily measure or explain changes in farm costs and income—the final results in which we are most interested.

We need (1) to strengthen our current farm income estimates wherever possible, especially the estimated income of farm people from nonfarm sources, (2) to substantially improve our estimates of farm production expenditures both by States and for the United States as a whole, and (3) to find ways of breaking down our annual farm income estimates as between classes of farms, especially commercial versus noncommercial farms. We also need to find some way of getting more adequate annual estimates of both the numbers of farms and of farm population.

The committee will recall that during the recent hearings on policy for commercial agriculture, Messrs. Nathan Koffsky and Ernest Grove from the Agricultural Marketing Service were asked to prepare a paper breaking down the national farm income estimates as between low production and high production farms—that is, farms with annual farm sales of $2,500 or more—for the years 1946 through 1957.

Good farm income estimates properly broken down as between the various States and as between commercial and noncommercial farms would, along with a revised index of prices paid by farmers, allow a much better judgment than is now available as to the relative well-being of farm people.

In addition to strengthening our aggregative measures of farm income and finding ways of breaking them down as between part-time, small-scale, and commercial farms, we also need supplementary analyses indicating the changes that are taking place with respect to different types of commercial farms.

Currently, the best approach to this is the costs and returns series for specific types of farms which are now maintained in the Farm Economics Research Division, Agricultural Research Service, but to be most useful the number of farm types or areas for which such series are calculated needs to be substantially increased.

Representative BOLLING. Thank you, Mr. Wells.

Do you have some questions, Mr. Reuss?

Representative REUSS. I have a number of questions for Mr. Bailey.

Mr. Bailey, you talk about the fact that whereas in certain industries—and I think you named steel and petroleum products—the list

prices remain fairly insensitive to market conditions, there is a good deal of fluctuation in the actual prices. That is, list prices less discounts, allowances, and so on?

Mr. BAILEY. Yes, sir.

Mr. REUSS. Does the appropriate BLS index—which I take it is the wholesale price index—take into account, as I believe it does, the actual prices? Or is it beguiled by these fictitious nonexistent listed prices?

Mr. BAILEY. Well, the position here, sir, is somewhat ambiguous. I think I overreached myself a little bit in the paper that I submitted to the compendium; because what I said there seemed to imply that the BLS makes no attempt to get at the true prices rather than the list prices charged for these products. And this is not correct. The BLS makes the best attempt it can to correct for discounts and freight absorption and things of that kind. But I do not feel that they are anywhere near successful in many important cases.

The problem seems to be that particularly in the case of steel and several other products—also I should say crude oil, although not refined petroleum products—that producers do not like to talk about open market prices which are truly competitive, or prices arrived at by the means of an oriental bazaar technique, or anything of that sort.

They feel there is something not proper about the prices arrived at with most of their customers by a bargaining process. And, therefore, they usually do not even mention these things when they talk about them; only in a highly deprecatory tone of voice.

I feel also in reporting to the BLS they make no mention of many of these price concessions.

Now, in this connection, I would like to correct another wrong impression that I gave. And with the chairman's permission I would like to insert into the record a revised series of prices for petroleum products which is more appropriate, more comparable, with the private prices that I secured from another source.

Representative BOLLING. Without objection, that will be done.

Mr. BAILEY. Thank you.

(The document above referred to follows:)

TABLE 1.—*Monthly prices of petroleum products, 1957*

[BLS index, 1947–49=100]

Month:		Month—Continued	
January	124.6	July	125.0
February	130.3	August	124.0
March	130.0	September	124.1
April	129.7	October	123.0
May	129.0	November	121.6
June	127.3	December	121.5

NOTE.—The above index was given as the correct index of the monthly prices of petroleum products, 1957, by Mr. I. Putnam, of the Office of the Bureau of Labor Statistics, U. S. Department of Labor. These figures are given in a special index in the back of the wholesale price index statement.

The figures given in the table on p. 96 of the compendium of papers on "The Relationship of Prices to Economic Stability and Growth," by Martin J. Bailey, are for refined petroleum and other products, according to Mr. Putnam.

Mr. BAILEY. The actual movements in this index correspond much more closely to the data that I got from other sources than the series that I used, which was not strictly comparable. However, there still is some disparity. And in the case of steel and, to take a really ex-

treme case, sulfuric acid, the price quoted and the one which has to be used by the BLS for the lack of anything better is clearly misleading, it seems to me.

I do not know what we can do about this except the kinds of studies which have been carried out for very limited periods in the past, such as the study done by the BLS and the OPA during the war of prices paid by steel consumers, and another study of the TNEC, which gave very broadly similar results of the prices received by steel producers, which gave a rather different pattern of price behavior from what is seen in either the published prices or those which have had to be used for regular price indexes.

Mr. RILEY. Mr. Reuss, I would like to comment on that.

Representative REUSS. Yes. I was about to call on you, Mr. Riley.

What about this suggestion that you are going through a fairly sterile exercise?

Mr. RILEY. We do get price modification, concessions, discounts, and other alterations. This is a matter of degree.

And, of course, it varies a great deal depending on the particular phase in the business cycle that we happen to be looking at. So far as steel prices are concerned, we have discussed them quite often with the members of the steel industry—American Iron and Steel Institute.

They insist that the index we produce follows very closely the index that the industry itself has been producing on a somewhat different basis.

However, under the circumstances as they now exist, I think it is very likely we are missing some of the special deals that are made; and particularly the changes that are made in the extras on steel orders. Most steel orders involve not only the supplying of the basic steel itself but a certain amount of processing on it of some kind at the plant.

That involves varying charges, including transportation, some of which under certain conditions may be absorbed by the manufacturer and under other conditions will be passed on to the buyer in the prices.

I think Mr. Bailey suggests that probably the steel price increase announced last July by the industry has no effect whatever. I am sure that some of that steel price increase actually took effect. Otherwise, the automobile manufacturers and the other major producers of steel products must have been misleading the public, because they certainly used it most vigorously in arguing for either maintaining or increasing the prices of their finished products.

Representative REUSS. You gave it as your opinion that the subject of administered prices in the free or unregulated part of the economy is not of itself a proper concern of public policy nor a subject, really, for the attention of the Congress.

On the other hand, you are firmly convinced that monopoly as such is a proper concern of public policy.

Just what is the difference between administered prices and monopoly? What is your definition of monopoly? Certainly not just one seller, as the name implies?

Mr. BAILEY. No.

Of course, I think of monopoly both in connection with a single-seller control or a group of firms which are engaged in some kind of conspiracy to maintain prices above a natural competitive level.

Representative REUSS. Isn't that administered?

Perhaps the word "conspiracy" isn't very good. It connotes a legal definition. But aren't administered prices an informal way of life which suggests that it is better not to go cutting prices too much; that everyone will prosper?

Mr. BAILEY. The term "administered prices" could be used in that context. But it has not been usually used in quite that way.

A monopolist, after all, is someone who having arranged that price cutting could not take place could possibly try to cover this up or just find it in his own interest for other reasons to let the price that he charges fluctuate a little from day to day, although it has fluctuated and stayed at a high level.

The characteristics of administered prices, as this term has been usually used, is that the seller simply lets the price stay put for long periods of time, whereas we observe, let us say, in the grain market, or something like that, which is highly competitive, that we have minute-to-minute fluctuations. And this is the kind of contrast which has been drawn.

Representative REUSS. Well, then, let me ask you: Why shouldn't the subject of administered prices, as just defined by you, be a proper subject of some congressional concern?

Mr. BAILEY. Well, I think that in any time there is a presumption that people are managing by tacit agreement or something of the sort to hold prices above the level of marginal cost at the going levels of output—by which I mean the level which really free competition would set—this is a concern of public policy and something ought to be done, if possible, to prevent it happening.

But administered prices—and by this we mean prices that just happen to remain stuck for a long period of time, or appear to do so, and this is the thing that worries me—are something else.

They can refer to the prices of haircuts or the prices of groceries which do not get changed every minute, at least, because it is more convenient for the grocer to let his current stock of peaches run out before he starts changing the price tags on them than to run around every couple of hours marking them up or marking them down.

I think that talk about prices where people are appearing to be administering them—behind which there may be genuine competitive bargaining which sets the level of current discounts in the market, and so on—and the attention which has been paid to this subject is somewhat misguided and not appropriate.

Representative REUSS. Now, you have just heard Mr. Riley of the Bureau of Labor Statistics say that in steel, for instance, he tended to agree with you up to a point, namely, that in the steel industry the system consists of an official price at one level and then having an unofficial real price that even the sleuths of the Bureau of Labor Statistics could not uncover—you have heard him testify to that effect.

And I wonder, is that a good thing? Is a price system which not only results in some stickiness but also results in such an elusiveness that the statisticians cannot get hold of a good thing—is that a good competitive market?

Mr. BAILEY. Well, as a person interested in being able to get interesting and relevant information, I deplore the fact that price concessions in steel and many other commodities are so carefully

kept secret. Because it does make it difficult to make investigations on whose conclusions we can rely. But this is not of itself—since my worries as a researcher are not really one of the concerns of the Congress—I do not think by and of itself this is a problem that is of great public importance. If we had reason to believe that there was really substantial price discrimination or substantial overpricing in certain periods of a commodity, resulting from this way of doing business, then I would agree that it was a proper concern of the public policy.

And after studying the TNEC and related studies I simply come to the feeling that this is not the case in steel; that there may be a certain amount of minor haphazard price discrimination; but that the general level of concessions—well, in the first place, concessions of a significant order of magnitude in a moderately weak market occur for about 95 percent of the business, according to these studies. At least that. Perhaps more.

And, secondly, one gets the feeling that the way in which the concessions are distributed by size of order and so on probably conforms pretty closely to the real costs.

Representative REUSS. How about the amount of the concession, though? There is a difference between giving the customer a cigar and giving him a 3-percent reduction.

As I gather, we do not know what the amount is, so, aren't we in the dark on that?

Mr. BAILEY. We only know for a certain period, in 1939, for which this study was made. And the concessions do differ by the size of order, which tends to suggest price discrimination, unless the scheduled prices by size of order do not truly reflect differences in cost in supplying these orders.

Now, the trend of decision in the courts on the question of price discrimination and justifiable differences in price, I think, have erred on the side of conservatism in not allowing certain costs which I think are true economic costs to be charged to the smaller order relative to the larger order.

And insofar as that is true, a truly competitive pricing system would imply a result different from what the courts have been willing to allow.

If the steel industry were competitive, then I would expect to see secret discounts which corresponded to what the price ought to be, that didn't correspond with their published price schedules, because they would have difficulties with the FTC.

I think by and large this is true; although I would have to admit that because of the secrecy involved and differing knowledge of the market on the part of different consumers it could lead to some differences of treatment which would not correspond to truly competitive conditions.

Representative REUSS. One more question.

You referred to the desirability of measures to promote competitive marketing of goods.

You say that some existing public policies do not promote competitive marketing and should be reformed. I would like to have you list some existing public policies which you think are inimical to competitive marketing and list some which you think would be helpful.

Mr. BAILEY. All right.

Well the entire phrase in this reference is "competitive marketing and the efficient use of resources."

Representative REUSS. Yes.

Mr. BAILEY. By far, I think, the most important single area of reform concerns public utilities, communications, and transportation, which in many or most cases are not capable of achieving a truly competitive market because of the nature of the business, as such; it almost has to be a monopoly or have certain monopoly characteristics, so that the only alternative seems to be direct public regulation.

In this case the pricing system ought to be such as to maximize the efficiency of the use of resources subject to the unfortunate circumstance that it is a kind of natural monopoly and that public bodies must regulate their prices.

Some very cursory and rough studies have been made of inefficiencies in transportation and communications and utilities because of the use of wrong or misguided criteria in the price-setting process by regulatory bodies. Here the conclusion that certain colleagues of mine and I have reached—which will have to be further thought out before we can really stick our necks out on it—but a rough tentative conclusion would be that transportation and communications are costing about twice as much as they should to get the same level of services, because of very bad policies.

Now the worst policy that I can think of in this context is the enforcement of minimum prices of pipelines and barges on the waterways, and things like that to prevent competition and to prevent them from lowering prices to their natural levels.

This particular area, if these rough estimates are approximately correct, would provide about a 5-percent increase in the national income, if the reforms were made. And that is quite a bit.

Representative REUSS. Have you or your colleagues spelled this out in any paper anywhere that you could refer to?

Mr. BAILEY. Looking at the transportation aspect of this, work has been done in that direction at the Transportation Center at Northwestern University. I believe there has been published a paper by Mr. Brozen. I am not sure whether it has been published in a journal or not, but I heard him give it. It is about the rentals of boxcars on railroads. That is one of the major points where this sort of thing is involved.

I do not know very much that anybody has done. I am planning to devote some time to this aspect in the future.

Another thing is the patent law, where patents may be abused in various ways through patent pooling and the use of research organizations to protect existing patents by getting a whole lot more patents, and so forth, very possibly making possible monopoly pricing in some fairly important commodity areas.

And I think that this is an extremely difficult problem. Even if we could have all the information in the world for nothing and we could theorize about this without any restraint, it would still be an extremely hard problem to figure out exactly what public policy should be.

But even granted that it is a difficult problem on which to set an appropriate public policy, I believe that considerable improvement is possible.

Representative REUSS. Thank you, Mr. Chairman.

Mr. RILEY. Mr. Chairman, I would like to make another comment on the methods of price collection, if I may.

Representative BOLLING. Mr. Riley.

Mr. RILEY. Mr. Reuss has referred to our sleuths. Unfortunately we have a very limited supply of sleuths. And this gives me an opportunity to put in a small commercial for improving our work in the wholesale price area.

All of our wholesale prices are collected by mail. We have a very limited staff of commodity experts. And they simply haven't the time to get out and talk to the people who actually report the prices.

We have some hope that we may have the opportunity in the fairly near future to enlarge our program to the extent that we can go and talk to the company officials who actually report prices to us. We believe that our relationship with them and their confidence in us is such that they will give us the kind of information we need, in most cases at least, if we have an opportunity to explain exactly what the problem is and to assure them that the individual company data will be protected as to its confidentiality.

So, while we know we have a problem and we know we are not getting all the information we need, we think we can get it if we can devote the proper attention to it.

Mr. WELLS. May I make a comment on this?

Representative BOLLING. Certainly, Mr. Wells.

Mr. WELLS. This pricing problem is not altogether confined to transactions between industrial concerns. One of the most difficult things we face in measuring prices paid by farmers, for example, is pricing automobiles.

This is partly due to discount or trade-in policies. And it is partly due to Mr. Arrow's satisfaction problem. We came out of the war period with a series of automobile list prices at the factory which do not tell us what people actually pay by a wide margin, even after freight is added.

I suppose Congressmen get more letters complaining about our price collectors trying to go in and find out what dealers are selling automobiles for than any other single item. But we also came out of the war with automobiles which have a great many accessories of one kind or another on them. These accessories are by no means standard. Yet until very recently it has been very difficult to buy the lower-priced models without a number of accessories, even though you might not want them.

We have had some real problems, because automobiles are quite important in our index, in getting the actual going price at which dealers are selling automobiles. We have also had some real problems in deciding on that list of accessories which we think the consumer wants versus that list of accessories which he must buy. You get into the question of the accessories and attachments which are added to automobiles and tractors and trucks which the farmers may or may not want.

Representative BOLLING. Dr. Talle?

Representative TALLE. I have no questions at the moment, Mr. Chairman.

Representative BOLLING. Senator Hoblitzell?

Senator HOBLITZELL. No questions, Mr. Chairman.

Representative BOLLING. I have a few questions.

First I have to display my ignorance and make sure I understand a few things.

Mr. Arrow, in the next to the last paragraph of your summary, I would like you to clarify for me the meaning of a chained index as opposed to a fixed base year index.

Mr. Arrow. As Mr. Riley explained in his statement, the Consumer Price Index and the Wholesale Price Index, too, for that matter, are based on a fixed set of weights; for example, the weights in 1950–52 of the average consumption of the different commodities which enter into the price index.

This means that each year prices are found which represent each of the commodities in each of this market basket. They are then multiplied by the quantity weights—the net amounts consumed in 1950–52. And this forms the price index.

This is the total cost, in other words, of buying the same market basket that was bought on the average in the base year. The same weights are used for the successive years, and the policy is to change them roughly every 10 years.

What I am urging is a change in the system. As a theorist I feel that my role is to point out the ideal, and it is up to other people to worry about budgetary problems.

I would like to see actual annual weights computed. Now, it does not follow, as Mr. Riley suggested in one place, that this means that I am getting the cost of living in his sense rather than a price factor, because one can correct for this.

The simplest example of a chained index would be something like the following:

I would use last year's weights with this year's prices; and this would be, in effect, what happened in 1953, the first year after the weights had been adopted. This, presumably, is some kind of a cost-of-living index for 1953.

Just to get the terminology straight, let me call it a price-of-living index. I think Mr. Riley is quite right; the words "cost of living" are sometimes confused with the amount that people actually spend in total, taking account of the change in the quality of the goods as well as the prices they pay.

What we are trying to do is isolate the price factor. If we start with the 1952 weights, the quantities consumed in 1952, we multiply them by 1953 prices, and we have a price-of-living index for 1953 relative to 1952. This has a slight upward bias. Suppose the prices did not change proportionately; some prices went up and others went down. So, if the consumer can get—and I have to use the subjective terms—more satisfaction for his dollar by changing somewhat the goods that he buys, he will buy more of the cheaper goods and less of the more expensive goods. This is what will happen, of course, in the economy. It will enable him to achieve the same level of satisfaction as in 1952 in a way that is cheaper than merely buying the same quantities in 1953 as in 1952.

To take a simple example: If the price of beef goes up and the price of lamb goes down, he might have bought a good deal of beef the first year and relatively little lamb, because this suited him. Now, if the beef price rises, he will tend to switch to lamb, and he will spend less than would be implied by the straight market basket. The fixed-year index tends to have an upward bias.

At the same time suppose we collect 1953 quantities and calculate the price index going backward in time instead of the usual way of going forward in time. After all, time just happens to flow in this particular way. We could easily be just as interested from a logical point of view in measuring 1952 prices relative to 1953 weights, as vice versa.

If you take the 1953 quantities and multiply them by the 1952 prices, we will have an index which in principle ought to be the reciprocal of the first one, but in fact will not be exactly. I would recommend some kind of averaging of the two methods. Then I would suggest doing this year after year—1952–53, 1953–54, and so forth—to obtain chained index numbers.

This has some virtues, I believe, especially when it comes to the changes in the commodity mix, the very presence of commodities. Suppose we consider a commodity which enters into the market, as many commodities do, rather slowly. The sales like televisions build up over a number of years.

Now, in any comparison involving 2 years, there will be a small error, because none of these theories is exactly right. Let's say in one year there were no television sets at all consumed; the next year there were a few. If you make this kind of comparison, you are averaging the weights and getting approximately correct figures.

In the second and third years you make a similar comparison and have more television sets, and the television sets are allowed to enter the index in a continuous way of being involved in an abrupt change of weights as occurs when you change over to a new period when television sets become relatively abundant as compared with the 10 years previously.

Representative BOLLING. I would like also to get your expansion on the last paragraph of your prepared paper. It is on page 87 of the compendium. And just for ease, I will read it:

> This leads to the final suggestion that considerable effort be put into pure research on the theoretical problems of index number construction. This has to be done, of course, in close context with practical problems, and, therefore, through the existing statistical agencies.
>
> Either there should be provision for a research unit within existing statistical agencies or arrangements should be made for contract research by universities under the supervision of the Bureau of Labor Statistics and similar agencies. For real progress a good deal of freedom must be granted.
>
> The possibility of experimental construction of index numbers must be allowed a wide scope. In this research issue, comparability with the past should not be allowed to dominate too strongly. The most important thing is the collection of the data necessary for price measurements. Even though such data were not available in the past, we should at least now plan for the future an adequate amount of information.

Now, before you do expand, I want to make sure I understand that.

The implication of this—to me at least—is that our present measurements are, in effect, so rough—although within budgetary limitations and the opportunities of staff, as good as they could be, presumably—that in fact we have measurements so rough that they are not really a guide to policymakers, or more than a very rough guide.

Now, I am curious as to whether that is your meaning or if I am misstating it.

Mr. ARROW. Let me say that in a way the trouble is that we do not know how rough it is. You see, in order to examine the roughness of one's measurements one must have a superaccurate standard for comparison. This is done through—well, let's take the ordinary ruler from the five and dime store, and make a comparison to the platinum bar from Paris. You only know by making this comparison. I think for our purposes we do not know if the present price indexes are thoroughly reliable as a basis for policy, or sufficiently reliable as a basis for policy without having at least on an experimental basis very highly detailed and highly accurate measurements.

So, it may be that the results of a highly accurate measurement will be to confirm that we are doing very well up to now.

To take a specific instance: It has certainly been held by a number of writers, including some in this compendium, that quality changes over the last 10 years haven't been sufficiently allowed for in the index so there is a serious overestimate.

Representative BOLLING. You mean things like the packaging of food products?

Mr. ARROW. Yes.

Consumer durables, in general, have changed their character in some sense, too. And it is possible that because of the great difficulties and great costs involved that our price indexes are insufficiently adjusted for this factor. Therefore, the prices appear to rise more than they do, because they underestimate the quality changes.

It shows up as a price rise when, in fact, it is really an improvement in quality.

Representative BOLLING. What you are, in effect, saying here is that we need at least some very detailed and very accurate rulers from Paris to compare with the dime store rulers we may have. It may confirm that the ruler is good, and, it may indicate it is not very accurate at all.

Mr. ARROW. That is right.

Representative BOLLING. Do you other gentlemen have comments on this?

Mr. RILEY. I am very happy to comment on the question of quality, because it is a matter of great concern to us. And I think there is quite a bit of misunderstanding, not on the part of Mr. Arrow, but other people, regarding our treatment of quality.

Now, we price packaged groceries. We price groceries in bulk where they are sold in bulk. In one store we may price potatoes in bulk and in another store we may price them in cellophane packages. But we don't compare prices for bulk and packaged potatoes and say the price is a real price increase. We will "link," as we call it, in making that comparison. So, we are comparing packaged potatoes this month with packaged potatoes next month.

In the case of automobiles—which is the well-known famous example—what is quality? It is entirely a subjective judgment. And we attempt, just for our own protection, to be as objective as possible in comparing prices. So, when we compare automobile prices from time to time, month to month, or year to year, as we have to when model changes are made, we attempt to exclude from the price comparison those clearly evident and measurable changes in the automobile such as the substitution of an 8-cylinder motor for a 6-cylinder motor.

There, we would not compare an 8-cylinder car with a 6-cylinder car. We would not have a car having an automatic transmission compared with last year's model which was sold without automatic transmission. We can allow for those in making the price comparison. However, I must admit that we cannot make any adjustment for the increase in the height of the tail fins, or anything like that.

Representative BOLLING. Nobody can seem to determine right now whether this was an increased satisfaction or not.

Mr. RILEY. On the other hand, I must say there are improvements in the quality of the car, based at least on the judgment of the buyers of the car, that may come about from reductions in the cost of production. So, you get improved quality with no change or even an accompanying decrease in price.

Mr. WELLS. I would certainly agree with Mr. Arrow; I do not think there has been much research done on index-number construction, certainly in my field, now for almost 30 years. I think it is time we had some attention directed to that.

At the same time, however, we are very much interested in getting more accurate observations. I would like to see more emphasis on collecting more accurate prices. And both Mr. Riley and I would like to see expenditures surveys of what people are buying, so as to brings our weights to date, as soon as possible.

With reference to the quality factor, there has always been some difference between the Department of Agriculture and the Department of Labor in the way we collect prices. Partly, this is due to the fact that the collection of farm statistics has largely been a byproduct of the system to measure acreages, yields, and production of crops, numbers of livestock, and so forth. Also, we collect most of our prices paid by farmers by mail.

We ask most dealers to report to us prices—except for the major durable goods—of the kind or class of commodities most commonly sold, which means that, when we are pricing overalls for farmers, we ask for the price of the kinds of overalls most commonly sold, or the kinds of workshoes most commonly sold, and so on, through a considerable list of commodities.

The quality or, at any rate, the specifications, to be scientifically precise, of these overalls and work shirts and workshoes and things of that kind may change from time to time. We are, generally, of the opinion that the farmer gets the best buy he can on these essential items and that the satisfaction he gets from them is not particularly changed as the specifications are changed.

We are under constant criticism that we should move toward a much greater degree of specification pricing. This would require us to use actual interview or personal observation of prices, as the Bureau of Labor Statistics now does. And it would, of course, raise our costs by a substantial amount.

Now, don't misunderstand me. On the major durable goods, we use specification pricing. But, in the case of automobiles and a number of other things, we try to decide whether the accessories are really a change in quality or something that the farmer must take along with the basic commodity. But, in case of many of the common items, groceries and clothing and things like that, we are simply pricing the quality most commonly sold in the stores, in the villages, and the small towns up to 50,000 people, whereas the Bureau of Labor Statistics

is using specification pricing. And you compare each year products of the same specification with the year before, whereas we compare the price of the product most commonly sold this year with the price of the product most commonly sold the year before.

In times such as this, I think the Bureau of Labor Statistics method is superior to ours. During the war period, when this was an extremely difficult problem of maintaining quality, strangely enough, I think our method was superior to the Bureau of Labor Statistics.

What I am really saying is, in times of relatively stable prices, the Bureau of Labor Statistics method is a much more precise method. In times of considerable economic stress, however, it seems to me that the most commonly sold or used method is certainly as good, probably the better way of pricing the essential everyday kind of item.

But I want to see an improvement in the pricing so we know more precisely what we are pricing.

I want to see an expenditure survey every 2 or 3 years to tell us what farmers are buying and what they are not buying, so as to see whether our weights which we use are getting out of line with reality, which is, I think, a practical approach to Mr. Arrow's recommended chaining between successive years, which assumes weights are revised every year.

I would like to see some real research done on the different methods of calculating index numbers and the kind of biases or results you get.

The question of improving the accuracy of our indexes turns partly on the public confidence that is placed in them. They must be objective, and we want to assure the users that they are correct.

There is a further question as to how accurate they must be for policy purposes. And this depends, in part, on how precise and finely grained your tools are on the other side for managing the problems the statistics measure. At this point I would agree with Mr. Arrow that I suspect our present indexes are accurate enough for the policy tools you have on your side of the table. But we should improve both our indexes and our tools of economic management. I think the two go together.

Representative BOLLING. Well, I think it would be reasonable to comment that these could be common objectives on both sides of the table.

Mr. WELLS. They go together.

Representative BOLLING. An improvement in both the policy and the intelligence factors needed to make sound policy decisions.

Senator O'Mahoney.

Senator O'MAHONEY. Mr. Chairman, the casual remark of Mr. Wells leads me to ask a question which may be a little bit off the beam of the discussion this morning.

But you referred, in discussing the gathering of statistics from farmers, of the prices of the things they buy, to the possibility of tie-in sales forced upon the farmer to buy things he didn't want.

The reference made me think it was a common thing; that you have had the experience to the effect that this is not at all unusual for the farmer to be compelled to buy things he doesn't want in tie-in service; is that right?

Mr. WELLS. The particular thing I was talking about was accessories on automobiles, Senator. I think it is a fact that following the end of World War II that many of us, myself included, as well as the

farmers, if we went to buy an automobile, found that there was a limited number of automobiles in stock. We could if we wanted to wait long enough and bargain long enough perhaps get precisely the automobile we started to buy.

But more likely we bought an automobile already on the floor, well loaded with accessories.

Senator O'MAHONEY. I am glad to know that the farmer is no worse off than the statistician.

Mr. WELLS. I am talking about the price of tractors and trucks and automobiles and refrigerators and rather sizable blocks of purchases for many farm families.

Senator O'MAHONEY. And in this particular category it is a rather common thing.

Mr. WELLS. We think so. And we try to go out and find out what is actually being sold and the accessories which are being included. We will not accept for our purposes simply the list price. I said at the beginning probably there are complaints to Congressmen about our asking for the prices of automobiles, tractors, and trucks. A great many people think it would be a simple deal to get list prices.

Senator O'MAHONEY. Do you find much resistance in gathering statistics?

Mr. WELLS. Not a great deal. Most of our material comes from country and small town dealers. And recognizing the fact that it is a mail questionnaire report, I think we get good cooperation. But there are always a number of letters of complaint, some of which you people get.

Representative BOLLING. Senator Hoblitzell. Or Mr. Talle?

Representative TALLE. No questions.

Representative BOLLING. Mr. Knowles?

Mr. KNOWLES. I want to clarify a couple of things from this discussion for fear the committee may have missed a point that went by in a hurry.

From the two practical agencies represented: In pricing items to go into your price indexes, particularly in the case of specification pricing where you actually tell either the reporting agency or your reporter who collects the information to report a price for a specific object with certain specific physical characteristics—such as an automobile with certain characteristics, with or without certain accessories—are you not in fact deciding for the consumer what expenditure in two successive periods of time will give the same psychological satisfaction, and hence are you not in fact saying that—whether you like it or not—you are going to get into the question of measuring the price of a standardized consumer satisfaction—and this may be very administratively inconvenient, but nevertheless a fact?

Aren't you in effect pricing psychological satisfactions for two periods in this time? And are you deciding that adding an automatic transmission increases the psychological satisfaction derived from the automobile, for example? And so you are deciding for the consumer what his satisfactions are?

Mr. RILEY. Well, we are deciding to that extent. We are not pricing units of satisfaction. You could say we make an arbitrary decision that in the year with which we are making the comparison this eight-cylinder car without an automatic transmission conveyed a certain amount of satisfaction.

All we are trying to do in the succeeding year is to measure the cost of that same degree of satisfaction. So in order to avoid so far as possible the complication of trying to determine how much more or less satisfaction is derived from the next year's model car, we try to make the comparison on the basis of as nearly similar specification as we can.

Mr. ARROW. But you see you have some basis for making comparison here. In 1 year, let's say—say for the year in which the automatic transmission is introduced—1 year you have only 1 kind of car on the market; the next year you have both kinds of cars, with a price differential. The fact that the consumers shift from one to another gives you a method of measuring to a certain extent the changes in the satisfaction in the two types of cars.

Mr. RILEY. In our perfect system where we could collect and analyze data and arrive at the decision as to what they mean almost instantaneously, I think we could do that. But I am afraid with our rather cumbersome method of collecting and analyzing prices we wouldn't find out until year after next what we should have used in the current year for distribution of weights.

Mr. KNOWLES. I was merely trying to make it perfectly plain to the committee from this interchange that of necessity any collecting agency in this position will have to make some such arbitrary decision about what constitutes a product of equal quality in the two periods. And they will have to, therefore, meet Mr. Arrow's dilemma which, in theory sounds, shall we say, impossible to do but which in practice you do do anyway.

And I just wanted to point out that if we could find any research that would make it easier for the operating agencies to reach as unambiguous and as true a comparison as possible, this would certainly be a contribution.

Mr. WELLS. I think the Bureau of Labor Statistics has reached the only real unambiguous answer, which is straight specification pricing. We in Agriculture have not gone that full direction yet. We have a considerable list of what we consider essential items where we really price the class of goods most commonly sold.

We should move further toward specification pricing. But at the same time I must say in terms of pure theory that for relatively low-cost essential items, the kind of goods most commonly sold may well come closer to measuring the consumer satisfaction than does the kind covered by pure specification pricing—or at least that price comparisons are more valid. I am not sure we want to spend the money to go all the way to what BLS is now doing if we have limited funds to work with.

Mr. KNOWLES. Now a practical problem has been raised: That is whether or not from the collective knowledge here of price indexes and their characteristics and the improvements that have been made in them over the years can we get an answer to two problems about prices in the current period which have been raised from other sessions.

First, do the price indexes in effect say a little something different about this recession than they would if they were still the same kind of price indexes we had when we had, let us say, some recessions in the past, such as in the 1930's or say 1921? Do our price indexes tell us something different about the way the economy is operating today

than they used to? And in this case some apparent superficial differences in this recession may or may not be correct.

Mr. RILEY. That would be the case with the Wholesale Price Index, in particular, because it now contains a much higher proportion of fabricated products than it did in the earlier stages. So when you compare the overall wholesale price index now with the index say, in the 1920's, you are not comparing the same kind of a measure.

However, it is possible if you go far enough into refinements, since we have the index broken down into components, if you compare, say, the raw materials group now with the raw materials group then you come closer to a true comparison of price movements.

That leaves a lot to be desired, of course, because the deficiencies in the index in the earlier period made it a less satisfactory measure of what was happening to the economy as a whole because after all we did have a lot of fabricated products moving in trade then which were not priced.

Mr. KNOWLES. Isn't it true that you have increased its sensitivity? Such things as discounts and concessions and the like—you would measure these better today in this recession than you would in the past?

Mr. RILEY. Yes.

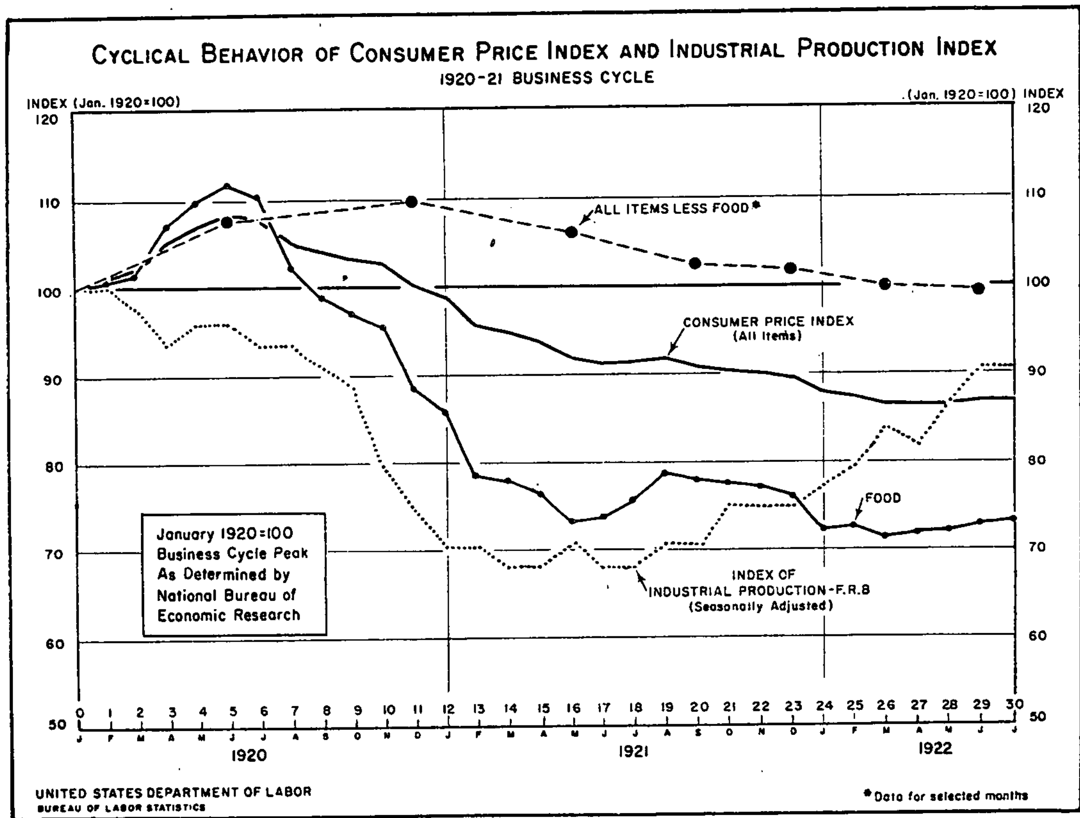
Mr. KNOWLES. Some changes are working toward making the indexes more stable and some less stable. Anyone who draws a conclusion from the overall indexes about price behavior is likely to be slightly fooled.

But now I come to the second part of my question, that is: Can we, aside from the very special problem of agriculture, where you have had a very unusual supply circumstance—this is a little bit of an unusual or a typical year in consumer food, certainly—aside from these, can we say that the price behavior in the current contraction in output and employment is essentially a different matter from what the pattern would be expected to be from studying past recessions?

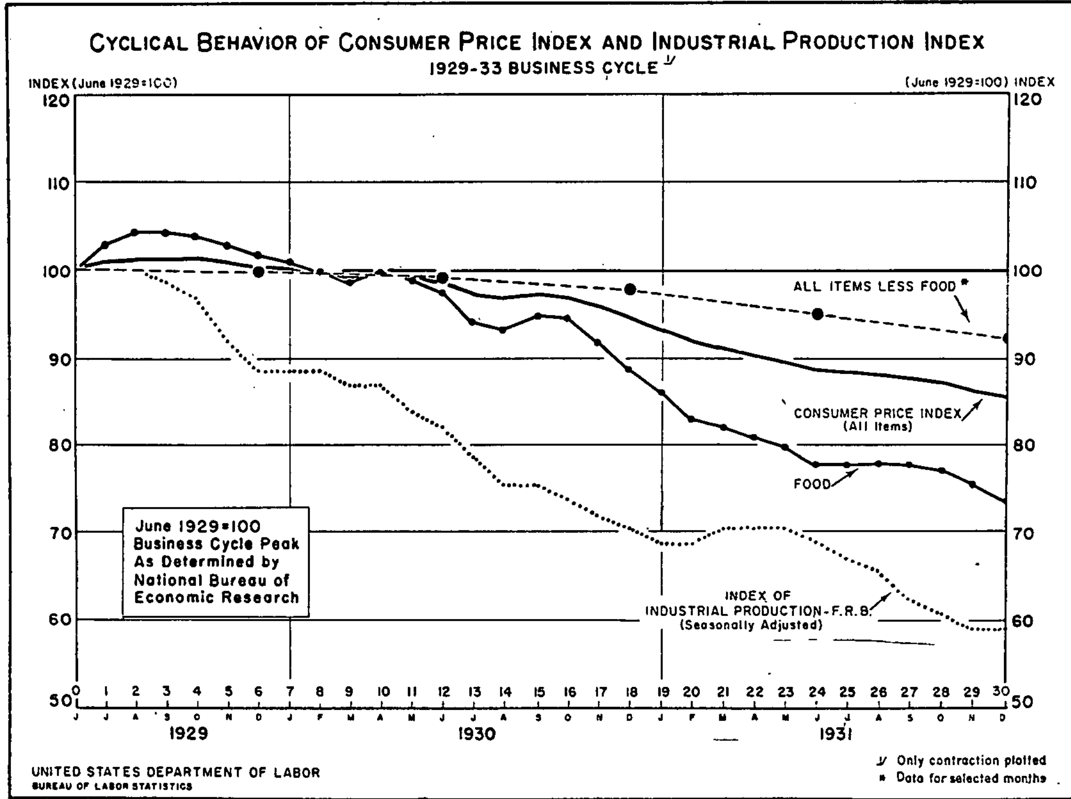
Is it really any different from, say, 1949? Is it really any different from, say, 1921 or 1924, or any other recession? Does the price structure reveal any essential differences?

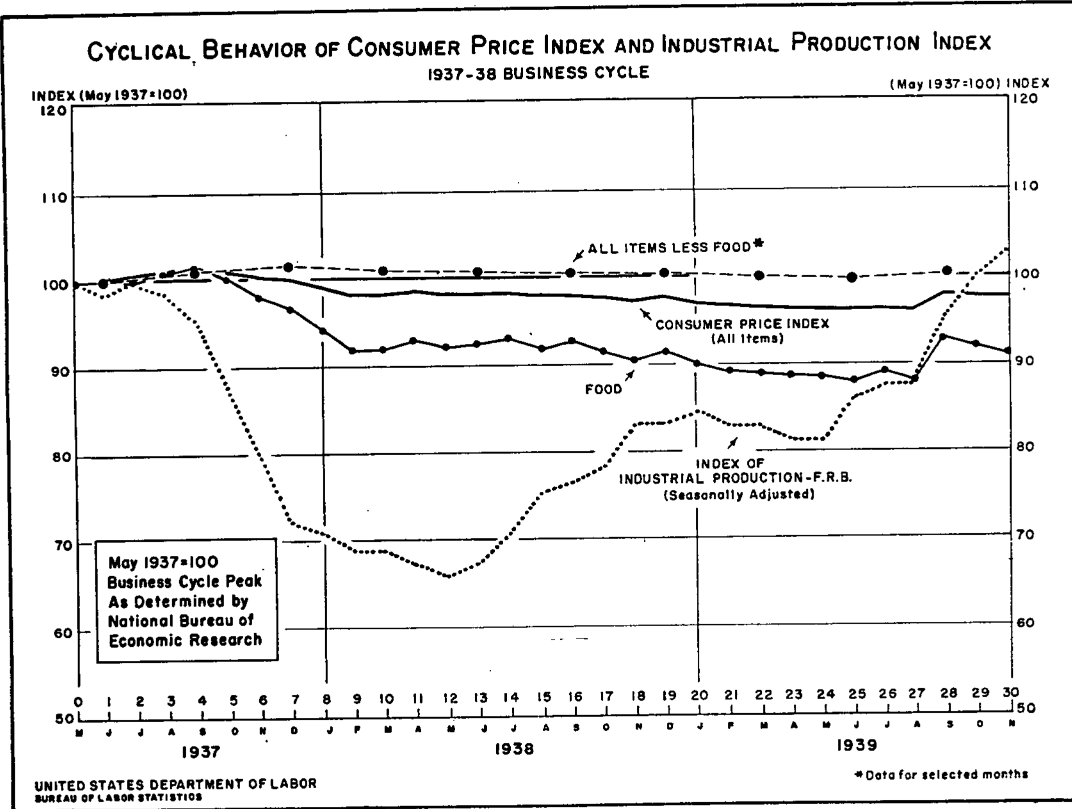
Mr. RILEY. Well, I think there are some—there are some significant differences. Every recession, depression, or business downturn differs in some respect from every other one, apparently, but we do see this feature.

We have looked more carefully at the Consumer Price Index in this respect than we have at the Wholesale Price Index, because we don't feel that comparisons of the Wholesale Price Index in detail over the earlier periods can yield as useful information. We have traced the movement of the Consumer Price Index and the Federal Reserve Index of Production in the last 6 recessions since 1920. Basing the indexes in each case on the cyclical turning point determined by the National Bureau of Economic Research, we find, as demonstrated in charts Nos. I through VI, that, contrary to what some people seem to feel, in every case prices are sticky; consumer prices at this time are sticky.

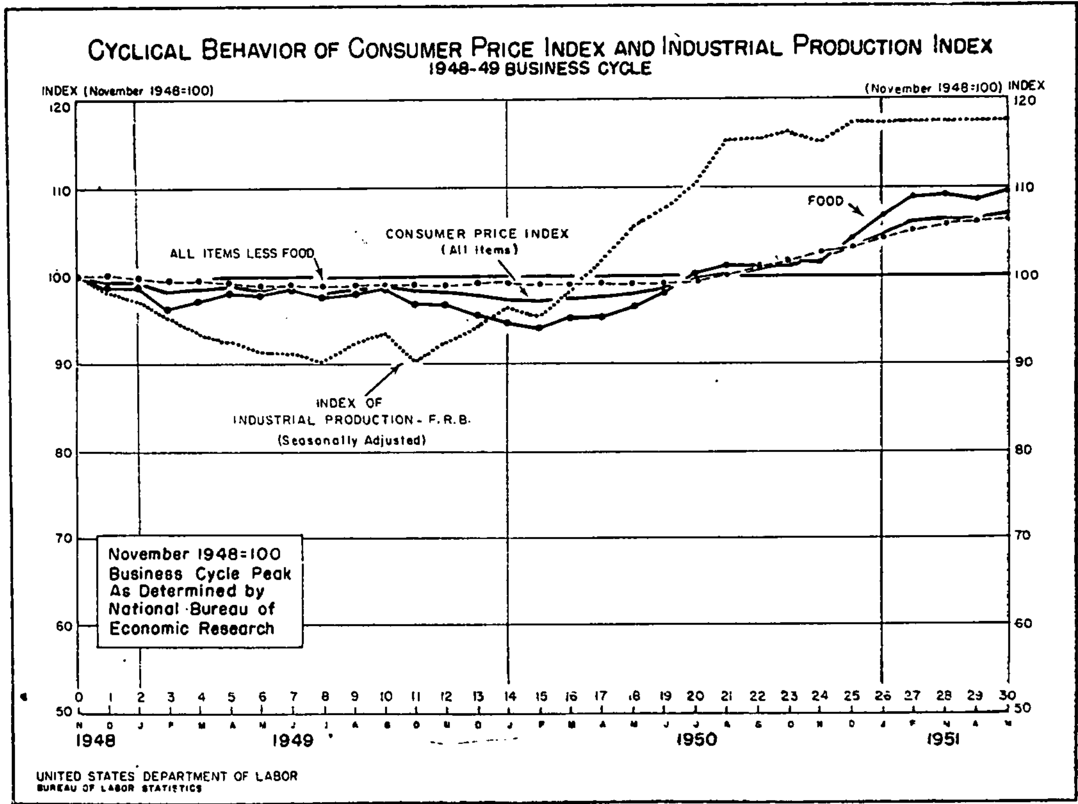


CYCLICAL BEHAVIOR OF CONSUMER PRICE INDEX AND INDUSTRIAL PRODUCTION INDEX
1920-21 BUSINESS CYCLE
INDEX (Jan. 1920=100)
(Jan. 1920=100) INDEX
120
110
100
90
80
70
60
50
ALL ITEMS LESS FOOD*
CONSUMER PRICE INDEX
(All Items)
FOOD
INDEX OF
INDUSTRIAL PRODUCTION-F.R.B
(Seasonally Adjusted)
January 1920=100
Business Cycle Peak
As Determined by
National Bureau of
Economic Research
0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30
1920
1921
1922
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
*Data for selected months


CYCLICAL BEHAVIOR OF CONSUMER PRICE INDEX AND INDUSTRIAL PRODUCTION INDEX
1929-33 BUSINESS CYCLE 1/
INDEX (June 1929=100)
(June 1929=100) INDEX
ALL ITEMS LESS FOOD *
CONSUMER PRICE INDEX
(All Items)
FOOD
June 1929=100
Business Cycle Peak
As Determined by
National Bureau of
Economic Research
INDEX OF
INDUSTRIAL PRODUCTION - F.R.B.
(Seasonally Adjusted)
1929
1930
1931
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
1/ Only contraction plotted
* Data for selected months



CYCLICAL BEHAVIOR OF CONSUMER PRICE INDEX AND INDUSTRIAL PRODUCTION INDEX
1937-38 BUSINESS CYCLE
INDEX (May 1937=100)
(May 1937=100) INDEX
ALL ITEMS LESS FOOD*
CONSUMER PRICE INDEX (All Items)
FOOD
INDEX OF INDUSTRIAL PRODUCTION-F.R.B. (Seasonally Adjusted)
May 1937=100 Business Cycle Peak As Determined by National Bureau of Economic Research
1937
1938
1939
*Data for selected months
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS



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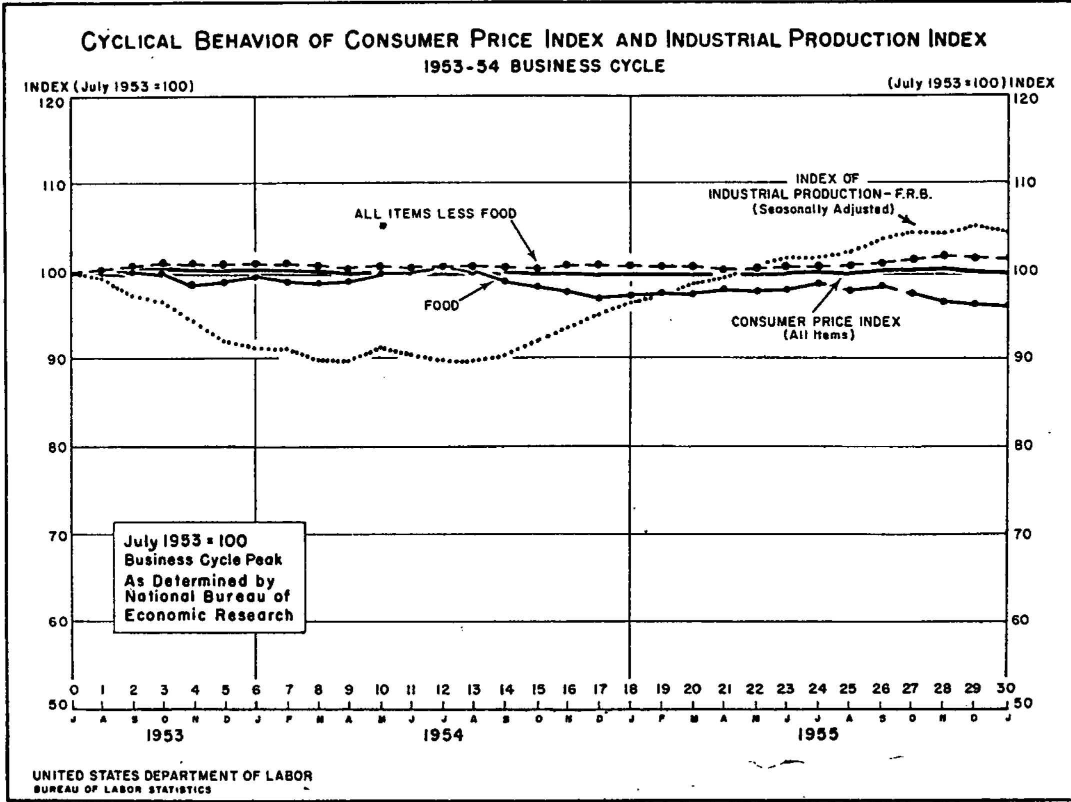
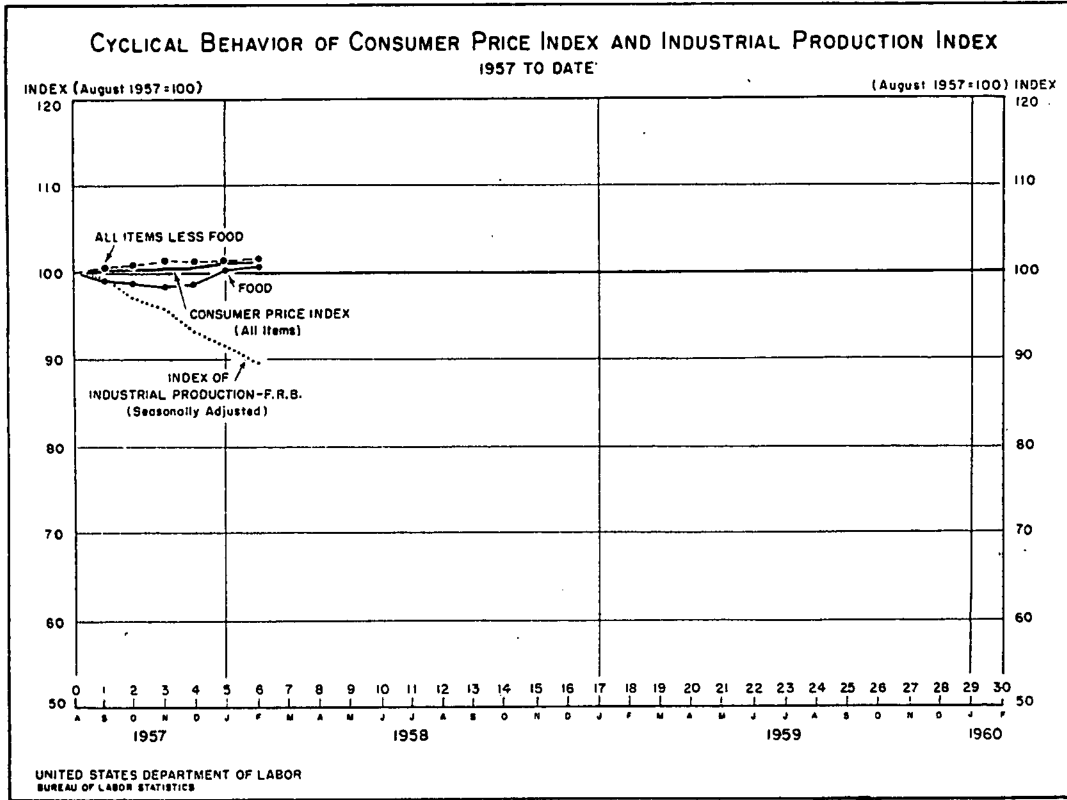

CYCLICAL BEHAVIOR OF CONSUMER PRICE INDEX AND INDUSTRIAL PRODUCTION INDEX
1953-54 BUSINESS CYCLE
INDEX (July 1953 = 100)
(July 1953 = 100) INDEX
INDEX OF INDUSTRIAL PRODUCTION – F.R.B. (Seasonally Adjusted)
ALL ITEMS LESS FOOD
FOOD
CONSUMER PRICE INDEX (All Items)
July 1953 = 100
Business Cycle Peak
As Determined by
National Bureau of
Economic Research
1953
1954
1955
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS


CYCLICAL BEHAVIOR OF CONSUMER PRICE INDEX AND INDUSTRIAL PRODUCTION INDEX
1957 TO DATE
INDEX (August 1957=100)
(August 1957=100) INDEX
120
110
100
90
80
70
60
50
ALL ITEMS LESS FOOD
FOOD
CONSUMER PRICE INDEX
(All Items)
INDEX OF
INDUSTRIAL PRODUCTION-F.R.B.
(Seasonally Adjusted)
0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30
A S O N D J F M A M J J A S O N D J F M A M J J A S O N D J F
1957
1958
1959
1960
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

The Consumer Price Index remains level or continues to rise several months after many other basic indicators have turned down. That is exactly what we are seeing now. The index is also sticky on the upturn. It lags behind the upward turning point. Industrial production and other indicators revive before the Consumer Price Index begins to react and rise. So, I think we see now a more or less typical phenomenon in consumer price movements, exaggerated, of course, by some rather unusual situations which, in part, are benefiting the farmer, in particular, since farm income has increased by about 10 percent over the past year.

Food prices in the Consumer Price Index have increased about 6 or 7 percent since a year ago. Weather conditions, of course, have affected food prices to exaggerate this movement in particular situations.

Mr. KNOWLES. That is all.

Representative BOLLING. Mr. Bailey, I was very much interested in this paper of yours. Not because I necessarily disagree, but because it takes a position that is a little different from the one I have heard most often.

With reference to your point No. 4, you mention steel. "Actual prices are sensitive to month-to-month changes in marketing conditions." The evidence certainly suggests that their realized prices are competitive, determined by supply and demand, as ordinarily understood, in every essential respect.

Then, in the discussion which you had with Mr. Reuss, you got into the beginning of a discussion, I would say, the implication of which was that the actual economic factors that effected the difference in price presumably on a larger order versus the smaller order were at least commonly underestimated. Have I stated that badly?

Mr. BAILEY. I think that is a correct restatement; yes.

Representative BOLLING. What I am getting at is something that may be beyond the purview of this particular panel, but, assuming that everything you say is correct and that you are also correct in your analysis of the true economic factors that maintain the different prices between the small order and the large order, isn't this an implication that carries you over from the administered question directly into the encouragement of a monopolistic situation?

Mr. BAILEY. Well, if it were true that the cost of supplying a primary material for any industry continued falling as the order or the size of the quantity supplied increased, this would mean that the economic facts of life, unfortunately, tended toward monopoly, because, of course, the bigger a firm the bigger the purchase, and the larger his orders the cheaper he could get the product, purely because of a natural factor, not because of any deliberate discrimination or unfair discrimination unrelated to cost in his favor.

This would enable him to undercut the smaller firm, if this were true. And, if this continued as firms got larger and larger, it would not stop until some firm had a monopoly.

However, I am merely saying that, over the range of orders normally supplied by a steel firm, the price tends to get smaller with larger orders. But this is only true up to a point. And beyond that the amount of price advantage that would be given for a large order would not further increase, I would think.

It is on very small orders where costs to the supplier begin to get very large. In steel and other industries with very heavy equipment, the cost of changing over from one specification to another slightly different one can get very high. If you have to put out a few tons of one product and then a slightly different product and then a slightly different one, you are spending all your time with the machinery stopped, switching over from one thing to another. And the cost of producing it then can be very large with these very heavy, mass-producing types of equipment.

But as soon as you get beyond a certain size of lot, which in the modern economy of the United States is not really very big—when we are thinking about monopoly and competition it is not necessarily a very big order—beyond that, the economies of large size begin to become negligible.

Representative BOLLING. Again, this may be out of the realm of this panel, but the discussion leads me, without any overtone of criticism or praise, to this question. I have the impression that steel is operating, roughly, at 50 percent of capacity now. I don't have any complete rundown on actual figures, but the indications are that, taken as a whole, steel companies, even at this low rate of production, are still operating on the black side of the ledger; that they are showing profits.

This implies that their break even has been substantially reduced from what used to be considered something like 70 percent of capacity to a figure in the order of 40 or 45 percent of capacity.

And the question then is: If, with current pricing policies, which are sticky but have these concessions involved, they are still profitable, if their break-even point has gone down to 40 or 50, what incentive do they have to fill the smaller order and increase production?

Mr. BAILEY. Well, their incentive would be to make even more profit. Of course, if they thought that, in particular—it isn't only a matter of increasing production. But if you fail to offer concession you may actually lose business to a competitor who gets there first. This is really the driving force, I think, in price concessions; not so much that people actively want to cut prices and get business away from competitors—although this is part of it—but that they are afraid of losing business because they can't trust the other ones not to do it first.

There is always this pressure. And it applies, I think, whether the orders are small or large, that, if the firm doesn't meet the market, he is likely to lose business to someone who is more ready to keep the customer from getting out the door, so to speak, by making a concession.

The difference between small and large orders is, also, ambiguous. What would be a tiny order for the United States Steel Co. might be a very large order to a smaller firm that could keep its plant working for several weeks on what looked very tiny to United States Steel. And, therefore, the studies that show a price differential for smaller firms supplied by the United States Steel Co.—in this case that is the company that was involved—I can't believe that this implies any real discrimination.

Representative BOLLING. Thank you.

Senator HOBLITZELL. Of course, as they cut down, the first they cut back is in the marginal plants that are old and antiquated. They

cut them down first, and the margin of profit in the operation is not nearly as much as in some of the older mills they have. That is a factor in making profits go down. Like in aluminum production, Kaiser shut down their west-coast production because they make it cheaper in my State, West Virginia. So, they operate the most efficient plant. They cut back on the inefficient operations.

Mr. BAILEY. If the marginal plants are less profitable than they used to be, it would be true that the break-even point would go lower. But I have never seen any study that would explain this trend to lower break-even points insofar as it has happened.

Representative BOLLING. I wasn't stating it as a fact, but as an apparent possibility.

Representative TALLE. Mr. Chairman, the Joint Economic Committee divides some of its labors among subcommittees. And we have had a Subcommittee on Economic Statistics since 1954. The conclusion we came to then was that economic statistics should be significant, they should be up to date, and they should be accurate so that business judgments in industry and judgments by Government might be based on as reliable information as possible. We have found since then that there are gaps in our statistical data. And what I would like to ask the panel is this: What gaps in our statistical data are you aware of that our subcommittee might pay attention to?

I think it was clear last January at our hearings that our data are not adequate for construction, say. Nor are they adequate for farm income. Perhaps you have in mind some other fields that you might like to mention in which there are gaps in our statistical data.

Mr. RILEY. I would be glad to make a few comments on that. We are always conscious of gaps in the data for which we are currently responsible, partly because of the inadequacies that we, ourselves, see in using these and interpreting them, and partly because of the kinds of questions we get from people for them.

I have already referred to one problem we face. And we think something should be done about it. That is the need for a new survey of family expenditures of the urban wage-earner and clerical-worker families, in order to bring up to date the weights for the Consumer Price Index.

Another area I referred to in the wholesale price area. We need to improve the quality of the prices we are now getting. We need to expand the coverage, and we need, perhaps, if conditions permit, to collect prices at different levels in economic activity.

We have in the Wholesale Price Index what we describe as a primary-market price index. But goods change hands at different levels. And a great deal of information, useful information, for policy purposes and general analytical purposes, could be developed if the structure of prices could be studied more thoroughly by collecting prices at different levels.

One of the most common demands made upon us in the Consumer Price Index area is for comparisons of the cost of living or consumer prices between cities.

To cite an example: About a year ago, a reader wrote to one of the Cleveland papers and said, "I am an elderly man. I am about to retire. I want to move to some place in the country where the cost of living will be low so that I can afford to live on my retirement an-

nuity." The answer column in the paper said, "Write to the Bureau of Labor Statistics to get your answer."

Within 3 weeks, we had about 2,000 letters from all over the country asking us, "Tell us what the cost of living is in—" from practically every place you could think of.

It is possible to make such comparisons. It is possible to do it, at least on a limited scale, to give some general indication as to the differences between large cities and small cities, between cities in the Northeast and in the West, and in the South, and so forth.

Of course, if you tried to do it for every city in the country it would be a tremendously expensive proposition.

We have in what we describe as the "city worker's family budget" a relatively easily understood technique by which such comparisons have been or can be made. We developed such a budget at the request of Congress back in 1947 and priced it a few times after that.

We have had to discontinue it, however, because the expenditure patterns and the consumption patterns represented by that budget were really pre-World War II patterns and no longer have any relevancy to the current situation. We are now engaged in an effort to bring up to date the items and the quantities in that budget, and, given sufficient resources, we could price it in a number of cities and provide some basis for comparing living cost between cities.

Representative TALLE. Thank you, Mr. Riley.

Mr. Wells.

Mr. WELLS. Well, Mr. Talle, as you well know, I think the interest of the Subcommittee on Statistics has been useful to us in the last several years. I think that interest has resulted in some substantial improvement in the Government statistical system.

Representative TALLE. Thank you.

Chairman Bolling and I are on that subcommittee. We take pride in the accomplishments of the subcommittee and we are grateful for the cooperation of your Department, Mr. Wells. Thank you.

Mr. WELLS. In my paper I point out that there are several places where we should strengthen and improve our agricultural statistics. Unfortunately, in the field of agriculture we have, I think, tried with inadequate resources to essay almost everything. So we have some kind of measure covering most of the things we would like to know something about.

As far as the question of strengthening and improving our statistics is concerned, we need to completely modernize the prices paid or "parity" index.

The coverage of the index needs to be expanded to take in all the commodities and services used by farmers. The present method of pricing individual items needs to be reviewed and, for some of them, very much improved. And, finally, we need to adopt a completely modern weighting system. We are now weighting the index of prices and cost rates paid on the basis of estimated outlays or average quantities purchased in 1937 to 1941.

Secondly, we need to find a better way of measuring farm population, and, perhaps even more important, the number of farms. Farm population is a matter of very considerable interest. For per capita income figures, for example, it is of course necessary that we have accurate annual measure of farm population. The number of farms is quite important to us in estimating numbers of livestock and acreage

of crops because many of our statistical indications, month by month, are per-farm indications. We need an accurate number of farms in the United States. And the way farms have been combining over the last 10 years, we are never certain whether we are close enough for our purposes to the actual number of farms. So we need to find ways of measuring farm population and number of farms annually on a much more accurate basis than we now have.

Senator O'MAHONEY. Do you have a table available now on the concentration of farm ownership in the last 10 years?

Mr. WELLS. We get out of each census, Senator, a count of farms by size and by class. So once each 5 years we get a fair measure. What I am saying now is we need a good annual measure which allows us to keep current. We have estimates but they are not——

Senator O'MAHONEY. But you spoke of the increasing merger of farms over the past 10 years.

Mr. WELLS. The number of farms is decreasing. We used to say—quite a few years ago we had 6 million farms. Now we have something less than 5 million.

Senator O'MAHONEY. Do you have figures on the acreage as of then and now?

Mr. WELLS. Yes; we have those figures. The total acreage in the farm plant remains about the same. The size of the farms is increasing. The number of small farms is increasing, too, in some areas because of rural residences.

Senator O'MAHONEY. I believe you should have whatever assistance is necessary to promote the more frequent gathering of these figures. But as a matter of valuable information, I wish you would enter in the record at this point or at the conclusion of your remarks the latest tables you have showing the concentration of farms in this 10-year period.

Mr. WELLS. I will be glad to see what we can get describing the happenings over the last 10 years. We estimate the number of farms each year. We are by no means sure how adequate the estimates are.

Representative TALLE. As I remember it, Mr. Wells, in my State of Iowa, the average acreage per farm was, in the early twenties, approximately 148 acres, whereas now, it is 172. And the enlargement goes on.

Mr. WELLS. If you would take the residence farms out, it would be probably larger than that.

This leads me to the third thing. We need to very substantially improve our farm-income estimates. We need to break our farm income estimates down as between types of farms—commercial farms, small-scale farms, and part-time farms. This meets the specification that Mr. Arrow laid down at first about breaking your universe into different groups and finding out what is happening to each class or income group.

We need to improve our index of prices paid. We need a more accurate measure of farm numbers and farm population. We need a substantial improvement and breakdown of our farm-income estimates.

(The following information was subsequently received for the record.)

The following table summarizes the trend of the number of farms by size groups as reported by the census for the years 1930, 1940, 1945, 1950, and 1954. The second section of the table also shows average size of all census farms and all commercial farms, while the last section of the table calls attention to the estimated acreage of all land in farms and the index on farm output. Such indications as we now have indicate that the number of farms has continued down from 1954 into 1957 at approximately the same rate as prevailed from 1945 into 1954.

Number of farms, by size of acreage group, average size of farm, land in farms, and farm output

[In thousands]

Item	1930	1940	1945	1950	[1] 1954
Under 10 acres	359	506	595	485	484
10 to 49 acres	2,000	1,780	1,654	1,478	1,213
50 to 99 acres	1,374	1,291	1,157	1,048	864
100 to 179 acres	[1] 1,388	1,279	1,200	1,103	953
180 to 259 acres	[1] 476	517	493	487	464
260 to 499 acres	451	459	473	478	482
500 to 999 acres	160	164	174	182	192
1,000 acres and over	81	101	113	121	130
All census farms	6,289	6,097	5,859	5,382	4,732
AVERAGE SIZE OF FARM (ACRES)					
All census farms	157	174	195	215	242
Commercial farms	(2)	220	255	[3] 300	[3] 336
LAND IN FARMS AND FARM OUTPUT (MILLIONS OF ACRES)					
Land in farms	987	1,061	1,142	1,159	1,158
Farm output (index numbers 1947-59=100)	72	83	96	100	108

[1] Corrected for comparability with more recent census data.
[2] Not available.
[3] Commercial farms include all farms for which the value of farm products sold was $1,200 or more. Farms for which the value of farm products sold was $250 to $1,199 are also defined commercial farms, provided the farm operator worked off his own farm less than 100 days a year and the income of the farm operator's family was less than the value of farm products sold. In effect, commercial farms are those from which the farm families derive their major source of income from farming.

Source: Basic data compiled from reports of the Census of Agriculture.

Representative TALLE. Do we have time to hear from Mr. Arrow and Mr. Bailey on my question about gaps in statistical data?

Mr. ARROW. I would like to call attention to one possibility that hasn't been explored. That is the idea that one should have different cost-of-living indexes for different income levels. It seems quite clear that in any index the composition of commodities consumed at different income levels is different.

It is one of the facts of economic life. The price of servants has probably risen relative to the price of household savings devices that might be used by lower- and middle-income groups.

I think that in an examination of changes in distribution—of distribution, what changes of distribution in income really mean—it would be very interesting to compensate the changes in money figures by different deflators. If, for example, as is possible, the price of living appropriate to high income levels has risen more rapidly than the price of level appropriate for lower income levels, this would mean there is some tendency toward equalization of income.

This kind of differential is picking up an extreme; but one is also interested in the difference of movements between varying income

groups. And this would apply particularly to pensioners and people like that as opposed to, say, middle-range wage earners or the slightly higher level of professionals so we may see what the differentials of the cost of living have been.

Representative TALLE. Thank you, Mr. Arrow.

Mr. Bailey.

Mr. BAILEY. I have two points: the first concerns the problem of quality change which has been the subject of a good deal of interchange between the members of the panel. The normal policy, as I understand it, in the BLS has been to put a new commodity in the index whenever it largely replaces a commodity which has previously been carrying the weight of a certain price in the index; which goes part way, in fact, toward doing what Mr. Arrow would like of having an annual revision of the index in the sense that when new commodities do come in and very drastically change the bill of goods being consumed, then the year-to-year changes do occur accordingly in the weight assignments in the index.

These are not nearly as thoroughgoing and sweeping as what Mr. Arrow wants. But the fact that normal prudence and conservatism require waiting quite a while before a new commodity is introduced in the index means that much of the benefit the consumer gets from new types of commodities—when they are just coming in and taking over the market and their prices relative to what they might have been if the commodity existed earlier—has fallen sharply. Most of this change escapes the index, because the major price fall in the new commodity has already occurred before the commodity is introduced in the index.

Now, the only study I know of which has been done partly in cooperation with people in the Bureau or people familiar with its procedures has been done by Al Rees at the University of Chicago. And he has worked on this new commodity problem in the furniture series in the index, taking the present bill of goods taken by consumers and working backward and taking out a commodity that is now in the index, let's say, when it first began to be important, and reintroducing the old commodity in the same fashion, but working backward instead of forward, as the BLS does it.

But here the new commodity stays in the index or is in the index whenever it has any importance at all, and you only get the old one in when you get back to the point that it was the whole market. The result has been that in his series on furniture he has a steadily declining price trend, whereas the BLS series shows it steadily rising.

Just this one simple change in procedure on the quality change question has produced quite a marked difference.

One has reason to wonder, if we really had a thoroughgoing study and research into the quality change problem, which is a very vexing one, throughout the index, we might conceivably even find that the purchasing power of the dollar has not fallen at all, although since 1930, let's say, we are told that it has fallen by about half.

Or at least I wouldn't be at all surprised if we found that except in wartime and the immediate postwar inflations if we took all major peacetime periods apart from the war and immediate postwar inflation we would find the dollar has not fallen in those periods.

Representative BOLLING. This would mean that there has been a much greater increase in the standard of living than recognized.

Mr. BAILEY. That is right.

Representative TALLE. Congressman Bolling is chairman of the Subcommittee on Economic Statistics. And I am a member of it. We are grateful to all of you. I would like to refer to a copy of the U. S. News that appeared in early April. In it there was an analysis of the current recession. Five items were noted: One, decline in domestic investment; two, decline in foreign investment; three, decline in inventory build-up; four, decline in defense expenditures; and then a fifth was brought in as a possibility, a "buyer strike," with special reference to automobiles. And the article suggested that, unless our statistics are up to date, we may be dealing with statistical data that are too old for recognizing that a recession is setting in before it is underway. And, by the same token, recovery may proceed before we are aware of it because our statistics are just not up to date.

Thank you, Mr. Chairman.

Senator O'MAHONEY. Mr. Chairman, I find a most interesting sentence in the paper of Professor Bailey; which I think merits a little amplification. It doesn't deal with the subject of the measurement of price changes and price relationships. But it does deal with the problem of public policy by Congress. I read:

> It is my opinion that the subject of administered prices in the free or unregulated part of the economy is not of itself a proper concern of public policy nor a worthy subject of the attention of Congress.

Would you like to expand on that a little bit, Professor?

Mr. BAILEY. Yes, sir. The emphasis in this sentence and the context in which it appears is that I feel we should concern ourselves with active or tacit conspiracies among major sellers or monopolies as such which tend to prevent entry into a new business or to prevent the fall in the price, let's say, when the market is weak, or to prevent the price from finding its natural level, and not on this more narrow question which has received considerable publicity at different times of the ability of a seller to let his price remain unchanged apparently in the face of changing market conditions.

The question of administered prices or prices which are set by, let's say, the front office of a corporation and which don't change very often is somewhat different from the monopoly question. I think that the proper emphasis should be on monopoly as such or related things which are proscribed in the present law.

Senator O'MAHONEY. Isn't it a sound public policy for Congress to study inflation?

Mr. BAILEY. Certainly.

Senator O'MAHONEY. In any segment of the economy?

Mr. BAILEY. Certainly, sir.

Senator O'MAHONEY. Now let me give you an example: Mr. Harlow Curtice, president of General Motors, was testifying before a subcommittee of the Judiciary Committee; and in response to an inquiry by one of the members of the committee, he testified that it is the policy of General Motors to set its prices on its commodities so as to earn 15 to 20 percent upon net value.

Now, when you consider that the automobile manufacturer sells its products to the automobile dealer c. o. d.—cash on delivery—and the dealer is under the obligation of indulging in the trading for used

cars in order to distribute the new cars, isn't it a matter of public policy to look into such a situation?

Mr. BAILEY. Well, Senator, there are many business firms which like to say that they have a policy of setting their prices such as to return so and so much on their capital. But when the chips are down they have to meet the market or go broke. And I feel that in automobiles as in many other cases what they say they do is not necessarily what they do——

Senator O'MAHONEY. Not necessarily true?

Mr. BAILEY. That is right.

In particular in the case of automobiles going to the dealer, the price at which they change hands between the manufacturer and the dealer may be different from what the price is that the company quotes. Because there are also possibilities of making concessions on extras, either loading up the car with extras in a tight market or being very generous about these extras in a weak market.

Senator O'MAHONEY. I will give you another example. This refers to the industry that Chairman Bolling brought up—steel.

George Humphrey, former Secretary of the Treasury, now head of National Steel was testifying before this same subcommittee of the Senate Judiciary Committee. At that time the facts were acknowledged that the steel industry was operating at about 48 percent of capacity. Perhaps it was a little more than that at that time.

But the price of steel had not been reduced.

There was evidence before this committee that because of the tight-money policy of the Federal Reserve Board, school districts in New York were unable to borrow the money that they needed to build schools that were required to serve the school districts.

Now that building would include steel.

There was a demand, but the price was too high. The price of interest on bonds was too high. And the price of steel was too high.

Mr. Humphrey was asked why, in such a case, the steel industry didn't reduce the price of steel because there would be a market. And there were unemployed steelworkers who could produce the needed goods. Do you think it is not a matter of good public policy for Congress to look into that?

Mr. BAILEY. If we could be absolutely sure that steel prices did not in fact come down at all from their announced levels of last July when they had their price increase, then——

Senator O'MAHONEY. Well, what better evidence can I give you that they didn't get out than the testimony of Mr. Humphrey that he wasn't going to reduce the prices?

Mr. BAILEY. Well, steelmen have never been eager to admit that they cut the price. Because within the industry this is considered not a nice thing to do. And my feeling——

Senator O'MAHONEY. In other words within the industry they believe in administered prices?

Mr. BAILEY. They believe in it. But I don't think they get them. In fact, from what secondary evidence we can pick up on this, I think that probably steel prices, when operations did get down to 50 percent of capacity, had probably gotten below their June levels before the price increase.

But these were very carefully kept secret because they just don't like to talk about it.

Senator O'MAHONEY. This is a very interesting subject, Mr. Chairman.

I have to go, Mr. Chairman, but I wondered if Professor Bailey would be good enough to write a little paper to this committee on this sentence. I would like to ask him first to define what he means by administered prices. Second, what he means by the free, or unregulated part of the economy. And how he thinks Congress can exercise its constitutional authority to regulate commerce among the States and with foreign nations, if it does not watch monopolistic pricing of administered pricing in that part of the economy which is not regulated.

How can we protect the free or unregulated part of the economy from monopoly if we don't make this a matter of public policy concern?

We talk a great deal about free economy. Do you in this sentence mean by a "free part of the economy" one that is free from Government regulation or free from monopolistic regulation?

Mr. BAILEY. I will be glad to submit a paper along the lines that you suggest.

Senator O'MAHONEY. Thank you very much.

Mr. WELLS. I just wanted to ask two brief questions to see if my understanding of Mr. Bailey's paper is correct.

Representative BOLLING. Very well.

Mr. WELLS. I thought you used the term "administered prices" to mean prices that were not the subject of direct and immediate bargaining, transaction by transaction.

When I go in and sit down in the barber chair, I know I am going to pay $1.75. I go in the grocery store and look at the 23 cents stamped on a can of tunafish. These are administered prices as I understand you.

What you are saying is you are not interested in those kinds of administered prices. What you are interested in is where there is enough monopolistic power to make it stick. Is that correct?

Mr. BAILEY. Partly; yes, that is correct. The idea of an administered price is one that stays put. And if in fact you read this label and you believe it and you don't bargain and you don't get a price concession, then it would be an administered price.

Mr. WELLS. In Rome, Italy, if I go into a retail shop I bargain for each item I buy. In the United States I never do unless I am willing to buy a case of frozen food or something of the kind.

Representative BOLLING. Any further questions, gentlemen?

(No response.)

Representative BOLLING. If not, we thank all of you for your participation and time and contributions. The committee will stand adjourned until 10 o'clock tomorrow morning when we will meet in room 1302, New House Office Building.

The topic for tomorrow is, "Past price behavior viewed in the context of cyclical and secular economic changes."

We will hear from Mr. Danhof, Mr. Hickman, Mr. Hultgren, and Mr. Kendrick.

We thank you.

(The following letter was subsequently received for the record:)

MAY 20, 1958.

Hon. JOSEPH C. O'MAHONEY,
Senate Office Building, Washington, D. C.

DEAR SENATOR O'MAHONEY: This is in reply to the question you put to me, asking for a written reply, near the close of the hearing of the Joint Economic Committee on Tuesday, May 13, 1958. To some extent the entire paper and testimony which I presented to the committee were related to this question; however, your way of putting it emphasizes certain points on which I must confess I was not sufficiently clear and emphatic. Therefore, I welcome this opportunity to amplify and clarify my position, and I am grateful for your encouragement in this respect.

On the question of monopoly pricing, and on the responsibility of the Congress to protect the public against it, I believe I could not be more in agreement with the concern which you indicate in your question, and which you have long been well known to feel. That this problem not only requires the strict enforcement of existing antitrust legislation but also calls for the enactment of new laws, amendments, and reforms seems to me also to be a point on which there is relatively little doubt. The subject of so-called "administered prices" however, is quite distinct from the monopoly problem in many respects, and the respects in which it is distinct are important and require emphasis.

The concept of administered prices, first introduced by Gardiner Means in 1935 and still receiving prominent attention, tends to emphasize the frequency of price change as a key characteristic of price movement. Roughly speaking, Means classed as administered prices those wholesale prices whose quotations changed least frequently, for example those which changed less frequently on the average than once every 4 months from 1926 to 1933. (He did not restrict the general concept to wholesale prices, of course, but used wholesale price data from the BLS for illustrative purposes.) Means argued that infrequent price changes of this type may occur in wide areas of the economy, wherever sellers have some discretion or possible range of choice over the price which they can get. He further argued that where this is true, sellers may prefer to hold prices constant as market conditions vary over a certain range, absorbing the variations through changes in output rather than price. This would not usually occur in a perfectly competitive market.

However, as Means himself has emphasized, the concept of administered prices is not an appropriate criterion or point of reference in relation to the monopoly problem. I would say that it is inappropriate for two distinct and highly important reasons.

First, the frequency of price change (or other related behavior, such as the failure of the price of a commodity to fall when its sales fall sharply) is not a reliable criterion of the existence of monopoly to an extent that concerns the public interest. The administered price phenomenon, as set out by Means, occurs in many lines of business that are quite evidently competitive to all intents and purposes, such as, for example, laundry and dry cleaning and other services, retail groceries, and so on. Although the prices of various items in these lines of business do change from time to time, they change relatively infrequently both because of rigidities in costs and because of the inconvenience of making small changes in prices from day to day. Similar considerations could apply to almost any business whose quoted prices change infrequently, so that the frequency of price change is not evidence on whether the business in question possesses a significant or serious degree of monopoly from the standpoint of the public interest.

Second, the frequency of movement of quoted prices, or list prices, may be entirely misleading as to the frequency and even degree of movement of prices actually charged. In many important cases, sellers frequently engage in various kinds of price cutting without changing their list prices whenever the market shows weakness. They may give outright cash discounts, or, which comes to the same thing, may increase their "freight absorption" to a given customer, or give a better quality of the product than the one for which they bill him, or give higher trade-in allowances if trade-ins are involved, and so on. Whenever the possibility exists that sellers may be doing this for a given commodity, judgment must be suspended as to the facts of the case. If they are doing it, the quoted price for that commodity is not a true price at all, and of course is entirely misleading.

Among the many well-known examples of this phenomenon one of the most important is that of steel prices. The most detailed information we have on steel pricing in a weak market emerged from the searching and valuable researches carried out, under your distinguished chairmanship, by the TNEC. The data from those studies show price discounting in various forms, varying according to the product and size of shipment, ranging up to more than 50 percent in February 1939 (when steel operating rates were higher than they are now). Substantial discounts tended to be available on all but the smallest shipments. Broadly similar results were obtained in a study of prices paid by purchasers of steel in 1939, carried out by the BLS and OPA, which also showed that these discounts fluctuated with the state of the market, as reflected, for instance, in steel operating rates. On the very uneven evidence I have for other commodities, I am led to believe that similar conclusions would emerge from the study of many other commodities whose prices do not appear to move as freely as they should.

The concept of administered prices is misleading in another, perhaps even more important respect—it may misdirect us on the question of the right policy for dealing with monopolistic pricing. Recent discussion of administered prices has tended to drift into proposals for price review, or even price control, for the prices of commodities which give the appearance of being monopolistically controlled by appearing to be "administered." Even if the doubts on the concept of administered prices which I have just expressed did not hold, i. e., even if the existence of a sticky or "administered" price was conclusive evidence per se of monopoly, it would not follow that price review or price control was the appropriate policy. The right general line of attack on monopoly pricing is already embodied in existing law, although that law needs strengthening and reform at certain points. If the alternative of making an industry competitive by the breakup of monopolistic firms and conspiracies is at all feasible in a particular case, the alternative of price controls or the like is appallingly bad by comparison. Price controls and the like tend to be cumulative, to call for more controls, to become worse and worse in their effects over time, and to become more and more difficult to get out from under. We have not only our own experience to justify this assertion, but the experience of other countries, some of which can regrettably be pointed out as horrible examples of what can happen in this respect.

Instead the emphasis of public policy should be such as to take advantage of one of the fundamental facts of economic life, namely, that competition is the most important single form of protection the public has against exploitation, and is, at the same time, a most effective spur to progress. This fact can be tremendously useful and valuable wherever the nature of an industry is intrinsically compatible with competition, but where competition has become weak or nonexistent. In any such case public policy can go straight to the heart of the matter by creating competitive conditions. In this connection the most important single reform might be the reform of the patent laws; however, serious consideration should also be given to the possibility of increasing the powers of the courts to order the breakup of very large firms if there is evidence that the dominance of an industry by these firms has tended to weaken price competition. I also believe it to be desirable that the coverage of the antitrust laws should be made complete, i. e., to be extended to cover labor and farm groups and to be enacted within all the individual States that have not already enacted antitrust laws of their own.

Further, I believe that reforms such as these should be adopted, not in anger, but in sorrow, only after the most careful weighing of alternatives and of their possible consequences. Above all, we should avoid being rushed into hasty action by a feeling of panic or bitterness in a time of economic depression, when ill-advised action could so demoralize the business community as to cause a complete collapse in investment and trade, or at best to deepen and lengthen the economic crisis.

Finally, we should not deceive ourselves about the amount of benefit that may be expected to flow from such reforms, even when well conceived. No one should be led to believe that the prices of industrial products can ever be made as flexible as the price of wheat, or that any group in the community can be completely freed of the inconvenience or loss that corresponds to a fall in income unaccompanied by a proportionate fall in the prices of the things the group buys. Losses and inconveniences of this kind have always been characteristic of life, perhaps more so in the past than they are now. The best that antitrust policy, or related

Government policies, can do for the public, is to minimize what is already a minor cause of inefficiency and loss of real income. (On this point, see pp. 98–101 of the compendium in my paper submitted for these hearings.)

To expect more is to expect too much, and to court disappointment and disillusionment.

I hope that these remarks will adequately clarify my position. I had never intended to convey the impression that the interest of the Congress and of this committee in prices and price policies is anything but legitimate and relevant; I merely wanted to show that certain aspects of the matter are not worth the bother, at best, and can be positively misleading, at worst.

Thank you for your kind attention.

Sincerely yours,

MARTIN J. BAILEY.

(Whereupon, at 12:10 p. m., the committee recessed, to reconvene at 10 a. m., Wednesday, May 14, 1958.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

WEDNESDAY MAY 14, 1958

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

The committee met at 10 a. m., pursuant to recess, in room 1302, New House Office Building, Hon. Richard Bolling presiding.

Present: Representatives Bolling, Reuss, Talle, and Kilburn.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk; and James W. Knowles, economist in charge.

Representative BOLLING. The committee will please come to order.

This morning our study of the relation of prices to economic stability and growth shifts its focus toward the historical records of what has happened to prices during the past cycles in economic activity and over the broad sweep of past secular trends.

We seek light from this historical record concerning general price movements and the cyclical and secular changes that have been associated with them. The members of this panel and their papers have been concerned not merely with the behavior of prices, goods, and services themselves, but in changes in costs and demands which have accompanied or may have caused price changes.

The committee is grateful for the distinguished papers which the members of this panel have contributed to the study, and we hope that from these papers and this discussion concerning past events we may learn how to improve our understanding of what is happening now and what is likely to occur in the future.

Of course, the committee, as a congressional body, hopes that this will enable us to arrive at better decisions about economic policies which the Government should follow to promote economic stability and growth, which is our common objective.

We will proceed this morning in the order in which the papers appear in the compendium. We will hear from each panelist without interruption for about 5 minutes in which time he will summarize his paper. Upon completion of the opening statements, the members of the committee will question the participants for the balance of the session.

I hope this discussion can be very informal, as the others have been, and that all members of the panel, as well as members of the committee, will participate in raising questions.

Our first panelist this morning is Dr. Clarence H. Danhof. Dr. Danhof is professor of economics at Tulane University.

Mr. Danhof, we are pleased to have you with us. You are recognized for 5 minutes.

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STATEMENT OF CLARENCE H. DANHOF, PROFESSOR OF ECONOMICS, TULANE UNIVERSITY

Mr. DANHOF. Thank you, Mr. Chairman.

The assigned topic, "Past Price Behavior," is an extremely broad one, even when limited to the problems of cyclical and secular changes. I have, therefore, addressed myself to what seems to me the key question: Can we identify in the pre-World War II structure of prices, any relationships which might appear to be cycle-producing forces of a self-initiating nature?

The answer is, in my opinion, "No." The relationships are so intricate and the causal relationships so complex that no sources of initiating influence can be identified with any confidence. On the other hand, the possibility that such forces do operate within the price structure cannot be ruled out.

This review of price behavior does, however, emphasize a danger inherent in our tendency to deal with the economy in terms of aggregates. The price structure is characterized at all times by cross and counter currents. Trends in factor prices, product prices, profits, and, of course, in production, are the net product of very numerous changes, rising and declining in a wide range of amplitudes. An overall trend is merely a preponderance of specific changes in a given direction.

Such opposing forces are constantly at play, and are frequently self-canceling. A long-continued preponderance of movements in an upward direction will hit a ceiling. Movements in a downward direction may fail to find self-adjustment at an acceptable floor and continue to plunge downward in the typical recession phase of the cycle. Such a change results from a critical failure in the economy's balancing mechanism. It may be a failure of the price structure to adjust with sufficient promptness and sensitivity.

It may be true, however, that such a movement reflects causal forces of an exogenous character. The latter interpretation underlies many popular anticyclical policy proposals.

I would like to comment more specifically on a point touched on only very lightly in the paper. I am very skeptical, as are some other members of the panel, of the effectiveness of the statistical aggregates in reflecting activity with the sensitivity we need.

Much further study of price-cost, price-price, price-income, and price-produce relationships in a variety of classifications is essential if we are to cope intelligently with the problems of maintaining a growth economy of reasonable stability. The development of tabulating and analytical machines in the past few years has vastly increased our capacity to handle and analyze masses of data. What we lack in large degree is data properly conceptualized and available in consistent form for narrow intervals over reasonably long periods of time so that we can effectively apply the analytical capacities we now have to the problems of economic stability.

Professor Ackley in his paper suggests at one point the establishment of a Wage and Price Commission. To the tasks which he would assign to such a commission I would like to add the responsibility of developing the data necessary for more precise analysis, the testing of current theories, and policy formation.

Thank you.

Representative BOLLING. Next is Dr. Bert G. Hickman, senior staff member, the Brookings Institution.

STATEMENT OF BERT G. HICKMAN, SENIOR STAFF MEMBER, THE BROOKINGS INSTITUTION

Mr. HICKMAN. My paper was an attempt to identify and analyze the principal factors which shaped the course of prices during the past 12 years. The detailed chronological analysis eventuated in a set of reflections on the inflationary process in the postwar American economy.

The reader must have been struck by the similarity of behavior of durable goods prices during the past 3 years and in 1947–48. (During the Korean war, of course, prices were under control.) In both periods these prices rose swiftly, and in both the advance accelerated in those months of the year when major wage increases went into effect, or shortly thereafter in 1947.

This timing relationship is certainly not surprising. Major wage increases are likely to raise unit labor cost in the short run, although productivity increases may offset part of the effect then or later. Prices of many durable goods are administered, moreover. Where industries are sufficiently concentrated so that individual firms recognize mutual interdependence, but there is no collusion, it is advantageous to all if prices are changed infrequently and in response to clearly identifiable factors known by each firm to affect the others in about the same way.

When the individual firms are also large and in the public eye, a further advantage accrues if price increases can be attributed to cost increases, even though profit margins may be maintained or augmented in the process.

The magnitude of the increases cannot be explained simply by the fact that prices are administered, however. Even administered prices have to be set at some level—and at a level which is profitable to the company. This means that product demand cannot be ignored; it sets limits within which the firm must price if it is to attain profits which are satisfactory or better.

By the same token, it sets limits within which costs must be held. These facts apparently are recognized by both labor and management, since the largest wage-price increases occur during periods of rising or high demand for durable goods. (Deferred wage increases written into long-term contracts may invalidate this statement in 1958, at least with regard to wages.)

The high demand for durable goods during the past 3 years cannot be dismissed from an explanation either of changes in relative prices or of inflation of the price level. Given that demand, sizable wage and price increases appeared feasible and satisfactory at expected levels of production and employment for at least one, and in some cases several years ahead. But the wage increases spread to other industries as well, although often with a lag of several months. Labor costs of production were thereby raised generally, but prices did not rise by the same amount everywhere. Why not?

First, although wage rates rose about equally through the economy, prices of materials did not. Many raw materials of agricultural origin were in chronic excess supply, with the result that prices were

stabilized at levels governed by Federal programs and the entire cost structure of products fabricated from the materials or their substitutes was anchored.

Second, relative demands differed among the several product classes. Among durables, this shows up in the fact that prices of producer goods rose more than those of consumer items, and within the latter group, those of automobiles more than household appliances—these actually dropped at retail—despite the similarities in prices of materials and labor.

As between durables and nondurables, the comparative strength of market demands is difficult to gage. The changes in wage rates and unit labor costs—whether fringe benefits and the earnings of nonproduction workers are included or excluded—have been about the same in the two divisions since the end of Korea, but the changes in prices of materials were not, and this may account for most of the contrast in the amounts of average price increase. Largely because many important industries in the division are unconcentrated and prices not administered, average prices of nondurables are rather sensitive to current market demands, so that prices do not always go up when wages do, and vice versa. This distinction rests on characteristics of market structure, however, and not on the relative strength of final demands among products.

I do not wish to imply by my emphasis on demand factors that there are no significant differences between 1947, 1948, and 1950 on the one hand and 1955–57 on the other. For one thing, money wages of factory workers lagged the cost of living during the earlier intervals, whereas they moved ahead of it in the last one until 1957. In the former inflations organized labor was reacting to previous price increases and attempting to restore the real value of labor income, whereas in the latter one it was seeking to augment real income. It is this last fact, coupled with the observation that money wages have outrun below-average productivity increments and raised unit labor costs, that has led many observers to speak of cost-push inflation during 1956–57. There are two kinds of inflation, it is asserted: Demand-pull and cost-push—and it is the latter which we have recently experienced. This is misplaced emphasis.

There are not so much 2 kinds of inflation as 2 degrees of inflation. The earlier inflationary episodes of the postwar period were more vigorous, and more widely diffused among the various sectors of the economy than the last. Prices tended everywhere to move upward in common surges. One reason for this, of course, was that market demands were more intensive and less easily discouraged by price increases than latterly, and this in turn was due to the powerful inflationary potential supplied by deferred demands and postwar liquidity in 1946–48 and by generalized, war-inspired expectations of physical shortages and price advances during 1950.

This is not to say, however, that cost pressures, and more specifically, wage increases were unimportant in 1947–48, for they did affect the timing and size of the price waves in those years. They did so not only in the durable-goods industries, and not alone because of the fact that they raised unit labor costs, but also because key wage-price settlements affected price expectations and hence product demands generally.

Demand pressures were clearly less intense in 1956–57, but that fact does not render them unimportant in the gentler inflation of those years. If one insists on a distinguishing categorization for this inflation, "bottleneck" may be more suitable than "cost-push." The former term at least carries the connotation of increased demand as well as increased cost in the sectors where prices rise strongly. It also has the virtue of emphasizing the fact that inflationary pressures may originate in particular sectors and spread to others, rather than appearing simultaneously everywhere.

That, in fact, is what one must expect under normal peacetime conditions. Widely diffused, powerful surges of excess demand are easily recognizable because they are abnormal. Such abnormal conditions aside, inflationary forces will tend to fan out from initial areas of disturbance.

Demand may figure in two ways in the process. First, specific demands may foster individual price and wage advances and serve as inflation starters. Secondly, aggregate money demand will have to rise if prices are to increase in other sectors. If the postwar American economy does indeed have an inflationary bias—and I think that it does—it is because its institutional framework favors the initiation and propagation of inflationary impulses, and guards against their liquidation.

With regard to the initiation of inflationary impulses, there is the fact that organized labor groups will press for money wage increases during periods of business expansion, since this is the variable affecting real income over which individual unions have some degree of direct control. Their success in winning wage increases will depend in part upon management estimates of the extent to which wage increases may profitably be passed on in product prices. This will mean that wage levels will tend to be determined by the increases which occur in the industries whose profit prospects are most favorable, and it is at this point that high demands for specific products become crucial in helping to set standards for wage increases. The standard-setting wage increases may or may not exceed the long-term average rate of overall productivity increase, but they are quite likely to do so for any given year and especially during years of full employment expansion.

Apart from acute inflationary disturbances like price decontrol or Korea, a problem of adjustment is posed for the economy each time wages and prices go up in key industries. Confronted with the fact that over much of our basic industry wages and prices are determined at discrete intervals and set for a year or more ahead, the question is whether aggregate money demand will rise sufficiently in response to the specific increases to sustain a higher level of prices and money incomes. This question, be it noted, is the same no matter what the causes of the specific increases themselves; whether, for example, they are heavily influenced by expected demand as in 1948, or are the lagged result of bargaining decisions made 1 or more years previously, as in 1957.

The additional money demand will be readily forthcoming when real demands are strong and financial constraints weak, as in 1947. Under those circumstances, increases of current money demand—including speculative inventory demand—will be large enough to raise

prices in all markets and hence wage and nonwage incomes in all industries about equally. When current—as contrasted with expected—real demands are weakening, however, as in 1948 or 1957, prices in other sectors, and hence nonlabor incomes per unit of output, will not rise correspondingly. And, of course, sales may become depressed everywhere, so that total wage earnings, profits, and other variable incomes may decline even in those industries where prices went up substantially.

The inflationary bias of the economy is apparent also when it comes to this question of the propagation of inflationary impulses. Our money supply is managed, and it is managed with regard to domestic stabilization objectives. This means that monetary controls will be used to curb an expansion of money expenditure under full employment conditions, and this whether aggregate demand is surging forward on a wide frontier because of powerful autonomous forces, or rising unevenly in response to the gentler prodding of demand or cost increases in specific sectors.

It means also, however, that monetary, or fiscal, curbs will tend to err on the side of too little restraint, since the goal is not stable prices at any cost, but stable prices accompanied by full employment and economic growth.

A distinction is sometimes drawn between demand inflation and cost inflation on the grounds that the former can be stopped at a given level of real income by eliminating excess demand, whereas even if that is done, autonomous cost increases will renew the latter type of inflation and force either a relaxation of the demand constraint or a reduction of output. I suspect that this contrast is more a property of static equilibrium models than of the dynamic economy.

In the first place, one should remember that autonomous demand shifts might also disturb a stable equilibrium if that were achieved through fiscal or monetary controls—and autonomous demand shifts occur frequently in the real world. Credit controls would have to be tight indeed to prevent a price advance fostered by new autonomous demands and financed by the activation of idle money balances.

Secondly, financial constraints powerful enough to keep prices from rising under demand pressures would almost certainly prompt a contraction of physical activity. If they did not lead directly to a downturn, they would do so indirectly by retarding or stopping the expansion of physical activity, with adverse consequences for real inventory demand and perhaps for fixed investment as well. Such considerations argue for that cautious application of inflationary controls which is observable in practice, no matter what the origin of the inflationary pressures.

Finally, our institutions and policies guard against the liquidation of inflationary pressures. Deflation brings not only lower prices but unemployment and lost production, and these are adjudged the worser evils. Instead of forcing credit deflation, the monetary authorities pursue easy money policies during contractions. Expansionary fiscal actions—increased Government spending and tax reductions—are more likely than not. Automatic stabilizers cushion the drop of income and demand. Agricultural supports slow or prevent price declines, and administered prices are preserved by company policy. General wage reductions are neither recommended nor antici-

pated. In short, the preponderance of public and private economic forces work directly, and in many instances deliberately, against price reductions during business contractions.

Since my subject has been price behavior, I have written of inflationary bias in these paragraphs. It is readily to be seen, however, that the bias is largely a byproduct of properties of the postwar economy which most persons would agree were desirable ones. This fact should be kept in mind when judging the performance of the economy during these past years, and it should come to the forefront whenever the benefits of alternative goals and the risks of alternative policies are to be weighed.

Representative BOLLING. Thank you, Dr. Hickman.

Next is Dr. Thor Hultgren, research staff, National Bureau of Economic Research, Inc.

Mr. Hultgren.

STATEMENT OF THOR HULTGREN, NATIONAL BUREAU OF ECONOMIC RESEARCH, INC.

Mr. HULTGREN. As you suggested in your opening remarks, Mr. Chairman, there is room for a good deal of background in an investigation of this character. In this paper I don't make any direct attempt to explain changes in prices or their effect on stability. I do try to supply some background information that may help in the interpretation of such changes.

The cost of doing business influences the prices business enterprises ask for their services, although it is not the only influence, and fluctuations in cost are not always immediately and fully reflected in prices. Labor cost is an important direct component of cost and it affects the cost of materials. It is also the kind of cost about which there is most information.

In the production of almost any industry, after allowance is made for seasonal and transient influences, we find cycles. Production passes through alternating periods of growth and decline. Does labor cost change in any systematic way during the course of these production cycles? We have information on this point for a considerable number of large industries, although not for the whole economy.

Labor cost depends in part on the number of man-hours paid for per unit of product and in part on the average wages paid per man-hour. Both components are worth examining.

Man-hours per unit usually falls during an upswing, or expansion, as we call it, in production and rises during a downswing or contraction. In other words, labor requirements per unit of product are inversely related to the volume of production.

Average hourly earnings, on the other hand, usually rise during an upswing in production. In downswings since 1932, they have also usually risen, but less rapidly than in the upswings. In severe contractions occurring around 1919–20 and 1929–32, on the other hand, they usually declined.

In expansions, the effect of declining man-hours per unit has been more powerful than that of rising hourly earnings. Labor cost fell in most cases, although not as frequently as man-hours per unit. In the more recent contractions, changes in man-hours per unit and

changes in hourly earnings have worked in the same direction, and labor cost has usually risen. In the severe earlier contractions that I have just mentioned, it seems likely that labor cost fell, although the data on cost are not very satisfactory.

The various industries do not pursue entirely independent courses. There are cycles in economic activity at large as well as in particular kinds of production; at present we are in the downswing of such a cycle. From some points of view, it may be more instructive to measure the changes in cost in each industry between turning points in general business activity rather than between turning points in that industry's own production. In spite of the ties that bind each industry to the rest of the economy, the two kinds of turning points often do not coincide, and computations based on one kind yield rather different conclusions from computations based on the other kind, for several reasons.

The rise or fall in production between turning points in business is usually smaller than the total rise or fall between turning points in production itself. The inverse relation between volume and hours per unit is therefore minimized. Frequently upswings in particular kinds of production are shorter than upswings in business at large. Often an industry has two expansions of output, separated in time by a contraction, during a single expansion in business. The cumulative effect of rising hourly earnings is therefore greater over business expansions than over production expansions. Technological progress tends to reduce hours per unit, and therefore labor costs, in contractions as well as in expansions.

In upswings of business, as in upswings of production, declines in hours per unit predominate. But they also predominate, by a reduced margin, in downswings of business, whereas rises in hours per unit predominate in downswings of production. The weaker influence of falling volume during business contractions, in conjunction with the effect of technology, explains this difference.

In most of our observations, labor cost rises during upswings in business and falls during downswings, whereas in production cycles, cost falls during most upswings and rises during most downswings.

In other words, on a business cycle basis the changes in average hourly earnings are more powerful during expansions than those in man-hours per unit.

The weaker influence of rising volume in business expansions, and the stronger influence of hourly earnings, accounts for the difference on the upswing. The explanation on the downswing is the same as in the case of hours per unit.

All the remarks I have been making refer to the net change during an expansion or contraction. When I say that hours per unit declines during upswings in production, for example, I mean that the figure is lower at the peak of production than at the preceding trough. It does not follow that hours per unit declined steadily from the trough to the peak. In fact, both hours per unit and labor cost frequently reverse their course during an upswing or downswing.

Declines in both are more frequent in the earlier than the later stages of an expansion either in production or in business. Rises in cost are more frequent in the earlier than in the later stages of contraction.

In general, technological progress tends to minimize cylical rises in cost. Without it, there would be fewer net declines during upswings in production, and more net rises during downswings in production. Even an industry with a strong inverse relation between cost and volume sometimes avoids a rise in cost during a shrinkage of production by introducing radical improvements in its basic methods of operation.

Representative BOLLING. Thank you, Mr. Hultgren.

Next is Dr. John W. Kendrick, associate professor of economics, George Washington University.

Mr. Kendrick.

STATEMENT OF JOHN W. KENDRICK, ASSOCIATE PROFESSOR OF ECONOMICS, GEORGE WASHINGTON UNIVERSITY

Mr. KENDRICK. I should like first to point out the important role of productivity advance in cushioning the effect on the general product price level of increasing prices of the factors of production. And in stating this in this way I do not mean to imply that increases in the prices of factors of production are autonomous and pull the product price level up. I am talking about the interrelationships of these variables.

Between 1919 and 1953 the gross private domestic product in current prices rose by 3.3 percent a year, on average, in relation to the physical volume of resource inputs—which gives us a measure of the rise in composite factor price. The general level of product prices, however, rose only one-third as much or 1.2 percent a year on average, because of a 2.1 percent average annual rate of total productivity advance. Total productivity is defined as the ratio of the physical volume of output to the physical volume of all the associated factor inputs: labor and capital—including natural resources.

The 3.3 percent average annual rate of increase since 1919 in total factor price is a weighted average of the prices of labor and capital. It is useful to break down this composite into its two major components.

Average hourly labor compensation over the same period rose by 3.8 percent a year on average, compared with a 1.9 percent a year average annual increase in compensation per unit of capital input. The capital price measure is the product of the average price of capital goods and the rate of return on capital. Since the rate of return on capital was about the same in 1953 as in 1919, the 1.8 percent increase largely reflects the rising prices of capital goods, including land.

The fact that the price of labor—that is, the wage rate, or more properly I should say, the average total compensation per man-hour, including all fringe benefits, went up approximately twice as fast as the price of capital is partly the result of a significant growth in the stock of capital per worker.

The declining relative price of capital has provided the incentive for industry to absorb the increased relative supply of capital into the productive mechanism. The declining relative input of labor, however, was more than offset by the increasing relative price of labor, so that labor's share in the private domestic national income—including an imputed compensation for the labor of proprietors—rose from 72 percent in 1919 to 79 percent in 1953.

Over the same period the percent increase in real average hourly earnings of labor was about one-fourth greater than the percent increase in total productivity—2.6 percent increase in the purchasing power of labor earnings per hour, compared with 2.1 percent at average annual rates. This was made possible by the fact that the real compensation of capital per unit increased by substantially less than total productivity. So long as real capital compensation per unit rises by less than the productivity increase, average hourly labor compensation can rise by somewhat more than the proportionate increase in total productivity consistently with stable product prices.

In other words, the real average hourly earnings of labor went up not only as much as the productivity increase but more, because of the fact that labor got a larger proportion of the national product.

It should be noted, however, that the increase in real average hourly earnings was about the same as the increase in "labor productivity" defined as real product per man-hour, which has risen more than total productivity due to the substitution of capital for labor and the relative shift of workers to higher-paying industries.

Perhaps I should note here that this measure of productivity is a little different from the usual measure where we have output related to man-hours. But I am trying to take account of both major factor inputs—capital as well as labor—because we know that output per man-hour could rise as a result of the substitution of capital for labor—more capital per worker, as well as because of higher productive efficiency as such. And so this measure takes account of that relative increase in capital as compared with labor.

Now, let us look briefly at the picture for the last 9 years—comparing the most recent cycle peak, 1957, with the first postwar cycle peak, 1948. Composite factor price has risen by more than 3½ percent a year, on average. The average annual increase in total factor productivity was 2.1 percent the same as over the longer period. As a consequence, average prices of final products have risen by between 1½ and 2 percent a year—depending on the price index used—or by about half the rise in factor prices.

In one important respect, the experience of the past decade differs from the longer term period. Whereas the average hourly compensation of labor has risen by about 5 percent a year on average in the private domestic economy, the price of capital has actually fallen somewhat, as a substantial decline in the rate of return on capital more than offset the rising price of capital goods. It is true that in 1948 the rate of return on capital was abnormally high because of the postwar capital shortage. But by 1957 the rate of return had reached a level at which continuation of restrictionist fiscal and monetary policies resulted in a decline in investment below the volume consistent with a full-employment level of national income.

This suggests that in coming years—say over the next decade—if underlying conditions of demand and governmental fiscal and monetary policies promote relatively full employment, then we will not have the partial offset to rising prices provided by the drop in the price of capital such as occurred during the past decade.

My point is that we can't push the rate of return on capital much below its 1957 level if we hope to have sufficient incentive to maintain investment at a level consistent with full employment. Therefore, if

we pursue full-employment policies we won't have the drop in the price of capital that we did have in the last decade.

To state it as a conditional forecast: If wage rates rise at the same rate in the next decade as in the past, if total productivity rises no faster than in the past—which I consider to be probable—and if the rate of return on capital remains steady, then the general price level will advance to a more rapid rate than was experienced in the past decade—possibly at a 2½-percent average annual rate compared with the less than 2-percent average annual rate of the past decade.

In other words, I foresee an even more difficult price problem ahead of us if the basic tendencies of the past decade continue as long as we try to promote relatively full employment which is our responsibility under the Employment Act.

There is not time in this opening statement to prescribe the remedies for the inflationary tendencies of this era nor do I have the wisdom to make detailed and certain prescriptions. But most of the papers in the Compendium make it clear that the solution must be sought on both the supply and demand sides of the price equation, and that both sides are interrelated.

Our fiscal and monetary authorities, while attempting to maintain a full-employment level of demand, must not permit effective demand to rise faster than our productive potential. This policy, effectively pursued, will result in a reasonable stability of the rate of return on investment. Avoidance of periods of profit inflation, in turn, may reduce the pressure by organized labor for boosts in wage rates that substantially exceed the secular rate of productivity advance in the economy.

This is the other side of the problem. Based on my statistical studies, I would consider increases in average wage rates in excess of around 3 percent in good years to be inflationary, assuming that the increases in unit costs of a secularly rising national output were accommodated by the monetary authorities by increases in the money supply, or by failure to offset a rising velocity of circulation of money. As large a figure as 3 percent is based on the assumptions (1) that the price of capital will continue to rise by less than the price of labor: (*a*) as capital per worker continues to grow, (*b*) as rising productivity in the capital-goods industries makes possible smaller increases in capital-goods prices than in wage rates, and (*c*) as the average rate of return on capital is held relatively constant; and (2) that productivity will continue to grow at no less an average rate than that of the past 40 years.

If I could add one comment: A very fundamental measure for helping to combat the inflationary pressures would be a conscious attempt to accelerate the rate of productivity advance in the economy; because, as I pointed out, the productivity advance cushions the effect of increasing money demand relative to factor inputs on the general price level.

I don't think this is something that could occur quickly because productivity advance depends on technological progress, on innovation. And innovation, basically, depends on invention of new ways and means of doing things to reduce the cost of output per unit. And invention, in turn, depends on an adequate supply of trained scientists, engineers for research and development work; and obviously such a supply cannot be increased rapidly or overnight. But I think very

basic to combating inflation is an acceleration of the rate of increase in our trained personnel who can devise new methods of production to reduce costs per unit which will increase productivity, and, therefore, help to mitigate the inflationary tendencies.

Thank you.

Representative BOLLING. Thank you, Mr. Kendrick.

Do any of the panelists desire to comment on each others papers this morning or on any of the points made in the papers?

Mr. HICKMAN. There is one thing I would like to say about Mr. Kendrick's last proposal.

It seems to me entirely possible that if you did succeed somehow in raising the rate of productivity advance that you would probably induce attempts by income receivers in the economy to demand a higher money wage increase. I am using "money wage" not just for labor, but for money incomes in general.

In other words, increasing productivity would not necessarily reduce inflationary pressure unless the desires of income receivers about the rate of increase of their incomes over time remained constant.

It seems to me entirely possible if it did become known that productivity was advancing more rapidly, this would simply increase the demand for increases in compensation and therefore offset much of that effect.

Mr. KENDRICK. Of course the increase in productivity would provide the larger increments to output out of which the real incomes of the factors could be increased.

So that if their demands increased, there would be the means of meeting increased demand up to that point. However, I certainly wouldn't want to tie in the desirability of accelerating the rate of increase of technological advance and productivity into its effect as an anti-inflationary force. Because it is even more important as a means of increasing our total production potential, since productivity advance has accounted for more than half of the increase in the total national output in the past.

Representative BOLLING. Mr. Reuss.

Representative REUSS. Mr. Hickman, your stimulating paper suggested a number of questions which I would like to put to you.

Did you happen to read the paper presented to this symposium yesterday by Professor Bailey of the University of Chicago?

Mr. HICKMAN. Yes. I have anticipated that question, I think.

Representative REUSS. How about this: He said "administrative prices; no such thing" and you say "prices of many durable goods are administered."

Mr. HICKMAN. Yes, sir. I don't think he says there are no such things as administered prices. What he implies is that they get chopped away at; that you get periodic changes in basic prices of some sort, and through discounts, extras, and so forth, they, in effect, are undermined. I think most of the evidence he presents deals with price changes during periods of contraction; the assumption being that when demand falls off, administered prices are not strictly maintained, but they get undermined, as discounts are offered, as extra costs are eliminated, and so forth.

I was dealing with changes in prices during periods of business expansion. And I don't think the same kind of smoothing would occur during such periods.

I suppose it is theoretically possible that if you have a measure of real prices, you would find that they were smoothed on the upswing. But it seems to me fairly unlikely that that same degree of effect would be present there.

So that I think mainly, Mr. Bailey's evidence with regard to periods of contraction has little to do with the question of the effect of market structures on price increases during expansions.

Representative REUSS. You also, on this same point of administered prices, comment on the fact that the size of price increases can't be explained simply by the fact that prices of durable goods are administered. You go on to say that demand for the product has a lot to do with it too.

Well, I certainly see that point.

Let me ask you this: Couldn't you state what you have stated there another way, by saying that prices administer a great deal better when demand is swelling? Isn't that when much of the administration goes on?

Mr. HICKMAN. If you mean by "administer a great deal better" the ability to make them stick, I think so. That isn't what I was getting at in that particular page. Often you hear a discussion of whether a given price and wage increase is or is not inflationary based on the profit prospects in the particular industry in question.

The argument is that in a given industry an increase in wage rates is or is not inflationary because profits can or cannot permit it to be undertaken in that industry. The point I would like to emphasize is this: that if you get wage increases in administered-price industries, that makes possible an attempt to set wages and prices at a higher level without the need for a previous increase in demand.

Although, if demand is expected to be higher, I think this will certainly influence the size of the increase which that industry tries to make stick.

Given that fact, then, if you have a profitable industry in which prices are administered, and in which labor is organized, it is entirely possible that you will get an increase in money wages and in prices which will be made to stick in the rest of the economy; if the necessary expansion of demand comes there.

Representative REUSS. I would just like to pursue one other line. Let's go a little farther forward in your paper in the compendium, on page 207, where you say that the inflationary bias of the postwar American economy is due to its institutional framework, both in starting and in preventing the stopping of inflationary pressures.

I hope I am not just quibbling about words; but I would like to ask you whether you really think that this gloomy conclusion—at least I think it is a gloomy conclusion—is inherent in the institutional framework; or whether it is not, in large part, the result of the fact that the men who run the institutions make some wrong decisions, or don't make decisions at all.

Before you answer, let me give you an illustration of what I mean.

If you would go on to page 208, you talk about the fact that the inflationary bias is strengthened and propagated by reason of the management of the money supply.

Mr. HICKMAN. No. The way it is managed.

Representative REUSS. The way it is managed?

Mr. HICKMAN. Yes.

Representative REUSS. It seems to me in the last 3 years that the trouble was not with the management of the money supply entrusted largely to the Federal Reserve, but with some manmade decisions by other people in Government.

While the Federal Reserve was trying to effect quite manfully the creation of bank credit, which is its particular bailiwick, other branches of the Government were issuing rapid amortization certificates like mad; were altering the tax system in favor of expansion of capital goods; were allowing consumer credit, housing credit, and many other aspects of policy (fiscal, tax, and credit) to go really in a direction counter to the monetary policy.

Therefore, is it fair to say that the trouble is with the institutions? Isn't the trouble with the way the institutions have been run? And why can't we, with our existing institutions, do a better job by making more sensible decisions?

Thank you for waiting this long on my question. I would like an answer, though.

Mr. HICKMAN. All right. Fine.

I think it may consist of several parts, but I will try to answer as best I can.

On this question of management of the money supply, I put that in really for professional peers.

The point is that if you had, say, a gold standard with considerably less discretionary authority on the part of monetary authorities, that would imply certain things about the behavior of the economic system which are not implied when the money supply is managed.

When it does come to the question of the management of the money supply, as I pointed out, the money supply is managed with regard to domestic stabilization objectives.

In other words, there is a discretionary kind of control. I didn't mean to imply criticism of the Federal Reserve System about the way in which they have managed the money supply. What I was trying to say in effect is that theoretically it would be possible to curb price increases by sufficiently rigorous monetary policy, but that this would imply certain dangers with regard to the behavior of output and real income. Further, since the monetary authorities are interested not only in preserving price stability in terms of constancy, but also in promoting full employment and economic growth, that they are likely, and I hope will continue to be likely, to err on the side of too little restraint in the sense of curbing price increases. I think a monetary policy which was tight enough to stabilize the average price level during a period of cyclical expansion would probably be sufficiently restrictive to bring about a contraction in output.

Representative REUSS. Do you think the Federal Reserve in the last 2 years—I am just talking about the Federal Reserve, not the rest of the Government—do you think the Federal Reserve in the last 2 years erred on the side of——

Mr. HICKMAN. Too little restraint?

Representative REUSS. Yes.

Mr. HICKMAN. Yes, by definition. We have had price increases of several percent per year. That could have been prevented.

Representative REUSS. Except that the Federal Reserve isn't the— the Federal Reserve, which has its impact only on a small part of the

economic structure, namely, the commercial banks, and not all of them—the Federal Reserve isn't the sole reliance that this country has against inflationary pressures, I hope.

Mr. HICKMAN. No, it is not. But it is, I think, true that there is a degree of restraint on the money supply, which if exercised would prevent price increases.

When I say they err on the side of too little restraint, I mean that they did not invoke that degree of monetary restriction. And perhaps I shouldn't use the word "err." I am not trying to imply criticism. As I say, I am pleased that they didn't try to be so restrictive as to prevent price increases.

When I used the word "err," I really had in mind the fact that forecasting is very difficult; that it is extremely difficult to adapt policy actions to the economic situation; and that, therefore, you always act in a field of uncertainty when you take policy actions; and that it is better, if you are uncertain about what is going to happen, to err on the side of not overdoing the things.

And in this case that would mean not overdoing a monetary restraint to try to prevent price increases.

Representative REUSS. But apart from the Federal Reserve's conduct in the last 2 or 3 years during an inflationary period, do you think that the other economic decisions taken by the Government in the field of taxation, in the field of rapid amortization, in the field of those governmental agencies other than the Federal Reserve that have to do with money and credit, and, in short, all fiscal and credit and spending and taxing fields, other than the purely monetary field of the Federal Reserve, do you think that those policies were adequate?

And if you don't think they were adequate, do you think that their inadequacy is the fault of institutions or the fault of those who happened at that particular time to be in charge of the institutions?

Mr. HICKMAN. That gets us back to the institutions, which I never did answer; did I?

I really am not prepared to give an opinion on recent fiscal actions taken by the Government. I haven't studied the question closely enough.

This paragraph to which you refer on monetary policy also mentions fiscal policy in passing. I was thinking here just in terms of the general attributes of the postwar economy, not in terms of any particular episode. I think that since we are committed to a policy of growth stimulation, of full employment stimulation, that this does mean, in effect, that during periods of business expansion we will tend, and should tend, in my view, to err on the side of too little restraint to prevent price increases.

Now, as far as institutions versus men, I think I see what you mean there; and I must say that I am using "institution" in the sense not only of formal organizational structure, but also in terms of the actions of the men who guide the institutions. So that the actions of our Government institutions in total, I think will be, as I have already said, in the direction of perhaps properly erring on the side of too little restraint, to curb price increases during business expansions.

I think organized labor will tend to demand money wage increases during business expansions. I think administered price industries

will continue to pose this problem that such demands can be met and the attempt can be made to have wage-price increases; and then you can wait and see whether they stick or not.

It was in that context that I was thinking in terms of our postwar institutions.

To put it a little bit differently, I think that you would have different price behavior in the postwar American economy if all industries were purely competitive; if there were no labor unions; and if you had a completely automatic monetary system, for example.

And it was in contrast to those things that I was speaking.

Representative REUSS. Then, if I understand you, Mr. Hickman, you were largely describing what has happened; and you were not necessarily saying that given our governmental institutions, the Executive, the Congress, the Federal Reserve, et cetera, that it is beyond the capacity of mortal man to come to grips with the extragovernmental institutions and corporations that administer prices, labor unions which make wage increases in excess of productivity increases, et cetera.

Mr. HICKMAN. Yes; as I pointed out in the introduction to the formal paper itself, I was not directing myself, to the question of whether the going institutional frameword should be changed, or what should be done, but only in analyzing behavior in the past.

I do think there are certain implications of that analysis. And in particular I think since my analysis was essentially focused on the proposition that price, output and employment effects are intermixed, that one point does emerge—and that is that you can't have the best of everything. This is entirely possible; and you will have to resolve alternative policy goals and choose among them.

I think that my own bias, which is fairly clear from the paper, is that I would not want the choice in the direction of price stability to be so overriding that it created dangers through Government action of creating unemployment or inhibiting economic growth.

Representative REUSS. Thank you, Mr. Chairman.

Representative BOLLING. Mr. Kilburn.

Representative KILBURN. Mr. Kendrick, in your paper, you didn't say anything about a question that has always seemed to me to be a difficult one to settle. And that is supplying capital. I remember several years ago reading about some witness here who was very, very wealthy. And he said he didn't pay a cent of income tax. He got it all through, of course, tax-exempt bonds.

If you could set—I don't know how you could do it—but if you could set a tax rate on wealthy people like that to where they would put some of their money into venture capital, common capital stock, I should think it would be a great help to our whole economy, if you think capital is scarce now—and I think that it sometimes is.

Mr. KENDRICK. I didn't mean to imply that capital is scarce, but that actually our saving habits are such that we have been increasing our capital stock more rapidly than we have our labor supply. And as a result of that, the return to capital has tended to remain relatively stable over longer periods; whereas, the wage rate has risen considerably.

And all I am saying is that those relative trends in the prices of labor and capital are a result of the relative supplies. It is the increasing abundance of capital and a growing relative scarcity of

labor which has made possible the considerably greater increase in wage rates than in the price of capital.

However, I certainly agree it is important to have a sufficient rate of return and a sufficient attractiveness of investment so that we have enough of it to maintain our economy at a high level, and that is why I don't think that we can afford to see any further reduction in the rate of return on investment compared with 1957, because it will probably bring us into the sort of situation we are in today in which we do not have sufficient private investment.

I am sure that in that connection the tax structure is very important and certainly one of the approaches necessary to an increase in productivity is a tax system which will give an incentive to venture capital.

Representative KILBURN. One other question is: Mr. Hickman, just what does the Brookings Institution do?

Mr. HICKMAN. It is a nonprofit research institution which does research in the areas of economics, international affairs, and government.

Representative KILBURN. If it is nonprofit, who furnishes the money?

Mr. HICKMAN. It stems from an endowment left by Mr. and Mrs. Brookings, the income from which furnishes a considerable fraction of its financing.

It is also financed with foundation support.

Representative KILBURN. This probably isn't pertinent to this inquiry: but do you sell your letters, or what?

Mr. HICKMAN. There is no research done on contract, except the research done by the institution for Government agencies at Government request. I think Brookings did one of the recent studies, for example, of foreign lending, where Congress had a series of studies made.

But aside from that, it does not do contract research.

Representative KILBURN. Then you don't have any income except from the endowment?

Mr. HICKMAN. That is right. The endowment and from foundation sources.

Representative KILBURN. I was interested in this because near where I live the Brookings Institution has torn down a lot of buildings and is going to build a big office building up on Massachusetts Avenue.

Mr. HICKMAN. Yes. Unfortunately our present building is on Lafayette Square and it was purchased under the Lease-Purchase Act. So we have to move. It will be torn down eventually to make room for an executive office building.

Representative KILBURN. Thank you.

Representative BOLLING. Mr. Danhof, in your statement, toward the end, and last paragraph, you indicate a strong feeling that we just don't know enough to really——

Mr. DANHOF. I don't want to make that a "we." I will make it just an "I."

Representative BOLLING. Well, I would like to join with you.

But, could you be a little more specific as to what types of things have to be done before we might know perhaps nearly enough?

You indicate "further study of cost, price, price income", and so on.

But I am chairman of the Subcommittee on Statistics and over a period of some time we have been trying to get the Congress to improve governmental activities in the statistical field.

I am curious as to how much of this problem is in the raw material field, the statistical field.

Mr. DANHOF. Well, that is a very sweeping question. I have had a number of conversations in the last few weeks with a member of our staff at Tulane who is in charge of putting into use a complete set of computing machines intended primarily for servicing private business. He faces some very difficult problems because the kinds of data that private business keeps have been developed from the point of standard accounting practices. He feels that in many cases this information is not the kind that is going to lead to useful applications of the computing devices to business problems.

I am not prepared to answer you question in detail because the problems of programing and computing research projects are extremely complex, highly technical, and I am not informed.

But I said somewhere in the latter part of my paper, that we need data on prices, including of course factor prices, on returns which I suppose we could call gross profits at this point and we need them at frequent intervals. And we need them in a consistent fashion.

One of my frustrations in working over the historical statistics is the fact that so frequently you have to doubt that the data you work with are consistent and accurate. And doubting their consistency or accuracy you simply cannot draw significant conclusions from them.

Now, this has changed enormously since the early thirties. But it is my feeling that a tremendous amount of work still remains to be done by the professional statistician, which I am not, let me say.

Representative BOLLING. Now, further toward the end you mention the suggestion by Professor Ackley of the establishment of a wage and price commission. I think you indicated that you were not necessarily supporting that suggestion, but just commenting on it.

I would like to get some comment from the panel on that point, the pros and cons of the advisability of such a commission. I have just finished reading last night, the first report of the Cohen Commission in the United Kingdom. And without having any awareness of its impact on English politics, on England, or the English economy, I found that it was a very useful little document from the point of view of my understanding of their situation. And I would like to get some further comment, if I might, on the possibility or the advisability of such a commission; or if there are institutions that you think already exist that might serve the purpose of such a commission.

Mr. KENDRICK. I haven't read Professor Ackley's paper. Was this a proposal for an investigative commission or one with some regulative function?

Representative BOLLING. I will read the paragraph.

Perhaps one approach might be for the Congress to establish a permanent wage and price commission charged with the responsibility of (*a*) formulating general standards for noninflationary wage and price decisions, (*b*) collecting the information necessary to apply these standards to particular strategic proposed increases in wages and prices, and (*c*) making public its findings.

I would supply the commission with the power of subpena and adequate economic staff and authority even to require temporary postponement of specific wage and price increases pending the commission's study. I do not see the commission as having any authority to establish legal maximum wages or prices,

but merely that of expressing in as concrete terms as possible its dispassionate and documented judgments as to what the general objective of price stability might seem to require in the settlement of specific issues.

That is the most pertinent paragraph. There is further discussion.

Mr. HICKMAN. How does that differ from factfinding procedures, arbitration procedures, mediation procedures, under our existing setup?

Representative BOLLING. It would seem to me to differ in that it would be a continuing process, and, presumably after the commission had been underway for a time, it would be an anticipatory process, rather than a process whereby the mediator came in at the crisis stage.

I perhaps misinterpreted the paragraph, but it would seem to me to be designed to make available to the public and to policymakers and so on, a continuing indication of what the circumstances were and what might happen if so and so happened.

I don't want to pursue it if this is awkward for anybody.

Mr. DANHOF. May I just suggest that I think I am going to join up with what seems to me to be the majority of the panel in feeling that in considering the problem of stability we must put it in secondary place to the problems of growth.

There are bottlenecks in the growth process also. And I would envisage a commission of this kind having responsibility of identifying and giving publicity to such bottlenecks.

Specifically—and this may be relevant to the interests of the committee, but let me make the comment—specifically what is the role of small business in technological advance and what is the role of fiscal policy with regard to the capacity of small business to accumulate necessary capital?

Now, this is a controversial area. It is extremely difficult for anyone to do anything definitive with it. That is, for any individual to make a real contribution to the problem because of the lack of data which is pertinent, revealing, and consistent. A commission, such as Professor Ackley suggested, might be able to contribute to solving the problems of statistical data and thereby help give us a little better understanding of the growth process of our economy. At the same time, I don't want to exclude the problem of stability at all.

It is part of the picture.

The question is whether we have to secure technological progress with quite the high degree of price inflation which has characterized the last decade or so.

Representative BOLLING. Mr. Hickman.

Mr. HICKMAN. I haven't thought about this proposal very much. But it seems to me if it were established as some sort of permanent commission with public recognition that it was interested in stabilization policies, that this would quite possibly raise pretty severe problems with respect to the relationship of that commission to the Federal Reserve Board, to the Council of Economic Advisers, and so forth, and who are also concerned with stabilization problems. That is how it differs with the mediation framework, where presumably something is done with respect to the merits of individual wage cases, if that becomes desirable.

But a commission of the type proposed sounds like one which might carry a considerable authority as a stabilization body. And I should think in view of the problem raised before—that is, the potential

conflict between price stability objectives and other desirable social goals—that if there were such a commission, it would have to be very carefully worked out as to how it would relate to the other stabilization agencies.

Representative BOLLING. Of course that comment raises the question the commission has already raised in my own mind—the problem that we clearly have in this country today.

We have a number of institutions and agencies which deal with different aspects of the same problem. And to the best of my knowledge only two institutions are designed to deal with a whole range of general economics at the governmental level—one is this committee and the other is the Council of Economic Advisers.

Obviously the Treasury has some concern. Housing and Home Finance Authority has certainly a large impact, and so on, and so on, and so on.

The reason I asked the question was more to get negatives than to get positives, because my own judgment would be that our own problem is to develop an institution which is more effective in dealing with the whole wide range of problems of growth and stability than any of the institutions that exist today are.

Mr. HICKMAN. If you want negatives, I will vote with you.

Representative BOLLING. Well, I got them anyway.

Now, I would like to ask another question. It is a very general question; but I think perhaps it may be a critical question.

You are all familiar with what most recently has been said by Allan Dulles of the CIA comparing the growth of the United States economy with that of the Soviet Union, particularly in the last 10 years. And no doubt you are familiar with the report of the Rockefeller Brothers Fund—the second one, the one, not on security, but on economics—in which they at least suggest that because of our investments already made, it may be necessary to achieve a growth in the economy at an annual rate of about 5 percent a year as opposed to the average of the last—whatever number that is—34 years, of about 3.3 percent, if I transfer this correctly. What is your thinking as to the possibility of having reasonable stability with a growth rate in that order?

Or am I taking you too far afield? I don't want to be unfair.

Mr. KENDRICK. Personally, Congressman Bolling, I do not feel that the goals of stability and growth are inconsistent. Mr. Danhof a few moments ago said that he, along with the majority of the panel, would put the requirements of growth ahead of those of stability.

I don't think that they are inconsistent necessarily and that we could have reasonable stability even with a 5 percent growth rate as compared with 3½ percent now.

First let me say that I am not at all sure that we could achieve a 5 percent growth rate. I think it is a desirable objective. And the major way of obtaining it would have to be through greater productivity increases. Because the increases in our labor force are pretty well determined for at least the next 14 to 18 years or so by the births that have occurred, although there is the possibility, of course, of not reducing hours further than they are at the present time, which has been an offset to potential growth of output.

And there is also the possibility of increasing our capital stock even more rapidly in the future than in the past. But this would require

an even stronger level of investment demand to absorb the saving which people would wish to do at full employment levels and the even larger saving that you would try to implement in order to get a greater growth of capital and thus a larger output.

But I think the major method for achieving this higher rate would be productivity advance which is already rather rapid in this country; more than 2 percent a year is high, compared with other countries.

And one other prefatory comment is that the Russian growth rate reflects the fact that it is still far less developed, overall, than the United States. And many industries are in this early phase of growth at which rates are higher than they become at a more mature stage.

Now, as to the achievement of stability with the higher rate of growth, the problem is basically the same as it is with the lower rate of growth. And that is one of preventing effective money demand from rising faster, on the average, than the capacity of the economy is increased.

And this is largely a matter of monetary and fiscal policy, I believe; although we do have the phenomenon of semi-autonomous price and wage increases which may aggravate an inflationary tendency. And in this connection, I would like to take issue somewhat with Mr. Hickman, who, it seems to me, overstresses the fragility of the business-cycle expansion.

He is afraid for the monetary authorities to act vigorously in the expansion to hold down the increases in money demand to the rate of increase in output, because of fear of reversing the direction of the economy.

We all know that business expansions tend to be cumulative processes. They are fairly durable. They tend to last on the average of 2 to 3 years.

And the cumulative momentum is such that I don't think we have to worry too much about halting it prematurely, particularly if the measures are well-conceived, obviously. But it seems to me the crux of preventing secular inflation is taking the necessary steps to slow down price increase in the expansion period because of the famous ratchet action of prices and costs which I am sure you are well acquainted with by now.

But briefly, as I conceive this ratchet, it is as follows: During the expansionary period of the cycle, we do get demand running ahead of capacity in the later stages with a tendency toward price increase, and, of course, labor tries to increase the wage rates not only to keep up with the cost of living but to get something more than enough to maintain their real purchasing power .

And insofar as these wage rate increases exceed the productivity increase, this further pushes costs and prices up, assuming the basic demand situation is strong enough for prices to go up to cover the increased labor cost at this point.

Now, at the end of the expansion we find wage rates typically have risen more than productivity increase. Profit rates have also risen a great deal since the bottom of the cycle. But in the business contraction, the profit rates fall, while the wage rates stay up.

In the next expansion profit rates rise again back up to the level they were in the previous expansion but wage rates have gone considerably higher than they were at the previous peak of the boom.

So that as a result of the inflexibility of the wages on the downside and their tendency to rise more than productivity during the expansion, we have a secular inflation problem.

Therefore, it seems to me the crux of the problem is trying to curb the expansion of demand in the business cycle expansion—and that means in the second phase of the expansion after you have gotten up near the limits of capacity, after which the economy usually goes along near capacity for another year or year and a half, or so, before contraction eventually sets in.

It is particularly important in that phase for the reason that Mr. Hultgren mentions. In the early phase the productivity increases usually are quite rapid; more than the secular rate.

From 1949 to 1950 we had a total productivity increase of over 6 percent coming out of that contraction.

In 1954–1955, the productivity growth was over 4 percent coming out of that contraction.

So that in the first year, the reduction in labor costs per unit is enough generally to offset or more than offset the rather weak increases in wage rates at that point, because there is still unemployment.

But in the latter phase where there is low unemployment and you are near capacity, then is when the continued expansion of demand can create the price increases which tend to be irreversible because associated with large wage increases and thus give us the secular inflationary tendency.

And I think that part of the problem is that the monetary and fiscal authorities at this phase of the cycle should be tougher, should be more restrictionist.

Recently I heard Chairman Martin, of the Federal Reserve Board, say that his only regret was that they didn't tighten credit more during the recent boom than they did; because by so doing some investment projects would have been deferred until later, which is one of the functions of monetary policy, to cut out some marginal investment projects which can later be undertaken when interest rates are more favorable.

So I would recommend a tighter credit policy in the expansion period as the chief method of achieving this stability, even with the 5-percent growth of output rate.

Chairman BOLLING. Do you limit yourself in this credit policy to the tools that are already available, to the tools of monetary and fiscal policy?

It seems to me for a number of years that the points that Mr. Reuss, in effect, raised were very important and very pertinent. I am not at all clear that we have adequate tools. It would seem to me that we had a built-in breakthrough in monetary policy, in the restraint in the kind of credit policies we had. The simplest illustration is that the average person buying a car doesn't pay very much attention to what the car is going to cost him. He pays attention to what the monthly payments are going to be.

The same thing is true in housing. And I think that the other point that Mr. Reuss made is also very pertinent, that this particular recession, for example, is generally conceded to be more than an inventory recession—a capital goods recession, and that we had preceding it a rather wild boom, in part brought on by certificates of necessity for accelerated amortization in capital goods investment.

It would seem to me that there is a very serious question as to whether monetary and fiscal policy—and I put here in parentheses that we have yet to arrive at a general acceptance of the use of fiscal policy on the upside, although we talk a good deal about it on the downside—it would seem to me there is a serious question that even if we used monetary policy ideally—and the Congress in this case used fiscal policy perfectly—that both of those together would be enough to do the job.

Mr. KENDRICK. I think they could be used even more effectively than they have. I think they are very powerful tools. Although I would certainly say that all the tools in our kits should be used in this inflationary expansion period.

For example, I think higher interest rates than we had in the latter phase of the recent boom would certainly have reduced the investment, the business investment, to some extent.

There are always some projects which are marginal at existing rates and could have been cut down. And this would have helped.

You mentioned the fact that the consumer looks at his payments on big ticket items more than on the interest he is paying for his consumer credit. But the Federal Reserve Board has the authority, the latent authority, to control the terms of consumer credit—I mean it did have or could be given that power.

Representative BOLLING. The interesting point is that when it came to the question of extension of that authority before the House Committee on Banking and Currency, all the votes were against extension except one.

Mr. KENDRICK. It seems to me in certain expansionary periods the use of consumer credit controls would definitely be indicated where there is a big wave of buying of consumer durables—to cut that back.

But I think we have enough tools in the kit to cushion inflation. It is just a matter of their use.

Representative BOLLING. Mr. Hickman.

Mr. HICKMAN. I would like to comment on 1 or 2 things that Mr. Kendrick said, particularly since he referred to my position on this.

I am not sure just exactly how far apart we are on this. It may be partly a matter of language.

First he points out that business expansions tend to cumulate and they are pretty powerful. They have been historically. I think he is quite right on that. But I don't think he is right in saying that they would be as cumulative and durable if you had an absolutely tight monetary policy. The expansions of the past have been facilitated by an elastic money supply and by a lack of the kind of really vigorous action that could have been taken if they actually wanted to curb those expansions.

There is no doubt in my mind that there is some degree of monetary restraint or fiscal restraint or any specific kind of tool with which you want to hit any particular sector of the economy, which, if employed powerfully enough, would prevent price increases.

But I do think that it would be entirely possible that to employ that degree of restraint during a business expansion would quickly convert that expansion into a contraction.

I think we ought to be a little more definite on what we mean by stability during the expansion. I don't want to argue that I don't want to see anti-inflationary actions taken. I do think that if the

policy were defined as rigorous stabilization (constancy) of the Consumer Price Index, or the Wholesale Price Index, that the rigor of action necessary to do that would prevent physical expansion or would bring about a contraction.

Perhaps the ideal goal is to have monetary demand increase just enough to finance the increased rate of total output which is made possible by population growth and technological advance at a stable price level.

That is, that is an ideal situation given certain assumptions about what you want in the way of price stability.

But even if it were granted that that is what you want—namely, absolutely stability of the price level—which I don't think I am willing to grant; but I will for the sake of argument—I think trying to achieve that during business expansions would require a degree of restrictive policy which would be in conflict with our full employment and growth goals.

If it comes down to a question of employing anti-inflationary policies in an attempt to curb the expansion and to curb price increases, that is fine.

But I would still rather see it done on the side of too little rather than too much. Because I rate the goal of full employment and output increase as above that of price stability.

Representative BOLLING. Are you saying in effect that in order to have full employment and a reasonably adequate growth rate—whatever that may be—that we inevitably must have some inflation.

Mr. HICKMAN. I am not saying it from the standpoint now of the debate over whether this is necessary for the achievement of growth or stability as a result of individual choices. That is, I am not arguing from the premise that you need price increases in order to stimulate that amount of voluntary investment or other expenditure needed to maintain growth.

What I am saying is that if you do have a bias toward price increases during business expansions—as I think you do—then a degree of monetary restraint or fiscal restraint which was sufficiently powerful to prevent any increase in the price level would be too powerful to permit the continuation of that business expansion in physical terms.

That is a different argument than the question of whether you need a price increase as a possible good.

Representative BOLLING. Doesn't that make it all the more important to examine with some care the possible other tools that might restrain price increases?

The idea has been that even with the most responsible and skillful use of monetary policy that they have demonstrated about 4 or 5 years ago that they did not in themselves have the capacity to continue growth with satisfactory stability and that, therefore, it is incumbent upon us both, in the profession and otherwise, to see if there were not other tools that would more satisfactorily achieve the goal we all agreed on.

Mr. HICKMAN. I don't know if you are calling for a response. I would certainly be in favor of using such procedures if they were thought to be generally consistent with whatever goals you have.

There is a danger of proliferating the kinds of controls—making them too specific, beginning to interfere excessively in that kind of approach.

Representative BOLLING. I have been careful to mention specifically the controls that I thought might be attempted, such as consumer credit. And I am not second guessing on this. Senator Douglas and I a long time ago had a footnote in which we questioned the soundness of the certificates of necessity for accelerated amortization on a long-range basis and made the suggestion that we might study what happened in Canada.

I don't want to belabor this. There seems to be a terrible resistance, not necessarily on the part of this panel, on the part of a great many people to explore methods of restraining inflation other than monetary and fiscal.

I am not getting into the much more controversial area of direct control. That is something we can leave for another discussion.

Thank you very much.

Dr. Talle.

Representative TALLE. Mr. Chairman, I want to say to the panel that I am sorry I couldn't be here earlier. My time is being divided between the Committee on Banking and Currency and this one. That is the best I can do under the circumstances.

How far afield am I permitted to go, Mr. Chairman?

Representative BOLLING. As far afield as you can reach, Dr. Talle.

Representative TALLE. Well, I respect the very fine academic standing of the gentlemen on the panel. And I am tempted to raise a question about the institution we call interest. I am keeping in mind what was said about it in the Old Testament, the judgment of the Roman Senator Cato and what the Lombards and Goldsmiths did down through the Middle Ages.

Is not interest a price?

Mr. DANHOF. I will lead out on that one. Yes, of course.

Representative TALLE. That is what I have always thought. It seems to me there is a tremendous reluctance to recognize that it is a price. It is somewhat like increasing the price of a postal card from 1 cent to something else, or our present 3-cent stamp to 4 cents. There is a strong public resistance to the increase of certain prices.

Now, is that not true of such a price as interest? Is there not a tremendous resistance to an increase in that price as against a good many others?

You have mentioned automobiles and some other things.

Mr. DANHOF. Well, you mentioned the public. Frankly I wasn't aware that the public seemed to have any deep antagonism to the changes in the price of money. Some governmental agencies have.

Representative TALLE. I think some Members of Congress have shown such reluctance. We talk about it, I guess, almost every day here. We have this year certainly.

Mr. HICKMAN. Independently of the question of public attitudes on this, I would like to point out that while interest, or rather the structure of interest rates, is a price, it is a fairly important price from the standpoint of what happens in the economy.

So that presumably the question of the choice of the price, of the interest rate, should really depend upon the question of what your

goals were for the economy. And it is not really a question of whether interest rates are or should be high or low in some absolute sense, and forever.

It is a question of how they should be altered in order to achieve whatever objectives you have in mind from a policy standpoint.

And it is entirely possible for changes to occur in the economic environment over time that would require changes either up or down in interest rates in order to try to promote more desirable performance on the part of the economy.

So I think it is important to recognize that the interest rate is a very important price in the sense that it is a symbol of the degree of credit availability.

And it may have some independent influence as a cost element affecting business decisions.

So it is not like post cards. It is a much more important price in the economy.

Representative TALLE. Do you believe that John Maynard Keynes overemphasized the importance of the interest rate?

Mr. HICKMAN. I don't think he overemphasized the importance of the interest rate during periods of unemployment of the type of the 1930's. I think he may have overemphasized it as a general control tool for dealing with expansions as well as contractions. But for the essential point he was making; namely, that the economy can get into circumstances where no matter how vigorously you act with monetary policy, you cannot drive the rate of interest any lower; and, therefore, you cannot stimulate investment any more. I think he was quite right in his emphasis. But that is for the particular circumstances of substantial underemployment situations when expectations are very low and investment is low and so forth.

Mr. KENDRICK. The importance of interest as a price is indicated by the great resistance you have on the part of many segments of the population to increases of the interest rate during prosperous times.

Very few people criticized the Federal Reserve Board for not raising interest rates more 2 years ago. But now they are being criticized for not having acted more vigorously for restraining the boom; but at the time when it hurt they were not being criticized for holding interest rates too low and not increasing them.

Representative TALLE. Thank you. There is still another gentleman to be heard from.

Mr. HULTGREN. I would like to say this: I think there is a tendency to assume that the interest rates are the only thing that is important in this matter, demand for new plant and equipment, and so on.

I think as suggested in Mr. Hickman's paper, we occasionally get into situations where people are just pretty well fixed up with plant and equipment for the time being. And I think that, as well as the interest rate, is a factor in how much capital building activity we have.

Representative TALLE. I have a feeling—and I may, of course, be in error—that in the minds of some people on Capitol Hill the interest is not thought of as a price, but as something else, which I won't attempt to define.

Thank you, Mr. Chairman.

Representative BOLLING. Mr. Reuss.

Representative REUSS. I have one further question on the subject raised by Mr. Bolling; namely, what does the panel think of the sug-

gestion that it might be well that there be a commission of some sort to give publicity to proposed wage and price increases in strategic areas and thus supplement monetary and fiscal policy as anti-inflationary tools.

The only objection I heard voiced from the panel was that by Mr. Hickman, that this presented some institutional complications, particularly with regard to the Council of Economic Advisers. I would like to ask Mr. Hickman whether it might not meet his objection if these anti-inflationary powers were to be given to the existing Council of Economic Advisers, perhaps beefed up by additional staff and whatever else is needed.

Wouldn't that overcome the diffusion that you were worried about?

Mr. HICKMAN. Yes. It would overcome the question of the possible conflict between the goals of an independent commission, which would obviously have to be concerned primarily with wage and price behavior in this instance, and the general goals of the Council with respect to the behavior of not only prices but also employment, output, and other relevant matters.

So that if it were considered necessary to give expression in some organizational sense to a concern over wages and prices in specific industries, I would prefer to see this done by some organization like the Council of Economic Advisers rather than an independently created commission for the same purpose.

I personally would—well, if it is to be any more than a general study group, I would want to think very carefully about its intrinsic desirability.

If it is just to be a study group making recommendations, this, then, falls into the class of exhortation; and I am not too convinced that this is a particularly effective tool for achieving stabilization objectives, although I suppose under some circumstances it could be.

But if there is to be a great deal of concern about wages and prices in specific industries expressed through some Government organization, I think that you would have to be quite careful about how it operated.

Representative REUSS. I think that to do Professor Ackley justice, he does make it clear when he says that the commission which he recommends "would avoid any effort to become a mediation or conciliation board."

It seems to me this to a degree at least meets the objection you were envisioning.

Mr. HICKMAN. I should think so, only to a degree if it is to be a permanent commission. If it is to be a permanent commission with some influence on economic affairs it has not to exert this somehow. If it exerts it via publicity, this would certainly be a more neutral way, a safer way, in a sense, of dealing with particular sectors of the economy than if it had some sort of enforcement power.

Representative REUSS. That is the proposal.

Mr. HICKMAN. I thought there was something else about being able to defer strikes and that kind of thing, which I thought was part of the Taft-Hartley procedure now in national emergency cases. I am not up on that field.

Representative BOLLING. It might even have the power to enforce postponements.

Mr. HICKMAN. If it is just a study commission, I don't see just what you are doing, except giving wages and prices more standing as a stabilization objective, which you already have going in the Government.

The Council does pay attention to wages and prices. They make recommendations—that is, the President makes recommendations in the economic report; asks groups to use restraint.

Representative REUSS. In general only, though.

Mr. HICKMAN. That is right.

Representative REUSS. Is there any evidence that anybody has paid the slightest attention to those exhortations?

Mr. HICKMAN. No.

Representative REUSS. If so, I haven't seen it.

It is the thought of the propounders of this proposal that specific ad hoc publicity on a given wage or price increase might bring to——

Mr. HICKMAN. It might be possible in singling out groups and in a sense putting them on a spot, to accomplish something by moral persuasion.

I think you are right there. It is a matter of weight of public opinion and what they could do to counteract that if they wanted to counteract it, or ignore it if they wanted to ignore it.

Representative REUSS. Thank you, Mr. Chairman.

Representative BOLLING. In connection with that point, it is obvious that the structure already exists for this particular type of moral persuasion.

The President could give extensive publicity to the question.

Mr. HICKMAN. I think the question would be what criteria would the committee use in establishing their recommendations. And this would be a very difficult and complicated problem of economic analysis. A general recommendation might be wage increases no more than equal to the average increase in productivity in the economy.

But I don't think anyone is willing to specify what that figure will be at any given time or for the next year or two, or something like that. One could specify that it would be likely to be high or low; and that it would be best not to have a certain degree of wage or price increase.

But I don't think you could go too much further than that without—well, not on scientific grounds, you couldn't go much further than that.

Mr. KENDRICK. If I may break in—regardless of whether we can specify precisely the wage increase which is consistent with stable prices, we can do so within a sufficiently accurate range so that we know when given wage increases are clearly outside of that range.

I suggested 3 percent as a round figure beyond which wage increases tend to be associated with inflation. But I think it is clear that something over 5 percent—that is, over 10 cents or so in terms of current average hourly earnings—that these would undoubtedly tend to increase unit costs of production.

And the only function of this proposed wage-price commission that I can see is the one of increasing the pressure of public opinion against such obviously inflationary types of wage contracts between big corporations and big unions which are to the detriment of the public interest.

Otherwise, we have the mechanics for studying the price problem. These hearings are an excellent example of the type of study which can be done. Whereas, in a commission you would have all sorts of institutional pressures to try to get a line on the part of the commission which would obscure various differences of opinion among individual analysts, and so on.

Representative REUSS. Well, unless you are prepared to say that all wage and price increases are acceptable—which I am sure we are not—it seems that public opinion can have some useful role to play here. Wouldn't you agree?

Mr. KENDRICK. Definitely. And I think this commission could focus attention and increase the public pressure toward wage increases consistent with stable prices. That is the chief function I see in it.

As Congressman Bolling said, there is a means for accomplishing that result at present.

Representative BOLLING. Dr. Talle.

Representative TALLE. Now that I have you gentlemen at my mercy, may I ask another question?

Is it not true that there is a considerable difference in the lag as between a change in manufacturer's prices and wholesale prices, and the lag between wholesale prices and retail prices?

Isn't the latter a considerably longer period than the former?

Mr. KENDRICK. That is very true. The retail prices tend to lag. And in the contractions of business activity they often continue to go up for some months after business has turned down, although I think the present recession is probably abnormal in that the Consumer Price Index has gone up for more months than it typically does in a contraction period.

Mr. HULTGREN. The farther back you go from the finished product, the bigger the fluctuations in prices get. That is speaking generally.

Representative TALLE. I am thinking of the lag, particularly, between changes in wholesale prices and retail prices.

Isn't it true that retailers are reluctant to mark down prices which they have set on goods already on their shelves?

Mr. HICKMAN. Mr. Hultgren's point is relevant, I think. Lags in a sense are two kinds. Sometimes when people speak of lags, they mean a smaller increase. Sometimes they mean a delayed increase. And Mr. Hultgren's point was that retail prices will fluctuate less than wholesale prices on the distributional level which in turn will tend to fluctuate less than manufacturer's prices, and so forth.

I think there is a general tendency which has been established for that.

The question of whether they lag in time is a somewhat different one. And I think that you would have to examine various industries and you would find varying behavior. There is one point, and that is that the lags are nowhere near as substantial as you might think offhand when you view the length of the productive process from, say, the beginning when raw material comes off the farm to the final retail level.

There is a very long time lapse in many lines of production between those two events.

If you are following one unit all the way through, it may take 6 months to process a given unit into a final product and then transport it and then sell it. But prices do not respond with anywhere near

that kind of lag because of the influence of inventory change on the various levels which makes it possible for various levels of business to make adjustments to market conditions much more rapidly than just depending on the rate at which things come in from some earlier level.

Ruth Mack's study—you will have her here in a day or two—she has studied this problem more than anyone else I know of. And I think you might address your question to her.

She has found that you get price fluctuations—at least from the wholesale level back—which are virtually simultaneous—although some may be larger than others.

As far as retail prices are concerned, I think you would perhaps find some lag there. Although special price concessions during sales might take care of a lot of that.

But I wouldn't expect the lag to be very long. And you do find if you take the rate of change of wholesale prices—including those of manufacturers and not just those of distributors—that the rate of change of the Wholesale Price Index is very closely timed with the rate of change of the Consumer Price Index.

So that when the Wholesale Price Index is increasing rapidly, the Consumer Price Index will be increasingly rapidly, and vice versa.

Although you do get into the problem that sometimes what is happening on later levels, like consumer prices, is that the rate of increase is dropping, but it is still positive. But it is moving in rough parallelism with the rate of change of wholesale prices which may be dropping, and negative, before the other becomes negative.

I hope I didn't get too far off base.

Representative TALLE. No, sir; you did not.

Mr. Danhof.

Mr. DANHOF. It seems to me the only thing I can add to these comments is to emphasize the fact that a product on the retail shelf is not the same thing as that product coming off the manufacturer's assembly line. There have been introduced the costs of supplying the services which the retailer renders.

These costs are typically quite rigid. If the retailer is cost-conscious in establishing his retail price, obviously there has been introduced a fairly fixed and fairly rigid additional cost which gives you the final retail price.

If you keep those things in mind, I am not very optimistic that there is very much possibility of achieving greater flexibility of retail prices.

Representative TALLE. Aren't there certain aspects that enter into this, such as the great number of retail outlets, many of them in small, sparsely populated places, and the disinclination on the part of the retailer to mark the price down once he has become accustomed to getting a certain price?

Mr. DANHOF. You are raising the question of the efficiency of our distribution system. That is the broad interpretation of your question.

This is a very common criticism. It seems to me however it has to be answered in terms of the buyer's reaction.

If the buyer is willing to pay more for goods which involves a substantial injection of service in our society, that is his privilege.

And it doesn't seem to me it reflects on efficiency so much as it reflects on the kind of distribution system that the buyer wants.

What I am saying is that I am not too much impressed by the frequent criticisms made of our economy's distribution sector, as long as we have freedom of choice on the part of the consumer.

Representative TALLE. Thank you, gentlemen, very much.

Mr. Knowles.

Mr. KNOWLES. I thought that since we have raised so many questions here, and apparently in other panels, about what we do about prices in bottleneck industries, and also about administered prices, that we might at least see if this panel can make itself a sort of technical adviser to some future price commission or wage and price commission if it is going to exist according to these theoretical proposals, and tell this commission what its staff should look for in going out in the economy to find and bring back some measures of administered prices. What are administered prices in terms of which some data-collecting clerical subordinates with the commission are going to go out and find some information?

I assume from the discussion here that the administered price is the source of this bottleneck problem. If this is so, can we define an administered price so that somebody can go out and find one and say this is an administered price which performed in such and such a way as contrasted to, I suppose, a competitive price?

Mr. HICKMAN. That is a very interesting question. And one which I personally find unanswerable, I think.

I would like to point out a couple of things that would be involved in an answer to it. In the first place my use of the term "administered price," which is one perhaps shared by most economists and the members of this panel, is not the same as that existing in Government circles.

I do not mean by an administered price one which is fixed and maintained for a long period of time.

It seems to me that is not the essential question. I was using it as terminology having to do with the ability of industries to, themselves, influence the price level of their product—in other words, in technical economic terminology, some degree of monopoly power by firms over prices in their industry.

In that sense the great bulk of prices in our economy is administered. There is some degree of individual discretion involved in setting prices. I think that the areas you would look in, if you wanted to look for the most administered price, or something like that, would have to be defined not from the standpoint of the characteristics of the price itself, but of the theoretical characteristics of market structures which would permit individual pricing of products.

And I think that you could identify certain industries from the point of view of the degree of concentration in the industry, whether there is evidence of price leadership, and so forth.

The essential point I am trying to make is that administered pricing is only important in the sense that it permits individual units to establish price levels which then the rest of the economy may or may not adjust to. But if the rest of the economy is structured in such a way as to facilitate the adjustment to that price-setting level, then that does have certain implications for the behavior of the general price level.

So that if you had purely competitive industries and labor markets, it is unlikely that you could have anywhere near the same kind

of problem of cost-push in key sectors as you have in our present economy.

I think you could still have bottleneck inflations where the question would be demand pressing on supplies of resources in particular areas, and the supplies would then be purely competitively determined but some would still be more inelastic than others and you would get price increases.

It is analogous to that as far as administered pricing in the economy is concerned. But trying to define administered prices in terms of their behavior over time I think would be a difficult task unless you just made a very broad division between wholesale auction markets and all other markets.

Mr. KNOWLES. In a meaningful sense, from the standpoint of any policy decision, of any remedial legislation, or administrative action, you are saying in effect we are back into the monopoly-competition box, so to speak; and what administered price means in this sense is that the producers or dealers have some, shall we say, for policy purposes, significant degree of monopoly, and that, therefore, they are to be dealt with through monopoly policy.

Mr. HICKMAN. Yes; from the standpoint of our present question, that is correct. That is, the question of the relationship between market structure and general inflationary pressures.

I had said that if you wanted to define administered prices in terms of their behavior, probably the only product division would be between auction markets and others. If you wanted to define them in terms of market structure, I think you would look for industries where you had a significant degree of union organization; because from the standpoint of this particular problem, the key question is joint action by union and management in particular sectors, and not just the one or the other acting alone.

But if you have an industry where you have industrywide collective bargaining and only a few firms establishing prices, you have circumstances which will facilitate to the utmost simultaneous wage-price increases if those parties want to put them into effect.

Mr. KNOWLES. I take it, from answers the panel has given to this and other questions, that there is some agreement that at the present time, and likely over the next decade, that the most significant way, or most important way, in which inflationary movements are likely to develop—cumulative inflationary movements—would be from impulses which start in a key industry or a few key industries, so that any policy or combination of policies to promote price stability in a growing and stable economy must aim at dealing with the problem of holding changes in prices and costs in these key industries to levels that are compatible with the stability of the general price level.

Mr. HICKMAN. That is true if you want to attack the problem at that stage. But it would also be possible to prevent key increases from becoming generalized in the economy with a sufficient degree of overall restraint.

Mr. KNOWLES. By this you mean enough restraint to produce unemployment?

Mr. HICKMAN. Yes. I think that a sufficient degree of restraint would produce unemployment. I gather Mr. Kendrick differs with me on this. But that was the issue we were discussing earlier; whether it is possible to use a sufficiently high degree of general restraint to

absolutely stabilize prices or only possibly to stabilize them to some degree.

There is some degree of restraint which will not produce unemployment, but whether it is enough to produce price stability I very much doubt.

Mr. KNOWLES. We are discussing this problem as if the only really significant aspect of price changes over the next decade, for example, would be the problem of inflationary bias and not one of cumulative decline.

This concern causes me to go back to something mentioned yesterday by Mr. Bailey, and also in Mr. Rees' paper of a later panel, both from the University of Chicago, which suggestion was that perhaps the price rise in recent years may not be as great as the indexes show.

And in fact, it may not have happened at all because of the bias in the indexes, particularly the bias created by the technological problem—the familiar one that users of index numbers will appreciate. He reports that tests on some items suggest that perhaps the conventional methods which show a rising trend may even show a falling trend when done by chain methods which correct as far as possible for technical change in the product.

I am wondering if the panel would have any views as to whether this is a real probability and whether or not we may be trying to stabilize an index which doesn't represent what is happening to prices anyway; that we did get stability in spite of our indexes.

Mr. KENDRICK. There is no doubt but what the technical construction of the price index is important and can influence the movement of the index depending, for example, on the base periods chosen for quantity weights for the different types of prices, also the methods of pricing, whether or not actual realized prices are collected or merely quoted, or list prices are collected, and so on.

All of these points are important. And often it is mentioned that the quality factor is subject to sufficient improvement to give a very serious upward bias to our price indexes if we were trying—as compared to what we would have if we were trying to price some standard product that was not subject to quality improvement.

However, I don't believe that all of these possibilities of error and of difference in movement depending on method of construction would negate the fact of substantial price increase in the several periods we are talking about today.

I don't believe that experimentation with different price bases would give us a downward movement instead of an upward movement. And I don't think that quality improvement is sufficiently important to give us an upward bias which is as much as the price increases that have been shown in these periods.

And I don't believe the changes in the terms of sale which are not reflected in the price as collected are sufficient to do this. I believe the best indication of this is the general public sentiment that people feel that prices have risen.

I told our maid this morning before I came down here that I was coming to testify about prices and give results of research in prices. She says, "Well, I sure hope they will do something about it. This price rise is terrible." And the feeling the people have that we have

had a price rise is good evidence that the indexes are not completely misleading.

Representative BOLLING. Mr. Riley, do you have any questions?

Mr. RILEY. Yes, Mr. Chairman.

There is a point I would like to take up with Mr. Kendrick which will take just a minute or two, I think.

You distinguish, Mr. Kendrick, between productivity measured in terms of total resources and productivity measured in terms of labor.

And you have pointed out, as I understood you—and I would like to be clear on this—that henceforth increases in wages that exceed the increase in productivity in the general or total sense, will put inflationary pressures on the economy.

Do I interpret you correctly?

Mr. KENDRICK. Well, it would be the productivity increase plus an additional amount which in the past 35 years has amounted to about one-quarter of the productivity increase which labor can get as a result of its increasing share of the national income which is due largely to the increasing relative scarcity of labor as compared with capital and thus the relative movements of the price of labor and of capital.

The 2.1 percent average annual increase in total factor productivity compares with about a 2.6 percent increase in real product per man-hour. It so happens that this is exactly the same increase that labor has obtained in its real average hourly compensation.

But this is somewhat of a coincidence, that the actual increase in real average hourly earnings has been the same as the increase in real product per man-hour.

I would say it has been about one-fourth more as the result of some redistribution of income which is likely to continue as long as capital increases faster than the labor supply.

Mr. RILEY. You point to the shift between 1919 and 1953 in the share of labor income in total national income from 72 to 79 percent.

You suggested, I thought, that a limit had been reached—had been reached in 1957 rather than 1953, in terms of the reduced return on capital.

Will maintenance of the return on capital at the 1957 rate or at some higher rate if that is necessary to get the greater growth that we may seek to achieve—will maintenance of that rate be consistent with further increases of wages in line with the past at a quarter above the total factor productivity increase?

Mr. KENDRICK. It could be consistent with that; yes. We would still have an increasing share of the national income going to labor under these circumstances with a constant rate of return on capital and an increase in the real wage rate, say, between 2½ and 3 percent a year. But these two assumptions are quite consistent, one with the other.

The important thing, it seems to me is that the increase in money wage rates not exceed substantially 3 percent a year and that this is partly a matter of restraining demand as well as it is a matter of self-restraint on the part of management and labor in concluding their wage agreements.

Mr. RILEY. Thank you very much.

Representative BOLLING. Gentlemen, we thank you for your contribution and your time.

The committee will now stand adjourned until tomorrow morning at 10 o'clock.

We will meet again in this room. The topic for tomorrow is, "Interrelationships among prices, demands, and costs." We will hear from Abba Lerner, Milton Friedman, Mrs. Ruth P. Mack, Gardner Patterson, Richard Ruggles, Nancy D. Ruggles, and J. Frederick Weston.

The committee stands adjourned.

(Whereupon at 12:21 p. m., the committee was recessed, to reconvene at 10 a. m., Thursday, May 15, 1958.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

THURSDAY, MAY 15, 1958

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

The committee met at 10 a. m., pursuant to recess, in room 1302, New House Office Building, Hon. Richard Bolling presiding.

Present: Representatives Bolling, Reuss, and Talle.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk: and James W. Knowles, economist in charge.

Representative BOLLING. The committee will please come to order.

The first three of our panel discussions have considered the relation of price stabilization to the objectives of the Employment Act, the measurement of prices, and past price behavior.

Today's discussion focuses on the important interrelationships among prices, demands, and costs. We are concerned with the way in which prices are determined and changes brought about. Our discussion will deal both with changes brought about by shifts in demand for goods, services, and productive factors and, on the other side, with changes that are brought about on the supply side, principally by movements in costs.

The discussion today approaches prices mainly from the side of price-determining forces and mechanisms, while tomorrow we will shift the discussion to the relation of changes in prices to changes in output, employment, incomes, and the use of resources. The committee recognizes, of course, that these two aspects of price relationships cannot be so neatly compartmentalized, but it will be useful in each case to focus the mainstream of the discussion in one direction or the other rather than on both simultaneously.

We will miss, this morning, the stimulating presence of Dr. Milton Friedman, professor of economics at the University of Chicago. Dr. Friedman has for the past year been with the center for advanced study in the behavioral sciences at Stanford University. We are sorry that unexpected complications prevent his being with us this morning. We will also miss Mrs. Nancy Ruggles who is unable to be with us today. I hope that their absence will not inhibit other members of the panel from commenting on any issues raised in their papers which should be brought into our discussions.

As in previous mornings, we will proceed in these hearings in the order in which the papers appear in the compendium. Each participant will be given about 5 minutes in which to summarize his paper without interruption. Upon completion of the opening statements, the committee will question the panel for the balance of the session.

This part of the hearing will be very informal, and we want all members of the panel to participate, commenting upon other papers in the compendium and on the questions of committee members.

Our first witness this morning will be Dr. Abba Lerner. Dr. Lerner is professor of economics at Roosevelt University and has been spending the past year as visiting professor of political economy at The Johns Hopkins University.

Dr. Lerner.

STATEMENT OF ABBA LERNER, PROFESSOR OF ECONOMICS, THE JOHNS HOPKINS UNIVERSITY

Mr. LERNER. Economists have for so long concentrated on the kind of inflation that is caused by "too much money chasing too few goods" that they have neglected the kind of inflation that is caused by suppliers, either of labor or of goods and services, raising the price at which they are willing to sell.

The first kind of inflation is generated on the side of the demand for goods and services. The force behind it is an attempt by buyers to buy more than is available, which produces a scarcity of goods and services and bids up their prices. This is usually called demand inflation, but I think it is better to call it buyers' inflation because it is the action of buyers that is responsible for it.

The second kind of inflation is generated on the side of the supply of goods or services. The force behind it is the use by sellers of bargaining power or monopolistic power to obtain higher prices for what they sell. This is sometimes called cost inflation, but I think it is better to call it sellers' inflation because whether it is wages or costs or whether it is profits that are being raised it is the action of sellers that is responsible for it.

Neither kind of inflation can go on for long unless the monetary and fiscal authorities make possible an increasing rate of money expenditure. Without this cooperation by the monetary and fiscal authorities a buyers' inflation would cure itself when the increased price level took up all the purchasing power put out by the buyers. At this higher price level buyers would no longer be trying to buy more than is available and the process would stop.

A sellers' inflation, if not helped along by the monetary and fiscal authorities, would result in output and employment diminishing because the public would have to buy less if it could only spend the same volume of money expenditure on goods and services whose prices had been raised. The sellers' inflation would be stopped as soon as the state of depression was severe enough to persuade the sellers to stop raising their prices, and it would be stopped for as long as this degree of depression was maintained.

The obvious cure for a buyers' inflation is for the monetary and fiscal authorities to remove the root—i. e., the excess demand for goods and services by buyers. This can be done either by reducing the quantity of money or by reducing its velocity of circulation—or by some combination of the two. The main instruments are monetary policy which works on the former and fiscal policy which works on the latter, and the different combinations of these that are suitable for different conditions.

Attempts to cure sellers' inflation by the same measures fail because the degree of unemployment that would have to be established and maintained to achieve the goal is unacceptable. The authorities therefore stop short of sufficient reduction of demand to stop the inflation but reduce demand enough to cause considerable depression. We thus get a combination of inflation and depression.

This seems surprising only because such a combination is impossible with buyers' inflation. Buyers' inflation is incompatible with depression because one cannot have at the same time both excessive demand—which is what makes prices rise in a buyers' inflation—and deficient demand—which is what causes depression. But sellers' inflation is perfectly compatible with depression. Sellers may be able to push up prices even in a depression as long as the depression is not severe enough to break their power to keep on raising prices. It is the attempt to cure sellers' inflation by the measures that are appropriate for buyers' inflation that gives rise to the paradox of inflation combined with depression.

If it is not thought worthwhile to bring about and to maintain a state of depression sufficiently severe to stop the sellers from exercising their bargaining and monopoly powers to raise their selling prices—and such a cure could be much worse than the disease—it is possible to stop sellers' inflation only by going to its root. Its root is not excess demand but the power of sellers to raise prices even when demand is not excessive and to hold prices up even when demand is deficient. In doing this they are preventing the market from carrying out its job of making the free enterprise economy work satisfactorily in the public interest.

Preaching to sellers will not help because the competitive free enterprise economy is built not on altruism but on the development of institutions that harness private interests so as to serve the public. The development of the power of sellers to raise prices even when demand is not excessive is a disease of the market mechanism. Because of such power it ceases to be true that "what is good for General Motors (or for the UAW) is good for the country." Only in a competitive free enterprise system, where the seller—and the buyer—is unable to manipulate the market price can that be true.

It is, therefore, necessary to restore the proper working of the market system by administered regulation of the administered prices which have escaped the automatic regulation of the market. Administered prices and wages—which are determined not in accordance with the principles of a competitive market but by the decrees of large corporations or of powerful trade unions or of combinations of powerful unions and employer groups—must be subjected to regulation in the public interest.

Such regulation would be similar in some ways to the regulation of the prices charged by public utilities. The regulation would aim at stabilizing the price level by stopping price from rising where the available supply is sufficient to satisfy the demand at current prices; by bringing about reductions of prices where the available supply exceeds the demand at current prices; and by allowing wage rates, on the average, to rise at no more than is compatible with a stable price level.

It is not sufficient to regulate total expenditure so as to avoid both excess demand and deficient demand—i. e., so as to prevent both buy-

ers' inflation and depression. It is also necessary to prevent sellers' inflation by the appropriate regulation of administered prices and administered wages. Only if both of these things are done will it be possible to maintain both a satisfactory level of employment and a stable value of money. Wages and incomes would rise parallel with the increase in output from improving technology as well as from the high level of investment—in improving equipment and expanding productive capacity—that would be made possible by the combination of maximum employment with price stability.

Representative BOLLING. Thank you.

Next is Dr. Ruth P. Mack, research staff, National Bureau of Economic Research.

Mrs. Mack.

STATEMENT OF RUTH P. MACK, RESEARCH STAFF, NATIONAL BUREAU OF ECONOMIC RESEARCH

Mrs. MACK. Over the past decade, prices of finished manufactured goods have tended to rise more than prices of crude materials, and still more than prices of sensitive commodities quoted on open markets. The difference is substantial even when foods are excluded. Between January 1947 and the 1956 or 1957 high point in each series, spot market prices fell by 10 percent of their 1947–49 average, crude materials rose by 16 percent and all manufactured goods rose by 34 percent. All price indexes exclude foods and constituent materials.

Labor cost does not explain these divergent trends. Between 1947 and 1957, according to the indexes prepared by the staff of this committee, labor cost increased about 15 percent of its 1947–49 average. In other words, the cost of labor and the cost of crude materials rose at about the same rate, and both rose substantially less than did the price of manufactured goods.

These comparisons, made for large groups of commodities and for the years 1947 to 1957, ought to be tested for other periods and for matched pairs of crude materials and manufactured goods. One such test that I have been able to make covered 18 industries from 1913 to 1935. For 16 of the 18 industries, manufactured prices again pulled away from crude prices and this was true both for the war period and after. Again, labor cost did not seem to provide the explanation. For 1947–57 I have matched 15 crude commodities with semiprocessed goods and find the divergent trends present in 12 of these pairs.

I have discussed this phenomenon with some well-qualified people at the Bureau of Labor Statistics to see whether it seemed likely that technical factors in the collection of price indexes could be responsible; a negative conclusion seems indicated.

What then is the explanation of the divergent trends? It does not lie primarily, of course, in bulging profits. Rather, must it be found in the increasing amounts of fabrication to which materials are submitted, increased marketing costs, increased administrative costs, costs of research, of insurance, of development. These shifts in products and in cost structure thrive in the general atmosphere of the times. Many of the emphasized costs are of the overhead or burden type. There is a widespread belief that the strong upward trend in demand is truly durable. This weakens usual fears of saddling a business with heavy overhead-type costs. These costs build prestige and growing

power, especially for large companies. The belief that prices will rise, and that everyone is resigned to it, turns attention away from the selling value of price reductions. Low price lines, rather than lowered prices, provide a way of supplying the low ranges of the income distribution.

But in addition to these general attitudes and strategies, are there any that are linked to the course of raw materials prices themselves? There are, I believe, several. They cause the highly fluctuating price of crude materials—a fluctuation that could account for over half of the cyclical instability of prices in recent years—to operate as a ratchet jack which lifts prices up and locks against a decline. It is all too securely locked at this moment.

On the upward side, rising materials prices, like rising labor costs are cited in justification of raising prices by more than the dollar-and-cents increase in cost. As an instrument of policy, the materials-cost argument is used when strategy dictates that it should be used—when prices rise but not when they fall. When crude prices and the volume of output falls, pressure of overhead costs on margins dictates, in the general atmosphere I mentioned a moment ago, that selling prices be maintained as far as possible.

This strategy is buttressed by the thought that if prices are lowered, demand linked to inventory buying will fall, since customers are likely to hold off placing orders in the hope of further price reduction. These waves in what is often called inventory buying but is actually directed toward shifts in ownership position, are closely interconnected as cause and effect with fluctuation in crude-materials prices. My paper presents evidence of this interconnection.

In short, the studies I have made point to an inflationary influence requiring a name. Among inflationary processes, we not only have the "cost push", the "demand pull", and the "quantity-of-money enticement", there is also the "strategy push."

I think there are certain things that can be done about this within the framework of free markets. But perhaps it would make more sense to wait in discussing these until later on in the session in the event that you wish to hear about it.

Representative BOLLING. Thank you.

Next is Dr. Gardner Patterson, professor of economics, Princeton University.

Since this is Dr. Patterson's first appearance before the committee I would also mention for the record that he was formerly with the Greek Currency Commission, 1946 to 1948, adviser to the United States Mission to Turkey, and representative in Africa and the Near East for the United States Treasury.

STATEMENT OF GARDNER PATTERSON, PROFESSOR OF ECONOMICS, PRINCETON UNIVERSITY

Mr. PATTERSON. Severe time limits have been set for this summary statement. I must therefore, by way of introduction, offer without supporting evidence or argument three important propositions, which I set forth in more detail in my paper in the compendium, and then go on from there.

(1) Although small as compared with a great many of our domestic activities, United States foreign commerce is an important factor in our economy.

(2) General price movements in one country often exert strong pressures in the same direction on prices in other countries.

(3) For the postwar period as a whole the United States has imported some inflation; it should be emphasized, however, that these inflationary pressures on us from abroad have subsided in the past few years. Given these propositions, what is likely to happen in the years ahead and what are the implications for United States policy?

It appears likely that most other countries will witness steady and serious inflation in the foreseeable future. Whether this will be at a faster rate than the United States depends upon our internal policies. The crucial point is that if our objective is stable prices, our policies must make allowance for some prabably moderate, but nonetheless unremitting, inflationary pressures from abroad.

For some of the industrialized countries with whom we deal these inflationary pressures will arise in part from the defense burdens they have assumed. Much more important, I anticipate, will be the conjunction of (1) the vigorous pursuit by many of these governments of full employment policies, (2) the existence of strong and aggressive labor unions, (3) the fact that much of the public now generally believe that by active use of monetary and fiscal measures any unwanted slack in demand or employment can be successfully combated, and (4) the assumption by many governments of responsibilities for providing extensive social and welfare services.

All of these forces exerting upward pressures on prices are of course also present in our own economy, but they seem even more intense in some foreign countries.

Turning to the so-called underdeveloped countries, there are other grounds as well for fearing that the prospects for inflation are even stronger. The governments of most of these areas are firmly committed to programs of economic development, that is to rapidly and drastically altering the structure of their economies. Economic development does not of necessity lead to serious inflation. But it has done so in most cases since World War II and it seems more likely than not that it will continued to do so. The reasons are simple.

For two reasons which time prohibits our going into here, changing the pattern of production of a country and greatly increasing total output and productivity are likely to be relatively slow processes. But the peoples of these nations are usually impatient.

Moreover, their governments often find it to their immediate political advantage to hold out great promises on these matters, thus increasing still more the public expectations of rapid improvement.

This combination of considerations tends to create for the authorities an irresistible temptation to attempt a level of capital formation and of consumption well in excess of the physically available goods and resources. The favorite devices used have been "monetary" ones—budget deficits, easy credit, expanded agricultural subsidy and loan programs, et cetera. Inflation is the consequence of attempting, by financial means, a level of economic development and consumption greater than the physical resources will permit at existing prices.

Now it must be recognized that this inflation, if it can be kept moderate, appears to many people a far less serious problem than having

a rate of economic development less than might be the case. One might say that they see the problem somewhat in the same way the industrialized countries saw the problem of preparing for war: unless there was pressure on prices you probably were not doing all you could.

Be that as it may, the present point is that we may expect prices abroad to rise significantly in the years ahead, both in the poorer countries of the world and in the richer ones.

What are the implications of this for United States policy? First, in order to achieve internal price stability, the United States will have to overcompensate for the purely domestically generated inflationary pressures. We will have to devise and pursue more rigorous, and probably more unpopular, anti-inflationary policies than our own excesses would dictate. It is always tempting to pursue policies on the assumption that some of our domestic problems will be solved by the actions of others. In this field our problems will be bigger than they appear when looked at from the inside.

Second, these considerations argue for the United States pursuing a more liberal import policy than it now does. Rising prices abroad will itself tend to curtail our imports and those that do come in, it was asserted earlier, will tend to raise our prices. But for them not to enter our markets would make our inflation even more severe. One of the most efficient ways of restraining inflation is to increase the amounts of goods and services in a market while reducing the amount of money looking for goods to buy. Increasing imports does precisely that.

Third, if the pace of inflation abroad is faster than here, the attractiveness of their goods to us will decline while ours will become more appealing to them. As a consequence, one may anticipate the emergence from time to time in some form or other of what has been called the dollar shortage. Faced with this state of affairs, we must expect an increase in barriers and in discrimination against United States exports.

Although this is to be regretted on many counts, we must refrain from retaliation in kind, for this will only enlarge the problem and add to the inflationary pressures here at home.

Fourth, the inflationary effect on us of rising prices abroad will tend to be less as the price of foreign currencies goes down in terms of dollars. Therefore, if our aim is to maintain a stable price level in the United States our policy should be one of encouraging other nations to make more frequent adjustments in their foreign exchange rates than has been their usual practice in the postwar years.

Specifically, the United States Government should reconsider its policy of supporting the adjustable-peg system of exchange rates and should consider encouraging other countries at least to widen the margin within which they let their exchange rates fluctuate or perhaps even to adopt a flexible exchange rate system.

Finally, we must admit that there is little the United States properly can do to help other nations avoid inflation. Most important is to prevent inflation at home and so at least not add to their price-level problems, which, in turn, add to ours. We can also, under many, but not all, conditions, help restrain inflationary pressures abroad by granting foreign aid. It is possible by extending foreign aid to reduce the net inflationary pressures on our own economy.

Fortunately, all the policies mentioned can be defended on the basis of our national interest, even if inflation were not one of the most serious economic problems facing the United States.

Thank you.

Representative BOLLING. Thank you.

Next is Dr. Richard Ruggles, professor of economics, Yale University.

STATEMENT OF RICHARD RUGGLES, PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. RUGGLES. In the past decade the American economy has experienced three recessions and a substantial secular price rise. The recessions are commonly considered to be temporary phenomena which, although capable of being influenced by public policy, are either unavoidable lapses or normal readjustments required by the economy. The secular price rise, in contrast, is considered a long-run problem of a more serious nature, reflecting either a lack of moral fiber on the part of the Government for not maintaining price stability, or irresponsibility on the part of monopolies who administer prices or self-seeking unions who demand unwarranted wage increases. The goal of price stability has been cloaked in an air of morality that does not seem to apply to the maintenance of employment.

The main reason recessions are considered temporary is that if we wait long enough they will cure themselves and prosperity will return. There is much truth in this point of view. Nevertheless, the record of the 5 years since the Korean boom raises some serious questions about it. In only 2 of these years, 1954 and 1955, was there any significant increase in output per man-hour, and in 1 of these 2 the economy was in a recession not too dissimilar from the present one. Thus only 1 of the last 5 years can really be characterized as a year of prosperity and growth. In 1956 and 1957, there was no appreciable change in actual output per man-hour, despite the rapid pace of technological change and the expansion of capacity. Thus far in 1958 there has been a substantial fall in output per man-hour. If the economy continues to exhibit this kind of behavior, any growth that is achieved must be crowded into a small space of time; all the rest of the time will be recession, recovery from recession, or leveling off prior to going into recession. In these terms, recession is not a temporary problem. It may be that prosperity is just around the corner, but so is the next recession.

A number of the other essays in this volume have emphasized the importance of price stability, but there has been little attempt to evaluate the welfare implications of moderate secular price rises quantitatively. Specifically, one may well ask how a 2 or 3 percent annual price rise would compare in importance with unemployment 2 or 3 percent over the frictional level. The inequities that are introduced by a price rise relate to that fraction of the population which holds assets in the form of money and/or depends upon a fixed income. In this category there are, of course, banks, pension holders, and college professors, of whom we have spokesmen here. It is probably true that it is the more articulate portion of the population that is affected most by price rises and least by unemployment, and that

this influences the amount of attention devoted to the two problems. There can be no doubt that secular price rises produce real inequities. But a very mild degree of unemployment—2 or 3 percent above the frictional level—may produce far more hardship. In the first place, such unemployment must by definition hit specific individuals more heavily than others. Those who have job security—like bankers and college professors—are not harmed at all. Other people, however—and they are people whose incomes were lower to begin with—may be totally unemployed for many weeks or even months. In contrast, the worst-hit group in a moderate secular price rise will suffer a reduction in real income of only 2 or 3 percent. It may be argued that unemployment tends to hit different people at different times, but this is not necessarily true. The marginal workers in industries highly sensitive to changes in output will continually be laid off in times of soft demand. Furthermore, even in the case of a secular price rise, many of the so-called fixed incomes are not absolutely fixed. College professors eventually do get increases in pay, and social security benefits do rise.

Furthermore, from an empirical point of view, price indexes tend to overstate the amount of price rise, since a large part of quality change is ignored. In contrast, unemployment figures understate the degree of unemployment, since a cut in hours worked is not reflected in the number of unemployed.

Moreover, a consideration merely of the level of unemployment misses another large element of the picture. There has been an unfortunate tendency to measure the degree of utilization of capacity by the degree to which there is full employment. But recent developments in our economic system have been in the direction of increasing the proportion of overhead labor. Automation, for instance, demands technicians rather than operatives. Even the level of operation falls considerably below capacity, technicians are still necessary to maintain and repair the machines and employment cannot be cut down as much as output falls. A considerable drop in the utilization of capacity thus may occur with small changes in unemployment. Similarly in certain parts of the economy that are growing in importance, such as communications, public utilities, transportation, and retail trade, employment does not vary significantly with short-run variations in output. As the utilization of capacity is increased, the efficiency with which the already-employed labor is used also increases. Thus from 1949 to 1950 man-hours employed increased 2.4 percent, but output increased 10.5 percent. Unemployment only dropped from 5.9 to 5.3 percent of the civilian labor force. In terms of opportunity costs, the question is how much lower our standard of living is than it could be if the economy were operating at a reasonable level of capacity. The inequities involved lie in the missed opportunity for a higher standard of living for a large proportion of the people.

The severity of postwar recessions has, of course, been sharply reduced by the automatic stabilizers that have evolved since the war. In the current recession, the $18 billion fall in gross national product has resulted in a drop of only $4 billion in personal disposable income. The fall in corporate profits and in Government revenue and the increase in transfer payments have absorbed three-quarters of the total decline. In the light of these figures, the estimate of a $9.7 billion

Government deficit for calendar 1958 which appears in materials prepared by the staff of this committee last February does not seem unreasonably high. Insofar as disposable income and consumer expenditures are insulated from sharp declines in output, the spiral will not be reinforced by declines in consumer spending, the decline in gross national product will be lessened, and the recession will not be as deep.

But these same stabilizers not only prevent income from going down; they also stabilize it in an upward direction, making it difficult for gross national product to rise. In recovery from a recession, any increase in income from production is partly siphoned off in taxes, and it is partly offset by a decline in transfer payments. For example, from 1954 to 1955, gross national product rose by $30 billion. Government receipts rose $11 billion, but total Government outlays rose by only $2 billion, and Federal expenditures on goods and services actually declined by $2 billion. As the economy grows, a Government budget that is balanced to begin with will automatically generate sizable surpluses. Looking at it another way, the income generated by private economic activity may not be sufficient to buy the product of that activity, if the Government removes 37 percent of those funds as it did in 1954–55, and does not return an equivalent amount. In other words, growth in an upswing may be frustrated before it can take place because of the siphoning off of the increase in income by increased tax payments. We are in fact in the position of being strangled by automatic stabilizers; the result is not stability but recession.

The problem of secular price stability is not independent of this dilemma of automatic stabilizers and growth. The dampening effect of the automatic stabilizers has resulted, when coupled with the inevitable recessions, in a low rate of productivity increase. Low rates of productivity increase coupled with even moderate increases in wages will result in the long run in steady price increases caused by rising costs. To the extent that the higher costs and prices mean a higher gross national product in money terms for the same level of output, growth becomes even more difficult, since the automatic stabilizers operate on the level of money flows in the economy rather than on the amount of real output. Thus we are caught in a vicious circle, where low productivity means higher wage costs and higher wage costs mean rising prices, and rising prices, given the automatic stabilizers, further dampen growth.

Many of the essays in this volume, and many economists generally, imply that an economy operating close to capacity will be under more demand pressure than one where growth is dampened, and thus that the secular price rise in such a case would tend to be accelerated. This argument overlooks the role of productivity in the price mechanism. At high levels of capacity utilization the economy is more efficient and productive, and a high level of investment tends to insure the continuation of productivity increases in future periods. The last 2 years are eloquent testimony to the fact that cost-inspired price rises can be appreciable even when there is excess capacity. In contrast, the spectacular rise in output in 1955 was achieved without significant rises, despite a relatively high level of demand.

What then is the solution to this problem of chronic recession, slow growth, and secular price rise? The wellspring of our economic

growth and productivity increase lies in the investment that we are willing to make in productive plant and equipment. For the immediate future, an expanded level of investment of a productivity-increasing nature would help to cure the present recession by providing additional demand in the hard-hit durable good industries. An increase in consumer expenditures achieved by tax reductions, on the other hand, would be likely to go into other sectors of the economy, such as services and nondurables, where demand has not fallen to the same degree. Similarly, even expanded public works might tend to cause excess demand in the construction sector of the economy, without spreading fully to other types of durable goods and equipment. From a longer range point of view, stimulation of the right kind of investment would increase productivity, and this in turn would tend to lessen the rise in wage costs and thus in prices, and at the same time the expansion of capacity and productivity would make possible a higher rate of growth.

I do not mean to suggest that there should be no tax reductions; it may well be that as additional capacity is generated some stimulation of consumer demand will be required. Similarly I do not wish to suggest that there should be no increase in public expenditures; there are many pressing needs in the economy for such things as urban renewal, highways, education, and health. But there are good reasons why, in addition, we should expand investment of a productivity-increasing nature beyond the level it has averaged in the postwar period.

Our rate of growth in this period has been small relative to many other countries, and this will inevitably be taken as a reflection on the efficiency of our system. Countries just entering the stage of economic development may well question whether a system such as ours would be optimal for their needs. Furthermore, we may well require, in the coming period, more resources than would be available to us if we continue at our present rate of growth. Problems, not only of defense, but of world economic development and provision for a rising standard of living, should lead to growing drains upon our future output. A growing economy permits adjustments to take place easily, but if growth is so slow that the demands upon our resources exceed our available output, frictions are bound to develop.

If for these reasons a high level of investment is a desirable goal, how can it be obtained under present conditions? In this connection we can learn from the experience of other countries in dealing with this problem. A number of other industrial countries have used various forms of accelerated depreciation or fast tax writeoff quite successfully to stimulate investment. In some cases, the charge-what-you-wish system, as in Sweden, proved to be such a powerful stimulant that the level of investment had to be held in check by a supplementary tax. The United Kingdom, a few years ago, tried a system of giving an initial allowance of 40 percent of capital expenditure, chargeable against profit during the first year; over the life of the asset, an amount equal to 120 percent of the original purchase price could be charged off. Such a device, of course, amounts to a direct subsidy, and it may not be necessary or desirable to go that far. Care would have to be exercised that less productive forms of invest-

ment were not unduly stimulated, and that the fast writeoff did not degenerate into a major tax loophole.

In summary, I would like to reemphasize the point that the problems of recurrent recession, secular price rise, and low rates of growth are all highly interrelated, and should not be considered separately. To this end, serious consideration should be given to raising the level of investment. Such a step would not only increase demand in a part of the economy which is presently hard hit, but it would also lessen the pressure of costs on prices and stimulate long-run growth. The use of fast tax writeoffs as a device for encouraging investment would constitute a significant offset to the automatic stabilizers in the upward direction since corporate profits and profits taxes are the largest elements in such stabilizers.

It may be, of course, that fast tax writeoffs would, in some periods, prove too powerful a tonic for investment; in such cases a supplementary investment tax or variation in the speed of writeoff might be used to keep investment at a viable level, in much the same manner that the Federal Reserve System now controls the availability of credit and the rate of interest.

Representative BOLLING. Thank you.

Next is Dr. J. Frederick Weston, professor of finance, University of California, Los Angeles, Calif.

STATEMENT OF FREDERICK WESTON, PROFESSOR OF FINANCE, UNIVERSITY OF CALIFORNIA, LOS ANGELES

Mr. WESTON. In my paper I attempted to build a bridge between some of the abstract analyses in the economic literature and current issues.

The framework developed by the paper demonstrates that the simple explanations of price behavior are at best oversimplifications. The views that the price rises in recent years are to be attributed to administered pricing by large firms or wage inflation rest upon selected bits of evidence without a full consideration of the major economic forces in operation.

The size of price increases has followed a definite pattern. A given increase in wages has had a small or large effect on prices, depending upon the extent of output increases by the firm. If the firm's output has declined or increased only slightly, the price changes will be small. If its sales have increased substantially, price increases may be larger, especially if increases in capacity will be required.

If there is ample capacity in the industry, the price increases will be smaller, because overhead will be spread over a larger number of units. But this result is also affected by whether earlier cost increases had been reflected in price changes. The size of price increases is highly correlated with the size of sales increases rather than with the size of firms or the size of wage increases.

Price behavior is the result of a complex of forces. The price rises since 1955 have been greatly influenced by institutional factors which are often overlooked. The capital equipment boom which got underway in 1955 was stimulated by the liberalized depreciation rules of the Revenue Act of 1954 as well as the need to retool for the new weapons developments of the defense program.

The lengthening of credit terms from 24 to 36 months which proceeded during 1955 stimulated the automobile and related industries. The 7.9 million production of automobiles in 1955 had a strong influence on the size of wage increases that were made in that and subsequent years. Federal Reserve policy was not sufficiently prompt or strong to correct for these developments.

Thus to point to a limited number of structural characteristics of our economy as the prime cause of recent movements or to argue inevitability of continuous price rises into the future is misplaced emphasis.

My analysis is equally applicable to the delay in action to meet the current business decline. Structural problems are less important than the unwillingness to accept the deficit increase that will result if the Federal Government is to perform its requisite role in turning the economic tide. While there is much we do not know about the economic process, important ideas we have learned in the past 20 years have not been put into practice.

Representative BOLLING. Thank you.

Do any of the members of the panel desire to expand on your statements or comment on the statements of other members of the panel?

Mr. WESTON. Mr. Chairman, I would like to ask Professor Lerner whether in his view the oligopolistic firms whose behavior he has been referring to have been maximizing their net receipts by these policies?

Mr. LERNER. I don't think I could be quite general about that. I think their decisions are guided by a great number of considerations. And it is very likely they have not always been maximizing their profits.

They are often in monopolistic situations in which they could make a larger profit. But they don't want to become too unpopular and risk possible legislation or other things happening to them.

Or they may think they are doing well enough and don't want to do any better.

Mr. WESTON. Your reply really referred more to the context of the situation where effective demand is strong and probably they could have raised their prices more.

What about the situation you refer more to in your paper where demand has fallen off? What about their price policy in those circumstances?

Mr. LERNER. Again I don't think I could really generalize. So much depends on particular situations. A firm might feel that if it were to cut its prices, it would start a competitive price cutting among some rivals; and that would cause a great deal of instability and uncertainty.

They wouldn't want to engage in that even if it looks as if they might be increasing their profits by doing so.

I don't really get what you are aiming at. Maybe I am not answering the way you would like.

Mr. WESTON. Well, let me make it more specific.

A representative of the Ford Motor Co. argued that it didn't make sense for firms to reduce their prices when perhaps the demand curve had shifted to the left and if elasticity of demand were less than one.

Under these circumstances, rational economic behavior would call for their increasing price to increase total receipts rather than de-

creasing price which would decrease total receipts. This then raises the question whether your administrative body in the circumstances where sales have fallen off for firms would require price reductions under your criteria even though (*a*) price elasticity of demand were less than one, and (*b*) as you indicated in your last statement, where adverse price expectations might set in.

And since consumers know what future price behavior is going to be under your rules for the administrative body, it would be foolish for consumers to come in and buy upon the initial price cuts because they know that as long as they stay away and sales continue to decline, then your administrative body under the rules would cut prices more and more. They would wait until, well, presumably prices could get down to direct costs, since you say that as long as direct costs are covered, you would require price decreases.

So if consumers were rational, knowing the rules of your administrative body, they would stay away until prices got down to direct costs.

Mr. LERNER. I think there are quite a number of things. Certainly if the demand is inelastic, that means that if you raise your price, you increase your revenue as well as decreasing your cost.

That is a good thing to do no matter what has been happening, whether the demand has been increasing or decreasing.

The question becomes complicated because you get different elasticities according to whether you are taking a shorter period or longer period point of view. And you often don't take advantage of an inelastic demand which might increase your revenue in the short period because of a longer period in which it will no longer be the case.

But I think what you are really considering is the operation of the kind of regulation of prices which I mentioned in my paper but which I didn't go into in my remarks today. And there I have the suggestion that where you have administered prices which do not behave in the market as described in a competitive market so that you can get excess available supplies and prices are not reduced, then these prices should be made to behave in a competitive way by having their prices pushed down by some regulative body.

Your question was: If this is going to happen would not customers hold off buying in anticipation that the price is going to be reduced?

This might refer to buyers who are thinking of the effect of their own purchases on the price—which I think is not the important case, because most buyers would regard what they do as not being decisive as to what is going to happen to the prices.

Even in the more general case where the buyer does not think that what he is going to do will have an important effect on the price, he would withhold if he felt the prices are going to be lower in the near future.

What this means is that if the price has to be reduced it is best to be reduced quickly rather than have a waiting period.

Mr. WESTON. Well, in my comments I really mixed two things. One was the price policy of large firms and the second was the consequences of an attempt to administer price changes by an administrative body.

Let me pursue the second a little more directly.

In your comment you say that more generally buyers don't recognize the influence of their behavior on price, and hence you wouldn't have to worry so much about adverse elasticity of price expectations on the part of buyers.

But I wonder whether this is really true. The pattern seems to have been emerging in the automobile industry that buyers have been waiting until the end of a model year to buy that model because they feel that price concessions will be made by the automobile dealers at that time.

I think this reflects a great deal of sophistication on the part of buyers, not so much that by holding off they will get these price concessions, but rather the recognition that certain patterns develop.

So that especially in the purchase of durables, where the amount of money invested by the consumer is large, there tends to be a great deal more thought and planning by the consumer. And I think the pattern of buying in the automobile industry is proof of this.

And I think if you have the situation where——

Mr. LERNER. May I interrupt by saying that I am agreeing with what you are saying now?

Mr. WESTON. If you do, then it seems to me this makes the task of administrative regulation of prices insuperably difficult and impractical, because you have to have some standards, some rules, for your administrative body.

And in your other writings you have set forth the need for rules most eloquently.

Now, it seems to me inconceivable that consumers wouldn't become aware of these rules, and as a consequence, especially on consumer durables, knowing your rules, as soon as the country got into any kind of a downturn then consumers would stop buying and wait for the administrative body to set prices at the point where they just cover direct costs only.

Mr. LERNER. I agree entirely with your main part of the argument that consumers do hold off if they think the price is going to be lower later. This is certainly true in things like automobiles and many other things.

But I don't think that this would make it more difficult. I think you are way ahead of me. I think what you are describing is what would happen when the thing had been well established and had been running for some time.

Then if there is an expectation that there is going to be a ruling that the price is going to be reduced, people will hold off; but not only the customers will be aware of this; the firms themselves will be aware of this.

And if it is perfectly clear that nobody is going to buy, they will make the ruling unnecessary.

This is a way in which a competitive market works better because of anticipation. And it will work better in this case too.

Mr. WESTON. But if the firm has a strong basis for demonstrating that elasticity of demand is less than one, I think rather than quickly cutting prices, they would make a strong argument with the administrative body that they are creating disaster for the firm. Because by cutting prices when elasticity demand is less than one, they are cutting the net receipts of the firm way down. And especially in these industries where overheads are large, you are asking these

firms to accept very substantial losses; not only cut some profits but to create some very substantial losses.

I think your optimism that they would very readily, therefore, cut prices is erroneous. Your statement that they would then act like competitive firms, I think, is also wrong, because it seems to me that on the basis of the evidence which they say is guiding their behavior they are now acting like competitive firms. And they would not be acting like competitive firms under administrative regulation.

Representative BOLLING. I think at this point I will ask Professor Lerner to reply if he wishes, and then we will move on to the other panelists.

Mr. LERNER. Yes.

I think we are now talking about a different case. You are talking not about the case where there is a clear expectation that the price is going to be reduced when there would be both the holding off of purchase by buyers and probably the anticipation of this by the sellers. You are talking about the case where there is going to be a fight and it is not at all clear whether price is going to be reduced or not.

If that is the case you don't have the expectation in the first place which would cause all the trouble. If there is expectation the price is going to be reduced then I think this will make it happen more quickly.

If it is not expected, why, that is a different situation.

Mr. PATTERSON. I would like to ask Mr. Ruggles a question.

In his statement, he inferentially at least looks with something less than horror at the prospect of a 2 or 3 percent inflation per year.

I would like in that case to ask two questions: (1), I agree that this is probably more desirable than a 5 or 6 percent increase in unemployment. But the question is, Are these necessarily alternatives, as I thought he suggested?

And (2) what reasons does he have for thinking that you can work into a 2 or 3 percent inflation and hold it there?

Several foreign countries have found that a 2 or 3 percent quite quickly becomes built into the system as "stability" and you move on from there and then have 5 or 6 and then 8 to 10.

Mr. RUGGLES. There are three issues here. I look upon a price increase with horror. It is a matter of degree. I look upon employment with more horror.

This was in answer to many of the essays. As a matter of fact it was not in my original paper. It was prompted on reading the volume; everybody seems so obsessed with this price problem that they are willing to endure considerable unemployment in order to get rid of even this degree of price inflation.

Now, I would say the price increase in the present period is a symptom of the lack of growth and the recession; namely, that we don't have sufficient productivity increase. I think you do want price stability. But I think you want price stability with full employment and growth. And you can achieve this.

I nowhere suggested as a way out that we should have sufficient demand to give us a price increase of 2 to 3 percent a year.

I would agree with you, I think these things do tend to spread.

Mr. PATTERSON. You don't think these, full employment and price stability, are incompatible?

Mr. RUGGLES. No, I do not.

Mr. LERNER. I was very much impressed with Mr. Ruggles' paper. And I agree very strongly with him that a 3-percent unemployment is a much more serious matter than a 3-percent rise in prices. I think it is unfortunate the way it was put might have given the suggestion that these are alternatives and we had to choose between them.

I don't think Mr. Ruggles thinks that is the alternative.

Mr. RUGGLES. No. This is the way it was posed in many of the other essays in the volume.

Mr. LERNER. If I had to choose between those 2, I would certainly choose 3 percent price increase rather than 3 percent permanent unemployment. But this is not the issue.

I think that one of the things Mr. Ruggles has raised fits in nicely with some of the things which I have been saying; namely, that you cannot separate these two things. And a concentration on any one of the problems makes you fall down on both problems at the same time.

It seems to me that the reason we are likely to suffer from continuing rising prices is because people are unwilling to accept the unemployment and fail to develop measures for correcting the unemployment by measures which would not at the same time lead to increasing prices.

I think if I am right in my suggestion that we have the situation in which prices are being pushed up even when you have 2 or 3 percent unemployed, that unless you operate on the push on prices, which seems like what you would do, only if you are worrying too much about inflation, then you will in fact get unemployment. This is because other attempts to stop the rising prices—operating on the demand or pull—will bring about the unemployment. So I agree very much with the idea that you must deal with both of them together.

Mr. RUGGLES. Apropos of this, to answer Mr. Patterson a little more, I think the key to this is that you have to have either wage control or a higher rate of productivity increase than the kind of recession-riddled economy that we may be getting into wide yield; what the recessions will do is lessen our long-run rate of growth below the wage rate increase.

Now, wage control, I think, would bring with it price control and lots of other things. Also wage increases are a stimulus to the economy to introduce more labor-saving devices. They have their good aspects as well as bad.

I think wage control is also a departure from the kind of system that we would like to have; so I would, therefore, suggest that we first try to operate on increasing our productivity. And this should lower wage costs in many industries by more than it will increase wage rates.

In other words, if the efforts to increase productivity through specific incentive measures have less of an impact upon the wage rate than they do upon productivity, wage costs will be lower than they would be otherwise. And this will mean the pressure on price is lower.

Mr. WESTON. It seems that there has been a tendency to look at a selected number of facts and to generalize on them without recognizing specific things that have been taking place in the economy. For

example, this exaggerated price behavior since 1955. It seems that if one looks at the source and sees what the real root of the problem is, you don't need any vast structural changes such as having an administrative body set prices or wage control or very special tax legislation to attempt to increase particular kinds of investment.

It seems that the problem doesn't involve these things. You had a capital equipment boom that got under way in 1955. As I argue, this was the consequence of some particular things that happened—which I won't repeat here.

Now, to combat these bottleneck price increases that started in the capital-goods industries, and then spread to the consumer-products industries, you had tight money. And here it seems that the Federal Reserve is in a dilemma. The Federal Reserve has argued that they didn't cause this recession. Yet we had tight money put on by the Federal Reserve since 1955.

Well, now, if tight money had no effect on economic developments in this country, then you may as well throw the Federal Reserve away, because this means that Federal Reserve policy has no influence on the economy.

But given the direction of Federal Reserve policy since 1955, it is pretty clear that its effect was a restraining effect on economic development in the economy. And this, in turn, lowered productivity increases and made the wage increases that took place price increases.

So that here again when you talk about generalizing a 2 to 3 percent price rise each year on the basis of recent behavior, this is an oversimplification. We had a growth in 1953 and 1954 without price rises.

What I am arguing is that if the Federal Reserve had been willing to accept some price rises in 1955 and 1956 growing out of these very special circumstances—and again this wouldn't have necessarily led to expectations of a secular price rise because the economy had shown that you could have growth and price stability—then you wouldn't have slowed the economy down so that productivity increases would have covered a substantial portion of wage increases.

And then all of these other apparent weaknesses in the economy really wouldn't have been weaknesses.

It seems that the force of the argument that some people have been expressing is: "Well, we have to do something to these big firms and to labor unions so that when we have an economic recession their competitive behavior characteristics don't result in price rises."

Rather, it seems, our emphasis should be that we don't slow down the growth of the economy, so that given certain structural characteristics, we don't aggravate the smooth operation of the economy.

Representative BOLLING. Mr. Patterson.

Mr. PATTERSON. I had a question. I yield to Mrs. Mack.

Mrs. MACK. I had a little to say on this same point. We have had two suggestions here of a rather far-reaching sort. Mr. Ruggles is saying substantial expenditure on capital equipment is an essential for growth, and that if this is going to involve a certain amount of price rise, let's have the price rise.

A price rise of 3 percent a year would mean, at compound interest, something like a 50 percent rise in about 13 or 14 years. This implies far-reaching changes in our whole financial system.

But there is another problem: The extent to which stimulation of capital equipment is itself without serious costs. I submit that in 1955 and 1956 the exceedingly rapid growth of capital equipment, regardless of whether Federal Reserve policy was well advised, could itself be one of the causes of our present problems. In some sort of commonsense terms, we overbuilt relative to long-term requirements. If too much is built in 2 years relative to what can be used in 15 years, there has to be a certain amount of building too little in the next few years. In this sense, too much capital equipment manufacturing in a specified short number of years can itself cause trouble. There are, in other words, serious potential costs to this kind of blanket suggestion of indiscriminate stimulation of capital goods industries.

I have similar worries about the blanket suggestion of regulation of prices on the subtle basis that Mr. Lerner advocates. The prognosis for price regulation is poor in view of the troublesome experience we have always had with any kind of regulation of prices, even where the objectives are simple as during wartime.

Well, this leads to the question of whether there are more delicate things one can do about controlling inflationary pressure. This was the question to which I was trying to address a few remarks in my paper.

If there is this strategy push to prices of a sort that I think Mr. Lerner is also interested in in his sellers' inflation, the question is, Can we do a little close-in punching on some of the factors that are operating? Are there remedial measures that do not have these sorts of serious potential costs?

I would like to suggest two: (1) First, a certain amount of education could result from more study and discussions and sharper formulation of the relation of cost change to price change. We read, in almost any hearing on wage rates, responses by businesses about what this means in terms of price change. Time and again business tries to justify a rise in prices that is percentagewise the same as the rise in wages.

Of course, if wages represent, say, 50 percent of a finished price—an unrealistically high figure—and wages rise by 10 percent, this means a $5 rise on a one-hundred dollar item, which is a rise of 5 percent.

Well, this sort of incorrect argument—the equal percentage rise in a particular cost and in prices—is used to justify a price boost, and since business is publicity conscious, it helps to boost prices. It applies equally to both labor costs and materials costs; a rise in either or both serve as a ratchet jack to boost prices. Clarification, education, and public discussion may serve to loosen the ratchet on the jack.

(2) The second suggestion that I would like to make involves shortening the jack by lessening fluctuation in crude-materials prices by attacking one cause of their fluctuation. It seems likely that we live in a world in which business objections to lowering prices will prove stubborn. In such a world it is of great importance to weaken tendencies for materials prices to rise. Crude-materials prices rise in part because of the tendency for businesses first to order more than current sales require and subsequently to order less than is needed, thereby alternatingly increasing and decreasing stocks of materials on

hand and on order. As the data presented in my paper suggest, if these buying waves could be muted, crude prices would fluctuate less. The contagious upward movements would lessen along with the non-contagious downward movements. Better information about backlogs of orders, which are often far larger and more variable than are stocks, would lessen the misjudgments that are partly responsible for these waves in buying and their unfortunate impact on the price structure. Statistics on orders for materials slipped through the roundup of available statistical information that the Joint Economic Committee requested and the Board of Governors of the Federal Reserve System organized in 1955. A survey of data on orders remains as an unfinished piece of valuable business.

Mr. PATTERSON. May I make a comment, though not on the point Mrs. Mack just made. If I may, I would like to go back to a point Mr. Ruggles made.

That is the notion that the solution to many of these problems of inflation, as well as of increasing real income in this country, can be found in increasing production and productivity. This is certainly desirable, but I don't think growing productivity will necessarily solve the problem of some of the seller-push, especially from the wage point of view, on prices.

An increase in productivity is no assurance at all—or a faster rate of increase in productivity is no assurance at all—that you won't be faced with very great pressures indeed to raise wages to keep full pace with this increase in productivity. Indeed they are likely to outpace it, I think, if these increases in productivity are associated with a larger capital cost per cut of output, which is, it seems, likely. That is, if your increase in productivity is brought about by an increase in the capital contribution output, this is, if the cost of capital contribution per unit of output goes up, then an increase in wages pari passu with increases in productivity must add to the inflation.

This seems to me to be typical of the situation.

Mr. RUGGLES. In other words to get price stability we should reduce the rate of increase in productivity—the lower the productivity the more price stability—because any increase in productivity leads to a more than equal increase in wages.

Mr. PATTERSON. No, no. I am not arguing against productivity increases. I am arguing this won't solve the problem. A rapid increase in productivity will not solve the problem of rising prices.

Mr. RUGGLES. We don't know whether it will or not. In the years when we have had rapid increases of productivity this has been so.

Now we had zero productivity increases in 1956 and 1957 and we had a price rise.

Mr. PATTERSON. Zero productivity is no answer to any of our problems.

Mr. RUGGLES. I am glad to hear that.

Mr. PATTERSON. I don't suggest that it is. But there is a time problem here. That is, an increase in productivity 1 year may reflect itself, of course, in the wage increases or profit increases the following year. I don't think we can be comfortable in the assumption that the——

Mr. RUGGLES. We had a 3.2 percent rise in the implicit GNP deflator in 1957 and I guess about an equivalent one in 1956. It does

not take a large increase in productivity to offset this. In 1955 we had no significant price increase.

Now it may be that you are right; that lagged relationships will catch up with us. But we don't have long enough experience either to prove your case or prove mine.

And I think this would be an interesting thing to find out.

Mrs. MACK. That very point has been argued in this way: we have not yet experienced the increase in productivity that will result from the large capital equipment additions in 1955 and 1956 because volume has not increased to the point where this overlarge plant can realize its full decreased costs.

Representative BOLLING. We have been so successful in getting the panel to discuss with each other that I am now a little confused as to which one I should recognize.

Professor Lerner?

Mr. LERNER. Mr. Ruggles has been saying we ought to increase productivity to keep up with wage increases. I have been saying we should stop wage increases from increasing by more than productivity, which looks as if we are both saying the same thing.

But I think there is a difference. The difference is that neither of these statements is really complete enough; because each of them assumes that you can change one without having any effect on the other.

Then, of course, that way it wouldn't matter which way you adjusted.

But whereas it seems plausible that raising wages more or less doesn't have an important effect on productivity but has an effect only on prices, changes in productivity can have an important effect on wages because the bargaining power largely refers to increases in productivity.

So if there is an increase in productivity which is recognized by trade unions as a reason for demanding higher wages, this could then bring about the effect which Mr. Patterson was pointing out.

Now this is not an argument for not increasing productivity. We all want to increase productivity as much as possible.

This brings out that whether productivity does increase or doesn't increase and whether the increase is much or little, you are still left with the problem of prices being pushed up by sellers, whether by wages or by the strategy of corporations or others who have some control over the prices which they set.

And, therefore, this is why, it seems, that it is essential to have some kind of regulation.

I just wanted to protest the suggestion that this is the same kind of thing as price control; which I abhor. And I think this is something completely different which does not have the evil effects of price control—because price regulation is an attempt to make the market system work better—the way it is supposed to work; whereas price control is an attempt to evade the market mechanism by fixing a price on other principles.

Mr. WESTON. I must protest again that generalizations are being made on the basis of very recent history and that recent history is being misread.

For example, with regard to the capital equipment boom, it has been argued that we have overcapacity because of the capital equipment boom. But I wonder whether necessarily we have overcapacity;

that is, necessarily we needed to have had overcapacity, because we had restraint on the growth of the economy for 2 years, while this capital equipment boom was going on.

And if you feared overcapacity because of increasing the productive capacity of the economy, then precisely you shouldn't have cut down on the growth of effective demand.

This applies to the discussion that has just been going on with regard to productivity changes and wage changes. It is said that if you increase productivity, this would be fine, but it is likely to cause wage increases to be even greater, and, therefore, you have to do something about controlling the behavior of the large firm. Notice the process of reasoning here.

But even again here when you look at recent history, the wage negotiations that took place from 1951 to 1954 when you had increases in output, increases in productivity and relatively stable prices, didn't go beyond the productivity increases.

The wage increases that took place in 1955 started in great measure from bargaining that was taking place in the automobile industry. And again here is a very special circumstance that I don't think can be used as a basis for arguing that wage increases will always be very substantial and be greater than productivity increases.

In the automobile industry the leaders in the industry had been forecasting in December of 1954 that automobile output in 1955 would be on the order of magnitude of something like 5½ or 6 million cars. And flowing from the relatively easy money conditions prevailing in 1954 and going into 1955, you had some pretty strong competition among lenders and terms went up from 24 to 36 months.

This was equivalent to cutting the price of automobiles in terms of monthly payments—and this is the relevant consideration—almost by a third, taking into account the interest costs.

But it was a very substantial decrease in the price of automobiles. So 7.9 million automobiles were produced instead of the expectation of around 5½ million.

Wage negotiations took place in May and June of 1955 in the midst of a tremendous automobile production year. And on the basis of that level of production and on the basis of what some of the automobile economists were saying about long-run prospects for automobile sales per year, it looked like productivity increases in the automobile industry would have supported an 8-, 10-, maybe a 12-percent increase in wages on the basis of that kind of volume increase.

So the wage increases that were granted in the face of the prospective productivity increases seemed then to be relatively moderate. And going from that 7.9 million production year to substantially lower automobile production, these wage increases were hard to live with in the automobile industry, and they were hard to live with in other industries which were influenced by the wage increases granted in the automobile industry in 1955.

Now here again it seems that you had a very special combination of circumstances which after the fact looked like the wage pressure was awfully strong. But actually, as I say, I think this was a very special circumstance upon the basis of which you can't generalize and say that you have inherently a set of structural characteristics in the economy that inevitably makes for a 2- to 3-percent price rise per year.

I think what you have is a set of circumstances where you get certain mistakes in policy, you can have sporadic price rises.

I don't think you have any inherent situation in the economy which makes for a systematic price rise of 2 to 3 percent a year. And there is a big difference between these two circumstances. If you had a systematic price rise of 2 to 3 percent per year then you might get produced a set of expectations that would make for even a larger price rise per year.

Our recent experience is actually the kind of behavior in prices which we have had since 1800. This doesn't involve any special change in economic behavior in this country.

Representative BOLLING. Thank you. I think because the hour is growing fairly close to 12 o'clock and members of the committee will probably have to leave shortly thereafter I will now call on Mr. Reuss for questioning.

Representative REUSS. Let me ask Mr. Weston about the subject that he has been discussing which is in his summary.

You say the price rises since 1955 have been influenced by a number of institutional factors.

You mention the capital equipment boom, the lengthening of consumer credit terms, and the wage increase in the automobile industry.

Then you say:

> The Federal Reserve policy was not sufficiently prompt or strong to correct for these developments.

I want to be sure I know what you mean by that. Do you mean that you think that the Federal Reserve policy should have been prompter and stronger than it was?

Mr. WESTON. Yes. If the Federal Reserve were going to take action against the capital equipment boom that was underway, the action that would have been called for was not leaning against the wind but driving into it. That is, you had a capital equipment boom and this would call for, if you wanted to stop it through Federal Reserve action——

Representative REUSS. Well, let me stop you right there, because that is my point.

Here men, not institutions, liberalized the depreciation rules in the act of 1954 and started the capital equipment boom.

Men, not institutions, refrained from imposing any controls on consumer credit. And men also had something to do with the wage-price structure in the automobile industry.

Wouldn't it have made more sense for the totality of the Government to have addressed itself to some of these other factors which fed the fires and not sent a boy to do a man's work and imposed an unfair burden on the Federal Reserve which not only didn't do the job of dampening the fires but caused, in my opinion, many untoward side effects?

Mr. WESTON. Yes. My view on this would have been that having done all the things we described, you accept the price inflation in this period particularly because the alternative would be to slow real growth and to create imbalance in the economy having the capital equipment expansion and cutting down effective demand.

But what I meant by this elliptical statement was that if you were going to have the Federal Reserve take any action, what they should have done would have been to engage in very drastic increases in re-

serve requirements, engage in open market sales at the long end to drive up long-term interest rates, to cut off the capital equipment boom as rapidly as possible rather than working on the short end of the rate structure, and then this would have cut down the capital equipment boom in 1955 and 1956.

And then they could have reversed their policy and eased off sooner, so that we could have continued growth in the economy.

If this—as I say, if the Federal Reserve were to take any action at all, this would have been the right action. But my own preference would be that if given the events which had taken place which may well set into motion some forces which are going to make for some price rises, let us understand the situation and don't repeat these mistakes, and let's work for long-term growth in the economy rather than be disturbed by the current price increases taking place.

Representative REUSS. I still perhaps haven't made clear my question, which is: Wouldn't it have been a more sensible and less schizophrenic policy on the part of the Government to have attacked directly some of these things that were causing the hyperthyroid effect that you think the Federal Reserve should have worked on even harder?

Wouldn't it have been a good idea to have used consumer credit controls?

Wouldn't it have been a good idea perhaps in the wage-price situation in the automobile industry to have used some variant of the publicity device suggested by Mrs. Mack, as well as by other panelists, and thus not have had to rely as much as we did on the very broad and meat-ax methods of the Federal Reserve?

Wouldn't that have been a better way to run the railroad?

Mr. WESTON. I think so. I would agree with the position which you have just described. I think it makes a great deal of sense.

Assuming that you had sufficient flexibility, you could have acted promptly enough to have reversed these forces that have been set in motion.

But if you couldn't administratively have acted promptly enough, I would have accepted the price inflation. But if you could have acted, I agree, this was the better way to run the railroad.

Representative REUSS. Thank you very much.

Now, Mr. Ruggles, you too have given me many things to think about.

Your remedy for recession, I take it, would be to attempt to start up a capital goods boom again as quickly as possible. You place primary significance on that, although you do say that tax cuts and some public expenditures also are necessary.

Mr. RUGGLES. That is right. If I may speak on this last aspect that Mr. Weston has been discussing: I think this would have been perhaps in some error, because I don't think we had a demand inflation in 1955. Prices didn't give any sign of that. If we had tightened up, we would have had less ouput in 1955. We would have had less capital goods produced. The prices of capital goods were not rising strikingly at that time.

Now, we may go into the argument that we just shouldn't have these large increases in output because we create excess capacity; that even though we have the labor, facilities and material it is just more than we can consume. In this connection I would like to come

back to the automatic stabilizers. It is true we have gone down $18 billion in GNP, and consumer expenditures have dropped only $1 billion.

If it were symmetrical—I am not suggesting it is—this is just for the purpose of illustration—this means if we had a rise of $18 billion in GNP we would have only $1 billion rise in consumer expenditures.

The burden falls on either Government or investment, and you aren't going to get that sort of increase in Government or investment expenditure. What is the answer? You are not going to get the rise. You are going to have stability of GNP in face of expanding capacity.

Then you have excess capacity. And with the excess capacity you naturally cut down on investment instead of increasing it. And you have a recession.

That I think was more the nature of the 1955 period: it was not a demand boom getting out of hand.

Representative REUSS. I agree but don't you agree that since the nature of the factors at work was not that of a demand boom, that the Federal Reserve tight money policy was irrelevant and harmful?

Mr. RUGGLES. To the extent that it was effective, yes.

Representative REUSS. Let me say, too, that I agree with you that we should not worry about excess capacity. Any industry that wants to build up excess capacity should be welcomed to worry about it.

Mr. RUGGLES. That is right.

Representative REUSS. Now, however, about the immediate problem of the recession: While I certainly wouldn't quarrel with you that we should do whatever is reasonably necessary to stimulate capital investment even now, even though we have at the moment substantial excess capacity in steel, automobiles, and other sectors of the economy, is the stimulation of capital investment in fact going to be the effective thing to combat the recession?

It seems that you can stimulate capital investment all you want in steel and automobiles, but companies are unlikely at the moment to respond to that stimulus because even though you have the most rapid amortization, they still don't want to sock the money away and let it lie idle.

Therefore, shouldn't the great emphasis in curing the depression, recession, or whatever it is, be on two things: First, providing those kinds of capital which we are very shy of now—schools, highways, homes; and, secondly, stimulating consumer buying power, which even though you say some of this will go chasing after haircuts and other soft goods industries, nevertheless if I read the figures correctly, there is overcapacity not only in the durable goods industry but quite generally.

In other words, I am not saying that your emphasis on capital goods stimulus is wrong; but shouldn't you emphasize a little more the other two aspects in view of the abundant supply of capacity in many industries at the moment?

Mr. RUGGLES. I don't think we should expand capacity in the sense of more tons of steel. But I do think we should increase productivity at existing levels of capacity.

Now, again in this connection we have only had a billion or so drop in consumer expenditures. Government expenditures have gone up. So where is the terrific drop coming in our economy? It has come in

investment. Sure, you can stimulate consumer expenditures and get them up and get Government up at the cost of investment over the long run.

Representative REUSS. It is true that we have a big drop in investment currently.

Mr. RUGGLES. That is right.

Representative REUSS. But isn't the bigness of that drop in large part due to the fact that investment was tremendously high, and as far as I am concerned, happily stimulated in recent years? Thus it concealed the fact that consumer income wasn't expanding as rapidly as it should expand in order to continue economic growth.

I put it to you, therefore, that the real area of immediate concern, primary immediate concern, is expansion of consumer purchases.

Mr. RUGGLES. In real terms, since the prices of capital goods have gone up more over the last 30 years than other goods, you will find that we are investing a smaller proportion of our total resources in the capital goods industries than we did in the twenties. We have not really had a capital equipment boom.

In 1957 we invested 14.4 percent of our resources in investment. Half of this was in construction. When you get down to how much of it is productivity increasing in nature, you get down to 5 or 6 percent.

I maintain this is not really a big capital investment, and that if you want high rates of growth you have to get up closer to the 20-percent level.

Representative REUSS. I agree with you. I hope nothing I have said has suggested any complacency about our present rate of growth or any feeling that in the past it has been too fast. I think it has been too slow.

Nevertheless, in immediately coming to grips with the 5½ or 6 million unemployed, isn't the stimulation of consumer purchasing power a quicker way?

Mr. RUGGLES. Yes, I would agree with you that we need both.

Representative REUSS. I have a question for Mr. Lerner.

I would like to hear more about your proposal for the regulation of administered prices, and particularly your explanation of why it is not price or wage control.

Mr. LERNER. Well, let me try to tie it in with the last point.

I think it does fit in there. I think I agreed very strongly with Mr. Reuss that we should encourage consumption not only because consumption is a good thing and gives jobs, but because I think this is a very good way of stimulating investment.

But if you do all of these together and you then get a period of prosperity by the best possible combination of investment and consumption encouraging each other, and you get a condition of prosperity, then I think you will get the kind of increases in prices which Mr. Weston emphasized as being sporadic but, I think, which are sporadic because our prosperity was sporadic. And it is something which happens in prosperity.

I understand by price control an attempt to fix a price which is less than that which would clear the market. People are trying to buy things. And this pulls up their prices. You then impose price control to stop the price from going up.

Now, this doesn't work because people can't buy all they want to buy at the reduced price as controlled. Then you get black markets.

You find we have to go into rationing and all the other things because the price doesn't work.

I call the thing I am suggesting "price regulation" because at no point would the price which is established be one which would make the demand greater than the supply.

It would be a reduction of a price only in a situation in which it is perfectly possible to produce much more than is being produced so that at lower prices people buying more would be able to get all they wanted to buy.

That is why you wouldn't have the evil effects of price control.

Representative REUSS. I would agree with you that a price control that attempts to set prices at a level lower than can be met by the productive economy working at full steam is fatuous and will simply result in a greater black market.

But as far as governmental control, regulation, orders, maybe even rationing, are concerned, your kind of price administration, price regulation, does involve those features.

Mr. LERNER. It does not involve rationing. Rationing is only necessary if you have what I am calling price control.

Where the people try to buy more than is available and they can't get it, rationing is necessary. Then you get an automatic rationing, first by the seller who rations it by giving it to his friends, and not to others. We do not like that kind of rationing.

So, we substitute other kinds, which are less objectionable, but still so objectionable that people want to get rid of them as soon as possible.

What I am suggesting is, never put a price which would make the amount available less than what people want to buy.

In automobiles or steels, if you were to lower those prices even substantially, it does not seem likely that it would not be possible to meet the demand. This is the kind of situation in which regulation would lower the price and this would result in a larger number being demanded and a larger number being produced, because it is only to be done where it is clearly possible that you can produce the extra amount.

I do not want to suggest that this is a very easy thing. I am aware there are very many great difficulties in this thing being adopted. In fact, I do not expect it to be adopted very soon at all.

But I believe unless something of this kind is done we will continue to have the same kind of trouble in which every time we restore prosperity we find prices are rising and we feel it is our duty to do the kind of thing we did in 1955 and 1956 to tighten up and stop the inflation. Then we lose the prosperity.

Mr. REUSS. Your kind of price administration, whatever it is, is like in theory, is it not, to the kind of price control, as it was then called, practiced in the early days of the OPA—Leon Henderson's early days—when there were something like 9 million unemployed in this country?

The theory was that it imposed price ceilings and let the increased demand at those prices call forth full production. And then when that is done, another look will be taken at it. Now, this theory was not followed through, of course, when full employment was reached.

Then you got into the kind of price control which you deprecate.

Mr. LERNER. I think there is a similarity. And I think the fundamental difference between that kind of price regulation—I do not want to call it control, because it is not a situation in which you cannot allow people to get all that they want—this, I think, is a crucial matter. If you can have a price regulation—it does not matter if you call it price control—and if at that price people can buy everything they want to buy, then you do not have all the evils which we associate with price control, which is why I think it is confusing to use the same word.

You could in certain cases have regulations which look just like the regulations of price control if the prices which are set are prices at which everybody who wants to buy can buy as much as he wants to buy.

Representative REUSS. Your price regulations would, of course, I take it, carry legal sanctions?

If the seller of the commodity or the labor involved did not abide by the order, there would be something done about it?

Mr. LERNER. It would have to have something to make it effective. If it was ignored, obviously it would not work.

Representative REUSS. What would you say to a suggestion which would use the same philosophy as embodied in your suggestion, namely, set prices at such a level as to permit the goods to be taken off the market and no lower, but which relied for its sanctions purely on publicity?

That is a suggestion which has been made, I think, by Professor Galbraith and Professor Ackley, and some others.

Mr. LERNER. My only objection to it is I think it would not work. If people would do it I think it would be perfectly fine. But I do not think this would be effective.

However, I do believe that being aware, as I am, of the grave difficulties of administering this kind of thing, I think it would be a step in the right direction to try to develop a sort of voluntary method of doing it, by having organizations which would examine this thing and recommend what the price ought to be and then try to get it pushed through.

If it did not work, I think it would lead to further steps being taken to see that it was carried through.

Now, the degree of coercion necessary can be regulated and kept to a minimum. It might have some sort of tie-in with taxation rather than sending anybody to jail. I am not confident that this would work, because I do not think the whole of our system works on people having to do things for altruistic motives.

Representative REUSS. I would like any other member of the panel who cares to comment either on Mr. Lerner's central suggestion for price administration or on the suggestion which I just put forward, that others have made, for an agency in the Government somewhere—the Council of Economic Advisers has at certain times been suggested—to bring to bear the light of publicity on price and possibly wage increases in so-called strong sectors of the economy—those sectors where it is suspected by many members of the panels that have been before us that there are administered prices.

Mrs. MACK. It seems to me that some of the larger sectors of the economy of which you speak are exceedingly publicity conscious. And

this does make one feel that the force of public opinion might have more impact than words alone might otherwise have.

But perhaps one could usefully think about your question in the context of recent occurrences. There has been a strange history of prices over the last 2 or 3 years. Crude material prices other than foods reached their peak at the very beginning of 1956. They leveled off, dropped in the middle of the year, returned almost to their previous level, and then went down throughout 1957. So, we have a full 15 months during which manufactured prices have risen slowly and crude material prices have been falling. Why?

Well, certainly there is this big overhead element to which business has been committed that makes people very unwilling to lower prices because it is going to be too hard to get prices back again and too hard to cover overhead with a reduced volume of output. In view of this kind of pressure, in view of these strong reasons for hanging on to a price structure, the thought that publicity alone can do much seems mighty questionable.

Incidentally, price policy is also involved in some of the investment problems that we have been speaking of.

Of the fall of investment in the first quarter, about $9 billion—I think that is the latest estimate—is attributed to inventories alone. It is an interesting question what the price picture is going to mean in relation to this fall of inventory.

Ordinarily, when inventory investment starts to level off, prices, which have previously been falling, have also started to level off. Eventually the rate of fall of inventories drops to zero and they even start to increase. The rise in inventory investment is often partly predicated on the thought that it is all right to buy more inventories now because prices are not going down any further.

Well, in this particular situation prices have not gone down. And it is a rather puzzling and rather troublesome question whether, when inventories now are liquidated enough to be reversal prone, the fact that business does not trust this maintained-price structure will inhibit the usual pick-up of inventory investment.

Representative REUSS. I would say just one thing on your comment: That the so-called voluntary publicity suggestion is made, I think, solely with respect to proposed price increases. I do not think that there is a serious suggestion on the part of the voluntary publicity adherents that it be used also as a method of reducing existing prices.

I do not see really how it could be done.

Mrs. MACK. I am pointing to the fact that this is a problem—to get prices to be reduced.

Mr. WESTON. I wanted to comment on the subject of prices with regard to the capital equipment boom: that machinery and motor products which would be one measure went up after 1954 by 18 percent in the 3 years following 1954 which represents a pretty substantial price rise from this sector.

Also on prices, Mr. Lerner's statement, that the only reason that price rises have been sporadic in prosperity in our recent history is that our prosperity has been sporadic, does not jibe with the fact that from 1951 through 1956 the wholesale price index actually dropped from 114.8 in 1951 for the average for the year to 114.3 in 1956 for the average for the year, a drop of a half of 1 percent in the whole-

sale price index over the years 1951 through 1956. And only 1 of those years, 1954, would be regarded as a depression year, which I think is consistent with my hypothesis that you can have years of vigorous increases in business activity with relatively stable prices.

That goes then to the question of whether you actually need an administrative agency of the kind which he proposes; and also it goes to your question whether you might be able to do this through publicity.

The question that arises in my mind in this connection is what do you do when effective demand is strong enough so that the people would be willing to buy goods at higher prices than actually would be set by this administrative agency? Wouldn't you be in exactly the same kind of situation we had before in these industries where you did have price restraint, where they didn't charge prices as high as the market would have paid, and you had all kinds of informal methods of rationing—for example, in the steel industry, when they didn't charge what the market would bear, there was a funny kind of gray market in steel. And the same thing in automobiles. You had bootlegging of automobiles where you were selling used cars at a higher price than new cars.

In the work of the administrative agency Mr. Lerner says you wouldn't have price control because you would not have to ration. Because if you set the price below what price would have prevailed in the market, then the quantity demand will exceed the quantity supply at that price.

Mr. Lerner. Mr. Weston is right on that point. If you have a price-regulating agency of the kind I have been describing and at the same time permit money demand to be excessive, you get all the evils of price control.

I am glad I have this opportunity of emphasizing that I never want to suggest that price regulation can take the place of a proper regulation of the volume of money expenditure.

If you have too much money chasing too few goods, no price regulation is going to stop the inflation. My essential point is that it is not sufficient to have a policy of keeping the volume of money expenditure at the right level. You must do that. If you have too much money expenditure, you are bound to get inflation no matter what price regulations you try to undertake.

If you have too little money expenditure, you will get depression.

My point is that it is not sufficient to have a policy of keeping the volume of spending right; because the right volume of spending which gives you prosperity also in present situations gives you a tendency for prices to be pushed up. Therefore, you need some regulation of administered prices and wages in addition to, or complimentary with, a policy of preventing demand from being excessive, because there are parts of our economy which are not operating the way described in a competitive description of economic textbooks of competitive economy.

And we need the regulation to make this part of the economy work like a competitive economy. Then if we have what I like to call functional finance, a proper volume of spending, then you can get both objectives.

One of them alone will not suffice to give us what we want.

Representative REUSS. Thank you, Mr. Chairman.

Representative BOLLING. Doctor Talle, do you wish to join the happy throng?

Representative TALLE. Thank you, Mr. Chairman.

I had to spend much of my time with the Banking and Currency Committee today. But I want to thank all of you on the panel for your contributions.

Thank you, Mr. Chairman.

Representative BOLLING. Mr. Riley, do you have anything you would like to say or any questions you would like to ask?

Mr. RILEY. Thank you, Mr. Chairman.

I have happily been able to scrap a lot of questions as the discussion has proceeded. But there are a couple of points that I think could stand a bit of clarification in the record.

I would like to start with Mr. Weston and pick up a remark I understood him to make with respect to the wage developments in 1955 in the automobile industry.

If I heard you correctly, Mr. Weston, you were relating the rise of wages there to the rise of productivity in the automobile industry. And as I understood you, you were saying that the increase of wages did not outstrip the rise of productivity at that time.

Mr. WESTON. The rise in productivity that apparently was going to be achieved in the automobile industry during the year 1955, on the basis of 1955 operations——

Mr. RILEY. Well, that brings me to the central question: as to whether it is your position that the proper gage of the rise of wages that can be permitted without inflationary pressures is related to the productivity increase in the area of bargaining rather than productivity increase in the economy as a whole.

Mr. WESTON. If you are going to relate increases to productivity changes, you should certainly restrict this to the particular area where bargaining is taking place, not to conditions in the economy as a whole.

I would say that I would not depend upon productivity increases even in a particular industry or firm where bargaining is taking place as the sole criterion for determining what wage increases, or what wage changes, should be.

But insofar as this is one of the pieces of evidence, or one of the kinds of information that will influence the bargaining process, certainly the experience of that particular firm or industry is the relevant data.

Mr. RILEY. Instead of pursuing that, let me ask Mr. Ruggles a related question.

And let me state first that yesterday we heard Professor Kendrick, who has submitted a very interesting paper on productivity developments.

He came to the conclusion that further increases of wages, if they were to be noninflationary, needed probably to be held to no more than approximately 3 percent per year to be consistent with the growth of productivity that we had experienced and which he was assuming would continue. And he was relating that rise to the overall national average.

And, indeed, he related it to the rise in total factor productivity, plus about one-quarter, which he found approximately equal to the rise of labor productivity.

I would like to ask you, Mr. Ruggles, whether I may understand your testimony to be in agreement with that general formula, that general finding, of a limit on the wage increase that we can safely live with; and secondly, whether you would agree with Professor Kendrick in emphasizing its relation to the overall average, whether overall labor productivity or total factor productivity; or whether you agree with Mr. Weston that it is safe to gear it in a given industry to what may be a substantially greater than average rise in productivity characteristic of that bargaining area?

Mr. RUGGLES. I do not think I would agree with Mr. Kendrick on one thing: He has taken as not variable the long-run rate of productivity increase in our system.

In the past this has come about through the averaging out of lots of different factors. We have had wars, and we have had depressions.

And if we can count on exactly the same things happening in the future, perhaps our rate of growth will be 3 percent.

But I hate to look forward to another depression like the thirties or a world war III, and so on.

So I don't believe that in charting our future course we should take historical trends of this sort into account.

Mr. RILEY. Let me elaborate in justice to Mr. Kendrick and say that he did not assert the future rise would be no greater than in the past; and he, as you have done this morning, stressed the importance of increasing the growth of productivity.

Mr. RUGGLES. Right.

Now, therefore, to hold wages to a past historical trend I don't think is—well, I think we have to wait and see what our productivity increase can be if we make it one of the aims of economic policy to raise the productivity level. We may be able to get up to, say 4 or 5 percent. I don't think this is out of the bounds of possibility if we desire to do so.

I mean this is a matter of economic policy.

Next, this problem of long-run prices is a complex one. In our economy, we do have wage rigidity in any case. If expenditures develop along the line of Engle's law where more and more of our resources are going into services, where we count zero productivity rise—in other words, when Government workers get an increase of 25 pecent, this is a 25 percent increase in prices—there is nothing you can do to offset this, except to have lower prices elsewhere in the economy.

Now, it may be that our economy can't adjust this way; that relative price change has to come about through some prices rising, because of the rigidities in the system. Suppose we had a system where zero productivity change took place; any rise in Government workers' wages would, by definition, have to be offset by a fall in wages elsewhere in the economy.

Fortunately, productivity helps offset this tendency for a relative price rise to disturb the system. But I am not sure it will offset it fully.

On the other hand, we are deluding ourselves if we think our price indexes are particularly significant. How do you measure the price of capital goods? By their productivity?

In other words, assume that a capital good today is twice as productive as it was if it was made 20 years ago. Has the cost per unit of

output fallen in half? Or just where do we take our productivity measures into account? In our price indexes? Or in our output indexes?

I just don't know.

So I think we are building a Frankenstein here if we start operating upon price indexes that we are not too sure of the meaning of. I, therefore, would not, until we see how our long-run policy works out, work on restricting either wages or prices.

I would still like this to be an economy in which everybody follows his self-interest. I would try to prevent obvious abuses of monopoly power, but it seems that the fault is not with the system but with the institutions such as the automatic stabilizers and so on; and the level of investment, and things of this sort.

Given a favorable setting in terms of these, I suspect the economy might operate satisfactorily.

Mr. RILEY. Thank you.

Representative BOLLING. Mr. Knowles?

Mr. KNOWLES. We have heard the argument revolve around the contrast between stable prices and rising prices. I thought I would quote a passage here from the first report of the Council on Prices, Productivity and Incomes of Great Britain. It was chairmaned by Lord Cohen. And I will ask your reaction to this point of view of the price problem. It is on page 32 of the report.

> For a country in which technical progress is active and capital equipment increasing faster than population, is stability of the price level a sufficiently ambitious objective? Ought not such a country to aim rather at a state of affairs in which the fruits of progress are being permitted to manifest themselves, to the general advantage, in a gently falling price level? This would be the result if, instead of attempting to stabilize the price-level policy was aimed successfully at stabilizing the general level of money income per head. There has always been a respectable body of economic opinion favoring this point of view, though until quite recently it might have seemed to us rather unrealistic even to mention the fact. But during the last few weeks we have been impressed by the apparently widespread revival of interest in the idea of falling prices and have been glad to note some practical steps toward its realization. Respect for this line of thought would prevent us from too ready an acceptance of the idea that an attempt should be made from time to time to estimate and proclaim the maximum percentage by which over the succeeding 12 months wages and salaries could be allowed, on the average, to increase without inflicting severe internal or external damage. We feel that this idea involves too definite an endorsement of the doctrine that the general level of prices should never be permitted or encouraged to fall.

At this point has the panel any reaction to the notion that maybe we should have as our objective stabilizing the money income per head; and in the circumstance, therefore, enjoy the benefits of falling prices rather than inflation?

Mr. WESTON. This raises, it seems, a very broad question about Government policy and it seems to me that in general, Government policy should not be concerned with prices as such, but rather with structural characteristics of the economy to the extent that the Government has responsibility.

Now, if under a full employment act, like the act of 1946, by taking the necessary steps to offset excessive demand or raise deficient demand, if the Government carries out these objectives, it is actually working with reference to a policy of promoting stability of growth in, it seems to me, money income per head.

I think such an objective is consistent with the spirit of the Employment Act of 1946 in this country.

Now, it seems, that what our action in Government policy has been in the last couple of years is an excessive preoccupation with such fetishes as that the Federal budget should not run a deficit beyond a certain size in a particular year, which fetish is devoid of economic content.

And also with being excessively concerned with short-run price behavior in attempting to link this short-run price behavior with structural characteristics rather than with particular circumstances and developments that took place during these years.

Now, if it were clearly established that there were certain structural characteristics of our economy that made for secular price inflation, then it seems that the proper action would be to change these structural characteristics. My argument is that you don't have that situation, but that rather we have had a series of individual mistakes piling up which have interfered with the objective consistent with the Employment Act of 1946 to provide for stability and growth in real income per capita.

And what we have done, actually, has been to deviate from this objective by putting in place of it, setting a goal such as avoiding a deficit of a certain size even if it means a decline in real output per capita, and being excessively preoccupied with what I would regard as sporadic price changes.

Mr. PATTERSON. I would like to make two comments on that quotation.

One: I think a good bit can be said for the incentive advantages of a system of stable prices and rising money incomes as compared with stable money incomes and falling prices. I think there is a good bit of illusion in people's minds about these things and most are likely to believe their welfare is going up faster when their money income goes up with prices being stable, then when their money income is stable and prices are falling. The former makes them think they are improving their position more.

And I think that providing such incentives for more work, and more efficient work, is an important need of our economy.

Two: I think a policy such as this would make more sense from the British point of view than from ours.

I can understand how with Britain's peculiar economic position and the desirability of strengthening her balance of payments position, something along this line would be a tremendous advantage. There is relatively little incentive for the United States to pursue something for that particular purpose at this time. So it might be more appropriate for them than for us.

Mr. LERNER. I would disagree with this proposition of the report, except for the special case which has just been mentioned.

I think it is useful in training economists to have them go through exercises which show it doesn't make any difference which you do. If you manage a perfectly flexible system, you could have prices going up or prices going down or prices going where they will on the average, as long as the relations between them remain the same, you could get the same output. And all that you need to have would be a corresponding rate of interest which would have to be higher by

the number of points at which prices are rising per annum or lower by the number of points at which prices are falling per annum.

It seems to me more sensible to avoid difficulties which are not necessary and to have a policy of keeping stable prices, because it has the additional benefit that we can make use of the general tendency to suppose that a dollar is a dollar. And the more we keep a dollar as a dollar in terms of what it will buy for the kind of things that it is spent on by most people, the less difficulty we will have in making the adjustments of all the other prices to fit this particular stable point.

Mr. RUGGLES. I think this discussion is very interesting, because there is pretty much unanimous opinion here that a price rise is bad, for reasons of equity. Yet when you introduce a price fall, nobody objects. But it is inequitable in exactly the same degree. Those who have assets in the form of fixed obligations and so on are placed in a worse position.

For example, supposing you have a mortgage on a house, the mortgage is fixed, the value of the house falls, and you are squeezed. Sure, those with fixed incomes, again, benefit by such a price fall. But there will be other people in the economy whose incomes will fall even more.

So because our system is geared to an existing set of institutions, with forward and backward commitments in terms of prices, assets, and liabilities, a falling price level can be fully as inequitable as a rising price level.

Therefore, I really can't see any point to this. As a matter of fact, I think we benefit more by a rising price level—it is less inequitable—because the people who lose with a rising price level tend to be those who own assets, where those who lose with a falling price level tend to be those who owe money.

Representative BOLLING. Thank you.

If there are no further comments or questions, before I adjourn the meeting, without objection this first report of the Council on Price, Productivity, and Incomes will be included in whole in the appropriate place in the record.

(The material referred to is as follows:)

COUNCIL ON PRICES, PRODUCTIVITY AND INCOMES

First Report

LONDON
HER MAJESTY'S STATIONERY OFFICE
1958

COUNCIL ON PRICES, PRODUCTIVITY AND INCOMES

Chairman Lord Cohen

Members Sir Harold Howitt
Sir Dennis Robertson

Secretary W. A. B. Hopkin

Assistant Secretary F. T. Blackaby

COUNCIL ON PRICES, PRODUCTIVITY & INCOMES
FIRST REPORT

ERRATUM

Page 19, para. 59, first line of table (Net surpluses/deficits of public corporations), 1956:

for (−18) *read* (−15).

LONDON: HER MAJESTY'S STATIONERY OFFICE

Contents

CHAPTER
I. Introductory
II. Facts and Figures
III. The Causes of the Rise in Prices and Incomes, 1946–57
IV. How do we want the Value of Money to behave?
V. Damping Down Demand
VI. Wages under Controlled Demand
VII. Prices and Profits
VIII. Summary

APPENDICES
I. List of Witnesses
II. The Measurement of Profit Income
III. The Consumers' Price Index and the Index of Retail Prices
IV. The Measurement of Industrial Production and Total National Production
V. Production, Productivity, Wages, Salaries and Profits
VI. Unfilled Vacancies and Unemployment
VII. The So-called Undervaluation of the Pound
VIII. The Velocity of Circulation of Money
IX. Investment

CHARTS

CHART

1. The course of retail prices, 1850–1957
2. Price movements, 1946–57
3. Retail prices
4. Where the money went
5. Production
6. Earnings, wage-rates, salaries
7. Wages, salaries and profits
8. Dividends
9. Unemployment and unfilled vacancies

CHAPTER I

Introductory

I

1. We were appointed in August, 1957, with the following terms of reference:

> "Having regard to the desirability of full employment and increasing standards of life based on expanding production and reasonable stability of prices, to keep under review changes in prices, productivity and the level of incomes (including wages, salaries and profits) and to report thereon from time to time".

2. We have endeavoured to contain our discussion within the framework of these terms of reference; but we think it right to point out from the start that some of the phrases which they contain are not very precise in meaning, and also that not everything which is "desirable" is always fully attainable.

3. It has been our aim to present the relevant facts about the movements in recent years in prices, productivity and incomes in language intelligible not only to economists but to all who may be interested in these questions, and to comment on those facts. This is not an easy task, and if we are to succeed it may be at the cost of some over-simplification. That risk, we think, must be accepted.

4. We have also regarded it as within our function to comment freely, both on certain steps taken by Her Majesty's Government since we were appointed which have a bearing on these affairs, and also on various suggestions for action which have been put forward in other quarters.

5. Our terms of reference direct us "to report from time to time". Our first report is necessarily of greater length than subsequent reports are likely to be. It has, however, been impossible for us, in the time at our disposal, to cover the whole field. There are a number of aspects of the problem—for instance, the international position of sterling, the techniques of wage bargaining, the connected problems of agricultural subsidies and food prices, and the lessons to be learned from foreign experience in the field of prices, productivity and incomes—to which we may wish to return at a later date, and on which anything we say in this report must be taken as provisional.

6. The statistics used in this report and its appendices are based in the main on figures contained in the official Monthly Digest of Statistics and the annual Blue Book on National Income and Expenditure prepared by the Central Statistical Office. They are supplemented in some instances by calculations made by the National Institute of Economic and Social Research and by the London and Cambridge Economic Service.

7. We have accepted as valid and appropriate for purposes of the analysis of national economic problems measures of income based on the principles of national accounting as exemplified in the Blue Book on National Income and Expenditure. We think it wise, however, to point out that these measures are prepared on lines which differ from those normally adopted in preparing company accounts and by the Revenue Authorities in making assessments to income tax. Thus, for example, we have treated as a proper deduction in arriving at the measure of aggregate profit a charge for depreciation based not on the original cost of the assets concerned but on the replacement cost at the time to which the statistics relate. We express no opinion on the contentious accounting problem thus raised ; we discuss in Appendix II how far our conclusions would be affected by the substitution of figures based on the more usual accounting practice. It should, however, be noted here that a consequence of adopting the replacement cost basis for calculating depreciation is that in a period of rising prices the figure of net profit income derived from the Blue Book is necessarily less than the figures of profit included in the firms' own accounts. We should add that in company accounts any extra amount required to cover increased cost of replacement is, if provided, normally dealt with by making reserves out of profits and is not treated as a deduction in arriving at profits.

8. The structure of the remaining chapters of this report is as follows. In Chapter II we present the leading facts and figures illustrating the behaviour of prices, productivity and incomes in the post-war years. In Chapter III we discuss broadly the reasons why the value of money has fallen during this period, and in Chapter IV the question of how it is desirable that it should behave in future. In Chapter V we comment generally on the measures taken by the Government in September last to damp down demand, and in Chapter VI we discuss more particularly their impact on the market for labour and their implications for wages policy. In Chapter VII we comment on various issues connected with the behaviour of prices and profits; in Chapter VIII we summarise our conclusions.

II

9. We have not thought it advisable to hold public sessions or to require written submissions from those whom we invited to discuss our problems with us. Such a procedure would have been too cumbrous if we were to report within a reasonable time. Moreover, we considered that we should learn more from informal discussions.

10. We therefore invited various Government Departments, bodies representative of employers and employed, and the Bank of England to send representatives to see us. We also extended invitations to certain selected individuals connected with institutions the activities of which touch on the subject of our enquiry. We have set out in Appendix I a list of those who accepted our invitation.

11. We were anxious to get the views of leading economists on the problems before us, and accordingly we invited a number of them to furnish us with memoranda on the subject. The names of those who complied with our

request are also set out in Appendix I. Mr. B. C. Roberts generously allowed us a pre-view of his book (shortly to be published by Messrs. Allen and Unwin) on *National Wages Policy in War and Peace.* We had also the advantage of an informal discussion with Professor Lionel Robbins.

12. We also received written contributions, in response to a general invitation, from a number of institutions, firms and individuals to whom no specific invitation had been extended.

13. To all who have co-operated with us in our labours we would express our appreciation. We have given full consideration in the course of our deliberations to all the material with which we have been supplied, but we must make it clear that the conclusions which we have expressed in the subsequent parts of this report are entirely our own and (except where otherwise expressly stated) no responsibility therefor can properly be attributed to any of those who have assisted us.

14. We cannot conclude this portion of our first report without expressing our deep gratitude to our secretary and his assistants for their invaluable help in the preparation of the report.

CHAPTER II

Facts and Figures

THE RISE IN PRICES

Introduction

15. The post-war years have been good years for the United Kingdom, in many ways: years of economic success. The contrast with the inter-war years is a sharp one. It shows up clearly in the figures both for employment and for the increase in the quantity of goods turned out by industry. In the inter-war years there were, on average, 1¾ million unemployed; since the war, about one-third of a million. And in the eleven years from 1946 to 1957, industry raised the volume of its output substantially more than in the twenty years from 1919 to 1939. On both these scores, the economy has performed well. It has provided jobs for all who wanted them; and the actual quantity of goods produced has risen in every year but two.

16. But, together with these two successes, there has been one big failure: the failure to prevent prices from rising. It is true that they had begun to rise before the war; they have in fact risen every year since 1934. But in the pre-war years from 1934 to 1938 they were rising only slowly—about 2¾ per cent a year; and it was a rise after a previous fall: in 1938 prices were still lower than they had been ten years earlier. They rose fast during the war, of course; but price rises are to be expected in war-time. The rise in prices in World War II was smaller than in World War I.

17. It is the price rise since 1946 which is exceptional. Since the end of the war, prices have continued to rise some 4 to 5 per cent a year, on average. Not unnaturally, after eleven years like this, many people tend to assume that price rises of this size are part of the natural order of things: that prices have always risen at the rate of 4 to 5 per cent a year, and are bound to go on doing so. This is not so. A peace-time price rise as big and prolonged as this one is wholly exceptional in this country; there appears to be no precedent for it in the last 100 years of British economic history. Chart 1 sets out the course of retail prices in this country from 1850 to 1957. There is no other peace-time period of comparable length which shows anything like as big a rise in prices as that of the last eleven years.

Measures of prices

18. Prices have risen some 4 to 5 per cent a year, whatever general price figures are used. For there is not just one measure of the rise in prices, but a number. Different collections of goods show differing price movements; and there is more than one method of measuring them.

19. There are separate price figures, for instance, for the three main groups of goods and services into which the country's total production can

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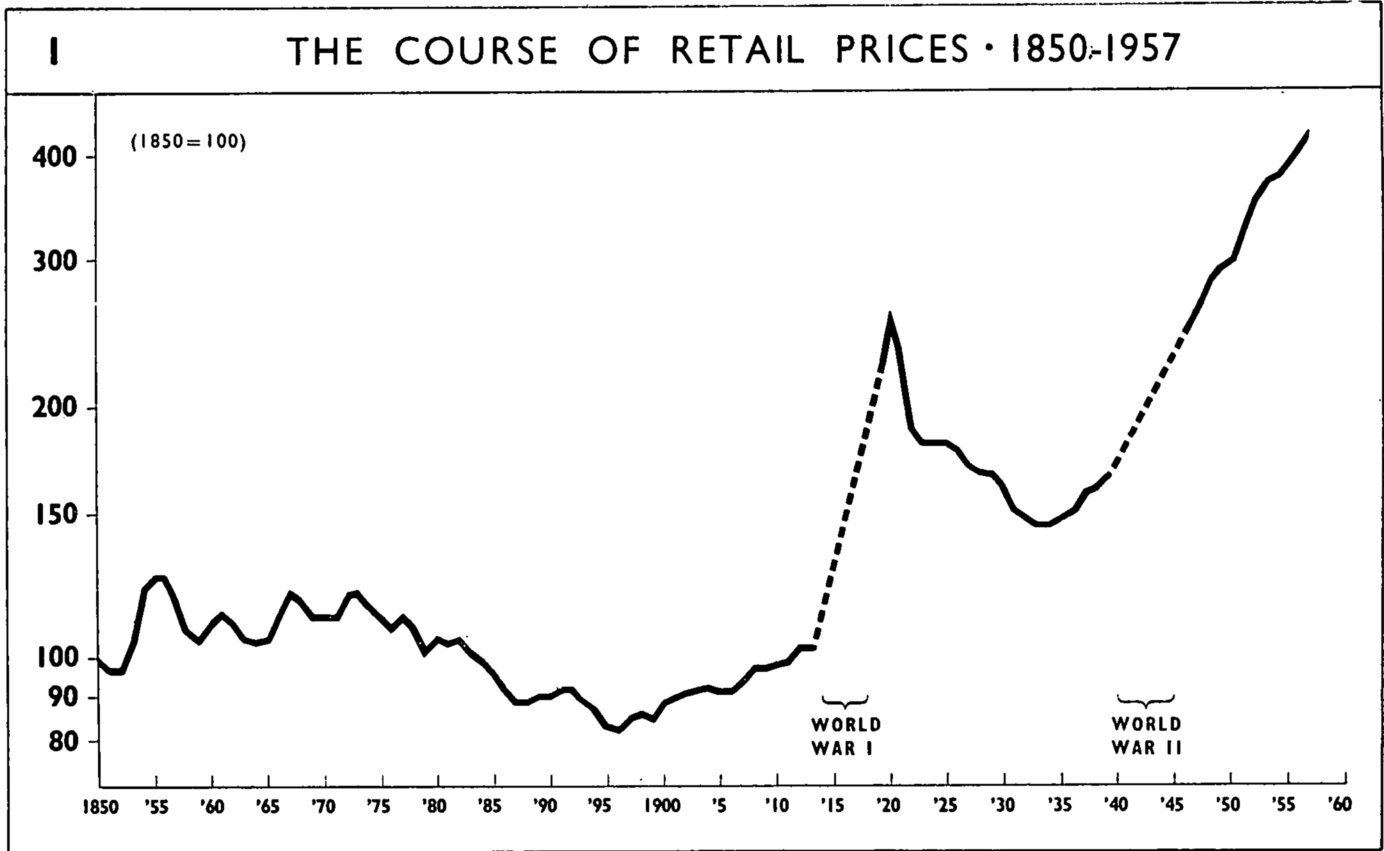


1 THE COURSE OF RETAIL PRICES · 1850–1957

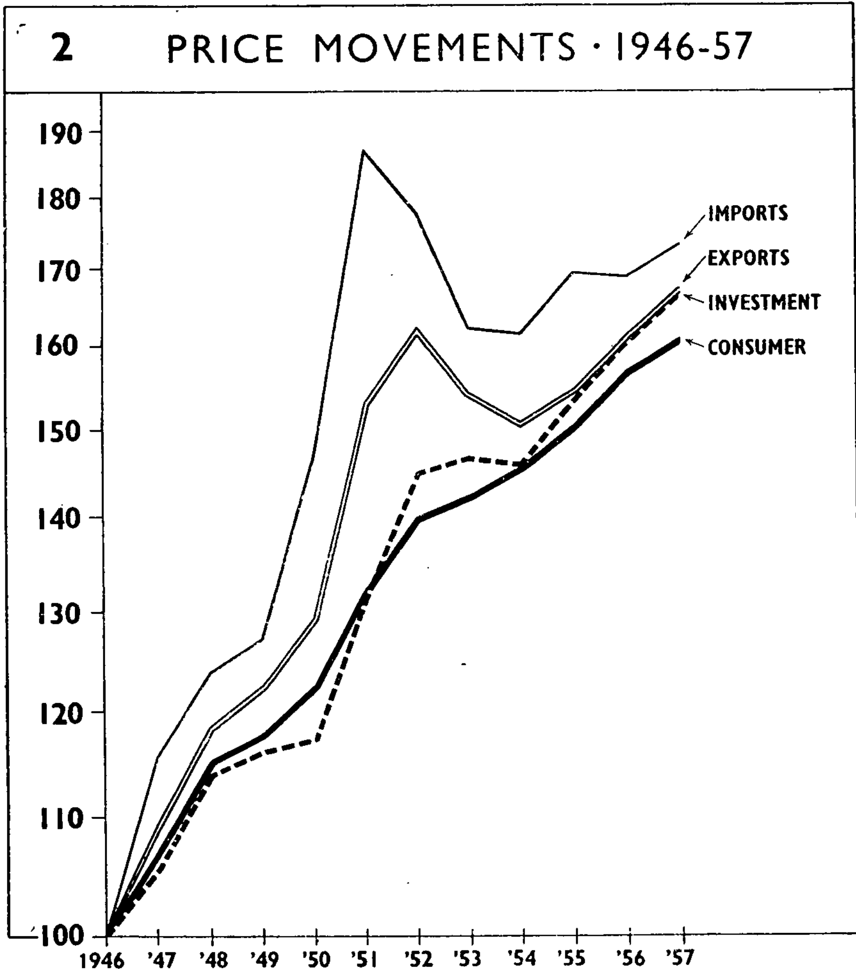
Sources : 1850–1913 : Layton and Crowther, *An Introduction to the Study of Prices*, Macmillan, 1935, p. 265. 1913–57, London and Cambridge Economic Service.

The chart is on a ratio scale, so that the same *proportionate* increase raises the line by the same amount.

5
A 3

be divided—that is, first, goods and services produced for the home consumer; secondly, investment goods—such things as machinery, factory buildings, and houses—produced for the home market; and, thirdly, goods and services produced for export. There is a further price series—the index of final output prices—which measures the increase in price of all three added together.

20. In fact, over the whole period from 1946 to 1957*, all four of these price figures show much the same price rise—of about 65 per cent. This does not mean that they rose in line every year; export prices rose faster up to 1952, and then fell for two years. Chart 2 shows the different price movements of the different groups of goods.



Ratio scale. 1957 : estimate based on first three quarters.
For imports and exports, the price series are for goods and services.

* Estimate based on the first three quarters of 1957.

21. It also shows separately the movement of import prices of goods and services. The other groups include imports: that is, the rise in the price of consumer goods and services includes, for instance, the price rise of imported food, and the rise in the price of exports includes the price rise of the imported materials which went into their manufacture. But it is useful to measure the rise in import prices separately, because this rise had its own special importance in explaining the other price rises (see para. 29). Import prices rose very fast up to 1951—by over 80 per cent; since then they have fallen. Over the whole period they have risen more than other prices: by nearly 75 per cent instead of about 65 per cent.

Consumer prices

22. The price rise most people are interested in is, of course, the rise in the price of consumer goods—the things ordinary people buy. There are three special points about the figures here.

(i) The first point is that there are two different measures for the rise in prices in this field. There is the figure mentioned in the last section—for the rise in price of all consumer goods and services. There is also the measure called the index of retail prices. The first covers all consumer goods and services. The second sets out to measure the price rise of goods and services bought by wage-earning or moderate-salary-earning households only. This second figure is therefore the one more widely used in wage negotiations.

Of the two, the index of retail prices has risen faster: it has risen at the rate of just over 5 per cent a year, on average, since the middle of 1947. The other measure—the figure for the prices of all consumer goods and services—has risen more slowly: just over 4 per cent a year. The reasons for this are discussed in Appendix III, where there is also a fuller description of the two sets of figures.

(ii) The second point is that, whichever of the two measures of the rise in consumer prices is used, there have been very big differences in the price rises of different items. Chart 3 is based on the index of retail prices*, and shows the price rises of six different groups from October, 1949 to October, 1957. A chart based on the other measure—the index of consumer prices—would show much the same sort of picture.

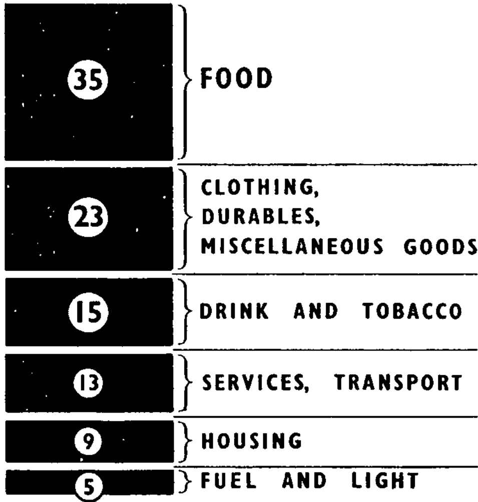
Food prices rose very fast from 1949 to 1955. Food is the largest single item in the family budget: the rise in food prices accounts for over half the total rise in prices in these six years. But since the end of 1955, the price of food has not been rising so fast.

Over the period as a whole, fuel and light prices have risen fastest. But they are a relatively small item in the average budget. At the other end of the scale, drink and tobacco prices hardly rose from 1949 to 1955; the rise since 1955 is partly explained by the increase in the tax on tobacco.

Clothing, household durables and miscellaneous goods—that is, the goods produced for consumption by manufacturing industry—show a smaller than average price rise. Between October, 1953 and October, 1955, their prices hardly rose at all.

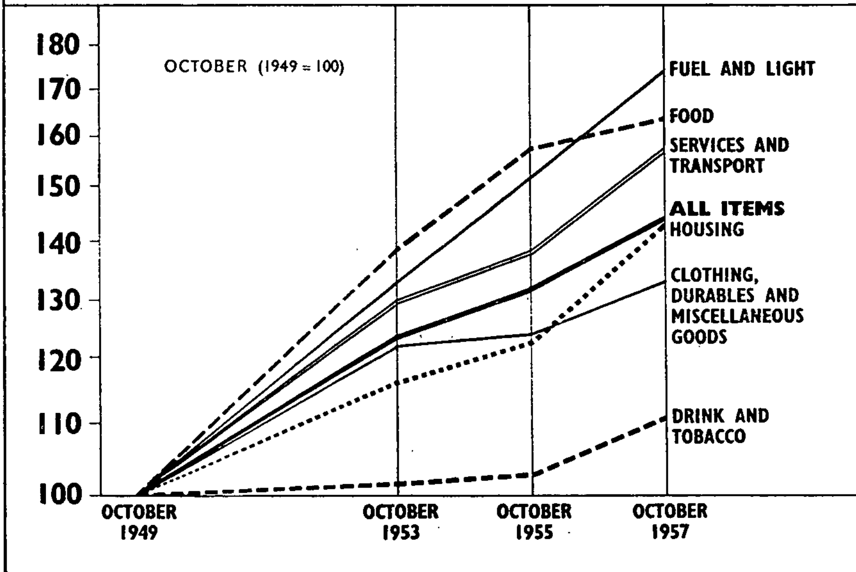
* These figures are taken from R. G. D. Allen, *Movements in Retail Prices since 1953*, Economica, February, 1958.

3 RETAIL PRICES



This shows the importance of 6 different groups of items in the budget of the average wage- or salary-earner earning less than £20 a week.

This shows the different rates at which the prices of those six items rose:



Ratio scale. Source: R. G. D. Allen. *Movements in retail prices since 1953*, Economica, February, 1958.

8

The cost of housing—that is, rent, rates and repairs—rose comparatively slowly up to the end of 1955 ; since then it has risen faster. The cost of services and of transport has also risen faster than average in the last two years.

(iii) This fact—that some kinds of consumer goods and services have risen more in price than others—might be expected to make the cost of living rise more for some groups of people than for others ; for different groups of consumers divide their spending in different ways. For instance, households where the main wage or salary earner earns up to £20 a week spend 35 per cent of their money on food, on average. Families with higher incomes, where the head of the household earns £20 a week or more, spend only about 20 per cent of their money on food ; at the other end of the scale, food takes over 40 per cent of pensioners' income.

23. With the help of the Ministry of Labour's enquiry into household expenditure in 1953–54*, a number of different measures of prices have been calculated to fit the pattern of spending of various groups in the country†. They show that it is true that the cost of living has risen rather faster—though not very much faster—for pensioners than for other groups in the last eight years. For the other groups for which the calculations were made, there is virtually no difference in the rise in prices.

	*Per cent increase in prices** (October to October)	
	1949–53	1953–57
Pensioner families:		
One person	28	20·2
Two persons	26	17·9
Manual employees	24	15·9
Clerical and professional employees	24½	16·3
High income families	24	16·1

* The figures for 1949–53 are less precise than those for 1953–57.

WHERE THE MONEY WENT

24. If prices rise in a country, it must mean that the money paid out for all goods and services produced and imported has risen faster than the actual quantities of home-produced goods and services and imports. The figures for Britain work out as follows.

25. In Britain in 1946, the total sum paid out for home-produced goods, services and imports was £11½ billion.‡ From 1946 to 1956 the actual supplies of these goods and services increased by about a third. So if prices had not risen, 1956's total supplies could have been bought for about £15½ billion—an increase of £4 billion.

26. In actual fact, they cost not £15½ billion, but £24½ billion—an increase, not of £4 billion but of £13 billion. The difference between these last two figures—£9 billion—is the difference made by rising prices : it is the extra money paid out on account of rising prices.

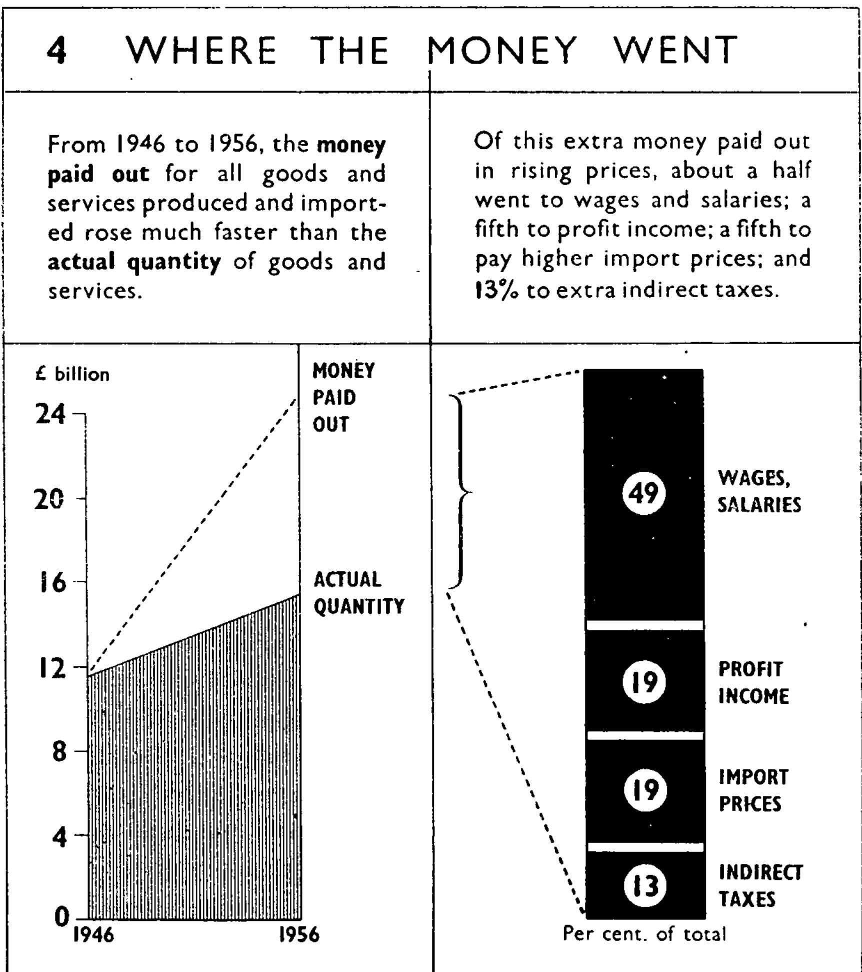
27. This extra money must, of course, have been paid to someone: the arithmetic below shows where it went. It was paid out either in extra wages

* *Report of an Enquiry into Household Expenditure in 1953–4.* H.M.S.O., 1957.
† R. G. D. Allen, *Movements in Retail Prices since 1953.* Economica, February, 1958.
‡ Throughout this report, the practice of using " billion " to mean " a thousand million " is adopted.

and salaries*, or in extra profit income—these include not only company profits, but all earned incomes which are not wages and salaries—or it went in higher import prices, or in extra indirect taxes† to the Government.

£ billion	Per cent of total	
9·2	100	Extra money paid out for higher prices in 1956 compared with 1946, *of which*
4·5	49	To extra wages and salaries (that is, extra over and above the amount accounted for by rising production).
1·8	19	To extra profit income.
1·7	19	To higher import prices.
1·2	13	To extra indirect taxes to the Government.

28. As Chart 4 shows, roughly half the extra money went to wages and salaries; about a fifth to profit incomes; another fifth went to pay higher import prices; and about an eighth went to extra indirect taxes.



* "Wages and salaries" is used in this report to cover all income from employment, including pay in cash and kind of the Forces, and employers' national insurance and other contributions.
† This also includes the effect of any reduction in subsidies.

29. It is illuminating to do these sums, not only for the whole period 1946–56, but also for 1946–52 and 1952–56 separately; for the importance of the four items is not the same in the two periods. Import prices were much more important in the first period; in the second, they were falling, and helped to prevent prices from rising further than they did. Wages and salaries, on the other hand, were much more important in the second period than in the first.

1946–56 (Per cent of total)		1946–52 (Per cent of total)	1952–56 (Per cent of total)
49	To extra wages and salaries	42	74
19	To extra profit income	19	22
19	To higher import prices	26	−9
13	To extra indirect taxes to the Government ...	13	13
100		100	100

30. Wages and salaries are considerably more important in the tables than profit income, mainly because they were substantially bigger to start with; but it is also true that, whereas from 1946 to 1952 wages and salaries rose roughly in line with profit income, from 1952 to 1956 they rose appreciably faster. This explains why, between the period 1946 to 1952 and the period 1952 to 1956, wages and salaries rose from 42 per cent of the total to 74 per cent, whereas profit income only rose from 19 per cent to 22 per cent.

£m.	1946	1952	1956	(Per cent increases)		
				46–52	52–56	46–56
Wages and salaries	5,732	9,105	12,222	+59	+34	+113
Profit income*	3,011	4,630	5,813	+54	+26	+ 93

* Profit income is here given as in Table 17 of the National Income Blue Book, 1957: that is, before providing for depreciation of capital assets, but after providing for stock appreciation. Profit income includes income from self-employment and rent.

31. The figures for the first three quarters of 1957, compared with the first three quarters of 1956, carry on the 1952–56 story. That is, import prices were unimportant as a factor in rising prices. Wages and salaries again rose more than profit income—by 6 per cent, compared with about 4 per cent; and both rose faster than the country's production, which went up by about 1½ per cent.

32. These tables do not, by themselves, explain the process by which all this came about; they do not give the cause of rising prices. These are discussed in Chapter III. The tables only set out where the extra money paid out in rising prices went.

INCOMES AND PRODUCTION

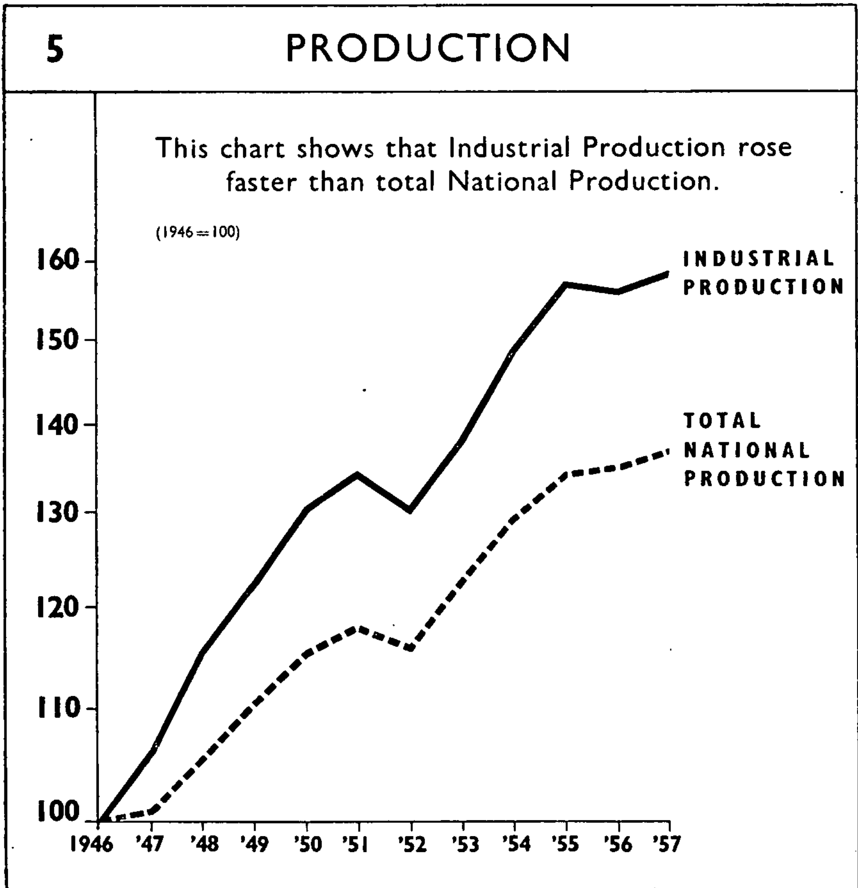
For the country as a whole

33. It is clear that the relationship between the rise in real production and the rise in money incomes—wages, salaries and profit income—is central to the problem of rising prices. If these incomes had risen in line with the rise

in the nation's production, instead of very much faster, the rise in prices would have been a minor one—limited to the rise brought about by higher import prices.

34. This section examines this relationship between production and incomes more closely, both for the economy as a whole, and for various parts of it. For in some parts of the economy the gap between the rise in incomes and the rise in production has been bigger than average, and so prices have risen more than average; and in other parts the gap has been smaller, and so has the rise in prices.

35. For the country as a whole, and over the post-war period as a whole, the best figure that can be given for the increase in the nation's production is that it rose, on average, by about 3 per cent a year. This is an estimate of the increase, not just in industrial production, but in production of all kinds, of services as well as goods. (The rise in total national production is compared with the rise in industrial production in Chart 5; and the methods of calculating the figures are set out in Appendix IV.)



Ratio scale. Total national production=gross domestic product at 1948 factor cost; 1957 figure based on the first three quarters.

12

36. Against this production increase of about 3 per cent a year, wages, salaries and profit income together rose by about 7½ per cent a year—just under 8 per cent a year for wages and salaries, and just under 7 per cent a year for profit income. This is the average over the whole ten years. There were years when the gap between the rise in production and the rise in incomes was a small one ; in both 1953 and 1954, production rose 4 to 5 per cent, and incomes 6½ per cent. In certain other years, the gap was much bigger than average: for instance, in 1956 a rise in production of about 1 per cent, and a rise in incomes of over 7½ per cent*.

For different industries

37. Equally, this gap between the rise in incomes and the rise in output has been very different for different industries: for some industries can raise their production more easily than others. The big distinction to make here is between manufacturing industry on the one hand and the rest of the economy on the other. Production has risen faster in manufacturing industry —by about 4½ per cent a year from 1948 to 1956—and more slowly in the rest of the economy—by about 2½ per cent a year. This difference is likely to continue: in many of the other industries there is not the same scope for raising production as there is in manufacturing industry.

38. Individual industries show wider differences: many of these, too, are likely to continue. For instance, the chemicals industry has, on average, raised its output by 8 per cent a year, and the figure for the vehicles industry is also a high one: in 1954—a single year—car output rose just on 30 per cent. In the mining and quarrying industry, on the other hand, where more difficulty has been experienced in raising output, the average yearly increase in production has only been about 1 per cent. This fact—that, in the nature of things, some industries can raise their output more easily than others—has important implications for policy ; these are discussed in Chapter VI.

39. In general, where production has risen fast, the gap between the rise in incomes and the rise in production has been a small one, and where production has risen slowly, the gap has been bigger.

Average yearly increase in incomes (wages, salaries and profit income) and production, 1948-56

(Per cent)

	Manufacturing Industry	Other industries and services
Incomes	8·0	6·9
Production	4·3	2·3
Difference	3·7	4·6
	Vehicles*	Mining and quarrying
Incomes	11·2	7·2
Production	8·1	1·1
Difference	3·1	6·1

* Figures are for 1948–55.

* Full year-by-year figures are given in Appendix V.

Productivity

40. The figures so far given have been for increases in total production and increases in total incomes. Over the post-war years, the number of people at work has risen; so, too, has the amount of capital employed. In the country as a whole, the total working population went up about ¾ per cent a year from 1948 to 1956. Figures for the increase in the nation's stock of capital are much less reliable than employment figures: such as they are, they suggest an increase of something of the order of 2 to 3 per cent a year.

41. So the comparison between the rise in national production and the rise in the total paid out in wages and salaries can be turned into a comparison between the rise in production-per-man and the rise in average earnings. Whereas national production rose about 3 per cent a year, production-per-man rose about 2¼ per cent; and, whereas total wages and salaries rose 8 per cent a year, average earnings rose about 7 per cent a year.

42. The various comparisons between rises in production and rises in wages and salaries can be changed in this way into comparisons of rises in production-per-man and rises in average earnings. (See Appendix V.) The general picture stays the same. In industries where production rose fast, production-per-man also rose fast; and where there is a wide gap between the rise in wages and salaries and the rise in production, there is also a wide gap between the rise in production-per-man and the rise in average earnings.

43. It is these figures for the increase in production-per-man which are usually meant when the word "productivity" is used. But it should be noted that capital as well as labour is used in the process of production; and the stock of capital has risen, too: indeed, it has certainly been rising faster than the labour force. This is a point to bear in mind when the rise in total profit income is compared with the rise in incomes from employment, and when the division of the fruits of any increase in production is considered.

GAINS AND LOSSES

Wages and salaries compared with profit income

44. The previous section considered the rise in income in relation to the rise in production. This section looks at the rise in incomes from another point of view: it considers which types of income have gained most and which least in the post-war years of rising prices. For some comparisons, pre-war figures are also given; for there were big changes in the distribution of incomes during the war, and account should be taken of these in any general assessment.

45. First of all, there are two large totals of income to compare: wages and salaries on the one hand, and profit income* of all kinds on the other. Profit income is taken throughout this section net of capital consumption†—that is, after a deduction has been made in each year for what is needed to cover the replacement value of capital equipment used up in that year. (This is not Inland Revenue depreciation; nor is it net of taxation. The figures are explained in Appendix II.)

46. Both in the ten-year period from 1938 to 1948, and in the eight-year period from 1948 to 1956, net profit income rose more slowly than wages and salaries.

* Profit income comprises the trading profits of companies; the trading surpluses of public corporations; the profits of other public enterprises; income from self-employment; and rent.

† Profit income is also given net of stock appreciation; this also is discussed in Appendix II.

£m.	1938	1948	Per cent increase 1938–48	1956	Per cent increase 1948–56
Wages and salaries	3,022	6,766	+124	12,222	+81
Net profit income	1,633	2,607	+ 60	4,274	+64

The wage and salary earner

47. There are three useful figures to show the experience of the average wage-earner in this period of rising prices. First, there is the index of weekly wage rates. This covers all the important groups of wage-earners; but it measures changes in wage rates only: that is, it makes no allowance for overtime payments, bonus payments, or for any shortening of the standard working week. Secondly, there is the figure for average earnings. This is based on enquiries made in April and October of each year. Overtime and bonus payments are included in these figures; but a number of important industries are not included*. Thirdly, there is the annual figure for the average wage in manufacturing industry. This is derived by taking the total wage bill for the industry and dividing it by the number of wage-earners.

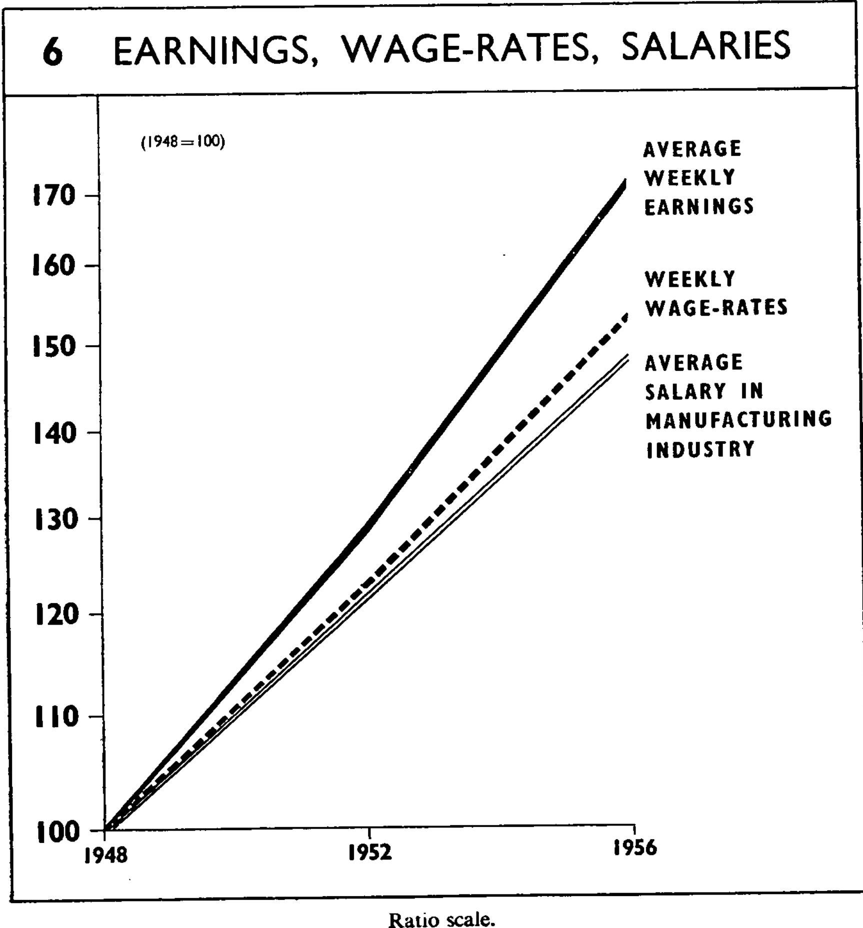
48. For each set of figures, a real figure is given as well as a money one; by dividing the index of money earnings per head, for instance, by the rise in retail prices, a figure is derived for the rise in real earnings per head. This gives an estimate of the change in the purchasing power of earnings.

Per cent changes	1948–52	1952–56	1956–latest available date (indicated below)	
A. IN MONEY TERMS				
Annual wage in manufacturing industry	+29	+34	—	—
Weekly earnings per head	+29	+33	+2½	April '57
(Hours worked)	(+1¼)	(+1¾)	(nil)	(,, ,,)
Hourly earnings per head	+27½	+31	+2½	,, ,,
Wage rates	+23	+25	+7	Dec. '57
B. RETAIL PRICES	+26	+15	+6	Dec. '57
C. IN REAL TERMS				
Annual wage in manufacturing industry	+2	+16½	—	—
Weekly earnings per head	+2	+15½	+¼	April '57
Hourly earnings per head	+1¼	+14	+¼	April '57
Wage rates	−2½	+9	+1	Dec. '57

49. In interpreting these figures, it must be borne in mind that the increase in real earnings is not the same as the increase in the standard of living. First, earnings are given before tax is deducted; and they do not allow for any changes in Government benefits, such as the National Health Service or family allowances. Secondly, the figures do not measure the rise in the standard of living which came about with the relaxation of rationing, and generally as consumers were able to buy the goods they wanted instead of their second choices. Many improvements in the quality of services do not show up in the figures, either.

* The most important ones excluded are agriculture, coal-mining, railways, London Transport, road services, port transport (docks), shipping services, distribution, catering, entertainment, commerce and banking, and domestic service. There may be good reasons for their exclusion; but there is no doubt that it greatly lessens the value of the figures.

50. Nonetheless, there is a very marked difference between the 1948–52 and the 1952–56 columns in the second half of the table. In the first period, real earnings rose very little. This was the period in which—because of the successive demands of post-war replacement of rundown capital equipment, of the very big increase in exports needed, and, after 1950, of the rearmament programme—the amount of goods available for personal consumption rose little. In the second period, real earnings rose substantially. (It is noticeable that in both periods, as Chart 6 also shows, earnings rose faster than wage-rates. The significance of this is discussed in paras. 82, 88.)



Ratio scale.

51. To compare with these figures of average wage rates and earnings, there is only one figure available for the average salary: the movement of the average salary* in manufacturing industry since 1948. In this sector, the salary-earner has not done as well as the wage-earner ; in real terms, the average salary fell from 1948 to 1952 and it rose much more slowly than the average wage from 1952 to 1956.

* Salaried staff include directors, managers, superintendents, works foremen, research, experimental, development, technical and design employees, draughtsmen and tracers, travellers and office employees.

Per cent increase	1948–52	1952–56
Average salary in manufacturing industry:		
in money terms	+22	+22
in real terms	− 3	+ 6

52. The general impression given by these figures of the real wage and the real salary is corroborated by the figures of the rise in real personal consumption. These figures estimate the increase in the quantity of goods and services consumed per head in this country. They cover the whole population, and not just wage and salary earners' families: but, of course, these families make up the majority of the population. Real personal consumption per head also rose very little from 1948 to 1952, and rose much faster from 1952 to 1956.

Per cent increase	1948–52	1952–56
Real personal consumption per head of population ...	+1¼	+11

Profit income

53. There are not the same convenient average figures for the various types of profit income as there are for wages and salaries. The dividend income of the average dividend receiver is not known; nor is the income of the average self-employed person. Only the totals are known—for instance, the total amount paid out in dividends and the total income of the self-employed. This section therefore has to set out figures for total profit incomes of various kinds, and it compares them with the total wage and salary bill. Throughout, the figures, as already explained, are given net of an allowance for the replacement of capital; the word "net" is used in this sense.

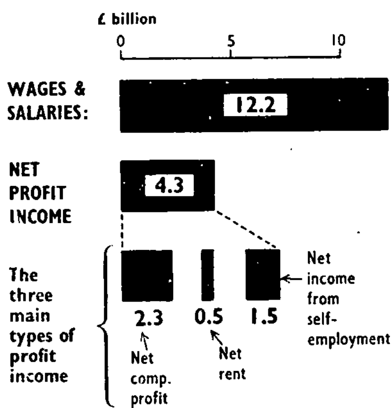
54. The total of profit income includes the profits of companies; income from self-employment—farmers, professional persons working on their own account, and other sole traders and partnerships; the surpluses or profits of nationalised industries and other public corporations; and rent. During the post-war years, there has been a good deal of movement between some of these groups. Many small, unincorporated businesses have either turned themselves into companies or have been bought by companies; in this way, the "company" sector has grown at the expense of the "self-employment" sector. On the other hand, some industries were nationalised and moved out of the "company" sector into the "public corporations" sector; and some subsequently moved back again. Because of these various movements to and fro, the most meaningful figure is probably that already given in para. 30 for all profit income together.

55. The figures for the different types of profit income* are set out separately in the tables below, and are also shown in Chart 7. Figures for wages and salaries are given, where appropriate, to provide some standard of comparison.

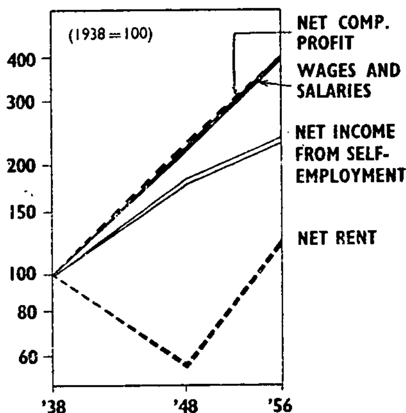
* The calculations used to derive figures net of capital replacement cost are described in Appendix II.

7 WAGES, SALARIES AND PROFITS

1. The relative sizes of wages and salaries and profits in 1956.

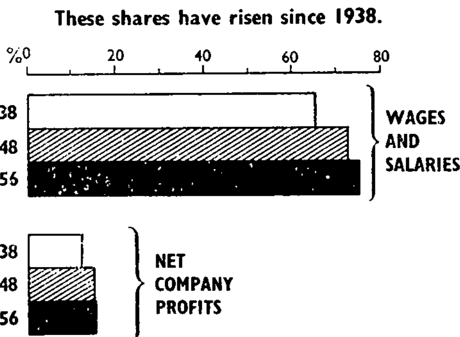


2. The rise in wages and salaries and profit incomes, 1938-56.

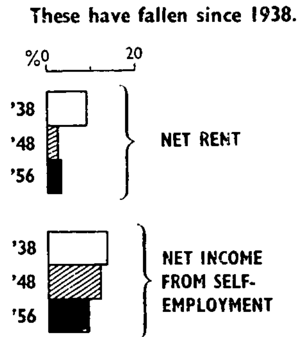


3. Shares in the National Income. = 1938 = 1948 = 1956

These shares have risen since 1938.



These have fallen since 1938.



No. 2 is on a ratio scale. For the definition of net profit income, see Appendix II.

56. *Net income from self-employment*

£m.	1938	1948	Per cent increase 1938–48	1956	Per cent increase 1948–56
Net income from self-employment ...	629	1,141	+ 81	1,482	+30
Wages and salaries	3,022	6,766	+124	12,222	+81

Income from self-employment, particularly since 1948, has not risen as fast as wages and salaries.

57. Net figures cannot be given for the three sub-divisions of self-employment income; but gross figures can—that is, figures of income before provision for capital replacement or stock appreciation.

£m.	1938	1948	Per cent increase 1938–48	1952	1956	Per cent increase 1948–56
Gross income of:						
Farmers	69	302	+337	404	406	+34
Professional persons	118	209	+ 77	230	253	+21
Other sole traders and partnerships	460	810	+ 76	874	1,038	+28

58. Farmers' income rose very fast from 1938 to 1948; it has hardly risen since 1952. The other two sub-divisions of self-employed persons—professional persons working on their own account and other sole traders and partnerships—show comparatively small rises in income both from 1938 to 1948 and from 1948 to 1956. How far this is true of the average income in this group it is not possible to say.

59. *Net surpluses of public corporations, and net profits of other public enterprises.*

£m.	1938	1948	1956
Net surpluses/deficits of public corporations ...	2	−68	-15
Net profits/losses of other public enterprises ...	23	− 1	6

The figures above, since they are arrived at by charging depreciation on the estimated replacement cost of capital assets instead of their original costs, are different from those in the industries' own accounts. On the replacement cost basis, the figures show a deficit over the post-war period as a whole.

60. *Net rent.**

£m.	1938	1948	Per cent change 1938–48	1956	Per cent change 1948–56
Net rent	410	232	−43	513	+121

Net rent—after allowing, that is, for the depreciation of buildings—fell by nearly a half between 1938 and 1948. It recovered from 1948 to 1956; but compared with 1938 it has risen less than any other main type of income.

61. *Net company profits.*

£m.	1938	1948	Per cent change 1938–48	1956	Per cent change 1948–56
Net company profits	569	1,303	+129	2,288	+76
Wages and salaries	3,022	6,766	+124	12,222	+81

* Rent here includes, not only sums paid to landlords, but "imputed" rent; when the owner of a property is also the user, an income is "imputed" to him which, in principle, represents the amount he would receive if he let the accommodation unfurnished.

While all other forms of profit income rose more slowly than wages and salaries from 1938 to 1948, net company profits rose at about the same rate, and continued to do so from 1948 to 1956.* In assessing these figures, there are three points to remember.

62. First, during the period from 1938 to 1956 some industries were nationalised, and moved out of the "companies" sector into the "public corporations" sector. If only those companies are taken which were not nationalised at any time from 1938 to 1956, the profits figures show a sharper rise from 1938 to 1948. (For this group of companies, only gross profits figures are available.)

£m. Gross profits	1938	1948	Per cent change 1938–48	1956	Per cent change 1948–56
All companies	690	1,798	+161	3,002	+67
Companies not nationalised at any time from 1938–56 ...	570	1,742	+206	2,904	+67

63. Secondly, there is little doubt that during the period there has been a movement from the "self-employment" sector into the "companies" sector, as small businesses have either become companies themselves or have been bought up by companies. But there are no figures to show how big this movement has been.

64. Thirdly, the comparison of profits and wages and salaries which is made here is a comparison of the total sums paid out, not allowing either for the increase in the numbers of people employed or for the increase in the amount of capital employed. Both have risen; but, as pointed out in paragraph 40, the amount of capital employed has, since 1946, certainly risen faster than the number of people in employment. Further, the movement of profits is very different from the movement of dividends; this is discussed in paragraphs 68 to 74.

65. Such figures as are available for company profits in 1957 can only be used to give a rough idea of what happened to profits in that year†. They suggest that profits—and also dividends—rose more slowly in 1957 than in 1956.

The distribution of company profits

66. This substantial rise in company profits since 1938 has not, however, led to a substantial increase in dividends. There has been a very big change in the distribution of companies' income since before the war, as the following table shows. Dividends and interest payments are here and later given before the deduction of income tax paid on behalf of the dividend receivers. The figure for United Kingdom taxes consequently does not include this element of taxation.

67. There are very big changes from 1938 to 1948. The share of company profits which was distributed fell by half; the share going in taxes quadrupled. The changes from 1948 to 1956 are much smaller: there has been a small rise in the percentage distributed, a fall in the share going to taxes, and a rise in undistributed income.

* For the movement of company profits on an alternative basis, making use of Inland Revenue depreciation figures, see Appendix II.

† The figures published in *The Financial Times* and *The Economist* do not cover all companies; and they are figures of profits declared, and so relate to financial years ending some 3 to 6 months earlier.

	Per cent share of total net company incomes*		
	1938	1948	1956
Dividends on ordinary shares†	40	20	22
Dividends on preference shares	13	6	3
Interest payments	14	6	9
Taxes and remittances paid abroad	4	5	8
Provision for United Kingdom taxes	10	40	32
Undistributed income	19	23	26
	100	100	100

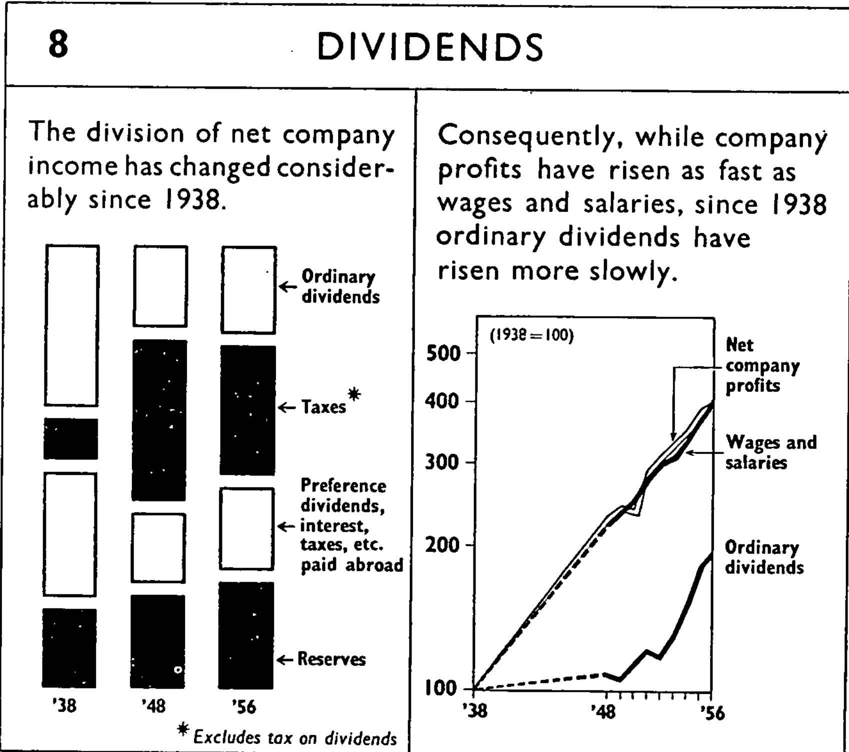
* This is the total of net trading profits of companies operating in the United Kingdom, plus trading profits earned abroad, plus non-trading income. The percentages, taken from Tables 26 and 57 in the National Income Blue Book, would not agree with figures shown by the firms' own accounts; but the trend between the years would not be greatly altered.

† Including dividend reserves.

Wages and salaries, dividends, and other property income

68. As a consequence of this changed distribution of company incomes since before the war, ordinary dividends, before tax, are much smaller, in relation to wages and salaries, than they were before the war. Before the war they were 12 per cent of the amount of wages and salaries; in 1948, 6 per cent, and in 1956 also 6 per cent.

69. The table below, and Chart 8, show how dividends and wages and salaries have moved since 1938.



Ratio scale. For the definition of net profit income, see Appendix II.

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Per cent increase	Ordinary Dividends	Wages and Salaries
In money terms:		
1938–48	+10	+124
1948–52	+ 9	+ 35
1952–56	+62	+ 34
1938–56	+94	+304
In real terms:		
1938–56	−24	+ 59
£m. in 1956	700	12,222

70. From 1938 to 1948 dividends rose very little, while wages and salaries doubled, and from 1948 to 1952 there was also a much slower rise in dividends. From 1952 onwards they have risen substantially faster than wages and salaries. Over the whole period 1938–56 they nearly doubled, while wages and salaries quadrupled. If account is taken of the rise in prices, from 1938 to 1956 the total wage and salary bill, in real terms, rose by more than a half; the total amount paid out in dividends fell by about a quarter.

71. These figures are given before tax. There are figures for the total of wages and salaries after tax; but for dividends, only an estimate can be made. It is not known how much of the total of dividend payments is paid in surtax, nor how much obtains some relief from the standard rate of income tax; it has roughly to be assumed that dividends, on average, pay the standard rate. The figures below, therefore, are only approximate.

Per cent increase	1938–48	1948–52	1952–56	1938–56	£m. in 1956
Income after tax:					
Wages and salaries	+113	+35	+34	+278	11,428
Ordinary dividends, charged at the standard rate	− 17	+ 4	+78	+ 54	402

72. The figures show that, over the whole period, the effect of taxation has undoubtedly been to widen the gap between the movement of wages and salaries and the movement of ordinary dividends.

73. Dividends paid to persons are, of course, only a part of the total of personal incomes from property : a wider comparison can be made of the movement of wages and salaries and the movement of the total of rent, dividends and interest paid to persons, before tax :—

Per cent increase	1938–48	1948–52	1952–56	1938–56	£m. in 1956
Wages and salaries	+124	+35	+34	+304	12,222
Rent, dividends and interest paid to persons	+ 4	+24	+32	+ 71	1,937

74. Over the whole period, and in particular since 1952, the total of rent, dividends and interest paid to persons has not risen as fast as the total of ordinary dividends.

Grants from public authorities; State pensions

75. Retirement pensions, sickness benefits, national assistance, family allowances, grants for education, and milk and welfare food schemes make up the bulk of these grants. There have, of course, been very big changes in the types of benefit and in the numbers of those who get them. The amount of unemployment benefit paid out, for instance, has fallen to a very small sum compared with 1938; on the other hand, the proportion of people of pensionable age in the population has risen. The figures below only show the total sum paid out. It rose rather faster than wages and salaries from 1938 to 1948 (probably because there was a concentration of changes in benefits in the years 1945 to 1948). This is also true for the whole period 1938 to 1956.

£m.	1938	1948	Per cent increase 1938–48	1956	Per cent increase 1948–56
National insurance benefits and other public grants	275	704	+156	1,194	+70
Wages and salaries	3,022	6,766	+124	12,222	+81

76. The standard pension rates can also be compared with the rise in prices. The comparison below is taken from 30th September, 1946, when the standard pension was raised from 10s. to 26s.

	30th Sept., 1946	3rd Sept., 1951	29th Sept., 1952	25th Apr., 1955	27th Jan., 1958
Single man:					
shillings per week	26	30	32½	40	50
index (Sept. '46=100) ...	100	115	125	154	192
Married couple:					
shillings per week	42	50	54	65	80
index (Sept. '46=100) ...	100	119	129	155	190
Index of retail prices* (1946=100)	100	135	143	155	175

* London and Cambridge Economic Service figures.

77. While prices have risen more or less continuously, pensions have been raised in a series of steps; the dates above are those on which the pension rates went up. Further, prices have risen rather faster than average for pensioners (see paragraph 23), though figures are not available for the whole of the period. Making a rough allowance for this, it would seem that, whereas through most of the post-war period the rise in the standard pension lagged behind the rise in prices, the latest increase does mean that, in real terms, it is slightly bigger than in 1946.

CHAPTER III

The causes of the rise in prices and incomes, 1946–57

I

78. What has been the cause of the rising trend of prices and incomes since the end of the war? Viewing the period as a whole, we incline to think that the main cause has been an abnormally high level of demand for goods and services in general, maintained for an abnormally long stretch of time. The country has pursued during the post-war period a number of objectives arising naturally from the circumstances of the time, and in themselves desirable, but making in the aggregate a greater demand on the industry and thrift of its citizens than they have had the power or the will fully to satisfy. In the early post-war years there was a drive to repair the damage and deterioration caused by the war, to restore standards of consumption and to improve the social services. Later on, as a consequence of the crisis in international relations associated with Korea, came the rearmament programme. Throughout the period, but perhaps particularly in the last few years, both public authorities and private firms have been seeking to put through huge schemes of capital development to realise the potential benefits offered by progress in scientific knowledge.

79. The translation of these desires into high and persisting levels of monetary demand was assisted above all by two circumstances. In the first place, monetary systems had evolved in such a way as to make easier the expansion of the flow of transactions to match the so-called " needs of trade "—whether these reflected a growth in the volume of goods and services exchanged or merely a general rise in their prices. Firms and individuals emerged from the war with abnormally large holdings of money and other liquid assets. Further, for a number of years after the war the general tendency in monetary policy was to permit ready expansion in the money supply and to maintain relatively low rates of interest. Thus the state of high liquidity persisted for a long time.

80. Secondly, many governments undertook so to direct their policies as to maintain what was at first described as " high and stable employment " and afterwards as " full employment ". The commitment thus undertaken has not only influenced the size of the government's own expenditure: it has acted as a powerful supporting force to those of other people. In particular, it was taken by business men as a signal that there would be no general drying up of the demand for their products, and thus encouraged them to maintain a high level of capital expenditure.

II

81. It seems to us that our view of the importance of the level of demand derives some support from the persistence in Great Britain throughout the period of a large number of notified vacancies for industrial employment, generally well in excess of the number of registered unemployed. A chart embodying these figures, with some notes, is set out in Appendix VI. It will be seen that the behaviour of the two figures conforms to what is generally known about the state of demand, reflecting the Korean boom, the post-Korean recession, the private capital investment boom in 1954–55 and the levelling-off of activity in 1956–57.

82. Another important feature of the period, already illustrated in Chapter II, has been the tendency for average earnings to rise faster than weekly wage rates. The reasons for this are complex, but there seems no reason to doubt that one of them is the tendency of some employers, in time of high demand, to attract labour by bidding up its price above the figure embodied in national agreements and awards. Here too, as we should expect, the extent of the gap seems to vary with the intensity of demand. Thus the excess of the percentage rate of rise in earnings in manufacturing and certain other industries over the percentage rate of rise in wage rates in the same industries vanished between October, 1951, and April, 1953, i.e. during the post-Korean recession alluded to above, remained fairly low thereafter for a year, rose sharply between April, 1954, and October, 1955, i.e. during the acutest phase of the private investment boom, and almost vanished during the following eighteen months as the boom tailed off.

III

83. The view that the main cause of the rise in incomes and prices is to be found in the general level of demand does not, of course, mean that in every case of a rise in wages or prices the immediate cause is an excess of demand *at that point*. There may be no excess of demand for bread, but the baking industry may be forced to raise the wages paid to its employees by the fact that wages have risen in the steel industry, where there *is* excess demand. The baking industry may give the increase with some apprehension of the effect on their costs and prices and so on their sales. But in a general environment of buoyant demand and monetary expansion it will generally turn out that the rise in wages which caused these anxieties has also ensured that the demand for bread will not be checked by the rise in its price.

84. In a world inflation what is true of a particular trade may be true also of a particular country. A country heavily dependent on imported foods and raw materials may find itself under the impact of a rise in the cost of its imports. Given the monetary systems and methods of wage-negotiation of modern industrial countries, such a stimulus will normally lead to a rise in the prices of its products, in the first place as a direct consequence of the increased cost of their import component, and in the second place through the granting of wage increases to compensate for the higher cost of living. The country may, or may not, find that the prices at which it can

sell its own exports have also been increased as a result of the rise in world spending.

85. In the post-war period there have been two short phases, 1946 to 1948 and 1950 to 1951, during which British import prices rose very sharply, in each case on the average by about a quarter. Britain is such an important customer for the world's supplies of foodstuffs and materials that we cannot safely assume the state of her own demand to be without influence on their prices. As regards at least the second of the two periods mentioned, however, it seems reasonable to ascribe the rise in world prices mainly to outside influences, arising especially in the United States. The effect in Britain of this " post-Korean " rise was all the sharper because it followed closely on the devaluation of the pound by 30 per cent (in terms of gold and the dollar) —a measure which sharply raised the sterling prices of some, though by no means all, of our imports. There is no doubt that the working through of this twofold increase in sterling import prices played an important part in the development of prices and wages during the next few years. It must not be forgotten however that this took place in an environment in which British exports were benefiting from the high level of world demand. Indeed, the sharp devaluation of 1949 had put her exporters in a particularly strong competitive position*.

86. Since 1951 no further stimulus to rising prices or wages has come from the side of import costs. In lesser degree, however, a similar effect has been produced by the policy of removing or reducing subsidies and controls on food and certain other goods and services. It was, of course, one aim of these policies to bring the prices of the goods and services concerned closer to their natural economic level. They have inevitably affected the index of retail prices to a certain extent. The effect of the reduction of the food subsidies in 1952 is discussed briefly in Appendix III. The matter is not free from doubt, but it seems clear that, as compared with the position that would have arisen if the total expenditure on subsidies had been maintained at the 1951 level, the direct effect was to raise the all-items index by more than 1 per cent, possibly by more than 2 per cent. Even at its maximum conceivable value, however, the effect was much smaller than the combined effect of all the other causes which were operating to raise the index at that time. Something should, no doubt, be allowed for the indirect effect of the subsidy reductions through the additional stimulus given to demands for higher wages: but even allowing for this its importance must be reckoned as relatively minor, compared for example with that of the rises in import prices. In subsequent years a further rise took place in the price of food. The causes of this rise are not entirely clear, but it would seem, in part at least, to have been associated with the decontrol of food supplies and possibly represents the effect of a sudden release of dammed-back demand. A further increase in prices followed on the abolition of the bread subsidy and reduction of the milk subsidy in 1956, amounting to about 1 per cent on the all-items index.

87. A further measure of the same general character which has been having an influence on the prices index in recent months is the partial

* As we shall see later (paragraph 101), some observers take the view that the devaluation set in motion an upward pull on Britain's domestic price and income structure which has even now not manifested its full effect.

decontrol of house rents under the Rent Act of 1957. It is estimated that the effect up to January 1958 has been to raise the all-items index by about one-half per cent. The full effects of the measure have not been seen as yet, however, and it will no doubt continue to exercise an upward pressure on the index for some time to come. The final effect cannot be estimated precisely, but it does not seem likely that it will amount to more than 2 per cent in total.

IV

88. It is convenient at this point to refer to a school of thought which takes a rather different view as to the main cause of the rise in prices. This view lays great stress on the power of the Trade Unions in such a society as ours, particularly at times when governments and public opinion generally are very anxious that industrial peace should be preserved. It also emphasises the importance of the flexibility inherent in modern monetary systems, and of the commitment to "full employment" policies, described in paragraphs 79 and 80. It states that in these conditions, if wages and other incomes are pushed up, the level of money expenditure will tend naturally to rise with them. It follows, so the argument runs, that there is nothing in the economic system which ensures that the rate of increase of money wages and other incomes is kept within the limit of the growth in average productivity. When they exceed that limit—as they have done in recent years—businesses in general find that their costs per unit of output have gone up; but they also find no difficulty in raising their prices so as to maintain their profits. The exact level of demand has not, according to this account, been crucial to the result of the successive wage-rounds; on the contrary, any level of demand sufficient to ensure a high level of employment would also be sufficient to enable the process to take place. On this view the figures for unfilled vacancies to which we have referred in paragraph 81 above would be evidence of the persistence of a high demand for labour, but not of its being the main cause of the inflation. Nor would much weight be given to the fact that the increase in earnings has normally tended to outpace the increase in wage-rates: for though this disparity may reflect the pressure of employer demand, it has other causes as well: and in any case it remains true that much the greater part of the rise in earnings can be accounted for by the rise in wage-rates.

89. We do not believe that it is necessary, or even possible, to give confident answers to such questions as the following:—What would have happened to wages in Britain during the last twelve years if, other things being unchanged, Trade Unionism had been non-existent or weak? What would have happened if, other things being unchanged, Britain had been self-supporting in food and raw materials? But it does not seem that policy need now be stultified by such inability to perform a completely satisfactory *post mortem* on the past. We have laid greater stress on the demand side of the story than some whose opinions we have studied. But we are well aware that, whatever *might* have been the case, the wage advances were in fact secured by workpeople organised in powerful Trade Unions and using, among many other weapons in their armoury, arguments based on preceding movements of the cost of living. That such Unions exist and such arguments are used may have great importance for the near

future even if it should be of less importance than some people suppose in explaining the recent past. Whatever its initiating cause, the habit of demanding large and frequent increases in monetary rewards grows by what it feeds on, and may be found to persist after any technical justification for it in the state of the labour market has passed away. Before, however, coming to grips with problems of present policy, it seems desirable to consider more explicitly the objectives as regard the behaviour of wages and prices at which it is reasonable for a country in our position to aim.

CHAPTER IV

How do we want the value of money to behave?

I

90. We have now to consider what our general objective for the behaviour of prices and wages ought to be. Our terms of reference recognise that "reasonable stability of prices" is desirable; but this phrase could have any of a number of meanings.

91. Many people would say that prices were reasonably stable so long as, though their trend was upward, it was a slow trend, say 2 or 3 per cent a year instead of the 4 or 5 per cent we have had in Britain since the war.

92. Such a gradual rise, it is argued, would be good for business confidence and the state of trade, and thus promote the fullest possible employment of human and other resources: while it would be in no danger of causing the hardships and breakdowns associated with "runaway inflation". In earlier times, it is agreed, such a policy might have had a bad effect on the distribution of income, since in those days wages used to lag substantially behind prices when they were rising. Nowadays, however, the argument runs, the workers are so strongly organised that they would not suffer in this way. Those who would suffer, principally the holders of Government and other fixed interest debts, are regarded by some of the advocates of this policy as constituting an inert and passive element in society whose interests need not be too zealously guarded. Indeed, the lightening of the burden of debt is, for some, one of the advantages of the process.

93. In examining the objections to this programme we will assume, to begin with, that the slow pace of the up-trend would in fact be maintained. It is well recognised that different groups in society vary very much in their ability to revise the contracts which fix their monetary receipts, and for this reason even a slow rise in prices works very inequitably as between them. It is probably true that in present conditions the industrial wage-earners are well able to protect themselves against damage from a gradual rise in prices: they may even, on balance, be gainers from the process. The active business classes are also likely to gain. In many cases the first effect of a rising stream of money demand is on trading profits; even if the tide of inflation reaches them first in the guise of an increase of costs, business men are usually well placed for protecting their profit margins. The holders of ordinary shares in joint-stock companies normally share in these gains.

94. On the other hand, there are many useful and meritorious elements in society who are disadvantaged in different degrees by the process. Salaried workers, with their weaker collective organisation and with traditions which rule out most forms of trade union pressure, find it hard or impossible

to maintain their real income. Events have been strengthening both their organisation and their determination, and economic forces also operate to prevent an indefinite reduction in their relative advantage. But there is no doubt that rising prices, even if at a slow pace, would mean for them, in the future as in the past, hardship, disappointment and discontent.

95. Another large group who suffer is that of the pensioners, whether on State pensions or on occupational superannuation schemes. Some of these are better placed than others to take avoiding action. The recipients of State pensions are in a position to exert political pressure, and considerations of social justice are strong enough to ensure that in the end pension rates get adjusted to the rise in prices (see paragraphs 76 and 77). In the intervening periods, however, the pensioners find their real income being steadily eaten away. The retired people depending on occupational superannuation schemes are in much worse case, for these will normally have no chance of getting their pensions raised.

96. Next, there are the holders of fixed and near-fixed interest debt, principally Government bonds but including also the holders of industrial debentures and preference shares. These suffer from rising prices without any hope of relief. Once, however, a steady upward trend of prices came to be generally accepted and anticipated, something would have to be done to mitigate the rentiers' losses—otherwise the Government would cease to be able to borrow any money on fixed interest terms. In the summer of 1957 there were, indeed, signs that such a development was far from being merely an academic possibility.

97. Finally, there are the owners of land and buildings which are let at legally controlled rents. Caught between fixed receipts and ever-rising costs of repair and maintenance, these may find not only their real income but even their money income eaten away as a result of the inflation.

98. In the present state of our social arrangements, it seems to us clear that the arbitrary redistribution resulting from a steady rise in prices, even if slow, is very unjust. It is natural to consider whether these consequences could not be mitigated by deliberate policy. Wages, salaries and pensions could be tied to some index of the cost of living. Even interest and principal of Government and other loans, and the premiums and benefits of insurance contracts could, in theory, be adjusted in the same way. It seems, indeed, highly probable that if the rise in prices is not successfully checked, sliding scale adjustments of this kind will naturally develop under the pressure of the groups who suffer most from the present regime. We do not think, however, that such a process represents in any way a satisfactory alternative choice to the policy of arresting the inflation. At the best, the operation of a double standard of value of this kind would be a cumbrous and inefficient way of conducting affairs. But the most important result is likely to be that the upward movement of prices would cease to be slow. At present the groups which are in a strong strategic position derive gains corresponding to the losses of the weaker groups. As the losses were diminished, the attempt to preserve the gains would tend to speed up the whole inflationary process. The final result might well be a situation so disastrous that a remedy would have to be sought at all costs, including perhaps heavy unemployment and distress.

99. In the trade cycles of the nineteenth century, the periods of boom brought the advantages of rapid creation of fixed capital and exploitation of inventions. These were generally secured at the cost of a temporary decline in the value of money, which was subsequently arrested and reversed, at high social cost, in the depression period. It is now generally agreed that the disadvantages of these cyclical depressions much exceed the advantages. As a result it has become more important than it was in the nineteenth century to find a way of enjoying high activity without allowing the value of money to decline.

100. These arguments against aiming at a slowly rising price level would, we think, be decisive even for a country like the United States which does not have to bother greatly about its foreign trade position. The case seems clearer still for Britain, whose position as a creditor nation has been greatly changed by the two world wars, and who has, above all, in order to obtain her supplies of food and raw material from overseas, to make sure of keeping her exports competitive in the markets of the world. It is true of course that if her chief competitors, whether by design or accident, are allowing their own cost and price structures to creep upwards, the danger to her of indulging in similar courses is reduced. But we certainly cannot count on that happening. The fact that in the most recent months the American monetary authorities have begun to move in an expansionary direction should not make us forget the determination which they showed during the summer and autumn of 1957 to bring to a halt the moderate price rise (about three per cent per year) which had been in progress in their country during the preceding two years.

101. We discuss in Appendix VII an argument which has been put before us to the effect that the devaluation of 1949 left Britain with an abnormal price advantage in foreign trade which has not yet been worked off, and that a substantial further rise in our home costs and prices is not only permissible but inevitable in order to bring us into international equilibrium. For the reasons there set out, we do not find this argument convincing.

102. We conclude that alike on internal and external grounds our objective should be to stop the inflation, not merely to moderate its course.

II

103. Let us assume for the moment that we adopt the most obvious of the alternative views, namely, that *stability* of the general price level is the normal state of affairs at which to aim. Such stability of prices in general would of course be compatible with moderate movements of *particular* prices in both directions ; it would be compatible too with a steady advance in average money income per head as average product per head increases with capital growth and technical progress. Can we be sure that in no circumstances it would be right to depart in an upward direction from stability?

104. We are afraid not ; we are afraid that there are circumstances in which a right policy would demand a rise in an index number measuring the price of consumer goods and services.

105. The first case is a sharp rise in the cost of imported food or materials, such as took place in 1946–48 and again in 1950–51. In the case of so large an importer as Britain it does not seem realistic to suppose that the authorities could hope by monetary or fiscal policy to offset the effect of such an occurrence on the general level of prices. It would have to be accepted as a national misfortune, rightly registered as a rise in the cost of living. It is very fortunate that at the moment there seems to be no threat from this quarter to the successful inception of a policy of price stability.

106. The second case is a deliberate decision to raise the level of indirect taxation, e.g., by increasing the rates of purchase tax. The reason for such a decision might be to raise revenue for some deliberately approved extension of public expenditure, for instance on a new social service or an important project of defence. Alternatively, it might be simply to reinforce the budget surplus as part of the machinery for regulating the flow of total expenditure so as to keep the value of money stable. In either event, the purpose of the action would be frustrated if it were prevented, by some kind of compensatory action, such as a subsidy, from registering its effect upon the cost of living.

107. The third case arises if the policy of stabilisation does not start with a clean sheet but with certain important price distortions which have not yet been properly corrected. Here this country is less fortunately situated than it is in respect of import costs. The recent measure of rent decontrol has not yet had its full effect on the index-number. We are clearly of opinion that, whatever the arguments for and against this particular measure, the distortions brought about by the long continuance of rent restriction should not be indefinitely retained in the name of price stability. But there is also a case for supposing that the prices of some of the products of the nationalised industries may still be too low. There is here one of those cases of conflict between reasonable objectives of which the world is unhappily full. We can perhaps hope that favourable developments on the side of import costs will make it possible to re-examine these cases in the near future without causing serious disturbance to the index number.

108. We do not think any class of income receivers has a right to be immune from bearing a share of such national burdens as we have been discussing in the last three paragraphs, whether those burdens are imposed from outside, as in our first case, or by the nation on itself, as in the second and third. We can perhaps allow ourselves to hope that such burdens, if they arise, will usually take the form not of an actual decline in real income per head, but only of a diminution in the rise of real income per head which the steady growth of productivity would otherwise have allowed.

III

109. For a country in which technical progress is active, and capital equipment increasing faster than population, is stability of the price-level a sufficiently ambitious objective? Ought not such a country to aim rather at a state of affairs in which the fruits of progress are being permitted to manifest themselves, to the general advantage, in a gently *falling* price-level? This would be the result if instead of attempting to stabilise the

price-level, policy was aimed successfully at stabilising the general level of money *income* per head. There has always been a respectable body of economic opinion favouring this point of view, though until quite recently it might have seemed to us rather unrealistic even to mention the fact. But during the last few weeks we have been impressed by the apparently widespread revival of interest in the idea of falling prices and have been glad to note some practical steps towards its realisation. Respect for this line of thought would prevent us from too ready an acceptance of the idea that an attempt should be made from time to time to estimate and proclaim the maximum percentage by which over the succeeding twelve months wages and salaries could be allowed, on average, to increase without inflicting severe internal or external damage. We feel that this idea involves too definite an endorsement of the doctrine that the general level of prices should never be permitted or encouraged to fall.

110. We do not wish to tie ourselves definitely to the opposite doctrine, for its rigorous application would undoubtedly be open to practical objections. But there is one implication of the policy even of stabilising the general price level which needs to be recognised. If money incomes generally are rising, even at a rate no faster than the average of national productivity per head, then in those sectors where productivity increases slowly or not at all, average costs and prices must inevitably be rising. The attainment of stability of prices in general therefore requires that in other sectors (those in which productivity is rising most rapidly) prices should be falling. We shall return to this point later in connection with wages policy (see paragraphs 143–145).

CHAPTER V

Damping down Demand

I

111. Since we were appointed last August, the situation has changed in two important respects. First, on 19th September, in reaction to a violent crisis of the foreign exchanges, the Government announced a dramatic series of measures designed to damp down the level of monetary demand. We have naturally felt bound to try to form an opinion on whether these measures were well advised, and on what their consequences have been and are likely to be.

112. Secondly, in more recent months there has been a certain change in the climate of world activity. In the United States, as a result of a temporary saturation and setback in the huge programmes of capital outlay on private account, a definite recession has now developed, and has been followed by a limited change of policy in an expansionary direction on the part of the monetary authorities. And a sharp fall in the prices of a number of important raw materials has given rise to concern about the effects of these falls on the buying power of a number of overseas countries. We have had to try to form a view whether, even if the British September policies were initially well conceived, these developments overseas demand their early re-consideration.

II

113. We can feel no doubt that at the time they were taken the September decisions were fully justified and urgently required. While their more immediate object was to staunch and reverse the outflow of gold and dollar reserves due to the loss of confidence by foreigners in the stability of the pound, that loss of confidence was due not to any immediate weakness in Britain's actual overseas trading position, but rather to the belief that she had lost control over the internal value of her money. Nor was that belief confined to foreigners : we now know that in the first half of 1957 there had been a marked acceleration of the rush by British residents to place their savings in the dollar countries ;* and in the summer there were times when even the British Government found increasing difficulty in marketing its longer-term securities. The authorities were thus surely right to emphasise that the object of the September measures was not simply to correct the foreign exchanges but to set in motion an attempt to produce decisive results in the sphere of home prices and costs.

114. We have read a number of criticisms of the September measures, based on very various and sometimes conflicting arguments. So far as these criticisms raise the question of the relation between prices and wages, we

* Whether this rush should not have been stemmed by a much earlier closing of the so-called " Kuwait gap " in the foreign exchange control is of course a separate question.

defer this crucial matter to the next chapter, dealing first with some more general points. In the first place, according to some critics the September measures were unnecessary, since such figures as are available to throw light on the plans of business men suggested that the boom in private capital outlay which had begun in the latter part of 1954 had already passed its peak and could be relied on to peter harmlessly out. The occurrence of the crisis seems itself to furnish a sufficient answer to this contention; it may have been—it presumably was—disappointing to the authorities that their not inconsiderable efforts of demand-damping during 1955 and 1956 had failed to achieve complete success; but so it was, and a belated recognition of the fact on their part was better than none.

115. Another bunch of criticisms is bound up with the admitted fact that the degree and manner in which, under present conditions, changes in official rates of interest and in the availability of bank credit can be expected to operate on the level of business activity is complicated and obscure. These highly technical matters have been remitted for thorough study to a strong committee under Lord Radcliffe, which is receiving a vast mass of testimony about them and which is unlikely to be able to report for some time. It would be the height of folly on our part to attempt to do their work for them on inadequate knowledge. But we have had to try to understand the outlines of the problem; and our provisional conclusion is that there is no reason to doubt that what is called "monetary policy", if pursued with greater resolution than has always been the case even since its resurrection in November, 1951, can play an essential though not an omnipotent part in moulding the general behaviour of the economic system.

116. We welcome the stress laid by the authorities on the importance of re-establishing their effective control over the quantity of money, and we do not take it as indicating any failure to appreciate how, even if the quantity of money is not increased, the stream of monetary demand can be fed by drawing into active use existing stocks of idle and semi-idle money. Such a process has indeed been at work since the end of the war, and it appears from the figures (Appendix VIII) that it was still at work in the early part of 1957. There are some who hold that it must now have nearly reached its limit; others who hold that, so long as business expectations remain optimistic, there is almost *no* limit to the length to which it can be carried. What does seem clear is that control over the quantity of money is a necessary condition, even though not by itself a sufficient condition, for controlling the supply of loanable funds and hence the stream of total demand.

117. Another line of criticism, accepting the feasibility of an effective damping down of demand, consists in painting the most discouraging possible picture of the consequent check to the growth of production. We think it important to be candid about the fact that such a check is to be expected and tolerated, as indeed it was in 1956. Excessive demand cannot be restrained if at the same time it is sought to wring the last ounce of output out of a given constellation of human and material resources. In an over-extended economy it is to be expected that a moderate contraction of demand will tend to eliminate the most costly units of output, thus diminishing the total flow of money incomes by more than it diminishes the total flow of output, which is, of course, from the "disinflationary"

standpoint, the right result (the employment aspect of the process will be considered in the next chapter). But further there seems every reason to hope that by facilitating a smoother flow of work and a better organisation of labour, and transmitting a pressure towards greater efficiency of management, the less congested condition of demand will also bring it about that the loss of output proves to be no more than temporary. Such conversations as we have had with those experienced in business do not lead us to regard these expectations as unduly optimistic. In particular, the experience of the motor car industry, which after the check to home demand in 1956 has recently been producing more cars with less labour and exporting a higher proportion of them, has been pointed out to us as being of hopeful augury.

118. There remains, however, one danger of which to take account. It seems possible that in a phase of *moderately* reduced demand, formal or informal arrangements for the maintenance of prices, or for the protection of the position of high-cost firms, may exercise a greater influence than they do either in positions of *very high* demand, when they are largely ineffective, or in positions of *very low* demand, when they are liable to be disrupted by "cut-throat competition". It is probably therefore fortunate that, as we understand, large numbers of such arrangements have in recent months been cancelled in preference to registration under the Monopoly and Restrictive Practices Act, while the fate of those which remain is shortly to be tested in the Court. It may also be presumed that the prospects of the formation of a European Free Trade Area are impelling many firms to accustom themselves to the prospects of facing sterner competition than they have been used to in the recent past. But we shall have a little more to say on this matter later on (see para. 155).

III

119. The September measures comprised, it will be remembered, a spectacular rise in Bank rate from 5 to 7 per cent, an instruction to the banks to limit the average level of their advances over the next twelve months to the average level attained over the preceding twelve months, and a trimming of the programmes of capital outlay in the public sector* from the levels previously visualised for 1958–59 and 1959–60 down to the level in money terms actually attained in 1957–58, estimated at £1,500 millions.

120. The ostensibly most powerful objection which can be brought against the scheme is thus that its whole impact is directed not against expenditure in general but against expenditure for capital purposes, commonly called "investment". A high level of investment is desirable, for evidently the chief, though by no means the only, method of bringing about a continual annual increase in productivity, in the sense of output per head, is through equipment of labour with a continually increasing stock of up-to-date and efficient capital instruments. Yet here too it is most necessary to preserve a sense of proportion, and of the impossibility of pressing to the extreme limit every one of a number of rival objectives.

* The public sector includes the Central Government, the local authorities and the nationalised industries. The total of £1,500 millions is only in part financed by the Central Government (whether above or below the line in its financial statement). (See also Appendix IX.)

121. As a background to the study of this problem we have set out in Appendix IX some of the official figures bearing on the behaviour of investment in this country in recent years. It will be sufficient here to note that the real value of the *net* additions to the stock of fixed capital in the country, excluding houses, was about the same in 1948 as in 1938 and has been greater in every subsequent year, reaching in 1956 nearly twice the 1938 level, whether expressed as an absolute figure or as a proportion of the net national income. Comparison with other countries may be made on the basis of the proportion of *gross* non-housing investment (investment as reckoned before making allowance for the depreciation of existing assets) to the gross national product. On this basis the United Kingdom proportion (11·7 per cent in 1956) is not very different from that of the United States (13·3 per cent), though a good deal lower than West Germany's (17·2 per cent).

122. We know of no grounds on which it can be categorically pronounced that this proportion (or any of the other " proportions " of the kind on which it may be thought more instructive to concentrate attention) is " too great " or " too small " ; but we are prepared to endorse what we take to be the general view that it will be desirable that it should be somewhat increased over the next decade, provided that the saving required to implement the increase can be obtained in ways that do not do violence to the stability of the currency. It may however turn out that the pressing home of the September measures involves some temporary setback from the proportion attained in 1956.

123. So far as the Government's own plans go, indeed, it does not look as if the proportion to which we have specially directed attention is likely to be adversely affected at all. For provided there is no further rise in prices, none of the Government's main investment plans for productive enterprise—coal, railways, roads, electricity, postal services—nor indeed those for the educational and hospital services—are to be cut appreciably below their 1957–58 level in real terms ; indeed most of them are to be expanded well above it, the containment of the total of public investment within the framework of £1,500 million per annum being secured mainly by a fairly sharp reduction in the Local Authorities' expenditure on house-building. Any idea that there has been a ruthless slashing of the nation's capital outlay on its basic services of fuel, power and transport is quite wide of the mark.

124. As regards private investment, the present position and prospect are not altogether easy to assess. We understand that the latest forecasts of private capital expenditure collected by the Board of Trade show an expected expenditure in 1958 at about the same rate as in 1957. It is nevertheless our impression that since September last there has been a good deal of revision of investment plans, though doubtless there is room for argument as to how far this has been due to the delayed action of previous phases of the credit squeeze, how far to the September measures, and how far to changes in the business atmosphere which might have occurred in any event. It is reasonable to suppose that the main impact of any reconsideration of investment programmes would be on plans not yet commenced, and on this assumption we may perhaps anticipate a decline of private capital expenditure in the somewhat more distant future.

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125. It has been urged in some quarters that if private investment was to be curtailed it should have been done in a more selective manner, with a greater attempt to discriminate between investment for "essential" and "inessential" purposes. It cannot be denied that the present method of control through the Capital Issues Committee and directives to banks is a somewhat illogical compromise between a totalitarian system and one which leaves everything to the play of the market, but we do not think that in present circumstances this illogicality can be wholly avoided. There are many pitfalls in the way of attempting to distinguish between the "essential" and the "inessential". On the other hand, we are conscious of the fact that the present methods of control leave untouched the application by a company of its own liquid reserves. We recognise that in some circumstances it might be necessary to supplement the present system by the re-introduction of physical controls over building. But we think that the practical objections to this course are very great; and since the demands on the building industry have now been considerably reduced by other parts of the Government's economy programme, we imagine that most people would agree that the need for such supplementary measures, if it ever existed, has now receded. Greater still, in our view, are the practical objections to the re-introduction of physical controls over investment through the allocation of machinery or raw materials.

IV

126. By and large, therefore, we are not disposed to take a tragic view of the check to investment involved by present plans. Nevertheless, it is reasonable to enquire whether, if the damper on total demand is to be maintained, some of the downward pressure should not now be shifted from investment to consumption through use of the machinery of public finance. There is, indeed, reason to suspect that on occasion in the past the full fruits of a fairly firm monetary policy have failed to be reaped owing to inadequate follow-through in the fiscal field; and it may well be argued that in present circumstances, even if the downward pressure on investment is not reduced, the pressure on consumption should be increased.

127. We are aware that at this season of the year those in authority are faced with difficult dilemmas in this field, and we are by no means adequately equipped to tender advice for their solution. All we can do is to point out the complex nature of the problem. There is in the first place the question of how large a surplus of the Government's receipts from taxation over its current expenditure should be aimed at in order to help in financing capital expenditure in the public sector*; in the second place, the question of how far any increase in this surplus should be derived from increases in taxation and how far from reductions in expenditure.

128. The leading considerations seem to us to be these. Increases both in direct and in indirect taxation can be expected to have a disinflationary effect in depriving the consumer of spending power, though as regards direct taxation this effect is blunted in so far as the taxpayer, instead of reducing his consumption, elects to reduce his saving or spend out of capital; this

* A summary account of the way in which public capital expenditure has been financed in recent years is given in Appendix IX, section C.

qualification may be important, especially in the case of the higher income-groups, where taxation is already high. Increases in both types of taxation may be used as arguments for increases in wage claims which may in fact be granted ; while increases in direct taxation may also tempt the business man to raise the price of his goods in an attempt to mitigate the burden of the tax. It may further be observed that the existing level of direct taxation is so high as not only to encourage wasteful expenditure on the part of business firms, but also to stimulate undesirable ingenuity, with the attendant waste of time and effort, on the part of the taxpayer in avoiding the intended burden of the tax.

129. It is obvious that every proposal for reduction or limitation of Government expenditure should be carefully considered in the light of its effects on the safety of the country, the efficiency of its administration, and the welfare of its people. But in our view no branch of expenditure should be regarded as immune from possible reduction or limitation, except those expenditures made in fulfilment of definite contracts.

V

130. We must now face frankly though briefly the second question raised in the first paragraph of this chapter, namely whether the change in the world atmosphere during the last few months is such as to demand thorough reconsideration or indeed reversal of those " September measures " of which we have felt it right to record our general approval. We feel entitled to express regret that the resolute attempt to secure decisive results in the sphere of home prices and costs which was at last made in September, 1957, was not made two years earlier, when the buoyancy of foreign demand was so great that any redundancies of goods or labour caused by the downward pressure on home demand would have had the best possible chance of speedy absorption, as in the case of the motor industry referred to above. We think it is very possible that the price of stabilisation may prove somewhat higher under the new conditions than it would have been under the old. But we see no sufficient reason so far for abandoning the struggle ; for a partially disinflated world will be a place even fuller of peril than a still inflating one for a Britain left out on a high cost branch. It is relevant in this connection that already in the first three quarters of 1957 the rate of increase in British exports had become less than in 1956, and in the last quarter had virtually ceased. Britain's share of the total of exports of manufactures from the leading countries has continued to decline, reaching about 18 per cent in the first half of 1957 as compared with 22 per cent in 1951 (and 1938). Though this matter of proportion may not be of the first consequence, the main explanation of it which it has hitherto been possible to advance, namely the late come-back of Germany and Japan into the world's markets, has now become of diminished validity. There is conflicting evidence as to how far difficulties of price, as contrasted with delays in delivery and defects in servicing and salesmanship, have hitherto been responsible for British exports not having grown faster than they have. But in any case it seems clear that this is no moment for an increase in the costs of production of British exports.

131. We do not think Britain can afford to indulge in a premature reflation in order to help to boost the prices of those foodstuffs and raw materials which have recently fallen in price, especially as in some cases a large part of the fall seems to represent a return to levels more in line with long run demand, and with the long run costs of efficient producers, than those previously prevailing. Britain has never been able to have the best of both worlds simultaneously as regards raw material prices, and she cannot now ; and it would seem to be unwise to imperil the stability of the pound by trying.

132. At the same time it is evident that the closest watch should be kept on the development of the world trade situation. If to the designed damping down of demand at home there should be added later in the year the depressive effect of a pronounced fall in the demand for British exports, very difficult problems of policy would arise, even if, thanks to the accompanying fall in the price of imports, there should be no great worsening of the United Kingdom balance of payments on current account.

133. It has been suggested in some quarters that in such an event any reflationary measures undertaken in the interests of employment should be directed rather to purposes which would directly support the demand for British exports than to the re-expansion of investment programmes at home. Subject to the country's international engagements, and to her long term interest in a freely trading system, we think that these suggestions deserve exploration.

CHAPTER VI

Wages under Controlled Demand

I

134. We must now attempt to examine the implications for the earnings of labour of a policy of damping down the intensity of total demand. In the first place it must be expected to lead to some reduction in the hours of overtime worked and in the special inducements offered by employers to attract labour; and hence to cause a check or reversal of that tendency of the rate of rise in average earnings to outstrip the rate of rise in standard wage rates which we have seen has been in evidence during most of the post-war period. Secondly, it may lead to the retirement from the labour market of a number of married women. Thirdly, it must be expected to lead to some rise in the percentage of persons registered as unemployed—the unemployment being much more, so far as any particular individual is concerned, of a temporary and transitional character than in pre-war days.

135. Signs of all these three developments have been visible since the end of 1955. But the third has still only gone a short way; the percentage of employees in Great Britain registered as unemployed, which was 1·2 in January, 1956, was 1·8 in January, 1958. No one should be surprised or shocked if it proves necessary that it should go somewhat further. In our opinion it is impossible that a free and flexible economic system can work efficiently without a perceptible (though emphatically not a catastrophic) margin of unemployment of this kind. A corollary is that ample public help in the matter of transport and lodging should be offered towards shortening the average period of such unemployment; we have been given details of the elaborate arrangements of this kind which are available. The question of redundancy payments by labour-releasing firms is here also clearly relevant. We were, indeed, informed that some firms already have arrangements under which redundant labour is compensated on a basis related to length of past service.

II

136. Much more important and difficult is the question of the effect to be expected from a decline in the intensity of demand on the behaviour of negotiated wage rates. We are aware that there are pessimists who maintain that it will be impossible effectively to secure the desired degree of restraint in demand by measures of the kind adopted by H.M. Government in September, 1957, unless they are pursued to an extent which will involve unemployment on a scale far different from the moderate amount needed according to the argument of the preceding paragraph to give reasonable industrial flexibility.

137. We ourselves at present take a more optimistic view. The decline in the intensity of demand, working through a decline in realised and anticipated profits, must certainly be expected to stiffen the resistance of employers to claims for increased wage rates. It would be excessive optimism to hope that it would prevent any wage claims being made, but we believe that the decline in the intensity of demand will tend to moderate the insistence with which they are pressed and to convince the members of the Trade Unions concerned that a successful attempt to continue the spectacular rise of wage rates in recent years would not only involve real hardship for large sections of their fellow citizens but would also ultimately endanger their own future employment and standard of living.

138. Claims for increased wages will no doubt be based largely on increases in the cost of living. It cannot be denied that the cost of living has risen substantially in the past year, but we do not think that this is conclusive. It must also be remembered by all concerned that wage increases in the past few years have not only exceeded the rise in the cost of living, but as the table below shows have gone beyond what would be justified by the average increase in productivity. This means that the wage increases have necessarily led to an increase in prices.

Year-to-year increases in prices, wages and productivity, 1953–57

	Per cent increases on previous year				
	1953	1954	1955	1956	1957
(1) Index of retail prices (annual averages)	3·1	1·8	4·5	5·0	3·6
(2) Productivity over the whole economy	3½ to 4½	2¾ to 3¾	2¼ to 2¾	−¼ to +½	(2½)*
(3) Index of weekly wage rates (annual averages)	4·8	4·4	6·7	7·9	5·1
(4) Average weekly earnings	6·2	6·5	9·2	7·9	not available

For definitions, see footnote †. * First three quarters only.

139. A general rise in wages in the current year based solely on the increase in the index of retail prices between December, 1956, and December, 1957, would amount to 4·6 per cent. This would be a higher rate of increase than the rate of increase of productivity between 1956 and 1957 or indeed than the average increase of the last five years, 1953–57. It must be expected that such a rise in wages would produce an upward pressure on prices and thus weaken our competitive strength in export markets. It would also diminish confidence in the stability of the value of the pound and so encourage a resumption of the movements of capital which played such a big part in the crisis of August and September, 1957.

140. It follows from what we have said that we would hope that if any wage increases are granted in 1958, they will be substantially below the

† *Notes on the items:*

(2) A range is given for the years 1953 to 1956, since there are two estimates for the increase in total national production (see Appendix IV). For 1957, there is as yet only one estimate, covering the first three quarters of the year. The production figure is divided by the total working population at June of each year, *less* the wholly unemployed.

(4) Average earnings for all workers in manufacturing and some other industries (see para. 47). An average is taken of the April and October figures.

average of the last few years. This would no doubt cause disappointment to some sections of workers, but we believe it to be essential for the establishment of a stable pound with all the consequent benefits such as the resumption of the upward trend in production which should follow therefrom.

III

141. Looking beyond the present critical year, we have had to ask ourselves whether we could say anything useful about the principles which should govern the making of wage bargains in the future. We have not had time to make an exhaustive study of the British system of collective bargaining in all its full complexity. Its leading features are that an individual wage negotiation usually refers to a single industry (sometimes rather broadly defined), and not either to individual firms on the one hand or to the whole field of industrial wage earners on the other. Recourse may be had to various types of conciliation and arbitration. These general features of the system we take for granted. Nevertheless, there are one or two matters of principle on which we think we can usefully comment.

142. We wish first to revert to a matter which we have already mentioned, and which lies at the very heart of our terms of reference, namely the complicated relations between prices, productivity and money incomes.

143. The "productivity" of a group of workers, in the sense of the annual flow of physical product turned out divided by the number of workers in the group, may increase as a result of any one or more of a number of causes. These causes can in principle be distinguished into three classes:— (1) increased energy or skill displayed by the workers themselves, or an increase in the number of hours per year for which they work: (2) more or better machinery with which to work, involving substantial capital expenditure: (3) improvements in factory layout, routeing of work or other matters of managerial technique, not involving appreciable capital outlay. Now it is evident that, even within the range of manufacturing industry, increases in output as a result of any of these three sets of causes are much more liable to occur in some branches of production than in others; while they are also much more liable to occur in manufacture in general than in transport or commerce, or in service occupations such as hair-cutting, medicine, teaching or government. Indeed it is easy to imagine cases in which in some sector productivity is increasing so rapidly that labour is bound to become redundant there, and it will be desirable that earnings in that sector should fall relatively to earnings in other occupations, in order to encourage labour to move to points where the demand for it is stronger. More usually, it may be hoped, there is some connection between the pace of technological advance in a sector and the degree to which a community advancing in wealth will desire to spend its increasing income on the products in that sector, so that some relative increase in the rewards accruing in that sector will be consistent with, and indeed required to implement, the right distribution of the country's labour force. Even in these cases, however, it is not desirable that wages should rise in that sector in the full proportion in which productivity has been increased there. In the first place, when the increased productivity is due mainly to improved capital equipment, some part of the additional product will be required to meet depreciation charges

and profit on the increased capital employed. But secondly, it is desirable that a large part of the benefit of the increase in productivity should be handed on elsewhere in the form of lower prices. For unless this is done, i.e., if wages—or wages plus profits—are forced up at the points where productivity has increased most to the full extent of the increase in productivity there, there will be a tendency for money wages to be forced up also at the points at which productivity has increased less or not at all. This will occur partly through the pull of the increased spending-power of those who are earning higher incomes in the more " productive " sectors, and partly through the push of those who see these incomes outstripping their own without any corresponding relative increase in skill displayed or effort expended. The result will be a rise in the level of *average* wages in the country in excess of the rise in *average* productivity, and a consequent rise in the general price level—which is just the result we wish to avoid. If, however, the rise of wages in the more productive industries is kept well below the rise in productivity in those industries, it should be safe to grant increases to those in other industries for whom increases could not be justified merely by the state of productivity in such industries.

144. Now the trouble seems to us to be that wage-fixing arrangements —piece-rates, bonus schemes and so forth—which are well designed for securing correspondence between individual effort and individual reward, and for effecting a reasonable distribution of the fruits of progress between employer and workman, are *not* equally well-designed for passing on a handsome share in those fruits to the consumers (the great majority of whom are of course workers in other less technically progressive occupations).

145. It is true that for some years after the end of the Korean upset, though not during 1955–57, the prices, whether at wholesale or retail, of most manufactured non-food products remained fairly stable while other prices were rising. But such a result is not good enough if overall price stability is the aim ; for in that case these " manufactured " prices must actually fall in order to compensate for the inevitable rise in the price of the services rendered by those whose productivity cannot be significantly increased. To bring about this result, it seems to us that the main reliance must be placed on the forces of active competition between firms, working within the framework of a well-regulated monetary system and governing the magnitude of the wage advances which employers are willing to offer or concede. But we cannot but think that to achieve the desired result without industrial strife or unnecessary unemployment, Trade Union policy and leadership has a significant part to play, since both groups of occupations—those in which productivity increases rapidly and those in which it increases slowly or not at all—are well represented in its counsels. We think too that the considerations to which we have drawn attention in paragraphs 143 and 144 should be continuously present to the minds of those who are called on to take any part, by conciliation, arbitration and the like, in negotiations about wages.

IV

146. As we have tried to bring out in the preceding discussion, the appropriate level of wages in any occupation does not depend only on what is happening even to overall productivity ; it depends also on the conditions

of demand for and supply of labour in that particular occupation. We think that in the long run these forces of supply and demand are the most powerful influence moulding the course of relative wages. But they are apt to be blunted in a period of over-full employment, when *every* industry can represent itself as being short of labour. They are apt too to be impaired by the persistence of customary differentials, based on abstract notions about the comparable merits of different types of job and no longer corresponding to contemporary requirements. We think it most important that the flexibility of relative wages in response to changes in the demand for labour should be preserved, since in a free enterprise economy without direction of labour this is the main means on which we must rely for ensuring the most efficient distribution of the country's labour force.

147. We must revert at this point to the suggestion that from time to time a percentage figure should be announced by which average money wages could increase during the year without damage to the national interest. We are conscious of the attractiveness of this proposal, offering as it does the hope of establishing a link between the rate of wage increases and the growth in overall productivity. There are, however, serious practical objections to it. There would always be industries in which there were good reasons for the advance in wages to exceed the average ; others in which much less good reasons for it to do so could be thought up ; very few in which the case for lagging behind the average would be readily conceded. There would thus be a real danger that the prescribed average would always become a minimum, and the process of wage inflation therefore built into the system. This is apart from the point already made (para. 109) that such a procedure seems to involve too definite an endorsement of the doctrine that in a progressive community the *general* level of prices should never be permitted or encouraged to fall as an alternative to a rise in money incomes.

CHAPTER VII

Prices and Profits

I

148. In preceding chapters we have stated our view that the factor principally responsible for too rapidly rising profits—as for too rapidly rising wages—has been the level of total demand, and that the main route towards preventing the excessive growth of money incomes of both kinds must lie through mastering the level of demand. Nevertheless it is right that we should consider if there are any acts of policy, whether or not of a legislative character, outside the immediate field of wage negotiation, which could be helpful towards securing in future a better balance between the growth of money incomes and the growth in real output than has been secured in recent years.

II

149. Three types of measure which we have considered are:—

(*a*) price controls;

(*b*) subsidies to reduce the cost of living; and

(*c*) dividend limitation.

In examining them we have concentrated on the contributions they could be expected to make to the efficiency of the country's industrial organisation.

150. We should not favour the reintroduction of the price controls which admittedly played an essential part in the war-time and immediately post-war economy. In a world in which the variety of products is enormous and in which change in their nature, quality and style is continuous, the operation of price control is bound to interfere with progress and adaptation. It cannot hope to be perfectly fair in its incidence on different industries and firms. Even to secure the roughest of justice involves an expensive administrative machine. The evils of evasion and black markets inevitably arise as soon as the divergence between controlled prices and the free market levels becomes substantial. For these reasons, whatever may be the case for the use of price controls in an emergency of limited duration, we should be opposed to their reintroduction to deal with a long-term problem of the economy in peace-time.

151. Nor again should we be in favour of retreating from the policy of reducing, and indeed as far as possible eliminating, those subsidies on particular forms of consumption which again were largely a heritage from war conditions. We would include under this head not only the use of public funds to reduce consumer prices, e.g. of food, but also the maintenance of rents at artificially low levels by the Rent Restriction Acts: for this amounts to an enforced subsidy of the tenant by the property owner. Measures of

both types distribute benefits in no close relation to need and encourage an uneconomic use of resources.

152. We are aware that to some wage-earners the payment of dividends to shareholders is in itself a source of irritation, and we do not doubt that the fact that ordinary dividends have increased somewhat rapidly since 1952 bulks largely in the consciousness of many workers. Less weight is given to the facts that even before tax dividends have less than doubled in money terms since 1938, while wages and salaries have increased nearly fourfold; that if account is taken of taxation the disparity is undoubtedly greater still; and that in terms of the goods and services they will buy, present wages are well above the pre-war level while dividends are well below (see para. 70). We do not think that the tendency towards increased distributions since 1952, after a long period of standstill, is open to serious criticism. Nor do we think that, accepting for the moment the size of company profits—a matter to which we shall return—attempts to interfere by legislation, or even (except perhaps in short periods of emergency) by exhortation, with the discretion of directors as regards the proportion of the whole which should be distributed are likely to be in the true interests of British industry or therefore of the working population. We do not think there are many boards of directors who need special encouragement to retain profits in their own businesses. We purposely refrain in this report from making any recommendations about specific taxes; but we think it relevant to this subject of dividend limitation, which clearly falls within our purview, to quote a sentence in which the Majority of the Royal Commission on Taxation record their objection to the present differential tax on distributed profits*. "The mere retention of profits cannot be rated as an economic advantage; on the contrary it would better serve the public interest that a company should be encouraged to distribute those profits which it cannot put to fruitful use, in order that there may be a chance that they may be invested effectively elsewhere."†

III

153. We turn therefore to the question of the absolute size of company profits, and of whether, as has been urged upon us from many quarters, there is a case for attempting to reduce them, not indeed through specific price controls but through modifying the attitudes and price policies of business men. The figures given in Chapter II have shown the importance of profits in the make up of prices: the total of profit incomes‡ is about 35 to 40 per cent as large as the total national wage and salary bill while

* Profits tax is charged at 30 per cent on distributed, 3 per cent on undistributed profits. (This is, of course, in addition to income tax.)

† Final Report (Cmd. 9474), para. 536. The Minority were opposed to the repeal of the differential tax except in conjunction with the imposition of a tax on capital gains; but they expressed (para. 103) the objections to the differential tax in even more forcible terms than the Majority—terms which in our view are equally applicable to compulsory limitation of dividends.

"It can be argued that the system of financing capital expenditure so largely out of the undistributed profits of companies does not ensure the best use of the community's savings. It makes it more difficult for fast-expanding firms to raise funds in the capital market; it strengthens the monopolistic tendencies in the economy, and it encourages wasteful expenditure on behalf of those firms who have more money than they can use and who are yet prevented (by custom and tradition as well as by the instruments of public control) from channelling these funds to their most profitable potential use."

‡ See para 54. The exact figure depends on the basis of calculation of profits. See Appendix II.

company profits alone form half, or a little more than half of total profits. We have already (para. 118) pointed out the danger that existing practices about prices and profit margins, which may have had no great effect upon the course of events when demand was very high, may hinder the reduction of prices and aggravate the decline in production and employment when demand has been damped down or has fallen away. We realise that exhortation to our fellow-citizens, whether they be wage-earners or profit-earners, is unlikely to be effective unless they can be satisfied that on a long view the course recommended is in their own best interest; we realise also that an adequate return on risk capital must be permitted if the supply is not to dry up. Nevertheless, we think that in this connection there are three things which can legitimately and usefully be said.

154. First, granted that business men know their own business best, there must be occasions in some businesses when the advantages of a high profit margin on a smaller turnover, and of a low profit margin on a larger turnover, with all that the latter might mean in the way of greater stability of production and improved consumer goodwill, are pretty evenly balanced; and it seems not unreasonable to ask that on such occasions the public interest should be allowed to turn the scale.

155. Secondly, exhortation in the void is one thing, and exhortation backed by the law another. We have expressed our opinion that the establishment of the Monopolies Commission, and the further development of policy embodied in the Monopolies and Restrictive Practices Act, 1956, have already been beneficial in stimulating a more competitive spirit among business men. But it must be remembered that in that Act the prohibition of *collective* action to enforce the maintenance of resale prices was accompanied by a provision actually strengthening the power of the *individual* manufacturer to make such price maintenance effective. We are aware that this is a very complicated and controversial matter, and that there may be great reluctance to reconsider it so soon after the passing of the Act. But circumstances alter cases; and the great emphasis which has been placed recently by the Government on the need for price reductions—an emphasis with which, as will have been seen, we largely agree—lead us to think that this matter ought to be carefully reconsidered. We have reached no conclusion on the subject, and even if it be within our terms of reference we cannot see any hope of dealing with it ourselves.

156. Thirdly, it seems to us entirely right and proper that companies should aim at making and retaining enough profits, after payment of very severe taxation, to provide for such expenditures on scientific research as cannot be charged as current expenses, as well as to contribute to the costs of physical growth. Nothing that we have said above in paragraph 152 should be taken to indicate dissent from that view. This is one of the methods by which businesses have always grown; even in 1938 the amount of saving done in this way by companies on behalf of their shareholders seems to have been more than half as big as the total amount of saving done by individuals. In the early post-war years the violent change in the distribution of income, leading to the almost complete disappearance of personal savings, increased the disposition of progressive companies to perform "self-financing" of this kind. Moreover, during the inflationary period it has been necessary for companies to provide out of profits (and heavily taxed profits

at that) for the increased costs of carrying stock in trade and work in progress at rising prices, and for the excess of the cost of replacing their fixed assets at replacement cost over the depreciation provisions which had been made for the purpose before the calculation of profit (see Appendix II). Had companies not adopted this course, it would have been impossible to fill the gap by recourse to the capital market. The special difficulties of the inflationary period should gradually diminish as inflation is mastered ; but it must be expected that an efficient and progressive company will always wish to finance part of its capital investment programme out of retained profits.

157. This practice does, however, mean that a considerable part of the costs of future growth is being placed, through the medium of higher prices than need otherwise prevail, on the shoulders of the present-day consumer ; and there seems to be some reason for supposing that in some cases, where there is no overwhelming competitive pressure, the practice may be carried to excessive lengths. The economy, in other words, might be in a healthier position if there were a greater diffusion of real income from the company qua company not merely to its shareholders (for whom see paragraph 152 above) but to its customers. But the corollary is that, if the pace of growth is to be maintained, some of the saving which in recent years has been done by the companies must in future be done by somebody else. The omens for this are not as unfavourable as they seemed a few years ago ; while the figures are uncertain, and are themselves inflated by the inflation, there seems no doubt that since 1951 the habit of personal saving, largely though not entirely through the instrumentality of pension and provident funds of various kinds, has made a considerable recovery.

158. But it is a tender plant. The needs for stable or falling prices and for increased saving are complementary. Exhortations to business men to reduce prices, if indulged in, should, we think, be coupled with exhortations to workpeople and other consumers to increase saving.

IV

159. We welcome the attempts which are made nowadays by many firms to exhibit clearly—by graphs, pictorially, and otherwise—the relationship of profits and dividends to taxation and to wage and other costs, though great care is needed to ensure that they give a true picture, free from distortions. We think it might help further if, in appropriate cases, more information were given about the relation of profits to sales proceeds and to capital employed, whether as measured by the sum of share capital and free reserves, or by the current value of the net assets of the business. We realise, however, that it is not in all businesses that such relationships can usefully be established and in particular that comparisons between businesses may be vitiated by differences in the range of their processes, in the variety of their final products, and in the rapidity of their turnover in relation to capital. Further it is not all businesses which have information about the current values of their fixed assets and, if this basis of assessing capital employed is used, the profits may need adjusting so that depreciation is related to those values.

CHAPTER VIII

Summary

I. FACTS AND FIGURES (CHAPTER II)

1. The post-war years have been years of high employment and in the main of increasing output, but they have also been years of rising prices (paras. 15, 16).

2. Prices have been rising since 1934, but the price rise since the end of the war has been exceptionally big and prolonged for times of peace. The average rise has been some 4 to 5 per cent per year (paras. 17, 18).

3. The rise in the price of consumer goods is particularly important because of its effect on the cost of living index and thus on wage claims. Food prices down to 1955 rose very fast, and food is a particularly important item in the index. The rise in food prices affects some groups of the population more than others, pensioners being the group most affected (paras. 22, 23).

4. The fact that prices have risen means that the money paid out for all goods and services produced and imported must have risen faster than the actual quantities of home-produced goods and services and imports (para. 24).

5. The increase in the cost per unit of home-produced goods and services and imports for the year 1956 compared with 1946 is attributable as to 49 per cent to extra wages, 19 per cent to extra profit income, 19 per cent to higher import prices, and 13 per cent to extra indirect taxes (paras. 25–29).

6. Wages and salaries dominated the picture mainly because they were substantially bigger than the total of profit income at the commencement of the period, but it is to be noted that whereas from 1946 to 1952 wages and salaries and profit income rose roughly in line, from 1952 to 1956 wages and salaries rose appreciably faster. The figures for the first three quarters of 1957 carry on the 1952–56 story (paras. 30, 31).

7. The overall increase in production in the period 1946–56 is estimated on average at about 3 per cent per year, whereas the rise in wages and salaries is estimated at just under 8 per cent per year and the rise in profit income at just under 7 per cent per year (paras. 35, 36).

8. The gap between the rise in income and the rise in output has necessarily been very different for different industries (paras. 37–39).

9. Productivity, by which we mean production per man, has increased over the period 1946–56 by about 2¼ per cent per year. Average earnings over the same period rose about 7 per cent per year (paras. 40–42).

10. In considering these figures, it should be borne in mind that capital as well as labour is used in the process of production and that the stock of capital has risen faster than the labour force (para. 43).

11. The movements of the different types of income can be summed up in this way:

(i) Wages and salaries, both since 1938 and 1948, have risen faster than the total of net profit income (paras. 45, 46).

(ii) The average wage-earner and the average salary-earner in manufacturing industry have both had a real gain in their standard of living in the last few years; the gain has been greater for the wage-earner than for the salary-earner (paras. 47–52).

(iii) As regards income from self-employment, the total sums paid out to professional persons working on their own account and to other sole traders and partnerships have risen comparatively slowly throughout. Farmers' total incomes rose very fast from 1938 to 1948; since then, they have risen more slowly than wages and salaries (paras. 56–58).

(iv) Rent, after allowing for depreciation, fell sharply from 1938 to 1948, and since then, though it has risen, it has not recovered the share it had in the national income before the war (para. 60).

(v) Company profits rose about as fast as wages and salaries from 1938 to 1948, and again from 1948 to 1956 (paras. 61–65).

(vi) Dividends are a much smaller share of profits than they were before the war, and have not recovered their pre-war real value. This is also true of the total of personal incomes from rent, dividends and interest together (paras. 66–74).

(vii) The sum paid out in Old Age Pensions and other public grants rose rather faster than wages and salaries from 1938 to 1956. The latest increase in the pensions rates makes the standard pension worth slightly more, in real terms, than in 1946 (paras. 75–77).

II. CONCLUSIONS (CHAPTERS III–VII)

12. The country has pursued during the post-war period a number of objectives arising naturally from the circumstances of the time, and in themselves desirable, but making in the aggregate a greater demand on the industry and thrift of its citizens than they have had the power or the will to satisfy. This has shown itself in an abnormal pressure of monetary demand for both consumer and capital goods and services, which has been the main cause of the rising trend of prices and money incomes (para. 78).

13. The expansion has been assisted by a plentiful supply of money and by the pursuit by Governments of " full employment " policies (paras. 79, 80).

14. Increases in import prices also had an inflationary effect, but this has not been an important factor since 1951 (paras. 84, 85).

15. Wage claims have been frequent throughout the period, and in support of their claims trade unions have naturally relied on the considerable increases in the cost of living. At certain periods in the past the abolition or reduction of subsidies has been an important factor, though never a dominant one, in the rise of consumer prices. The partial decontrol of

house rents is in course of exerting a similar, but smaller, effect (paras. 86, 87).

16. Although the main cause of the rise in prices and incomes has in our opinion been high demand, the wage advances have chiefly been secured through the instrumentality of powerful trade unions, and the importance of their attitude will increase as the measures adopted to reduce demand take effect (paras. 88, 89).

17. Our terms of reference mention " reasonable stability of prices ", but this is an ambiguous term. Some people might hold that it does not preclude a slow rise of prices by 2 or 3 per cent a year. But even such a slow rise does great injustice between different sections of the population, and if it were generally expected to continue indefinitely would hamper many kinds of business dealings, including long-term borrowing by Government (paras. 90–97).

18. If attempts were made to avert these results by sliding-scale arrangements, etc., the most probable result would be to speed up the rate of price rise, which might reach disastrous dimensions (para. 98).

19. It is specially important for Britain, with her great dependence on imported food and raw materials, and her consequent need for high exports, to avoid inflation, since she cannot count on her competitors indulging in it (paras. 100, 101).

20. Accordingly in our opinion the objective should be to stop, not merely to moderate, the inflation (para. 102).

21. We recognise that the price-level might have to be allowed to rise if:

(*a*) there were to be a sharp rise in the cost of imported goods and services, or

(*b*) the level of indirect taxation were to be raised, or

(*c*) it were decided to correct some important price distortion, e.g., if it were thought that the prices charged by some nationalised industry were too low (paras. 103–108).

22. Apart from such special cases, it is arguable that the general level of prices should actually decline gradually as productivity increases (paras. 109, 110).

23. We consider the measures taken in September, 1957, by H.M. Government were justified and indeed overdue (paras. 113–118).

24. These measures must necessarily, if effective, have a tendency to slow down investment, the growth of which had already been slackening before September, 1957. This trend may be emphasized as a result of the Government's measures. There is no sign so far of any reduction in expenditure on projects already in progress, but it may well be that private investment plans are being revised. Expenditure on most of the important public investment programmes is being maintained (paras. 119–125).

25. We have called attention to various matters which we think the Chancellor of the Exchequer should have in mind when considering the levels of direct and indirect taxation and of Government expenditure. We

have not sought to tender advice as to the conclusions which he should reach (paras. 126–129).

26. The recent change for the worse in the outlook for world trade renders it all the more important that British costs of production should be kept under control. But if a severe depression in the demand for British exports should develop, very difficult questions of policy would undoubtedly arise (paras. 130–132).

27. The September measures must also tend to lead to some rise in unemployment, but the figures available do not suggest that the rise has been such as to afford an argument for any general relaxation of the restrictive pressure. The percentage of unemployment has risen only from 1·2 per cent in January, 1956, to 1·8 per cent in January, 1958. It would not be alarming if it went somewhat higher (paras. 134, 135).

28. We believe that the decline in the intensity of demand will tend to moderate the insistence with which wage-claims are pressed. Claims may be based on the increase in the retail prices index since the previous settlement. During 1957 the index rose by over 4½ per cent. A general rise in wage-rates on this scale would exceed the rate of growth of productivity in any recent year ; it would produce an upward pressure on prices and risk damaging our external position. Moreover, it must be remembered that wage increases in recent years have regularly exceeded the rise in the cost of living. We would, therefore, hope that if any wage increases are granted in 1958, they will be substantially below the average of the last few years (paras. 136–140).

29. In general, we think it important that, in the occupations where productivity is rising fastest, wages should not be allowed to rise in full proportion to the increase in productivity. For if they did, wages elsewhere would tend to rise in sympathy, and the result would be that *average* wages would rise faster than *average* productivity, and the rise in prices would continue (paras. 142–145).

30. We further think it important that wages in any occupation should reflect not only what is happening to overall productivity, but also the conditions of demand for and supply of labour in that occupation. For in a free enterprise economy without direction of labour, this flexibility of *relative* wages is the chief means on which the country must rely to ensure the best distribution of its labour force (para. 146).

31. While we appreciate the attractions of the suggestion that a percentage figure should be announced by which average money wages could increase during a year or other period without damage to the national interest, we have pointed out certain objections to the adoption of the proposal, one of which is the risk that the average might come to be treated as the minimum (paras. 109, 147).

32. We have considered, but we cannot in present circumstances recommend, the reintroduction or introduction of physical controls over investment, price controls, subsidies or legislation enforcing dividend limitation or the repeal of the Rent Act of 1957 (paras. 125, 149–152).

33. Linked with the question of dividends is the question of ploughed back profits. Had industry, in the post-war inflationary period, not ploughed

26215 O—58——15

back a large amount of profits it would not, we think, have been able to find from the market the funds necessary to carry out the capital investment which has in fact taken place (para. 156).

34. We have mentioned the desirability of lower price levels through policies aiming at low profit on large turnover. In this connection we have suggested that the question of the power of the individual manufacturer to enforce price maintenance should be the subject of an inquiry. We have ourselves reached no conclusion on the subject (para. 155).

35. We have made certain suggestions as to additional information which might in appropriate cases be included in the annual reports of companies (para. 159).

COHEN (*Chairman*).

H. G. HOWITT.

D. H. ROBERTSON.

W. A. B. HOPKIN (*Secretary*).

F. T. BLACKABY (*Assistant Secretary*).

February 17*th*, 1958.

APPENDIX I

List of Witnesses

PART I

Government Departments

Treasury

Sir Roger Makins
Sir Thomas Padmore
Sir Leslie Rowan
Sir Robert Hall
Mr. M. Stevenson

Ministry of Labour

Sir Harold Emmerson
Sir Wilfred Neden
Mr. P. H. St. John Wilson
Mr. G. C. H. Slater
Mr. R. F. Fowler

Board of Trade

Sir Frank Lee

PART II

Bank of England

The Governor
The Deputy Governor
Mr. W. M. Allen

PART III

Representative bodies

Association of British Chambers of Commerce

Lord Riverdale
Mr. Frank Bower
Mr. A. C. F. Hey

British Employers' Confederation

Sir Colin Anderson
Lord McCorquodale
Mr. George Pollock

Federation of British Industries

Sir Hugh Beaver
Mr. Hugh Weeks
Sir Norman Kipping

National Union of Manufacturers

Mr. C. S. Garland
Sir William Robson-Brown, M.P.
Mr. M. D. Oliphant
Colonel E. R. Mayer
Lieut.-Colonel V. I. Robins
Mr. P. M. Hubbard

Trades Union Congress

Mr. J. A. Birch
Mr. H. Douglass
Mr. D. Houghton
Mr. W. E. Jones
Mr. W. J. P. Webber
Sir Thomas Williamson
Mr. G. Woodcock
Mr. L. Murray
Mr. F. Jones

PART IV

Economists who submitted memoranda

Dr. T. Balogh
Professor A. J. Brown
Mr. J. C. R. Dow
Mr. R. F. Harrod
Sir Ralph Hawtrey
Professor J. R. Hicks
Professor D. T. Jack
Sir Donald MacDougall
Professor J. E. Meade
Professor F. W. Paish
Professor E. H. Phelps-Brown
Mr. W. B. Reddaway
Mr. C. R. Ross
Mr. C. T. Saunders
Mr. G. D. N. Worswick

PART V

Mr. S. P. Chambers
Viscount Chandos
Sir Oliver Franks
Lord Kennet
Lord Piercy
Mr. David Robarts
The Hon. Peter Samuel
Lord Weeks

APPENDIX II

The measurement of profit income

1. As stated in Chapter I, the figures for net profit income used in this report are based on the principles of national income measurement followed in the Annual *Blue Book* on *National Income and Expenditure.* As regards the measurement of the contribution of companies and other profit-receivers to the national income, these principles diverge in effect from the methods of ordinary commercial accounting in two important respects, namely (1) the treatment of depreciation of fixed assets, and (2) the treatment of stocks and work in progress.

2. In ordinary commercial accounting the allowance for depreciation of fixed assets is normally based on the assumed length of life of the asset and on its original cost. In national income accounting, the measure of "capital consumption" (the term used by the Central Statistical Office for the deduction on account of depreciation of fixed capital) is similar in being derived from an assumed length of life, but differs in that the cost assumed in the calculation is the current replacement cost of the asset and not its original cost. The reason for this treatment, put summarily, is that in principle *all* the items entering into national income work have to be stated in prices of the same period, in order to ensure a proper comparability between them. (For a fuller account of the matter, the Notes to the 1957 Blue Book may be consulted). There are considerable statistical difficulties in the way of estimating "capital consumption" on these lines, but these difficulties are of less importance when what is in question is the aggregate of particular types of income and its movement as between different years than they would be in an attempt to apply the same principles to the measurement of the profit of an individual business.

3. The divergence in the treatment of stocks arises because in national income accounting only that part of the increase in value of stocks which represents a physical growth of stocks is included in the reckoning of income. The excess of the increase in the value of stocks in any period over the value of the physical increase is called by the Central Statistical Office "stock appreciation", and is deducted in reckoning the gross national product and national income. No such deduction is made in normal accounting. Estimates of the amount of stock appreciation are given in the Blue Book. Here again there are considerable difficulties in the way of accurate estimation. A fuller account both of the principles of treatment of this matter, and of the statistical problems, is given in *National Income Statistics Sources and Methods,* H.M.S.O., 1956.

4. There are no complete statistics for profit incomes as reckoned on commercial accounting principles. The National Income Blue Book, besides giving figures for "capital consumption" and for "stock appreciation" as mentioned above, also gives figures for the statutory allowances for depreciation given by the Inland Revenue in reckoning liability to tax. The tax allowances have varied considerably from one year to another in the post-war period as a result of changes in the law relating to the "initial allowances" and subsequently the "investment allowances", and in consequence do not provide a basis for estimating aggregate profit as it would be reckoned on commercial accounting principles.

5. As a basis for the calculation of aggregate profit incomes allowing for the depreciation of capital, we have therefore had no alternative to adopting the "national income" approach. We have proceeded by deducting from the estimates of gross trading profits of companies, of the self-employed, etc., the Blue Book estimates of "capital consumption" (with some adjustments arising from the treatment of rent in the national statistics) and of "stock appreciation". Since, in a period of rising prices such as we have had in the United Kingdom since 1939, the replacement costs of fixed assets will generally exceed their original costs, "capital consumption" will generally exceed "depreciation" as reckoned on normal accounting principles. Further, stock appreciation is in most years positive, and in some large. For both reasons, profit income reckoned

by the methods of commercial accounting will be larger than as reckoned on the principles we have adopted.

6. The extent of the divergence cannot be measured with any precision, but it is possible to frame a *maximum* estimate by using the Blue Book table on Depreciation. This includes estimates of the annual allowances granted by the Inland Revenue, and these, as distinct from the "initial allowances", are calculated on principles which approximate to those of commercial accounting. By adding back the stock appreciation, and the excess of capital consumption over annual allowances, we obtain the following results, taking the year 1956 as an example:

	£m.
Total profit income before deduction of stock appreciation or capital consumption	5,963
Stock appreciation	150
Capital consumption	1,539
Net profit income after deduction of stock appreciation and capital consumption	4,274
Annual allowances (depreciation provision in the case of public corporations)	855
Net profit income after deduction of annual allowances (depreciation provision in case of public corporations)	5,108

7. The total net profit income arrived at by using the annual allowances as a measure of depreciation thus comes out at £834 million (about one fifth) more than is obtained by using capital consumption and deducting stock appreciation. This, however, is certainly an overestimate of the difference that would be found if we had available figures based on commercial accounting methods, because the accelerated writing down of assets under the initial allowances inevitably reduces the annual allowances below the depreciation that would be allowed by commercial accounting.*

8. The tables below set out figures for gross profit income and for net income on the two alternative bases discussed above.

Gross and net profit income, 1938, 1948 *and* 1956

£m.

		Total Profit Income	Companies	Self-employed
Gross profits before deduction of depreciation or stock appreciation	1938 1948 1956	1,881 3,759 5,963	690 1,798 3,002	647 1,321 1,697
Profits after deduction of Inland Revenue annual allowances (depreciation provisions in case of public corporations)	1938 1948 1956	1,704 3,387 5,108	548 1,590 2,516	633 1,267 1,590
Profits after deduction of capital consumption and stock appreciation	1938 1948 1956	1,633 2,607 4,274	569 1,303 2,288	629 1,141 1,482

* That the difference is *considerably* overestimated by this calculation is strongly suggested, though not absolutely proved, by an examination of the published accounts of companies whose shares are quoted on the stock exchanges. These have been conveniently collated by the National Institute of Economic and Social Research (see *Company Income and Finance*, 1949–53, N.I.E.S.R., 1956). These figures, which are of course prepared by normal commercial accounting methods, may be compared with the figures given for companies in the Blue Book. The two sets of figures are not *directly* comparable, because the N.I.E.S.R. publication covers only *quoted public* companies, while the Blue Book includes *all* companies, private and public; but they can be compared in respect of the *ratio* of depreciation to gross trading profit. For the year 1953, this comes out at 16·4 per cent for the depreciation provisions of the N.I.E.S.R. quoted companies; while for the Blue Book companies it comes out at 19·6 per cent if capital consumption is taken as the measure of depreciation, and at 13·0 per cent if the annual allowances are taken. (The gap of 6·6 per cent for companies should not be directly compared with the figure of one-fifth given for all profit-receivers above—apart from the difference in dates, the latter includes stock appreciation and has as a large component an allowance for the depreciation of houses, for which nothing is included in the annual allowances).

Increases in profits and wages, 1938–1956

	1948 as per cent of 1938	1956 as per cent of 1948
Wages and salaries	224	181
Total profit income:		
(*a*) " annual allowance/depreciation " basis ...	199	151
(*b*) " national income " basis	160	164
Company profits:		
(*a*) " annual allowance " basis	290	158
(*b*) " national income " basis	229	176
Profits of self-employed:		
(*a*) " annual allowance " basis	200	125
(*b*) " national income " basis	181	130

The principal effects of the comparison may be summarised as follows:

(i) The rate of increase of total profit income from 1938 to 1948 comes out distinctly bigger on the " annual allowance " basis than on the " national income " basis—99 per cent as against 60 per cent. On either basis, however, the increase was less than the increase in total wages and salaries (124 per cent).

(ii) The increase of total profit income from 1948 to 1956 comes out a little smaller on the " annual allowance " basis than on the " national income " basis—51 per cent as against 64 per cent. On either basis the increase was less than the increase in wages and salaries (81 per cent).

(iii) The ratio in 1956 of total profit income to the total wage and salary bill (£12,222 million) was 35 per cent if profit is reckoned on the " national income " basis (when it comes out at £4,274 million), 42 per cent if reckoned on the " annual allowance " basis (£5,108 million).*

(iv) The increase in total income from self-employment from 1938 to 1948 comes out larger on the " annual allowance " basis than on the " national income " basis—100 per cent as against 81 per cent. On either basis the increase was less than the increase in total wages and salaries (124 per cent).

(v) The increase of income from self-employment from 1948 to 1956 comes out much the same on either basis (25 per cent on the annual allowance basis as against 30 per cent on the " national income " basis). On either basis it was much less than the increase in wages and salaries (81 per cent).

(vi) The increase in company profits from 1938 to 1948 comes out a good deal larger on the " annual allowance " basis than it does on the " national income " basis—190 per cent as against 129 per cent. On the former basis the rate of increase is much greater, but on the second basis only a little greater, than the increase in total wages and salaries (124 per cent).

(vii) The increase in company profits from 1948 to 1956 comes out somewhat less on the " annual allowance " basis than on the " national income " basis—58 per cent as against 76 per cent. On either basis it was less than the increase in total wages and salaries (81 per cent).

NOTE

Calculation of profit incomes, net of stock appreciation and capital consumption

For the calculations used in Chapter II, capital consumption and stock appreciation were allocated between the various incomes as follows:

The stock depreciation of £80 million in 1938 (item 21, Table I, National Income Blue Book) was divided as follows:

	£m.
Income from self-employment	20
Company profit	55
Public corporations' surpluses	0
Other public enterprises' profits	5
	80

* It should not be assumed that the divergence would be similar if the comparison were limited to profits, wages and salaries within the company sector.

Stock appreciation in 1948 and 1956 was divided as indicated in Table 59 of the National Income Blue Book.

Capital consumption was allocated as indicated by Table 57, National Income Blue Book, except that about one-eighth of the capital consumption of "other assets" by the personal sector was allocated to rent. The capital consumption figures applicable to income from self-employment and to rent are therefore:—

£m.	1938	1948	1956
Income from self-employment ...	38	121	177
Rent	60	187	284

Capital consumption of the non-trading sectors of the Central Government and local authorities was not deducted from profit income.

APPENDIX III

The consumer prices index and the index of retail prices

I. *The consumer prices index*

1. This is a by-product of the estimates which the Central Statistical Office make of the total amount spent by persons in this country on various kinds of consumer goods and services. These estimates are published for each quarter, about three months after the end of the quarter, giving consumers' spending both in total, and divided between twelve different kinds of goods and services. Once a year, the figures are given in greater detail, with about 45 sub-divisions, in the National Income Blue Book.*

2. One table gives estimates of the actual amount spent in each year or quarter. A second table gives estimates of what those same goods and services would have cost, had they been bought at the prices ruling in 1948. By combining the two tables, price indices† can be derived both for total consumer spending, and for the various sub-divisions.

3. The two important characteristics of the index of consumer prices are these. First, it covers all consumers' spending, not the spending of a particular group of households. Secondly, it does not take a fixed collection of goods and calculate the way in which the cost of that collection rises; it takes the goods and services actually bought in a particular year or quarter, and calculates how much more that collection costs now than it would have cost in 1948. So this index is influenced by changes in consumers' spending habits; if, for instance, they buy more meat in a particular year, and less bread, the index gives more importance to meat in that year, and less to bread. It is a changing collection of goods whose price is measured.

II. *The index of retail prices*

4. This index is calculated by the Ministry of Labour and is published monthly, about three weeks after the end of the month to which it relates. Its method of construction and calculation is based on the recommendation of a Cost of Living Advisory Committee whose members include both Government and University statisticians, and representatives of employers and Trade Unions.

5. It differs from the consumer prices index in two main ways. First, in principle it takes a fixed collection of goods and services, and measures the month to month change in the cost of that fixed collection.

6. Secondly, it sets out to measure the rise in prices for a particular group of people, who certainly form a large part of the population, but not the whole of it. In the selection of the goods whose prices are collected, and in the importance given to any particular change in prices when the final figure is calculated, the index of retail prices bases itself on surveys of the budgets of a particular group of households.

7. The old prices index, called the Cost of Living index, which ran from 1914 to 1947, was based on budgets collected from 2,000 working-class families in 1904. In June 1947, this index was replaced by the interim index of retail prices; this used budgets collected in 1937 and 1938 from more than 10,000 families of manual workers in general, and non-manual workers earning less than £250

* For a fuller description of the compilation of these estimates, see *National Income Statistics: Sources and Methods*. H.M.S.O., 1956, page 97 et seq.

† Strictly speaking, they are currently weighted index numbers of average values.

a year. This interim index was roughly revised in January, 1952, to the pattern of spending in 1950. Finally, in January, 1956, a new index was started; this used budgets collected in 1953 and 1954 from 11,638 households. These households were those of which the head—whether he earned a wage or salary—brought in less than £20 a week; households where the head earned more than this, and households where most of the money came from pensions or national assistance, were excluded.*

III. *The differences between the two indices*

8. The table below compares the rise in the two indices, year by year:—

	(Per cent increase on a year earlier)									
	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957†
Index of retail prices	7·7‡	2·9	3·0	9·1	9·2	3·1	1·8	4·5	4·9	3·4
Index of consumer prices	7·7	2·5	3·3	8·2	5·7	2·1	1·9	3·4	4·5	2·4
Difference... ...	0	+0·4	−0·3	+0·9	+3·5	+1·0	−0·1	+1·1	+0·4	+1·0

‡ Per cent increase on June 1947. † First three quarters.

Since 1950, the general tendency has been for the index of retail prices to rise faster than the consumer prices index. This was particularly marked in the year 1952.

9. The table below makes a rough comparison of the weighting of the two indices. The weights given for the retail prices index are those for the three successive series, beginning in June, 1947, January, 1952, and January, 1956. The consumer prices index is currently weighted: and so the weights given below for 1950, 1954, and 1956 are the percentages of total spending which went on that group in that year.

Weights	Retail Prices Index			Consumer Prices Index		
	1947–52	1952–56	1956	1950	1954	1956
Food	34·8	39·9	35·0	29·2	32·0	32·6
Rent and rates	8·8	7·2	8·7	8·5	8·8	8·3
Clothing	9·7	9·8	10·6	11·4	9·8	10·0
Fuel and light	6·5	6·6	5·5	3·8	4·1	4·4
Household durables	7·1	6·2	6·6	6·6	6·9	6·9
Miscellaneous goods	3·5	4·4	5·9	6·7	6·5	6·5
Transport and vehicles	} 7·9	} 9·1	6·8	} 17·5	17·9	17·7
Other services			5·8			
Drink and tobacco	21·7	16·8	15·1	16·3	14·0	13·6
	100·0	100·0	100·0	100·0	100·0	100·0

10. The retail prices index has given a much bigger weight to food; and the consumer prices index has given a bigger weight to services.

11. The second table gives a comparison—again, a necessarily rough one, because the groups do not match exactly—of the rise in prices which the two indices show from 1948 to 1955.§

* For a full description of the construction of this index, see *Method of Construction and Calculation of the Index of Retail Prices.* H.M.S.O., 1956.

§ The retail price index figures are as calculated by R. G. D. Allen, *On the Decline in the Value of Money*, Athlone Press, 1957.

(Per cent rise, 1948–55)	Retail Prices	Consumer Prices
Food	69·4	57·9
Drink and tobacco	1·2	1·6
Rent and rates...	24·5	31·3
Fuel and light	51·7	39·0
Household durables	25·0	18·6
Clothing	32·8	23·0
Miscellaneous goods	30·2	14·4
Services...	39·1	29·0*
All items	38·1	30·1

* Includes private motoring and cycling.

12. In all the groups except two—drink and tobacco, and rent and rates—the consumer prices index shows a substantially smaller rise than the retail prices index over these seven years. It is normal for a currently-weighted index of prices to show a smaller rise than a base-weighted index ; for there is a tendency for consumers to increase their spending on goods whose prices have risen relatively slowly, and to reduce it on those goods whose prices have risen relatively fast.

13. Further, the fact that food is more important in the retail prices index than in the consumer prices index accounts for some of the difference in price movements, since food prices rose so much faster than the average. On the other hand, the fact that drink and tobacco had a heavier weight in the retail prices index will have served to narrow the difference.

IV. *The effect of the reduction of food and agricultural subsidies*

14. The total of these subsidies† has moved as follows since 1948 :—

£m.	*1948*	*1949*	*1950*	*1951*	*1952*	*1953*	*1954*	*1955*	*1956*
	450	420	377	370	314	261	310	235	251

15. A straightforward calculation can be made of the effect on the consumer prices index of the reduction from £370m. in 1951 to £261m. in 1953. The calculation assumes that subsidies remained at £370 m. and that there was no other effect on food consumption. (In fact, lower prices might have led to some small increase in food consumption: but it is not possible to calculate how big it would have been.)

16. This calculation is only one of a number of possible calculations of " the effect of the reduction of food subsidies ". Keeping the total of subsidies at £370 millions is not the same as keeping the subsidy on individual commodities unchanged ; for food consumption was rising, and if the individual subsidies had not been reduced, the total bill for subsidies would have risen. It is, however, not unreasonable to suppose that in any event action would have been taken to prevent the total bill from rising.

17. With subsidies £370 millions in 1953, instead of £261 millions, and assuming no other changes, the rise in the consumer prices index from 1951 to 1953 would have been 7 per cent instead of 8 per cent.

18. This type of calculation—that is, the effect of reducing the total subsidy bill from the 1951 level—cannot be made with any precision on the index of retail prices. But food has a heavier weight in the retail prices than in the consumer prices index ; and within the total of food, subsidised foods were also more heavily weighted in the retail prices index.

19. Further, it is perhaps significant that 1952 is the year when there was a large discrepancy between the movements of the indices of consumer and retail prices. So it is reasonable to assume that the reduction of the subsidy bill raised the retail prices index by more than 1 per cent, and quite possibly by more than 2 per cent.

† National Income Blue Book, 1957, Table 22.

APPENDIX IV

The measurement of industrial production and total national production

I. *The index of industrial production**

1. This index, prepared by the Central Statistical Office, is intended to provide a general measure of monthly changes in the volume of industrial production in the United Kingdom. Mining and quarrying, manufacturing, building and contracting, and gas, electricity and water are included; but agriculture, trade, transport and finance, and all other public and private services are excluded. The index covers production for the home market, for export and for the armed forces. It can be said to cover about half the British economy: the sectors included in it accounted for just over 50 per cent of the gross national product in 1956.

2. About 1,300 production series are incorporated in the index. Although some are quarterly, and a few annual, the majority are for weeks or calendar months. Most of the series—1,150 out of the 1,300—represent physical quantities produced—tons of coal mined; tons of cement produced; numbers of domestic washing machines; numbers of cars, divided into three categories; and so on. For some industries—for example, parts of the engineering group—it has been necessary to use series of the value of production, adjusted for changes in prices. For a few industries where there are no good output figures it has been necessary to use figures of raw materials used or numbers of persons employed.

3. These series are then combined by giving each one a " weight " proportional to the money value of the net output of the industry concerned in 1948, based on the Census of Production in that year. The resultant total figure is expressed as a percentage of the average monthly production in 1948.

4. The index of industrial production has moved as follows since 1948:—

1949	*1950*	*1951*	*1952*	*1953*	*1954*	*1955*	*1956*	*1957*
106	114	117	114	121	130	137	136	138

II. *Total national production*†

5. These index numbers—which, strictly speaking, are for the gross domestic product at 1948 factor‡ cost—are given yearly in the National Income Blue Book. They set out to cover all goods and services which result from economic activity.

6. Two methods are used for obtaining these figures—the production method and the expenditure method: and there are two sets of figures for the rise in the country's total real production. Over the whole period from 1948 to 1956 the figures show almost the same rise; but there are some appreciable differences in the movement from one year to another. In most years, the rate of rise for

Indices of gross domestic product at 1948 factor cost
(1948=100)

	1949	*1950*	*1951*	*1952*	*1953*	*1954*	*1955*	*1956*
Expenditure method ...	104·4	107·4	112·0	112·3	116·9	121·8	125·9	127·6
Production method	104·6	109·4	111·9	111·0	116·4	122·6	127·3	127·8

* For a full account, see *The Index of Industrial Production*, H.M.S.O., October, 1952.
† For a fuller account, see *National Income Statistics: Sources and Methods*, H.M.S.O., 1956, pp. 37 et seq.
‡ Factor cost means " at the cost paid to the factors of production ": that is, it excludes any indirect taxes and includes any subsidies.

total national production was slower than for industrial production; but there were years—such as 1956—when this was not so.

7. The production method is, in effect, an extension to the rest of the economy of the methods used in calculating the industrial production index. Series are found to represent the movement of the volume of output of the various industries outside the industrial production sector; and these series are combined by weighting them according to the money value of their net output in 1948. Some 200 different series are used in addition to those covering the field of industrial production. Some examples of these are given below.*

Industry	Weight, out of 1,000	Indicator	Unit	Remarks
Railways ...		British Railways passenger traffic:		
	0·45	Workmen's tickets ...	Passenger Miles	
	0·85	Season tickets	Passenger Miles	
	7·56	Ordinary tickets	Receipts deflated	
	0·72	London Transport railways...	Passenger car miles	
		British Railways freight traffic:		
	6·00	Merchandise and livestock	Ton miles	
	2·06	Minerals	Ton miles	
	4·74	Coal and coke	Ton miles	
	1·58	Parcels	Receipts deflated	
	0·50	Mail (letters and parcels)	Number posted	One parcel is assumed to be equivalent to 30 letters.
Banking and bill discounting	6·54	Stamp duty on cheques ...	Value Deflated	
	1·18	London Clearing Bank advances	Value Deflated	
	0·46	London Clearing Bank other assets	Value Deflated	
	1·06	Amounts invested at mid-year in Post Office Savings Bank and Trustee Savings Banks	Value Deflated	
	0·57	Amounts outstanding National Savings Certificates	Value Deflated	
National Government Service: H.M. Forces	26·96	Strength of Armed Forces and Women's Services.	Index†	
Defence Departments	7·85	Civilians employed on defence work.	Number	At 1st April in each year.
Other ...		Maintenance of law and order:		
	0·28	Prisons—inmates	Number	Average daily number.
	0·72	Courts of Justice—cases tried.	Index	The index is a weighted average of various classes of action.
		Services to persons:		
	0·49	War pensions in payment ...	Number	At 31st March in each year.

* The full list is given in *National Income Statistics: Sources and Methods*, Appendix IV, page 353 et seq.

† One officer is assumed to be equivalent to three other ranks, and a National Service man is assumed to be equivalent to four-fifths of a regular.

Industry	Weight, out of 1,000	Indicator	Unit	Remarks
National Government Service: Other—*cont.*		Services to persons—*cont.*		
	0·50	Claims for sickness benefit *plus* 90 per cent of births.	Number	Representing national insurance benefits; births represent maternity benefit.
	0·49	Numbers insured, Classes 1 and 2.	Number	
	0·57	Persons registered as unemployed.	Number	Representing unemployment insurance.
	0·66	Numbers insured, Classes 1, 2 and 3.	Number	Representing old age and widows' pensions and death benefits.
	0·16	Number of family allowances in payment.	Number	Average of figures at the beginning and end of the year.
	0·10	Number of industrial injury benefits.	Number	Representing industrial injuries insurance.
	0·09	Numbers insured, Class 1 ...	Number	
	0·14	National Assistance beneficiaries.	Number	
	13·46	Other National Government Service, wages and salaries.	Index	Total wages and salaries of civilian employees of the National Government excluding those engaged in defence, law and order and services to persons, deflated by index of civil service wage and salary rates.

8. Whereas the production method of measuring the gross domestic product sets out to estimate the increase in the output of all the producing units in the country, measured at the point of production, it is possible to use an expenditure method which sets out to measure the increase in the quantity of goods and services purchased, measured at the point of final sale. This revalues, at 1948 prices, the components of final expenditure on goods and services—that is, consumers' expenditure, public authorities' current expenditure, investment in fixed capital and stocks, and imports and exports. For some of this expenditure—for instance, for nearly half consumers' expenditure—there are figures of the actual quantities of goods purchased: these, therefore, are simply multiplied by 1948 prices. In the absence of good figures of quantity, the main method is to deflate estimates of expenditure by an index of price changes.

9. In a few instances, the same basic statistics are used, both in the production method and the expenditure method calculations. But in general the two methods rely on different sets of figures.

APPENDIX V

Production, productivity, wages, salaries and profits

The tables below give figures, for the economy as a whole and for the industries referred to in the main text, for:

1. The rise in production.
2. The rise in (*a*) total incomes ;
   (*b*) wages and salaries ;
   (*c*) profit income.
3. The rise in production-per-man.
4. The rise in the average wage or salary.

Lines 3 and 4—the rise in production-per-man and the rise in the average wage or salary—have a wider margin of error than lines 1 and 2.

The employment series used in the tables are the average numbers in employment.

A. THE WHOLE ECONOMY

	1948	1949	1950	1951	1952	1953	1954	1955	1956
1. Production	100	104·6	109·4	111·9	111·0	116·4	122·6	127·3	127·8
2. (*a*) Total incomes ...	100	107·0	111·0	123·5	136·0	144·8	153·9	163·6	176·2
(*b*) Wages and salaries	100	106·8	112·4	125·2	134·6	142·3	151·9	165·8	180·6
(*c*) Profit income ...	100	108·3	108·3	118·8	134·8	144·9	153·9	161·2	169·3
3. Production-per-man ...	100	104·3	108·2	108·9	108·7	112·7	116·9	119·9	119·5
4. Average wage/salary ...	100	106·5	111·1	121·9	131·8	137·7	144·9	156·2	168·9

Notes on items in this table.

1. Gross domestic product at 1948 factor cost. National Income Blue Book, Table 12.
2. (*a*) Gross domestic product at current factor cost.
   (*b*) All incomes from employment.
   (*c*) Before providing for depreciation but after providing for stock appreciation. National Income Blue Book, Table 17.

3 & 4. Divided by the average numbers in employment, *plus* members of H.M. Forces.

B. INDUSTRIAL PRODUCTION SECTOR

	1948	1949	1950	1951	1952	1953	1954	1955	1956
1. Production	100	106·3	113·6	117·2	114·1	121·1	129·6	136·6	136·5
2. (*a*) Total incomes ...	100	105·9	115·7	129·8	133·2	144·1	157·1	172·7	185·5
(*b*) Wages and salaries	100	106·3	112·7	125·2	136·4	146·0	157·3	174·8	190·7
(*c*) Profit income ...	100	105·0	122·1	139·7	126·4	140·0	156·6	168·3	174·5
3. Production-per-man ...	100	104·7	109·9	111·0	108·6	114·2	119·8	123·5	122·4
4. Average wage/salary ...	100	104·7	109·0	118·6	129·8	137·7	145·4	158·0	171·0

Notes on items in this table.

1. Index of industrial production, covering manufacturing, mining, building and contracting, gas, electricity and water.
2. (*b*) All incomes from employment. (*c*) Before deducting depreciation and also before deducting stock appreciation, since separate figures for this sector are not available.

C. MANUFACTURING INDUSTRY

	1948	1949	1950	1951	1952	1953	1954	1955	1956
1. Production	100	106·8	115·8	120·6	115·6	123·2	133·2	141·9	140·1
2. (a) Total incomes ...	100	105·6	117·1	132·9	133·7	144·3	158·3	174·9	185·0
(b) Wages and salaries	100	106·6	113·9	127·0	138·0	148·2	160·4	179·3	195·1
(c) Profit income ...	100	103·9	123·0	143·5	125·9	137·2	154·4	166·9	166·6
3. Production–per-man ...	100	104·8	110·7	112·5	108·6	114·6	120·8	125·5	123·2
4. Average wage/salary ...	100	104·6	108·9	118·4	129·7	137·9	145·4	158·5	171·6

Notes on items in this table.

1. Index of production for manufacturing industry.
2. (*b*) All incomes from employment.
   (*c*) Before deducting depreciation, and also before deducting stock appreciation, since separate figures for this sector are not available.

D. MINING AND QUARRYING

	1948	1949	1950	1951	1952	1953	1954	1955	1956
1. Production	100·0	103·2	104·2	107·8	109·0	108·6	109·8	108·5	109·2
2. (b) Wages and salaries	100·0	103·2	104·4	116·0	133·4	137·2	143·9	152·0	164·8
3. Production–per-man ...	100·0	103·1	107·1	110·7	109·7	108·9	111·3	110·6	111·9
4. Average wage/salary ...	100·0	103·1	107·3	119·1	134·3	137·5	145·9	155·0	168·8

Notes on items in this table.

1. Index of production for mining and quarrying.
2. (*b*) All incomes from employment.

E. VEHICLES

	1948	1949	1950	1951	1952	1953	1954	1955
1. Production	100	110·7	121·2	124·4	124·2	137·7	155·3	171·8
2. (a) Total incomes	100	104·4	118·5	133·1	145·3	161·5	181·5	209·9
(b) Wages and salaries ...	100	105·9	112·8	127·0	143·1	158·6	175·3	205·9
(c) Profit income	100	98·8	140·0	156·3	153·8	172·5	205·0	225·C
3. Production–per-man	100	109·0	115·5	114·8	109·2	117·8	127·0	134·6
4. Average wage/salary	100	104·3	107·5	117·2	125·8	135·7	143·4	161·3

Notes on items in this table.

1. Index of production for vehicles.
2. (*b*) Wages and salaries only, not including employers' insurance contributions.
   (*c*) Company profits only.

APPENDIX VI

Unfilled vacancies and unemployment

1. The chart below presents the figures for unfilled employment vacancies and for unemployment, referred to in Chapter III, paragraph 81.

2. The figures for vacancies represent the number of positions notified by employers to the Employment Exchanges and known to be still unfilled on the day of the count. Not all vacancies are notified to the Exchanges and the total number of unfilled employment positions must exceed the number given in these figures. Further, there have from time to time been changes in the regulations governing the recruitment of labour through the Exchanges. Under the Control of Engagement Order, which was in force during the war and afterwards until March, 1950, many kinds of labour could be recruited only through an Exchange, and the Notification of Vacancies Order, with broadly similar effect, was in force from February, 1952, until May, 1956, when it was revoked. These administrative changes must be presumed to have had some effect on the statistics, though it would appear from the movement of the figures that in no case was the effect very striking.

3. Both the unemployment figures and those for unfilled vacancies show clear signs of regular seasonal fluctuation on a considerable scale. In the figures given in the chart a correction has been made to eliminate the effect of this fluctuation. The figures are quarterly and are expressed as percentages of the total number of employees. In this form the figures were calculated by Messrs. J. C. R. Dow and L. A. Dicks-Mireaux of the National Institute of Economic and Social Research, and are taken from the Appendix to their article on *The Excess Demand for Labour,* Oxford Economic Papers, February, 1958*. We are indebted to Messrs. Dow and Dicks-Mireaux for permission to quote them.

4. It will be seen that the movement of the unemployment series has been broadly inverse to that of the vacancies series, and that the correspondence has been closer in the later than in the earlier years of the period. Between early 1947 and 1950 the number of vacancies was on the whole declining, while unemployment showed no sign of increasing: both were at levels which suggested a high pressure of demand for labour. From mid 1950 to mid 1951 unemployment fell and vacancies rose; from mid 1951 to mid 1952 unemployment rose and vacancies fell; from the later part of 1952 unemployment fell and vacancies rose, these trends continuing for about three years, i.e., until towards the end of 1955. In 1956 vacancies fell steadily, and unemployment rose, though less steadily. By early 1957 the two percentages were about equal, and since then no clear trend has appeared.

* The figures for 1957, which do not appear in the article, were supplied direct by Mr. Dicks-Mireaux.

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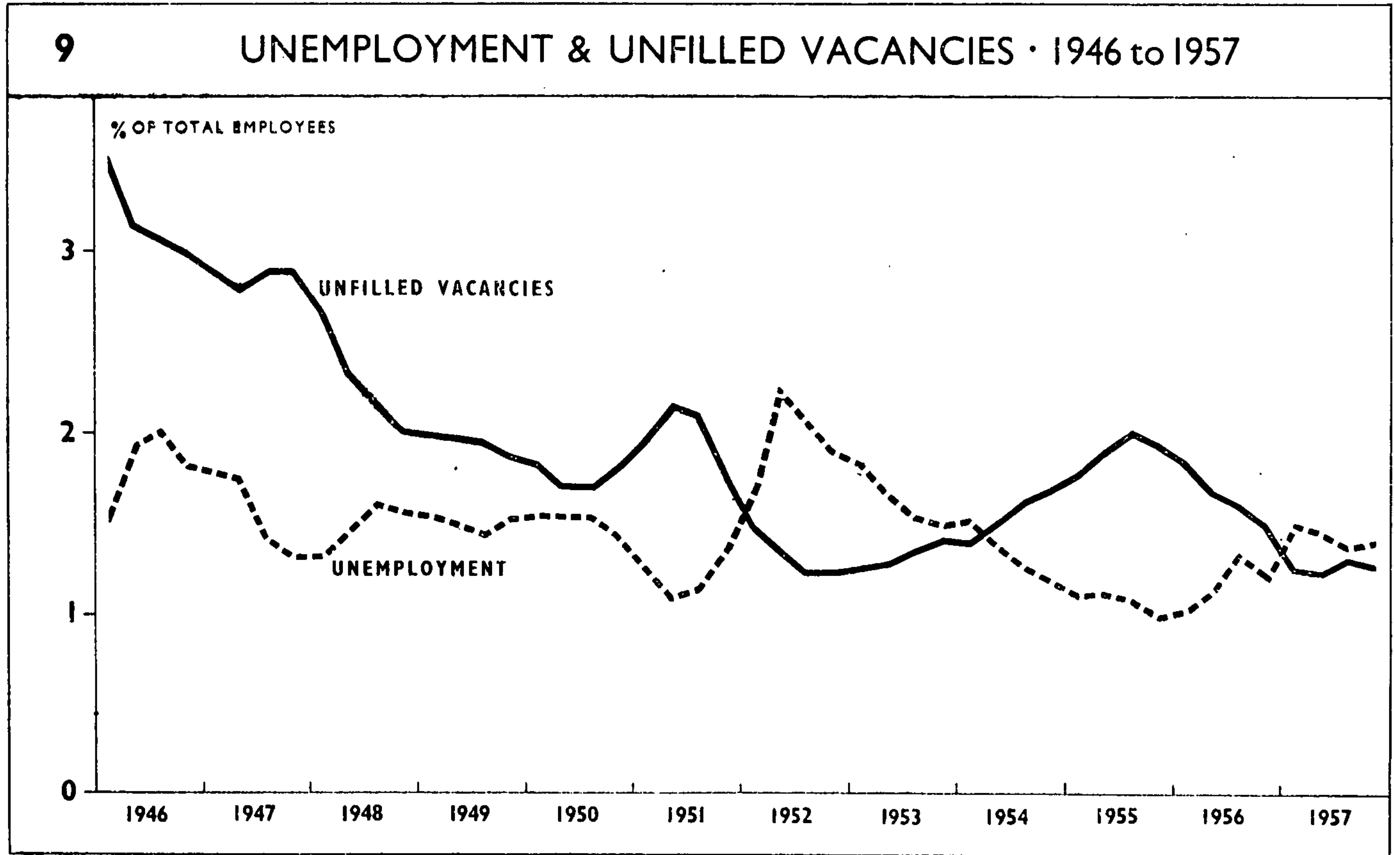

The figures are for Great Britain. For sources, see text.

Appendix VII

The so-called "under-valuation" of the pound

1. The argument in question, as developed by Mr. Harrod, is supported by figures purporting to show that, between 1938 and 1955, when allowance is made for the changes which had occurred in the rate of exchange,

(i) consumer prices in U.S.A. had risen relatively to consumer prices in U.K. by 30 per cent;

(ii) weekly earnings in U.S.A. had risen relatively to weekly earnings in U.K. by 70 per cent;

(iii) output per head in U.S.A. had risen relatively to output per head in U.K. by about a quarter;

(iv) as a consequence of (ii) and (iii), wage costs per unit of output in U.S.A. had risen relatively to wage costs in U.K. by say 36 per cent.

2. Sir Ralph Hawtrey, comparing 1937 with 1957, reaches a rather lower figure, 23 per cent, for the relative rise in U.S.A. wage costs.

3. Mr. Harrod presents supplementary figures showing, for the U.K. between 1938 and 1955, a rise in export prices of about a quarter, and a rise in import prices of over a half, relatively to consumer prices.

4. The inference drawn by both writers is that, unless the exchange is raised above $2.80 to the £, there is room for a considerable increase in U.K. domestic prices and costs, and indeed an almost irresistible force tending to bring it about.

5. All such arguments depend for their validity on the assumption that conditions in the period chosen as a starting-point can be regarded as in some sense "normal". It can, however, be argued that it was the conditions of the late 1930s which were abnormal by the standards of the earlier past, and it can be shown that if comparison is made between the 1950s and the 1920s we reach much less disturbing results. And, what is even more to the point, we must surely recognise that the post-war "normal" in these relationships may be very different from that prevailing in any pre-war period. It must reflect on the one hand the enhanced creditor position of the United States and the world wide increase in the demand for her products; on the other hand the diminished proportion of Britain's imports which can be paid for out of the profits of overseas investment, and her increased need for a surplus on the balance of payments for repayment of debt, building up of reserves, and investment overseas.

6. Of the factors affecting Britain a rough quantitative idea can be given as follows: in 1938 she had a net income from overseas investments of about £190 million, worth say £760 million at 1956 import prices; in 1956 her net income from overseas investments was about £180 million, leaving a gap of £580 million to be filled. In 1938 she had an adverse balance of payments on current account of £70 million, to obliterate which would have required a volume of exports which in 1956 would have been worth about £230 million. But in fact she achieved in 1956 a surplus of £230 million, and it is generally agreed that this is not adequate for her needs. Taking it, however, as a minimum standard, we reach a total of well over £1,000 million (i.e., £580 million + £230 million + £230 million) as a measure of the increase in export effort required of her now as compared with 1938. It is not to be expected that such a change-over could be accomplished without some lowering of her costs per unit of output as compared with those of more fortunately situated countries.

7. In trying to estimate the appropriate rate of exchange, or—given the rate of exchange—the appropriate level of home prices and incomes, we shall do better to examine the actual behaviour of the balance of payments over recent years, and its relation to the desired balance, than to pay much attention to these interesting historical studies of prices and costs.

Appendix VIII

The velocity of circulation of money

1. In Chapter V, paragraph 116, reference is made to the drawing of existing stocks of idle and semi-idle money into active use as a way in which, even if the quantity of money is not increased, the stream of monetary demand can be fed. The process is often described as an increase in the velocity of circulation of money, because it involves a rise in the number of times, on average, each unit of money changes hands against goods and services in a given period. Alternatively, it can be thought of in the converse way as a decline in the ratio of the money supply to the volume of transactions in a period.

2. These concepts cannot be measured directly because there are no statistics for the flow of transactions in goods and services. It is, however, possible to use some of the series contained in the Blue Book on National Income and Expenditure as indicators of the trend in the flow of transactions. Having chosen a series for this purpose, we can relate to it some measure of the quantity of money, and so obtain figures which should indicate at least the year to year movement, if not the absolute magnitude, of the velocity of circulation. Both in regard to indicators of the flow of transactions, and in regard to the quantity of money, a variety of series is available and the results will differ to some extent according to the choice that is made.

3. The table below gives for 1938 and each year from 1946 to 1957 two measures of the ratio of money stock to the flow of transactions. The measure

Table

The stock of money and the flow of transactions, 1938–1957

	I Estimated note circulation with the public £m.	II " Net deposits " of London clearing banks £m.	III Stock of money (=total of I and II) £m.	IV Total domestic expenditure at market prices £m.	V Money stock as percentage of total domestic expenditure per cent	VI Domestic expenditure plus exports (" final output ") £m.	VII Money stock as percentage of domestic expenditure plus exports per cent
1938 ...	442	2,213	2,655	5,822	45·6	6,545	40·6
1946 ...	1,332	4,922	6,254	10,324	60·6	11,575	54·0
1947 ...	1,351	5,454	6,805	11,181	60·9	12,637	53·8
1948 ...	1,229	5,703	6,932	11,837	58·6	13,828	50·1
1949 ...	1,238	5,761	6,999	12,457	56·2	14,762	47·4
1950 ...	1,244	5,800	7,044	12,911	54·6	15,696	44·9
1951 ...	1,291	5,918	7,209	14,975	48·1	18,445	39·1
1952 ...	1,370	5,844	7,214	15,644	46·1	19,248	37·5
1953 ...	1,462	6,012	7,474	16,803	44·5	20,200	37·0
1954 ...	1,551	6,225	7,776	17,721	43·9	21,329	36·5
1955 ...	1,657	6,171	7,828	19,154	40·9	23,081	33·9
1956 ...	1,765	5,998	7,763	20,296	38·2	24,660	31·5
1957* ...	1,828	6,059	7,887	21,139	37·3	25,732	30·7

* First three quarters (Columns IV and VI as annual rates).

Sources

Col. I: *Monthly Digest of Statistics.*

Col. II: *London and Cambridge Economic Service.*

Cols. IV and VI: *National Income Blue Book,* and *Economic Trends,* January, 1958.

of the stock of money is the same in both, being the sum of the estimated note circulation with the public and the "net" deposits of the London clearing banks. As indicators of the flow of transactions two series are given, first the total of domestic expenditure on final goods and services at current market prices, and secondly the sum of the domestic expenditure and the total of exports of goods and services (this second magnitude being called "final output" in the Blue Book).

4. It will be seen that the two indicators of the ratio of money supply to the flow of expenditure have moved in much the same way since 1938. Immediately after the war the stock of money was much higher, in relation to expenditure, than it was in 1938. With each successive year it declined until in the early 1950s (1951 in one series, 1953 in the other) it fell below the 1938 level. The decline has gone on since then without a check so far. Since 1954 the stock of money has grown by less than 2 per cent, while the money value of transactions as measured by either of these two indicators has risen by about 20 per cent.

APPENDIX IX

Investment

A. Gross and net capital formation in the United Kingdom, 1938–57

1. Some recent trends in fixed investment in the United Kingdom are illustrated in Table I below.

TABLE I

Gross and net fixed capital formation, United Kingdom, 1938–1957

	I Gross fixed capital formation in total £m.	II Gross fixed capital formation, excluding dwellings £m.	III Gross fixed capital formation, excluding dwellings, as percentage of gross domestic product* Per cent	IV Net fixed capital formation, excluding dwellings £m.	V Net fixed capital formation, excluding dwellings, as percentage of National Income* Per cent	VI Net fixed capital formation, excluding dwellings (Col. IV) and valued at constant (1948) prices £m.
1938	656	476	8·5	171	3·2	392
1948	1,430	1,093	9·4	374	3·4	374
1949	1,584	1,252	10·1	493	4·3	485
1950	1,702	1,371	10·6	553	4·5	536
1951	1,893	1,517	10·6	576	4·3	510
1952	2,114	1,620	10·3	570	3·9	452
1953	2,367	1,737	10·4	617	4·0	480
1954	2,550	1,894	10·7	714	4·3	559
1955	2,855	2,215	11·7	919	5·2	679
1956	3,139	2,483	12·2	1,090	5·8	771
1957†	3,287†	2,639†	12·4	—	not available	—

* At market prices. † 1st 3 quarters, yearly rate.

2. The first three columns relate to gross fixed capital formation, i.e., capital expenditure on fixed assets; they differ in that the first column includes and the second excludes expenditure on new housing. Thus the second column is an approximation to what is sometimes called "productive" investment. The fourth, fifth and sixth columns relate to net capital formation, which is obtained by subtracting from gross capital formation an estimate of "capital consumption" (or depreciation at current replacement cost—see Appendix II) in the year.

3. The movement of the figures in Columns II and IV, giving capital formation in terms of the money expenditures of the year, reflect the influence of price changes and also the general expansion of the national economy. To show the changes in the *proportion* of national resources devoted to investment, Column II gives the percentage ratio of gross capital formation to the gross domestic product, and Column V gives the ratio of net capital formation to the national income. Finally, to show the trend of net investment in real terms, Column VI gives the figures of Column IV revalued at constant prices. The figures come from the *National Income Blue Book, 1957* (principally Tables 53 and 54), and from the *Monthly Digest of Statistics*, January, 1958.

4. The figures show that the proportion of national resources devoted to gross investment in assets other than housing was in 1948 a little higher than in 1938, and has risen considerably (though not regularly) in the years since then. Net investment has grown even more strikingly and represented in 1956 a share of the national income not far from twice as great as in 1938. In real terms net investment has almost exactly doubled between 1938 and 1956.

B. International Comparisons

5. Comparisons in rates of investment between different countries encounter difficulties both of obtaining accurate and comparable statistics and of subsequent interpretation. It seems to be established, however, that in the proportion of resources devoted to gross capital formation the United Kingdom occupies a low position among European countries. Certainly the West German proportion is a good deal higher. Excluding investment in housing, the proportion of gross national product devoted to investment comes out for 1956 at 11·7 per cent for the United Kingdom, 17·2 per cent for West Germany, and 13·3 per cent for the United States.*

C. Public sector investment and its financing

6. The "public sector" comprises the Central Government, the public corporations (roughly equivalent to the nationalised industries) and the local authorities. Table II gives figures for capital formation in the sector for each year from 1948 to 1956, analysed first among the three kinds of authority and secondly between its two components of fixed investment and investment in stocks. It will be seen that the total investment has grown rapidly since 1948. The principal contributor to the increase has been the investment programmes of the public corporations, though local authority capital expenditure has also grown substantially. The second part of the Table shows that over the period as a whole, as distinct from year to year movements, it is in fixed investment that the increase has been taking place.

7. Table III is designed to show how far this large and increasing public investment programme has been financed from saving and other "internal" sources, and how far by borrowing from the capital market (here taken in its widest sense to include the market for Treasury bills and other short term borrowings as well as the new issue market). The principal components of the internal sources of the public sector are the current surplus of the Central Government and the depreciation provisions of the nationalised industries. The figures (all taken from Table 47 of the National Income Blue Book) show that up to 1950 these internal sources were more than sufficient to cover the capital expenditures of the public sector, and there was a positive contribution to the funds available in the capital market. As time went by, however, the demands of the capital expenditure programme grew, while funds available from internal sources were on the whole declining. From 1951 onwards the internal sources have been insufficient to finance the whole of the investment, and the balance has been found by large borrowings from the capital market.

* O.E.E.C. *General Statistics*, January 1958. The figures are as a percentage of gross national product at market prices; O.E.E.C. figures differ slightly from those in the National Income Blue Book.

TABLE II
Capital formation in the public sector

£m.

	Gross fixed capital formation *plus* physical increase in stocks and working capital				Total public sector	
	Central Government	Public Corporations	Local Authorities	Total public sector	Gross fixed capital formation	Physical increase in stocks and working capital
1948... ...	52	170	372	594	666	−72
1949... ...	69	297	383	749	763	−14
1950... ...	−84	273	406	595	822	−227
1951... ...	248	363	460	1,071	992	79
1952... ...	292	460	540	1,292	1,165	127
1953... ...	270	456	608	1,334	1,308	26
1954... ...	69	455	577	1,101	1,288	−187
1955... ...	81	582	540	1,203	1,299	−96
1956... ...	195	610	562	1,367	1,372	−5

TABLE III
The financing of public sector investment

£m.

	Public sector total investment (gross fixed capital formation *plus* physical increase in stocks and working capital)	Internal sources of the public sector*	Net contribution to (+) or withdrawal from (−) funds available in the capital market
1948	594	878	+284
1949	749	1,055	+306
1950	595	935	+340
1951	1,071	833	−238
1952	1,292	744	−548
1953	1,334	642	−692
1954	1,101	641	−460
1955	1,203	803	−400
1956	1,367	758	−609

* Comprising the following items from Table 47 of the *Blue Book:* Saving including depreciation provision *less* provision for stock appreciation, *plus* taxes on capital, *plus* net receipts from capital transfers, *plus* net borrowing from taxation and interest reserves.

Representative BOLLING. We are very grateful to you all for a very stimulating session.

And we are grateful for your time, patience, and contributions.

The committee will meet in this same room tomorrow at which time the subject will be interrelationships among prices, employment, output, income, and resources.

And the witnesses will be Messrs. Bloom, Bodenhorn, Christ, Eckstein, and Lewis.

With that, the committee stands adjourned.

(Whereupon, at 12:30 p. m., the committee was recessed, to reconvene at 10 a. m., Friday, May 16, 1958.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

FRIDAY, MAY 16, 1958

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

The committee met at 10 a. m., pursuant to recess, in room 1302, New House Office Building, Hon. Richard Bolling presiding.

Present: Representatives Bolling, Reuss, Talle, and Curtis.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk; and James W. Knowles, economist in charge.

Representative BOLLING. The committee will please come to order.

Yesterday the committee benefited from a very animated and informative discussion of the ways in which changes in demands and costs bring about changes in prices, together with some of the policy implications of these relationships under existing and foreseeable circumstances.

Today we shift our focus, and our discussion proceeds from prices to their relationship to employment, output, incomes, and the allocation of resources. Our subject today can perhaps be divided into two major sections:

(1) The first involves questions about the way in which price changes are related to the allocation of resources. In this area we will be dealing with what economists call relative prices; that is, the effects on the economy of changes in the relationship between prices of different goods and services independently of what happens to the general average level of prices.

(2) The second part of our discussion centers upon ways in which prices are related to aggregate economic activity, and in this connection we will, of course, be mainly concerned with questions associated with changes in the general price level.

As in previous sessions, participants will be heard in the order in which their papers appear in the published compendium. Each member of the panel may be given about 5 minutes in which to summarize his views without interruption. After the opening statements are completed, the hearing will consist of a very informal discussion in which we want all members of the panel to participate freely along with the members of the committee, commenting upon other papers in the compendium as well as upon questions posed by the members of the committee themselves.

Our first witness this morning will be Dr. Clark C. Bloom, professor of economics and assistant director of the bureau of business and economic research, State University of Iowa. I understand that this is

your first appearance before our committee. Dr. Bloom, you are most welcome to our deliberations.

STATEMENT OF CLARK C. BLOOM, PROFESSOR OF ECONOMICS, STATE UNIVERSITY OF IOWA

Mr. Bloom. Thank you, sir. I think I will proceed with the summary of my paper.

Prices play a key role in our predominantly market-oriented, capitalist economy. Relative price movements reflect underlying shifts in the demand for products, in the supply of factors, and/or in changes in technique for combining inputs. These relative price movements in turn trigger shifts in the composition of output, in the specific uses made of resources, and in the resultant distribution of income and output. The price-market system provides a viable arrangement for determining what is to be produced using what resources in what combinations and for determining the persons, or purposes, to receive the resulting output. Indeed, economists have devoted much attention to the argument that, consistent with the values of our society and with only relatively minor qualification, such a price-market system does this job in an "optimum" fashion for a fully employed economy in which no decisionmaker can personally significantly influence price. This, indeed, is the burden of Professor Christ's paper, as I understand it.

As a consequence, attempts to fix prices—and/or outputs—and thus to substitute individual for market judgments have usually been evaluated as counter to good economic policy.

Incidentally, a specific set of prices in a fully employed economy is consistent with a specific level of saving, investment, and growth in the stock of capital equipment out of which growth in per capita output stems. If rapid growth is a high priority objective, a specific set of prices which sets a higher, rather than a lower, level of saving and investment is to be preferred, but, if prices are to be determined in the market place and not by edict, this result is only to be hoped for and not to be dictated by policy moves.

However, despite this important role for prices, relative price shifts are not conventionally cited as determinants or causes of important aggregate movements in the price level or employment. Relative price changes are seen as a crucial part of the process determining the composition of output and resource use, not as an important part of the process determining aggregate price or employment levels. Such aggregate levels are usually held to depend upon total expenditures flows which are not systematically related to relative price changes.

This simple view, which explains total price and employment levels via changes in expenditures flows rather than relative price and/or output movements, seems to have much to recommend it during a period of recession. It is recommended by (1) the view that prices are inflexible via the noncompetitive administration thereof, (2) the observation that past recessions sometimes deepened and lengthened even as relative prices fluctuated wildly and their overall level moved downward, and (3) logical analysis.

This logical analysis suggests that no industry confronted by a reduced flow of expenditures for its product will hold—or restore—employment at levels existing prior to the reduction. Only if the flow

of expenditures can be broadened toward its prior level can employment be fully restored. But, under most circumstances, the predominant pressures seem to dictate still further reductions in flows—not increases—so that logic argues that prices flexible downward will not restore full employment once a decline has begun.

This is not to say that relative price movements cannot be related to expenditures flows and thus be held causal of aggregate changes. Indeed, shifts in demand in favor of goods in inelastic supply purchased out of income at the expense of goods in elastic supply purchased with the aid of borrowed money will, for example, diminish the aggregate expenditures flow. So also will monopolistically raised prices for products and factors reduce the real volume and employment consequences of expenditures flows.

It is also important to note that the economy's many expenditures flows must be mutually consistent—well articulated—in terms of outputs, factor supplies, and income distributions. The composition of outputs, factor supplies, and income distributions is determined by relative prices. A specific bundle of relative prices is thus prerequisite to an articulated full-employment level of flows.

In summary, price shifts are important to levels of expenditures flows—although this relationship is not conventionally systematically treated—but are not likely automatically to restore these flows to full-employment levels once they have diminished.

Representative BOLLING. Thank you, Dr. Bloom.

Next is Dr. G. D. Bodenhorn, professor of economics, University of Chicago.

STATEMENT OF GEORGE D. BODENHORN, PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. BODENHORN. Thank you. I shall also read my summary statement.

In a free enterprise economy, investment decisions are made by private individuals and corporations who are seeking primarily to further their own self interest. It is the function of the price system to draw investment into socially useful projects, and to see to it that the total level of invesment is high enough. Public policy requires that we be concerned whether these functions are adequately performed.

In the first place, at the level of the individual firm, investment should flow into firms which can use the resources most efficiently. Efficiency in the use of productive resources is measured by profits which are earned, so that we want profitable firms to attract investment and expand output. Recent studies in this area seem to indicate that, by and large, this function is being performed properly. This does not mean, to be sure, that no mistakes are ever made, but simply that, on the average, profitable firms attract more investment than less profitable ones.

Profits and investment perform similar functions at the industry level. Here again, the society benefits if profitable industries attract investment and expand, while unprofitable ones do not attract investment and decline. Our economy is apparently performing satisfactorily in this respect, even though there are occasional lapses, particularly in agriculture and railroads, where the price system is doing

its best to discourage investment in spite of the large amount of interference.

The total investment of the economy as a whole is supposed to perform two functions, and these have been rather controversial in recent years. First, investment should be large enough to maintain the flow of income which is cut off by those members of the society who save; and second, investment must provide for the future growth of the national product.

Let us consider briefly the recent performance of our economy in each of these areas.

In balancing the flow of saving, investment provides employment for those people who are not required to take care of the immediate consumption needs of the economy. Instability of total investment, primarily inventory investment, but currently also investment in plant and equipment, has played an important role in our postwar business cycles. However, the postwar cycles either in total output or in investment have been quite mild, and some cycles in business activity are inevitable in a free-enterprise economy. The type of monetary and fiscal policy which we have employed in combating such cycles is more appropriate than a policy aimed directly at smoothing out the rate of investment. A policy aimed directly at the investment cycle might easily have the effect of causing a lower average level of investment by inhibiting more investment during prosperous periods than it promotes during recessions.

Concern over the problem of the adequacy of the rate of growth of our economy stems from recent comparisons with Russian growth rates. Here again, I would urge a very cautious approach to public policies designed to stimulate the rate of growth of our economy, and for two reasons.

First, it is not clear that the Russians can continue to grow at the rates which they have recently achieved, and produce a national product as large as ours within the next 20 years, as has frequently been predicted. It is much easier to achieve high growth rates by applying production techniques which have already been developed, as the Russians have been able to do in the past, than it is when growth depends primarily upon the invention of new products and processes. We may, therefore, see slower Russian growth rates in the future.

Second, even if the Russians succeed in continuing their present rate of growth and in catching up with us, we should be very careful of the kinds of measures which we take to counteract this.

The great advantage of our social, political, and economic system over that of Russia is not that we can produce a higher standard of living for our citizens, but that our citizens are free men who control their own Government.

In the past, we have been lucky in that our system has not only permitted freedom and dignity for the individual but also produced the highest standard of living in the world.

If, in the future, we are faced with a threat to our leadership in living standards, we should not sacrifice our freedom in order to try to maintain that leadership and I am not sure that it would be possible to double our present rate of growth without severe impairments of our basic freedoms.

Representative BOLLING. Thank you, Dr. Bodenhorn.

The next is Dr. Carl F. Christ, professor of economics, University of Chicago.

STATEMENT OF CARL F. CHRIST, ASSOCIATE PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. CHRIST. Thank you, Mr. Bolling. In this summary I would like to begin by noting the wide range of agreement among economists, including contributors to these hearings, on several important matters of economic fact and economic goals. Then I want to take sides on two important unsettled issues.

One of the most important technical matters on which economics as a field of knowledge has something to say is the matter of resource allocation and the relative prices of goods and services. By relative prices we mean the ratios of prices of individual goods and services. Thus if a haircut costs $1.75 and a stripped 1958 Plymouth costs $1,750, then the relative price of these two things is 1,000 haircuts for a stripped 1958 Plymouth. By resource allocation we mean deciding what kinds of goods and services to produce, how much of each to produce, and for whom, and what kinds and amounts of resources to use in the production of each.

In economic terminology, an optimum allocation of resources is a situation in which no person can be made better off without someone else being made worse off. This means of course that it is still possible to transfer wealth from one person to another, but it is not possible for any two or more people to make any new contracts that will benefit all of them, because all such mutually advantageous contracts have already been made.

What economics has to say about relative prices and resource allocation is this. Relative prices can do a job in a complex economy. They can carry information to the people who decide how to use resources, and what to produce, and how the product shall be distributed. If relative prices of individual goods and services are set freely by the buyers and sellers in the market, and not by public policy, then the resulting allocation of resources will be an optimum one, provided—and this is important—that certain conditions are substantially satisfied.

In the first half of my paper in the compendium I have discussed these conditions, and what happens to the allocation of resources when they are not met, and what kinds of policies might improve matters in that case. I have done this because I believe that public policy can improve upon the working of a free price system, but that to do so it is necessary to understand where and why that system succeeds, and where and why it falls down.

Of these conditions, the one that is most relevant to stabilization policy, and happily also the one that public policy is most able to enforce, is the condition that there should be no substantial monopoly power.

Now let me turn more directly to stabilization policy. Nearly everyone, economist or not, agrees that both high stable employment and a stable general price level are good things. Why don't we have them all the time?

Unemployment arises when less product is demanded with money than is supplied by resource owners, at the existing price level. It can be cured by increasing the total demand for goods and services. Inflation at full employment arises when more product is demanded with money than is supplied by resource owners, at the existing price level. It can be cured by decreasing the total demand for goods and services.

Fiscal and monetary policy can either increase or decrease total demand. With the aid of fiscal and monetary policy, we can do a tolerable job of maintaining high stable employment, or a stable price level. So much is generally agreed among economists.

What is not generally agreed on is whether we can do both at once, using only monetary and fiscal policy. And if we cannot, what choice should we make? These are the two unsettled issues on which I want to take sides.

Suppose that we allow private markets, as they now operate, to set the prices of individual goods and services. And suppose we succeed in keeping a high stable level of employment by means of monetary and fiscal policy. To be specific, this might mean that unemployment averages about 4 percent of the civilian labor force (as it has done since the war), never rises above 6 or 7 percent and approaches that level only rarely and briefly. Then can the price level be kept fairly stable? Again to be specific, can it be kept from changing more than 10 percent in a decade?

Some of the contributors to these hearings are satisfied that the answer is "No." They argue that when employment is kept high, powerful economic groups can and will raise the prices of the goods and labor that they sell, without much regard for competitive forces. The result is known as a wage-price spiral. If this is correct, then of course monetary and fiscal policy can still prevent increases in wages and prices, but only by being so restrictive that unemployment will become intolerably large.

I will conclude by stating my position on the two unsettled issues mentioned a moment ago.

(1) In my view, the evidence does not support the wage-price spiral hypothesis in the United States before 1956, and the evidence since then is mixed. I believe that if we let relative prices be set by the market, and if we use fiscal and monetary policy to achieve a high stable level of employment and to try to keep the price level as stable as possible consistent with that, then the risk of substantial inflation in the next few years is quite small, even though the risk of inflation at the rate of 10 percent per decade may be quite large. Further, if this is wrong, we will know about it before much damage is done.

(2) I believe that inflation at the rate of 10 percent per decade is tolerable. I believe that the disadvantages of public regulation of the prices of individual goods and services are very great. Therefore I believe that we should use fiscal and monetary policy to try to achieve first a high stable level of employment, and, second to that, a stable price level, but that we should avoid policies that regulate individual prices and wages.

Representative BOLLING. Thank you.

The next is Dr. Otto Eckstein, profession of economics, Harvard University.

STATEMENT OF OTTO ECKSTEIN, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. ECKSTEIN. Thank you, Mr. Chairman.

I shall not attempt to summarize all points in the paper I submitted, but shall concentrate on the main conclusions which pertain to recent history.

Study of the wage-price spiral shows that money wages have risen every year since World War II, but by widely differing amounts. The state of the labor market affects the rate of wage increases, but the amount of unemployment required to keep wage rises below 3 percent a year is very large, much larger than our political tolerance levels would permit.

Increases in the real purchasing power of workers were found to be largest in periods of stable consumer prices. When these prices rose rapidly, real wages were stagnant. This suggests that unions have some stake in price-level stability.

Productivity gains, which can take the sting out of the wage-price spiral, were largest in periods of economic expansion. The idea that a certain amount of unemployment raises productivity cannot be supported by American postwar experience. In fact, the data suggest that keeping the economy in a rather slack state retards productivity. This cyclical movement in productivity, with the rate of increase largest in good years and least in slack years, can partly be explained by management's unwillingness to lay off nonproduction workers. The productivity of the production workers rises rather smoothly; but in slack times employment of production workers declines, while nonproduction employment tends to remain constant. It is the increased proportion of nonproduction workers in the employed labor force which leads to the stagnation of average productivity.

As for movements in profits, margins widened during the upsurge of prices in the Korean war, indicating that profits gained from that inflation. But during the recent investment boom, when prices crept upward gradually, profit margins shrank, as business could not fully pass on the rising costs.

The effect of investment on the wage-price spiral is two-edged: On the one hand, the increase in the demand for goods tightens the labor market and produces the bottlenecks which generate inflation; but investment also raises productivity in the long run, thus reducing the inflationary impact of rising wages. Whether the net effect raises or lowers the rate of inflation depends on the specifics of the particular historical episode.

Turning to the inflation of the last 3 years ,which was largely caused by the investment boom, we find that the incidence of the inflation was very uneven. The rise in the Consumer Price Index was largely due to the rising cost of services, caused by such long-run factors as the lack of productivity rise in this sector, the rising cost of medical care, and so on. But there also was substantial inflation in the wholesale prices of finished goods. These rises were concentrated in the steel industry, in some branches of the machinery industry and 1 or 2 other fields, where prices rose by about 30 percent from 1953 to 1957, while finished goods prices of manufacturing as a whole only rose by 10 percent. This suggests that a considerable part of the inflation can be blamed on specific shortages. There certainly was no general

state of excess demand, since unemployment never reached particularly low levels, and the utilization rates in many industries were below levels desired by the industries. The oligopolistic market structure of some industries, characterized by administered prices and strong unions, were probably a contributory cause of inflation; there is some evidence that prices rose more in industries with a relatively high degree of concentration. But the industries in question also achieved the highest degree of prosperity during this period.

The policies used to fight this inflation were relatively uneconomical; that is, they were not particularly effective, yet impaired the country's prosperity. These policies, consisting largely of tight money, were too general. Much of their impact was on residential construction, an industry which had idle capacity, and other fields of this sort. Policies that would have taken the pressure off the bottlenecks more directly would have resulted in a smaller increase in prices and less economic dislocation. Some form of consumer credit controls would have been desirable; a pent-up demand for consumer durables would have proved most advantageous during the present recession. Variable depreciation allowances might have served to smooth out fixed investment by business. Finally, policies which change the market structure that underlies the wage-price spiral would have been desirable from an anti-inflation point of view; but I doubt that it is possible to devise such policies without a system of direct controls which would constitute excessive Government interference with business in peacetime.

Representatives BOLLING. Thank you, Dr. Eckstein.

The next is Dr. John P. Lewis, professor of business economics and public policy, of Indiana University.

STATEMENT OF JOHN P. LEWIS, PROFESSOR OF BUSINESS ECONOMICS AND PUBLIC POLICY, INDIANA UNIVERSITY

Mr. LEWIS. Thank you, Mr. Chairman.

I think I might say first that I am afraid that your statement that the hearings were going to shift gears and move to another subject was more a statement of aspiration than an accurate forecast, at least as I am concerned, and I think I detect the same in my colleagues.

The question of whether pricing practice in the United States inadvertently has become antisocial in its economywide effects has been haunting many economists and public policymakers for more than a decade. I take it that the committee's present problem is whether such pricemaking and wagemaking institutions and procedures as collective-wage bargaining, cost-oriented pricing by corporate manufacturers, farm price supports, and the court-commission system of utility rate regulation have, in concert, become sufficiently injurious in their overall impact on the economy to warrant remedial legislation.

In my paper, I first indulge in a schoolteacher attempt to outline the mechanism through which pricing practice affects economic stability and growth. Mainly there are two such mechanisms. The first is the impact of pricing practice upon the distribution of real income among businesses and households, and hence upon the balance which steady growth requires between investment and consumption.

The second is pricing practice's direct impact upon the comparative price responses and output responses to changes in total spending.

This is what some economists would call the influence upon "the shape of the aggregate supply function." At least in one way of thinking, my own, the latter is the key to the whole question of how well we can achieve full employment without inflation.

Having sketched these general considerations, I then pose three questions which, it seems to me, the committee should ponder carefully in these hearings.

The first is whether contemporary pricing practices has been causing progressive maladjustments in income distribution which threaten long-term economic growth in the United States. The most familiar fear of this kind is that as industry's ability to produce per man-hour rises, the resulting productivity gains won't be distributed to consumers broadly enough or fast enough to prevent a progressive spoilage of markets. The record of the past 30 years indicates no cause for long-term worry on this count. On the contrary, the more serious cause for concern appears, superficially, to be a relative decline in property incomes that might signal an attrition of investment opportunities, incentives, and finance. But for reasons detailed in the paper, I think this too is a false worry. If we want to reach well into the future I can imagine some problems arising out of our present habit of distributing productivity gains to consumers mostly via higher money wages rather than falling money prices. But if we are talking about the next few years, I can see no clear reason for belaboring present pricing practice for any failure to meet the growth requirements for real income distribution.

A second question for the committee to consider is whether present pricing practice is seriously at fault with respect to short-run fluctuations. Here I conclude emphatically that it is not. Because nothing can more perniciously disrupt business conditions than a frothy, speculative, cumulative price and wage spiral—downward or upward. Any reform which substantially increased the flexibility of prices and wages would, in my judgment, greatly increase the instability of the economy in the short run. Our present pattern, which concentrates most of the ups and downs in total income in the business and Government sectors of gross national income is largely beneficent, and we should not tamper with it. In general, I argue that the most practicable approach to reasonable overall stability in the economy lies less in the direction of trying to eliminate all of the wiggles from the more volatile sectors of demand than it does in weakening the interdependencies among the sectors and—in particular—in improving the insulation of soft goods and services consumption from limited fluctuations in other areas.

A third concrete question for the committee is whether modern pricing practice in the United States confronts us with the prospect of gradual but substantial secular inflation. Here my answer is "Yes"—for a whole list of mostly familiar reasons. Accordingly, I am left with the conclusion that, on the basis of present evidence, the issue for public policy is simply how earnestly we want to fight inflation in its own right—not fight inflation as a means of facilitating growth or as a means of preventing recessions, but as an evil in itself.

With respect to this issue, I make two suggestions. The first, a negative one, is that, since the kind of inflation which we are con-

sidering arises out of institutional practices embedded in the supply side of the market, it is exceedingly unwise and costly to attempt to fight it to a standstill with the demand-restraining weapons of monetary and fiscal policy. What we must do if we are really serious about eliminating "cost-push inflation" (a highly imperfect term) is to invent some social policies that will effectively charm, goad, or otherwise persuade the most politically as well as economically powerful private organizations in the economy to alter some of their key decision-making patterns. My second, a positive suggestion, is that this is a problem which must be attacked initially more in a political science than an economic vein, and at the very end of the paper I speculate a bit about what some of the elements in such an attack might be.

Representative BOLLING. Thank you, Dr. Lewis.

I would like to offer the members of the panel an opportunity to expand their own statements or comment on the statements of the other members of the panel.

Yesterday we had a go-around with the panel that was so good that I had to finally stop it so the committee could get in the act.

I would like it very much if you would want to comment on each other's paper.

Mr. CHRIST. I would like to make a comment on Mr. Lewis' remarks. I think this is the kind of discussion that could go on all morning, so I trust you will stop us if you think we are getting out of control.

You have said that you feel it is unwise and costly to use monetary and fiscal policy to try to fight inflation. You say this is a question which has been bothering economists for 10 years. It has been bothering economists for 10 years. But it seems to me that there is no really good evidence until perhaps the last 2 years that this problem is really serious.

If we look at the increases in the price level that we have had, say, since 1929, which is a convenient place to begin, they have been either in the recovery from the great depression of the thirties, or they have been during World War II and following it when there was a large price increase when people began to spend the extra money they acquired during the war, or during the Korean war.

We had a period of substantial price stability from 1948 until the Korean war. We had a period of substantial price stability from about 1952, when the Korean war was fought off to a standstill, until late 1955 or early 1956.

I grant that there may be a problem appearing in the last 2 years, but I certainly do not see that the problem has been serious until 2 years ago.

I think it is possible to explain all of the price increases essentially by means of demand. The wage increases that have come along, sometimes at 3 percent a year, as Mr. Eckstein has mentioned, it seems to me, are not particularly serious as long as we can keep productivity increasing.

Mr. LEWIS. I would say that I think maybe in trying to make its point, my paper leans a little on one side of the issue. I don't actually mean to say that demand has nothing to do with price increases. Obviously we can have an inflation that is very largely the result of demand in excess of capacity.

I would not want to deny that demand has been a very real factor in almost every inflation we have had.

I think Mr. Eckstein's paper has a nice balance on this point. I think Mr. Hickman's long paper on the experience since World War II follows this theme all the way through. Actually you have an interaction of demand factors and of factors on the supply side of the market.

I do think that these factors on the supply side of the market, however, have been significant. I think you can identify them in inflations long before 1955–56. For instance, they were quite a factor, it seems to me, in the inflation of 1935–36 and into 1937.

As Mr. Hickman points out, they were certainly a factor in the 1946–48 inflation, only perhaps a minor one in that case.

Mr. CHRIST. In the 1946–48 case, I think they were really quite minor. Some work by Professor Rees of Chicago, who is going to appear later on in these hearings, next Thursday I believe, suggests that the rate of increase of wages where there are unions and when there is a general inflation is slower than the rate of increase of wages where there are no unions when there is a general inflation going on. Apparently what happens is that the negotiation process takes a while and also the employers are a bit afraid of being stuck with high wages which they won't be able to get back down again in a unionized industry.

I think until 1948 we really have to attribute the increase in prices to the hangover of the increases in the stock of money that took place during the war.

Mr. LEWIS. There is another point I would like to make about this—I make it in my long paper. It may be that these so-called cost-push factors have been with us for a very long time. It seems to me that they have to the extent that you have had corporate pricing that has been cost-oriented. This has some advantages in a very inflationary period because you don't charge all the traffic will bear and the price does not go up as much as it might. You have had some elements of inflexibility and stickiness in wages for quite a long time. But the offset to inflation in the past had been major downturns.

If we have succeeded in eliminating those or if we are going to eliminate them, then we may reveal this secondary problem, which had been a minor problem as far as stabilization was concerned, but may now be the largest one left. And we do not know how to cope with it.

I would like to join with you to this extent: I, too, looking at the price system overall, have come to the conclusion that it looks a lot better than a lot of the talk would suggest. I think it is doing pretty well. I think it does have an inflationary bias: The issue for policy is whether to deal with the bias is worth the cost of dealing with it effectively. This is very hard to evaluate because we do not know what the policies would be that would deal with it effectively.

Mr. BODENHORN. In this connection, maybe it was just a question of emphasis—it would seem to me that, to go along with any kind of politically oriented policy that is designed to induce restraint on the part of these people, as a minimum we should also keep a strong monetary and fiscal policy so that the punishment, if they fail to exercise restraint, is fairly clear.

I think one of the problems that we have been having is that people, when they get into these bargaining situations, really do not have a strong incentive to keep prices down because they have a feeling that they are going to be bailed out by the general inflation we have been talking about.

Mr. Eckstein. I do not think anyone in his right mind in economics would argue that they should pursue a loose monetary policy in a period of inflation.

What the argument is really about is whether general monetary policies were appropriate to the kinds of inflation we have experienced in recent years.

To come back for a moment to Professor Christ's point, it is true that looking at the history of prices from the war to now, till 1953, the situation was dominated by the two war episodes and their effects. We really cannot isolate the factors; we cannot abstract from the wars, and so we cannot come to a judgment as to whether or not there was an inherent inflationary bias at that time. After 1953, we did have price level stability for a couple of years which was partly due to the decline of raw material prices, partly due to the decline of farm prices, and partly due to the fact that we had experienced a recession during a good part of this period.

Since then we have had inflation, and I think this is the critical point, we have not had excess general demand. We have had it in a few spots, but as a whole the economy has not really been pushing at the ceiling of its capacity. The actions that we have taken to counteract this inflation have been aimed at a situation which did not exist, namely, overall excess demand.

Representative Bolling. Thank you.

Are there further comments?

Mr. Bloom. Yes. I would like to make two observations.

I think there is a basic question to which we have not really devoted our attention adequately this morning. No matter for what reasons prices rise, we must ask ourselves whether they rise in such a pattern or in such a way as to give rise to disarticulations in price relationships, output relationships, which perhaps reduce output and employment and give rise to subsequent recessions or depressionary periods.

I would like also to point out, however, that we may be concerned with the differential rates of price rise from one sector to another in this connection. For example, it is perfectly possible for industry X, let us say the automobile industry, to find wage costs rising more rapidly than for industry generally, and prices and profits perhaps rising more rapidly than for industry generally, with the consequence that this particular industry is out of phase or relationship with the rest of the economy. If this is a sufficiently important industry, it will give rise to an apparent level of unemployment which might be thought to be general when, as a matter of fact, it is pretty highly concentrated in a particular industry and in its suppliers and dealers.

We have had this situation in agriculture, it seems to me, for a long time, but in agriculture the unemployment is simply underemployment on the farm and is not manifest in the employment statistics, whereas, when it happens in industry X, let us say the automobile industry, it is manifested immediately in the employment statistics.

I think that we must be concerned, then, with the disarticulations

accompanying a general price rise or, stated in another way, the changing rates at which prices rise during an inflationary period.

I am sort of disappointed that more attention has not been paid during this session to this possibility.

Mr. LEWIS. I would like to endorse a point in Mr. Eckstein's paper that I think my own was rather light on, and particularly the references to this recent inflation. That is the fact that the problem is specific; that is, it had a bottleneck aspect. For instance, there undoubtedly was a tremendous investment boom, and there were demand pressures and price pressures created in that area. In early 1955 and 1956 there were some material shortages.

There is the very important point brought up in Mrs. Mack's paper about the inventory fluctuations that create speculative behavior which aggravates the whole price problem. It seems to me that if you wanted to stop inflation completely in the last 2 or 3 years and do it in a way that would not impede total activity, two sorts of policies could have been used: For one thing, I think there is the sort of basic cost-push problem, or the institutional problem of pricing practice—wages rising faster than productivity and pricing decisions in corporations. This is one for which we have very little precedent in devising policy and where we get into some very sticky going in political terms if we try to innovate.

But there are also policies for dealing by means of more conventional tools with pressures in specific areas. Mr. Eckstein mentioned consumer credit regulations, and the possibility of varying depreciation allowances. Also there is the possibility of stockpiling of raw materials. These things are the bottleneck policies that I think are more accessible in political terms than the anti-cost-push expedients. The latter I think we must explore very carefully, but slowly.

Mr. BODENHORN. This is something that I have not really studied very carefully, but I am somewhat disturbed at the comments that seem to go side by side that, on the one hand, there has not been an excess in demand in the current inflation, and on the other hand that the inflation has to some extent been localized in the bottleneck industries where presumably there has been excess demand.

I am not quite sure from that point of view, really, what the association between the idea of relative prices and the price level is.

When we talk about this in theory, it is easy to talk about it and say this is a movement in relative prices and that is a movement in the price level.

On the other hand, if you have a bottleneck, you have excess demand. Unless we have some other price that is going to start falling we will see the two of them build together, the relative prices and the price level.

Mr. CHRIST. On a point similar to what Mr. Bodenhorn just mentioned, I would like to refer to the table on page 371 in the compendium which Mr. Eckstein has provided us with.

TABLE 8.—*Wage, price, and profit changes, selected industries, 1953–57*

Industry	Percent price rise [1]	Percent wage rise [1]	Percent profit rise [2]	Profit 1953 [2]	Margins 1957
All manufacturing	10.0	18.1	42.5	4.2	5.0
Durable manufacturing	13.0	19.3	(3)	(3)	5.1
Machinery excluding electrical	11.0–31.0	18.9	63.4	4.2	5.2
Electrical machinery	21.9	18.2	48.4	4.1	4.1
Rubber products	20.5	20.2	36.6	3.8	4.4
Contract construction	9.8	21.0	(3)	(3)	(3)
Steelmaking	30.7	26.4	61.2	5.3	6.9
Nonferrous smelting, etc	3.8	24.1	28.9	6.4	7.4
Coal mining	13.4	22.6	(3)	(3)	(3)
Copper mining	(3)	21.0	(3)	(3)	(3)
Iron mining	(3)	26.2	(3)	(3)	(3)
Autos	14.1	19.2	44.0	4.0	5.4
Chemicals	3.5	22.4	72.5	6.1	7.8

[1] Average 1953 to October 1957: BLS wholesale prices and hourly wages.
[2] SEC data, 1953 versus last quarter of 1956 plus 3 quarters of 1957.
[3] Not available.

I do not want to go so far as to say that I think in the last 2 years the cost-pushes have had nothing to do with the price rises. I am not sure about that.

Mr. Eckstein, may I ask you a question? In the third row, "Machinery excluding electrical," there are two numbers. Is this a misprint?

Mr. ECKSTEIN. No. There are about half a dozen machinery industries; the low value is for the agricultural machinery and the high is for the oil well drilling machines and things like that.

Mr. CHRIST. Thank you.

I would like to use the first two columns of this table to say something that I think is relevant.

If we look at the industries which have had price rises greater than 20 percent, I find 3 of them.

Let us assume that the machinery excluding electrical has an average of around 20. Even that would have a bigger than average price rise, I suppose.

The fourth row, electrical machinery has 21.9.

The fifth row has 20.5, and steelmaking is 30.7.

These are the industries in this table that have had the greatest price rises.

With the exception of steel they are not industries that have had particularly great wage rises. Steel has had about the biggest wage rise we find there. Iron mining is another one with a big wage rise.

Among these industries that have had large price rises we have had about average wage rises with the exception of steel.

Also, these industries where the prices have been large include some of the industries where the bottlenecks have been.

This again suggests that demand is quite important here.

I would like to speculate on what might have happened in the last 2 years and this is purely a speculation.

I have been assigning my classes to write papers to explain this because I do not understand it. The word has gotten out that that is what I do now so they do not take me so seriously any more.

In reading Mr. Eckstein's paper, this speculation occurred to me and it is this: There is an expectation on the part of labor, on the part of business firms, that we will have pretty steady prosperity as we

have had since the war. There is an expectation that productivity will continue to go up more or less regularly as it has since the war. It is not possible to tell until after the year is over or the quarter is over whether productivity actually did go up or not.

When labor unions came in with wage demands, the employers are reasonably willing to grant these on the assumption that they would be able to keep roughly constant prices when productivity increased. Then they look at their profit statements and they look at their costs and they raise prices when productivity did not increase, perhaps in the feeling, as someone said earlier, they would be bailed out by a monetary and fiscal policy which was designed to maintain full employment.

If it is really true that productivity is a sporadic sort of thing, and it is 3 percent one year, 5 percent another year, and 1 percent another year, and if firms try to maintain profit margins roughly constant by setting prices above wages, then we are going to have some years, I would guess, in which there will be price rises of the order of 3 percent a year as we have had in the last 2 years. I would guess there would be other years where there would be little or no price rises.

Mr. ECKSTEIN. May I try to reply to all these points in order?

First, in reply to Professor Bodenhorn, I think there are three positions, at least, which can be taken in interpreting the inflation. First, there is the general excess demand position. Second, there is the localized excess demand or bottleneck position. Third, there is the cost-push, market structure position.

What I looked for in analyzing the last few years was to try to make some sense of these three positions; the conclusion I came to was that there was not a general excess of demand, there were bottlenecks, and perhaps there was some influence of the cost-push through market structure. I have not really been able to come to a definite resolution between the last two positions.

On the basis of these sketchy data, I lean toward the bottleneck view, with some pressure from a pure wage-price spiral.

From this follows the policy conclusion that you want policies aimed at bottlenecks and market structure.

The second point is about the role of relative prices. I think the relative price system worked quite well in the last inflation. It did pull the resources into the capital goods industries. That is where the prices went up and that is what you would expect. It is not a uniform wage-price upcreep. It is more in some sectors than in others. Thus the relative price system fulfilled its classical function of drawing resources to where they were needed, though at the cost of inflation.

Turning to Professor Christ's points, he mentioned the relatively uniform increases in wages and, on the other hand, the wide dispersion of increases in prices. This struck me also. I tried this out on some of my labor economist friends. Their answer was the following: The largest wage increase was granted in the steel industry in the summer of 1956 after a brief strike. This, of course, was partly demand induced. This set the pattern for other wage increases in other industries which did not have the same demand excess. So it is true that demand is important, including localized demand.

Then as for his speculation or his hypothesis, that an increase in productivity is built into our expectations and sometimes we are dis-

appointed, I think this is true. But there is a subsidiary point which has to be made, and that is that the productivity in the last 2 years appears to have been retarded by the slackness in some industries. In other words, if we had not pursued as tight policies against general demand we would have gotten more productivity, and perhaps we might have gotten less inflation, at least in the nonbottleneck areas.

That is all I have to say.

Representative BOLLING. Unless there is somebody who is particularly anxious to make a further comment, I will ask Mr. Reuss if he has some questions.

Representative REUSS. Yes. I would like to start out with Mr. Christ.

I liked your specificity in talking about 10 percent inflation over a decade as being a goal of tolerability. Let us be even more specific and try to refine that. Ten percent on what index—consumers price or wholesale?

Mr. CHRIST. I am almost willing to let you take your choice because the Consumer Price Index and the Commerce Department's deflator for gross national product move fairly closely together. There are changes in their movements, but they are not large, and they are not so large that I would be worried by this.

Representative REUSS. You would say take your choice, and you will come out a percentage point or two different?

Mr. CHRIST. Yes.

Representative REUSS. What about the period? Obviously you are not suggesting that the index cannot go up more than one-twelfth of 1 percent a month?

Mr. CHRIST. Certainly not.

Representative REUSS. You are talking about a 10-year period, are you not, or are you talking about a 5-year or 1-year period?

Mr. CHRIST. Not a 1-year period. Perhaps not a 5-year period. It seems to me that the kind of damage that inflation is going to do in the way of redistributing income is going to be important only if the redistribution of income turns out to be important.

Suppose a man buys a life-insurance policy when he is in his twenties or thirties when he has a family, and this policy matures when he is 55 years old, 20 or 30 years later. If it is worth only half as much at that time, then he has had a substantial loss. If it is worth in 30 years 30 percent less, it is a 30-percent loss, obviously, and it is to be deplored, but it is a degree of loss which is not so great that we have to be really terribly concerned about it.

This is a value judgment on my part which you are at liberty not to share.

Representative REUSS. If you were President of the United States and had to make an annual economic report and——

Mr. CHRIST. I would have some differences.

Representative REUSS. I imagine so. And had to set up a long-term goal of obtaining maximum purchase power, would you think it would be a useful thing if you reiterated every January that your long-term, 10-year goal was not more than 10 percent price increases over a 10-year period, and then reviewed the history of the last year in the light of that? If you were over 1 percent in that year, you would say: We are getting ahead of ourselves here, but there were

good, and not alarming, reasons for it, and maybe we can pick it up in the years to come. Would you think that was a good idea?

Mr. CHRIST. It is a little hard to know all the things I would think if I were the President of the United States. I might not want to be so specific as to say 10 percent in a decade. I think I would be quite willing to keep this goal in my own mind and to say if we had had an increase of 2 or 3 percent a year for the last 2 or 3 years that this was more than we want to stand for. Whether I would want to publicize the 10 percent or not I do not know.

Representative REUSS. If it was your secret, would it be helpful to let the public in on it so that they know what you were driving at? Maybe you do not think this should be your goal.

Mr. CHRIST. Yes, I think this would be a reasonable goal.

I would like to strive for stable prices. I do not think it is possible to achieve perfectly stable prices and high stable level of employment and still leave the price system free. So I would be willing to settle for a slight upward drift of the price level. I have thought about how big a drift would be acceptable, and it seems to me if it got over 10 percent it would begin to be serious.

Representative REUSS. In talking about this acceptable drift you would, I take it, give primary emphasis to the goal of maximum employment and production and say that it was your goal to get maximum employment and production accompanied by a drift upward in purchasing power and an inflation of no greater than 10 percent over 10 years?

Mr. CHRIST. I think so.

Representative REUSS. I saw some signs of nonagreement on the part of your colleagues.

Would any other members of the panel, if placed in this hypothetical situation, choose a different internal goal or have a different view on whether this should be publicly stated or not?

Mr. CHRIST. May I say one more thing here?

Representative REUSS. Yes.

Mr. CHRIST. I think the goal ought to be full employment plus absolutely stable prices. This is really the goal. When I say 10 percent I am trying to concede a bit to what I think might be necessary on the price side in order to achieve the full employment which I would regard as more important.

Representative REUSS. I was pressing you into a more inflationary position than you really want to talk about.

Mr. CHRIST. Yes. I do not want to say that a stable price level is worse than a 10-percent price rise per decade. I want to say that a 10-percent price rise in a decade is tolerably close to what we really want.

Mr. BLOOM. I would simply insert a comment here: I think there may be some wishful thinking in Mr. Christ's position here.

Mr. CHRIST. I think there may be, too.

Mr. BLOOM. There may well have to be price rises in excess of 1 percent if full employment is the goal. I, for one, would not be so deeply disturbed as I think Professor Christ would be if this turned out to be the case. I certainly would not want to see price rises of 10 percent a year. I do not know, however, that there is any reason to feel that rises of 20 percent a decade are obviously bad and harmful and disastrous at all.

This is true particularly when you see the fact that it is the functional aspects of the distribution of income which are fixed, not necessarily personal incomes which are fixed.

For example, the income of a retired person may be apparently fixed, but if he is able to work and, as a matter of fact, chooses to work, his income is in no sense fixed.

I think it is easy to overstate the redistribution effects of inflation.

Representative REUSS. Of course, if everybody's income doubles and the price level doubles, theoretically no harm is done. But as a practical matter, we know, with the present organization of our society, that cannot happen.

Mr. BLOOM. Not perfectly. But it does not work as imperfectly as we often imply either, I think.

Representative REUSS. What would you do if you were President? Would you keep quiet about the whole matter or would you hope for stability but have as your practical, outside goal an increase of 20 percent for 10 years?

Mr. BLOOM. I do not believe I would want to state a percentage goal. I would simply want to say a reasonable level of employment is our goal. The minimum level of price rises which is consistent with this full employment objective we will take.

Incidentally, one should be concerned about this matter of inflation if this inflationary situation is accompanied by changes in relative prices or changes in the use of resources which are themselves threatening to employment. This, it seems to me, is the crucial question: Are there patterns within the inflationary movement of prices upward which threaten the continuance of a high level of activity and employment? This is much more important than the overall general level of price rises within tolerable limits which redistribute income.

Representative REUSS. You would want to deal much more aggressively with those elements of price rises which, by causing maldistributions, hurt productivity and full employment, and you would be less concerned, though concerned, with rises in the price level which do not primarily have those effects but have their effects on what different consumer segments get out of the economy.

Mr. BLOOM. That is certainly true, in my judgment.

Representative REUSS. Professor Bodenhorn?

Mr. BODENHORN. I think I would be inclined to agree more with Mr. Christ here, in this sense: I think the stated goal and the objectives should be for a stable price level.

The real question then becomes: When do you decide that this goal has been defeated, not how you are going to state your goal? You are not going to say the goal is to have the price level rise 10 percent a decade.

Representative REUSS. Nobody suggested that. This was to be a workable maximum or the limit of tolerability.

Mr. BODENHORN. In the same way we talk about a level of unemployment that we are aiming at as 3 or 4 percent, but if this hits 6 or 7 percent for a reasonably short period of time, we are not going to feel that the policy has been a complete failure. We are willing to accept this temporarily but not as a permanent matter.

In this sense, it seems to me, we have the same kind of objective with our price level stability.

Unfortunately, here we may have to accept a bias. We may have to accept a situation in which the prices are not coming back down again after they rise, or at least not coming down as much.

Representative REUSS. The two differ, though, in that, if you have 5 million unemployed during a period when you are doing rather worse than what you should be doing, you cannot compensate for that by overemploying 5 million later on, whereas you can, though maybe I am being too wishful, pare prices in a future period or prices may go down in a future period.

Mr. BODENHORN. I also agree with Mr. Bloom, that the problem of the people who are on fixed incomes are not quite as serious as some people make them out to be. Certainly the largest retirement scheme we have in this country is the social-security program, and while this is stated in dollar terms, history suggests, and I would be very surprised if this were changed, that the benefits rise with the price level. So that people who are saving and contributing in this plan at the present time are not going to be stuck with whatever the current level of benefit is when they retire 30 years hence, if the price level has doubled. Congress will, in the meantime, have changed these laws and increased the benefits.

I suspect also, as far as the private schemes are concerned, that private retirement programs are going to be tied more to the price level as well.

I am not sure whether the variable annuity has been legalized or whether it has not, but my expectation is that within 10 years we will certainly see these policies offered freely in this country and the people can therefore protect themselves in their retirement programs against the possibility of inflation.

Still, I would like to see a vigorous policy against inflation. I am not trying to argue for inflation. I am simply pointing out that there are ways of hedging and preventing your income from being quite so fixed, and I suspect that these are going to become more popular.

Representative REUSS. I would like to comment at this point that really I am not sure I share your confidence in Congress as one of the automatic stabilizers of social security, for instance. I am afraid the record recently is not very good on that.

Secondly, it would not do, I think, to say that there are ways of cheating inflation. I think the fact that wives of postal workers, letter carriers, who have to leave their children and go out to get a job to make the family budget balance because of the fixed income, that is socially as bad as inflation.

I think the fact that old folks in their late seventies, or their early seventies, have had to go back to work is not socially as it should be.

I am not suggesting you said it was, but some of these methods of cheating inflation are really about as bad as inflation itself.

Mr. BODENHORN. The methods are rarely perfect anyway. Even in terms of what I might expect social security or the variable annuity to do, these people probably will be hurt. I do not doubt this. I was just saying that there were ways of making this a little more tolerable.

Representative REUSS. Mr. Eckstein, I think you had a comment.

Mr. ECKSTEIN. Could I make one comment on the question of stated objectives?

I know in the papers in this compendium many people have followed Dr. Arthur Burns' suggestion of making price level stability a goal in the full Employment Act. It would seem to me that the main function of the stated objective is to give some indication of what is important to the policy people in the executive branch of the Government.

It would be my view that if they had price level stability as a stated objective they should have growth as well.

From a long-run policy point of view, it seems to me that the growth of the country is a good deal more important than the level of the price level in 10 or 20 years.

My view would be either to add both or neither, but not to single out price level stability as of such overriding importance in the year 1958 as to add that to the full employment objective.

Representative REUSS. You do not think the phrase "maximum production" connotes growth and the phrase "maximum purchasing power" connotes some price level stability?

Mr. ECKSTEIN. I would say it only connotes it by interpretation. "Maximum production" is an ambiguous term. "Economic growth" is a straightforward term.

Representative REUSS. You feel as a member of the professional economic community that the general understanding among professionals is that the present Employment Act of 1946 is ambiguous on both the subjects of economic growth and price stability, that the mandate is not clear?

Mr. ECKSTEIN. On those few occasions where I have heard members of the executive branch of the Government address themselves to the broad economic policy questions, I have had the feeling that they have not explicitly taken account of economic growth. I think, especially of the Federal Reserve System.

Representative REUSS. At this point, let me ask the panel whether any one disagrees with the statement of Mr. Eckstein, that among professionals there is a considerable amount of ambiguity as to whether the act, as now formulated, contains a mandate on growth and a mandate on price stability.

Does anyone feel that is an exaggerated statement?

Mr. LEWIS. I personally feel that is an exaggerated statement but I am not sure whether I am judging from my colleagues in the academic world or referring back to my experience in Government. It seems to me it has been perfectly plain within the Government, from the very beginning through the forties—late forties and early fifties—that price stability has been a goal and, of course, growth has been a goal.

The phrasing of the Employment Act at the time it was written was primarily preoccupied with the problem of the postwar depression. I think, in effect, the goals are perfectly obvious throughout the Government.

It might tidy things up a little bit to put such language in the act.

I personally cannot see that it would make much difference one way or another.

I have a comment on this question of goals. On the matter of the goal of price stability, I would be inclined to be very doctrinaire. I developed this point of view when I was in the Executive Office and I do not suppose I will ever change it. It seems to me that the only

possible announced goal with respect to prices for the Federal Government is one of stability. One reason for this is that a tremendous unknown in this whole situation is what happens if and when decisionmakers really come to expect secular inflation. What really happens? I think we have never had a period when this has been quite true, although I think the business community has been veering in that direction in the middle fifties. The investigations of consumer opinion by the people at Michigan certainly do not indicate that consumers generally make decisions on the expectation of further price inflation very much. If they should come to it, it might be possible that the kind of creeping inflation that all of us, I think, at this table are inclined to be a little tolerant of, could not stay creeping.

I do not think historically we have evidence for this conclusion yet but I am afraid of it.

One of the worst things that could happen or one of the most effective means to induce such expectation would be for the President, in his economic report, to announce or even imply a satisfaction with nothing more than a 10 percent per decade inflation.

I would also say, though, that it seems to me that the Federal Government is always caught in the situation where it is trying to achieve a multiplicity of goals that are partly conflicting. This is one of those cases.

You are not going to make perfect scores in all of the dimensions that you would like to make them in. If it comes to a compromise, I would agree with the hierarchy of goals suggested here. As of now, if I have to choose, I suppose I lean on the side of the less underproduction and less unemployment and maybe a little more price instability. But I am not very happy with the inflation.

Finally, I think that Mr. Christ's forecast—it is not a forecast but a hypothesis—of 10 percent as tolerable is unrealistic. I think the prospect is probably for considerably more than that under present conditions. In fact, it seems to me that there are several reasons for thinking that the long-run outlook for inflation is rather stronger in the future than in the past. For one thing, with very rapid economic development in other parts of the world and almost an explosion of population, it seems to me very likely that we will be encountering more materials bottlenecks in the future decades than we have in the past on balance.

For another thing, we can be sure that depreciation charges per unit of product for a while are going to go up almost without control because of changes in the composition of capital and because business will be replacing old lower-cost stuff with new higher-cost stuff even if prices should not go up any further.

I do not see any reason to think that business will shift its cost-changes, money wages will go up no more than productivity gains.

I do not see any prospect, personally, that, without institutional oriented pricing policies.

I think there is some chance that the decline in capital-output ratio which has moderated inflation in the past generation may cease. I do not see any reason to expect that in the future we shall avoid occasional explosive increases in demand.

For all these reasons, I would be personally delighted to hold inflation to 10 percent a decade without new policies, but I would be very, very surprised if we did.

Representative REUSS. So what you are saying is that, while your overt goals should be zero increase over the next 10-year period as a perfect goal, your private prediction is that the performance will be further off from that goal than the 10 percent?

Mr. LEWIS. My private prediction is that without changes in policy the performance will badly miss the goal. Therefore I conclude that we need some changes in policy.

Representative REUSS. Thank you, Mr. Chairman.

Representative BOLLING. Mr. Curtis?

Representative CURTIS. Mr. Chairman, I find I have the same difficulty with these summary papers that I had in the compendium papers, except those in the very beginning, because I do not completely understand the definitions. In other words, we have been using the word "inflation" in a sense that, at least as far as I am concerned, needs further definition as to just what we are talking about. I think the papers that dealt with the very conception of what inflation is did point out—and I suggest implicit in all this discussion of inflation is this difference that is made between what might be called increased standard of living as opposed to the increased cost of living—in two different ways that which might be called increased cost of living as opposed to that which is increased standard of living.

For example, in Mr. Ekstein's paper, he says:

> Turning to the inflation of the last 3 years, which was largely caused by the investment boom—

and so forth, he points out that the rise in Consumer Price Index was largely due to the rise in cost of services, and in there is a rising cost of medical services which I always like to use to illustrate the point.

The rise in cost of medical care to a large degree is increased quality, and what you are getting for it. To me that is an entirely different thing than something that would be the identical thing, say a pack of dried beans which you buy 1 year and which you might buy 10 years later.

When we talk about stable prices, I see a distinction between what might be called—in fact, I would worry about stable prices—if we looked upon the price of going from St. Louis, Mo., as I do, on the airplane as an indication, because I remember when I first came to Congress 8 years ago it took me about 4 or 5 hours to go to St. Louis by air. I now go in 3 hours and frequently less, and within another year I understand I will be able to get out there in an hour and a half. Actually, the price has decreased. The relative price, incidentally, in regard to the train is more and has been.

Another way I look at it is this. My home is Webster Groves, which my great grandfather bought as a summer place. I used to go to my office and it took me a little over an hour. Now I can go in a half hour. My father used to be able to go down there in over an hour, but he had to depend on train schedules so he certainly had the inconvenience of picking his time. My grandfather used the place only as a summer home and weekend place. The differences here are implicit.

I think if we look at what is increased standard of living as actually inflation, we are going to be missing the boat in getting to the economic factors. I wonder in all this discussion how much of what we have been talking about—prices—is actually measuring some increase in quality.

I recall reading a fairy story as a kid where this person was supposed to get strawberries in January for some queen. It was a fairy story, but today getting strawberries in January is not unusual. There are all sorts of things we have that could not be acquired before. Where does that enter into this business of pricing?

I think the dollar can be a measuring stick, as I have described it sometimes, of economic things. If we are talking about that, then we are talking about a stable dollar, if there could ever be such a thing, and I do not know that there could, but we are not talking about stable prices because the price of a doctor's visit could increase and yet the real return could be also increased, as I described in traveling from St. Louis to Washington.

Would anyone comment on that?

Mr. CHRIST. Let me try. I think conceptually, if you have a blackboard and piece of chalk and some curves that show the level of satisfaction of a consumer, it is easy to distinguish between standard of living and cost of living. When we come to try to make measurements we run into problems of just the kind that you mentioned.

I think it would be very fine if the Bureau of Labor Statistics, which makes the Consumer Price Index, had a group of people—who were not so busy making the index every month that they had no time to think about these questions—who could devote their time and resources to trying to improve the index along these lines.

I do not know in great detail how the index is made. I expect to spend a great part of this afternoon on questions of this sort.

Representative CURTIS. Some of the papers are devoted to that theory.

Mr. CHRIST. For example, take medical care. The number of visits that a doctor makes to a patient in his home with pneumonia is much less nowadays than it used to be. The number of treatments required to cure syphilis is much less than it used to be.

Representative CURTIS. One of the nice things on that is the fact that the actual length of time in the hospitals has increased but you come out on your own feet instead of feet first. How do you measure that?

Mr. CHRIST. For example, if the Consumer Price Index measures in its medical care the price of a doctor's visit to a house, then a mistake is being made of the same kind you have mentioned. It would be better to try to devise a price that would cover not a visit to a house, but the curing of some standard disease which is reasonably representative of what is going on.

Representative CURTIS. What I am suggesting is what you have been suggesting, this creeping inflation, or that you can stand a certain amount. I suspect what you really are saying is that because the cost-of-living index does not measure these things that we are always going to have this increased standard of living, and I hope we do, and that is going to show up in the cost of living and some people will interpret it as inflation.

I suggest that it is entirely a different thing. If we attempt to correct for inflation and thereby create stable prices, we can do some real damage to growth. To me it is very important to distinguish between those two things, even though we are not able at this time to measure them.

We should at least recognize that there are these two factors in the cost-of-living index.

I might make another comment before others comment further. As far as the individual person 70 years old on fixed income is concerned, it sometimes does not make so much difference to a human being whether it is an increased standard of living or this cost of living because the cost is there. So much of what a human being wants is in relation to what the other human beings have. I have speculated on this.

I dare say you could cross the continent on foot, and live on dried beans and salt pork, probably cheaper than you could do it 100 years ago if you were willing to do it in the same way. But the quality of living as far as individual human beings are concerned, how the Joneses are doing, is even more important than the fact that it is perfectly true their standard might have actually been above what it was before.

But if it is way below or further below those next door, the human element is going to call for a change.

Would anyone else comment on the point I am trying to make on whether you think that this makes sense: That if we are going to hit at these economic problems, we have to define inflation a little more carefully.

To me, pure inflation is where the dollar, as a measuring stick, has been stretched.

Mr. LEWIS. Mr. Curtis, I think it is a very valid point that you make. The only comment I would have is that what we do not know is essentially a quantitative question. It is a question of degree. We all, I think, use the term "inflation" to mean generally rising prices, and by this we mean increases in one or more of the general price indexes when you talk about measurements.

The index makers are trying to take care of this question that you raise. As Mr. Christ says, undoubtedly they are not doing a perfect job. It is just a question of how much of this erroneous indication of price rise from which we interpret that the price for a given item or an average of given items has risen is dependent upon an improvement in the quality of items.

Personally, and this is just guesswork, I do not think that a very large portion of the total amount of rises in the general price indexes that we have had in the last 20 years could be accounted for on this basis.

Representative CURTIS. You do not think so in the light of this tremendous technological revolution that we have been going through?

Mr. LEWIS. No, I do not. I do not know as much about it as Mr. Christ does, but I am confident that the index makers are trying to allow for this.

Representative CURTIS. As I see our way of living compared to 20 years ago, communications, transportation, and the quality of living,

the fact that you can live in the suburbs, all of those intangible things, and certainly economically very costly things——

Mr. LEWIS. Excuse me, but our statistics do indicate this. If we take disposable personal income on a current price basis and then we divide it by population so that we have disposable personal income per capita on a current price basis, and then we deflate this for the indicated price changes, we still find that real disposable personal income per capita has risen enormously since 1940.

Representative CURTIS. Certainly.

Mr. LEWIS. So this much of the kind of improvement in welfare you are talking about is not hidden in the price indexes.

Representative CURTIS. A lot of it is not. I am wondering whether the margin of error that still exists—and I think it is certainly a fair subject of discussion how much it is—it seems to me it is that margin of error more than anything else that economists talk about when they say they can stand a certain amount of inflation.

At least it is my speculation that they do not really mean that we could stand any inflation insofar as we could have a stable dollar. I think we all agree on the stable dollar, but certainly not stable prices. If you had stable prices, you would not permit the quality factor to enter into the picture or you would try to prevent it.

I have some specific questions I want to ask.

In discussing prices and how profits enter into the picture, I was going through a series of statistics to find out if there were any series of statistics that attempted to measure how much actual capital investment we do have in the private sector.

To me, the question would be what is the percentage of return on the investment dollar rather than what is the actual corporate net profit? Is there any series or combination of series—I ask you all this as economists—that attempts to measure how much capital investment we have in a particular year?

We can measure how much new capital goes in, perhaps, but it is a cumulative thing. Do we know, for example, how much private capital investment there is?

Mr. CHRIST. I am not clear whether you are asking whether we know how much new capital goods are put in place in a year—we certainly know that.

Representative CURTIS. For the year 1957, do we know how much we have?

Mr. CHRIST. Regardless of when it was built?

Representative CURTIS. That is right. The collateral question to it is whether we know how much capital investment was in the governmental sector. There were some series that were started, the latest I have seen was 1952, that attempted to measure it, but they felt it was so inadequate that they abandoned it. I think the Tax Foundation has those figures.

Mr. CHRIST. There is no Government agency I know of that makes estimates of the total existing stock of capital. It has been suggested that the Commerce Department ought to expand its activities and give us not only national accounts of income and output and expenditures, but to give us national balance sheets as well.

The work that has been done on this kind of question has largely been done by economists in universities or in private research organi-

26215—58——18

zations. One of the biggest pieces of work of this kind was done by Raymond Goldsmith, who has an office in Washington. He runs a small economic consulting agency, I guess you would call it. He has published a large three-volume book recently called A Study of Saving in the United States which makes estimates of the capital stock in the United States at various points since, I believe, 1896.

Another set of estimates of the capital stock has been made by Simon Kuznets, who is a professor at Johns Hopkins University. These can be found in a book called Income and Wealth, series II, published in London.

Representative CURTIS. Do you know whether they indicate that the investment dollar has been getting increased return or decreased return, or how it averages out? To me that is a very fundamental thing in trying to measure this. I would hasten to add, as I analyzed it, there are three sources of capital investment.

We start with what is given at the time, but it can be increased and it can be decreased through debt financing, or it can be increased through new equity issue, or it can be increased through plowing back earnings.

I imagine it would be a very difficult thing to measure but nonetheless, I think it would be a very important thing to be able to measure.

Mr. LEWIS. Mr. Curtis, there are some data assembled in one of the publications that the committee put out last June, the one on productivity and prices and income, that bear on the question you raise.

I am thinking of some data that are provided by Machinery and Allied Products Institute, which has done some work on capital stock. These indicate that the return on net worth from the 1920's to recently has not varied very much on an average. That is as a result of a decline in profits per unit of sales but, on the other hand, also a decline in stock of capital per unit of output. So you are really getting more mileage out of our capital stock. It is a more productive kind of capital than it was a generation ago.

I think it should be added that there is at least one agency in Government which has worked on this, the Office of Business Economics. It has a group that has worked on the capital stock of manufacturing for a good many years off and on, and there is a very important article in the Survey of Current Business in November 1956, by gentlemen named Wooden & Wasson on this subject. You will find some good data there.

Representative CURTIS. Thank you. I think it makes considerable difference in how a business finances its growth—if it finances it through plowed-back earnings or debt financing or through new equity issues. I have often speculated that it does it through plowed-back earnings essentially, the immediate consumers are paying for the capital expenditure for growth.

If it flows through equity issue, then it is being financed by the investor dollar. I notice the A. T. & T. had half of its new equity issues since a certain date since World War II for the financing of growth of the A. T. & T.

On the other hand, the steel industry has had practically no new equity issues, which would indicate that steel prices financed the growth of the steel industry. In other words, the growth of the steel industry, which has been considerable, has been done through the price paid by the immediate consumer.

I wonder if anyone would care to speculate on the basic problem.

Mr. ECKSTEIN. Of course the public utilities industry as a whole is the one sector in the economy which relies to any large amount on external equity financing.

Representative CURTIS. It has to do that.

Mr. ECKSTEIN. The steel industry did do some debt financing.

Representative CURTIS. That is right. But not new equity. I think I am right on that.

Mr. ECKSTEIN. A lot of the growth of capital in our economy does come out of retained profits. The reported retained profits, as the Machinery and Allied Products Institute points out, are somewhat larger than actual retained profits because of our method of historical cost depreciation accounting.

I think this is just something which is built into the American economy. A lot of the growth of capital, particularly in manufacturing, does come out of retained profits, which come out of prices. If we did not have this form of saving—that is, out of higher prices—the growth rate of the economy would be considerably lower.

Representative CURTIS. I am not drawing any conclusions right now. I am trying to examine a little bit.

Do you agree that there is a difference of how the growth is financed, whether it is equity or through plowed-back earnings? The plowed-back earnings and even debt financing must come from the price that is charged to the consumer, because you are not getting really new equity capital in.

You are not broadening the base of the investment level. Would you agree that there is an economic difference of some considerable magnitude?

Mr. ECKSTEIN. Yes. The retained earnings are really almost like a tax on consumption, while both debt and equity financing are drawing on voluntary personal saving.

Representative CURTIS. I do not think debt is. I would suggest that debt is put pretty quickly on the consumer—it is not as quick as the plowed-back earnings. The cost of the interest money and the fact that you pay back, depending on how long a term enters in. If it is short-term financing, it is pretty quickly on the consumer. If it is longer term, it spreads it out.

New equity investment is ultimately paid by the consumer and it goes into prices sometimes. I suspect that equity is the one that hits the consumer least and would be less reflected in your prices over a given year.

Mr. CHRIST. May I speak to this for a moment?

Representative CURTIS. Yes.

Mr. CHRIST. I think we are making a difference between two things that are really not so different.

Representative CURTIS. That is what I wanted to hear.

Mr. CHRIST. Suppose that I am running a corporation and it is paying out all of its earnings in dividends, as A. T. & T. does.

Representative CURTIS. No.

Mr. CHRIST. Seventy-five or eighty percent, where the rest of the economy pays out less than half. Their dividend is about $9 a share, and for many years they earned $10 and $11. I think they have done better than that some recent years. Say I am paying all of my earn-

ings out in dividends and when I want to expand I issue new stock to members of the public. Some of the people may be stockholders in the firm already and some may be people who were not stockholders before.

Suppose I change my policy and decide I am not going to float any more stock. This is because the people who are the stockholders in this company have decided that they do not want to let anybody else in from outside; they are not going to issue any more stock, but they want to continue to grow. What do they do? They cut the dividend rate down to half of the earnings on the stock, and they use the other half to plow back in the firm.

Representative CURTIS. If they do not, they keep the dividend rates the same. There might be a short transition when the dividends go down, but, theoretically, when you split the stock you have the same amount.

Mr. CHRIST. I am not splitting the stock. I am changing over from the kind of company that pays out all of its earnings in dividends and, when it needs to expand, it floats new securities in the market, to the kind which does not float new securities in a market and which finances its expansion by not paying the money out to the public in dividends, but, rather, by keeping it.

I do not think there is very much difference between these two. What is happening in either case is that some capital for buying the new property that the firm is going to use has to be raised, and, in a case where it is raised by retained earnings, it is, in a very real sense, obtained from the stockholders of the firm.

Representative CURTIS. No. Where did the earnings come from in the first place? They came from the price of the product.

Mr. CHRIST. All right.

Representative CURTIS. No. But new investment capital comes from outside this area.

Mr. CHRIST. Suppose we have two firms that make the same product, that are in competition with each other. They sell it for the same price; they use the same kind of capital and equipment, and are expanding at the same rate. They have the same earnings. The only difference between the two firms is that one expands by issuing new stock and pays out all its dividends to the stockholders; the other finances its expansion by having a lower dividend rate and using the retained earnings to finance its expansion.

In one case, the company pays out all its dividends—let us say it pays out a million dollars in dividends and raises half a million by issuing new securities—the other company pays out only half a million in dividends and has the other half million which it uses to buy new plant and equipment.

In either case, there are investors who are supplying the half million dollars to the company. In one case, they are outsiders who take it out of their pockets and pay it to the company in return for new shares, and in the other case they are insiders, present stockholders who, perhaps, did not vote for this dividend policy, but the majority of the stockholders did, and said, "Do not pay us a million dollars in dividends; pay us a half million and you keep the other half million and reinvest it in the firm."

In either case, the new investment is coming from some owners of capital who are willing to let the firm have the use of it. I do not

think you want to make a distinction between the price that is charged in these two firms. That can be just the same.

Representative CURTIS. I think your hypothetical case is so hypothetical I do not think it would last long. Actually, what I am suggesting, I think, will make a real difference in price, as to how you finance.

Mr. BODENHORN. The question seems to me to be really whether the earnings of this company are necessarily larger. It seems to me your assumption is that the dividend payment on the invested capital is going to stay the same, so that the rate of earnings on their invested capital has to be larger for them to be able to retain the earnings.

Representative CURTIS. That is the theory; yes.

Mr. BODENHORN. If they get any retained earnings, this has to be done by making larger profits.

Representative CURTIS. That is right. It has to come from somewhere.

Mr. BODENHORN. That is true. But I am not sure that the companies that are retaining earnings necessarily have a total rate of earning on invested capital that is any higher than the companies that do not. They may be paying a smaller rate of dividends.

Representative CURTIS. I do not know how else they would get the money. The only economic difference that I see at all is: When do you pay back the amount of capital that has been put in there? If it is retained earnings, it has already been paid for out of the price charges to the consumer. If it is new equity capital formation, when you ever pay it back is speculative.

Mr. CHRIST. In the case where the firm is floating new capital, the thing that has been paid for out of the price charged to consumers is the higher dividends that a company like A. T. & T. pays.

Representative CURTIS. It may or may not be.

Mr. BLOOM. I have two comments here. The first one is, of course, that it is much more expensive to raise money via dividend payments, and then a reinvestment of those dividend payments in the business, given our tax structure. So, there is a very good tax reason for retaining earnings. You avoid a personal income tax on the dividend distribution and, hence, have a larger amount net for investment.

Representative CURTIS. You are now coming to what I really want to pose.

Mr. BLOOM. That is one point. It makes a good deal of difference in the direction of investment. Money is less expensively available to existing, going concerns than to new concerns in this sense.

The second point I want to make is that I think Mr. Christ is precisely correct in his analysis, provided you really see the firm as a competitive firm operating where prices are given to it.

I do suspect that in some of the oligopoly sectors of our society dividends are regarded very much as interest charges, as a fixed cost, where prices can, within limits be administered, so that an item to be determined by policy is the amount of retained earnings.

This is the situation to which you are speaking, and I think this situation exists. I think it has limited existence in the sense that it is not applicable to all sections of the economy. I do not even know how important the sector is to which it is applicable. I am sure it exists. In this sense, I certainly agree with you, and not Mr. Christ.

Representative CURTIS. I am running over my time, so all I want to do is to pose what really was disturbing me. It all has to do with the channeling of investment money and how much of restrictions and, actually, the determination of where investment money is being channeled, is being accomplished at the Government level.

One question that I have, to which I do not have the answer, is this: I think the most growth in our economy occurs in the small- and medium-sized companies. I cannot prove it, but I suspect it is true. I suspect that the growth we see in the large companies, to a large degree is a vertical thing, where they take over various economic functions that are being performed by independent groups. There is where the growth comes.

Getting back to the effect that the Federal tax system has on investment, our tax structure very definitely favors debt financing and plowed-back earnings. Debt financing escapes the 52-percent corporate tax because it is deducted. Plowed-back earnings escape the personal income. Equity financing gets hit at both levels.

That is only one aspect of the thing. The other aspect, and the intriguing thing to me, which gets back to real inflation, is this: The areas where Federal taxation, where money seems to have been plowed in considerable quantities in the corporations, has occurred where we happened to have a percentage figure in our tax laws, mainly for plowed-back earnings, percentage depletion in oil, life-insurance companies where we have used a formula which is a percentage formula.

Percentage reflects inflation. That is what I am getting at. The other area that happens to come to my attention is between savings and loan and mutual banks which are given 12 percent that they can put back and escape the tax. Those are the companies that have had a bigger access to new capital for financing growth.

It seems to me that our tax structure, being as it is, as high as it is, those that cannot escape in some way or have a lower incidence have a more difficult time. If anyone doubts the tremendous effectiveness of capital formation, just take a look at certificates of necessity, the rapid amortization.

Just by opening up that little gate, investment immediately plows in. For example, what we did recently for freight cars. We said that they would be given rapid amortization, and immediate investment money went into that area. I suggest that herein lies a great deal of need for economic study, as to just how much our tax structure has been influencing the growth of our economy, and I might say, also, how much it has been impeding it.

I see a tremendous number of uneconomic, as I describe them, mergers and acquisitions of small and growth companies by the larger ones, and the uneconomics comes because a decision is made for tax reasons, rather than the merger and acquisition that comes about for what I think would be a normal economic reason.

If this thesis is at all true, this underlies a great deal of this pricing that is going on at this time. As I say, I ran out of time. I did want to pose that point before I stopped.

Representative BOLLING. Mr. Riley, do you have any questions?

Mr. RILEY. Thank you, Mr. Chairman. There is one point that I think might usefully be clarified.

It has been suggested in other hearings, and suggested, also, in Mr. Musgrave's paper in the compendium, that general fiscal policy should be made more quickly adjustable for purposes of stabilization. This suggestion had been previously made, of course, by Gerhard Colm and others.

It has also been suggested in the course of these hearings that general control must be expected to prove inadequate under many typical inflationary situations. It has been suggested that it may even possibly be perverse in that it tends to check the growth of productivity and thus undercut the basis for sustained growth.

Supplementing or replacing general fiscal and monetary controls, it has been suggested yesterday and today that such policies as variable depreciation allowances, decelerated depreciation in certain circumstances, might be used.

I should like to ask the panel's view of the usefulness of such selective control, particularly in the recent boom. What contribution might it have made to checking the boom and perhaps to preventing, the present recession? Let me ask, too, whether such controls would have been less deleterious to productivity through their repression of investment than the general controls that have been complained of, and whether such controls should now be added to our kit of available measures for use in the next boom.

Mr. Eckstein. Could I first make one historical comment in connection with variable depreciation allowances?

The recent boom, which was an investment boom, surely to some extent was heightened by the revision of the tax laws in 1954. So what we have had is a variable depreciable allowance which, so far, has been revised downward. That is, it has become more liberal.

I think as that boom unfolded, it became clear that it was generating inflation rather than investment at some points. If the law had been a variable one, that is, if there had been some possibility of tightening up on depreciation allowances, it probably would have been advantageous.

Now, more generally, as I expressed before, my own view is that we do need some more specific controls. I think they are very hard to administer. It takes perhaps more skillful analysis to administer tools which have a known impact, such as consumer credit controls, variable depreciation, than general policies.

But I think if we are really going to try to bring full employment and price level stability into somewhat more consistency than they are at present, we are going to have to resort to measures of this kind.

Mr. Bloom. I think there are two comments here. In the first place, the so-called indirect controls are indirect only in the measure of our ignorance. To the extent that we really know the consequence of indirect controls they are quite direct in their impact.

The only thing that I think is suggested by the use of the so-called direct controls of whatever kind is that we take action where we think we specifically know the consequences rather than where we leave these to be worked out while being ignorant of precisely the processes in terms of detail as to who is to be hurt and who is to be helped by the control.

A second point I am making, or that I would want to make, is that if we are going to use these direct controls or indirect controls with

knowledge of their direct consequences, we do need to know in a way in which I think we do not know it now the relationship between relative price movements and aggregate levels of employment and output.

Unfortunately, I think there is in economics a gap between aggregate thinking and micro-thinking which, as far as I have been able to ascertain in the compendium or the discussion this morning, remains unbridged. This unbridged gap in knowledge is going to make it very difficult to use either direct controls or indirect controls for which we really know the impact.

Mr. LEWIS. I would make two comments, too. I am a little less skeptical than Mr. Bloom is about our ability to use more specific controls over demand. We certainly do not know all that we need to know. But I feel quite sure that if the Federal Reserve Board had its old discretionary control over consumer credit, length and downpayment, that it could have tightened up. Almost everybody knew it ought to tighten up in the spring of 1955 and check somewhat this fantastic surge of automobile credit that year which was, I think, a somewhat unstabilizing development.

Moreover if we had variable depreciation allowances, I believe we would have moved to tighten up a little bit on the plant and equipment sector in 1956. I think we would have moved in the right direction—not precisely the right amount, no doubt, but enough to do some real good.

My second comment is that I would criticize the use of general controls, particularly with respect to timing in this last swing. The Federal Reserve Board has become guilt-stricken or conscience-stricken over the speed with which it relaxed its general credit controls in June of 1953.

Personally, I think this was a beautiful piece of timing. I think where it erred was not tightening quickly enough and emphatically enough in 1955 and then, above all, I think it erred when it went off on this "do or die" fight against inflation and only against inflation beginning in April 1957. At that time it was perfectly clear, I thought, that we were beginning to get a sag in demand relative to capacity. It was a time when we should have switched to a neutral position.

Also I would make the same point about tax policy. I feel we should have had a tax cut about 3 months ago.

Mr. CHRIST. I would like to second that.

Mr. BODENHORN. As far as these problems are concerned, Mr. Lewis is talking about the difficulty in timing our general controls, and I suspect that the problem gets worse if we think about more direct controls.

As I see it, the difference between direct and indirect controls is in the generality of the effects we are expecting to get from the action that we take. I see no reason to believe that we will not make at least as bad mistakes with direct controls as we do with the indirect ones.

In fact, I expect that it is easier to see what kinds of general policies we need than it is to see what particular areas we want to try to either stimulate or try to cause to contract. The case of the automobile market in 1955 is a good example.

Mr. ECKSTEIN. I want to say I do not share the pessimism of Mr. Bodenhorn of the ability of the Government to administer these controls. In the really clear-cut situations, and there are quite a few of

them, you can count on them usually to do the right thing, particularly if you get them to take a multiple objective view of the problem—if you always get them to worry about full employment, about growth, about price level stability and about equity of income distribution.

Mr. RILEY. Thank you, Mr. Chairman.

Representative BOLLING. Mr. Knowles?

Mr. KNOWLES. Perhaps it is appropriate to make 1 or 2 corrections of fact for the record before I ask my question.

One of them refers to some information which has been referred to from our study of productivity and prices. The Government's calculations are in this compilation to which Mr. Lewis referred. To the extent that any of this information was available at the time this present compendium was printed, it is in the appendix. This unfortunately does not include most of the information on rates of return because this was not yet available.

A second fact is concerning the quality bias that Mr. Curtis was referring to in the BLS Index. This is a matter which they try to take into consideration as they testified on Tuesday. In the case of the medical items to which reference has been made, if I understand their own statement to us in another publication, the Historical and Descriptive Supplement to Economic Indicators, what they actually price are the rates which physicians and dentists charge per visit, or what hospitals charge for specific services.

So there would be, I would think, the possibility of a bias arising, depending on how long it is, since the last time they reweighted the index by the relative importance of expenditures, because only in the expenditure totals in the base period do you get quality change corrected by correcting it by the relative proportions of total expenditure.

So, I presume it is still open as to whether or not the index has this bias to which reference was also made on Tuesday by Mr. Bailey and by Mr. Rees.

There has been raised several times the problem of selective controls versus general controls in handling situations such as happened in 1955, 1956, 1957. If you used some direct control such as installment credit controls in the case of automobiles, and some sort of depreciation allowance in the investment field, you could slow down the expansion of the demand in these specific sectors and slow the inflation.

This raises a query as to whether or not you are then saying that aggregate demand was excessive at that time for the economy as a whole. If you are saying this, then obviously dampening down these particular sectors would get you down to full employment.

On the other hand, if you were saying that you were at a reasonably tolerable approximation to full employment, dampening down these demands must mean that you have fallen below full employment, unless you found an increase in demand somewhere else in consequence. How would these weapons operate to provide this additional employment somewhere else?

Mr. ECKSTEIN. My argument was that in general there was not excess demand, but in a few specific areas there was excess demand. These specific controls would have removed, if properly administered and with luck, the demand pressure on the bottlenecks without reducing demand in general, which I think was done.

Mr. KNOWLES. This is where I got lost.

Representative BOLLING. May I interrupt at this point?

Do you mean that you feel that if consumer credit controls had been applied on automobiles so that we did not have the jump from 24 to 36 months which resulted in a lower monthly payment and a lower price, that perhaps consumers who were buying the very large number of automobiles would have diverted their expenditures to another area?

Mr. ECKSTEIN. That is right. There might have been a better situation in residential construction, in which there was idle capacity. There might have been more demand for textiles, for nondurables, for travel. In any event, it would have reduced the inflation at a minimum cost in output. In fact, I think it was reduced finally with a considerable loss in output.

Mr. KNOWLES. It would have acted in the short run to reduce production and employment and wages and incomes in the automobile industry.

Mr. ECKSTEIN. We have to have some base line of comparison. If you assume that you would pursue selective controls which had as much effect on inflation as the policies that were pursued, then I say that they would have had more output.

On the other hand, if you had pursued the selective controls in such a way as to reduce the total demand by the same amount as the actual policies, then I say you would have gotten less inflation because you would have taken demand away where it should have been taken away rather than a little everywhere.

Mr. KNOWLES. I am a little back to the ancient logical principle that the whole is somehow related to the sum of its parts.

If you reduced an important part of demand, it seems to me you would have to have some showing of a reason why this is going to turn up someplace else—be shifted. What you are saying now is that this policy will force a shift in the aggregate without changing it.

Would the inflationary consequences be any different from shifting this excess from an excess demand for automobiles and machinery to an excess demand somewhere else?

Mr. ECKSTEIN. Ideally, it would have been a shift in demand for automobiles to a demand for residential construction and textiles.

Mr. KNOWLES. If I remember my prices, the price of houses was going up as fast or faster than anything in the machinery industry, so I hardly think you would have contributed to price stability by this shift. Textiles are another matter.

Mr. ECKSTEIN. There was a lot of idle capacity in residential construction.

Mr. LEWIS. I think the point here is, partly at least, that it was in plant and equipment especially that you had the bottlenecks and the materials pressures that you had; and you had machinery prices going up very, very rapidly.

If the demand were shifted to other areas, the chances are that it would have been more widely dispersed and would not have encountered similar bottlenecks. I could not agree, although it complicates our position a little, that all of this demand would be readily shifted, particularly in the case of plant and equipment where I think you have, in effect, business appropriations for certain things. They

do not go out and buy lollypops or something else if they cannot buy machinery. They just do not buy.

I will speak for myself. What I would have recommended would be a greater use of selective controls and a somewhat less rigorous use of general monetary restraint. This would have had a very significant impact on the housing market where you did have housing pulled down very clearly, I think, by general credit restraints because of the peculiar impact they have on Government-guaranteed housing.

Mr. KNOWLES. Does anyone else want to comment?

Mr. BODENHORN. It seems to me that the real issue is whether you are going to try to hold down the prices in the areas where there is excess demand by selective controls, or whether you are going to try by general controls to permit these prices to rise but push other prices down; that is, force people to reduce their consumption in other areas if they are going to get the funds to go after goods in the bottleneck area.

One of our problems, I suspect, has been that there are sufficient rigidities in these other areas that these prices do not come down even when demand is reduced. We find that some prices are going up and others are not coming down enough. Sometime later there will be bottlenecks in other areas and these other prices will go up, but unfortunately the first prices will not fall enough to compensate for this.

We seem to have absolute prices always going in one direction. But this can be greatly exaggerated also. There are all sorts of items in which the absolute price is lower today than it was 5 or 10 years ago, for example the durable goods like washing machines where the price of steel supposedly is so important.

I would argue that we should permit the prices to go up in the areas where there is excess demand, and that we should not try to reduce the demand in those areas. What we should try to do is to cut the demand in other areas.

Mr. ECKSTEIN. And make prices flexible?

Mr. BODENHORN. Yes.

Mr. LEWIS. How do you do it?

Mr. BLOOM. There is the implicit view that somehow or other the resources used in one industry can quickly shift in response to a change in demand. I am not at all sure this is possible.

For example, had you inhibited the demand for automobiles in 1955 and this did have an employment consequence, that employment consequence would have been highly localized. I am not sure it would have led at all to an expansion of output and employment in other industries.

If you have two or three fairly substantial industries in which there is localized unemployment, that is easily generalized to the view that you have a general recession. I am not at all confident that you can push down demand in one area without simply getting pockets of unemployment.

Mr. KNOWLES. This discussion leads me to the other thing that struck me. In this compendium and in other suggestions through the years, the remedy for failures, so called, of general monetary and fiscal policies is to adopt some more new and direct tools to deal with specific areas.

This always strikes me as saying that the human beings, the personnel department, have failed to use the tools properly and we hope they

will not be as stupid—if I can be pardoned in the use of the word—in their estimates of the situation in using the specifics as they have been in using the general tools. I am wondering what hope the panel suggests we have that they will be brighter in using the new set of tools than the ones you are criticizing them for misusing on the general level?

Mr. ECKSTEIN. I share some of your concern about our capability to administer more complicated controls. I would say this: If it really is true that we cannot do it, then we are on the horns of the inflation and the full employment and growth dilemma. Then I would embrace the full employment and growth side of it.

In other words, if we are going to administer the things badly, let us administer them in such a way that we will have a strong growth bias rather than a price stability bias.

Mr. LEWIS. My comment would be that it seems to me rather typically the judgments that have to be made in acting with respect to the general controls are more complicated than the selective controls, in the sense that you have to choose between doing some good things and some bad things all at once, sort of blindly and generally.

I have had a problem with my lawn this spring. Some of it has been growing like mad. I fertilized for the sake of the rest of it that was barren. Now I have some pitifully small grass growing one place and this luxuriant growth in another place. With the kind of lawnmower that cannot select along these spots, I am having a terrible time managing this lawn. If I could deal more selectively with it, I think it would be a much simpler problem.

I think there was really no question about the desirability of inhibiting the growth in automobile credit in 1955 if we had had the right tools. Incidentally, I would say that we were not talking in a context where this would mean an increase in unemployment. We are talking about an upsurge where you simply try to dampen the boom in a particular segment, not depress it. The same goes for plant and equipment in 1956.

Mr. ECKSTEIN. If I may add another comment, when we speak of consumer credit controls, we do not mean we reenact Regulation W. We have devised an extremely elaborate method of regulating the commercial banks. In this day the consumer credit corporations have as large an effect on the economy and we could find a gradual way of regulating them which does not move in large jumps.

Mr. BODENHORN. We have some other regulatory agencies that perhaps I had better not name, that I do not think are doing the best job they could be doing. I doubt that regulatory agencies are the solution to this problem.

I am also sure that I would not have been in favor of restricting automobile credit in 1955, although I do not know how much other disagreement you would get on this particular issue.

Mr. BLOOM. Interestingly enough, the expansion in automobile sales financed largely by expansion of consumer credit was looked upon as one of the major influences in getting us out of the recession of 1954. As a matter of fact, generally we look to expansion of spending out of new borrowing, whether it is done by consumers or businesses, as getting us out of recessions once they appear.

Now what is being advocated here is apparently the inhibition in the growth of consumer indebtedness which at the time was looked

upon as highly desirable for the stimulation of the economy. I think it would have been very, very difficult to have timed this properly even if one agrees that it should have been done. I would agree with Mr. Bodenhorn and would not agree that it should have been done.

Representative CURTIS. I would like to comment.

I would think that it would be better to leave the decision of how many automobiles are to be made to some of the high-priced executives on whose welfare the industry depends. If they make a mistake, they have to pay for it economically.

In my judgment, they certainly did make a mistake, and in many people's judgment in retrospect. But to try to bring that to Washington for decision, instead of leaving it in the hands of the private sector, would be very disturbing to me. I think we could get better brains and better analysis of the situation in that fashion because we are still human beings.

Representative TALLE. Mr. Chairman, I must at the outset say this: I am sorry I could not be here sooner. We have a hearing going on in the Committee on Banking and Currency. I have not followed your discussion long enough to know what your primary thesis is, but I call to mind that in 1922, which is probably too far back for most of you to remember, the closed car had a lot to do with the revival of business prosperity.

Two years later, in 1924, the four-wheel brake was no small factor in continuing prosperity. What we apparently did during the 1920's was to postpone the severe shock until the early 1930's.

That is all at the moment. Thank you, gentlemen, for your contributions.

Representative BOLLING. Mr. Bodenhorn, I have a question with reference to the last sentence of your summary, which says:

> If in the future we are faced with a threat to our leadership in living standards, we should not sacrifice our freedom in order to try to maintain that leadership and I am not sure that it would be possible to double our present rate of growth without severe impairments of our basic freedoms.

Is it the meaning of that sentence that in the event it were necessary, as a matter of policy, to substantially increase expenditures for defense and foreign policy at the expense of our living standards, rather than increase our growth substantially, we would sacrifice the living standards to the so-called public necessities or public goods?

Mr. BODENHORN. I do not think so. That is not what I had in mind. What I had in mind was that we would have to at least double our current growth rate to the neighborhood of 7 or 8 percent to keep pace with them if the Russians continue their present rate of growth, and I am not sure this can be done in a free-enterprise society.

I was not thinking in terms of the proportion of the income that the Government might want to use for defense or any other purposes.

Representative BOLLING. Then my question would be, How can one think of economic growth while leaving that out—the needs of defense and foreign policy along with the need for economic growth?

Mr. BODENHORN. I do not seem to understand the question.

Representative BOLLING. I will put it another way.

There have been studies and statements, the most recent, I guess, by Mr. Allan Dulles, indicating that the rate of growth of the Soviet economy is very substantially larger than our rate of growth. As I understand it, he has drawn from that certain implications.

Without getting into the argument of difference in maturity of the economy and their ability to maintain it—for the sake of argument assuming that they can maintain it—this taken in conjunction with the fact that there has been at least one study made by the Rockefeller Brothers Fund with a very distinguished panel, which indicates that if we are to meet our total responsibilities as a nation, it would be extremely difficult to do so at our past historic rates of growth; that it will be somewhat possible to do so if we have a rate of growth of about 4 percent and it would be relatively convenient and would allow for some increase in the standard of living if we had a rate of growth of 5 percent.

There is a great deal of variation even among economists as to what the historic rate of growth has been. I find myself very confused as to what that actual figure is. It would seem to me that the concern not only of policymakers but of all people involved in the whole set of problems—of which this set of hearings is a discussion of one—would be to look at the possible necessities of the situation and see if we have not the wisdom to devise methods whereby we can have that rate of growth we need to have with stability.

This leads me to my question: First, is is the view of anybody in the panel that it is impossible or that it is inconceivable that we could have a substantial rate of growth in the economy of the United States and not have stability? Is it impossible for us to have both?

Mr. BODENHORN. I suspect that the only way we could achieve stability would be to impose severe restrictions of the kind that we had in wartime, that is, direct control over the economy.

Representative BOLLING. OPA–OPS type of controls?

Mr. BODENHORN. Allocation of steel, and so on.

Representative BOLLING. Is that the general view of the panel?

Mr. ECKSTEIN. I do not think we have found that there is an inconsistency between stability and growth. I think we can run a countercyclical policy with fairly modest fluctuations at any rate of growth. Where there is a hazard of inconsistency is between price level stability and the other objectives.

The question is, Can we have a price level stability and 5 percent rate of growth? We have not looked into this problem either within the Government or in the academic field. Nobody has taken a hard look at whether the American economy could grow at 5 percent and what kind of institutional changes would be necessary to achieve this. I would think this would be of the very highest order of priority in the economic field.

Mr. LEWIS. I will agree with this. It seems to me that there might not be much more inconsistency between price stability and a 5 percent rate of growth than a 4 percent or 3 or whatever it is, particularly with this increment taking the form of additional public procurement.

This would undoubtedly induce kinds of investment that would not otherwise occur. It would tend to keep us running at a pretty taut, full-capacity rate. Although this might maximize some demand pressures on prices, it would also, I think, assure us of as vigorous a growth in productivity as we can get.

As has been emphasized here and at other times in the hearings, actual productivity is very sensitive to fluctuations in output. A

little sag in the economy seems to have rather considerable negative effects on productivity. I do think myself that there is a strong prospect, whether with the 4 percent or 5 percent rate of growth, that we will have some secular inflation.

I do not think this should be the limiting factor on deciding whether we need the 5 percent rate of growth by any means. In either case, I think there is room for us to do a lot more thinking than we have done about some innovations in policy that will help to get private price and wage makers to reach decisions that are more in agreement with the social interests to which they are very sensitive but which in the context of their decisionmaking they cannot very well respond.

I think we have a situation where the sum of all the parts of sensible decisions privately does not add up necessarily to the socially most desirable thing as far as price and wage making is concerned. I think it is silly to think about a permanent OPA or OPS. It would be technically impossible, let alone politically unacceptable.

I do not see the Government behaving as a unilateral controller in this area. I do not think it has the political resources to do this as a continuing matter. I think it may play a role as a catalyst in bringing out the best in private decisionmakers, which by and large they want to have brought out. There is a great deal of latent statesmanship in the labor community and the corporate community about these issues.

Mr. BLOOM. I was simply going to note that there is always a tendency to define freedom as being able to do what you are now doing. I think if we define freedom in this fashion, it is pretty clear we have developed a set of institutional arrangements and a response to them which keeps the rate of growth substantially less than 5 percent a year.

I do not see anything in the abstract inherently impossible about changing this set of institutions and responses to them which inhibits or keeps this rate of growth at this lower level.

I agree with Mr. Eckstein that we do not know precisely what these new institutional changes would have to be and what kinds of responses we would need to expect from these institutional changes and we ought to find out about this. I do not see any reason to suppose, however, that this implies in any philosophical sense a loss in freedom. It might imply this, but not necessarily so.

Mr. BODENHORN. I deliberately chose the doubling of the rate of growth because I wanted to avoid some of these problems that are being raised. This does not mean that it is impossible to raise it from 3½ to 4½, or whatever the rate may be at the present time. As you say, there is disagreement on what the present rate is.

I do think that the problems would be substantially greater if we really started thinking in terms of doubling the rate of growth. But also the point I was trying to make was that I think that, in determining what we need to do by way of growth, we need most to grow in such a way that we will preserve our freedoms, and that the international political considerations are not as important.

I also think that we can afford, with our present rate of growth, to spend quite a bit more on defense if we think this is necessary, but this is another question.

Mr. CHRIST. I think there are two ways in which, or two fronts on which we have to guard the freedom that we want to maintain. One is essentially on the homefront and the way in which we run our Nation here.

I think the thing that motivates people who look at the Russian statistics and look at our statistics, and may have motivated your question, Mr. Bolling, is the possibility that if the Russian nation continues to grow at a more rapid rate than we do, then there will be a greater external threat on us and we will not be able to maintain our freedom on the internal front.

If we are going to increase the rate of growth in the country, this will require essentially devoting a larger proportion of our current output to investment and a smaller portion to current use. There is at least one area in which I think it might be relatively painless from the point of view of internal freedoms and, indeed, might create an improvement in this way, which is to devote more resources to basic scientific research and to training and education.

This is something that would improve the freedom of the people to whom this kind of training goes, and I would guess that it would also have a high payoff in terms of the rate of growth of our economy in the future.

Representative BOLLING. Thank you.

Representative CURTIS. One of the questions implicit in here is how we measure growth. Usually it is measured by GNP, and that really is, in my judgment, something that has to be recognized as measuring the amount of activity at a given time.

The real growth, I guess, is measured in your capital plant plus your trained labor force plus the element of productivity. The GNP is simply what amount of the labor force, what amount of the capital plant, times the productivity, is applied in a given year.

Dr. Christ mentions that research and development is the future growth and yet it is hardly reflected at all in our GNP of the particular year in which we might be spending money on it.

I think probably the only way we can measure growth is the GNP. I am not arguing that does not serve as a good indicator. I have often wondered if there were some other way or some better way of balancing off or measuring real growth.

I have in mind the steel industry when the Korean war was being operated at 110 percent capacity in the steel industry, which meant they were not shutting down for routine maintenance. That would produce an unusual GNP at a particular time and yet the net result would be a deterrent to growth. Now, of course, we are at 50 percent capacity, but our potential is still there.

So in measuring Russia versus the United States, I certainly think we cannot stop at just the GNP. Russia is spending money on capital goods, and money on research and development, and this might make the picture darker as far as we are concerned.

I personally think that a full evaluation leads me to feel quite relaxed upon our competition with Russia if we will tend our own knitting and continue to analyze our own errors and go around and correct them. I think we will be well ahead of them if we continue that attitude.

Representative BOLLING. I understand that one of the members of the panel has a time problem in relation to a plane. When we arrive at that moment, do not hesitate to leave.

Representative TALLE. I have just one question. Dr. Christ made reference to Russian statistics. My question is this:

How firm are the figures that we have on Russian statistics?

Mr. CHRIST. I wish I had somebody here to turn to to answer this. I have not spent very much time on this question and I am really not qualified to say. I know a little bit about the problems that are involved in trying to assess the Russian statistics.

I think there is a good case that some of the claims that were made at least a few years ago were exaggerated in terms of the kind of standards that we apply to our own economy. So the rates that you got coming from Russian publications are not strictly comparable to the rates that we have derived for our own economy.

The Russians have been much less secretive in recent years about giving out the base periods on which they tell you that they have made such-and-such an increase in output, and it is possible to make a much better evaluation of the data that they have. But I am really not in a position to answer the question.

Representative TALLE. For four years I have tried to get what I have called improvement of foreign economic statistics on the agenda of the international organization whose conferences I have been attending for many years, and the only serious objection I have encountered has come from the Russian delegation. Each time the delegation has said, "What is your motive?" I have always replied, "The same motive that lies in the multiplication table." We would like to have some firm figures that tell the truth.

The Ways and Means Committee has found it would be desirable to have significant and reliable foreign economic statistics.

Mr. CHRIST. There is a good deal of work going on in American universities concerning this. One of my colleagues, Prof. D. Gale Johnson, who has been before various congressional committees on agricultural policy, has taken an interest in Russia and is operating a project at the University of Chicago on the growth of the Russian economy.

Representative TALLE. He was here last December to help us on agricultural policy.

Thank you, gentlemen. Thank you, Mr. Chairman.

Representative BOLLING. Mr. Knowles?

Mr. KNOWLES. I think we should at least have in the record for consideration the fact that in any discussions of both growth rates and rates of growth of productivity, particularly in recent years, we should remember that the aggregate figures we are talking about come from putting together statistically, in effect, growth rates and also productivity rates for individual industries and occupations.

If you merely had a different mixture of the aggregate demand between the product and the service demanded, the growth rate might have been as high in recent years very probably as it had been before. I should think it was influenced heavily by the change in demand. The figures that we have show that the individual industries are going along pretty much as you expect from the trends. There must be

some changes in the mixture accounting for a lot of the slowing in rates.

On the same basis, if we wanted a high growth rate of aggregate output, part of the problem may not be one of increasing very drastically the amount of our investment, but of shifting our demand as to what we want, from industries, such as some of the services where we have low growth possibilities to something like automobiles where I assume we could double the growth rate in about 16 to 18 months.

The question is, therefore, not merely how much growth in the aggregate you want, or what rate of growth you want in the aggregate, but how much of a growth rate you want in what; what are the particular products and services that, as a nation, would contribute to our objectives.

If this latter turns out to be a large part of the problem, then we are back to the difference between general policies and selective policies—of deciding whether the Federal Government is going to try to influence particular sectors of demand or whether it is going to stick to general policy. This is my reaction to the discussion.

Representative BOLLING. Are there any further comments by anybody? If not, gentlemen, we will thank you all for your contribution and your patience.

Monday the committee meets in this room. We will stand adjourned, then, until 10 o'clock Monday morning.

(Whereupon, at 12:55 p. m. the committee adjourned, to reconvene at 10 a. m., Monday, May 19, 1958.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

MONDAY, MAY 19, 1958

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

The committee met at 10 a. m., pursuant to recess, in room 1302, New House Office Building, Hon. Richard Bolling presiding.

Present: Representatives Bolling presiding, Reuss, Talle, and Curtis.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk; and James W. Knowles, economist in charge.

Representative BOLLING. The committee will please come to order.

This morning we approach the subject of prices from another direction. In two previous sessions we have been concerned with the general forces determining prices and the way in which price changes affect employment, income, and the allocation of resources.

Today we are concerned with private pricing policies, how they are formulated, how they affect the general price structure and price movements, how pricing decisions are made in various types of concerns; how these decisions are affected by various factors within and without the firm?

Our usual procedure will be followed with each participant being heard for 5 minutes, in which time he is to summarize his views without interruption.

After these opening statements are completed, we invite all panelists to participate freely commenting not only on questions of committee members, but also on the other papers presented this morning.

Our first panelist this morning will be Mr. Wroe Alderson. He will discuss business price policies and economic stability.

STATEMENT OF WROE ALDERSON, ALDERSON & SESSIONS, INC., PHILADELPHIA, PA.

Mr. ALDERSON. Government policy directed toward stability and growth must take account of business policy which seeks to achieve the same ends for the individual firm.

A business firm exercises policy in setting its offering prices and in determining when and how it will make changes in its prices.

It may avoid or delay price increases because of goals of growth and market development. It may avoid or delay price decreases for fear of contributing to further instability and loss of confidence.

Business involves a network of expectations linking suppliers and customers at successive levels. The essential value of price stability

for a firm is in facilitating planning for the firm itself and other firms with which it deals.

Some economists have felt that business price policy in itself is a threat to economic stability. It has been argued that a firm which can exercise policy may choose to maintain prices while cutting its output in times of recession.

Others are rendered uneasy by the very fact that businessmen can exercise price policy, taking this fact as proof of an undue concentration of economic power.

My own view is that price policy is, by its very nature, a self-imposed restriction on the area of discretion within which prices can be made. From this viewpoint the three basic issues are to assess the aims of business in imposing restriction on its price behavior, to determine the extent to which it obeys these restrictions in times of stress, and to consider how the aims of public policy might be supported through changes in the price policies of business.

The basic aims of business price policy are related to marketing plans. We need better planning for stability and growth based on more adequate knowledge of future markets and more imaginative programs for the use of resources in developing these markets.

Tremendous progress has been made in market analysis and creative merchandising in the past 50 years. We are on the threshold of even more striking developments in systematic techniques for planning in marketing.

The facts as to how strictly policy restrictions are obeyed in times of stress are difficult to determine. Individual salesmen may depart substantially from stated price policy with or without the full awareness and tolerance of the management.

Companies differ in the quality of their administrative machinery in making price adjustments wisely, promptly, and fairly, as among different customers or different segments of the market. The constructive outlook is not for the elimination of administered prices, but for better price administration by business management.

The third area in which progress is to be desired is a greater understanding on either side in the formulation of both public policy and business policy. Progress does not lie in each deploring the policy-making powers of the other. There is a major role for what has been called business statesmanship in the formulation of price policies.

There is no question that the presumptive aims of public policy are taken into account in increasing degree by modern business management.

The growing professionalization of executive training and outlook should accelerate this trend. Policymakers in both government and business could profit from concerted efforts for a better understanding of our market economy.

Representative Bolling. Thank you, Mr. Alderson.

Next, Dr. Lawrence E. Fouraker, professor of economics, Pennsylvania State University.

STATEMENT OF LAWRENCE E. FOURAKER, PROFESSOR OF ECONOMICS, PENNSYLVANIA STATE UNIVERSITY

Mr. Fouraker. I attempted to relate market structures, price characteristics, and economic fluctuations. This was done by:

1. Classifying prices into two groups, a C sector and an M sector.
2. The C sector commodities were largely staple, nondurable goods, produced under relatively competitive conditions.

It was argued that these prices were more likely to be in the inelastic ranges of their respective demand curves.

3. The M sector commodities were largely durable goods produced under relatively monopolistic conditions.

These prices were more likely to be in the elastic ranges of their respective demand curves.

4. The C sector prices tend to lead the M sector prices over the business cycle.

That is, the C sector prices tend to turn down before the crest in either M sector prices or general business activity is approached, and they tend to turn up before the trough is reached.

5. This change in relative prices will induce changes in the propensity to consume.

Thus, if C sector prices rose relative to M sector prices, the propensity to consume would tend to rise, and vice versa.

6. General business activity will tend to move in the same direction as the propensity to consume, via the multiplier and accelerator effects.
7. Thus, price induced shifts in the propensity to consume may consistently lead changes in business conditions.

Therefore, changes in relative prices may be a contributing factor in the fluctuation of general business activity.

In conclusion, it is suggested that the policy implications of this study be endorsed only when they are consistent with the program derived from conventional price and income analysis.

Representative BOLLING. Thank you, Mr. Fouraker.

Next is Dr. Stanley C. Hollander, associate professor of business administration, Michigan State University.

STATEMENT OF STANLEY C. HOLLANDER, ASSOCIATE PROFESSOR OF BUSINESS ADMINISTRATION, MICHIGAN STATE UNIVERSITY

Mr. HOLLANDER. In spite of the importance of retailing in the American economy, retail pricing techniques and price decisions have received little serious economic study, and our ignorance of these topics far exceeds our knowledge.

The wide variety of retailers, differing in size, motivation, and commercial problems, complicates retail price study.

"Discount selling" and other deviations from the "one-price" system also complicate the matter, since such practices often cause the prices at which sales are actually made to differ from the ostensible price tags.

The retail pricing discretion in the hands of retailers is limited somewhat by governmental intervention, usually designed to place a floor under prices.

Various actions by suppliers, including the use of resale price maintenance where legal, place important restrictions on retail pricing in some fields. Suppliers controls also often take the form of floors under prices.

The price choices available to retailers are further limited by a tendency to cluster prices in "price lines" and at "psychological" points.

The extent to which retail pricing, through built-in rigidities such as price lining, reduces the effects of price changes at manufacturing and wholesale levels is an important question related to the work of the committee.

Some merchants, notably in the department store field, are generally believed to apply fixed percentage margins to acquisition costs. This technique would exaggerate, rather than dampen, the dollar changes involved.

Other merchants, especially in the food field, are reputed to think in terms of dollar margins that would reduce the percentage changes involved. The limited evidence available suggests that both beliefs are an oversimplification.

The relationship of retail margins on specific items to the cost of retailing those items presents another important question in equity and in economics. The relationship cannot be a perfect one, since:

A. The common or joint nature of most retailing costs inhibits the determination of specific costs for selling specific items;

B. The number and speed of pricing decisions required in the typical retail firm force the development of rough rules of thumb for price determination; and

C. Demand considerations which permit—or necessitate—the raising—or lowering—of margins on specific items do not necessarily accord with the costs of handling those items.

Competitive pressures and the development of new techniques for costing and pricing, such as merchandising management accounting, are likely to work toward improvement of the cost-price relationship.

A question also arises as to the extent to which existing price policies and controls inhibit innovation and improvement in retailing. This finally leads into a question of the social costs and benefits of innovation in retailing.

Representative BOLLING. Thank you.

Next is Dr. Robert F. Lanzillotti, associate professor of economics, State College of Washington.

STATEMENT OF ROBERT F. LANZILLOTTI, ASSOCIATE PROFESSOR OF ECONOMICS, STATE COLLEGE OF WASHINGTON

Mr. LANZILLOTTI. For quite some time, and particularly since the debacle of the 1930's, economists have endeavored to determine the actual connections between private pricing policies and general economic behavior. We have a reasonably good knowledge of the relationships between changes in total consumer spending, total business expenditures for plant and equipment, and Government spending on the one hand, and national income and production on the other, but the links between private pricing policies and general economic behavior have been difficult to identify factually.

A basic problem confronting those who have worked on this question is the relative dearth of detailed information on the nature of the pricing process in industry, which has made it necessary to rely more on deductive logic than on inductive studies. Unfortunately, as a consequence, it is not possible to assert with any high degree of confidence the nature of the actual relationships that exist.

Recent case studies of pricing policies and practices of large companies provide some new insights to the nature of pricing policies in

industry and their ties to expenditures for plant and equipment, and are suggestive of some of the probable influences on economic stability and growth. It seems reasonable to conclude that pricemaking in industry is based upon selection from among several possible courses of action that provide for both necessary internal control and for sufficient flexibility for overall strategy of the firm in marketing various products. The emphasis here in pricing policy is on the firm or enterprise as against individual products or product groups.

Large companies have as an objective for price policy certain long-term goals. A predetermined target rate of return on investment—frequently balanced with market share considerations—appears to be a typical approach of large corporations to pricing.

The time horizon of the particular profit objective is long range; that is, the expectation is not necessarily to realize the desired rate of return year to year but rather as an average over a period of years of both high and low operating rates. Managements of large companies have found it increasingly necessary and desirable to utilize some variety of capital budgeting and profits planning, and target-return pricing provides a satisfactory approach.

Target-return pricing ordinarily involves the use of some system of "standard" costs—that is, estimated costs at a projected long-run average rate of plant utilization; e. g., 75 percent. The standard cost formulas are designed to avoid the necessity—and cost—of making short-run changes in prices that would result if price adjustments were continuously made for change in the rate of operations and actual costs.

Interestingly, target-return pricing implemented via a standard-cost procedure involves the planning of capital investment with some built-in or planned excess capacity.

The formulation of price policy in terms of profit-investment requirements or objectives of the corporation reflects in part the ability of such companies to "administer" profits, and in part the increased efforts of large companies upon anticipation of changes in market conditions, as a means of maintaining or enlarging market share of various products. This ability of some firms to administer profits to conform to corporate objectives raises some fundamental questions for public policy.

A basic question, which is probably of concern to this committee, is whether this kind of profits planning, and the price behavior it involves, tends to promote or inhibit economic stability and growth. We do not have enough data to permit any sweeping generalizations on this question, but assuming present general economic policies continue, these observations seem justified:

(1) With respect to business expenditures, for a number of reasons long-run investment plans of large corporations are ordinarily made well in advance of actual expenditures which reduces the likelihood of large deviations from anticipated expenditures.

Thus, to the extent that investment decisions of firms are more closely related to long-run profits than to current profits, and no sharp alterations are made in investment plans because prices and profits are expected to hold up better and recover more quickly, the actions of administered profit corporations will lend a stabilizing influence on minor downswings and minor upswings. The depth of short-term business decline may be attenuated and the speed of recovery accel-

erated. This, in turn, may produce a favorable impact on economic growth.

(2) With respect to prices, profits-planning in combination with the influence of various Government pressures, overall market strategy of the firm, and other considerations, induce firms to seek stabilized or constant prices. This means that some restraint will be exercised in both raising and lowering prices during periods of generally rising and generally falling price levels.

Such restraint in pricing may be destabilizing both upward and downward—higher prices may follow in other sectors on the upswing and price declines elsewhere in the economy may be aggravated under general economic decline. Moreover, if demand is more responsive to lower prices than businessmen commonly believe, the lowering of prices in periods such as the present would lend even more stability to production, profits, and investment expenditures of producers.

However, since firms do not believe, and there are not adequate factual data to show, that sufficient responsiveness to price cuts exists, firms are reluctant to experiment with price changes, especially under conditions of changes in anticipations generally.

Therefore, short of direct public policy measures, whose overall merits we may wish to examine in detail later in the discussion, we cannot expect more flexible prices in industry generally. Continued reliance will have to be placed upon more refined monetary and fiscal measures in combating cyclical movements.

Among the specific proposals mentioned in my paper in the compendium, I would like to stress the need for a permanent research commission, committee, or other appropriate Government agency, perhaps a National Social Science Foundation, to undertake and support, among other things, comprehensive and continuing cross-section economic studies of industrial pricing policies and practices.

In my opinion, in the interest of providing adequate information for the formulation of economically sound long-run policies, this is one of the very best actions that could be taken.

Representative BOLLING. Thank you.

Next is Dr. Alfred R. Oxenfeldt, professor of marketing, Graduate School of Business, Columbia University.

STATEMENT OF ALFRED R. OXENFELDT, PROFESSOR OF MARKETING, GRADUATE SCHOOL OF BUSINESS, COLUMBIA UNIVERSITY

Mr. OXENFELDT. My paper discusses industrial pricing behavior during recession in order to illuminate the following questions:

Under what circumstances are prices reduced during recession?

How speedily after the onset of recession are prices ordinarily changed?

Finally, do price reductions help to stem recession, or do they stimulate sales very little?

Empirical studies of price behavior recession revolve around analyses of price quotations which have deficiencies as indicators of sums actually paid, especially during recession.

On the other hand, my account of price behavior represents a generalization from the limited number of individual cases known to me personally.

The conclusions of my paper are presented in the form of a list of propositions. This list includes a summary of the pertinent preliminary results of a questionnaire study which have just become available:

1. Many top business executives feel personally threatened and are unnerved by recession. At such times, they probably are motivated primarily by their highly personal goals, and would not feel obliged to adopt policies that might yield social benefit if they involved a sacrifice of company profit and personal position.

Moreover, it is my impression that very few executives believe that their pricing behavior could alleviate recession.

2. Four combinations of pricing objectives, policies, strategies, and methods apparently account for the overwhelming majority of industrial situations:

A. The first calls for stable prices during prosperity and recession alike to avoid price disturbances in both the buyer and the seller industries.

B. The second calls for price reductions only when the seller can reasonably anticipate a very substantial increase in sales volume, a situation that is not widespread, especially if one rules out increased sales that merely move forward purchases that would have been made in any event.

C. The third calls for price reductions after the existence of recession has been confirmed on the ground that they are inevitable.

D. The fourth, and possibly the most prevalent, calls for adherence to the firm's customary pricing method—usually some version of cost-plus pricing—because the method is intended to serve for all stages of general business conditions.

3. These four pricing syndromes suggest that prices are reduced primarily under the following recession circumstances:

A. Some firm—other than a tiny fringe member of the industry—has reduced price because it has gotten into financial difficulties; many industries have such weak links and the longer and deeper the recession, the greater the certainty that some links will develop weakness.

B. When a major cost element is required.

C. When a large buyer, who has been badly hurt by the recession, exerts his full bargaining power—typically on the weaker links among his suppliers.

D. When it becomes common knowledge that a recession is in progress.

4. Price reductions do not come promptly after sales drop off because of recession.

Businessmen must perceive a decline in sales as likely to endure rather than as one of the many inexplicable temporary unevenesses in sales. Recognition of recession almost always lags considerably behind the fact.

5. Businessmen are generally hopeful at the onset of recession that it will be brief; they postpone price reductions on this account and, when forced to reduce price, favor concessions that can be quickly withdrawn and avoid changes in price lists.

6. The effects of price reductions during recession are not wholly clear, though they have been illuminated considerably by a questionnaire study completed by Purchasing magazine.

Among the more significant findings of that study, which are based on responses from 184 purchasing agents during the month of April 1958, are the following:

A. Nineteen and two-tenths percent reported they did not receive any price cuts at all in the previous 9 months.

Twenty-three and six-tenths percent reported cuts on only single items.

Fifty-seven and two-tenths percent reported cuts on more than one item.

B. Almost 80 percent did not change their purchasing plans in response to the price cuts they had been offered during the preceding 9 months.

Almost 10 percent bought more and about 4 percent were induced to buy sooner as a result.

A total of 6 percent bought less or postponed purchase.

The survey provided no basis for estimating the quantities of goods involved in the various types of behavior.

I might mention that these results are preliminary; a reexamination of the results may change the figures slightly, but the basic conclusions will hold.

Sixty-five percent of the respondents reported that when a new source offers to sell at a lower price, they normally call their existing source and let him match it.

C. The firms that have been the first to offer the largest price concessions made to the respondents during the last 9 months, include primarily old firms—65 percent; in less than 4 percent of the cases the first firm to offer them a sizable price reduction was a "declining" firm.

D. Almost one-quarter reported that they expected further price reductions in the next 3 months on items on which they had already secured price cuts.

A similar percentage—23 percent—said they regarded the first price reduction on an item during recession as a signal to hold off buying while less than 3 percent considered it a signal to buy immediately.

Almost three-quarters said they do not typically change their buying plans as a result of the first price reduction.

E. Although these results are extremely interesting, a followup based on personal interviews is urgently required before the significance of these findings can be appraised.

I would emphasize they represent the responses of a self-selected sample amounting to about 20 percent of all the purchasing agents to whom the questionnaire was sent.

7. Price reductions apparently divert patronage from usual suppliers to firms offering price concessions, but only in a very small minority of cases.

In the overwhelming majority of situations, they have no effect on the amount purchased or the source patronized.

Consequently, there would appear to be slight inducement for a seller to reduce price during a recession and very little social gain if he were to do so. Although this point can scarcely be settled on the basis of what we know now, it seems that prompt price reductions by industry during recession would do little, if anything, to combat recession.

8. Price reductions that might help to stem recessions are likely also to delay and reduce the momentum developed in the subsequent revival.

9. Social objectives, both economic stability and economic growth—probably cannot be achieved efficiently by altering the objectives and behavior of businessmen within our economic system. These objectives call for national action outside the pricing sphere.

To require businessmen to adopt pricing policies to speed economic growth and increase stability at the threat of financial loss and possible destruction of their enterprises would greatly alter our economic system. The constraints on business action that such a policy would involve would, in my opinion, result in an economy characterized by substantially slower economic growth and possibly greater instability than is the case at present.

10. The measures employed to end recession must take account of the sharing of the burdens of recession.

Failure of prices to decline much during recession—which may be the pattern for this and many subsequent recessions—intensifies the burdens of those whose income has been reduced by the recession.

Also, it eliminates the gain in value of accumulated assets that customarily took place during recessions prior to World War II.

I would like to burden the committee with just two more points.

First, we must not assume that departures from past pricing behavior during recession necessarily are changes for the worse.

Secondly, I would say there is a very strong presumption that our economy has changed substantially in the last 20 years and we probably do not understand the nature of that change.

It is very early for us to do so, and these hearings will certainly help toward that end.

Representative BOLLING. Thank you.

Do any members of the panel wish to comment on statements of the other panelists, or on other statements that appeared in the compendium or to expand somewhat their own summaries?

Mr. ALDERSON. Mr. Chairman, I would like to support what has been suggested by some of the other speakers with respect to the urgent need for a greater understanding of our economy as it is today.

One witness suggested studies of industrial pricing policies as being very much needed.

I would also like to nominate a type of study to be resumed, namely, the input-output studies of industries that were undertaken previously by the Government.

Since so much of economic planning is necessarily in the hands of businessmen, it is in the public interest to make them better planners. Planning depends on forecasts.

We who engage in that type of business analysis are very hopeful of what we might presently be able to do in the way of application of the input-output studies and we were quite concerned when the attempts in that direction were abandoned.

Representative BOLLING. Thank you.

Are there any other comments?

Mr. Reuss, do you have some questions?

Representative REUSS. Mr. Oxenfeldt, in your paragraph 10 in the last sentence you mention the—

Failure of prices to decline much during recession—which may be the pattern for this and many subsequent recessions—intensifies the burdens of those whose income has been reduced by the recession. Also, it eliminates the gain in value of accumulated assets that customarily took place during recessions prior to World War II.

I take it you mean accumulated fixed return assets, not accumulated equity assets, such as industrial stock, for example?

Who, in your opinion, are the sufferers and what are some of the measures which you would recommend to alleviate their suffering?

Mr. OXENFELDT. My reference was to anybody who holds fixed dollar assets. That would be savings accounts, commercial banking accounts, bonds, and large cash holdings.

Representative REUSS. If I may stop you at that point, where you identified the fixed dollar assets, what you are saying is that many of the same people that get hurt during an inflation also get helped during a recession?

Mr. OXENFELDT. There used to be that compensation.

To the extent that prices do not decline now, that compensating effect is gone.

Representative REUSS. Now, would you proceed to your suggested recommendations.

Mr. OXENFELDT. The recommendation I would offer would be to have no recessions and no inflations. I really think that is the only answer, sir. I do not believe that you can, nor would it be wise to try to, compel price reductions simply to restore some of the lost value of accumulated balances. There must be better ways of doing that.

Representative REUSS. You could, of course, by taking a look at certain governmental policies perhaps do something about the total price index.

I am thinking of the system of farm price supports, I am thinking of excise taxes and other governmental policies which do affect the overall Consumer Price Index.

Mr. OXENFELDT. All of these things have an effect on the value of accumulated assets. I do not think this should become a major goal of economic policy.

Representative REUSS. Then in saying that the measures employed to end the recession must take account of the sharing of the burdens of recession, I am right in thinking that all you need is vigorous measures which should be taken both to end recession and to prevent the resumption of inflation.

You do not envisage any particular coloration of those measures for any equilatarian reasons?

Mr. OXENFELDT. I thought the point should be raised because other people might place different weights on these objectives than I do. I think there are some who feel that the losses during inflation when added to by possibly inflationary losses during a recession, which is possible, might have an adverse effect on the value of accumulated assets and on our whole incentive system so that they might consider this a primary objective.

I do not. I do not agree with them.

Representative REUSS. Mr. Lanzillotti, you refer to certain direct public policy measures saying:

Therefore, short of direct policy measures, whose overall merits we may wish to examine in detail in the discussion, we cannot expect more flexible prices in industry generally.

I think we are at that point in the discussion now.

I would like to hear your explanation of some of them, both the proposed national social science foundation you mentioned, and whatever else you have in mind.

Mr. LANZILLOTTI. To begin with, I think I ought to make it perfectly clear that the data upon which I am basing the conclusions of this particular paper are limited to very large firms who are price setters or base setters or leaders in their industry.

With respect to the specific direct actions, I have in mind some of the suggestions already made to this committee. One proposal that would be more direct in its impact on price behavior, than perhaps general fiscal policy or monetary policy, is the suggestion of having public hearings and discussion in advance of contemplated general revisions in price structure in industries like steel and automobiles.

The advantage of this kind of advance notice by certain basic industries would be that hearings could be held before the fact rather than after the fact. For example, if firms in industries such as steel, autos, aluminum, or some other, wished to make a price increase, the public would be appraised of the cost-demand conditions involved, and if the companies chose to go ahead, they could. Thus, by informing the public and other interested parties before the fact, a more "restrained" action would be expected.

This represents, as I outline in more detail in my paper, what I regard as a kind of quasi-public utility status that some have suggested we accord to certain large firms and industries in our economy. While the suggestion has merit for special situations, I do not believe that we have any assurance firms will be any more restrained by this procedure on price increases than they already are by other public pressures to which they are definitely sensitive and which are considered in their price actions. I have in mind here especially the ever present threat of action by the Department of Justice's Antitrust Division, or by the Federal Trade Commission, plus the pressures of congressional committee hearings such as this and others. Also, I do not see that this arrangement would bring about any price reductions and I am not certain in my own mind, as Mr. Oxenfeldt has pointed out, whether this kind of action (that is, price restraint) is in and of itself desirable.

I would be glad to develop this point in more detail if you like, but this is one of the suggestions which has been made.

Representative REUSS. Though you are dubious of its effect on bringing about price reductions, a development which some of you at least feel is not only not essential, but maybe not desirable, what about its effect on preventing unnecessary and harmful price increases?

Mr. LANZILLOTTI. By an unnecessary increase, I presume you mean one that is not justified by cost or one that does not reflect demand influences. So you are speaking here of a price which is arbitrarily raised beyond a certain point for profit purposes. Is that what you mean by unnecessary price increases?

Representative REUSS. Yes, or the kind of administered prices which have been talked about throughout the discussions here.

Mr. LANZILLOTTI. As I understand your point you are wondering why this would not be a desirable measure to prevent that sort of thing?

Representative REUSS. Yes.

Mr. LANZILLOTTI. My point is first that I am not sure that it would. I think that in these industries firms have the power to raise prices and I say they are already restraining themselves on the upswing because of certain other pressures and I do not believe that this additional pressure would be more effective than working through the antitrust agencies. I frankly am not too much impressed, as a general policy, with appeals to industry.

I do believe that certain "industrial statesmanship" has been displayed, but I do not think that this is the sort of an area that we ought to develop and concentrate on in formulating policy toward industry. It may help, but I am not advocating it as a very effective means of bringing about the sort of thing in which you are interested.

Representative REUSS. What about the effect of studies, publicity, such as we are talking about, on wages which go beyond the point of recovering productivity gains?

Mr. LANZILLOTTI. Now, you are touching on a point which I think most of the panel members have emphasized here. Frankly, we do not really know much about the cost-price relationships in individual firms. This is a thing which we would need to know in order to determine for specific products whether particular price adjustments are justified on the basis of cost increases.

Representative REUSS. One of the suggestions is to find out more about cost-price relationships by getting the data in a specific case, whether industrywide or firmwide.

Mr. LANZILLOTTI. Unless the data are available in the form which would make it easier for us as economists and laymen to find out what the specific costs are, we would not get any further along via public hearings than we are at present.

My own feeling is that firms do not have data available in such a form that we can really tell what the costs are on individual products, and I question whether they use actual cost data in pricing. I find it difficult to understand the pricing of individual firms, particularly the large multiproduct firm, except within the context of a firm as an enterprise in which some products will carry more attractive margins or markups than others.

Some products will be carried by other products. As I tried to emphasize in my paper, I think there is not available, even to the firm, and they do not use, even where available, detailed cost figures in arriving at individual prices.

Now, if we could bring out this additional information, I, for one, would certainly like to have it, but in my own studies, and from talking to other people who have done research in this field, have not run across detailed price-cost data for specific products that would bring out the necessary relationships in which we are interested.

Representative BOLLING. Mr. Oxenfeldt.

Mr. OXENFELDT. I wanted to question the desirability of having all "public utility type" prices, whether you would have the kind of price system you want, whether you would actually want to limit price increases during revival to those that were "justified" by changes in cost and compel price reductions only when there were reductions in cost during recession.

This whole notion of an economy in which prices are proportional to cost is one that I do not believe any economist has ever explored thoroughly.

I, for one, would think this would take all the guts out of the price system.

Representative REUSS. I do not believe anybody has suggested a public utility approach with prices following costs up and down plus six percent.

I certainly agree that this would be a disastrous change in our economic policy.

The thing I thought we were discussing was a public device for focusing publicity, not on price reductions—those as far as I am concerned are simply splendid, no publicity is needed—but on price and wage increases in those pace setting industries—steel, automobiles—where because of the relatively small number of producers, there is something like administered prices. The suggestion which has been made in these hearings before is that, to the extent that there is a corporate attention to public relations, the mere existence of such study and publicity powers by a governmental agency would tend to make both labor and management more cautious in their upward pressures on wages and prices.

That is what I was talking about rather than any public utility concept.

Mr. OXENFELDT. I expect that the tendency of any such arrangement would be to use only the standard that cost increases alone are a justification for price increases.

By the way, I am not sure it would be a bad idea to apply that standard to a couple of pace setting industries, but for the economy as a whole, I think it would not work out. I don't know any authority who has claimed that it would.

Representative REUSS. Thank you, Mr. Chairman.

Representative BOLLING. I have a few questions.

I gather that the burden of your last paragraph, Mr. Alderson, is two points, and I want to be sure that I am correct in my understanding.

The last sentence would indicate in the first place that everybody involved in this process lacks the basic data and consequently the basic information with which to make wise and fully informed decisions.

Mr. ALDERSON. Yes.

Representative BOLLING. This requires not only a very substantial amount of effort in government, but also in business and in the academic field, so that we may come up with a body of knowledge which will give us the kind of economic intelligence on which we may all make rational decisions instead of the present situation where we are basically guessing.

Mr. ALDERSON. That is essentially what I had in mind, sir.

Representative BOLLING. Then the other point in mind is that there needs to be a lessening of, let us say, the hostility between the two decisionmaking, or the several decisionmaking sectors, and a greater understanding that inevitably one will impinge on the other and that there must be greater cooperation if the economy is to function at the highest level of efficiency.

Mr. ALDERSON. That is right.

Under our type of economy we cannot have stability and growth without wise action on both sides.

I would like to see industries and firms which engage in price administration become better administrators rather than trying to get rid of price administration.

In the broad sense it just cannot be done. You have to have a seller name a price and make his own decisions as to when he will change his price.

If I might give an example which might be useful, in particular cases where I have seen smaller firms acquired by larger firms the products previously made by the smaller firms thereafter had more flexible prices because the large firm had better machinery for price administration.

I know of individual cases where price flexibility was very substantially increased through acquisitions.

I am not suggesting that as a general program, but only to illustate the point of the importance of a firm really being in touch with its market and having the knowledge and the machinery and skill for making prompt adjustments to changing conditions of the supply and demand.

Representative BOLLING. Thank you.

Mr. Fouraker, there are several points in your summary that I would like to explore.

I want to be sure I understand what point 4 means and what these largely staple nondurable goods are.

Would you illustrate a few that would fall in that category?

Mr. FOURAKER. As I recall, they are essentially farm goods and consumer soft goods.

Representative BOLLING (reading):

> It was argued that these prices were more likely to be in the inelastic ranges of their respective demand curves.

I presume the reason that farm prices are relatively unelastic is fairly self-evident. What about soft goods? Is there an answer to the why on that?

Mr. FOURAKER. This would be for the same reason that the demands for farm goods are inelastic. These are necessaries that are purchased daily. There are few adequate substitutes and their prices individually are not an important part of the consumer's budget. This makes the demand for such commodities relatively inelastic.

Representative BOLLING. Then the next section is:

> Largely durable goods produced under relative monopolistic conditions. These prices were more likely to be in the elastic ranges of their respective demand curves.

Are these the ones whose prices indicate some elasticity?

Mr. FOURAKER. That is my presumption.

Representative BOLLING. This is again related to demand?

Mr. FOURAKER. That is right.

Representative BOLLING. Because the demand obviously is much more flexible there?

Now, your last sentence:

> In conclusion it is suggested that the policy implications of this study be endorsed only when they are consistent with the program derived from conventional price and income analysis.

Will you expand on that?

Mr. FOURAKER. I think what I had in mind was to avoid the implication that if these changes in relative prices are a contributing factor in the business cycle, an appropriate policy would be control of the prices. This is for the same reason I think that Mr. Oxenfeldt has discussed, that a free pricing system is, as far as I know, the most efficient allocator of resources and income.

Consequently, this analysis, I think, does suggest certain lines of action that are consistent with a free enterprise economic system, such as monetary and fiscal policy, and only in those instances would I derive policy conclusions from it.

Representative BOLLING. I see.

Somebody else spoke of the more flexible use of monetary and fiscal policy. Where was that?

Mr. LANZILLOTTI. I spoke in terms of "more refined" policy.

Representative BOLLING. What does refine mean?

Mr. LANZILLOTTI. In hearings before this committee, I believe, last year, and in some of the economic literature, the point has been made that monetary policy is rather crude in the sense that it hits different types and sizes of business differentially.

As an illustration, under conditions of rising interest rates generally and the Federal Reserve raising the discount rate, partly in recognition of the increased demands for funds, then larger companies with resources, its own reserves, and undistributed profits are better able to finance their expansion than smaller businesses.

This is an argument with which you no doubt are familiar. Part of this is getting beyond my own particular area of study, but the problem involves monetary measures that would be refined in the sense that more credit could be made available, perhaps a special agency for making more credit available to smaller businesses (if this seems desirable under conditions of general monetary restraint), and more control over semifinancial institutions whose activities are not subject to the authority of the Federal Reserve.

In the fiscal policy area, what I had in mind is some exploration of various types of policies, tax policies or special tax concessions perhaps, which would induce favorable effects on stability via impact on investment. For example, initial rapid writeoffs, which have unfavorable effects on investment at the wrong times, making it possible for these firms to put funds into plant and equipment for protection of bondholders instead of setting aside sinking funds for debentures.

I am not a financial expert by any means, but in talking this particular subject over with others working in this area it seems to me that we have not explored the possibilities of such direct means of encouraging business to maintain business expenditure under various types of conditions, minor downswings particularly and of curtailing expenditures in upswings.

These are some of the things that I had in mind, Mr. Chairman.

Representative BOLLING. This would carry an implication that in the present situation there are many insulations built in by action of the same policy body, making not the Federal Reserve, but the Government as a whole, which insulate certain individuals, or groups, from the effect of monetary policies.

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What you are suggesting is that the thing should be approached at the same time from a more consistent total approach with a greater understanding of all the policy implications of existing circumstances and a greater use of the ability to make policy create insulation, a more conscious use of it, let us say, than we have now.

Mr. LANZILLOTTI. Yes, I think it is all too clear that monetary policy has been quite effective in the past year and a half or so in curtailing expenditures. The effectiveness, I believe, is amply demonstrated, but the differential impacts it has entailed are things that we might not be very happy about simply because they may undermine the ultimate purpose of the specific policy action itself.

Representative BOLLING. Thank you.

I hesitate to raise anything that is currently controversial, but I cannot help doing it on the basis of Mr. Hollander's paper. I am not suggesting that the paper in itself is particularly controversial, but I wonder if I can get a comment from the panel on a piece of legislation that one understands, both through the grapevine and the newspapers, may be confronting the House and Senate fairly soon.

You spoke of retail price inflexibility—of retailers being limited somewhat by governmental intervention. One hears a good deal about the possibility of another fair trade bill.

I wonder if the panel would feel like commenting on the effect on price and price flexibility of fair trade legislation.

Mr. HOLLANDER. Perhaps I ought to respond to that first. The available evidence on the price effects of retail price maintenance leaves a tremendous amount to be desired.

I believe in the paper submitted to you I cited an article by Marvin Frankel, which appeared in the Journal of Business 2 or 3 years ago, entitled "Retail Price Maintenance, Fact and Fiction in the Findings."

The evidence he was able to gather from various sources and studies showed little statistical validity. More recent studies such as those by Bowman and Oaks do not add terribly much to what we know of price effects of resale price maintenance.

However, what evidence there is seems to suggest that when resale price maintenance accomplishes its purpose of placing a floor under prices, to that extent it tends to raise the level.

There is some tendency for the minimum price to become the maximum price as well.

Prices tend to narrow down. In the United States probably only 5 to 10 percent of all goods at the most have been subject to formal resale price maintenance even when it was considered legal in 45 States that had supposedly valid nonsigner clauses.

There are other ways in which manufacturers can also control prices so that sometimes the discussion of resale price maintenance tends to overemphasize its importance, both the proponents and critics at times see it of more importance than it is.

Basically in the field of electrical appliances it seems to have complicated distribution. It seems to have slowed up innovation in retailing and I think has generally adverse effects where successful.

Mr. ALDERSON. Could I add to that?

I would agree in general with Professor Hollander's conclusion. I have had considerable contact with the various types of price control legislation over the years, resale price maintenance laws, and the Robinson-Patman Act, and others.

With respect to resale price maintenance it is ironic that the legislation was passed in a period of depression and tailored to the presumption of falling prices, but for most of the period in which it has been in effect we have indeed had generally rising price trends.

So among the many things we don't know about resale price maintenance is how it would work in the kind of periods for which it was originally designed; namely, a period of falling prices.

Mr. LANZILLOTTI. I would like to comment on this particular proposal.

One thing which I believe studies of resale price maintenance, including some of the work referred to already here by Frankel and others, show that retail price maintenance which is ostensibly designed to protect the position of the small retail, in fact does not do this. It has not accomplished this particular objective for several reasons.

In the first instance the reasons why the small retail establishments fail are not due to the fact that the prices are held or not held by competitors. The evidence that is available suggests that the failures are due to lack of funds, rather poor management, and related items.

Also, violations tend to develop, deviations from the suggested resale price, as Mr. Oxenfeldt and I were remarking on the side. Resale price maintenance legislation probably did more, or as much as anything else, to bring on the discount house. As much as any one thing, in this instance is that in the public's mind a particular "fair trade" price is identified as the manufacturer's bona fide price. Thus, a discount house can offer an attractive proposition to a customer by offering to reduce prices below that known price to the consumer and, therefore, encourage many to buy from them.

I would also second the point that has just been made here by Mr. Hollander, that I think this type of legislation is designed, or, at least, has the impact of delaying or interfering with innovations in the distribution area.

I do not feel that this is the type of legislation that would correct the ills of the small businesses.

Representative BOLLING. So far I would gather that the comments added up to the fact that it does not do what it is supposed to do, and it is not very good anyway.

Mr. OXENFELDT. I would take a somewhat more bullish position on its doing what it is supposed to do, but I am strongly bearish on whether we should do that kind of thing.

I think that resale price maintenance does create a double standard. I think the small retailer does not comply with the fair-trade prices to the extent that the large one does.

In that sense, he not only is protected against being undercut, but he also has the opportunity to undercut the big fellow who previously could undersell him because he enjoyed economies of operation.

So if you want to help the small retailer, I think that this helps him. I do not think this is all he needs, however, to prosper. I certainly agree that he has other troubles and shortcomings.

On the other hand, I would maintain that resale price maintenance vastly simplifies and greatly strengthens manufacturers' efforts to administer prices. That is to say by virtue of allowing manufacturers to not only set the prices they charge, but the prices of all their retailers, the law greatly expands their area of control and this, if you like, increases the rigidity of prices.

Mr. LANZILLOTTI. I would agree with the latter part of that definitely.

Mr. HOLLANDER. This may be somewhat parenthetical, but I would like to suggest that Mr. Lanzillotti's remark about retail price maintenance bringing on the discount house be modified to say, "Probably helps it," because discount houses certainly antedated passage of resale price maintenance.

In the Library of Congress I was looking at some old issues of the American Legion magazine and saw an ad for association of Army-Navy stores. The ad I saw appeared in the American Legion magazine for August 1919 and it was a discounting buying arrangement that provided 5 to 15 percent discounts in such stores as J. Hudson, Detroit, Arnold Constable in New York, and so on.

Mr. LANZILLOTTI. I would accept the amendment provided we emphasize that it accelerated the development.

Representative BOLLING. Thank you.

One more line of questions.

Mr. Oxenfeldt, your ninth point:

> Social objectives—both economic stability and economic growth—probably cannot be achieved efficiently by altering the objectives and behavior of businessmen within our economic system. These objectives call for national action outside the pricing sphere.

Would you expand on that last sentence I read?

Mr. OXENFELDT. My reference here is to relying on fiscal monetary controls and other things in which I am not expert, to achieve economic stability and growth rather than to ask businessmen to set prices on the basis of what they believe would contribute to economic growth and stability.

I would want to keep my businessmen acting as businessmen and have my public policymakers make policy in those spheres where they can.

Now, I possibly have overlooked a possibile way in which businessmen could be directed to take price action that would benefit the economy. I do not know that they would ever know what was good for the economy. I do not know that this is a burden that should be placed on the businessman's shoulders.

Representaive BOLLING. Does that represent a conflict with the position that Mr. Alderson took earlier, that there should be a greater understanding of the objectives of policymakers in Government and in business, of each other's problems and abilities?

Mr. ALDERSON. I do not believe it does. When I said each side deploring the policymaking powers of the other, I was thinking of the kind of business sentiment that is quite opposed to the Government employing its powers with respect to monetary and fiscal policies, in the field of taxes and other fiscal and monetary measures.

On the other hand, it seems to me that Government, as Mr. Oxenfeldt has suggested, must recognize that the thing that we call administered prices is an essential aspect of the way our economy now operates. There is no way of getting rid of it.

I would like to see businessmen do a better job of administering prices and since their pricing policies are directed to their carrying out their plans, I want to see them better planners.

I feel that in that respect the Government through its investigative, informational services, could help make better planners out of businessmen, and if they had the information for better planning, better forecasting, what they then did would result, it seems to me, in better long-run prices and that would be in the interest of the economy as a whole.

Mr. OXENFELDT. I probably am speaking for the panel, but you would have to poll them. I don't believe we are in favor of administered prices as such, Mr. Chairman. I don't know on the other hand that we believe it is possible or desirable to get the equivalent of commodity markets with that high degree of price flexibility.

I would, myself, want to understand what kinds of market structure limit businessmen's power so that they must administer prices in a benign way.

My own inclination is to give them a minimum of power.

On the other hand, I do not feel that I can at least—there may be others who can generalize about the kind of market structure that gives you what you want.

I wanted to disassociate myself from any suggestion that administered prices are desirable.

I am inclined to feel that some degree of administration is inevitable.

I think, on the other hand, that we do not know and we could find out, by studies along the lines that Mr. Lanzillotti suggests, in what kind of market situations you get the kind of behavior that we would consider benign and where it is obnoxious.

Representative BOLLING. Are there any other comments from the panel?

Mr. LANZILLOTTI. I would like to interject a comment here, Mr. Chairman, along the same lines.

On the side of investment expenditures, as well as on the side of pricing decisions, I do not believe it is likely that any corporation is going to deliberately inject what it thinks is a stabilizing influence in the economy, for example, carrying forth business expenditure in the face of any adverse conditions, unless special considerations make it in the company's interest to do so, for example, replacing obsolete plant. I think that to the extent that firms know more about the behavior of the economy, then they tend to adjust their investment expenditures for the long haul.

I would like to second the point that Mr. Oxenfeldt has raised here, about the administered "price behavior." I would agree with him that this seems to be an inherent feature of industry, but I am not certain in my own mind that I would like to permit administered prices to the extent that firms could use their own discretion and their own power to administer prices to their own benefit.

I am not sure that is what Mr. Alderson had in mind, but if that is what he had in mind about the administration of prices, then I would take exception to it.

Representative BOLLING. Of course, there is another aspect of this. You talk about administered prices. They could be administered in a great many different places.

I presume your choice would be that it would be infinitely better for them, if they are administered, and if they are administered somewhat benignly, that they keep on being administered by business rather than by government.

We have had some discussions in previous panels of the advisability of adopting one device or another, a commission, public utility, and so on, to have a public opinion impact on administered prices.

The answer usually made by other panelists is that companies which are strong enough to administer prices today are also the ones that are most sensitive to public opinion.

I am not expressing my agreement with anyone of those points of view, but we have had a great deal of that kind of discussion.

I do not think we really come very much closer at any point to a decision as to how best to define and analyze administered prices, or, if they are undesirable, how best to end them.

Mr. LANZILLOTTI. I would add this further comment to what you have said, Mr. Chairman.

It might be more informative, that is, you might get more of a handle on this problem, if you looked at it in terms of the profit side of the picture. I am convinced that firms are more interested in administering—if that is the term you think is more informative in this context—administering their profit position.

The particular price in a particular area serves that overall company objective and I think it is the company objective that we might well concentrate on as well as the means by which this objective is accomplished.

What I have in mind here is the desire and the objective on the part of the firm of realizing a set percentage target profit over the long run.

I do not know that we have developed in economic theory or anywhere else any standard by which to appraise the reasonableness of profits in any given industry. The difficulties and the complexities I think are quite obvious, since we do not know the specific risk factors that are present in the various industries.

But what I would emphasize is the administered profit side of corporate behavior that seems to me to offer us more opportunity for a better understanding of industry pricing.

Representative BOLLING. Thank you.

Mr. Curtis?

Representative CURTIS. Mr. Chairman, I am going to refer to a point that was made in one of the other papers in another panel.

Mr. Bailey, of the University of Chicago, made this statement:

> The general opinion is divided sharply into two groups, those who think administered prices or monopolies are widespread and extremely important, and those who think such prices are nonexistent or of no great importance except in public utilities and other enterprise regulated by government.

He goes on in his paper to join the school of the second group that does not believe that they exist.

I would judge from reading Mr. Alderson's paper that he is sort of that school of thought, too. I was wondering how the panel lines up on that, or would they disagree that the line is so sharply drawn?

Is the panel of the opinion that there is such a thing as administered prices?

Of course, then, what does the term mean? I am not sure I know what the term means.

Mr. ALDERSON. I would say that obviously in the broad interpretation of the term, "administered prices" our economy is largely run on administered prices, but you regard that as a matter of form and not substance.

I would not agree with coupling administered and monopoly prices, as apparently Professor Bailey did, as if they were the same thing.

Representative CURTIS. The term has just come into vogue recently, it seems to me. Is that not the implication that is in it?

Mr. ALDERSON. The term was created back in 1936 or 1935 by Gardiner Means, a well known economist. Gardiner is in business. He has a firm in Virginia where he produces and sells something called Zoysia grass, which is supposed to be the marvel of the age.

But he sells Zoysia grass under administered prices.

Administered prices means that the seller must name the price because there is no auction or exchange, no kind of open competitive prices such as there are on wheat or cotton and so on.

Now, Gardiner Means does not monopolize grass. I am sure he would agree that there is no such necessary connection between monopoly prices and administered prices.

Representative CURTIS. Then getting to the definition, it seems to me the way "administered prices" is currently used popularly, it has that implication. It certainly seems to carry the implication that you can ignore economic factors, that is the result of a whim, as it were, of the person who administers them.

Mr. ALDERSON. I agree entirely that there is that implication in the term which is unfortunate and misleading. Every businessman who originates a product that is not made precisely in that form by anyone else, has to set a price on it because nobody else can price it for him.

He and only he is responsible for deciding when he must change the price.

Mr. OXENFELDT. I do not think, Mr. Alderson, that you mean to assume away the problem because of the difficulty of defining it. I think Mr. Curtis gave us an interesting way of defining the concept, a price which does not respond to changes in cost conditions or demand conditions.

An administered price is one that we do not teach our students about in elementary economics courses is another way of defining it.

I have only seen a reference to the interchange with Mr. Bailey in the press and I have the impression that he is both moderately right and substantially wrong. There are many more price concessions than meet the eye.

The survey that was made by Purchasing magazine does indicate that an awful lot of reductions have taken place in the prices charged.

On the other hand, most of these are tiny itty bitty shifts. This is where I think maybe you have his fundamental error; even in many industries which have suffered a very drastic decline in demand prices have responded slightly, if at all.

I think this is really what it is you want to talk about.

The term "administered prices" is one that makes it easy not to talk about that subject.

Representative CURTIS. That is what worries me about the term. Sometimes people seem to mean one thing; sometimes another.

Now, if we took it to mean the price that ignored the cost factors and demand factors, it still could be paying considerable attention to many of the factors that Mr. Alderson points out in his paper which go to make up the price that is decided upon, which are perfectly proper economic considerations although they could not be included under cost and demand.

I wonder if the panel would agree that what we are talking about, administered prices, reflects some economic factors, or is it just monopolistic?

In other words, you can ride herd on the market because you have control of it.

Mr. LANZILLOTTI. I would comment on that in this way:

You say, does it reflect any economic factors, and by that I interpret you to mean does the administered price reflect cost changes and demand changes?

I think that particularly in large companies you need to recognize that a firm may be circumscribed to a certain extent by market influences. It will consider demand perhaps. It will be sensitive to pressures of a congressional hearing. It will be sensitive to antitrust.

But within that context the discretion really remains as to what price will that firm in fact select for different products. It is the discretion, the control, over that price-setting mechanism some firms possess that we have in mind, when we are talking about administered prices.

I am not convinced that firms are going to be in the final analysis influenced only by those particular considerations which you term somewhat ancillary, public pressures, and the like.

Representative CURTIS. Let me interpose.

In your own paper you point out that price policy is formulated in terms of meeting profits and investment requirements. That would not exactly be your cost and demand in a sense, yet if prices were administered on that basis, formulated in terms of profit and investment requirements, that is paying real attention to the economic factors involved in an industry, is it not?

Mr. LANZILLOTTI. If I understand you correctly, Mr. Curtis, I am not stressing that. What I am saying is that it may be in the interest of a firm to price some things below cost and some considerably above cost—all geared to realizing the company profit target.

We have some examples in the papers presented here, as, for example, the pricing of original equipment items as against replacement items. It may be in the interest of the firm's overall profit position to price some products at cost or even below cost (cost in the sense of total per unit cost).

It may also be in the interest of the firm's overall profit position to take a pretty comfortable markup on it, something that would perhaps write off the investment cost in a year or two.

My point in the reference which you have quoted is to just this kind of approach to pricing by the firm in which it looks at the overall profit position in which pricing decisions are fit, rather than pricing individual products on the basis of the cost considerations pertinent to that product and the demand considerations pertinent to that product strictly.

I am looking at prices in the context of the firm as an enterprise. I am including price considerations, the power politics of interfirm relationships, plus other pressures mentioned earlier.

Representative CURTIS. Suppose a company, say Steel, administered its prices, based on its consideration of the profit investment formula, and did it on long range. That still would be paying attention to economics.

In other words, they could not just make an arbitrary thing, or could they?

Mr. LANZILLOTTI. I do not think we are in fundamental disagreement, Mr. Curtis. What I am saying is that they do take these things into consideration, but the market conditions are themselves not controlling in the decision that is made.

Mr. OXENFELDT. Isn't another way of saying the same thing that the company has the power to decide in what way it will respond to a change in market conditions in an effort to get the same rate of return that Mr. Lanzillotti speaks about?

For example, you may use a very high price, low sales volume approach to get a particular return or a very low price, large volume approach.

If I may continue, I think what, in effect, this panel has said is that we do not know, we really do not know how most businessmen set prices.

I would say this with a great deal of feeling, even about those cases where I participated in the setting of a price: that there are so many forces at work and so many people involved and so many things you take into account, what you end up with as a description, if you bothered to write down, is something that is most easily defended to a board of directors and not necessarily the truth, because you are not sure what it is.

This panel, I am delighted to see, is very anxious to have you bring about the kind of research that is needed to let us know how prices are, in fact, administered. We do know that there is administration, but the way it takes place and the effects it has and what percentage are administered one way rather than another, I, for one, do not know. I wonder if anyone knows.

Mr. HOLLANDER. One of the things that struck me about Mr. Bailey's paper is the fact that he exempted retailing. He said this was an area of administered prices but was no cause for concern.

> For example, virtually all retail trade is of this character. It is agreed that retailers' margins are essentially competitive and flexible, although from day to day the retailer has a wide range of discretion within which he could set his prices without immediate drastic shifts in sales.
>
> As many consumers are very price conscious, however, very large shifts in a retailer's sales would definitely take place after a moderate delay if his prices were substantially out of line either way.

The British economists who have been worrying a great deal about whether retailing is competitive or not have not come to an agreement. I feel Bailey has come closer to the truth. If we talk about administered pricing, either in retailing or industrial context, we can be close to market pricing and try to take into account cost and demand conditions.

But this does presuppose certain things. One is that the price administrator knows cost, knows demand, and much of the discussion emphasizes the areas of ignorance. Second, that he has the ability to shift prices, he is free of restrictions; and third, there are still questions with regard to the relationships of prices in multiproduct firms, such as retailers.

Mr. ALDERSON. I would like to take another cut at this matter of monopoly prices versus administered prices. I think, in a case like steel, for example, which has been mentioned, it is a question of fact

whether or not monopoly power exists which, in its conventional sense, means control over supply or control over a large enough segment of the supply to enable one or a few firms to lead prices for the industry.

Now, the fact that they administer their prices, that they have to publish pricelists, and from time to time make changes in them, is no different from the situation of the toothpaste manufacturer. Every manufacturer of toothpaste, a relatively small item in the economy, has to handle his prices in the same way. As we know, there is no national toothpaste exchange on which you can get competitive bids and offers on toothpaste.

The price has to be administered; there is no other way out.

I am trying to say it is a question of fact to be determined in particular cases whether monopoly exists, or oligopoly, or any monopolistic element that might be contrary to public interest in conjunction with administered prices.

I think it is unfortunate for the term "administered prices" to be used as if it implied monopoly. It is a matter of form rather than substance.

Representative CURTIS. I read it in the political arena because it is being used, by certain people at any rate, to imply that it is monopolistic, and it could be, I suppose.

I have a couple of other points I would like to make. One is that it does seem to me that, possibly, in some of these vertical empires you have really administered prices. They are just an accounting proposition, to a large degree. Yet that comes out and does reflect the market to this extent.

I know in talking to some large businessmen one gentleman told me that at one time he used to think small-business competitors of his were an anathema. After a while he began to think they were valuable, because he said a small business that was trying to compete against one section of his company gave him about the best check he had on the efficiency of the operation of that particular shop. And if his shop got so inefficient, then they would just contract with a small concern for that particular item that went into their process.

It may be, in these vertical empires, there would be some basis for determining how prices might be administered, because there it is just a matter of accounting. I wonder if anyone would comment on that.

Mr. LANZILLOTTI. I would not like to leave the implication here that the panel members are all of the opinion that the question of administered pricing involves the kind of pricing that Mr. Alderson has talked about so much here.

The emphasis in these hearings and other discussions and writings on this subject has been on those cases where the firm, in fact, does possess the degree of control over the market, and it can exercise the kind of influence over the market, where it can, in fact, tailor pricing to its own ends.

In referring to the continuum of administered prices, it is important to distinguish between the cases where, on the one hand, a firm has to quote a price, from that kind of situation where a firm can, if it wishes, set a price irrespective of the current cost and demand conditions. I think this is a real and important difference.

Representative CURTIS. I am glad you brought that up.

I, personally, think there is, and it lies in the definition of what people mean by the term "administered prices." If the term is going to mean one thing to one person and another thing to another, we had better avoid using the term and start using what we do mean, "monopolistic prices." Surely, all prices are administered in the sense as they are pointed out by the panel.

Mr. OXENFELDT. I am afraid if you substitute the term "monopolistic" for "administered," it does not improve matters.

Representative CURTIS. If there is an area where we do have in the economy what amounts to monopolistic price fixing, in other words, if the manufacturer can set the price he wants in order to meet his ends, his ends, of course, are economic; they can be growth; they can be one hundred and one things; at least he can fix it according to his ends.

Mr. OXENFELDT. This is a matter of degree. It is clear when you call it monopolistic that you don't like it and, similarly, when you use the term "administered," but both of them are just plain, meaningless, dirty words. We have no suitable vocabulary to substitute. I, myself, would prefer words like "objectionable" or "not objectionable." This change may be objectionable, too.

Representative CURTIS. What I suggest happens is that all get some good terms, and we politicians get hold of them.

Mr. OXENFELDT. That is right. You use up our words awfully fast.

Representative CURTIS. So that they lose their meaning. When I used the term "monopolistic" I actually did not intend it to have any improper overtones. I think a couple of papers brought this point out; that some large companies begin to talk about their prices in terms of setting it like a public utility.

A public utility is an administered price; I mean administered by law. So, if it is true that some of the corporations, big corporations, begin to talk in terms of their setting their prices like public utility, I think perhaps they are approaching a monopolistic setup.

It does not mean it would not be for the welfare of the people, as I feel utility pricing, theoretically, is, but it does give us an economic picture.

Mr. OXENFELDT. First, there are administered prices, to my knowledge, outside of the public-utility field, that are objectionable. Second, that there is a lot more collusion than most people in the cloisters imagine—that is to say, real, illegal practices. These are not to be taken lightly.

I would like to have that clearly on the record. On the other hand, I do think you have to recognize that a lot of businessmen feel that a gun is pointed at their heads; they do not know how they are going to keep their heads above water, and yet they still administer prices, as Mr. Alderson says. They have discretion; they have business policies, but they have discretion within such a narrow area that we cannot get worried about it.

Mr. FOURAKER. I think another aspect of the administered-price problem, apart from monopoly or competition, is one that was touched on earlier in the discussion. That is that prices, administered prices, particularly, are apt to reflect increases in cost much more rapidly than decreases; that is, they are flexible upward more than they are downward. This may be one of the contributing factors in the recent phenomenon of prices continuing to rise even in a depression.

I, personally, think this is a very serious problem. If this does, in fact, represent a structural change in the economy, I can see it squeezing the middle class out of some historic professional pursuits that are characterized by fairly stable incomes, such as public service and teaching, as cases in point. This, perhaps, requires an alteration in pricing policies in these areas.

Representative CURTIS. I like your phrase, "objectionable," because that makes more sense to me.

One suggestion was that certain companies can set their prices on the basis of meeting profit and investment requirements; that brought to my mind the question I asked some other panelists about how industry, certain industries, finance their growth and, I might say, their new products.

I suggest that there are two different ways, and there are two different economic ways, although I must confess the panel did not seem to agree with me.

One is to plow back investment, which means that it is coming right out of the consumer; it has to come out of the price.

The other way is by financing through new equity investment which, I suppose, will ultimately come out of the consumer, but it certainly will be spread over 30 or 40 years.

Now, I do not know whether it will be objectionable or unobjectionable, but I do note that United States Steel has had tremendous growth and has practically had no new equity issued.

In fact, there has been a great deal of recent growth in our economy that has come from plowed-back investment, almost exclusively, as opposed to new equity issue.

It seems to me there is a fundamental factor that might or might not be objectionable if certain companies have the power to administer prices in such a way that they can meet a profit-investment formula. I pose that for any comment you may wish to make.

Mr. LANZILLOTTI. I would like to comment on that, in part. As I interpret it, you are saying that, to the extent that a firm plows back its funds, this could be objectionable because, in order to expand as rapidly as they wish, they need to charge higher prices that will permit them to do the very thing you are talking about.

Representative CURTIS. They are financing all their growth if they did it exclusively that way. I think, traditionally, the American industry has grown through sale of their product, and I think it is highly desirable, but it does seem to me that the entire burden of financing growth and new product and so forth should not come from the customer. Some of that should come from the new equity issue which is going to the investing public and saying, "Do you have faith in what we are trying to do?"

Mr. LANZILLOTTI. I am not am expert in this field of equity financing, but I would tend to agree with your statement that it would be desirable if some of the financing of this investment came from sources other than the consumer.

The impact of this on the economy, I think, would involve weighing several considerations, among which, the very thing we are trying to learn here today, whether the price increases in themselves are destabilizing; or the investment expenditures, on the other hand, which higher prices make possible, are stabilizing or destabilizing.

This is something about which we are not certain.

I think the panelists here are all in agreement that we are not sure of the exact relationships here. I can see a stabilizing influence to the extent that a firm is able to, and does, maintain its expenditures over the course of the cycle that can exercise a stabilizing influence on the economy, but there are other destabilizing influences that are present; also, I am not very sure of the net effects of these price-investment relationships on the economy.

Mr. OXENFELDT. I was wondering about describing undistributed profits as something that comes at the expense of the consumer.

Representative CURTIS. Where else would it come from except from the price that the product is sold for?

Mr. OXENFELDT. I think I would, myself, prefer to describe it as coming at the expense of the stockholders. I would suppose that the price was set, as you would expect any price to be set, to take account of the cost and demand situation and good planning of the kind that Mr. Alderson endorses, and that these prices would give the businessman the highest rate of profit available under the circumstances. Then these funds get to be in a pot that the owners—or management—uses as it wishes.

It belongs to management, the owners, the stockholders.

Representative CURTIS. Yes, but it has come directly from the consumer.

Mr. OXENFELDT. Without wanting to quibble, one could equally well say it comes from the consumer's employer, because the employer gave the consumers money to buy the goods that yield the profit that the stockholders do not get.

Representative CURTIS. Then so we do not quibble, it comes, as I said, ultimately, I think any business money comes from the consumer, but the direct source of the money is the undistributed profits, is in the price paid. All I said was that equity capital is going to be paid by the consumer in prices eventually, but it is a spread over 30 or 40 years, depending on when you do recoup.

But certainly financing through equity is spreading it over more consumers than taking it out of plowed investment which comes immediately from the group of consumers that have bought in the preceding year or 2 years.

I am trying to direct attention to something that I think is a real economic factor.

Mr. OXENFELDT. I agree with you, sir. I would think that the case would be a little stronger though, if you did not say that the consumer either paid for it when it comes out of undistributed profits or is the source of the investment if you go to the capital market.

I think that economists are right in distinguishing functions and the fact that a man is part of a household does not make him a consumer. A man that puts money in a business is not a consumer, but an investor.

Representative CURTIS. Here is the difference in the price. A price, assuming it were administered to meet the profit investment formula, deliberately is set on the books at the price you are going to recoup what you put into research and development and marketing that product and you want to get it back 5 years, perhaps.

That is one way of financing growth of a new product.

Another way would be to go out into the equity market and finance it that way, which would be promising as it were, the stockholders

return on their investment over a period of X years of 8 percent, but not getting their capital back, maybe if they were promised a 10 percent dividend over 10 years they would get it back in 10 years, but still the company would not recoup the whole amount.

So there is an economic difference.

Mr. OXENFELDT. I agree.

Representative REUSS. (presiding). Dr. Talle.

Mr. TALLE. Thank you, Mr. Chairman.

If I say nothing else, I would like to say thank you to you gentlemen of the panel for your labors and for your further contributions here today.

Many years ago I used to work during school vacation time in grocery stores. I remember one grocer was sufficiently important, so that each Monday morning he would have the answer ready when the other grocers in that city asked him what the price of sugar should be that week. He would tell them and that was the price of sugar for that week.

Maybe you could call that following the leader.

Do you find in industries that the practice of following the leader is a part of administered prices, or is that not true?

Mr. ALDERSON. I think it is still with us and I agree with Professor Oxenfeldt that many of the deplorable or objectionable practices that we talk about in our classes actually exist in practice, but I feel relatively optimistic on that score.

I think businessmen, individual businessmen, are relatively much better informed today, they know much more about their market than they did in the thirties, they are more inclined to stand on their own judgment now than they were then.

I think personally that that is a stabilizing factor in the economy that is quite often overlooked, the extent to which businessmen are just getting to be better businessmen with better information and more skill in using that information.

On the other hand, I would agree entirely with the panel that there are still very great areas of ignorance both for the businessmen and for the economist and particularly in this matter of whether administered prices is a socially desirable practice, or not.

If it turns out to be an objectionable practice, I believe we would tend to agree that is often because of ignorance rather than intent.

We don't know enough to set a good price.

Mr. LANZILLOTTI. I would say that this would be a very good example, the one you have cited, of what I would call an administered price, one which a firm sets with the assurance that it will stick.

You have also made the point here that not all of the deplorable practices are to be found only at the manufacturing level. I would second that particular statement.

Representative TALLE. Does any other member of the panel wish to comment?

Mr. HOLLANDER. There has been a statement by one of the vice presidents of one of the Standard Oil companies, I believe, of Indiana, that the company follows the practice of being a leader on the way up, allows its competitors, particularly its small competitors, to be a leader in taking the market down.

I think this sort of practice is not uncommon. There are public relations reasons; there are economic reasons, for their holding off on

the downside of the market. They know that other people will take it down if they do not.

Whereas, they feel they are the largest ones in their market and they are the only ones who can take the price up.

So even price leadership turns out to be a fairly complex phenomenon. It may be available to a firm under some conditions, and not under other conditions.

Representative TALLE. Is there any other member of the panel who chooses to comment?

Thank you very much, gentlemen. We appreciate your excellent cooperation.

Representative REUSS. Mr. Riley.

Mr. RILEY. Yes, Mr. Chairman, I have two.

Mr. Oxenfeldt, in your summary you make the point, No. 7, that:

> It seems that prompt price reductions by industry during the recession would do little, if anything, to combat the recession.

Then you go on to point 8:

> Price reductions that might help to stem recessions are likely also to delay and reduce the momentum developed in the subsequent revival.

I don't recall the full development of that in your paper. Could you just elaborate on it for today's record?

Mr. OXENFELDT. I was suggesting here that a price reduction that did in fact increase sales would often do so by leading people to buy goods sooner than they were going to buy anyhow. As a result of this, the momentum that is so important in getting an upswing started would be sapped from the revival and cause you to languish on the bottom.

Mr. RILEY. Thank you. Now, the other question is one for the panel. It is one that I hope will reinforce Mr. Curtis' line of questioning. I would like to ask the panel whether in their opinion an industry that is characterized by strongly administered prices, if I may introduce a further qualification of the term, can typically administer prices within so wide a range that management can choose to price so as to finance capital requirements through plow-back of earnings rather than rely on outside financing? Does it have this choice, within a significant range, of a price that will give it surplus revenue to meet its capital requirements as an alternative to a lower price and lower revenue, coupled with reliance on the market for its financing?

Mr. OXENFELDT. I am sure no one answer will apply to all industry, Mr. Riley. I would suggest that a businessman in setting a price would not often, and certainly should not take into account what he wants the money for.

I refer here indirectly to something Mr. Alderson spoke of and it is true, some businessmen say I need more money for advertising and marketing, so they add to their price.

If they did what we teach in the classroom they would get as much profit as they possibly could under the circumstances—legally, of course. Then they would have the biggest possible pot for spending on marketing advertising, and, if they wanted to, to reinvest in plant and equipment.

So that in answer to your question, first to the extent that a company is in a position to make profit, it is in a position to make money which it can use for reinvestment. And the extent to which it will in fact

use funds for that purpose will depend on the balance of power within the board in distributing dividends.

So that you are really asking, and I am sure you intended to, how many companies or industries in our opinion are so blessed with marketing power that they can in fact get sizable profits, enough to keep their stockholders happy and finance the reinvestment desired.

I think it is a statistical question when worded that way.

We can see that many companies, at least since 1946, were able to do this. Whether between 1958 and 1966 there will be many companies that can do that is really a question.

Mr. LANZILLOTTI. I would support much of what Mr. Oxenfeldt has said here.

I could not generalize for the economy. I think it is even difficult to generalize with respect to a given company, except to say that in net a firm having sufficient relative size in the industry and sufficient absolute size in the sense of financial resources, can do the sort of thing that you are commenting on. A firm of the administered type variety can set certain profit objectives for itself and have a fairly good assurance that over a period of time that particular objective will be realized.

A small sample of large companies that I have studied suggest to me that this is, in fact, a very typical approach to pricing, and these are specific profit targets.

This is a small sample. I would hesitate to generalize about this for the economy as a whole, but with respect to a relatively small sample of firms I think there is the ability there to set certain profit objectives and thereby to determine prices for the specific purpose of realizing overall an amount of profit which that firm can thereby plan, capital investment and expansion.

I think it needs to be emphasized here that one of the related objectives of large firms particularly is to maintain position in the market and maintaining position in the market is ordinarily not accomplished simply via a pricing policy.

I found again and again that firms were talking about market position in the sense that "we want to be there first with expanded capacity in order to maintain our position and possibly to improve it in certain specific markets where we believe we do not have the share we would like to have."

I see a very close connection between profit target objectives and market share positions. I think it is via the investment channel that they are able to realize both objectives over the long haul.

Mr. OXENFELDT. May I ask Mr. Lanzillotti, whether GM and GE would have been able to achieve the same objective in that way in the 1930's?

Mr. LANZILLOTTI. I think it is a very good point. I would say in the postwar period—I am not speaking of the thirties—that firms have assumed that the Government will follow through on its "full employment guaranty," and to this extent they have more assurance that if they price in this way the Government will step in under the provisions of the Full Employment Act and their assumptions will be correct assumptions in terms of their own planning.

To this extent I would say in the postwar period there is definitely this particularly tendency on the part of the small number of companies I have studied.

The economic climate is such that they can go ahead with this type of planning and the assumptions they are making are pretty correct assumptions for the post World War II period.

Mr. ALDERSON. I would like to say, and I believe the panel would agree, that in many cases where a firm is oriented toward growth target profit simply acts as a constraint on the growth objective. They want to grow as far and as fast as they can subject to making a minimum rate of profit, or making no more than a certain stated rate of profit.

That rate of profit frequently yields under such a policy a smaller total number of dollars of profit than the theoretical point of optimization.

I would like to make the other comment as to the power of setting target rates of profit. The price that is determining in many cases is the price to the consumer and if that is not satisfactory the consumer won't buy.

Whatever the automobile companies do, if the sale of automobiles is subject to the so-called price pack by the retailer, the automobile manufacturer may still fall far short of his projected sales.

So it is of some interest that this industry, which is one we have discussed here as a possible example of administered prices, is in effect coming to Congress and asking them to administer prices for them in the legislation that is now under consideration to require that a basic price be put on every automobile at the plant.

Mr. RILEY. Thank you.

Representative REUSS. Mr. Knowles.

Mr. KNOWLES. Thank you, Mr. Chairman. I have several questions that may clarify matters.

I might say in the beginning that I find this discussion of words interesting. I am wondering if we are not getting into a position where we have not merely obsolescence of plant and equipment, but semantic obsolescence as well.

Now, on administered pricing it seems to me there is an assumption in the discussion that has gone on so far that administered prices are more sticky, that is, more resistant to a decline than to a rise in demand, hence they tend to operate in a fashion which has been called in a previous day's hearings, by a ratchet—they go down less in depression, they go up more in recovery, and hence the trend of the price level is upward.

Does the panel want to comment on whether the statistical evidence is likely to support this assumption?

Mr. LANZILLOTTI. I do not believe that you can demonstrate the administration of prices very effectively by looking at the problem in terms of broad product groups or broad statistical indicators for short-term periods.

I do not think you can do this because even within a given group some prices will be rising much more rapidly than other prices.

Some may even be constant or falling. I think the way in which this needs to be done is in terms of specific individual price series for relatively longtime intervals in order to determine the net long-term rate of price changes.

In anticipation of this hearing I did just that for several dozen individual product series in the Wholesale Price Index. I was attempting to determine whether there was any long-run pattern here

in terms of the rate of price change as compared to year-to-year price changes.

I have not completed that work, but I must say it is not clear to me at this juncture that for firms which I believe have certain discretion, sufficient discretion to administer prices, that even for the products where they are price leaders, I could say that across the board for their varied lines administered prices were highly correlated with all of their profits. I could not say that on the basis of the price evidence I have looked at so far.

Then again, there is the problem that Mr. Oxenfeldt, I think, referred to in his own paper: Is a quoted price really an accurate reflection of prices in the market?

In some of the studies that I have done, I found that the ways in which firms can give concessions are so varied one wonders whether you can really generalize on the basis of quoted price statistics.

Mr. ALDERSON. I would like to suggest that certainly in my own experience as a management consultant there are cases where I think businessmen have tried initially in this recession to solve their problems of decreased demand by raising their prices. But I would not try to explain that through the existence of the machinery of price administration.

I would explain it by the established notion of businessmen that consumers had become quite insensitive on the matter of price because of the established inflationary trend.

I think there have been a number of individual cases where prices have been increased to try to make up the loss in volume, but it seems to me that that has little to do with administered prices as such.

It is an established belief about the trend of the economy.

Mr. OXENFELDT. I was going to suggest that you might find that the larger the amount of discretionary power, the greater the likelihood the prices will be reduced during a recession because sellers have confidence that they can get them back up when they want to do so.

The time you have the greatest stickiness and the ratchet working as I understand it, is when the sellers feel they cannot afford to upset things. It was hard enough to get people to live together peacefully as it is, without upsetting prices.

Mr. KNOWLES. Mr. Hollander?

Representative RUESS. Mr. Hollander, do you have something?

Mr. HOLLANDER. The ratchet effect perhaps is more clearly pronounced in regulation by the Public Utilities Commission.

Representative REUSS. Mr. Knowles.

Mr. KNOWLES. The reason I raise this question is the fact that the areas of administered prices, as this term is used by you, is most frequently illustrated by reference to automobiles and steel. I think that economists generally would agree that these were the two areas which, immediately after the war, had the most widely prevalent gray or black markets for their products. To a simple-minded classicist like me, this sounds like somebody is pricing his products below the market and that the demand would support a lot larger price and still take a lot larger volume of product.

If this is indeed what those black and gray markets inferred, then it would seem to me that you are saying that an administered price is one which, for whatever reason, the administrator of the price sets below what the free market will legitimately set at one time, and,

above what the market would otherwise let him get at other times. Thus, he completely fails to try to maximize his own profits.

This leads me to the conclusion that what you are talking about is the difference between ignorant pricing and knowledgeable pricing.

Mr. LANZILLOTTI. I would comment on the last part of that where you say this seems to you to be in ignorance. I think as a long-run proposition this type of pricing may in fact yield the amount of profits which the firm feels it would like to have over the long run.

I would agree with you that certainly in the group of firms that I would call administered price firms that there is this restraint upward. The restraint is exercised because of the very things brought out in this discussion, congressional hearings, antitrust threats and the like. Downward they may restrain themselves for other reasons, namely, they do not think the demand is sufficiently sensitive to price in times of changing anticipations.

But I would disagree with you that this stems from ignorance, I would rather say this stems from a rather careful, rational, and cool, calculated approach to the matter of pricing over the long haul rather than pricing from a very short-range point of view.

Mr. ALDERSON. Mr. Knowles, there is one thing that always bothers me about the long run, that is when does it run out? When do you take this profit that you have been anticipating in your current behavior or if you are doing that with 5-year horizon in mind, then when this year runs out do you just add another year and go on behaving the way you did before?

It is my observation in business that in many cases you do just like that so that you are perhaps chasing a will-o'-the wisp of long-run profit and behaving in the public interest whether you choose to or not.

Mr. LANZILLOTTI. I presume, Mr. Alderson, at least had me in mind in raising that question. I mean by the long-range plan what he had in mind when he is talking about planning—that the firm is in the long-run view all the time and it is constantly revising its short-range, intermediate, and long-range plans.

In revising them it has in mind the corporation or firm as an institution that will exist indefinitely, rather than a firm that may be in and out of the market.

This does influence across-the-board pricing.

Mr. FOURAKER. I would like to add that in the only study that I have done in this area we selected as a sample supposedly very able administrators in business, in the grocery business, and tested the hypothesis that their long-range profit plans were consistent with maximization in terms of their feeling of demand-and-supply conditions in the market.

We found in every instance it was.

So I think there is no necessary inconsistency between these various discussions of planned prices, of objective profits and so forth, and profit maximization, if the management is capable.

Mr. OXENFELDT. I would like to see the study Mr. Fouraker refers to. It strikes me it would be very difficult to even visualize a test of this because you have to imagine all other businessmen doing something different from what they are doing and try to project what will be most profitable for any one of them to do under changed situations.

That doesn't mean it has not been done, but I am not smart enough to see how it would be doable.

I would like to strongly endorse the description of reality you get from Mr. Lanzillotti's paper that businessmen do in fact adopt a rule of thumb, whether it is profit targets or markets share targets, something other than maximizing profit and I think they would not do it, and I would be interested in whether Mr. Lanzillotti would agree, they would not do it if they honest-to-goodness really knew what would be the most profitable price.

If you could prove that adherence to the rule of thumb would cost you X million dollars, they would scream and drop it, I am sure.

But in view of the fact they don't know the demand and are not always too clear on cost, this rule of thumb at least makes it possible to play golf once in a while.

Mr. FOURAKER. The rule of thumb practices employed by able businessmen are not necessarily inconsistent with profit maximization. You cannot prove a hypothesis of this nature, but the evidence we collected did not enable us to reject it.

Mr. LANZILLOTTI. I would say parenthetically that I agree with the interpretation that Mr. Oxenfeldt has made that these rules of thumb provide a satisfactory approach on the part of the firm. They simplify the price-making procedure.

In this instance they are unnecessarily incorporating in a very refined calculus the various variables that would influence a price decision in a cool, rational, profit maximization sense for a given instance.

These formulas simplify the procedure, and they are quite satisfactory as an approach to pricing so long as the overall goods of the company are realized.

Mr. KNOWLES. They are satisfactory, I take it, then, mainly because they overcome the difficulty created by the businessman's ignorance of: A, cost; and B, the external conditions over the future which will, in fact, determine what his most profitable policy will be.

Since he cannot determine that with any degree of, as we say, rational knowledgeability, such as economic theory often assumes, he adopts some rule of thumb that lets the chips fall where they may.

If he not only shows a lot of good judgment and intelligence, but also has some luck, the results of this will exactly and precisely agree with what would happen if he knew everything he should know.

But if it does not work out that way, there is no assurance that he will come up with a price which also will maximize his own profit.

Mr. OXENFELDT. I think that two points should be made here.

First, a rational businessman selling a branded product would not, even if he could, alter his price in my opinion, whenever there was a change in cost or demand because he does have a longer run—and he will be very much alive in this long run—objective. What I have in mind are the objectives of creating a brand image and a price position vis-a-vis his competitors that would make unwise, the change-it-every-5-minutes kind of thing you are describing.

Second, I do not think that this is simply a reflection of ignorance. I think it is partly that but I think it is more a reflection of the fact that our businessmen are really very confused as to what is proper in setting prices.

I think by now they believe much of what their public-relations men tell them to say. It must be very confusing, after a while, to know whether you are setting a price because we have a free-enterprise system, or whether you are a self-appointed public utility executive who

is trying to balance the interest of the consumers and stockholders and workers and so on.

So I think the morality involved in this target percentage is perhaps the major reason that it continues to survive.

Mr. KNOWLES. I would like to clarify one thing, my use of the word "ignorance." It is not used in its sometimes invidious meaning of the term, but merely to connote a state or condition as frequently met with among professionals as among businessmen and politicians in which you really wish you had a lot more knowledge and could use it if you had it.

We have been talking about people making price decisions. If we took a department store, of the sort we are familiar with in Washington, Woodward & Lothrop or Hechts—a multimillion dollar department store, how many people in that organization will be setting prices on any given day?

Mr. HOLLANDER. Probably about 100.

Mr. KNOWLES. And the number of top executives, obviously is only a fraction of that?

Mr. HOLLANDER. That is right. Pricing process in a department store has been described as an interesting conflict between the buyer who is interested in particular bits of merchandise, who makes particular judgments with regard to specific items, and his superiors and the controller who are thinking in terms of the statistical averages for the department as a whole.

The results of the department's operations, of course, are presented as statistics and I think this is one of the reasons why department store people are often described, quite erroneously, as simply applying a flat markup to their costs, but these are their targets again.

Mr. LANZILLOTTI. The department store example is a pretty good one to look at, in terms of understanding the large multiproduct organization.

I would like to emphasize here something that possibly you are driving toward, Mr. Knowles, that is, the joint-revenue aspects of pricing, which are very clear in the case of a department store.

I am reminded here of a case study or at least an example of some experimentation by a department store. I believe it was a department store in Chicago, which attempted not very long ago to rationalize products by departments and they were going to do this on the basis of cost revenue comparisons, except for, I believe, some types of activity like the restaurant which they wanted to carry in any event.

They went through a very elaborate accounting tour de force and they found out that the best thing they should do was to kick ribbons and laces out of the store because they did not pay their own way.

The management found out very quickly thereafter that they had to put ribbons and laces back since overall revenues fell as a result.

The point here is that even where detailed costs are available and known it is doubtful whether the firm would use the costs as economics might suggest they should use the data because of these joint-revenue considerations.

This makes the further point which I believe was stressed earlier, that in this sense costs are the result of policy and possibly other factors that go into pricing, rather than themselves the basis for the formulation of price policy.

Representative TALLE. I was wondering how discount houses go about determining their prices.

Mr. HOLLANDER. Well, in part I suspect some of them go about it by taking the prices charged elsewhere and then taking a certain percent off. But there does seem to be a great interest in thinking in terms of dollar profit per unit rather than a particular percentage of profit.

Also, I think, this has been particularly true of some of the smaller and more aggressive discount houses, a great interest in the effects of price reductions upon sales volume and a marginal approach to price, get our prices down and with our overhead fairly fixed we can return a profit on lower price levels.

There has been a great deal of interest in the last 2 years or so in department store circles, in what is called merchandise management accounting, which is not an accounting device so much as an approach to making a buying and pricing decision whereby the buyer tries to plan on a worksheet what costs will actually be incurred by the store if it sells various volumes of a given item at various price levels and then sets its price that way.

In this sense it gets closer to dollar price margin rather than percentage price margin.

Representative TALLE. A number of years ago I wanted to buy a tennis racket. I knew a good brand name. That name was assurance that the product was high class. Then I discovered that the same racket, of identical quality, could be bought at a much less price if the brand name was not on it.

So I bought that. Is there quite a little of that going on?

Mr. HOLLANDER. The Federal Trade Commission has just brought an action against the Borden Co. for selling condensed milk to people who place their own labels on it at a substantially lower price than applied to the Borden label.

The problem is that the consumer is not quite certain that he or she is getting the identical merchandise.

Representative TALLE. I suppose the buyer is not always sure that he is not getting, say, an article that is a "second" when he buys at a discount house.

Mr. HOLLANDER. This would be a problem of merchandise sold in the manufacturer's name.

Representative REUSS. I want to thank the members of the panel for their very helpful contribution. The committee will meet tomorrow morning at 10 o'clock in room P-38 of the Capitol for a discussion of the relationships between public policies and private price policies, price changes, and price relationships.

The committee is now in recess.

(Thereupon, at 12:30 p. m., the committee was recessed, to reconvene at 10 a. m., Tuesday, May 20, 1958.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

TUESDAY, MAY 20, 1958

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

The committee met at 10 a. m., pursuant to notice, in room P–33, the Capitol, Representative Richard Bolling (presiding).

Present: Representatives Bolling (presiding), Reuss, Talle, and Curtis.

Also present: Roderick H. Riley, executive director, John W. Lehman, clerk, and James W. Knowles, economist in charge.

Representative BOLLING. The committee will please come to order.

This morning's panel has been asked to concentrate upon the relations between public policies, private pricing policies, price changes, and price relationships. The participants have been asked to discuss how government policies enter into private pricing decisions; how public policy affects costs of productive resources and the proportion in which they are used, and the mechanisms through which public policy affects individual demand choices.

As you can see we are carrying forward our discussion of yesterday concerning private pricing policies, at the same time laying the groundwork for tomorrow's discussion which will be concerned with the general problem of formulating public policies for economic stability and growth.

As in previous sessions, participants will be heard in the order in which their papers appear in the published compendium. Each member of the panel will be given about 5 minutes in which to summarize his views without interruption. After the opening statements are completed the hearing will continue with a very informal discussion in which we want all members of the panel to participate freely along with the members of the committee, commenting upon other papers in the compendium as well as upon questions posed by members of the committee.

Our first panelist this morning will be Dr. Joel B. Dirlam, senior consultant, Boni, Watkins, Jason & Co., Inc. We are sorry that Dr. Myron W. Watkins, who was joint author with Dr. Dirlam in the Compendium paper, cannot be with us this morning.

Mr. Dirlam.

STATEMENT OF JOEL B. DIRLAM, SENIOR CONSULTANT, BONI, WATKINS, JASON & CO., INC.

Mr. DIRLAM. It is the assumption of this paper that the antitrust laws have on the whole contributed to the favorable economic environ-

ment under which this country has achieved such remarkable progress. The impact of our antitrust policy on pricing has been consistent; it has also been in the main negative. Its main thrust has been to determine how prices should not be fixed, rather than to fix them.

In our economy price regulation is usually carried out under certain procedural safeguards, and only after legislative determination that the industry concerned should be exempted from the presumption of competitive operation. In line with this principle, the Antitrust Division and the courts have, with justification, regarded with severity all price combinations or collusive price agreements even when they seemed to be protected by patents.

Unquestionably, to this action there has been a reaction. Patterns of behavior have evolved, perhaps unconsciously, that permit a certain amount of evasion of the spirit though perhaps not the letter of the prohibition of price fixing. Price leadership—in the steel industry, for instance—product differentiation—typical of the automobile industry—and pricing formulas such as zone or delivered price systems—have moderated the force of the antitrust thrust toward independent pricing. While the Robinson-Patman Act lies in the mainstream of antitrust tradition, it has not been administered so as to avoid unnecessary limitations on pricing discretion.

Of particular concern, because their broader implications seem to have been overlooked by the antitrust authorities, are the provisions in consent (and sometimes mandatory) decrees leading to permanent and detailed price regulation by Federal courts. The willingness of defendants to subject themselves to these controls undoubtedly stems in part from their anxiety to avoid the risk of treble damage suits. Consent decrees cannot be used as evidence—or even alluded to—by plaintiffs in such suits.

The danger of interference with competition resulting from some provisions in these decrees is illustrated by the requirement that United Fruit refrain from disseminating information on banana prices. By a provision in the International Business Machines judgment ordering the company to sell its machines at prices that have a reasonable relationship to lease charges the district court is saddled with continuing problems of complex financial analysis. Supervision over minutiae of Alcoa's pricing is required under a 1946 decree. The Antitrust Division is dissatisfied with the indirect price control it obtained in the pipeline decree, but can do nothing about it.

While there is, perhaps, more excuse for price control under mandatory than under consent decrees, because the judge is familiar with the economics of the firm and the industry by the time he hands down the decree, such interference is nevertheless difficult to defend. Thus, it is hard to justify the limits imposed by the 1946 decree on Alcoa's pricing freedom.

In order to avoid piling up of these directives, which the courts are too busy to enforce and whose value is questionable at best, certain changes are called for. In the first place, the Antitrust Division should be more insistent on, and the judiciary more sympathetic to, divestiture and divorcement clauses in mandatory or consent decrees. These provisions would tend to make perpetual price supervision unnecessary. Moreover, if treble damage actions were permitted to rely on consent decrees as evidence of antitrust violation, the incentive to settle by consent decree would be reduced.

Most important, the Antitrust Division should be more sensitive in proposing or accepting remedies for violations of the law to the dangers of direct interference with the pricing mechanism.

Representative BOLLING. Thank you.

Next is Dr. George E. Lent, visiting professor and director of research, The Amos Tuck School of Business Administration, Dartmouth College.

Mr. Lent.

STATEMENT OF GEORGE E. LENT, VISITING PROFESSOR AND DIRECTOR OF RESEARCH, THE AMOS TUCK SCHOOL OF BUSINESS ADMINISTRATION, DARTMOUTH COLLEGE

Mr. LENT. The subject of my paper is the price effects of tax changes.

The full impact of a tax on prices can be determined only by an analysis of its income and its announcement effects. All taxes have an income effect on the transfer of money income to the Government. And a tax may be shifted through a price change if it affects the terms of choice of the taxpayer with respect to the allocation of resources.

My analysis is confined to the latter process by which changes in major types of taxes may be shifted in higher or lower prices, as well as the implications of such shifting for the general price level. Tax revenues of governments in the United States absorb about 25 percent of the gross national product. Of the $105 billion or so collected in 1957, individual income taxes accounted for about 50 percent; corporation income taxes, about 22 percent; sales and excise taxes, 19 percent; property taxes, 11 percent; payroll taxes, about 7 percent.

While it is known that taxes of this magnitude have an important impact on prices and production, their is no agreement on the extent of the price effects of particular taxes.

For some taxes, no price changes are likely; other types may be shifted within the short run; and still others may be fully shifted only in the long run—a period long enough to alter the scale of plant.

It is generally believed that personal income taxes have negligible effects on prices. While a reduction in wages due to a higher tax may reduce worker incentive and therefore the supply of labor, the reduction in incomes may induce greater effort in order to meet commitments and maintain living standards. Except possibly for more highly skilled and professional workers, a supply of labor is relatively inelastic and personal income taxes have no perceptible effects on wages and salaries.

However, in industries where labor is relatively strong, tax increases may lead to demands for wage rises. If successful, higher labor costs would tend to result in higher prices.

Payroll taxes on employees are akin to income taxes in their effects on the supply of labor and wages. Partly because they are related to retirement and related benefits, they are even less subject to shifting. Payroll taxes on employers, however, become a part of variable production costs and tend to be reflected in higher prices.

Many economists are inclined to the view that taxes on business income lead to long-run price increases. To this extent, the corporation

income tax is a sales tax in disguise. Since corporate profits include cost of capital and management that are essential to business investment, there is some theoretical support for this view. Except in the case of regulated utilities, however, there is no clear evidence. Prices of goods tend to be raised by the amount of excise and sales taxes. Producers may absorb part of the tax in the short run and succeed in shifting it fully only after reallocation of industry resources, including the exit of some firms.

This adjustment depends on competive conditions and the elasticity of supply as well as the demand for the product. There is substantial disagreement as to whether specific excises or general sales taxes result in an increase in the general price level.

The shiftability of property taxes depends on the nature of the property taxed and its economic relationships. While taxes on the value of land are not considered shiftable, taxes on improvements to land tend to be reflected in higher rentals or ultimately in higher prices of goods and services.

Tax induced price increases tend to have secondary effects on wages and other prices. This is particularly true when they are incorporated in the Consumer Price Index and are reflected in higher wages based on escalator clauses in wage contracts.

It is also true of farm parity prices based on the prices of industrial goods. Wage escalator provisions directly affect only a small part of American labor, but wage increases of this group tend to have a chain reaction on wages in other industries.

The tracing of price changes attributable to changes in tax rates is thus uncertain in theory and frequently indeterminable in practice. Except in the case of excise and sales taxes, there is a wide divergence in theoretical views and conclusions. And even here there is no agreement with respect to effects on the general price level.

Representative Bolling. Thank you.

Next is Dr. Warren L. Smith, associate professor of economics, University of Michigan.

Mr. Smith.

STATEMENT OF WARREN L. SMITH, ASSOCIATE PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. Smith. The effects of monetary policy are transmitted to the economy through the market mechanism and are significantly influenced by the structure of the markets through which they pass. This can be illustrated with respect to monetary restriction by the experience of 1955–57.

The Government securities market occupies a position of key significance in the structure of the United States financial system, because various investor groups use this market as a means of adjusting their asset portfolios to changing conditions. To some extent, it serves as a conductor which transmits the effects of Federal Reserve action throughout the financial system, thus contributing to the effectiveness of monetary controls.

At the same time, however, it provides a means by which investor groups may, through rearrangement of their portfolios, escape the discipline which the Federal Reserve is trying to impose upon them. For example, during the 1955–57 period of credit restriction, com-

mercial banks were able to expand their loans to the private sector by a very large amount even though the Federal Reserve's restrictive monetary policy prevented the money supply—demand deposits and currency—from increasing significantly. A large part of this loan expansion came about as a result of bank sales of Government securities and the use of funds obtained through such sales to increase loans to the private sector.

It appears that this process, together with similar adjustments by other investor groups, served, in effect, to activate money balances which were previously idle, thus contributing to the substantial increase in monetary velocity which occurred during the 1955–57 period. The increase in velocity seems to have constituted a leakage which considerably reduced the overall effectiveness of the Federal Reserve's restrictive policy.

To the extent that the restrictive policy of 1955–57 was effective, its incidence appears to have been quite uneven as between major sectors of the economy. The effects on the various sectors are conditioned by such factors as established financing practices, the structure of financial as well as product markets, Government regulations applicable to the sector, and so on. Residential construction was perhaps affected more than any other activity, the effect being primarily due to the existence of interest-rate ceilings on FHA-insured and GI-guaranteed mortgages, which served to channel away the supply of funds as interest rates on competitive investments rose above these ceilings.

There are some indications that State and local governments were also affected significantly. Both theoretical reasoning and past empirical studies indicate that business expenditures on plant and equipment are not likely to be very sensitive to changes in monetary policy, and the 1955–57 experience seems to support this view. There are, however, some reasons for believing that smaller businesses were affected more than large concerns. It is doubtful whether the effects on consumer installment credit were very significant.

Monetary policy is superior to fiscal policy with respect to administrative flexibility, but the 1955–57 experience suggests that the lag between the time action is taken and the time the economy feels its effects is considerably longer for monetary than for fiscal policy. Furthermore, the apparent unevenness of the effects on different sectors appears to controvert the widely accepted view that general monetary controls are nondiscriminatory. Moreover, the uneven incidence seems to make general monetary controls an inappropriate means of stabilization under some circumstances. These considerations suggest that selective controls in some sectors might be a useful supplement to general control. In particular, the apparent leakages resulting from shifts between Government securities and private loans by commercial banks suggest that some control over the composition of bank portfolios might be very useful.

As an antirecession device, monetary policy is probably less effective than in time of inflation. To some extent, however, the effects are similar but with directions reversed. For example, easy money seems likely to have its greatest effect in the field of residential construction.

Monetary policy is a potentially useful instrument for promoting balanced economic growth and stability, and the possibility of strengthening our monetary controls should be thoroughly explored.

However, efficient policy for stability and growth requires the coordinated use of monetary and fiscal policies; hence it would also be desirable to increase the flexibility of our fiscal controls.

Representative BOLLING. Thank you, Mr. Smith.

Next is Mr. Murray L. Weidenbaum, senior operations analyst, Convair Division, General Dynamics Corp., Fort Worth, Tex.

STATEMENT OF MURRAY L. WEIDENBAUM, SENIOR OPERATIONS ANALYST, CONVAIR DIVISION, GENERAL DYNAMICS CORP.

Mr. WEIDENBAUM. Thank you, Mr. Chairman.

I should like to point out that the views I express are my own and not necessarily those of the General Dynamics Corp.

The Federal Government can exert an important impact on private price formation through its spending programs. As a major buyer of privately produced goods, it sets or strongly influences prices. As a seller of the goods it produces or buys, the Government affects the costs or prices of and demand for privately produced goods. Also, acting as a promoter, the Government reduces business costs and increases business demand by subsidizing private production, making funds available, furnishing facilities, and aiding in the development of new products.

As a purchaser of goods and services, the Federal Government can affect price levels in varied ways. It can establish a floor under the prices of some commodities by guaranteeing a market at the support price. It can strongly influence the prices of other commodities through its dominant position as the major customer.

Also, it can affect the labor costs of business firms by setting wage and other working standards in its contracts and through its position as a major employer of many types of skills and professions.

Under conditions of relatively full employment, the Government can cause general price increases through bidding against business firms and consumers for available goods and services or even through "announcing" that it intends to increase its volume of purchasing.

Similarly, the Federal Government can affect price levels through its position as a seller of goods and services. It can set the price at which it sells specific commodities, often thus establishing a ceiling on their prices. When combined with purchase programs, the Government thus can determine the prices for these items charged by all sellers.

When it is in a monopoly position, the Government, of course, can set the price unilaterally and, hence, determine the cost to private firms. It can also sell to certain classes of buyers at less than market prices, thus reducing their costs compared to buyers who obtain the items from commercial sources. In addition, the Government can produce and sell goods and services for internal Government use, thus reducing markets for private business firms.

The Federal Government, through its expenditure programs, can affect private price policies in other ways. It can lend funds at lower than commercial rates, reducing the interest costs of the recipients. It can also lend to recipients who otherwise would be unable to obtain funds, thus enabling them to engage in various investment and production programs.

The Government can subsidize the private production or sale of goods and services which business firms would not otherwise produce or could not afford to sell at the subsidized price. It can provide facilities to private firms to enable them to engage in production. These facilities may not be provided commercially or only at higher rates.

Furthermore, the Federal Government can make available to business firms the results of the research it conducts and it may provide other information and assistance to reduce costs and increase efficiency. Finally, it can encourage the public to purchase certain types of goods and services, thereby altering the structure of demand.

In some basic sectors of the economy, notably agriculture and mining, Government programs often exercise a decisive influence on prices. In contrast, Government spending programs exercise an insignificant impact on retail and wholesale trade.

In other sectors, such as manufacturing, Government programs have varied impacts on prices. In the aircraft and shipbuilding segments, the Government is a major factor; however, neither Government purchases nor sales are an important factor in the manufacture of food, apparel, furniture, and related programs. Similarly, while Government programs have an important influence on the demand for medical and educational services, they have little impact on other service areas, such as personal services, repair services, and business services.

A number of implications can be drawn for public policy purposes. For example, exceptions may be desirable in any general policy to reduce Government spending during an inflationary period. Certain programs, such as subsidies to permit private sales below cost or to increase needed production, may contribute to a reduction in price levels. It might be preferable to maintain or even to increase such programs in the face of a general reduction in Government spending.

Such a period might also be appropriate for reviewing the prices charged for Government-produced goods and services. Particularly in view of the cost increases which are likely to be occurring, price increases might be needed to cover costs. Such increases in charges would be similar to tax increases in their anti-inflationary effect.

The Government could also reduce its stockpile of material and equipment to help alleviate shortages and dampen price rises in the private economy.

Conversely, during a recessionary period, it might be desirable to restrict Government programs which curtail demand by maintaining private prices artifically high. The Government funds thus made available could be channeled instead into programs which increase private demands. In addition, scheduled increases in prices of Government-produced goods and services might be postponed during such a period. Also, the Government could slow down its disposal programs for items in long supply in the private economy, thus tending to strengthen weakening markets.

During either inflationary or deflationary periods, it may be desirable to adjust nonexpenditure programs, such as loan guaranties and other assistance, in a similar manner as direct expenditure programs for economic policy purposes.

If any single conclusion emerges, it is that the price effects of the Government's combined role as buyer, seller, and promoter need to be considered in formulating Government programs designed to promote economic growth and stability.

Representative BOLLING. Thank you.

Next is Dr. Simon Whitney, Director, Bureau of Economics, Federal Trade Commission.

Mr. Whitney.

STATEMENT OF SIMON WHITNEY, DIRECTOR, BUREAU OF ECONOMICS, FEDERAL TRADE COMMISSION

Mr. WHITNEY. The views in this paper are my own, as the Federal Trade Commission has no official position on these matters.

My paper reviewed such statistics as I could find on the price consequences of antitrust dissolution cases—against the oil, tobacco and powder trusts in 1911 and 1912, and against Alcoa in 1945—and of cases dealing with price agreements of conspiracies—against a gasoline price-support program in 1940, the cigarette manufacturers in 1946, and the cement basing point system in 1948.

These dates are those of the controlling court decisions.

The statistics proved little. Aside from the introduction of a new, cheap type of cigarette in 1913, antitrust price effects were evidently obscured by more powerful demand and supply factors.

I pointed out, however, that prices are likely to be lower and more flexible in a competitive economy as protected by the antitrust laws than in a monopolistic one. Section 2 of the Clayton Act, according to one school of economists, is an exception which makes for price rigidity, but on this ticklish question I concluded that there is no proof.

I gave my reasons briefly for not going along with certain other proposals for influencing prices, such as direct regulation, or reinterpretation of the antitrust laws to break up large corporations and thus create price competition.

Nor am I convinced by the proposal that industries should justify price increases before a public body armed with the power of publicity. What criterion will the public body rely upon? If it is to be cost, my first reaction is that our traditional profit and loss economy should not be abandoned so lightly.

I do favor thorough economic studies of prices, their determinants and effects. We have too little such information, as several writers in the symposium have pointed out.

Today's issue in the area of individual prices—and I did not discuss monetary policy and the general price level—is whether they should be reduced to stimulate buying. Some of the foremost economists of our time, including J. M. Keynes and Professor Slichter, have argued that the first price reductions may lead merely to hopes of more, and thus to postponement of purchasing.

Nevertheless, I lined up with those who believe that an essential part of a rounded recovery program is more price cutting than has occurred—and, of course, some is already in progress. The proposition that when demand slumps prices should be held firm as a symbol of confidence, and production be allowed to fall, is one that I cannot disprove, but cannot accept either.

Although I did not say so in my paper, I believe the most desirable areas for price cutting are in consumer durable goods and housing. There is less need for it in nondurable goods and services; and in

capital goods it would do less to stimulate buyers, who are influenced by the outlook for profit more than by price.

If prices are reduced but costs are not, producers will of course run out of cash unless demand responds strongly, and their incentive to give employment may fade even sooner. In 1957 the average profit margin on sales in American manufacturing, before income taxes, was 8 or 9 percent. If a 10 percent price cut could restore the 1957 level of sales, the average company would be losing money. Many profitable and well-financed large firms could carry on successfully, but what would happen to their smaller competitors?

I feel, therefore, that prices cannot be brought down enough to make a strong contribution to recovery unless costs come down too—and the prospect for this seems dim. There are certainly more ways to cut costs than by reducing wages, but just as certainly union-bargained wage increases are inconsistent with lower prices. Some recent speeches and articles criticizing failure to cut prices, but saying nothing whatever about costs, mystify me.

Along with price reductions, I would favor continued easy money and a planned deficit. Elimination of the $3 billion of Federal excise taxes on consumer durable goods and transportation would facilitate price cutting.

Unless all such measures are taken quickly and together, they may lose much of their effect. The less price cutting we get, the more seeds of inflation we will be sowing—and these will have to be rooted out when prosperity returns by raising taxes, creating a surplus, and hoarding it.

In view of the effects of unemployment and reduced imports on our relations with Latin America and the free world generally, recession and not inflation is the present danger.

Representative BOLLING. Thank you, Mr. Whitney.

Do any of the members of the panel wish to comment on statements of fellow panelists, or other statements in the compendium, or to expand on any point they made?

Mr. SMITH. I would like to raise a couple of points about Mr. Whitney's paper.

One is that there seemed to be an implication in the first part of the paper that an effective antitrust policy is likely to bring about a lower price level. This isn't necessarily true, because the purpose of the antitrust laws, as I understand them, is not to lower the price level, but to bring about an improved allocation of resources. For example, if you break up a monopoly in one sector, this is likely to bring the price of the product or products of that sector down; but it will do so by expanding the output of that sector. And if the economy is fully employed this is going to mean resources are drawn away from some other sector, pushing up prices somewhere else. The gain consists in achieving an allocation of resources which accords more closely with consumer preferences.

The second point is with respect to the question of price flexibility as a factor contributing to recovery. It is rather doubtful whether price flexibility would do very much good in bringing about recovery, because one must remember that as prices and costs come down, incomes come down too. That is, since the income of the economy is derived from selling products, if products are sold throughout the economy at 10 percent lower prices, this is going to bring incomes

down by about 10 percent. This will reduce total monetary demand in about the same proportion. Whatever effects a falling price level may have on the level of employment and business activity are quite indirect. They are quite different from the effects of the fall of a single price on the output of a particular product. And if one analyzes them, it seems they are pretty weak. In fact, I am rather inclined to think that extreme price flexibility would do more harm than good in a recession period.

However, there is something to be said for a limited amount of price flexibility in order to avoid this ratchet-type inflation; when prices never go down during recessions but do go up during inflations, the long-run effect is an upward drift on the price level. Some price flexibility in a recession strikes me as a good thing as a means of balancing out the price increases we get during inflation periods.

Mr. WHITNEY. With regard to Professor Smith's first point, he is correct. I should not have implied that prices throughout the whole economy would be lower. I meant the prices in the industries which would otherwise be monopolistic and which, due to the protection of the antitrust laws, are not monopolistic.

I phrased that too hastily.

Now, with regard to his second point, I, of course, am only advocating price cuts in certain areas. Whether the whole price level would fall, I wasn't commenting. I would say that insofar as these price cuts put into motion or help put into motion recovery, the whole price level might eventually be stable or rise.

Representative BOLLING. Any further comment from any member of the panel on this or any other subject?

Mr. DIRLAM. I would like to ask a question of Mr. Lent.

When you considered personal income taxes, you considered them primarily in the light of their effect upon the supply of labor.

I wondered whether there was the possibility that the structure of personal income taxes and the relationship of income taxes to capital gains tax might not affect the direction of investment in such a way as to, let us say, distort the flow of resources into some industries.

I am thinking particularly of the oil industry where it seems to me that the high level of the personal income taxes, the high brackets, plus the capital gains provision, plus certain allowances for oil production companies, may have channeled more investment into oil exploration than would otherwise have come forth.

Mr. LENT. I think you are quite right. I haven't examined many of these interstices of the tax structure in my paper. But certainly to the extent that we have depletion allowances which permit oil companies to exploit new oil reserves more or less taxfree, and to the extent that we provide for expensing of exploration and development costs, I think the tax system has contributed to undue allocation of capital resources into the oil industry. This would also apply to other industries where we have similar provisions, such as the mining industry.

And I think this tax advantage has contributed to the present glut of oil.

I do feel that the tax incentive given to exploration for oil and for minerals has resulted in some distortion of our resources and undue investment in favored areas, as compared to more fully taxable industries.

Mr. DIRLAM. I was wondering also: Isn't there a general tendency to shift from areas which would result in taxable income at the higher brackets into income that would be taxable at maximum under the capital gains provision?

I wondered whether you thought that had any broader impact on the resource structure.

Mr. LENT. Well, I think possibly in this way: That there has been a redirection of investment in corporations that retain rather than distribute their income for the purpose of realizing gains rather than ordinary income which would be taxable at the higher surtax rates.

And there is considerable evidence that this development has taken place. How significant it is, I just don't know.

Representative BOLLING. Any further comments?

Mr. WEIDENBAUM. Professor Lent has a statement here in his summary to the effect that the supply of labor is relatively inelastic.

I wonder, Professor Lent, do you have in mind price elasticity or elasticity in terms of changes in income tax rates?

Mr. LENT. Price elasticity.

Mr. WEIDENBAUM. The reason I asked is that I had in mind the fairly significant expansion of the labor force during the early stages of World War II. Women and younger workers entered the labor force; older workers remained in the labor force. The increment in the labor force was above and beyond normal growth.

And I was wondering whether you felt that the increase in wages had some effect there on the expansion in the labor force.

Mr. LENT. Well, I rather guess the expansion of the labor force was also patriotically motivated in part.

Don't forget this period was also characterized by a considerable amount of absenteeism.

In fact there was quite a serious absentee problem in the aircraft industry.

But, studies of Senator Douglas and of the others have come up with the conclusion that the supply of labor, that is, the quantity of labor offered at various wage rates is inelastic, and some believe, is characterized by a negatively sloping supply curve.

That is what I was addressing myself to in particular, these studies that have been made of wage rate elasticities.

Mr. WHITNEY. I failed to comment on Professor Smith's point that cutting prices and costs cuts incomes; hence, is in principle defective.

Now, in fact business firms of all sorts are very actively cutting costs now as far as they can. And they have always done this in recessions. They are implicitly cutting incomes by doing that. There is no doubt about it. It has always been considered an essential part of the recovery process. That is a paradox. It would be a paradox also to raise incomes at the expense of raising costs. But if it is false to cut costs because it cuts incomes, perhaps one should advocate raising incomes, even though it raises costs.

It seems to me that each does contain a paradox. The answer therefore must lie in balance. Proper balance now, with consumer buying power low and consumers hesitant, lies on the side of the lower costs and prices rather than on the side of the higher costs and prices.

Representative BOLLING. I would like to throw in something at this point in line with part of the preceding discussion.

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The figures I have indicate that in August of 1957 the personal income was $347.3 billion. In April of 1958, $342.8 billion, which is a drop of $4.5 billion, or roughly 1.3 percent.

I wondered if there would be, in line with this part of the discussion a relationship between that relatively small drop in personal income and the relative rigidity of prices during this particular recession.

Mr. SMITH. I think it is true that the rigidity of wages and prices has contributed to the maintenance of personal income. I would just like to say in general that I don't think either reducing wages or increasing wages is a very satisfactory recovery device. Some groups advocate cutting wages as a means of reducing costs and increasing employment; and that group tends to overlook the fact that wages are incomes. And other groups advocate raising wages as a recovery measure, looking only at the income side and forgetting that wages are costs. In the main, changes in the wage level in either direction are not likely to help very much to induce recovery, because the fact is that changes in the wage rates unless they are balanced by changes in productivity change costs at the same time that they change incomes. There is perhaps a little more plausibility to reducing them than increasing them, but I don't think there is very much to be hoped for in either direction. The main reason for some flexibility is to balance the tendency for prices to go up in inflations in order to keep the price level over the longer run reasonably stable and to prevent this ratchet effect that really bothers me, that prices stay stable in recessions and then go up in inflations.

Representative BOLLING. If I may interpose this: How do you handle this in recessions?

If you want a certain amount of price flexibility to prevent that ratchet effect or this business of moving up to a higher plateau each time—never coming downhill really—what is the effect on recovery from the recession?

Mr. SMITH. I don't think it has very much effect one way or the other. I am inclined to think that a really drastic fall in prices might do more harm than good because it might set up the wrong expectations, but moderate declines in prices that reflect the tendency for costs to fall as output contracts in the individual firm and moderate flexibility of wages would be all to the good.

Representative BOLLING. Well now isn't the exact reverse true, certainly in some of the durable goods fields; that the costs don't fall, and that the overheads involved are such that the unit cost certainly will go up—the overhead remaining very much the same, but the production workers—the number of production workers involved going down.

Is there anything to prove that unit costs fall?

Mr. SMITH. Of course, prices should be related to variable costs not to fixed costs as they fluctuate—but as you say, even variable costs in the steel industry, for example, seem to be constant as output changes until you get close to the capacity of the plants. This is one of the reasons why we do have rigidity of prices, and it means that if you are going to get product prices down, you must have some flexibility of factor prices.

Representative BOLLING. Mr. Reuss.

Representative REUSS. Mr. Whitney, I certainly agree with you that vigorous enforcement of the antitrust laws is one essential in establishing a competitive economy.

I would like to go on, however, to your lack of enthusiasm, shall I say, for the proposal which has been made repeatedly in these hearings that in certain strong industries at least, certainly including steel, proposed price increases should be the subject of examination by some governmental body, perhaps the Council of Economic Advisers, which would then bring to bear the force of publicity on the validity of the proposed price or wage increase.

You say of this proposal that—your first reaction is that our traditional profit-and-loss economy should not be abandoned so lightly.

Well, isn't that a rather stern view of this modest proposal?

Mr. WHITNEY. In other words, you feel it is quite an overstatement.

If the Commission were to receive the evidence on a proposed price increase and were to say we do not find this justified by your costs, your cost justifies the following price, but not this price, it sounds to me as though the Commission is requiring the industry to adopt cost-plus pricing.

Representative REUSS. May I interrupt you right there? I think we are slaying a strawman there. I haven't really heard that proposal advanced.

What I have heard advanced is the proposal that in the case of a proposed price or wage increase in a strong industry, a public body, perhaps the Council of Economic Advisers, be authorized to examine the equities of the price increase to point out its absorbability or nonabsorbability in the profit structure, to comment perhaps on the general wage structure in that industry, vis-a-vis the wage structure in other industries, and then to let public opinion play its role in influencing the management or the leaders of the labor union, as the case may be, on how seriously they want to press for their proposal.

It is thought, particularly in public relations conscious industries, and in public relations conscious segments of the labor movement, that this might have some effect.

I wonder whether you really think a proposal of that nature would tear up the American profit-and-loss economy?

Mr. WHITNEY. In what you say I haven't yet seen any other criterion than cost.

I believe you meant to say: Is the cost increase that will occur absorbable by the industry?

Representative REUSS. Yes. But I haven't said as you did, that the public body will say: "Look, you can just have cost plus 6 percent."

The public body would say: "Look, this proposed price increase would give you cost plus 20 percent, and while we don't say how much is enough, we call to the attention of the public that in this and in this and in that industry they seem to be getting by very nicely with much less." Historically in your own industry here is what a typical profit has been.

Therefore, in view of this, and this, and this prognosis about the future, the Council of Economic Advisers are not convinced that this proposed price or wage increase is in the public interest.

Mr. WHITNEY. I feel what you say still justifies my position. If the industry is to be told that you are asking for a 20-percent profit

that is too much, and they come back and say, we will revamp it to 15. Then you begin to analyze it more carefully—15 is too much.

Finally it turns out that 12 percent is justified by their history, which in mind should have no real proper bearing on their meeting the current situation, and secondly, it is justified in public opinion which to my mind is probably uninformed on this subject, it seems you are getting at some figure—it may not be 6 percent—but some figure which is accepted by public opinion which is what they will be allowed to make without being condemned by some public commission, even though it has no actual legal authority.

Representative REUSS. May I pursue this a moment?

What you are saying is that there are no objective standards evolvable by mortal man to guide labor and management in their price-increase policy?

I am not talking about price decreases now, because I do not think they can be reached by this, but I am talking about increases—price increases. And this goes back to what Mr. Smith said a moment ago, that really if you can stop exaggerated price increases in good times, that is probably a better way of leveling things out than to try to reduce prices in bad times.

The latter is not very realistically possible.

Mr. SMITH. Could I comment on that?

Representative REUSS. Yes. I brought you into this.

Mr. SMITH. Just briefly: I do not think you can entirely prevent prices from going up. As a practical matter, in good times they are going to go up a little.

Representative REUSS. We are talking about slowing.

Mr. SMITH. I quite agree with you that every effort should be made to prevent them from going up. But unless you can bring them down somewhat during recession periods, you are still going to have this ratchet effect.

Representative REUSS. All right.

Let me go back to my question of Mr. Whitney, which is: Are you, then, suggesting there are no objective standards to govern what price and wage increases in an inflationary economy are in the public interest and what are not?

Mr. WHITNEY. I have not seen any such standards brought up yet.

Since I am not making the proposal, it isn't obligatory on me to set the standards.

Representative REUSS. You have not seen any?

Mr. WHITNEY. None that have convinced me.

Professor Lerner, with some support from Professor Ackley, suggests that price increases should be allowed if the industry is operating at full capacity, which would mean, in all probability, that where profits are already very, very high, then they would allow price increases. This would be the opposite, I believe, to the standards you have spoken of now.

Representative REUSS. If there are no objective standards on this point that occur to you as economist for the Federal Trade Commission, then wouldn't you agree that it is really a monstrous thing that the President has been asking of labor and management for these many months when he says: "Come on, boys, start behaving." It turns out, if you are right, that the reason he does not tell them what constitutes good behavior is because neither he or anybody else knows?

I, myself, do not agree there are no standards of good behavior. But isn't it completely indefensible and amounting to a hoodwinking of the public to act as if there were standards if, in fact, there aren't any?

Mr. WHITNEY. Well, two things: The Federal Trade Commission has a standard, which is to prevent collusion, and enforce competition.

Now, a person can make any amount of money he wants and get as high wages as he wants or as he can get, as long as he does not violate the laws.

The point of view of the Commission is that if business firms are not in collusion they can make all they want; we do not bother them.

Representative REUSS. That is all the law delegates to you?

Mr. WHITNEY. That is right.

I think that is all that is in the law. In the economics that I learned, the theory was that if profits are unusually high in an industry, more capital will go in or those companies will expand their own business. And eventually profits will come down.

There are certain barriers to entry. The theory then was that the barriers to entry should be attacked, if artificial, directly, rather than abandon the system by setting controls to prevent profits from going so high.

Now, in the President's statements, he was asking people to undertake the Government's burden, as I see it. He was asking individuals in the time of inflation not to raise prices, not to raise their demands, not to overbuy, when the Government should have stepped in and raised taxes or cut down its own spending or taken some other broadly effective measure which would not put on the mere individual the burden of carrying a national responsibility.

And similarly, now in the recession, he is urging people to buy more, whereas you just cannot get anywhere urging a person to act against his own interests to carry the burden which is a national burden.

Representative REUSS. Well, you pointed out that in the recent inflationary period, proposals to behave are an inadequate substitute for action on tax policy, action on fiscal policy, both of which operate primarily upon the demand-pull type of inflation.

However, I am not directing myself to the cost-push type of inflation, which most of our witnesses have agreed, has some objective existence. Don't you think that in addition to all the measures which need to be used to slow down demand-pull inflation, there needs to be measures directed at so-called cost-push inflation?

Obviously one such measure is all the things the Antitrust Division and the Federal Trade Commission do.

But, as you have just said, in the absence of a conspiracy, or at least a genteel kind of conspiracy, your jurisdiction ceases, and there has been abundant testimony before us that that no longer covers the cost-push; that there is a whole field of activity which is not in violation of the antitrust laws, where nevertheless very reputable economists feel that things are being—they feel that prices and wages are being pushed up higher in particular fields than is good for the economy.

What I am doing is groping for some method of dealing with that problem.

Mr. WHITNEY. On the President's statement I was perhaps too narrow. Insofar as he urged moderation on unions and companies in their profit and wage increases, that might have some effect. I have not seen much effect yet. And yet I could conceive of its having effect.

But it could not be by the President's statement alone. I think we have to reeducate the whole public and have public opinion reinformed on the whole subject to achieve much gain that way.

Someone in the compendium has spoken of increasing economic enlightenment, as is now occurring, he feels.

I feel we need a great deal more. And in that case it will be possible perhaps to have organized groups act in such a way as to conform more to the public interest in these matters. But, for example, right now we have a proposed big wage increase in the automobile industry, and I do not know what the effects would be.

To my mind they probably would be wholly bad. And the administration naturally cannot pinpoint that and say this is the kind of thing we don't want. But until they can pinpoint it and say frankly that it will have a bad effect, each person will feel they are talking about someone else and not about him.

Representative REUSS. How can you start educating the public, though, if the educator has not sorted out his own thoughts and figured out what are proper price and wage policies; to what extent should cost govern? To what extent should substandard industry problems intrude themselves?

I think these are tough problems. But it is high time the Government, which is guarding our economy, addressed itself to them.

I have exceeded my time, Mr. Chairman. Thank you.

Representative BOLLING. Well, there are several other members of the panel who have indicated a desire to comment at some point.

Mr. DIRLAM. It does seem to me that this pattern of Government inquiry into price increases seems to have become standard operating procedure and must exercise some control over prospective price increases. The fact that the steel industry may have to go—or the executive may have to justify a price change before legislative inquiry, not perhaps with any absolute standards imposed, but nevertheless with the standard of publicity, I am sure checks and sets a limit to what otherwise might be a more substantial increase.

And this has become so interwoven into the pattern that I am sure in many large industries today the possobility and the obligation to explain is much more prevalent than it was, say, 20 years ago.

With all deference to Mr. Whitney, I think that this does exercise some informal control that isn't against the public interest.

Representative BOLLING. Further comments on this subject?

Mr. WEIDENBAUM. Yes. I am a little concerned about the concept that organized groups acting in concert would be in the public interest. That is, if labor unions and management groups generally would support an administration policy for holding the line in costs, that would be desirable. I am afraid in the back of my mind this makes me feel that this would lead us toward a less free and more controlled economy.

I am greatly disturbed by the long-term public policy implications of the CIO–AFL supporting a hold-the-line policy on wages, while

the NAM and the Chamber of Commerce would support a hold-the-line policy on prices. Granted that the——

Representative REUSS. May I interrupt at that point. Because there again I do not think it has been suggested—and certainly not by me—that there should be a hold-the-line policy on wages.

Certainly wages, in order to distribute purchasing power, need to go up with advancing productivity; not with micrometer-like precision, but with some general relationship. So that the real problem is holding the line on prices and on wages just to the extent that they do not exceed productivity.

Mr. WEIDENBAUM. Well, my point about holding the line was merely an example of concerted action.

Another example would be wage increases limited to productivity; or price increases limited to X percent a year. I am quite concerned about the setting of business prices, not in the market place, but in the public arena.

Representative BOLLING. Mr. Weidenbaum, is this the implication—that if this process was carried to its completely logical conclusion that you would end up with something that would not be unlike the economics of Italy——

Mr. WEIDENBAUM. I really haven't thought it through. But I am concerned that it might lead us down a road that would be undesirable. I have not explored that road.

Representative BOLLING. I should put in quickly: Italy in another era than this one.

Mr. WEIDENBAUM. I might point out that we do have some experience in a very limited area. I have in mind the Renegotiation Board where, without any specific criteria, the Board reviews the profit positions of major Government contractors.

And certain elements of the industry have expressed the view that this has an adverse effect on the incentives of the producers, because profits rather than cost and cost reduction programs have been the focus of the Board's attention.

I am certainly not convinced that our experience with the Renegotiation Board, as a public policy board reviewing private pricing practice, is such, that the principle needs to be extended in any form, voluntary or otherwise, to business concerns which are not primarily Government contractors.

Representative REUSS. Of course, there are several very important distinctions between renegotiations and what we are talking about here.

You named three of them. What we are talking about here would only apply to certain strong industries.

It would not, as I understand it, involve setting up in advance elaborate philosophical criteria, because I do not think we are capable of doing that. It would involve ad hoc step-by-step procedure, with the hope that it would have some checking influence. It would be before the event rather than after the event, as in the case of renegotiation.

Secondly, renegotiation, while not conducted in stealth and secrecy, is not a very public exercise either. And the whole point of this proposal would be publicity and so-called summit-type price-wage negotiations.

But I think you made a point that has to be met.

Thank you, Mr. Chairman.

Representative BOLLING. Mr. Curtis.

Representative CURTIS. I would like to pursue this renegotiation aspect further inasmuch as the House Ways and Means Committee is going to have before it very shortly the perennial question of whether we extend, and, if so, how long.

Of course, in essence, it is a cost-plus type operation, just as our public utilities price-fixing amounts to cost-plus, which puts the incentive on having your costs and your investments as high as possible—just the reversal, I think, of good economics.

And we resort to that only—at least my theory would be that we resort to that only where there is no alternative. In the nature of public utility, you cannot have a free market. And I presume in some of these Government contracts you cannot have real competition.

I want to get back to a basic problem that has been disturbing me in all the papers. And that is getting back to definitions of what is price; and what is inflation; because it strikes me that a lot of this ratchet effect that has been referred to here, or this constant increase in prices over a period of many, many years, as an economy grows, is not inflation at all, but is really increased quality, and although the cost of living index attempts to adjust for quality I am satisfied that even after adjustment it really does not accomplish it—plus another factor, which is an economic cost, which it does not measure at all.

And that is the cost of choice; the fact that the consumer, as he gets a variety or greater choice about where to spend his dollars, that, of course, has an economic cost.

And I am wondering just how much of what we are calling inflation actually is increased quality or this increased economic cost.

I notice Mr. Whitney in his paper in one spot says: I believe the most desirable area for price cutting is in the consumer durable goods and housing.

I have noticed that most economists testifying before us have said they do not think there has been much increase in productivity in housing, and the price has remained fairly constant.

But with the experience I have had—which is little, not great—in the housing field, I can say that the increase in quality in the house of today over the house of 10 years ago or 20 years ago is just tremendous. Even in your lower- or middle-class type housing, selling for around $14,000 or $15,000 in St. Louis it is standard equipment to have air-conditioning in it; and the materials and everything else that go into it just produce a product that is so much greater in quality; the people who can afford whatever kind they want really out of choice will go and buy the modern-type home.

So, I would ask the panel whether or not you agree that a great deal of this thing that we call inflation and this ratcheting upward and the reason it doesn't go down is that we actually are measuring economic values?

And if you have got this increased quality, of course, your prices might go up. Or to put it another way: You can decrease costs by selling the same product, which is increased quality for the same price.

Mr. DIRLAM. Of course, that is the argument that has justified increases in prices or maintenance of prices in the automobile industry.

Supposedly we have a car which has much greater quality than we got 20 years ago.

Representative CURTIS. It certainly is. It has four-wheel brakes and a lot of things.

Mr. DIRLAM. To me, as the consumer, the alternative is choosing between a car that has improved qualities and another that may be simpler and less expensive to maintain.

Representative CURTIS. And the consumer does that. And that is one reason I think the American auto industry is having its problems; because the consumer can buy the foreign Volkswagen. And apparently there is a tremendous demand for that that cannot be fulfilled.

Mr. DIRLAM. You have to wait 11 months to get it.

Doesn't that indicate a lack of flexibility in our own automobile industry?

Representative CURTIS. I think it reflects a mistake in judgment on the consumer's part. But also suppose we had the choice available, how do we measure the fact that the consumer does have the choice?

We do not measure it in our standard-of-living index. And yet, certainly it is a costly thing economically. And it certainly raises the standard of living.

Mr. DIRLAM. I would agree with you that a high standard of living, which is exemplified by an expensive car and all the costs that are entailed by having the expensive car, such as lengthening your garage and getting rid of traffic jams, is a rather odd sort of high standard of living.

Representative CURTIS. Well, but if you have the choice, though, of buying a Rambler or Cadillac, the very fact that there is the choice—I remember the T-Model Fords used to all come out black—it costs more money to have a car that you can get in different colors.

It would be cheaper to make all cars black. How do we measure in our cost-of-living index those items? What I am getting at is: Isn't a great deal of what we are calling inflation not inflation? That is, the value of the dollar has not changed, but actually economic factors are being measured in here; and because it has increased the price we have called it inflation.

Now, I am satisfied a lot of it is in inflation, but there is a considerable amount of it that I don't think is inflation. And this ratchet effect that is referred to, I suggest, is probably not inflation. I don't know.

Mr. Smith?

Mr. SMITH. Since I was the one who mentioned the ratchet effect here——

Representative CURTIS. It has been used in all the panels.

Mr. SMITH. Unquestionably the price indexes have an upward bias due to the fact that it is almost impossible to make proper allowance for quality. But, as Mr. Dirlam mentioned, it seems to me that as quality increases the consumer does not continue to have the effective alternative throughout his whole budget of buying the products that he bought before.

Representative CURTIS. He could or he could not; wouldn't you agree?

Mr. SMITH. He could.

Representative CURTIS. You could still live on dried beans and salt pork, I guess, if you wanted to.

Mr. SMITH. Nevertheless, from a practical point of view, there is a real problem here that we have got many people who 20 or 30 years from now are going to be living on pensions that they are accumulating now; and if in the meantime the price level has gone up by, say, 20 or 30 percent, or whatever it might be, this is certainly going to reduce the purchasing power of those pensions and make it more difficult for those people to live comfortably.

Representative CURTIS. Well, let me interpose there: Because that is the same reasoning I have gone through too: I think that to a large degree it is a psychological thing; that human beings are more concerned how they live in relation to their neighbors.

Mr. SMITH. I quite agree.

Representative CURTIS. So, from that standpoint it does not matter whether the cost of living has gone up because of increased quality and choice, if you can't avail yourself of it—or if you haven't got the budget to meet it.

Mr. SMITH. It is not so clear, though, as to what the ultimate effect of the Consumer Price Index is; because there are a number of biases that work in both directions.

It is pretty difficult to say that the quality bias is not offset, at least partially, by other things. I just happen to think that a considerable amount of the gradual upward drift in the price level that appears to have been going on is really inflation.

Representative CURTIS. I think it is too, myself. But I do think—I don't know how much of a factor—I do think if we are going to discuss it, they have to be distinguished. Because inflation is one thing that is messing around with your measuring stick. But I don't think it is fair to call the measuring stick out of kilter if it is seeking to measure an economic phenomenon.

Mr. SMITH. There is another point here, too. If there is a reasonable degree of flexibility in the price mechanism, you can maintain the price level constant, even though quality is going up. This is a problem of aggregate demand and wage-price adjustments and so on. It is not an improper objective of public policy at all to try to keep the Consumer Price Index constant even if these quality factors are involved in it. Why should we let prices drift up because quality goes up? We don't have to.

Representative CURTIS. Because there is an added economic cost. That is the reason.

Mr. SMITH. If it has undesirable effects, let's not do it.

Representative CURTIS. Well, I think if you tried to prevent that, then you would really be stunting growth; because you wouldn't be allowing for an economic cost.

Let's take precooked foods that you can now buy. It costs something to do that. I don't know what the economic net result is. Some people have said that the housewife spends an hour and a half less time now in preparing good meals for the family.

Well, her hour and a half is worth something. But we have never measured it before, perhaps. We still don't measure how much the housewife contributes to the overall economy. But there it comes out in another area that we haven't measured.

We certainly can call it an increased standard of living, at least as far as the housewife is concerned.

All I am trying to suggest is that in a way I have been disappointed in the papers; because there isn't the attempt to distinguish between this factor of cost increase and what we refer to as what I would say is "inflation," which actually is changing the dollar as a measuring stick.

And I think there is that factor in there, too.

Well, let me go on to my next question which gets on to the inflation aspect and has to do with Mr. Lent's paper.

Don't you think that ultimately all taxes are reflected in prices; that somehow or other they have to be paid for out of the private sector of the economy, and the only way you ultimately pay for it is through the consumer prices?

Or wouldn't you agree?

Mr. LENT. Well my position generally is that taxes are not reflected in any higher general level of prices, with the notable exception probably of the tax on business income. Even there it is a debatable point.

Representative CURTIS. Let me pose my question more carefully perhaps. I can see certain things like in excise that there is an immediate absorption in the price that is charged. And I think it is a question of when it is paid for.

But ultimately taxes will have to be paid for out of the private economy. Isn't that right? How else are they paid if it isn't ultimately reflected in the price?

Mr. LENT. You might say that the Government absorbs the purchasing power of the taxpayer and reallocates it to the purchase of goods other than those the individual would have bought.

Representative CURTIS. But the individual only gets his wages or salary from business which in turn is going to have to reflect that as a cost in its price. And when you say that the economy is bearing 25 percent—or rather about 22 or 25 percent now in the taxes, it seems that is bound to reflect in cost sometime—in price.

Mr. LENT. Well, in individual cases, yes. This would be true of excise taxes in particular. We know that the excise tax on gasoline tends to be reflected in a higher price of gasoline by the amount of the tax, more or less.

Representative CURTIS. Well higher wages——

Mr. LENT. But even here there is some doubt, and serious question has been raised as to whether excise taxes in general or general sales taxes raise the general price level.

Representative CURTIS. Where will the money come from?

Mr. LENT. Because it is similar to an income tax in absorbing the income of the taxpayer.

Representative CURTIS. Well, don't you think, though, that your income tax actually is reflected in the price because cost of wages is a cost that goes into the price that you set for your product. And the wages, of course, reflect the amount that goes for taxes.

Mr. LENT. The individual income tax?

Representative CURTIS. Yes, individual.

Of course I think you have suggested that the corporate tax is a sales tax in disguise, which I have long felt is actually the truth of the matter. But I think also your income tax ultimately—I don't think it happens—I don't think it is a question of timing—I don't

think it comes out in the price this year or next year but over a period of time, I think it has to come out.

I don't see how taxes are paid any other way, except through ultimately reflecting in price.

Mr. LENT. Well, as I said, the income tax would affect prices depending on the effect of the income tax on the supply of labor, or the amount of labor that is offered.

Representative CURTIS. What I am getting to is this; if my theory is right, and I see that you don't agree with it. But if it were correct, then we could expect increased prices overall—again whether it is the ratchet effect or whatever it is—because the amount of tax take—the Federal and State and local governments—has gone up.

If prices didn't go up to reflect it, I don't know where the money would come from.

Mr. WEIDENBAUM. I would like to point out, of course, that in the aggregate, taxing private and business incomes by governments withdraws from private purchasing streams funds which otherwise would go into demands for privately produced goods and services.

You are dampening private demand, in the aggregate. And when you get down to the individual, the individual employee, the taxpayer, he finds his gross income, gross of taxes, available for a number of items which vary from fixed charges—certainly fixed charges as taxes—to completely discretionary purchases, such as luxury or impulse items.

Conceivably to the extent taxes are raised this alters the individual's discretion as to how he will dispose of his income. Hence, an increase in taxes would not tend to effect his overall income position but merely the way he allocates his resources.

As Professor Lent pointed out, unless the individual acting in concert through unions or otherwise can have some effect on the wage bargain, an increase in taxes wouldn't particularly have any effect on the price of his services but on the allocation of his income.

Representative CURTIS. Well now to go to another point: Most economists that have been testifying before our committee now over a period of time have agreed that inflation itself is a form of taxation from a standpoint.

It transfers purchasing power from the private sector to the Government sector.

Now, we largely financed World War II through this inflation. I would think, too, that we would look to see how that is bound to have to come out in prices, too. That is another thing that would strike me as being a factor in this increased price that we are having, the financing through taxes, through the device of inflation.

And that gets over to this question of just how this inflation has worked in transferring.

I have thought that the tight money situation of 1957 to a large degree was the final effect of this method of governmental financing. And it came to a large degree through our depreciation allowances for business; because they, of course, under our tax laws are set on the basis of cost in dollars of 1940, what they have to put on their books; and then they have to replace the identical equipment at least twice the amount.

And they have to dig up that money just to stand still—not to finance any growth at all.

And in a 10- or 15-year period you get a complete turnover of your capital plant.

So we have to come in and find almost twice the amount of money to finance it. Then comes the question, How has American industry been financing its replacement and its growth?

Then we get into the three areas they can finance from. One is plowed back earnings which I have suggested is immediately reflected economically or it already has been reflected in the price that the consumers are paying. Because it is in the product; it has to be there.

The other way is debt financing, which is reflected in the price as you pay off the debt and pay the interest, although that is a shorter range.

And the third way is new equity issues.

Our tax laws are such that we have been giving tremendous advantage to plowed back investment, because it escapes the personal income-tax factor. Debt financing escapes the 52 percent and puts a burden of the double tax on the equity.

The result has been that we have had very little equity financing in this area. Therefore, we have not spread the cost of replacement and growth of industry over—as equity financing will do—a period of 20 to 30 years. We have confined it to a very narrow area.

I think that factor has come out in your immediate prices.

Now, I just expose that for any comment.

Mr. SMITH. Plowed back earnings are a form of equity financing.

Representative CURTIS. It is not, I don't believe, from this standpoint. Where do the earnings come from? They have to come from the price you have been charging the consumer. That is why I say what I am talking about is the economic effect. Plowed back earnings becomes again equity. But where does it come from? It doesn't come through the process of savings. You can say it is the saving of the fellow who doesn't decide to use it.

But the net result is that has immediately come from the price that the consumer has been charged in that particular industry.

Mr. DIRLAM. I would certainly tend to agree with you on that. If you are going to grow through reinvested earnings you are going to have more each year than you would if you are simply paying for outside capital.

This brings up something I was going to ask Professor Smith. The agreement seems to be that we should maintain prices even during a recession to cover not only variable costs, but what industry regards as its overhead. And if industry tends to think, as it does, that it should replace at current price levels, this element of overhead is going to feed on itself, so to speak.

The steel industry is running at 50 percent of capacity. And they are all thinking in terms of replacing at three or four hundred dollars per ton. And growing.

Representative CURTIS. And yesterday we had brought out the fact that some of the industries—I think steel was one—had been setting their price—if it is administered I don't know enough to get into that question of what is administered—but certainly with the objective of recouping the amount of investment they will put in for growth.

Now if that is being reflected in the price—and the steel industry is one which I think I am accurate in saying has had no new equity issue over this period of equity growth. I saw some figures the other day that the one company, the A. T. & T. had taken one-half of the amount of new equity issues since—I have forgotten what the period was—right after World War II—of course they being a public utility more or less have to grow through new equity issue.

But here we have got this tremendous portion of our productive industry and distributive industries financing their growth through these other two devices rather than equity capital.

Mr. SMITH. I would agree with that. The only point I was trying to make was that plowed back earnings from the point of view of maintaining the capital structure of the company are similar to stock issues. But I believe it would be desirable if the tax laws could be changed in such a way as to encourage more outside equity financing, because for one thing, I think it is more desirable for the company's expansion policies to be subjected to the discipline of the market rather than to come about through plowing back of earnings.

Representative CURTIS. I agree for so many reasons that it would be desirable, socially and every other way. And I think one of our troubles we have gotten into—well, I have one other comment: Again for Dr. Lent's paper here——

Mr. LENT. May I interject a question?

Representative CURTIS. Sure.

Mr. LENT. I am not entirely sure what you were driving at in the matter of reinvestment of corporate earnings. It is a form of savings, of course, by the corporation.

Representative CURTIS. Yes. But what I am suggesting is timing. It is done immediately. While, if you have it brought in from the outside sector, that is savings already existing.

It ultimately came from the same place. But it is not immediately reflected in your price of that particular industry. It is retained earnings, of course, because that is where it came from. It came from the fact that you had your profit and your goods—the price at which your goods were sold produced at less than the immediate thing. That is all I am saying.

Mr. SMITH. I would like to comment on the depreciation question. It seems there are a couple of offsets, rather important ones, to your point that corporations have to replace their equipment at higher prices than are used in calculating depreciation. One is the quality factor that you mentioned in connection with consumers. That is, when a corporation installs new equipment to replace wornout equipment, this new equipment, in most cases, is really better and more productive than the equipment it replaces.

Representative CURTIS. There is no question there about that. And actually if you will take a look at the costs, they are far from being 2 to 1. The thing is sometimes four times what it was before, because it reflects the other.

But you take a thing like in utilities, just take a telephone pole, a wooden pole, the same darned thing will cost you two and a half times what the one they had to replace cost.

Mr. SMITH. But across the economy as a whole this is an important point. The second offset is that in an economy that grows as rapidly as our does, the capital stock is growing all the time. We

are, therefore, depreciating a continuously larger capital stock. And, as a result, the amount of funds provided by depreciation today is not as inadequate for replacement purposes as you would think.

Representative CURTIS. I think you are making a very good point. In other words technological advancements can mean that for a new machine you can replace something—or you end up with a better machine and your costs might not be—I will agree with that. But I think the other is basic in there.

One final comment I would like to make is this: This was brought up by Professor Lent's reference to the oil depletion.

I couldn't agree with you more. But I think it is one of the areas that indicates that what I am saying is true. Because strangely enough in our tax laws there are three items to which we have applied a percentage formula in relation to the allowances that we permit for tax deduction. Percentage depletion is one. And percentages, of course, reflect inflation and allow for it. And in the three areas where we have percentage figures, we have seen a tremendous influx of capital for growth and expansion.

One is your oil depletion, for example, which is percentage. Another has been in life insurance where, because we couldn't figure out how to tax them, we went to an industry formula, which is an 85 percent, which is really an arbitrary thing. But again being a percentage thing, it has allowed them to escape the brunt of inflation.

The third thing is savings and loan, with a 12 percent bad debt reserves. Notice the percent on their reserves.

Now, I just brought that out because that has been intriguing me for some time. All three of those industries have had very little difficulty even in this tight money situation of getting ample funds. And in oil it is just flowing over.

The proof of that is: Look at how many areas the oil money is being invested in outside of oil. They don't put it back into oil. Because they go into all sorts of new ventures, which I think—at least from my thinking—tends to point up that this method of financing growth of our industry has had a lot to do with the prices that are charged.

These various elements I have tried to bring out are just as important in the increased costs that we have seen as traditional inflation.

Mr. WEIDENBAUM. I would like to make a couple of points on this question of depreciation.

Representative CURTIS. Sure.

Mr. WEIDENBAUM. First of all I would believe that in a perfectly competitive industry, the profit of a given firm would not necessarily be related to the prices it charged.

That is, given the same price level for all the firms in this completely competitive industry, the most efficient producer would have the largest profits; the least efficient producer might be operating at a loss; and they would all be charging the same price.

Of course as you go away from free competition, this factor would lessen. But to some degree, I just want to point out there isn't necessarily a complete tie between retained earnings and prices charged.

I also would like to point out—my facts are a little rusty as I have here a paper I did a year or so back—that in the calendar year 1954, depreciation allowances of United States corporation amounted to $13.1 billion. Funds obtained from retained profits and issues of new securities were $12.3 billion in the same year.

In other words, depreciation was not only the single largest source of funds for capital expansion in American business in that period, but larger than these other two put together.

Representative CURTIS. But theoretically, depreciation is supposed to be more replacement. And if we didn't have depreciation allowances in our tax laws, we would have an unconstitutional tax, because it would be a capital levy.

I am talking theory.

Mr. WEIDENBAUM. There has been a bit of discussion as to what is the nature of a depreciation allowance. One way of looking at it is: you are costing out annually a one-shot capital expenditure. Using that line of reasoning, replacement value does not enter into the equation.

In other words, if something cost you $10, either you expense it for income tax purposes and mark if off at $10 the first year, or if you have an expected useful life of 10 years, you will take, using a straight line method, a dollar a year.

But it may cost you $15 to replace the thing.

Representatives CURTIS. That is what I am saying. The tax laws are based on that theory, which all it is is a replacement of capital that has been expended.

But with inflation you have created a situation—I have maintained that inflation actually is a capital levy through the depreciation allowance.

Mr. WEIDENBAUM. I would like to make another point and that is this: It is true, inflation does have this adverse effect on business financing . However, when you get into these proposals for liberalizing depreciation allowances—particularly to go from historic to replacement costs—you may be taking away one of the factors which tends to dampen or prevent inflation.

To the extent you make inflation painless, you may be bringing it on that much faster.

Representative CURTIS. I am not advocating anything. I am examining.

We did that in utilities. The old argument.

Of course I wonder about that. There is another area. Notice how utilities are continuing to go in this thing because their investment was available for replacement.

Representative BOLLING. Any further comments?

Representative CURTIS. That is all.

Representative BOLLING. Dr. Talle.

Representative TALLE. No questions at this time. I would like to thank the panel, though, for being here and for their statements.

Representative BOLLING. Mr. Reuss.

Representative REUSS. Yes, I do.

These would be addressed to Mr. Smith.

While your analysis is couched in moderate language, it does seem to me to add up to a fairly devastating analysis of what we have done in the last 3 or 4 years in terms of fighting inflation. And in a few words, what you seem to be saying is that the policy of leaving the attack on inflation to the Federal Reserve's rediscount policies, and reserve policies, has not been very effective in combating inflationary price increases, but has produced some disconcerting side effects.

Is that a fair summary of what you are saying?

Mr. SMITH. I would say that is pretty fair, yes.

Representative REUSS. I happen to agree with that analysis myself. But whether I did or not, I think we have to be concerned with examining whether our governmental machinery is really in good order to prevent this sort of thing in the future. I am impressed, unfavorably impressed, by the fact that, particularly in recent years, the President in his economic report, and the Council of Economic Advisers in their advice to the President, have acted as if the Federal Reserve—though of course independent, as it should be—is in a world apart from the rest of the Government.

For example, in the last 4 or 5 economic reports there hasn't been a word about what the Federal Reserve ought to be doing and what our monetary policy ought to be, even though there have been plenty of words about what even more independent agencies of Government ought to do, such as the Congress, such as State governments, such as local governments, such as our representatives on the International Monetary Fund.

Would you agree that it would be a good thing for the President, whoever he may be, acting, as always, on the advice of the Council of Economic Advisers, to be heard from time to time on the matter of monetary policy and on other matters within the jurisdiction of the Federal Reserve Board and the Federal Open Market Committee?

And would you agree with me that the very imposing of that responsibility on the President in clear terms might in the future result in better coordinated economic policies by the Federal Government?

To give an example of what I mean before I let you answer: It seems that while the Federal Government in the last 2 or 3 years was saying in effect, "Let Bill do it," referring to Bill Martin, of the Federal Reserve—that they were adopting policies in other branches of the executive that were quite inconsistent with that. For example, rapid tax amortization and other means of stimulation of investment, at the same time that investment was supposed to be quelled by what the Federal Reserve was doing; or, again, the failure to impose controls over consumer credit at a time when another branch of the Federal Government was trying to quell consumer credit.

I would like your comment on the general thought that one of the reasons for our poor performance in this field has been inadequate machinery.

Mr. SMITH. Well, let me start by saying that I believe one of the reasons for the failure is that we started off with too much confidence in monetary policy. A few years ago there was almost no confidence that monetary policy could do anything. Then the emphasis shifted to the point where for a while we thought monetary policy could do everything. The truth of the matter lies somewhere in between.

I happen to like monetary policy, and I think it has something to contribute. I would like to see it strengthened, and I suggested in a general way some of the things that I think might be helpful. Some extension of selective controls might be desirable, although I don't believe the right kind of proposals can be devised without very careful study. But then if we did strengthen monetary policy to the point where it was considerably more effective than it is now, it

26215—58——23

should most definitely be more closely coordinated with other stabilization policies.

Even if monetary policy were effective, we should not rely entirely on it to control inflation or deflation either, because monetary policy if it is effective, it seems to me, tends to have its effects on capital formation.

I don't think in the last 2 or 3 years it has hit that area very hard. But if it is strengthened, that is where it is going to be effective. You don't always want to combat inflation by cutting back capital formation. The more effective monetary policy is, the more important it becomes for it to be more carefully coordinated with fiscal policy.

This means that as a correction of the present administrative setup with a separate Federal Reserve System some method should be devised to coordinate Federal Reserve policy more closely with the other policies of the administration, and that the Federal Reserve should in some manner or other be brought more closely into the councils of the administration in office. I don't like the fact that the Federal Reserve System is able to exercise its powers without, it seems, political responsibility for the policies that it recommends. The administration can disavow the measures taken by the Federal Reserve System.

Representative Reuss. And in fact in such matters as the raising of the rediscount rate in August 1957, in such matters as reserve requirement changes in 1956, the administration has disavowed what the Federal did?

Mr. Smith. Well, this I think is almost inevitable. That is, we have taken careful pains to see to it that the Federal Reserve is kept independent. And this makes it difficult for the administration really to exercise much control over it. But it does seem to me that measures of this importance should be subject to political discipline in some manner or other.

Representative Reuss. Is it really so insoluable? After all our whole theory of the Employment Act of 1946, which I think is a wonderful piece of legislation, is that you centralize in one office, i. e., the President, who is elected by the people, the responsibility for coming forward with recommendations to various independent elements like the Congress, like State governments, like local governments; and it is up to the President, so the philosophy runs, to come forth with the right recommendations. If Congress doesn't follow the recommendations, all right, the public can take notice of that. So with other elements in the economy.

But, I think the fact that the Federal Reserve is, and should be, independent has been allowed to make it irresponsible. The administration, for some reason, feels that it is improper to tell the Federal Reserve on a particular point, "Look, we think you should take the following action or we think you should refrain from taking the following action—if you in your independent judgment think you should go counter to what we say, all right, but it is your decision." I don't see anything impossible about developing machinery to clarify that.

Mr. Smith. I don't either. It seems what is needed is some kind of national economic council in which the Federal Reserve and the authorities in the administration responsible for tax and expenditure recommendations and probably representatives of the various agencies

which are involved in Government lending programs of one kind or another, should all be coordinated and should all be tied in with the political process.

Representative REUSS. Couldn't you do that very simply by requiring the President, in addition to his telling Congress and the State governments and the local governments how he thinks they should comport themselves for the national economic good, to tell the Federal Reserve Board, too? That fixes responsibility for recommending things.

Mr. SMITH. Well, yes. Of course, I think that it would be desirable to make it a two-way street. That is, the administration should have the Federal Reserve's views about what ought to be done. I know these views are available now, but it might be desirable to have a more formal means of communication, in both directions, and more formal ways of coordinating Federal Reserve policy with the other policies of the administration.

Representative REUSS. Of course, you do have this very nice ad hoc committee set up last September, where the Secretary of the Treasury, and the Chairman of the Federal Reserve, and the Chairman of the Council of Economic Advisers sit down together. This is good. But it still doesn't enable the public to find out after the explosion who was responsible. Thus the whole theory of the Employment Act of 1946, which was supposed to fix responsibility, is dissipated.

Mr. SMITH. But it is also important that considerable thought be given to means of strengthening monetary controls, as I mentioned before. It would be desirable to have an extensive inquiry into our financial system and the changes that have occurred in it and the possibility of changes in the kinds of financial and monetary controls we use. After all, we have not really had any changes in our monetary controls—scarcely any that amount to much—since the Federal Reserve Act was passed. It is high time for a careful look at the ways in which changes in our financial structure have altered the channels through which Federal Reserve policy makes itself felt.

Representative REUSS. Part of this trouble is due to the thing we are describing—namely, the attitude on the part of the President and the Council of Economic Advisers that monetary policy is something they should not enter—that they should not make recommendations about it because it is a holy matter.

I think this is a mistake; that we should impose the obligation on the President not to neglect this sector.

Representative BOLLING. Dr. Talle, are you moved to ask a question or make a comment?

Representative TALLE. Well, yes, Mr. Chairman. I am wondering what the panel believes should be the relationship between the Government and the central bank.

Would it be good to have the Government tell the central bank what to do?

Mr. DIRLAM. I don't know whether I correctly understood Professor Smith. If he supposed that the Federal Reserve is to become subservient to the Treasury and there is to be a monolithic monetary and fiscal policy, I am not sure I would go along with him the whole way. This would make the Federal Reserve System a captive of the Treasury and there seems to be an inflationary bias built into the Treasury's

policy that might make it better if you did have in the Federal Reserve a certain degree of independence.

Perhaps we should have the President suggest policy of the Federal Reserve.

When it becomes too much of an imposition, I am wondering if Professor Smith shouldn't have some reservation.

Representative TALLE. I will explain the kind of thing I have in mind, if I remember my history correctly.

The Bank of France was, I thought, a pretty good monument to Napoleon. In addition to his code, I think that was an important nonmilitary achievement. That bank was independent of the French Government.

And, if I remember my history correctly, the Bank of France consistently refused to bow to Government until a bad situation occurred in World War I. The frugal French peasant quickly lost confidence in the Bank of France. And out of that came that nasty situation—the loss in the value of the franc.

Our friend, Harold G. Moulton of the Brookings Institution, went over there and tried to put French finance in order again. But France has been in financial trouble ever since. I am fearful of a close political tieup. That is, close tieup between Government and the central bank of any country.

Mr. WEIDENBAUM. I would like to point out that certainly in its public statements, the Board of Governors has stated that the Federal Reserve System is a part of the Federal Government. The Congress certainly can, through legislation particularly, make its desires felt and acted upon by the Federal Reserve System.

Of course the question essentially relates to the relationship of the Federal Reserve System to the executive branch of the Government. And there, of course, it is a question of how far the Federal Reserve can go to exert its independence without some counterreaction.

I believe it would be a question of an area, a zone. If the Federal Reserve went too far in exerting its independence of the Treasury and the President, there might well be reaction on the other side. And I believe Chairman Martin has intimated as much in his recent statements before some of the House and Senate committees; that he feels that the Federal Reserve is a part of the Government and has responsibility for executing Government programs.

Representative TALLE. It was the psychology of the French peasant that was so important. He is a frugal fellow—a little home, a little garden, a little savings. That is his goal. And when he discovered that the Bank of France had bowed to Government in the way the bank had never done before, he lost confidence in the bank. And it was a disastrous thing. France has not recovered from it.

Mr. SMITH. I would like to comment on this. It seems to me that the way to prevent irresponsible action on the part of a Treasury in conjunction with a central bank is for the policies established by the Congress and the executive branch to be generally responsible. I can't see how we can hope to get responsibility by taking certain important elements of the economic control process outside the political arena. I am not so fearful of irresponsibility that results from coordinated action on the part of the Treasury and the Federal Reserve System as some other people are, provided there is a well-

designed general framework of legislation controlling our national economic policy. Basically it seems that responsible economic policy depends on Congress and on the administration, and that you cannot get it by dividing up authority and taking certain parts of it outside the political process. Politics is the thing that is designed to give us responsible public policy.

Mr. WEIDENBAUM. I would like to voice dissent to the concept of a national financial or economic council particularly when its membership becomes fairly extended to include not only the Council of Economic Advisers, the Federal Reserve, and Treasury, but the various loan agencies, that is, both operating and advisory organizations. Just based on my own observation of Government operations this kind of body may deliberate, it may be a forum for discussion but it is not the kind of vehicle out of which comes an effective program for Government action over a period of time.

Essentially the agencies subject to the jurisdiction of the President constitute one area of activity. And there the President, through the various agencies in the Executive Office and through such devices as the Cabinet, can see that a Government program can be formulated and executed.

Going from there, I believe the question essentially relates to the Federal Reserve System: Do you put the Federal Reserve System under the jurisdiction of the President or permit it to remain independent?

The particular device which the President might use, such as a council or advisory committee, would be secondary. You would have to face this major question if you would want to formulate Government economic policy in that manner.

Do you wish the Federal Reserve to be independent of the executive branch or do you want it to be another agency under the President?

Representative BOLLING. If I understand what both of you said, you said in effect that, by and large, the institutions that exist could be effective if they were responsible. Since you talked about the Congress and the Executive and a number of other things I am not casting stones toward anybody.

Mr. SMITH. There are some technical problems. I am talking mainly about the area of economic stability. Even with the best, most responsible administration in the world, you can't achieve complete success in this area. With the tools we have available and with the lags and uncertainties and other things involved here, you just can't.

But I do think we could do a better job if policy were more closely coordinated.

Representative BOLLING. What in effect you said was there was no way for Congress to create a set of institutions which would take the place of its own responsibility.

Mr. SMITH. That is true.

Representative BOLLING. I think this is a truism and I heartily agree with it.

The best illustration of the difficulty of the problem is that while there seems to be a general acceptance on the part of practically everybody in Congress, that there is some merit in countercyclical activity on the downside; there would be a serious question as to how Congress would respond to countercyclical activity on the upside.

My own view would be that there is no substitute for this. We can create as many magnificent coordinating groups and as many other institutions as we like, but unless that responsibility is accepted by Congress we don't get anywhere. I am not implying that I think the structure is perfect or the advisory and coordinating and technical and so on, structure is perfect or that we don't need a great deal more basic information just at the level of statistics.

Mr. SMITH. I agree with this, but I would like to make the point that this area of stabilization is an area where it doesn't seem to me that Congress can successfully administer. That is, it must delegate authority.

Representative BOLLING. I agree with that.

Mr. SMITH. There may be something to be said for delegation of more authority in some areas than we have up to now. But I would be inclined to favor a central bank policy that was under the control of the administration.

Mr. DIRLAM. I was just going to raise the question whether the independence of the Federal Reserve wasn't a helpful influence on the Treasury prior to the reaching of the Treasury-Federal Reserve Accord when the Treasury wanted to preserve the wartime pattern of interest rates. It was only under Federal Reserve pressure that that was relaxed.

At that time the influence came from the independent agencies. I think you would agree it was a good one.

Mr. SMITH. I would agree it was a good one.

Representative BOLLING. Well actually, a lot of that influence came from Congress through informal methods.

Mr. SMITH. That is right.

Mr. WEIDENBAUM. I don't think the work of this committee ought to be ignored in that respect.

Mr. SMITH. I am not so sure that if the Federal Reserve had been a part of the executive branch its influence in this area at that particular time might not have been greater than it was. Its status as an independent agency, I think somewhat weakened its bargaining power here in relation to the Treasury during that period. And I would agree with Congressman Bolling that a good share of the effective pressure to do something about this came from Congress.

Representative BOLLING. I think that question is one that I would qualify as a semiexpert on, having sat through all of the second set of hearings on general credit control and debt management. And I never came to a conclusion on that particular point. I thought it was impossible to reach one.

Mr. WEIDENBAUM. I would like to take an exception to what I think is the point that because the Federal Reserve is an independent agency it couldn't deal with the Treasury as an equal, that it was in a relatively weaker position. My own feeling is quite to the contrary. That is, if the Federal Reserve were an ordinary Government department, a conflict between it and the Treasury Department would then certainly have been resolved within the family. And the Treasury of course in financial matters has quite generally had such a close relationship to the President and usually is deferred to.

I think, on the contrary, the independence of the Federal Reserve gave it a status on which it could meet the Treasury almost as an

equal. I think you might tend to lose this if you put it under the direct jurisdiction of the executive branch.

Representative BOLLING. Let's declare that one moot and see what Mr. Reuss has to say.

Representative REUSS. It is going to be mooter.

Representative TALLE. Will you yield to me?

Representative REUSS. Yes.

Representative TALLE. A number of thoughts are going through my mind. And I am wondering what pronouncements we might get, say, from the two political parties on a matter of this sort, if the Federal Reserve were strongly involved with the administration. Would these things get into party platforms and so on?

How far would we go?

Representative BOLLING. We would split in both parties. Again I would be a semiexpert on this. I sat as a swingman on a subcommittee which consisted of Senators Douglas and Flanders, Representative Patman and Representative Wolcott. One Republican and one Democrat were on either side of me. So I guarantee you both parties would split.

Representative TALLE. Thank you.

Representative REUSS. I did want to make the point that what I was suggesting here in no way involved impairment of the independence of the Federal Reserve Board. There may be a case for impairing that independence. I wasn't seeking to make it.

Let's assume we are all satisfied with the present System where the final decisions on monetary policy are made by this priest-like class of the Federal Reserve System which has almost life tenure and is removed from the immediate pressures of politics. I would call your attention to the fact that the whole reason for the Employment Act of 1946, as I understand it, was that Congress just wasn't a suitable instrumentality for coming forward with a full economic program, an across the board economic program, every year.

It is unrealistic to expect a legislative body to do that. And so there was centralized in the President, with the advice of the Council of Economic Advisers, by the act of 1946, the responsibility, not only of keeping its own executive family in order in terms of maximum employment, purchasing power and stability, but the responsibility to recommend, to make very specific recommendations to the Congress, which is certainly independent of the Executive, to the State governments, to localities, and to anyone else involved.

My point is that somehow or other, and particularly in recent years, the Federal Reserve and the Open Market Committee have been removed from the list of agencies to which the President is privileged to make recommendations.

This seems to me a rather wide gap in our armor. I think that we could, while completely preserving the independence of the Federal Reserve System, and thus avoiding the Bank of France troubles which Dr. Talle has so graphically pointed out, we could make clear—and Congress is the body that has to evolve institutions—we could make clear that the President, in addition to telling everyone else how he thinks they ought to run their business, in order to make for ourselves a full employment, full production, full purchasing power economy, should also tell the Federal Reserve what to do.

If the Federal Reserve doesn't want to do it, more power to it. Then you have made the issue. But as it is now, the President and his Council of Economic Advisers never put themselves through the annual intellectual drill of saying what is the complete, across the board, employment and stabilization program; with the result, as described by Mr. Smith, that too much of a burden has been placed upon the Federal Reserve. They have been assigned tasks which they are incapable of doing all by themselves, and very harmful by-products have arisen from assigning to them excessive tasks. That was my point.

I just wanted to make clear that there is no suggestion that the independence of the Federal Reserve Board to thumb its nose at the administration should be impaired. I think that is fine.

Mr. WEIDENBAUM. I picture a situation where the President does not view himself as the person to make specific recommendations to the Federal Reserve. Given a statute that he must make some recommendations, I would assume some of the most simple, vague pronouncements would be made which meet the letter of the law. I believe that adequate facilities already exist and are used for the transmission of the views of the administration to the Federal Reserve System and back.

Representative REUSS. I am not talking about transmission of views. They lunch all the time. And they telephone. That is fine. I am talking about the fact that when the train went off the track, as it did last summer, when all was said and done, nobody knew who was responsible.

The Federal Reserve said we were valiantly fighting inflation last August, so we raised the rediscount rate. It turned out after the event that the administration didn't really like this.

Well, what they should have done, under a decently worded Employment Act, was to have told the Federal Reserve last August—don't do this; if you do it, you do it in exercise of your independent powers.

Mr. WEIDENBAUM. My point was there is nothing to prevent the President from doing it under existing legislation. I don't think legislation could force him to do it.

Representative REUSS. There is nothing to prevent him. But I think there should be something to compel him to do it, just as the theory of the Employment Act was to compel the President to tell Congress what it ought to do. Otherwise, you don't have overall responsibility fixed in one place.

Mr. WEIDENBAUM. I think the Employment Act gives you an excellent example of how the President, if he so desires, can respond in the most general manner. I have in mind, particularly, the section of the Employment Act to the effect that the President shall specify levels of employment, production, and purchasing power. It appears, on the basis of experience to date, that the President has interpreted that in a very general manner. My own feeling is that he would interpret that sort of legislation similarly.

Representative REUSS. The next sentence in the act says that—

in addition to setting forth needed levels of production, employment and purchasing power, the President shall come up with a program for achieving the ends of the Employment Act.

In practice, whether by interpretation or by actual bad wording in the act of 1946, whereas the President does come up with a responsible program to achieve all these ends as far as what Congress should do is concerned—in taxation, and other fields—and as far as what State and local governments should do, the annual economic report brings with it such recommendations, they don't tell the Federal Reserve what it ought to do. I think they should.

If the Federal Reserve doesn't want to do it, that is fine; just as if State and Local Governments and the Congress refused to accept the recommendations. But do you really think that there is something sacrosanct about the monetary policy administered by the Federal Reserve which should exempt it from the recommendatory power of the President?

Mr. WEIDENBAUM. No. I fail to see what particular benefit would result if the recommendations from the Federal Reserve were made public instead of informal.

I can see some additional friction arising between the two organizations without corresponding benefit. I think the point that you might have to face at a later date would be who resolved the conflict between the Federal Reserve and the President.

Representative REUSS. Obviously the Federal Reserve. They are independent.

Mr. WEIDENBAUM. Or the Congress.

Representative BOLLING. Actually, historically I think the great swings have come from congressional action in a formal or informal fashion.

Representative REUSS. It seems that your argument that this can all be done by luncheons, telephones, and informal representations could apply as well to everything else the President is supposed to do under the Employment Act. He can call up his friend the Governor and tell him what ought to be done. He can talk to the leaders of Congress at the White House and get his ideas across. The structure of the Employment Act, as I read it, is to make these recommendations a matter of public record so there may be informed public debate; so that you people, for instance, can say, well, was the President right in telling the Federal Reserve Board that they ought to start a different policy?

Mr. WEIDENBAUM. Of course I am not particularly impressed with the effectiveness or the profundity of the President's recommendations to State and local governments on economic policy. I don't mean to single out any President on that.

Representative REUSS. How about his recommendations to Congress?

Mr. WEIDENBAUM. There, of course, the economic report has been used as a vehicle for transmitting the legislative program of the President, and giving it an economic environment. I wonder whether the legislative program of the President, either under Truman or Eisenhower or their successors, would be significantly different if transmitted in the budget message, as an appendix to the state of the Union message or separately in an economic report.

Representative REUSS. But we think there ought to be an economic program of the President. We would like to see a more forceful one. Similarly shouldn't there be a monetary economic program of the

President which he sends over to the Federal Reserve, which they can agree with or disagree with as they wish?

Mr. WEIDENBAUM. It is at a different level. An economic policy is a fairly broad general thing. A monetary policy of course is a more technical animal. I have in mind Treasury policy on debt management. This maybe sees even less of the light of day than Federal Reserve action.

Mr. SMITH. On that point, monetary policy is not any more technical than hundreds of other things that the Government does.

Representative REUSS. Right; like taxation.

Mr. SMITH. The notion that monetary policy is so much more complicated and mysterious than anything else that it ought to be conducted by an independent agency never impressed me too much.

Representative CURTIS. I might comment on debt management. There is some exposure to the light of day like there will be shortly when the administration comes before the Ways and Means Committee to ask for increasing it. But also we got very much into debt management when the administration came before us, I think last year on the interest rate of E-bonds. So I think it does get exposed to—it doesn't get exposed periodically, I mean at a certain time, but when certain things occur, the process does provide for its public exposure.

Sometimes though we hold our hearings in executive session.

Representative BOLLING. Dr. Talle.

Representative TALLE. No further questions, thank you, Mr. Chairman.

Representative BOLLING. Mr. Riley?

Mr. RILEY. No thank you.

Representative BOLLING. Mr. Knowles?

Mr. KNOWLES. No questions.

Representative BOLLING. Gentlemen, we thank you very much.

Tomorrow we meet in room 457 of the Senate Office Building. The subject is "Formulating Public Policies for Economic Stabiilty and Growth."

I would like the permission of the committee to insert in the record a paper on Liberalization of Depreciation Allowances for Federal Income-Tax Purposes, by Murray L. Weidenbaum.

Without objection, that is so ordered. And with that, the committee stands adjourned.

(The document follows:)

PAPER ON LIBERALIZATION OF DEPRECIATION ALLOWANCES FOR FEDERAL INCOME TAX PURPOSES

(By Murray L. Weidenbaum)

BACKGROUND

This paper analyzes a proposal that business firms be allowed, for Federal income-tax purposes, to select whatever depreciation schedule for their assets they deem most suited to their needs, including immediate cash flow writeoff. This differs from the existing rapid tax amortization program under which certificates of necessity are issued to permit writing off a portion of investment in defense-related facilities in 5 years. The latter program has been justified on the special grounds that defense-related facilities may not have a market for their products throughout the normal length of life or may become obsolete quickly.

The nature of depreciation allowances

In its latest restatement of accounting principles, the American Institute of Accountants describes the nature of depreciation allowances as follows:

"The cost of a productive facility is one of the costs of the services it renders during its useful economic life. Generally accepted accounting principles require that this cost be spread over the expected useful life of the facility in such a way as to allocate it as equitably as possible to the periods during which services are obtained from the use of the facility." [1]

In effect, depreciation is a device for measuring the annual conversion of the outlay represented by an asset into cost as the asset is exhausted over its service life. The cost is usually measured by the depreciation allowances deducted from gross income in accordance with the tax laws. However, the AIA recommends that where rapid tax amortization results in sigificantly greater depreciation charges companies should maintain separate depreciation accounts for nontax purposes.[2]

Since the end of World War II the depreciation allowances of business firms have been steadily increasing. In the calendar year 1954 they amounted to $13.1 billion for all United States corporations. Funds obtained from retained profits and new issues of securities were $12.3 billion in the same year.[3]

The Federal income tax treatment of depreciation

Section 167 (a) of the Internal Revenue Code provides for deducting as a current business expense:

"A reasonable allowance for the exhaustion, wear, and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income."

Prior to the adoption of the Internal Revenue Code of 1954, the law made no specific reference to the methods of recording depreciation for income-tax purposes. The straight line method was most frequently used, although other methods—such as the declining balance up to 150 percent of the straight line rates—were also used subject to approval of the Commissioner of Internal Revenue.

The Internal Revenue Code of 1954 specifically authorized the use of the straight line method, the declining balance method (using a rate not to exceed double the straight line method), the sum of the years-digits method, and "any other consistent method" which does not, during the first two-thirds of the useful life of the property, exceed the total of the allowances under the declining balance method (26 U. S. C. 167 (b)).

The House Ways and Means Committee stated in its report on the bill enacting the 1954 code (H. R. 8300):

"In the formation of its liberalized depreciation policy your committee relies heavily upon the use of an improved declining balance method. This method concentrates deductions in the early years of service and results in a timing of allowances more in accord with the actual pattern of loss of economic usefulness * * * based on a realistic estimate of useful life, the proposed system conforms to sound accounting principles" (p. 23).

However, the Senate Finance Committee report on H. R. 8300 revealed that the Congress was interested, in addition to attaining a realistic depreciation policy, in promoting business investment and economic growth:

"The incentives resulting from the changes are well timed to help maintain the present high level of investment in plant and equipment. The acceleration in the speed of the tax-free recovery of costs is of critical importance in the decision of management to incur risk.

"The faster tax writeoff would increase available working capital and materially aid growing businesses in the financing of their expansion" (p. 26).

However, a subsequent section of the report made it clear that the committee wished to "prevent unrealistic deductions and resulting tax avoidance." It made this statement in connection with the provision which limited the new methods to assets with an expected useful life of 3 years or more.

The 1954 code made no change in the method used to determine the period during which depreciation will be taken—the expected useful life of the asset. Bulletin F of the Internal Revenue Service[4] remains the official guide to estimates of useful life of different types of assets but firms can use a different life

[1] AIA Bulletin No. 43, 1953, p. 76.
[2] Ibid., pp. 66–67.
[3] Survey of Current Business, December 1955, p. 12.
[4] Bulletin F—Income Tax, Depreciation and Obsolescence, Estimated Useful Lives and Depreciation Rates, January 1942.

based on their own experience with the approval of the Commissioner of Internal Revenue.

ANALYSIS OF THE PROPOSAL

The general adoption on a permanent basis of a depreciation period shorter than the expected useful life of an asset would represent a comparatively new departure in the American tax structure.

Joel Dean, an economic and business analyst generally sympathetic to letting business firms select that schedule of depreciation charges which they deem in their best interest, claims that most firms would "expense" their capital outlays—write them off completely in the year of acquisition. He says, "almost any rational firm would prefer a lump-sum tax reduction this year to the same reduction spread out over a number of years in the future." [5] However, Swedish business firms, who operated under this type of system for about 17 years, are reported to have in most cases spread their depreciation charges over a period longer than 1 year.

The proposal to give taxpayers freedom in selection of rates goes much beyond the ideas of many who advocate more liberal allowances because the present system is not realistic enough. For example, George Terborgh of the Machinery and Allied Products Institute—who has been in the forefront of the campaign for more liberal depreciation—states that both theoretical and empirical evidence appear to justify writing off a two-thirds to three-quarters of an asset's value over the first half of its life, "about this degree of acceleration for short- and medium-lived assets, mostly capital equipment, though perhaps somewhat less for extremely long-lived assets, chiefly buildings and structures." [6]

Mr. Terborgh has warned that, "* * * incentive or subsidy depreciation obviously rests on a much less secure footing than does a legitimate realistic writeoff."

For the purposes of the present paper, it is assumed that a liberalized depreciation statute would contain a provision similar to that in existing law, whereby once a depreciation schedule is agreed upon between the taxpayer and the Internal Revenue Service, the taxpayer may not alter the schedule without the agreement of Internal Revenue. In the absence of such a provision, the taxpayer could alter his depreciation schedule each year in order to minimize his tax bill.

ARGUMENTS FOR AND AGAINST THE PROPOSAL

Many of the arguments in this section are taken from papers contributed to the compendium issued last year by the Joint Economic Committee, Federal Tax Policy for Economic Growth and Stability. Some of the arguments can be used either to support or to oppose the proposal, depending on the reader's personal philosophy.

Effect on economic growth and stability

Pro.—(1) It would enable and encourage business firms to invest in plant and equipment, thereby increasing the total income and output of the economy; and (2) it would encourage a dynamic economy, giving every firm the incentive to be an innovator.

Con.—(1) It would tend to be a destabilizing factor in the economy as it would encourage additional investment during expansionary periods (when incomes and profits are rising and offsets are most desirable for tax purposes) and discourage investment during contractionary periods; (2) the American economy is not faced with obsolete plant and with investor disinterest in replacing and adding to capital stock, as were some of the European countries that adopted various forms of this proposal (Sweden tightened its depreciation system recently because the destabilizing effects mentioned above were materializing to a very considerable degree).[7]

Effect on business institutions

Pro.—(1) It would permit businessmen greater freedom in meeting the economic demands of the market; (2) it would reduce the discretion exercised by

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[5] United States Joint Economic Committee, Federal Tax Policy For Economic Growth and Stability, 1955, p. 513.

[6] George Terborgh, Realistic Depreciation Policy, Washington, D. C. Machinery and Allied Products Institute, 1953, p. 543.

[7] United States Joint Economic Committee, The Federal Revenue System: Facts and Problems, 1956, p. 51.

the tax collector over business decisions; and (3) it would permit businessmen to use to a greater extent the discounted cash flows method in evaluating business decisions (whereby investments are portrayed in terms of their cash outlays and receipts, ignoring noncash items such as depreciation).

Con.—(1) It would favor debt financing over equity financing (businessmen could utilize tax deductible interest expenses in the period when no further depreciation charges could be taken on existing assets); (2) it would enhance the position of the risky investor compared to the safe investor; and (3) it would distort a firm's accounts and, hence, decisions concerning prices and dividends.

Effects on specific types of businesses

Pro.—(1) It would be most valuable to small, new, and growing companies unable to tap the organized capital markets, and (2) it would encourage investment in long-lived physical assets.

Con.—(1) It would benefit heavy industry at the expense of commercial establishments, whose plant and equipment outlays are relatively low, and (2) it would place at a competitive disadvantage those firms with small investment programs.

Effects on the tax structure

Pro.—(1) It would yield more than compensating increases in revenue as a result of economic growth; (2) it would vastly simplify the task of the taxpayer by reducing recordkeeping, extensive computations, and legal and administrative disputes; and (3) it would ease the task of tax collection and permit reductions in personnel and funds for the Treasury Department.

Con.—(1) The tax system should not generally be used for nonrevenue purposes. Accelerated depreciation provides a hidden subsidy because firms in effect have an interest-free loan of money which would usually be paid out in taxes, and (2) it causes a tax loss to the Treasury in two ways:

(*a*) the original tax saving is not offset by higher payments later in an economy where investment is continuous (see illustrative table), and

(*b*) increased taxpayments after faster depreciation of a onetime investment is completed will not occur if tax rates are reduced in the future.

ILLUSTRATIVE EFFECT ON FEDERAL TAX RECEIPTS OF DIFFERENT DEPRECIATION METHODS

With annual investment of equal or increasing amounts, the Government tax loss in the first years under a law allowing more liberal depreciation writeoffs will not be recouped in later years. This is illustrated with a table for a single firm (but is equally true for the entire economy). To save columns, a 4-year period is used as a normal period and an immediate writeoff as the accelerated rate. The hypothetical firm has a taxable income of $1,000 prior to deductions for depreciation and invests $100 a year in facilities. The tax rate is kept steady at 50 percent.

I. USING SCHEDULE DEPRECIATION ON ASSETS WITH 4-YEAR LIFE

	1st year	2d year	3d year	4th year	Each succeeding year
Taxable income	$1,000.00	$1,000	$1,000.00	$1,000	$1,000
Depreciation charge	−25.00	−25	−25.00	−25	
		−25	−25.00	−25	−25
			−25.00	−25	−25
				−25	−25
					−25
Taxable net income	975.00	950	925.00	900	900
Corporate tax	487.50	475	462.50	450	450

II. USING IMMEDIATE WRITEOFF

	1st year	2d year	3d year	4th year	Each succeeding year
Taxable income	$1,000.00	$1,000	$1,000.00	$1,000	$1,000
Depreciation charge	−100.00	−100	−100.00	−100	−100
Taxable net income	900.00	900	900.00	900	900
Corporate tax	450.00	450	450.00	450	450
Tax saving (I minus II)	37.50	25	12.50		

CONCLUSION

We do not know with certainty the extent to which business firms will avail themselves of more liberal depreciation allowances, nor the resultant effects on the economy or on tax receipts. However, it does appear that, although the proposal would be advantageous in some ways, it also has potential disadvantages and drawbacks.

Some of the more important advantages of the proposal would be the resultant simplification of tax administration, the encouragement of expansions of productive capacity, and the reduction of the Government's role or influence in business decisions.

Disadvantages of the proposal would be possible losses of revenue, creation of inequities among different industries and classes of taxpayers, and encouragement of inflationary pressures endangering the maintenance of economic stability.

Adoption of a tax proposal of such general application should depend not only on judgment about the pros and cons cited above, but, also, on the relative advantages of this proposal compared with other requests for major tax reform which have been delayed pending substantial improvements in the budgetary and public-debt situation. Other revenue proposals include reductions in (1) individual income-tax rates, generally; (2) the sharply progressive upper brackets of the individual income tax, specifically; (3) corporation income-tax rates; and (4) excise-tax rates. Some of these proposals might be fully as effective in encouraging business investment and in helping free the economy from Government controls.

(Whereupon, at 12:24 p. m., the committee was recessed, to reconvene at 10 a. m., Wednesday, May 21, 1958.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

WEDNESDAY, MAY 21, 1958

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

The committee met at 10 a. m., pursuant to recess, in room 457, Senate Office Building, Hon. Richard Bolling presiding.

Present: Representatives Bolling, Reuss, Curtis, and Senator Hoblitzell.

Also present: Roderick H. Riley, executive director, John W. Lehman, clerk, and James W. Knowles, economist in charge.

Representative BOLLING. The committee will please come to order.

The first seven of these panels have discussed with the committee the relationship of prices to the objectives of the Employment Act, the measurement of prices, the determinants of prices and price changes, the ways in which output and employment are affected by prices, how private pricing policies were formulated, and the ways in which public policies affect private pricing.

This morning we turn our attention to the merits and limitations of alternative economic policies in the light of the relationships between prices and the economic stability and growth which our economic policy should promote.

We are concerned with the criteria that can be used to determine the optimum combination of the various types of policies—monetary and debt-management policies, fiscal policies, including taxes and expenditures, and direct controls.

In many ways this is familiar ground for our committee since we have discussed many of these same problems of economic policies in discussions such as this with panels of experts during previous committee hearings.

Today, however, we are looking at these problems in a little bit of a unique way, in that we are concentrating our attention upon the ways in which our policy decisions should be influenced through considerations of prices and the relationship which they bear to the problem of achieving economic stability and growth.

We shall proceed as we have in previous panels, with each member given about 5 minutes in which to summarize the key points in his paper, which was published in the compendium. After the opening statements we encourage all members of the panel to participate freely in a very informal discussion with members of the committee, commenting not only upon other papers in the compendium but also upon questions posed by members of the committee themselves.

Our first witness this morning is Dr. Oswald H. Brownlee, professor of economics at the University of Minnesota.

Professor Brownlee.

STATEMENT OF OSWALD H. BROWNLEE, PROFESSOR OF ECONOMICS, UNIVERSITY OF MINNESOTA

Mr. Brownlee. My proposals relate to the kind of long-run economic policy that I believe will promote economic growth at rates desired by the population and at the same time will avoid serious fluctuations in the general level of economic activity and the price level. As general observations let me state that (1) I would not expect the desired course of economic growth to be a smooth one and that changes in the growth rate will be a source of fluctuations in the general level of activity. However, I do not consider it desirable to try to smooth the growth rate by means of controls imposed directly on capital accumulation or invention. (2) Prices of specific goods and services should not be kept stable. It is only stability in the purchasing power of money with which we should be concerned. (3) My proposals, or any other set that takes both the course of economic growth as selected by the population and economic stability as important objectives, can achieve such objections only in an economy that is essentially competitive. I consider much of our present economy to meet the competitive requirements. If I am incorrect, monopoly elements should be attacked directly rather than modifying growth and stabilization policies in acknowledgment of these elements.

I shall mention only two of the principal requirements for economic growth at the desired level. First, there should not be direct control of product prices, wages, or interest rates. Such direct controls make it impossible to obtain vital information about preferences for various goods and services and willingness to sacrifice current consumption for future consumption. This information is required to evaluate the performance of the economy. Also relative prices, wage rates, and the interest rate are important instruments for allocating resources. Second, we should try to maintain that amount of Government investment such that its expected marginal rate of return is the same as that of private investment. One should underline the words "try to make" in the previous sentence, for, as yet, there is not agreement as to how returns from Government investment should be evaluated. But, it is also important to emphasize that the criteria for Government investment should not be its effect upon aggregate demand and that Government should not invest in projects with returns below those of private investments simply because Government can borrow at terms more favorable than those available to private borrowers.

Making Government investment according to the criterion stated above could contribute to economic stability in that shifts of fairly long duration in private investment would be accompanied by changes in the opposite direction in Government investment. For example, if there were a drop in private willingness to invest—as is characteristic of the present recession—and a fall in the interest rate—as has not been characteristic of the current situation because of the restrictive monetary policy that has been followed—Government investment would be increased. However, such changes are not sufficient to get as much stability as we might have. An additional instrument for stabiliza-

tion that should be employed is a "stabilizing budget"—a Federal budget such that current tax receipts are equal to current expenditures when current gross national product is at some predetermined desired level, there is a current deficit when gross national product is below the desired level, there is a current surplus when gross national product is above the desired level and deficits and surpluses are accompanied respectively by expansions and contractions in the money supply. Our present fiscal structure contains elements of the desired structure. In particular, net current tax collections, in the absence of a change in the tax system, vary directly with gross national product. However, achieving a balanced budget at an appropriate level of gross national product is not explicitly sought. And, there is not assurance that an increased deficit means a larger money supply or that a larger surplus will result in monetary contraction.

That concludes my summary statement.

Representative BOLLING. Thank you, Professor Brownlee.

Next, Prof. Allan G. Gruchy, professor of economics, University of Maryland.

Professor Gruchy.

STATEMENT OF ALLAN G. GRUCHY, PROFESSOR OF ECONOMICS, UNIVERSITY OF MARYLAND

Mr. GRUCHY. Mr. Chairman, members of the committee, my approach to this problem of price stability and economic growth is from the viewpoint of the coordination of public and private policies. I believe that much of our trouble stems from the fact that we have had inadequate coordination between private and public economic policies.

For example, in 1956 and 1957, while the Government was seeking to curb inflation, at the same time negotiated wage rates and administered prices were moving in the opposite direction to Government policy; and out of this clash of opinion and views about policy, we have today a lack of integration and coordination of economic policies.

This problem is not limited to the United States. It is a problem that confronts all Western democracies under full-employment circumstances.

The growth of large unions and large business has complicated the issue in recent years, and made it increasingly difficult to get the coordination that I have in mind. The basic disagreement between labor and business, I feel, stems from a disagreement about the division of our national income between consumption and investment.

Labor presses through price increases for higher wage incomes and a higher level of consumption; and business presses through price increases for higher profits and a higher level of investment. And there is no third party to mediate in this disagreement as to how the national income shall be divided.

The result is strong inflationary pressure, inflationary pressures from the seller's side—sellers of labor and of industrial products. So the basic problem is to somehow handle this disagreement between labor and business.

I think most economists today would agree that the fiscal-monetary approach is unsatisfactory in the sense that in order to achieve a

26215—58——24

satisfactory curbing of inflation, a high level of unemployment and a low level of production would be a necessary consequence. The disease, I think, is a matter which we can agree upon—this lack of adjustment between the demands of the two parties. The cure is different. Here we have a matter of disagreement among economists. I would say that today students of the problem fall into two categories—first, those who think in terms of breaking up the concentrations in the labor and business worlds, with the hope of providing more competition among businesses, and a more competitive approach to wage making. This approach, the punitive approach, has been recommended time and again. But I feel it lacks political realism. Everybody applauds the idea but nobody sponsors it.

The second approach is what I call the negotiational-consultative approach to the problem. This is an approach which I feel is quite in line with the American democratic tradition. It is not punitive. It is not manipulative. There is no attempt to punish labor or business for being large. There is no attempt to manipulate the economy out of an inflationary situation through a fiscal or monetary adjustment.

This approach has been developed most extensively in the last few decades in the Scandinavian countries. In these countries, the wagemaking and the pricemaking processes are carried on on a negotiational basis. Labor and business negotiate within the framework of the national economic budget, which attempts to provide some criteria in the light of which the national output is divided between total consumption and total investment.

Likewise, the pricemaking process of Scandinavia is a matter of consultation between the government and the price directorates of these various countries, and an attempt is made to arrive at a price level and at individual prices which are satisfactory both from the firm point of view and from the national point of view.

In these countries, Denmark, Norway, and Sweden, you have a continuing review of the pricemaking and wagemaking processes in the light of the general economic framework which is provided by the government. And the result has been that a fairly satisfactory division of the national total output has been achieved, and also a rather constant economic expansion in the postwar period.

It is my feeling that a similar approach merits consideration in this country. I mean the negotional-consultative approach. I feel that somewhere in the governmental structure there ought to be a board or an office of price and wage investigation which would be prepared to study, to analyze, and to investigate wages and price increases to see how they affect the general functioning of the economy, the division of the national income, and how they may be developed in terms of standards to avoid inflationary developments.

This board or this office, in my opinion, ought to study these proposed changes before they are made. Reports ought to be made to the public, and the support of the public ought to be elicited with the hope that satisfactory wage and price policies would be developed. Such a board would cooperate with other governmental agencies and the Council of Economic Advisers, in order to work out a coordination of fiscal, monetary, wage, and price policies.

I don't mean to imply that fiscal and monetary policies are by any means useless. But we have put too much of a burden on these fiscal

and monetary policies. We expect them to overcome the excesses of price and wage increases. That, to me, is a burden which fiscal and monetary adjustments just can't carry. So an integration of these policies with the help of some third party in the nature of a Government board or an office would go far to develop this negotiational-consultative approach, in my opinion, and would enable us to work out price and wage, as well as fiscal and monetary, policies which would contribute to achieving price stability and economic growth at the same time.

Thank you.

Representative BOLLING. Thank you.

Next, Dr. Richard A. Musgrave, professor of economics, University of Michigan.

STATEMENT OF RICHARD A. MUSGRAVE, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. MUSGRAVE. Mr. Chairman, members of the committee, I shall not attempt in this brief statement to give a complete summary of my paper in the compendium, but only to set forth some of the major points. I start from the premise which I believe is shared by all of us here on the roundtable that stabilization policy by Government—in which term I include the Federal Reserve System—is needed.

The market economy if left to itself is inherently unstable, and it is unstable beyond limits—regarding both unemployment and price-level changes—which are tolerable in an orderly democracy.

Since this instability arises from the roots of the system, since it is inherent in the market economy, it cannot be solved by do-it-yourself appeals to consumers, labor, and business.

The basic responsibility for stabilization policy lies with Government, again including the Federal Reserve, and with the Federal Government in particular. It can surely not be left at all to State and local governments who are essentially in the position of consumers and businesses as far as instability is concerned.

Among the problems which arise in keeping with this central responsibility for stabilization policy are the following:

(1) Stabilization policy should utilize both fiscal and monetary measures. An either-or policy will be ineffective. Reliance on monetary policy alone is surely doomed to failure in the depression, as is reliance on fiscal policy alone in the boom.

(2) While the role of budget policy instabilization is vital, this is but one among other functions of budget policy. Therefore it is desirable to meet this stabilization function without interfering with an efficient pursuit of the other objectives of budget policy, including appropriate provision for public services and for distributional adjustments. On this point I find myself in agreement with Mr. Brownlee's paper.

From this premise it follows that countercyclical adjustments should be primarily on the tax side of the budget. I do not object, in a situation like the present, to accelerate public expenditure projects which should be undertaken anyhow. But I say that fiscal stabilization can and should be conducted without making work projects in

the depression and—which is the counterpart—without cutbacks on necessary public services in the boom.

Also it follows that stabilization adjustments in tax policy should be more or less neutral with regard to the basic problems of equity in the tax structure. In other words, a distinction should be drawn between (*a*) measures of tax policy which aim at making the tax structure more equitable, at providing for a higher rate of growth or other structural objectives, and (*b*) tax measures which are aimed at raising or lowering the level of demands for purposes of short-run stabilization. As I have argued previously before your Subcommittee on Fiscal Policy, I believe that responsibility for the latter type of short-run adjustments to control the level of demand should be delegated, within very specific limits set by Congress, to the executive branch. This is a function which in our system of government can only be met effectively at the executive level.

(3) The essence of countercyclical fiscal policy is that there will be periods of surplus and periods of deficit in the budget. A deficit in time of depression, or rather a deficit sufficient to avoid a potential depression, is a sign of efficient public policy. We must get away from the thought that such a deficit is a disgrace, an admission of failure for the capitalist system, a defeat in the cold war.

It is precisely this thoroughly mistaken attitude that may bring about such a failure and defeat. Moreover, I see little merit in the proposition that we cannot afford to fight unemployment because the addition to liquidity resulting from the deficit in a period of recession may cause inflation later on. Precisely the same might then be argued when it comes to dealing with the boom where restriction will be held not permissible because it may accentuate a later depression.

This point of view seems to me an abject admission of failure. Let's deal with the problem at hand and do later what is needed to meet new conditions.

(4) In recent years, there has been, I believe, too much emphasis on the thought that stabilization policy requires no active policy determination and guidance on the part of the Government, but that it may be left to the blessed workings of the built-in flexibility of the economic system and in particular of the fiscal system. Built-in flexibility is fine, provided it works in the right direction.

But at best it is quite insufficient.

Discretionary action in tax and monetary policy is required. The curves in the path of economic instability are much too unpredictable to permit us to set the steering mechanism in advance and then trustingly go to sleep. We may wake up with a bent fender if we are lucky, but more likely with a head-on collision.

This is a point on which I am in thorough disagreement with Mr. Brownlee.

(5) While most of the discussion of stabilization policy has dealt with so-called general controls, these are not enough. Selective controls may be needed to deal with particular maladjustments such as a possible overextension of consumer credit, excess accumulation of inventory, pointing to the kind of problems of selective credit control which Professor Smithies has discussed in his paper; then there may be concentration of unemployment in particular areas, and other situations which may all require selective devices.

Moreover, I believe that the distinction between general and selective controls may easily be exaggerated. To some degree the distinction is a matter of semantics invented by people who support the kind of controls which are usually referred to as general.

This consideration applies in particular to the case of so-called general monetary controls, controls the impact of which in a highly imperfect credit market may not be as even and impartial as presumed. There is less difference than usually assumed between restriction by tax policy and restriction by monetary policy.

In addition to these considerations it remains to be seen whether the traditional theory of inflation control must not be adjusted to a new environment. This traditional theory was based on the concept of a demand-pull inflation; and it is not applicable if we are now confronted with a new situation of cost and profit-push inflation.

While I am not so certain as to the degree to which the inflationary problem of the last decade should be explained in these terms—and it is very difficult quantitatively to establish this—nevertheless, to the extent that this problem exists, we face a new situation.

Now, it may be argued that expenditure restriction may still be used to meet cost and profit-push inflation if we are willing to take unemployment in exchange. The argument is correct. But the price is too high.

Nor is the problem solved by arguing, utterly unrealistically I believe, that we should return to competition throughout the economy so that no pressure groups can arise which can generate a cost or profit push.

Perhaps the problem is not as serious as it has been made out to be. But if it exists, the solution must be found either in public education, leading voluntarily to more responsible behavior, or in a new type of institutional arrangement such as public hearings on pending wage-price decisions in key industries, as has been suggested by Professor Gruchy and as is being suggested in the compendium by my colleague, Professor Ackley, arrangements which would be designed to pressure pressure groups into more responsible action.

The solution in this case cannot be provided by fiscal or monetary policies alone.

Thank you.

Representative BOLLING. Before I recognize the next witness I would like to point out the tables are turned. The last time Mr. Smithies, that you and I were together, we were participating in a seminar which you ran. I hope, and am sure, the discussion today will be as interesting and pleasant as I found that one.

Our next witness, Prof. Arthur Smithies, professor, economics, Harvard University.

STATEMENT OF ARTHUR SMITHIES, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. SMITHIES. I feel sure I will be treated with the same courtesy here as you were treated there.

My paper is very brief. And many of the points in it have already been ably summarized by Mr. Musgrave. But I shall briefly indicate what is in it.

I start with the rather elementary point that the difficulty about price policy arises because price policy is not a single objective. This point seems to be worth making, because many people seem on occasion to act as if there is a single objective of stabilizing prices.

If there was a single objective of achieving stability of the price level, there would be no difficulty whatever in achieving it. If prices were going up, you could restrict money and credit sufficiently to stop them going up. And if prices were going down, you could expand money and credit and also engage in price-support operations so as to halt the downward movement.

The difficulty arises because this policy conflicts with other important social objectives. I think the theory of monetary policy was worked out at a time when it was hoped and believed that prices were flexible. If a slight restriction of credit would produce a downward, an immediate downward, fall of prices and wages, it could be very effective.

But the trouble is, as we all know now, monetary restriction, general monetary restriction, or general fiscal restriction for that matter, results in unemployment. And I don't see any possibility of having a general policy of tightening credit or raising taxes in times of inflation without creating unemployment.

Consequently, I think our real problem in the area of price policy is that we have to achieve some kind of a compromise among price stability and other objectives such as continued economic growth and full employment.

Early in my statement I advert briefly to the two major questions, which have been much more exhaustively discussed in earlier sections of this compendium. The first question is, "What price behavior is necessary if you are going to have continued growth and full employment?"

The second question is, "Is an acceptable price behavior consistent with continued employment and growth?"

With respect to the first question, there are some important limits on the types of price behavior you can prescribe deriving chiefly from the fact that wages can't be reduced. Let me put it more accurately: Wages cannot be reduced without causing a degree of unemployment that is thoroughly unacceptable to anyone. So, it seems to me we must assume as a datum of public policy that the wage level must either remain constant or go up.

Furthermore I think if wages—if no important sector of wages can go down, the general average of wages must go up most of the time, because we do live in a changing economy that needs continual adjustment. And if in order to get adjustments you have to put some wages up, the average of wages go up. So I think the price behavior that we can expect as a minimum is the price behavior that is consistent with this wage behavior that I have previously described.

The price behavior that is consistent with rising wages depends on the rate at which the productivity of labor is increasing.

It is conceivable that the productivity of labor may be increasing so rapidly that despite rising wages you can have falling prices. My own guess is that the floor on prices that you can expect as a practical matter is stable prices.

So my conclusion is that full employment and continued growth do require either stable prices or somewhat rising prices.

The second major question I raise is whether a price behavior that we can regard as acceptable is consistent with full employment and economic growth.

If we mean by "full employment and continued economic growth" a perfectly smooth upward trend of income and employment with no fluctuations at all, I would suggest that that is not consistent with a degree of price stability that we can regard as acceptable.

If there is complete certainty on the part of business and labor that growth is going to be maintained and full employment is going to be maintained through thick and through thin, the tendencies for price increases will inevitably accumulate, because under those circumstances a strike is not worthwhile for any employer to take.

Under those circumstances whatever wage increases occur, an employer can, by definition, be guaranteed that if he puts up the prices he can sell the product. The only way of not giving him this guaranty is to create some uncertainty concerning whether full employment and growth will continue in this very smooth way. And consequently I feel that minor recessions are necessary if we are going to have an acceptable degree of price stability.

I mean by "minor recessions" recessions on the order of magnitude of those that occurred in 1949 and 1953. I hope recessions of the present order are not needed for this purpose. But I do think the degree of uncertainty engendered by a depression of the 1953 variety is necessary to create uncertainty in the minds of people that cost increases just cannot be passed on. And so I come to the conclusion that complete full employment and smooth economic growth are basically incompatible with price behavior that we regard as acceptable.

Now, I come to the last few paragraphs of my paper about the coordination of policies.

Despite these minor interruptions—I mean allowing for these minor interruptions, I feel it is possible to devise both long- and short-run policies that will keep us on, if not a smooth curve, a curve that is subject to some minor jiggles.

This requires in the first place that the general level of taxation, the general level of expenditures, and the general conditions of credit should be fixed at the appropriate levels.

I won't say any more about that. I will address the remainder of my remarks to the shorter run problems of achieving the adjustments that are necessary as you go along. Most of these adjustments, I think, arise from things that go astray in particular sectors of the economy. We have had several examples of that over the last 20 years.

I think, for instance, in 1929, a major factor was, say, speculation on the stock market. In 1937, a major factor was speculation in commodity markets. In 1955, I think the wave of buying, of enthusiasm for consumer durables, had an important part to play. And I feel that the short-run price problem involves very much nipping these short-run disturbances in the bud.

And as Mr. Musgrave has pointed out, I think a big question arises whether you can deal with these things by general controls or whether you should have selective controls.

Theoretically, you could deal with them by general controls if you had complete coordination of the general controls. For instance, in 1929, you could have tightened general credit conditions as we did in

order to try to stop the stock market speculation. And then you could have reduced taxes drastically to try to keep prosperity going, at the same time that you were controlling the stock market.

But we have not got this degree of coordination in general fiscal and tax policies to make this a practicable method of procedure.

Consequently, my final point is to urge that this committee and the rest of the Government consider very seriously the establishment of selective controls. We already have selective controls over stock market speculation that would have been enormously useful if we had had them in 1929. We also have selective control over housing. And I think we badly need selective controls over consumer durables.

The final point I would like to make is that I don't altogether share the skepticism of some of my colleagues about fiscal and monetary policy. I frankly don't think we have given fiscal and monetary policy a good enough run for its money to be completely skeptical about it. We have had, and we may at the moment be carried away by the experience of the last 3 years. I would like to push these instruments a good deal more energetically and skillfully before we get into the much more treacherous area of trying to control prices and wages directly.

Representative BOLLING. Thank you.

Are there comments on the part of the panelists on the statements of the other panelists or on anything they may choose to talk about?

Mr. BROWNLEE. Mr. Chairman, I would like to ask Dr. Smithies a question.

Are you in general satisfied with the performance of the economy since 1948 except for, say, the period of July 1950 until March 1951, the Korean war episode, and, say, November 1957 to now?

Mr. SMITHIES. I had occasion to go into the condition in 1949 and 1950 in connection with the enterprise I was then engaged on. And I convinced myself that, at that time, the depression was on the way to being over by the time the Korean war broke out. If I can make that assumption that the Korean war wasn't necessary to get us out of that depression—and my best judgment is that it was not—I am very satisfied with the performance of the American economy until 1955.

I think there is good reason for the opinion—this is very much with hindsight—that we pulled out the stops too soon in curing the 1954 depression. It may have been better to relax credit a bit more slowly at that time.

In 1955 it seems there was the first real indication of a kind of boom psychology. I am not at all sure where it came from. It may have been due in part to this rapid relaxation of credit.

Then I think things began to go wrong and we began to feel that inflation was a permanent feature of the economy.

I think with just a little bit more skill—I am not blaming anyone for what was done—the picture might have been different. If we had been able to control consumer credit during 1955 the boom psychology might have been avoided; we would have gotten a recession a bit earlier than we did; but I think it would have been a milder and a more manageable recession than the one we have.

And we might have had rather different points of view about many of these things we have been discussing recently.

Representative BOLLING. Any further comment?

Mr. BROWNLEE. My point in asking the question is we really haven't employed any what you might call special controls during this period. And it appears to me at least, if the performance of the economy has ben moderately satisfactory during this period, except for the mistakes that have been made possibly in 1955 and since, say, November of 1957, the talk about this being a new special situation seems to me not to make too much sense.

Representative BOLLING. Could I interject. I don't remember the dates, but it seems we did have consumer-credit controls during at least a couple of years in the Korean period.

Mr. BROWNLEE. That is right. We are sort of tossing the period of the Korean war out; and it would be 8 or perhaps 9 of these 10 years we are talking about.

Representative BOLLING. Further comment?

Mr. Reuss.

Representative REUSS. Mr. Gruchy, I would like to ask you about the experience of the Scandinavian countries with bringing to bear the power of public opinion upon wages and prices as an anti-inflationary tool.

Has it worked? That is to say, since 1953 have those three countries maintained something like full employment and something like price stability?

Mr. GRUCHY. With regard to the first objective, full employment, they have succeeded quite well. I might associate that with the industrial index or the flow of production. They have also maintained their production quite well.

They did not have the dips in production that we had in 1948–49 and 1953–54. And the current drop in production has not been duplicated in Scandinavia.

Representative REUSS. What about prices?

Mr. GRUCHY. Coming now to prices: They have not been able to keep their price level as stable as they would like to have done. But their general aim has been achieved. And that is to keep prices in these countries low enough so as to maintain their international trading position; in other words, to be competitive with other countries in the international markets.

They have, however, had price increases for two reasons, in spite of their stabilization program. First, the rise of world prices is beyond their control.

Now, these nations are nations in which imports and exports play a major role, more so than in the case of the United States. So they couldn't isolate themselves from the rising prices for internationally traded commodities.

That has been a major factor in their general price rise since 1946.

Second they have also had some inflation due to a wage push, because employers in these countries—Denmark, Norway, and Sweden—have paid higher wages than the negotiated wage rates. And they are now thinking about fining employers who pay wages above those agreed upon by the trade unions and the employer's associations.

So, in conclusion, I would say their stabilization policy has been effective in terms of full employment; in terms of industrial production; and in terms of changes in the price level they have succeeded to the extent of keeping their products at internationally competitive prices.

Representative REUSS. What can you tell us about the degree of acceptance of this national price-wage policy by management and labor respectively today?

Mr. GRUCHY. On no policy do you ever have complete agreement. I will say that my general observation of several months' investigation in those countries is that the general public is thoroughly behind the program. What I mean to say is the majority of the people. I would say there are some groups that are not in favor of the general program. Some of the business groups feel that there are limitations placed upon their operations of which they would like to be relieved of.

So that in certain business areas there is no complete agreement with the policy. In general I would say the policy has been widely acceptable. It has been a popular policy. The farm groups have accepted the program. The labor groups have accepted the program. And certain sections of the industrial sector have accepted the program.

Now, of course, that means that in terms of politics the majority have approved the program. And so we see the program being carried on without any letup, since the close of World War II.

Representative REUSS. In these Scandinavian countries is there a legal requirement that the governmental authorities be notified in advance of major price and/or wage increases; or does the Government agency, in fact, by reading the papers or otherwise, find out about them in sufficient time to make its impact on public opinion?

Mr. GRUCHY. That is a very significant problem. I think it ought to be emphasized very much that the businessman in the Scandinavian countries is free to set his own prices.

In other words, there are few direct price controls today. They had them in the early postwar years. They have moved consistently toward what economists call free market economy. Today a businessman can set the price he chooses to set.

Now that price, however, is of course a matter of public knowledge. There is no question of the price increase being recorded. It is up to the governmental price directorate to observe such price changes. If the Government feels the price change is not in line with the basic policy of growth and stabilization, then they raise the question with the enterprise, the firm, as to the soundness of its price adjustment.

And then they discuss the matter and they attempt to negotiate a price—not through bargaining but through negotiation—a price which will be satisfactory to both sides.

The same applies to labor. Each union negotiates with each industry its own wage rate. And there is no requirement to receive approval prior to enforcement of the wage rate.

Representative REUSS. So in both the case of wages and of prices, there is no mandatory legal requirement of advance submission, although there is, as I gather it, a custom of voluntarily coming in and saying this is what we are about to do and what do you think of it?

Mr. GRUCHY. It depends upon the industry. If it is a large industry, say, the wood products industry, they would drop around and say, we plan to do this. If it is a smaller industry, such as the textile industry, they won't inform the Government. There is a working relationship between them—well, I might say that in these countries it is rare to find a businessman or worker who is not a member of an organization.

In other words, they accept organization as a part of their way of living. Everybody belongs to an organization of some sort. So that there is a close working relationship between the Government and the various sectors of the economy.

Representative REUSS. In advocating a somewhat similar approach to our—well, how do you keep full employment without an inflation—problem here at home; you recommend a board on price and wage increases, and you also point out that one of the troubles here is that there is no governmental agency with an overall or national view of the economy which is closely integrated with wage- and price-making activities.

Couldn't the Council of Economic Advisers conceivably be invested with some such study and report powers as you are advocating and thus avoid atomizing the agencies which have to do with full employment policy?

Mr. GRUCHY. There is a section in the Employment Act which gives the Council the authority to consult with various groups in the economy—labor, industry, government, and so on—about the policies with which it may deal. That feature has never been developed.

In the 1950 annual report of the Council there was reference to the possibility of such a program being activated. But so far, nothing has been done. My general feeling is no, I prefer to see a board independent of the Council for the reason that this problem of wage and price negotiation is here somewhat different from the problem in Scandivania, because in Scandinavia they have the necessary institutional arrangements.

The employers have an overall employer association; the workers have their confederation of trade unions. Each industry is well organized and represented. We do not have such well-developed organizations on the private enterprise side.

I feel, therefore, there is a need for a governmental agency which will fill that gap. I think the Council itself is very much concerned, and properly so, with the overall broad economic policies of the Nation. After this board would attempt to deal with wage-price problems, then the Council itself would go to the higher level of coordinating wage and price problems with fiscal and monetary problems.

That is the responsibility of the Council—overall coordination. It would be too much of a burden on the Council to make it responsible for the investigation of wage and price problems.

Representative REUSS. May I yield at this point?

Representative BOLLING. Senator Hoblitzell.

Senator HOBLITZELL. I agree with Mr. Smithies about the thought that monetary controls have never been given a real chance—for instance, I think that if we had sort of exercised some restraint in 1955 we would have had a much more minor recession.

I know as a banker I was dealing with people back and forth for the last 3 years; and with these problems with the automobile dealers and things just went too far.

This extension, for instance, on automobile paper from 24 months on new cars to 30, 36, and 42 months was beyond reason. If some controls had been exercised in that respect, I think that the automobile industry would not be in the same situation in which it is today. The people overbought and overextended themselves.

You mentioned special controls. What controls would you propose?

Mr. BROWNLEE. I would have proposed no special controls. By "special controls" I mean a ceiling on a particular price, or even a particular interest rate, as far as that goes.

I do not think I would go as far as you are suggesting in imposing restraints on the length of paper for automobiles. The general monetary restraint, if it is really tight enough, would not make it profitable for a banker, or an auto dealer to advance too much credit.

Senator HOBLITZELL. This is unwise policy.

Mr. SMITHIES. Could I interject there?

Senator HOBLITZELL. Yes.

Mr. SMITHIES. I think if you made the general controls tight enough you would really create a general depression. Is this what you want to do, Mr. Brownlee?

Mr. BROWNLEE. If it was no worse than in 1953–54 or 1948–49.

Mr. SMITHIES. No, but I think if you had to try to prevent the consumer buying in 1955, or even to restrain it by general controls, you would have tightened everything up so much so that you would have had a general depression.

I think the facts of the matter are that people are prepared to pay very high interest rates, say 10 percent. Consumer credit lending institutions are prepared to pay 10 percent on their borrowings from banks, and private individuals are prepared to pay 10 percent; this is a very high interest rate.

And there is a very big margin, between that and the 5 percent or 4 percent for investment borrowers. If you are going to tighten things generally so as to make this 10 percent business unprofitable, you are going to tighten them a great deal.

This is why, it seems to me, you do have to have selective controls in this area.

Mr. BROWNLEE. If you move, say, from 10 to 12 percent, Mr. Chairman, on consumer credit charges, it would not be necessary that you move from 5 to 7 percent for business borrowing purposes.

The risk involved in consumer credit is in general so great that we do have these wide margins between what consumers pay for credit and what businesses pay.

Mr. SMITHIES. It is the shortsightedness of consumers that make them prepared to pay very high interest rates. That is the difficulty.

Senator HOBLITZELL. They never object to rates; it is the payment per month they object to. That is the thing they think about—that is the thing the average consumer thinks about.

Mr. MUSGRAVE. I would side with Mr. Smithies on this. I believe Mr. Brownlee implies—and he would probably agree to this—that if you restrict the availability of credit in an overall sort of way then it can be left to the loan preference of the bankers to allocate this restriction in the market in an efficient fashion. The trouble is that there may be a conflict, as there is throughout economic theory, between the objective of securing a proper allocation of resources in an ideal system and the problem of maintaining stability.

Now, I think Mr. Brownlee likes to think about and write about systems where no such conflict exists. And this is a very happy one to live with. If you live in this happy world, the kind of world

the classical economists thought about, then indeed you can neglect these things. But if you live in reality the situation may differ. In this case, for instance, introduction of very easy consumer credit has had a tremendous impact on consumer behavior, and this has led to a situation where there developed a maladjustment in a specific area, so that something might be said for meeting it by specific devices.

As Mr. Smithies says, the degree of restriction which would be required overall to avoid this particular maladjustment may have bad announcement effects and create unhealthy anticipations; it might just go too far to be permissible.

It is important to distinguish whether one argues in a normative system, or whether one argues in a system where imperfections exist.

Senator HOBLITZELL. Mr. Gruchy, your theory sounds something like the old NRA in terms of industry setting up these negotiations with respect to wages, prices, and so forth.

Mr. GRUCHY. Well, I wouldn't like to compare it with that rather ancient animal.

I would say "no" in the sense there are no codes involved here. This is a matter of attempting to work out criteria for the guidance of wage determination and price determination, not in terms of codes being set for various industries, but in terms of trying to arrive at the combined effect of, say, wage changes.

In this country our wagemaking process proceeds over several months in the first half of the year. And nobody knows what is going to be the total effect of the wage changes in steel, and coal, iron, rubber, and so on.

And such a board would have as its concern the total effect of these wage-rate changes to arrive at the average hourly wage-rate change. Likewise, in the price field, when steel prices change and when aluminum prices change, there is no way of seeing the combined effect of these price changes. So, again, the board would be concerned with what is the total effect of a series of price changes.

No firm has that responsibility today, and properly so; it is not the responsibility of the Aluminum Company of America to be concerned about the effect of its price change and that of steel and oil, and so on, upon the economy; it is not geared to that sort of thing.

So, this is filling a gap in a situation which would remove this lack of comprehension of the combined effects of these changes.

Representative BOLLING. Mr. Curtis.

Representative CURTIS. I would like to pick up just a little bit, Mr. Gruchy, on this point.

In your paper you said in referring to this conflict between management and labor: Neither side in this serious conflict is willing to give in. And there is in this country as yet no third party who is prepared to say what division of the total national production between consumption and investment would maintain full employment, et cetera.

I raise the question that there seems to me to be a third party. For instance, in automobiles right now there are some people who think that maybe the industry itself has priced itself out of the market; that management and labor in that particular industry continue to go their own way, the industry itself has been priced out of the market.

If that were so, or take another example—we have aluminum versus copper, and lead too, where aluminum has been able to replace the

competition in materials. Whether it was the action here or not, it could have priced itself out of the market.

Don't you think there is a third party that both management and labor in a given industry have to consider?

Mr. GRUCHY. I would agree that the market does effectively provide a certain amount of resource allocation in terms of consumer preference, and that economic system itself performs to some extent without the need of guidance.

In other words, the decisions of businessmen and labor leaders as to wages and prices do bring about a large part of the necessary allocation, but not enough to meet the goals with which we are concerned here; namely, full employment, economic growth, and price stability.

Now, you mentioned the automobile situation. I think that is much to the point.

I think as a result of automobile pricing, we are going through a tremendously costly readjustment process in that industry which I feel could have been avoided if the automobile industry had exercised more statesmanship in terms of price determination.

Now, such a board as I have in mind would be in a position to suggest, to recommend, to nudge the industry into an appropriate price policy to prevent what has happened.

Representative CURTIS. My observation would be that I think that is a process of business judgment.

I do not carry it so far as lack of statesmanship. I just raise the question that if you pay these people the amount of money they receive then I expect them to exercise better judgment.

But, on the other hand, it is a matter of constant judgment that is being exercised and mistakes are being constantly made and are going to be constantly made. I do not care who the individuals are, whether you put bureaucracy around them or if you keep them in a private enterprise sector, they remain human beings, and they are going to make mistakes on the basis of lack of knowledge, and everything else.

So, it seems to me that is implicit in the human endeavor. You have a factor here that is constantly bearing on this thing and reaching decisions within an industry.

Mr. GRUCHY. I would agree that to err is human. But I don't think that the extent of the erring is necessarily acceptable.

Representative CURTIS. I would dare suggest that people in the auto industry—both labor, where they are paying pretty good salaries; and management, where they are paid pretty good salaries; where they both have to be concerned about the economics—are more apt to come at correct decisions over a period of time than somebody you would put in a bureaucracy who would not be concerned with that particular industry.

Or do you think that a different personnel setup would bring about better decisions?

Mr. GRUCHY. I think that the automobile industry along with such experts as the Board may have in its employ would do a better job than just the automobile industry alone.

Now, this is not a matter of control. This is a matter of negotiation. The automobile industry would not have to assent to anything. If they want to go ahead and raise their prices in spite of the Board's recommendations they are free to do so.

Representative CURTIS. No they aren't. They have to consider economics. And if they don't they are going to end up just where they are. Apparently they have misjudged it.

Mr. GRUCHY. They are free to make the price apart from the Board's position and then take the consequences, as you have indicated.

Representative CURTIS. Yes, but if they continue taking the consequences, why, they pretty soon go out of existence or certainly become a less important factor in the economy.

Mr. GRUCHY. I don't think that General Motors or the Ford Motor Co. is going out of business. But I am rather confident that the price behavior of those corporations in the past several years has been unsatisfactory. A recent study of the American Management Society showed that in 1955—and I quote their figures—the return to General Motors on its net worth was "50.8 percent." Now I submit that a return of that amount is excessive and is indicative of trouble to come in the future.

The reason why it was high, of course, was that they did succeed in selling a vast number of cars and they made a good profit.

But it was too good in terms of stability.

Representative CURTIS. What did they use as net worth?

Mr. GRUCHY. The net worth of the corporation consists of the total assets minus the various obligations.

Representative CURTIS. I see. Depreciated assets and so on?

Mr. GRUCHY. Yes.

Representative CURTIS. I am inclined to agree with that. I think you do have this third element that actually serves as an umpire. As far as I can see it is the best umpire we can get to figure it out.

Mr. GRUCHY. These third parties are really the same people.

This board is an arm of the public. This is a method by which the American people, who after all are the consumers and the producers in the market, would in my opinion try to introduce a slightly higher level of economic statesmanship.

Representative CURTIS. I think we are getting back to the personnel involved. And I just frankly don't see that the motive—if you had the personnel at the Government level trying to study these things, would they have any better information or greater interest than those in the auto industry itself, whether they are in labor or management, who come to correct economic decisions?

I think that labor and management, if they could accurately appraise the economic factors, would reach the conclusion too. And I just don't think switching a decision over to a governmental sector is going to give us more information or more desire to pay attention to economics.

Mr. MUSGRAVE. But may you not actually have a situation—I am now not speaking in particular of the automobile pattern of the last year—where labor and management would not be justified in raising prices if the Government in turn would not be forced to support them; but in fact they can get together and raise prices because they can anticipate, as Mr. Smithies has pointed out, that the Government in order to maintain employment, will then have to raise the level of money demand to verify these higher prices.

With this guaranty, you might have a situation where both labor and management in doing this jointly might find out that what they did has not harmed them, because the Government will underwrite full employment at whatever price level is needed.

It is to meet this sort of conflict that such a board——

Representative CURTIS. Even if the Government does, that isn't going to get the consumer to buy, as the consumer has not been buying automobiles.

Mr. MUSGRAVE. We have sort of two problems here. One is the general problem of a cost-profit, price-wage spiral. And the other one may be the possibility of a maladjustment in a particular industry. Perhaps the one you emphasize is——

Representative CURTIS. That is why I emphasized it; because this was a general statement. But I think in this your bundle is made up of a lot of individual situations. So in order to understand the whole you have to understand each one. And I think in your individual ones, each one is up against this business of competing for the consumer dollar, competing against another kind of material like in copper and aluminum or whatever. And it is that form of competition that provides the umpire on this thing.

If they get off base too often and too far, they pay the penalty.

Mr. MUSGRAVE. But the danger is they all act in unison and the Government has to underwrite them, then they may get away with it except the poor saver whose dollar depreciates in value.

Representative CURTIS. I would be more concerned about their acting in unison if they got together or if the Government actually brought them together as a bundle.

Whereas if you keep them separate and each one having to test the market themselves, you don't get it done as a group. You have autos going the way they are going, and other industries like services going to town.

Mr. SMITHIES. Could I make a comment on this?

Representative CURTIS. Yes.

Mr. SMITHIES. I sympathize with a lot of what you say about the market. But it does seem to me that you have to recognize that the market is imperfect. And I think the automobile industry illustrates that. I mean there are the factors of credit and the factors of advertising involved. And I frankly don't think the consumers behaved very rationally in 1955. It seems to me rationality may have overtaken them partially in 1958.

This lapse, and the subsequent recovery, have been rather disturbing from the point of view of the economy.

Representative CURTIS. My point is whatever process you are going to have, you are going to have errors made.

Mr. SMITHIES. Yes I agree you are going to have errors made. Frankly I am afraid I am not very sympathetic with the board idea. But on the other hand my own position is to some extent in that direction. I urge consumer credit controls. This is to some extent a recognition of the fact that the market does not behave perfectly. But frankly I would confine interferences with it to pretty broad areas. And I wouldn't go as far as Mr. Gruchy does.

Representative CURTIS. My solution to it, of course, is more knowledge.

Mr. SMITHIES. Yes.

Representative CURTIS. The more we learn, if we have a board or anything else, if we create more knowledge of the situation, then I go along. But to me the only way we are going to make less errors is to have more knowledge of economic factors and more estimates of consumer interests and preferences and so on.

Mr. SMITHIES. Could I raise a point about the board that I would like to get elucidated. I am worried about the wage aspects of this board. It seems if any kind of an informal board is going to announce a wage policy it will say something about the wage increases it expects—the general wage increases it expects during the next year. Suppose it said 3 percent or 5 percent? How could any self-respecting union leader ask for less? If this is to be the average, how does one man say to himself, look this is the average and my union should be under it. This is a floor you put under wages and doesn't everything go up faster than the announced figure?

Mr. MUSGRAVE. One might add this question which I was going to ask of Mr. Smithies in connection with his principles of price policy.

Is the principle to be that wage rates in all industries would rise at the rate at which average productivity per man-hour increases? Or would the sound principle—leaving out for a moment the political difficulties—be that wage rates in each industry would rise in line with the increase in man-hour productivity in that industry? And also what would be the underlying assumptions as to what happens to the wage and capital share? If we let wages increase by man-hour productivity, then this assumes a social compact between labor and capital that keeps the shares constant.

Mr. SMITHIES. My point is that it does soon become a floor if you announce a general wage policy.

Mr. GRUCHY. I don't agree that the coordination between national wage changes and productivity changes would necessarily result in what you have referred to.

Mr. SMITHIES. Wouldn't you get around to saying wages ought to go up 4 percent on the average next year or something like that; that would tend to become a floor?

Mr. GRUCHY. My wages didn't go up 5 percent a year from 1945 on.

Mr. SMITHIES. It may be 2 percent. But it is something. You didn't have a trade union.

Mr. GRUCHY. That isn't exactly the point.

Of our forty-five-million-odd workers, only some 16 million are organized. It is generally recognized that wages shouldn't rise to the same extent in all industries. It is also recognized that some industries are progressing more rapidly than others. Their productivity is rising, and their output per man-hour. Therefore they are entitled to a higher wage increase than those in which the productivity increase is less.

Now if every trade union leader is going to say, "in spite of what happens in my industry I want a wage rate increase of at least 3 percent," then you don't have economic statesmanship on the part of labor.

You say that might happen.

I say the purpose of the board is to educate the public and the labor leaders to the position where they don't ask for a wage increase

in their industry which is not warranted by the productivity improvement.

So, I would countenance different wage increases in different industries just the way it happens in Norway and Sweden. They don't all rise 3 percent a year. Some rise to a limited extent. Some rise above 3 percent. It is generally recognized that productivity is a fundamental basis for such a determination.

Now you might say, "Well, that is putting an awful burden on human nature." I think that is precisely the meaning of economic statesmanship. If you are going to have wages rise in all industries at least by 3 percent and in steel by say 4 or 5 percent, of course you will have the general average going up and up and up.

I am not arguing here what is liable to happen today; what I am arguing here is that we want to change what is liable to happen today. We want to change this. Some might not have faith in the possibility of making the change. But I have faith in the possibility of making the change.

Representative CURTIS. Won't wages and profits go down when a mistake has been made?

Mr. GRUCHY. Well, I wouldn't have the mistake made in the first place.

Representative CURTIS. We are going to have mistakes made. If you are going to have this productivity, and grant wage and profit increases out of it, could this process go backward? Could we, when productivity is declining because of a big mistake in capital expenditure, and so forth, have wages and profits go down; would that include your statesmanship?

Mr. GRUCHY. Of course we are talking here about an overall program of stable economic growth; and the general thesis is that if we adjust wage changes to the appropriate availability of consumer goods, and adjust price-profit changes to the availability of investment goods so that wages are correlated with consumption and prices are correlated with investment, you get the stable growth we are talking about.

Representative CURTIS. In the auto industry where a great deal of money was spent on tooling up for this recent design, and they haven't been able to produce it, that cut back on productivity. There is no question but that decline in productivity is a result of that. Labor has been getting their increases based upon increased productivity.

Mr. GRUCHY. That is right.

Representative CURTIS. Now, then, should we in 1958 actually have a situation where the auto companies cut back on their profits, and labor actually cut back on their rates?

Mr. GRUCHY. I would say, "Yes," if the situation today in the auto industry is unsatisfactory, I would say wage conditions should take that into account and possibly not increase.

Representative CURTIS. I like that idea.

Mr. GRUCHY. I would like to point out one thing if I may. There is a slight misunderstanding, I think, in terms of my view of this board. I don't wish to imply that the board interferes or intervenes or that the board imposes controls. This is not a matter of interference and controlling. This is a matter of attempting to arrive at the knowledge of the situation as you indicated. This is the idea

being that if the knowledge is available, that with public support policies will then be created or formulated which will use the knowledge of such a board. I do have a feeling that private industries, although highly specialized in their own fields, having more knowledge than other groups, don't have the overall knowledge which is the concern of our Council of Economic Advisers.

Representative CURTIS. It might be a Joint Economic Committee set up on a permanent basis to go into specific problems like this; whole panel discussions like this.

Mr. GRUCHY. If you wish to add the board to the Joint Economic Committee, I would be very happy.

Representative CURTIS. To me it is a question of getting knowledge more than anything else, rather than changes in the personnal system of who makes the decisions.

Mr. Chairman, I have some other questions. But I will yield and get back to them later.

Representative BOLLING. Mr. Reuss.

Representative REUSS. I would like to pursue this subject a little more. We certainly agree that the fundamental need here is more knowledge, as Mr. Curtis has suggested. I wonder, however, if some modification of Mr. Gruchy's suggestion isn't a good way of procuring that knowledge.

I am thinking of the fact that the President has, for some months now, been advising labor and management in strong industries to be public spirited and patriotic about price and wage increases. Since he doesn't accompany that admonition by any standards to determine what is public spirited and patriotic, no one is able to pay the slightest attention to the admonition.

I am wondering if it wouldn't be possible, in specific cases of strategic price increases or wage increases, to develop such information that the President, instead of being able to simply give generalized advice, would be able to say: "Well, in this particular proposed price increase in steel or automobiles or whatever it is, while I am not prepared to say that some increases are not justified, the proposed increase is not justified."

I would like your comments on that because it seems that, unless we can conceive of situations in which he can say that, then, aside from outbursts of vanity and vexation of spirit, he certainly ought to stop making his generalized admonitions.

Mr. SMITHIES. Mr. Reuss, you remind me of the last time I worked in the Federal Government, which, I believe, was in 1952; I left it because I didn't altogether like the way the steel wage dispute was settled in the Government with the benefit of this kind of advice.

And there was abundant economic knowledge available. We knew everything about costs and prices and everything else. But I don't think this led to a good decision.

I frankly am rather horrified about that major price-wage question getting into the neighborhood of the White House. And I frankly have greater faith, as Adam Smith did, in some of the anonymous processes of the market than the effect of knowledge in these areas.

That is, in the detailed areas of prices and wages I feel we need an abundance of knowledge in the overall aggregate of kinds of things. And this is why I feel we ought to make every possible effort to work

the fiscal and monetary controls to the full, rather than to get into this exceedingly difficult area where knowledge may lead to political decisions rather than the exercise of economic judgment.

Representative REUSS. I certainly agree with you in the need for better tailored fiscal and monetary policies than those we now have. But I also am concerned about the fact that the third person in major price and wage decisions, i. e., the public, does not have the benefit of both the facts and analysis of the facts. The two central parties concerned—management, and if it is a wage question, labor—each has its own ax to grind, and the public interest is likely to be either lost sight of, or not very well illuminated, in the course of the negotiations on prices or wages.

Mr. SMITHIES. I agree with what you just said. But maybe this job ought to be done by organized consumer lobbyists outside the Government which would represent the consumer interest and exert pressure similar to the pressure exercised by business and labor.

Representative CURTIS. Would the gentleman yield for a question on that?

Representative REUSS. Yes.

Representative CURTIS. How would you determine what is the consumer interest?

Mr. SMITHIES. I would let the consumers do that just as you would.

Representative CURTIS. That is what I mean. How would they?

Mr. SMITHIES. I think organizations like Consumers Union and Consumer Research play a very valuable role.

Representative CURTIS. Yes; but a lot of these consumer groups that are organized, if I may say so, will show a lack of real knowledge of what is to their interest, in my judgment. They have done things that seemed to me were the very opposite of what they wanted to accomplish.

Representative REUSS. In answer to your question I would say that under our society the only real protection a consumer can have is in its elected representatives, because big labor, big management, big agriculture—the latter isn't as big as the other two—are the grindstones. And under the Employment Act of 1946, the elected person in this country who was vested with the general role of guardian was the President.

So, my thinking tends to go in the direction of saying that, among those needing more knowledge, not the least of these is the President.

The next question is for Mr. Gruchy. You speak of price and wage investigations, and I gather that you would try to formulate standards in the abstract, not only for price increases, but for price policy generally, and not only for wage increases that seem to directly cause price increases, but for wage increases or wage policy generally. Aren't you making your proposal much broader than it needs to be to accomplish what, I take it, is the core of your idea?

Couldn't you concentrate on more knowledge with relation to price increases in strategic industries; thus narrowing your proposal in a good many particulars? True, this might bring into focus wage increases, but only to the extent that in those particular industries they are caught up with price increases?

I say all of this because I share, to a degree, Mr. Smithies' distaste for more intervention in these colossal problems than is absolutely necessary.

But, I am wondering if much of your purpose couldn't be settled by something much more modest.

Mr. GRUCHY. Well, I accompanied the proposal with the suggestion that such investigations be limited to the Nation's major industries. Now if you examine the records of the Federal Trade Commission you will discover that about 200 of our largest corporations do about 85 percent of our investment, our capital expansion.

So, it would be the price increases in these larger industries only that would be a matter for consideration. I wouldn't deprive the board of the opportunity to discuss prices in any industry. But the concentration would be upon the major cases in the major industries, as you have indicated—steel and automobiles.

So the area of operations would be limited. But it would have to operate on the basis of specific cases.

Here is steel. Every time we have had a steel price increase after a wage increase, I have heard from both sides that the price is—from the labor side it is more than justified by the wage increase; from the business side it is just enough to take care of the wage increase.

I have never been able to find an independent study on the basis of which I could arrive at the conclusion as to whether or not that price increase exceeded the wage increase, the labor cost increase. Such a board would be able to arrive at a determination of this nature.

And in that fashion, these constant disagreements and controversies between the two sides would be eliminated, as far as we can satisfactorily do it, and reports would be made available to the public on the basis of this information and knowledge of which we are speaking.

Representative REUSS. That is the point I was raising. Isn't what we are really interested in the price contact point?

Mr. GRUCHY. Prices would be more crucial than wages in that sense; yes.

Representative REUSS. I wonder about trying to set general wage standards. I should think that you could accomplish most of your purpose by focusing on proposed price increases. If the public admonition, which is the end product of this exercise, in commenting adversely on a proposed price increase, has to reach back and say, "And, furthermore, the proposed wage increase is also in whole or in part unjustified," isn't that enough of a bringing into the picture of wage increases without trying to set more general overall wage standards than we have now?

I suppose that it could be said that we do have a general wishful wage pattern—that wages should not exceed productivity, more or less, by and large, and over a certain unspecified period.

Mr. GRUCHY. That in itself is a general standard. And since it is fairly well established—if you assume that is already established, then I would be willing to say "Yes, that problem is taken care of."

But in application, if the policy is not yet worked out—that is to say, wages have not moved with productivity—sometimes they have exceeded it; sometimes they have fallen behind. So, if you assume that this basic standard of wages and productivity—that this correlation has been accepted in the labor world, then that would take care of that problem.

The problem from then on would be to make sure that in the business world price developments provided adequate investment in order to maintain the desired rate of growth.

In other words, you have to relate prices and profits to the investment needs of the particular industries and then to the total economy. And that would be the basic problem in the field of price changes.

To me price problems are primarily profit investment problems.

In other words, the corporation expects to get from a price a profit; the bulk of which will go into investments either through retained earnings or will come back from paid out dividends from the stockholders.

So it is primarily a question of an investment criterion.

Mr. SMITHIES. I agree entirely with what Mr. Gruchy just said. And that illustrates how exceedingly complicated his proposal is.

It involves problems the surfaces of which have just been scratched by economic analysis. In the institution where I work, there has been a project going for about 25 years trying to explore the general subject of interindustry relationships. And I think the project itself would agree that despite great skill and painstakingness, it has gotten a very short distance in the direction we want to go.

My fear is that if such a board were set up it would act on quite different criteria. It would act more like a public utilities regulatory commission and try to establish prices on the basis of a fair return for a fair value of property, or something like that.

And it might get other sectors of industry into the same miserable condition into which the railroads now are.

I think this is a real danger in this kind of proposal. The board just won't do the kind of thing you say they ought to be doing.

Mr. MUSGRAVE. I wonder whether I might insert a somewhat different perspective on this.

Much of the struggle and the conflict in thinking about what people demand with regard to wage rates and prices is a distributional one. What should be fair wages? What should be fair profits?

Now it seems that the basic concern with income distribution in society ought not to relate to distribution of national income between wage income and profit income, but it ought to relate to the distribution of national income, from whatever source, between small incomes, medium incomes, and large incomes.

The problem here is that we should not deal with what really are distributional issues at a level which should concern itself with price determination and the efficient allocation of resources. The need is for moving this discussion out of the pricing area, of both factors of production and products, into the distribution policy area.

Some people feel that we should have a fairly equal distribution of income. This should mean that we tax large incomes more heavily than small incomes.

If, incidentally, a larger share of large incomes is profits and a larger share of small incomes is wages, a redistribution from profits to wages would result in the process.

The basic distribution problem ought to be handled through tax policy, progressive taxation if somebody likes it, and regression taxation if somebody likes that. But in any case it ought to be handled vis-a-vis total income, and not as a matter of pricing. One of the difficulties with the idea of trying to determine just prices, profits and

wages, is that we apply distribution policy in the wrong place. Distribution policy ought to be in terms of the total income which people receive, and their family characteristics and their needs.

Representative REUSS. So that, if the auto workers are getting too much, vis-a-vis the textile workers, let us say, don't try to do it by dampening their wage demands but do it by taking more of their income by income tax?

Mr. MUSGRAVE. Yes, the basic concern here is with distributive justice. If I happen to find that the average income of auto workers is $6,000 and the average income of textile workers is $3,000, then, along with other peoples whose average incomes are at these levels, I tax the $6,000 people more heavily than the $3,000 people. The important fact is that the one gets $6,000 and the other gets $3,000 and not that they are automobile or textile workers respectively.

Economists as economists have no particular business to say that income ought to be distributed more or less equally, although they may have personal judgments about this like other citizens. But economists can make the point that where we are concerned with the problem of distributive justice, it should be in terms of total income a person receives.

One of the difficulties with this board problem is that you start thinking about justice problems in the pricing field; rather than in terms of distribution of total income.

Representative REUSS. So your conclusion, Mr. Musgrave, is that really you don't see much future in fooling around with devices for bringing public pressure to bear upon wage—price decisions, and that that being so, you think vague admonitions about patriotism in that area also are futile?

Mr. MUSGRAVE. I don't feel quite as positive about it. If Mr. Smithies' small recessions should prove insufficient to handle these inflationary pressures, even though we use more fully the selective controls and all the fiscal and monetary apparatus, then, we have got to face this problem somehow. Then we may have to do something along these board lines.

But I would much rather have the distributional problem handled through the general tax system and try to avoid it at that level if it can be done.

Mr. SMITHIES. If you do have to face the problem—and I hope you won't—then I think the approach should be to alter the structure of the labor market and the product market to make them both more competitive.

One has to recognize two factors: there are the factors of wage demands and resistance to them. If the monetary and fiscal devices failed, I think one would have to go to work on the antitrust laws in the product area and the Congress would have to face the difficult task of labor legislation tending to increase competitiveness in the labor market.

Representative REUSS. Are you sure that competitiveness in the labor market would make for more moderate wage demands? Might it not do just the opposite?

Mr. SMITHIES. I don't know. I think some kinds of competitiveness could moderate them. I can see what you mean. You may have price leadership in the labor field.

Mr. MUSGRAVE. I think it would be extremely difficult, quite apart from political problems, to modify the structure of the unions in such a way as to secure this result which Mr. Smithies would like to have.

You would practically have to smash the unions. Given the fact that unionism is a highly desirable part of our social structure, I just don't see how this can be done, either on the union side or the——

Mr. SMITHIES. Well increased competition on the product side might do it.

For instance, I think there is a great deal of difference between a situation where industry in general is working over capacity compared with those working generally under capacity. I mean if industry has a fair amount of excess capacity around, it seems it is much more unwilling to pass on a wage—to raise its prices than if it is working right up to capacity, and has, therefore, no need to fear that its competitors will move in on it.

Mr. GRUCHY. May I say a word about this small recession approach that I have been hearing a lot about?

I am somewhat concerned about such an approach. I recall very well our small recession in 1949 brought England to the brink of extreme financial difficulties. The devaluation of the pound followed upon that depression. I am very much concerned about these small recessions and how they influence our foreign associates.

While it is true our recession of 1953 did not have adverse effects in Europe because they were enjoying an investment boom, the same thing is not true today. Europe is already feeling the consequences of our current recession. You just don't know when a small recession will become a big recession.

So while I sympathize with the desire to maintain a certain degree of flexibility in the economy, I think that the small recession approach is a dangerous approach and certainly not in conformity with the Employment Act, which I don't believe countenances small recessions. If you want to make a small recession small enough to be a minor adjustment, a kind of a rolling adjustment, I would go for that all right. I wouldn't define a small recession in terms of acceptability—as being comparable say to the 1949 or 1953 recessions.

We just don't know when a small recession will become a big recession.

So I think the emphasis ought to be upon removing any such dangers from our economic development and working for a program of rather sustained growth.

This would be the concern of such a board, although it wouldn't be the primary concern of the board. Its contributions would be in the direction of a fairly sustained expansion, not a completly stable expansion, but a highly sustained expansion. Perhaps we are talking about the same thing. Adjustment to me may be a small recession too. If it is, we have no problem.

I dont' like the phrase "small recession approach."

Mr. SMITHIES. I don't like avoiding that phrase, because it seems that gives a false impression. It seems you must have these fluctuations. And Mr. Gruchy gives me an opportunity to elaborate a bit.

The immediate sufferers from such a small recession are the unemployed. And I certainly feel this should be a liberal system of unemployment compensation.

It should not be called doles. It should be called unemployment compensation. And people who are thrown out of work in such small recessions should be provided with compensation.

Mr. Gruchy also gives me an opportunity to make an international point. I agree with him fully that the international consequences of recessions are serious. But what the rest of the world would like would be for us to keep ourselves in a state of gradual inflation all the time.

This would be very convenient for most of the rest of the world. It would be convenient for raw materials producers. It would be convenient for people who compete with our industries.

I just don't think we can run our economy on that basis.

But there are various international measures which can and should be taken that would protect the rest of the world from the vicissitudes that I think are inherent, that ought to be inherent, in our economy.

And I think it is most important that these insulating measures should be taken to meet the difficulties that Mr. Gruchy mentioned.

Representative BOLLING. Mr. Curtis.

Representative CURTIS. One thing I want to inject into the discussion is the statement that the Employment Act doesn't contemplate small recessions. I certainly think it does. And it goes back to the old argument that we had at the time the Employment Act was adopted, of whether you use the adjective "full" or use the adjective "maximum."

We finally hit upon "maximum" on the theory—and I think the dictionary backs it up—that that is something that is attainable, as opposed to being actually able to maintain full employment.

The maximum obtainable, of course, reflects that you are dealing with economic factors that are going to be controlled. And if small recessions are in the nature of unemployment, as Mr. Smithies suggested, well I look at it this way: We are going to have economic errors committed. And that is what it amounts to.

One other comment that I just don't want to let pass either is this: I agree with Mr. Smithies in not calling that unemployment insurance but unemployment compensation. But the whole issue on the unemployment extension was that if you couldn't relate it to employment it did amount to a dole. And anything that was not related to actual employment would have to be treated in that fashion and the argument really got down to whether it should be handled by the personnel who are in the unemployment compensation bureaus of the various States or through the relief agencies.

One of course would be unconnected with unemployment; the other would be connected with it.

Mr. SMITHIES. I agree this is a complicated matter; I mean this particular issue is complicated. The general point I wanted to make is this: I don't think it is feasible to enjoy the luxury of what I call small recessions unless everyone who is thrown out of work by them does receive adequate unemployment compensation.

Representative CURTIS. The only reason I mention it—I do think it is an interesting point—and I think you are right—if it is connected with unemployment, which means a desire to be employed, and all that goes with it, it certainly should not be a dole. And I agree with you.

I just wonder whether or not we in this recent House consideration of the unemployment compensation extension really were tying it sufficiently to prior records of employment and desire to get employment if one could obtain it.

Mr. SMITHIES. But the alternatives may be, I think, liberal unemployment compensation and highly inefficient employment. Because if your unemployment scheme is not sufficiently liberal to allow you the luxury of a small recession, as you know better than I, there would be enormous pressure on you to keep people employed frozen in occupations where they are not productive.

Mr. GRUCHY. May I interject at this point: the reason why we have a large recession today, I think, is because we were lulled into believing we would always have small recessions. We had a small recession in 1949. We had a small recession in 1953.

Representative CURTIS. Wait. I don't understand. Do you call this large?

Mr. GRUCHY. Yes, I would call the situation where there are more than 5 million people out of work, a large recession.

I would call this a large recession.

Representative CURTIS. Well, we disagree on that.

Mr. GRUCHY. If you want to call this a small recession, it makes it more serious to say this is the kind of recession we ought to tolerate. My argument against it is still the same argument.

Representative CURTIS. Well, in relation to 1949 and 1953 and 1954, I certainly think this is a different kind. But it is certainly not nationwide. It is actually largely confined to only certain industries.

Mr. GRUCHY. Unemployment is between 7 and 8 percent.

Representative CURTIS. But it is in specific industries really. It is really to a large degree in specific industries and specific States.

Mr. GRUCHY. No. Detroit unemployment is about 15 percent.

Representative CURTIS. I know. But that is what makes the national average what it is.

I say this recession is almost confined to specific industries and specific areas. That is why I say it is different from the others. But it is still not what I would call nationwide unemployment or a nationwide recession.

This is a serious thing as any recession is. But, of course, just talking in terminology you would say "large." You would use perhaps unemployment as the indication of whether it is large or small.

Mr. GRUCHY. That is right.

Representative CURTIS. That to me is a factor and an important factor. But I still would not regard—what would you regard 1939 and 1940 as?

That must have been a severe depression then.

Mr. GRUCHY. Severe depression; yes.

Representative CURTIS. In 1939 and 1940 it was 10 million. Yet that is referred to as a recession within a depression.

Well, the other point I wanted to pick up: In regard to the consumer groups, it seems that one difficulty is—the stable price as meaning the same thing as a stable dollar. I think there is a considerable distinction between a stable price for a particular product or service and what might be called a stable dollar.

If you try to keep stable prices as opposed to a stable dollar, you might well stunt growth. On this reasoning: The increase in prices

can be the result of increase in quality, but this is not really fully reflected at any time in your consumer index; it doesn't include increase in choice and other things that go into increased standards of living. It doesn't include the cost factor of taxes and other things which could make prices just go up on that basis alone without any relation to what we call traditional inflation. And I often wonder whether we tend to—in fact I think we do make a mistake in thinking in terms of stable prices.

Now, I made the comment with regard to consumer groups that not knowing what was to their best interest they sometimes hurt themselves badly. And one group did by putting a ceiling on rents in various areas. And they tried to actually—and did successfully—stunt growth in that sector to the extent that even today you have a difficult time getting people to invest in new rental property.

One final comment: I have mentioned definitions here, and this business of defining price and defining stability, I think, is at the base of some of our discussion here.

But then I have another question. We keep talking about growth, and without defining what we mean by growth or how we measure it. Most people talk of growth as if it were gross national product. Well, that may be an indication. But I am not so sure that it is actually real growth. It is a measure of activity of a given kind. You can't have any activity if you don't have the physical plant and the labor force applied to it. But you could still have the same plants and the same labor force and have a lower gross national product by not utilizing it, when you could actually have growth in your plant and labor force and not utilize it and not reflect it in your gross national product.

Then also it comes to the question, I again say, of what kind of growth. It can be an erroneous kind of growth. But that evidently is a mistake in growth and now has become a waste, as it were. To me, I am not just certain and not content just to have growth for growth's sake. It has to come somewhere to some sort of subjective judgment of what kind of growth you want. So now I come to the final question I wanted to ask. This is for the panel.

Mr. Gruchy, in your paper you start out with a statement: "The problem of securing price stability along with full employment and sustained economic growth is one which confronts all the Western democracies."

The question is this: Don't you think that same problem confronts Russia and other forms of government?

Mr. GRUCHY. No.

Representative CURTIS. Why not? To me the only difference is that they make their economic mistakes, socialize them, and bury them. But they have still got the same problems.

Mr. GRUCHY. The Communist countries have no similar problems—rather the problem is different in the sense that they order or plan their growth. They don't have depressions, recessions——

Representative CURTIS. I think they do. Do you mean they don't have people that are not being fully utilized in employment?

Mr. GRUCHY. What I mean to say is the pattern of expansion is more stable in the Communist countries because they have a forced-draft method of development. It is a forced type of planning.

Representative CURTIS. I wonder if that is so. How can that be so when you can have over the history of your economy—you actually have situations where you have had millions of people starve at one time in the rural areas; or you have people liquidated.

Mr. GRUCHY. That was in the early years.

Representative CURTIS. I still think they have got those problems. This is the real question: What makes you think that by a form of government you can escape economic laws?

Because this seems to me a statement of an economic problem that would face any group of people.

Mr. GRUCHY. May I explain that sentence? What I had in mind was that we in the Western democracies are trying to achieve full employment, sustained growth, and price stability through the democratic processes. The nondemocratic countries or, shall we say, the Communist countries, don't have the democratic processes we do. So there, their problems are different.

Representative CURTIS. I think it is the same problem. They are meeting it differently.

Mr. GRUCHY. All right. The method of meeting it is different. And we find it difficult to get sustained growth, full employment, and price stability under our democratic arrangements. I don't think it helps us at all to review the problems of Russia or China. We won't learn from them what to do because they are not democratic nations. Our problem is something we have to work out in the Western World, how to achieve these goals within the democratic setup. I was merely pointing out that this is a special problem of Western Europe; and the North and South American countries. It is different from the problem of growth in——

Representative CURTIS. I think it is different—my own observation would be that we have got a lot to learn from how Russia tries to meet the same problem, if for no other reason than that we can see how gross the errors can be if you concentrate your economic power in a central spot.

Mr. GRUCHY. The errors, you say?

Representative CURTIS. The errors, sure. Because human beings are going to make them.

Mr. GRUCHY. There are plenty of errors in Russia. But the annual rate of growth in Russia—the growth in what you refer to as gross national product, by conservative estimates, has averaged in the last 15 years about 7 to 8 percent, about twice our rate of growth. This is the rate established by the various congressional committees.

Representative CURTIS. Our committee made a study of that. And I don't think that—what did our study reveal—was it a figure like that?

Mr. KNOWLES. About 7 percent per year over the last 10 to 15 years—that is, since the war.

Mr. GRUCHY. Since the close of the war, 7 to 8 percent. Ours has been about 3½. About half of theirs.

Representative CURTIS. Taking it from their plane at the end of World War II, and at a much smaller base, your growth can be much more rapid. Can you think that can be sustained, though?

Mr. GRUCHY. No; I think the rate of growth will decline over future decades in Russia.

Representative CURTIS. Does the panel think essentially that Russia doesn't have a similar problem of trying to maintain stability of full employment and growth?

Mr. SMITHIES. I think there is a difference, Mr. Congressman. I think a private enterprise economy might be more subject to chain reactions than a Socialist one. The Socialist government may make bigger initial mistakes than the market does. But the consequence of the mistakes may not spread so easily.

For instance, suppose you had two industries, A and B, both of which are planned; and planner A may make a serious mistake. In the Socialist state that doesn't necessarily spread to industry B. In the private enterprise economy we may make a smaller mistake in A, but unless something is done about it, for instance, by compensatory, monetary, or fiscal action, it will spread to B, and I think this is an important difference.

Representative CURTIS. Then direct growth, too?

Mr. SMITHIES. Yes; they can direct the growth. And they may or may not make mistakes on that. We made a serious mistake in 1958 and they have undoubtedly make serious mistakes. I don't know how to assess this.

Mr. MUSGRAVE. Mr. Congressman, I think there is a quite basic difference between the problem of growth and the problem of stability in these two settings.

Now, I would say Russia has two basic problems in planning its growth policy. The one problem they face is to decide the extent to which they can forego consumption and build for the future. This is a preference problem, and a problem of political stability; just how fast can they go?

This has to be decided.

Secondly, after they have decided that, they have a problem of planning their capital formation in such a way that it will really give them the consumer goods which they want to have in the future; that they don't make mistakes in figuring what sort of consumer goods they ought to plan for. This is the point where they may go very wrong, because it is a tremendously complicated problem. They are apt to make mistakes and then find out that they had capital formation which was to no avail because later on they really don't want the things they are prepared to produce.

Our problem of growth again involves the question of how fast we want to go in accumulating for the future. We do not recognize this clearly as being a matter of public policy—some people would say that the proper rate of growth may be decided by the market. However, public policy comes in to some extent, even in our economy.

Now there is another difficulty, and it seems the basic point, to which your otherwise excellent arguments don't give quite enough weight. In the kind of economy which we have—and this is its weakness compared to otherwise great advantages—businessmen and consumers and everybody may make what, with any barometers available to them, seems a perfectly correct decision; yet, trouble may result in the end.

The problem is not so much that the businessman decides to produce something which the consumer in the end doesn't want, and that everything would have been all right if he had produced something else.

Everybody may make the right decisions; but there may nevertheless be rigidities in the system which make us end up with a depression and with unemployment, simply because the system isn't sufficiently flexible to make all these proper individual decisions add up to the proper total result.

The system may jam. To meet this problem of instability, given certain rigidities in the system, we can't assume that if only market decisions are made correctly by the individual firm, that then everything will come out right.

It may not come out right. This is a particular problem which results from our institutions and which is at the heart of the stabilization policy problem. This particular problem the Russians don't face.

Representative CURTIS. That is all.

Representative REUSS. Thank you, Mr. Curtis.

There is a quorum call on in the House. I want to thank you four gentlemen for your invaluable contribution to the committee's deliberations.

The committee meets again at 10 o'clock tomorrow morning in this room.

We now stand in recess.

(Whereupon, at 12:15 p. m., the committee recessed, to reconvene at 10 a. m., Thursday, May 22, 1958).

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

THURSDAY, MAY 22, 1958

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

The committee met at 10 a. m., pursuant to recess, in room 457, Senate Office Building, Hon. Richard Bolling, presiding.

Present: Representatives Bolling, Reuss, and Curtis; and Senator Hoblitzell.

Also present: John W. Lehman, clerk, and James W. Knowles, economist in charge.

Representative BOLLING. The committee will be in order please. This is the last of the nine panel discussions in which we have been considering the relationship of prices to economic stability and growth.

The distinguished economists we have with us this morning have been asked to present a summary view of the entire subject of this investigation. This is a departure from our practice in most of the committee's project. Each member of this panel prepared a summary of the study for inclusion in the compendium. These statements were written before the authors had a chance to study the views of the other participants. In addition to access to the other papers in the compendium they have been furnished with the copies of the transcripts of most of the first eight sessions.

We are interested to see what overall views of these problems result when the entire content of this investigation is filtered through the trained and experienced minds of these five outstanding economists:

We have this morning, Dr. Gardner Ackley, professor and chairman, department of economics, University of Michigan, who, in addition to his research and teaching, has had extensive Government service especially as Assistant Director of OPS.

Dr. Neil Jacoby, dean of the Graduate School of Business Administration, University of California, Los Angeles. Many of us remember Dr. Jacoby when he was a member of the President's Council of Economic Advisers.

Dr. Albert Rees, associate professor of economics, University of Chicago. Dr. Rees has appeared as a witness at a number of our hearings.

Dr. Herbert Stein, director of research, Committee for Economic Development. Dr. Stein also has had extensive Government service.

Dr. Robert C. Turner, professor of business economics and public policy, Indiana University. He is another former member of the

President's Council of Economic Advisers, and also consultant to the White House Staff.

We will now hear from our first panelist.

Dr. Ackley, you are recognized for 5 minutes.

STATEMENT OF GARDNER ACKLEY, PROFESSOR AND CHAIRMAN, DEPARTMENT OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. ACKLEY. Mr. Chairman, the panelists in today's group are supposed to be concerned with a general summary of the issues arising in the relationship of prices to economic stability and growth. Consequently, I may owe the committee and my fellow panelists an apology for dealing in my paper with only one issue. Yet I think that the issue I have selected is, by far, the most important one for this hearing and one of the most significant issues for our times: It is that of peacetime inflation; its cause and its cure.

As I see it, the unresolved question of economic analysis is this: Is inflation in the United States since World War II, and currently, a product of an excessive aggregate demand for goods and services, and thus, at least in principle, controllable by the standard measures of monetary and fiscal policy, without harm to employment and growth? Or is it something quite different? This seems to me to be the $64 question for employment and stabilization policy. Lack of a good answer to this question is at least one reason for our tragic failure to employ the means of fiscal policy to deal with our current serious economic troubles.

For what they are worth, my views on this question are clear cut. They are that our postwar inflation is not basically the direct result of excessive demand. Rather, it represents a process that flourishes under conditions of high demand, but that can and does continue to operate even in the face of some, perhaps considerable, deficiency of demand.

On the analytical side, I have criticized the usual view that inflation must result either from excess demand or from a cost push. It seems to me that inflation in our postwar economy can be understood primarily as a process of jockeying for relative position between labor and capital. In effect, the two groups extend claims that add up to more than the total national product—inconsistent claims that can be resolved only by inflation.

In thinking our way toward a more useful analysis of inflation our first step is one that many accept. Wage setting can be to some considerable extent independent of supply and demand forces: Wage rates do not rise only when demand exceeds supply and rapidly fall in the reverse situation. The symbol of this, in my mind, is offered by General Motors' recent proposal that the existing UAW contract be renewed. This obviously represents the lower limit of any settlement which will emerge in the automobile industry. This contract provides not only for wages that rise automatically in response to increases in the cost of living, but also for a further generous annual wage increase euphemistically described as reflecting increased productivity. And how many automobile workers are unemployed?

The second step toward a more realistic analysis of inflation is one that fewer economists take—or they refuse to see its relevance.

It is to recognize that, in important measure, prices for goods and services are also significantly independent of demand conditions.

Most prices, like most wage rates, are not set by impersonal market forces and at levels which adjust sensitively to "clear the market". They are "administered."

Several contributors to our compendium argue that administered prices and administered wages may actually dampen inflation: In response to excess demand they rise much more slowly than would sensitive, flexible, clear-the-market prices and wages.

I agree thoroughly. That is just my point. Wage rates and goods prices today are to a large extent insulated from demand supply considerations. This means that the demand inflation analysis is not even very relevent to a situation in which excess demand clearly exists. And it also means that it is not relevant to a situation in which there is no excess demand.

If we want to understand inflation, we have to look at how prices and wages really are set, and how and when and under what circumstances they change. If we must have an oversimplified "model" to summarize and clarify our thinking—and I believe we must—I suggest a simple "markup" model. Prices in this model are determined by producers in the short run primarily by applying standard markups to costs, with an effort to include in the markup or exclude in the measurement of costs some part of the rise which occurs in productivity. Price inflation then occurs when costs rise.

Costs are either other people's prices or they are wages. Wage rates in the model are set to reflect the cost of living, with a strong effort by labor to appropriate a larger part of the pie. In effect labor tries—and significantly succeeds—to apply a constantly rising "markup" to the cost of living.

Many contributors to this compendium see the significance of administered wages and prices in preventing price declines when there is excess supply. This again accepts my premise but fails to follow through to its significance. Not only do administered prices and wages not fall in response to excess supply, they can and do rise if costs rise. Since every man's price is someone else's cost, all costs and prices can rise even with excess supply.

Of course demand and supply are not without influence. Changes in the relative supplies and demands for different goods or kinds of labor gradually readjust the relative markups, fortunately preserving sufficient relative price flexibility to aid in sensible resource allocation. And the general average of the markups which producers apply in pricing goods, and the general average of the markups that management and unions apply to the cost of living in setting wage rates, both tend to rise moderately in response to higher demand and to fall moderately in response to lower demand.

I think my contribution, if any, to finding a means of controlling peacetime inflation lies in the clarification of analysis. Nevertheless, my analysis leads me almost inevitably to the view that we must look in new directions for a method of control. I have little confidence in my specific suggestion, which is a permanent watchdog commission on prices and wages, but I think that it is in the direction which we must ultimately pursue, and that it might help us gradually to evolve an adequate solution.

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However, I regard our discussions here today as being properly directed primarily toward an understanding of the problem of prices in relationship to stability and growth, leaving to the committee and the Congress the task of forging solutions.

Representative BOLLING. Thank you, Dr. Ackley.

Next, Dr. Jacoby.

STATEMENT OF NEIL H. JACOBY, DEAN, GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA, LOS ANGELES

Mr. JACOBY. Mr. Chairman, I should like first of all to apologize to the committee and to my colleagues for not having a written summary to present. I was on the point of preparing one when the virus got me down. And I have just gotten up to come to the hearing. If desired, I will submit a written summary afterward.

I have had an opportunity to read most of the other papers in the compendium. I would like in about 10 minutes to set out my own summary of the problem before the committee, which will consist of a synopsis of my own paper modified in some respects by my reading of other papers in the compendium.

In my own paper I set out at the beginning five hypotheses about the relationship of price behavior to steady economic growth in the United States, which I examine and defend.

The first is that stability of the price level is an objective of the Employment Act parallel in every sense to full employment and full production and of equal importance for public policy.

Second, a stable price level promotes real economic growth in the long run. Inflation, creeping or otherwise, has the effect of reducing the average annual gain in the real output of a competitive free market economy.

Third, full employment and a stable price level are compatible economic objectives, provided that competition is pervasive, prices are flexible, and resources are mobile within the economy.

Fourth, creeping inflation of 2 or 3 percent a year appears to be a very recent phenomenon arising from a complex of causes and calling for a broad program of economic reform.

And, fifth, a program to reduce or eradicate the causes of creeping inflation involves actions desirable on other grounds, including the need to strengthen the efficiency of the United States economy and to improve our diplomatic position in the world.

First, as to the parallelism of price-level stability and full employment as objectives of the Employment Act: I think it must be concluded that price stability or price-level stability is only an implicit objective of the Employment Act, but that there is much to be said for making this goal explicit by amendment to the act. The merits of doing so would be, I think, to call continuously to the attention of Congress and to the Federal Executive the need for examining the implications of every action for the price level as well as for the level of employment. I would be willing to argue, for example, that had the Employment Act contained such an injunction from the beginning it seems probable that the basic inflationary policy of Federal Reserve support of the market prices of United States Government securities

would have been discontinued long before March of 1951, and that the postwar rise of price levels would have been less extensive than it was.

In my paper I also examined year-to-year changes in the basic economic factors with which this committee is now concerned—annual changes in real output, in consumer prices, in productivity, in wage rates, and in business profits.

The main conclusions that I think one draws from such an analysis (which should be extended and made much more intensive than I have been able to) are these:

First, that over the postwar period, the 11 years of 1946–57, we have witnessed a 90-percent increase in hourly wage rates, which exceeded the sum of 37-percent increase in output per man-hour and a 44-percent increase in the Consumer Price Index. This seems to indicate that an excessive increase in wage-costs was a central factor—not necessarily the causal factor—as I shall argue later—in the postwar inflation.

Secondly, that some part of rising wage incomes have been accompanied by a shrinkage of business profit margins as well as by a rising cost of living. I think the shrinkage in profit margins is a matter of great importance for the future growth of our economy.

Thirdly, there has been no clear relationship between annual gains in real output and annual increases in the Consumer Price Index. And while the record is inconclusive in revealing and price-output relationship, it certainly lends no support to those who contend that inflation promotes increases in real output.

Fourthly, another significant factual consideration is that during the 4 calendar years 1952 through 1955, which included a brief business recession, the United States economy enjoyed an increase in real output of nearly 14 percent, accompanied by a lift in the Consumer Price Index of only about 3 percent. Now, this experience, which is very recent, suggests that a satisfactory annual average rate of growth of the economy—although not an absolutely steady rate—is possible only with nominal changes in the cost of living.

Fifthly, the movement of the Consumer Price Index since the Second World War has not been one of steady ascent. It has not been creeping inflation in the strict sense of the word "creep." Nearly three-quarters of the rise was an aftermath of World War II, the removal of wartime controls, and an incident to the Korean conflict. The most unsatisfactory segment of the postwar record of price and output changes occurred during 1957 when a gain of less than 1 percent in real output was accompanied by an increase of more than 3 percent in prices. And this suggests to me that true "creeping" inflation is a phenomenon of quite recent origin.

I have attempted to examine this phenomenon at some length. I shall here not attempt to reproduce my argument, but rather shall cite the conclusions that I have reached, and which I think have been borne out by many of the economists who submitted other papers. I believe that the primary causes of the recent inflation may be summarized under five headings.

First, inadequacies in the coverage, in the timing of usage, and in the power of fiscal and monetary controls, which have permitted the price level to rise unnecessarily during the latter expansion phases

of business cycles. To be specific, it appears to me—and I believe Professor Rees made note of this in his submission—that monetary controls should have been invoked more vigorously at an earlier stage of the 1955–56 boom. I also feel that they should have been relaxed more quickly and more vigorously as that boom ended.

Secondly, another cause of the inflation has been various governmental price-raising and price-supporting programs which have tended to increase or to prevent a reduction in the prices of individual commodities and services, and which have therefore retarded the movement of manpower and capital into more efficient employments.

A third set of causes, I believe, we find in tariffs, import quotas, and other impediments to trade between the United States and foreign countries which have sheltered inefficient domestic producers from foreign countries which have sheltered inefficient domestic producers from foreign competition, have restricted the foreign markets of efficient United States producers, and have also prevented the movement of manpower and capital into their relatively most productive employments.

A fourth set of causes are various monopoly powers possessed by labor unions, business corporations, and other private economic groups which have tended to make entry difficult into given lines of activity, to restrict output, to dampen advances in productivity, and thus to maintain wage rates and prices above competitive levels and to create pockets of unemployment, even in the face of an aggregate demand that is not excessive, but may even be deficient.

Fifth—and I lay some emphasis upon this, although it is not strictly an economic factor—a public opinion which has been inadequately informed regarding the causal forces producing the rising price level and the adverse consequences of dollar depreciation. The public has been insufficiently aroused up to recent days to censure those responsible for inflation and to demand necessary reforms in public and private economic policies. And in our society it seems the public opinion as well as the amount of unemployment is a very powerful influence on the kind of wage agreements we get.

This leads me to consider what actions may help us solve this problem of maintaining a high level of employment—full employment, if you will—in a regime of overall price-level stability. I believe that any such program must be very broadly based. There is no panacea. And I would say further that the prevention of inflation in the future, while maintaining a high level of employment, entails the taking of actions that are thoroughly desirable on other grounds. It calls for actions that should be undertaken even though they had no effect on the price level.

A true anti-inflationary public policy is one that will promote the overall efficiency of the United States economy, its flexibility, and its trading and investing relationships wtih other parts of the free world. It is, in short, a policy that will immensely strengthen the political influence of the United States throughout the world by binding our country in a growing network of efficient trading and investing relationships with all countries outside of the Soviet orbit.

An anti-inflationary public policy for the future should, I believe, include the following elements:

First, the sharpening of our instruments of monetary and fiscal powers, to make them of broader and more equitable application; to make all elements of the financial structure sensitively responsive to flexible monetary policies, and to use these instruments of monetary and fiscal policy more promptly and decisively than they have been used heretofore. I, for one, do not believe we have yet witnessed a truly flexible monetary policy adequate to the requirements of a reasonably stable and growing economy. Nor have we, as a matter of fact, either, had a closely coordinated and sufficiently flexible fiscal policy to strengthen monetary action.

Second, the extension of competition throughout the economy. This, I believe, involves not only vigorous enforcement of our antimonopoly laws to those segments of activity to which they are now applicable; but the extension of these laws to cover labor unions, cooperatives, and other presently exempted activities, so that the entire range of private economic activity may be brought under the scrutiny of the courts.

In principle, it seems quite indefensible that any kind of private activity ought, per se, to be exempt. It is time the courts got to work, I believe, in laying down ground rules concerning conditions of entry into all kinds of unionized or professionalized activity in our country; and concerning featherbedding, and to reduce excessive monopoly powers which result in rigid wages and prices, in immobile resources and thereby in unemployment even in the face of inadequate aggregate demand.

Thirdly, the gradual withdrawal of Government from various price-fixing and price-supporting programs, whether in agriculture, or in metals, or other commodities.

Such programs also have the effect of preventing price flexibility which is essential if the price system is to function well as a resource-allocating device. In the field of agriculture it seems that the essential bankruptcy of our present policy is already rather clear. We must shift to some scheme of agricultural aid that involves aid to persons and not the supporting of agricultural prices.

Fourthly, a reduction in tariffs, import quotas, and other restrictions upon international trade, which have also operated to prevent necessary price adjustments and to foster the growth and the persistence of inflationary forces in our economy.

All of these elements of an anti-inflationary program involve, of course, actions that will necessarily need to be the subject of study by Congress. And I do not attempt to spell them out further here.

I think it important, however, to recognize their relevance to the problem of inflation, which I repeat is not a problem to be solved by some panacea, such as abolishing industrywide collective bargaining. And certainly it is not to be solved, if we are to be true to the traditions of a free economy, by the direct control of wages or prices by governmental authority.

Thank you, sir.

Representative REUSS (presiding). Thank you, Dr. Jacoby. I see that Senator Proxmire is sitting in the back of the room.

Senator Proxmire, you are very welcome to come up and join us up here.

The next panelist is Dr. Rees of the University of Chicago.

STATEMENT OF ALBERT E. REES, ASSOCIATE PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. REES. Thank you, Mr. Chairman.

In this summary, I shall list very briefly the main points made in my paper in the committee's compendium.

1. Both reasonably stable prices and reasonably full employment are major goals of Government economic policy. The employment goal has been set forth in the Employment Act of 1946. It would now be desirable to give similar explicit recognition to the goal of price stability.

2. At times, as at present, the goals of full employment and stable prices come into conflict. There is some evidence that over the years this conflict is gradually becoming more severe, but this evidence is by no means decisive. Consumer prices have always been rather slow to turn down in business recessions. The conclusion that we are suffering from a new kind of inflation—sellers' inflation or cost-push inflation—is surely premature.

3. To the extent that we must make policy choices between fighting a severe recession and fighting gently rising prices, our choice must be to fight the recession. Both recessions and inflation distort the distribution of income; recessions slash the income of the unemployed, while inflation erodes the income of pensioners, bondholders, and some salaried workers. But recessions not only alter income distribution, they also cut the income to be distributed, and thus are the greater evil. If we minimize them, we can use the added income in part to compensate victims of inflation.

4. To some extent, the conflict between reasonably stable prices and reasonably full employment may be an illusion resulting from upward biases in the price indexes. Although the Consumer Price Index is one of the best price indexes in the world, it is probably inadequate for some of the policy uses to which it is being put. In particular, the index is probably biased upward because it does not allow fully for the improvement in quality of the goods and services priced. It is not unlikely that there has been no rise in the true price level in the past 5 years. Thus we may be paying an excessive price in unemployment to hold down the index through monetary and fiscal policy when we could at a minute fraction of this cost improve the index instead.

5. The goal of reasonably stable prices applies to the general price level and not to the prices of particular goods and services. The Government should not seek to control particular prices, nor should it urge sellers to gear prices to costs. When demand rises where resources are fully used, an increase in prices relative to costs serves important economic functions. It allocates the commodity to the most essential uses until supply can be increased, it encourages the postponement of purchases and the use of substitutes, and it stimulates the increase in supply. To be sure, there are some interferences and lags in these responses, but it should be the task of Government to reduce these, not to reinforce them.

6. The role of administered prices in inflation seems to me to be widely misunderstood. To a large extent, administered prices are fictitious; they do not represent the prices at which sales are actually made. To the extent that administered prices are real, they tend to

rise more slowly in an inflation than competitive prices. The justified complaint against administered prices is that they are too slow to fall when demand falls.

The proper cure for this is surely not more Government regulation or supervision of private pricing, which would make prices still more sticky and rigid. Instead, the Government should increase its efforts to promote competition, and should relax or remove the many Government measures that now set minimum prices on a wide variety of commodities.

7. There is no firm evidence that unions are a cause of inflation, and there is a good deal of evidence that in rapid inflations wages set by collective bargaining lag behind other wages. The view that gradual inflation results from a "wage push" is based on casual observation, which can be highly misleading. Much further study is needed before it can be accepted as a basis for public policy. It would, however, be a contribution to economic stability for unions to forego wage increases during recessions in industries where unemployment is high. By raising costs, such wage increases are likely to create more unemployment, which would be offset only in part by any favorable effect of the wage increase on purchasing power.

8. In seeking to combat both recessions and inflation, we must be careful to choose monetary and fiscal policies in each phase of the cycle that do not aggregate the opposite phase. Our anti-inflation measures must not linger into recessions, our efforts to combat recessions must not nourish subsequent inflations.

On these grounds, the so-called built-in fiscal stabilizers are our best weapons for economic stability. One of the most important of these, unemployment insurance, has been allowed to fall into a shocking state of neglect. I favor immediate strengthening of the unemployment insurance system along the following lines:

(*a*) Extension of benefit duration during recessions, with extended benefits not charged against the payroll taxes of particular employers;

(*b*) Increased benefit levels to be specified by Federal standards; and

(*c*) Extended coverage of the unemployment insurance system.

It will also help to minimize the conflict between fighting recession and fighting inflation to rely on tax cuts rather than expenditures as the principal discretionary weapon against recessions. Most expenditures on public works authorized now would not actually be made for more than a year. By that time, inflation might be our primary problem. Tax cuts, in contrast, would be effective immediately. I would favor an immediate cut in Federal taxes of not less than $5 billion. Our needs for schools, hospitals, and urban renewal should be met with long-range programs to be adopted on their merits and carried on regardless of business conditions.

9. In conclusion, let me emphasize that the problems I have touched on, though very difficult, have always been difficult. There is no reason to believe that there has been any radical recent change in the nature of the American economy that would justify Government intervention in the setting of prices and wages.

Representative REUSS. Thank you, Dr. Rees.

Next is Dr. Stein, director of research, Committee for Economic Development.

Dr. Stein.

STATEMENT OF HERBERT STEIN, DIRECTOR OF RESEARCH, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. STEIN. This committee has obtained the views of 47 economists in 700 closely printed pages and has already heard most of these economists explain themselves in 2 weeks of hearings.

It would be presumptuous for me to think that I could add something new at this juncture. Moreover, since my paper has the distinction of being the second shortest in the compendium I feel little need to summarize it—I had originally written "shortest," but I discovered Dr. Smithies outdid me.

Instead I would like to emphasize four points:

1. There is some discussion in your compendium of the inflationary gap and the deflationary gap. I would call your attention to two other gaps. The first is the gap between what we do and what we know. This is the policy gap. The second is the gap between what we know and what we need to know.

This is the knowledge gap. The papers in the compendium seem to run at two levels because some are concerned with the policy gap and some are concerned with the knowledge gap. Some deal with the kind of inflation that we know has existed and that we know how to prevent.

The problem here, as in the old story about the farmer, is that we haven't farmed as well as we knew how to farm. We haven't used anti-inflationary policies that we could clearly identify as appropriate. Some of the papers deal with a kind of inflation the very existence of which is uncertain and the remedies for which are even less clear if it does exist. This is a subject on which a great deal more study is needed. But in our fascination with the intellectual problem of cost-push inflation let us not forget that the overwhelming proportion of the inflation we have actually experienced has been demand inflation, that we know how to deal with it and have an obligation to prevent it.

2. I suppose that the main evidence for the existence of cost-push inflation is the experience of 1955–57. In appraising this experience we should remember that it followed 15 years of demand inflation, which strongly, but perhaps not permanently, influenced the behavior of the economy even after the demand has subsided. In this connection I am much impressed by the remarks of Sir Dennis Robertson of Cambridge University.

> The habit of demanding large and frequent increases in monetary rewards grows by what it feeds on, and may be found to linger on after, as a result of the successful application of monetary and fiscal pressures, justification for it in the technical state of the labor market has passed away. Economic forces, as my teacher Pigou has reminded us, "operate upon human beings, not upon electrical machines of perfect sensibility," Nobody, therefore, can guarantee that an ebbing of the high tide of inflated demand will not, unless wise counsels prevail, lay bare rocks of inflated wage claims, which will lead to industrial strife if denied and to loss of trade and consequent unemployment if conceded, unemployment for which the prime responsibility would then lie not upon those who have done their duty in safeguarding the standard of value but upon those who have got into the habit of opening their mouths unreasonably wide.

3. I do not believe that the evidence forces us to the view that there is an irreconcilable conflict between high employment and stable prices under present institutional arrangements and public policies. But it is not possible to be confident about the future trend of these arrange-

ments and policies and their implications. Optimism would have to be based on the expectation that reasonable competition will be maintained in business and labor markets. And since the necessary degree of competition will not maintain itself it will have to be maintained by public policy. This applies both to business and labor. But the main question, as I see it, concerns labor. We have at least a public philosophy and law intended to maintain competition in business. We do not have the beginnings of such a policy with respect to labor.

4. In all the discussion of the compatibility of high employment and price stability I miss any consideration of the wage rate implicit in the definition of high employment. I suppose that there are millions of housewives who would be willing to take paid employment if they could earn the wages received by some of our better-paid movie stars. But we don't consider these women unemployed. That is, we have the notion that unemployment is a state of inability to obtain work at some reasonable wage, not inability to obtain work at whatever wage might be specified by the jobseeker.

In the 1930's there was considerable argument about whether workers unable to find work at the existing wage level, but unwilling to accept any lower wage, should be counted as unemployed. This argument was settled, or abandoned, on pragmatic grounds—that wages simply would not go down. That is, we accepted as the goal of high employment policy the employment of those willing to work at the prevailing wages.

I do not think the consensus reached in the 1930's implied that the maintenance of high employment requires the provision of job opportunities for those willing to work only if their wages rise X percent a year, regardless of what X may be. It is important for this committee, charged as it is with some responsibility for the achievement of maximum employment, to decide whether it wants to make this step. In some of the papers submitted to you the question is raised whether price stability is consistent with the Government's commitment to maximum employment. I am asking whether this commitment includes the provision of job opportunities for people willing to work only at wage rates inconsistent with price stability.

Representative Reuss. Thank you, Dr. Stein.

The next panelist is Dr. Turner.

STATEMENT OF ROBERT C. TURNER, PROFESSOR OF BUSINESS ECONOMICS AND PUBLIC POLICY, INDIANA UNIVERSITY

Mr. Turner. I feel a little bit like the tip of the tail on a very long dog.

A number of participants in these panels have identified—rightly I believe—cost-push pressures as the primary cause of inflationary tendencies in the nonagricultural sector of the economy in recent years.

The term "cost-push," however, is an unfortunate one in that it focuses attention solely on the cost side. It fails to recognize that every cost to one man is income to another. An increase in wages is an increase in costs to the employer, but it is increase in income to the worker. An increase in the price of steel is a cost increase to the automobile manufacturer, but it is income to the steel company.

It is sometimes contended that a cost-induced price increase cannot be sustained unless it is matched by a price decrease elsewhere because otherwise the market would not clear.

This argument may be valid as applied to the individual firm or industry acting alone. But as applied to an entire economy in which cost-induced price increases are fairly prevalent—and this is a point widely missed by writers on this subject—if there is no effective monetary restraint on the autonomous creation of money income, and if such increments in income are promptly spent, a cost-push inflation creates its own demand. A much better phrase to describe the process, if I may borrow a term from the electronics industry, is "push-pull" inflation.

On the whole, as we look over the historical record, the correlation between nonagricultural prices and business activity is high. But it may be that the historical relationship between prices and business activity has taken a new twist. Downward price swings are still not conducive to economic stability; of that there can be little doubt. And upward swings in prices seem to be conducive to economic stability.

But they do not assure economic stability and recent experience seems to suggest that significant declines in business activity can occur in the face of rising prices—perhaps even that stable prices may be impossible to achieve except at the expense of economic instability.

And the reason for this lies in the disassociation of the price-making process from the employment—and production-creating process. Prices, to an economically significant though not complete extent, are related, not to demand, but to costs. And the price- (cost) setting process has been shifted from the competitive market place to the conference table, whether it be the conference table where labor and management negotiate a wage agreement or the conference table of the large business firm where administered prices are set.

The case for push-pull inflation should not be overstated. There is still a substantial complement of competitive, demand-oriented price setting. And obviously if sufficient monetary pressure is applied, or if recession deepens into depression, prices and wages must ultimately respond to declining demand. But the point at which they respond may be well below that level envisaged in the term "economic stability."

Economic growth is also influenced by movements in the general price level. Looking at the matter strictly as a long-run problem, the conclusion is usually reached that, whereas deflation may serve as a drag on long-run growth, inflation does not accelerate it. This conclusion does not necessarily follow, however, when we recognize that growth is the product, not only of these long-run factors, but also of short-run and presumably temporary factors. In a sense, growth is simply a series of interconnected short runs. It occurs, not in an even, smooth progression, but in a series of jerks and spurts, the character of which is determined largely by short-run influences. And it does not occur automatically, simply as the inexorable result of these underlying factors. The long-run forces may not have a chance to exert their proper effect unless, in the immediate short run, the appropriate people make the necessary decisions and take the necessary actions to make growth a reality.

The size of the labor force fluctuates with changes in the availability of jobs. Average workweeks are partly a function of the level of economic activity. Labor productivity itself varies with the level of activity. Technological research and especially innovation are accelerated when business is good and retarded when business is bad.

All of these are important contributors to the process of growth. To some extent, growth may occur when short-run forces are unfavorable. But in the main, the forces which produce a vigorous upswing in the current volume of business activity are the same forces which generate long-run growth.

Inflation, to the extent that it stimulates a high level of business activity, also tends to stimulate long-run growth.

Moreover, once an expansion in output is generated by strictly temporary, short-run inflationary factors, the growth process creates the conditions to sustain itself. Marginal workers may decide to withdraw from the labor force, but youngsters just coming into the labor force take their places and find jobs to take.

An expanded labor force, if short-run conditions permit full employment, generates the income to create the demand for their output. Productivity increases, from more and better capital, from better techniques of production, from better attitudes toward work, are seldom lost once they are achieved. Output per man-hour sometimes fails to increase as much as long-run considerations would suggest, but rarely does it actually decline.

Thus, long-run growth is inseparable from short-run fluctuation. This is particularly true if these short-run factors persist, as they often do, for months or even years and thus provide an important, perhaps strategic, stimulus to the very forces which make long-run growth possible.

The fact that long-run growth is strongly affected by short-run fluctuation forces us to reexamine the relationship between price level shifts and growth in the light of the conclusions reached in the first half of this paper regarding economic stability. If it is true that our economy has changed its character enough that a gradual upward movement in the price level is a necessary condition of relatively prosperous short-run business activity, this is a fact of great importance to economic growth. It would mean that efforts to restrain inflation by measures focusing on demand would not only create unemployment; they would inhibit the process of growth itself. Or conversely, we would conclude that inflation, in some uncertain degree, has become a necessary prerequisite to growth.

The evidence is not conclusive, but it is strongly suggestive, that this growth cannot be reconciled with price stability.

Representative Reuss. Thank you, Doctor Turner. I would like to give the members of the panel an opportunity to comment on the testimony that has been given here and to ask any of their colleagues any questions they may wish before we of the committee get to our questions.

Dr. Stein.

Mr. Stein. I would like to ask Dr. Ackley a question: On page 2 of his statement he explained the process of inflation as a process in which both parties, labor and business, are in combination trying to get more out of the national product than the national product will produce. That is, their claims add up to more than the total national

product. Then he goes on to say these inconsistent claims can be resolved only by inflation.

Now, it seems to me that we could say that these inconsistent claims cannot even be resolved by inflation; that is, inflation as such, since it only adds to the monetary values of things and does not add to the real output, does not provide a basis by which the two parties in combination can get more and certainly provides no basis by which they, in combination, can get more than the national output.

Representative REUSS. May I ask the members of the panel to speak up a bit; because this is a most interesting discussion; and I hope the people in the back of the room can hear it.

Mr. ACKLEY. Mr. Stein, I think you are entirely right. I should not have allowed the contrary impression. As a matter of fact, in my paper I explicitly point this out. Let me read the paragraph which is directly relevant:

> What needs to be recognized is that it is the attempted or desired markups by labor and business which are too high individually or in combination. The actually realized markups can never be inconsistent. The two interest groups can lay claims that add up to more than 100 percent of the national income, but they can never receive more than 100 percent. It is inflation that chisels away the excess. And to say that social policy should find a better way of chopping these inconsistent claims down to size is not to say that either group must necessarily take a smaller share of the national income than it is, in fact, getting.

Certainly you are entirely correct in calling me on this.

Representative REUSS. Anything further?

If not, Mr. Knowles, you seem to hold in your hand a document. What is the document?

Mr. KNOWLES. As of 1 minute ago, they released the Consumer Price Index for April. Since we are considering prices, I thought the assembly would appreciate hearing the figures. The Consumer Price Index rose another two-tenths of a point from the March level of 123.3 to 123.5; an increase spread through food, housing, rent. The rest of the components were either stable or declined. There was a decline in apparel, in transportation, and in other goods and services.

The index was still rising in April, dominated particularly by food, rent, and services.

Mr. TURNER. It seems to me that many of us in these panels—and I confess I have been guilty on occasions myself—have made the mistake of using the term "inflation" to be synonymous with a high level of business activity and employment, and to use the term "deflation" to be synonymous with a low and declining level of business activity and employment.

Mr. Rees in his paper assumed synonymity in the two terms; and I believe Dean Jacoby did also. Dean Jacoby said we need a more truly flexible monetary policy. I would like to ask Dean Jacoby just exactly what policy the Federal Government should have followed in the last 9 months; watching the price indexes move steadily upward in the face of the declining employment and declining business activity. What would you consider to be a flexible monetary policy?

Mr. JACOBY. I will be very glad to try to answer that. I am already on record on this matter. It appears to me that the Federal Reserve authorities should have spotted the peaking out of the boom

a little earlier than they did. We can now see with hindsight that the peak was reached in August of 1957. And yet I believe it is true that the Federal Reserve did not shift to a policy that might be called one of "active ease" until some 4 or 5 months after this peaking out occurred; until after inflationary pressure arising from currently excessive aggregate demand had clearly disappeared.

Here let me, if I may, make a point that I think is rather important. I think that we exaggerate the true proportions of this problem we face of reconciling a stable price level with high employment, by failing to recognize that the upward creep of the Consumer Price Index during the last year has in large part, I think, represented two factors: First, there is an inflationary bias in the Consumer Price Index, which I am not yet satisfied has been adequately allowed for by statistical adjustments. The fact that we are getting higher octane gasoline and tires that run a larger number of miles are quality improvements which really represent price reductions, that do not come out in the index. This inflationary bias in the index makes it unreliable as a guide to monetary policy.

The second factor is that a good deal of the upward creep of the CPI in the last year and a half has been the working out of certain residual forces of past inflationary movements; it has not reflected current inflationary demand. I have in mind upward adjustments in public-utility rates in order to allow them to earn a fair rate of return on the higher level of costs that past inflation has produced. The removal of rent controls in certain cities, or wage increases under old wage contracts still in effect, represent other illustrations.

If you put aside these factors that have helped to push up the CPI, I did not think we had had very much, if any, true current inflationary pressure remaining during the past year.

It seems to me our monetary authorities should be guided not by gross movements of the CPI, which for two reasons I have cited may be misleading; rather they should be guided only by movements in the Consumer Price Index which reflect the current pressure of demand. If they had been so guided, I am persuaded that they would at an earlier date have detected the recession of total demand, owing primarily to the tremendous cutback in Federal expenditure for national defense, and in business expenditure for inventory, and would have eased the conditions of credit.

As a matter of fact, they proceeded in a rather tentative and, I think, timid basis. It was only some 5 months after the turn that we even had a small reduction in the legal reserve requirements of the member banks. Today the money supply is actually a little less than it was a year ago. It has been a very tentative and delayed policy of credit ease. The result has been that the long-term interest rate, which is important to investment—mortgage rates and long-term business loan rates—have only come down substantially very recently. This has delayed the time at which they might have had some substantial influence on investment.

So, I hope this is in response to your inquiry, Professor Turner. Now I, in turn, would like to ask you a question, if I may.

I was very much interested in your summary, and particularly in your provocative conclusion. The evidence is not conclusive, you say, but it is strongly suggestive that this growth—referring, I take it, to

what we might think of as an adequate rate of growth for our economy—cannot be reconciled with price stability.

Representative REUSS. This is one of the questions that I am sure we wanted to generate some discussion on. So, I am glad you are asking it.

Mr. JACOBY. Well, I should like to assert that, while I agree with you that the evidence is indeed not conclusive, to me, at least, it is not strongly suggestive that growth cannot be reconciled with price stability.

I think there is some rather weighty evidence to the contrary. And I should like to ask how you explain the fact that in the United States during the 1920's, and in the United States during the years 1952 through 1955, we had a 3½ percent annual growth in real output combined with virtual stability in prices? (I dismiss an annual change in the CPI of less than 1 percent as meaningless.)

I would like to ask also how you reconcile the remarkable stability of prices in the free economy of Western Germany since the currency reform, with a growth in real output that has averaged, according to the evidence, something like 7 to 9 percent per annum.

Mr. TURNER. I cannot speak with regard to Germany. But with regard to the United States in the 1920's, this was a period when we did have stable prices partly as a result of a continuing and perhaps deepening agricultural depression.

So that agricultural prices declined, whereas other prices crept upward. I would not say that the stability of economic activity in the 1920's is the kind of stability we are looking for. The experience of what happened shortly thereafter suggests that that kind of stability was not sustainable. We are looking for the kind of economic stability and growth which can be maintained more or less continuously and does not erupt into a major depression.

Now, in 1952 to 1955 this was another period when the indexes were stable. The early part of that period is, I think, explainable by the fact that shortly after Korea we had a surge of consumer buying. The price index rose, if I remember correctly, about 11 percent over a period of 7 or 8 months.

Consumers stocked up very heavily in anticipation of the possibility of war. When it appeared that Korea was not going to be world war III, this consumer buying slackened off. And we had what one of my colleagues has called the lull that came to stay.

A temporary cessation of demand, particularly for big ticket items, for consumer durable goods, because consumers stocked up pretty heavily shortly after Korea, was the result.

Again during this period, however, we had declines in agricultural prices and increases in nonagricultural prices, and if you average them out, you get stability. But stability in the overall index concealed diverse movements in its components.

Actually I think the forces of creeping inflation, of push-pull inflation, as I call it, were at work during this period. They were somewhat concealed by some very considerable increases in productivity resulting from very considerable investment in new plant and equipment for very intensive research, technological research, and innovation.

By 1955 these forces of push-pull inflation, when they were not matched by corresponding increases in productivity, erupted into overt increases in the price index.

Mr. ACKLEY. Mr. Chairman, could I comment briefly on that question?

Representative REUSS. Yes, surely.

Mr. ACKLEY. It has seemed to me quite misleading to refer to the stability between 1952 and 1955 without reference, as Professor Turner suggested, to the preceding history.

During the Korean episode, many prices spurted up far beyond anything that could have been justified by the then current situation. Prices of many volatile raw materials trebled within a few months.

Many other prices were advanced in the light of expectations of war and of very troubled times. And prices in many cases were just too high.

And it took a little while for the pressures of continuing inflation after that period to catch up with the inflated price level with which we were saddled as a result of the Korean speculative boom.

Therefore, I agree with Professor Turner that the evidence of 1951 to 1955 is hardly one that indicates that it is possible to have, under modern conditions, high-level activity in the absence of inflation.

I might comment just a little with respect to the West German situation.

I do not claim to be an expert at all. But it seems to me that a most important factor in the price stability in West Germany has been the stability of wage rates, which in turn is largely explained by the great influx of refugees into West Germany, and until recently by the traditional apathy of trade unions and their concentration on political objectives rather than on wage increases. In fact, West Germany provides a good example of an economy in which the push forces, at least from the wage side, were pretty largely absent; it is a very different situation from the one we face here.

Representative REUSS. Thank you, Dr. Ackley.

Mr. Curtis.

Representative CURTIS. I would like to ask a question of Mr. Rees.

I want to say I certainly appreciate his paper very much, also the other comments and papers with regard to the cost-of-living index. But I am referring to your discussion of unemployment insurance.

And I would like to examine it a little more.

You say there you think that one of our best weapons is the unemployment insurance, but you feel that it has been allowed to fall into a shocking state of neglect; and then you suggest certain areas of improvement: One, extension of benefit duration during recessions which extends benefits not charged against the payroll taxes of particular employees.

Do you mean we should abandon the basic system which does relate to the experience of the various employers?

Mr. REES. The reason this question of unemployment insurance gets in here is that I feel it is perhaps the least inflationary way of fighting a recession.

It is very difficult to overdo it. You can overdo a tax cut and public-works expenditures, and create a subsequent price rise once your recession is over. But unemployment insurance benefits have the great virtue of being self-extinguishing.

As you put these unemployed back to work, you automatically stop paying benefits to them.

Representative CURTIS. May I interrupt to say that I fundamentally agree with you. And that is the reason I wanted to explore it further.

Mr. REES. One of the ways of getting more mileage out of the unemployment compensation system is surely to extend the period benefits.

We are now, I think, in a recession which is likely to be long enough so that very many unemployed workers will exhaust their 26 weeks of benefit before they have found new work.

Now, I am not opposed to the present experience rating system of making payroll taxes depend to some extent on the experience of the particular employer. That has now been so firmly established in our laws that I think the old controversies over whether it is a good or a bad system are really of not much importance today.

But I do think that whatever case there is for saying that an employer has some responsibility to keep his workers employed, and this should be reflected in his tax rates, gets pretty weak after the man has been unemployed for 6 months.

If 6 months later that man is unable to find another job, I would regard that as kind of the fault of the economy at large and not the fault of the initial employer.

That is why I would not like to charge the costs of extended duration to that employer, but to charge them against the general tax system.

Representative CURTIS. Let me interject a question at that point.

Would you, then, at the same time tighten up your standards as to what job a person must accept and the kind of job he must accept if he is to remain a beneficiary of unemployment insurance?

In other words, as you know, a person does not have to accept a certain kind of job. It has to be within his line of endeavor. Now, would you at the same time, carrying out these philosophies, relax those standards so that if any kind of job came up he would have to take it?

Mr. REES. Yes. I believe as the period of unemployment lengthens the standards of what constitutes suitable work have to be broadened.

I believe that our State unemployment insurance administrators do this to the best of their ability. And I believe they should be encouraged to continue to do it if the duration is extended.

There is another point I might make here. I believe the eligibility standards just like the benefit standards have been eroded, and that one reason why the unemployment insurance system is rather expensive and yet has less impact in a recession than it might have is that too many people are getting eligible for benefits on the basis of rather tenuous attachment to the labor force.

Now, if we tightened up the eligibility standards at the same time that we liberalized the amount and duration of benefits, we would not only increase the amount paid out of the system in recessions, but we would also decrease the amount paid out during good times and prevent it from contributing to inflation during prosperous times.

What happened is that many States set the eligibility standard in terms of so many dollars in earnings in covered employment. And

those dollar eligibility requirements, just like the benefit levels, have not kept up with the rising wage levels.

Representative CURTIS. We have got the problem, too, where we have two or sometimes three in the same family who are wage earners; and one or two of those in the same family will go in or out of the labor market depending on whether they really want to work or whether the price that they can get is sufficiently high.

And yet they will qualify under this program. What I was really interested in pursuing—I was a little bit afraid in your suggestions here that what we might be getting to would be sort of extending benefits and so forth, that we might be getting close to this guaranteed annual wage or even getting into a system that I found some of the Italian manufacturers were in where the Govenment wouldn't let them discharge employees or lay them off.

And that, of course, was reflected in prices; that process was reflected in prices in the ensuing years. It had to be.

And it ties in, too, I think, with one of our papers presented to the committee which attempted to measure productivity in relation to recessions and booms in the economy, to the effect that it seemed that productivity went down during recessions and seemed to go up pretty quickly as we were rising, which had to do to a large degree with the utilization of the employees, the wage earners.

And I wonder if we aren't quite careful if we might make the unemployment insurance system not responsive to good economics; that we might further encourage the decrease in the productivity during these periods.

Mr. REES. Well, Mr. Curtis, I don't believe I can agree with your interpretation of the reason for decreasing productivity during recessions.

I do not think this means less worker effort or less worker willingness to take jobs.

Representative CURTIS. No, no; what I meant to imply—at least as I read it—is the fact that you keep employees that you really cannot keep fully busy. I mean the employer does that.

Mr. REES. I think you keep them fully busy; but they are not turning out as much output.

Let me give you a concrete example.

You have a railroad train which in prosperity is pulling a hundred cars, and in a depression it is pulling only 50 cars. Now, the engineer is just as busy during the depression; but if you measure his output per man-hour, it has fallen by half.

That is, if you express output in ton-miles of freight hauled, or something like that, that is what you find. You find that phenomenon all around. It has nothing to do with effort.

Representative CURTIS. Yes. But I think everyone can have this experience. It is always dangerous to rely on an individual experience. But I have gone around plants at times when orders were down. And it is good economics, really, to keep your labor force together as best you can.

And so they will keep them busy. And maybe they will do a lot of house cleaning—anything that they can figure out that might be reasonably productive in order to keep their labor force intact. And they will stretch it, even, to cover it. I think employers are a lot more human and their concern for fellow human beings is a good deal more

than some people would like to believe—and there is one real reason why you have a decline in productivity.

Mr. REES. Well, I agree with you. This certainly does occur.

And it really is a fallacy in our productivity measurement. Because this man who during the recession is working on maintenance that has been deferred because previously you were too busy to do it, he is really contributing to future output.

And when that output finally comes forth, you say productivity has gone up. And you fail to recognize it was this maintenance work during the recession that made this possible. I would be perfectly willing to leave that to the discretion of individual employers.

If they feel that it is valuable to them to hold on to the skilled members of their labor force, to employ them doing maintenance work, or something of that sort, then we should recognize that that is what is happening, and not be too worried about the fact that productivity indexes go down during recessions.

And I think this may have misled some of the contributors to the compendium into taking too narrow a position that we can only get growth during periods of rising prices or during periods of boom activity.

They fail to recognize that some of these activities that worry us, because they show up in a decline in the productivity indexes during recessions, are in some sense contributing to future growth.

Representative CURTIS. Well, I certainly agree with that.

The tie-in, of course, is that the experience rating an employer gets seems to me to be a good incentive to encourage this.

I was a little bit concerned in your suggestions as to whether you felt that by extending without regard for that we would be tending to remove some of that incentive.

Mr. REES. We would not be removing it; we just would not be adding to it. We would keep the amount we now have.

Representative CURTIS. Now, if I may, I have a general line of questioning.

The papers that refer to this recession as cost-push—and some of them have said that they did not think it was—and in my own judgment I can't see it either—the thing that impressed me as much as anything was that there actually has been an increase in disposable income in the first quarter of 1958 in relation to the first quarter of 1957. Of course, that is due to increased population probably in a large degree.

Nevertheless, there is an increased amount of purchasing power. That is one comment.

The next comment is: Taking a place like Washington, D. C., this metropolitan area, where you actually have had an increase in disposable income, and yet you have the identical problems among the same group that we have throughout the economy; in other words, the automobile dealers are having exactly the same experience in Washington, D. C., with disposable income up, as they are in other sections of the country where disposable income is down.

It seems to me that that sort of situation—and the further fact that it seems that this unemployment problem is sort of confined to about 8 or 10 States; and then when we break it down we find it very definitely is confined to certain types of industries like autos, steel, and durables; it strikes me there is something different in this recession than cost-push for those reasons.

Now, I want to go on to the thing I have been wondering about.

I have felt that this recession was to a large degree the result of our tax laws, which in my judgment have produced a tight money situation, a tight investment money situation, that we experienced, and which came to a head in 1957, which, in turn, channeled investment money into certain areas which certainly did not seem to be responsive to the economic picture.

In other words, you went into retooling to produce a great quantity of automobiles. And so we had that growth.

But the companies that seem to have cut back on their plans for expansion—I should have prefaced this by saying that one of your big cutbacks seemed to have been in business inventory and also in business capital expansion—but the place where the money was tight wasn't in your larger corporations where your McGraw-Hill estimates are of value, but seemed to me more in your small and growth companies.

Another thing: There seems to be a concentration in our economics on production as opposed to distribution. A lot of things we tend to measure are the companies that are involved in production rather than those that are involved in distribution.

Now, I have seen that in the various proposals for small-business tax alleviation. There is a group that is always talking about helping the small-business concern by lowering the corporate tax, ignoring the fact that only 15 percent of our small businesses do business under the corporate form. Eighty-five percent of them are noncorporate.

And the bulk of them, I might state, are in the distributive field, as opposed to production.

The other thing is the proposal that this administration is making to grant some liberalization of depreciation allowances. Again depreciation really is of value to your production industry where you have depreciable assets; while your distributive industry, as they grow—well, it isn't so much in depreciable assets as it is in accounts receivable and in inventory. So, I do think there has been a concentration in most of the panelists' thinking—not this panel necessarily—concentration on production industry as opposed to the distributive field.

And when you look to see where the cutback on—or when you look to see where the tight money was for investment, it seemed to be in that area.

The reason I emphasize it is that economists testified and thought there was a cost-push behind this thing; they have at the same time said it is obvious that investment capital could not be at fault, because we had overexpanded. But what the overexpansion seemed to have been in was mainly the production end and in certain areas.

But the distribution, or proper economic distribution of where expansions could have occurred and should have occurred wasn't the same as where they actually occurred. I want to make one other point, and then turn the discussion over to the panel for comment. Or two other points, rather.

One of the cutbacks in activity was in housing. Yet to me the very interesting phenomenon was that the entire cutback was in Government-financed areas; the privately financed programs practically held their own; which, again, indicated that it was financing and that it

was investment that was lying at the base of that cutback, as well as in the small and growing companies that I have suggested who had plans, and put them on the shelf because of the tight-money situation.

Now, in the final observation that I wanted to make to try to get this across is that those industries that have adequate—in fact, more than adequate—access to the capital market, or rather to capital investment, through our tax laws like percentage depletion in oil, your savings and loans, which had a 12 percent—all of these are percentages—freight cars in the railroad industry where they were given these certificates of necessity—those were where more investment capital could be intelligently used.

I certainly saw it in oil where that money was not being plowed back into oil at all, but looking for other areas to place it.

To me this has been a misallocation of capital investment, stunting the growth that should have come about normally in the small- and medium-sized corporate areas and allowing for an even larger growth and an uneconomic growth in these other areas.

Now, if you can, will you tell me if I am completely wet on that philosophy? Where do you think an error might lie?

Dr. Turner?

Mr. TURNER. I would like to clarify one point. I don't think that any of us are claiming that the present recession is a cost-push recession. Rather we are saying that the upward creep in prices in recent years is attributable to cost-push or push-pull, as I call them, forces.

And the recession in part—in part, but an important part—can be attributed to the use of demand-restraining weapons to contain a cost-push inflation. And you can curtail a cost-push inflation by restraining demand only by restraining demand sufficiently vigorously so that either enough unemployment is created so the labor unions moderate their pressures for wage increases, or so that profits are decreased to the point where employers will resolutely resist any wage increases.

Representative CURTIS. Well, Doctor, to pinpoint it so I can follow it: Take the two areas of automobiles and housing. On autos, obviously, there is not any restriction on demand from any governmental action, but rather on the consumer's own inclination, it seems.

In housing the demands seemed to be there, and they are still there, very strongly.

So, how about those two?

Mr. TURNER. The automobile area is complicated by the fickle consumer who changes his mind a good deal from year to year about whether he likes particular models or not.

Representative CURTIS. It wouldn't be complicated if he needed transportation.

Mr. TURNER. We have gotten beyond the point where the sheer need for transportation determines the demand for automobiles. The style factor is now very important.

In housing I would say the pressure of tight money exercises influence on the entire housing market. What happened was that when money became tight and interest rates generally rose, lenders were unwilling to lend on VA or FHA mortgages with their fixed rates of interest. A man who wanted to buy or build a house in spite of tight money would come into the bank or savings and loan associa-

tion and ask for a VA or FHA loan. The lender would say no, but we will make you a conventional loan at 6½ or 7 percent.

If the buyer was willing to go that high, he would proceed to buy or build. That is the reason conventional loans held up very well whereas the VA and FHA loans fell off.

Representative CURTIS. I think there is a lot to that. On the other hand, because the tight money situation existed, the builders themselves couldn't turn over or dispose of their paper.

Mr. TURNER. I don't want to leave the impression that the decline in housing over the past 3 years is attributable entirely to tight money. I think it is attributable also to the fact that we have had a very large amount of housing built in the postwar decade; that the rate of net family formation is down somewhat. The demand which previously arose from an undoubling of doubled-up couples has disappeared. There has been some decline in the real need for housing.

That has been an element. I would not want to blame it entirely on that either. It has been a combination of some decline in the real need for housing plus tight money.

Representative CURTIS. My own observation, at least from the St. Louis market, with which I am a little bit familiar, is that the demand may be cut down. Someone made a joke about a hotel operator, that he really felt the recession because he was turning down only 50 people now instead of 200. I think in housing it is almost like that.

The demand is still there. But you have only 50 asking instead of 200.

Mr. STEIN. Housing starts turned down in 1955, and construction expenditures shortly thereafter. And was that not a good thing?

The economy was booming. This current recession which began in August 1957 is not, I think, the result of a decline in housing which began in 1955. I think we are probably now in the position where we can get more houses built in the latter half of 1958 and in 1959 than we would otherwise have gotten built because we held housing back somewhat in 1955–56.

Mr. TURNER. But too long.

Mr. STEIN. We all know these things 8 months later.

Representative CURTIS. Don't you agree that housing contributed to the recession?

Mr. STEIN. We would wish that housing turned up quicker. But I don't think the fact that housing was going down during 1955 and 1956 contributed to the recession. I think it helped to moderate it.

Representative CURTIS. The reason I suggest that is, of course, becauser consumer durables are tied in quite closely with housing. That is, as housing goes up, your consumer durables do also.

Mr. STEIN. We want now to stimulate a rise in housing and a rise in associated durables. I think we are in a better position to do that now, having held them back in 1955 and 1956 somewhat, than we otherwise would have been.

Mr. JACOBY. Mr. Chairman, may I make a few comments that I think are responsive to Mr. Curtis' question.

It seems that there have been two primary factors in the economic recession that began last August. One was the very radical cutback in the procurement by the Department of Defense of military hardware. This was quite an important factor. The other was the con-

current effort of businesses to reduce inventories. And the inventory reduction has in the first quarter of this year reached almost climactic proportions—I would be inclined to think an annual depletion rate of about $10 billion.

I think that one may feel that the recession has about run its course, because a rate of inventory depletion of this size, combined with the stability of consumer income and expenditures to which you refer, cannot go on at this rate very much longer.

That gives rise, then, to the next question; whether or not we can anticipate strong forces of revival of renewed growth.

Here it seems that the prospect is a little less certain than one might wish.

We must examine the prospective demand for consumer goods, including housing, and for capital goods.

The most ominous factor in the prospect, it seems to me, is the very sharp reduction that is now occurring in business expenditures for plant and equipment. This is highly important, not only because such expenditure affects productivity—it is the primary force in improving the productivity of labor and keeping down prices—but also because it does have a multiplier effect in its influence on aggregate demand for final products, which most other kinds of demand do not.

And as I see the situation, the very sharp drop in business profits, which reached an annual rate before taxes of almost $42 billion in the third quarter of 1957, and which currently in this quarter may drop as low as $30 billion, has been such as to make the profit prospect dim in many lines of business; and also to make the financial position of businesses so liquid that they are unable to finance acquisitions of plant and equipment.

Turning to the matter of housing and consumer durables, there is a factor that we will be faced with in the next few years, of which we are aware but often overlook. That is that we are now living through the period of low family formations, tracing to the abnormally low birthrates of the pre-World War II and World War II years. This will be a dampening influence for some time to come on the expansion of housing demand. Similarly in autos, we are now at the period when the nonexistent cars of the years 1941 through 1945 would have been junked most rapidly, and we would have had a large replacement demand that we cannot now expect.

So in the face of this, a renewal of the boom in consumer expenditure on durables and housing, including autos, seems to me quite unlikely.

Therefore, I should think that public policy ought to be framed in directions that would tend to moderate the decline in capital expenditures by business, and if possible, to reverse it, and to bring about a renewed expansion of it. My thinking about that question has led me to the conclusion that it would be very wise for the Congress to consider both the further liberalization of the discretion that businessmen have in depreciating new investments as a means of stimulating them; and, in addition to that, it seems to me that the most advantageous kind of tax reduction we could have now would be about a 10 percent cut in the corporate income tax. A dropping of the rate from 52 to 47 percent is now scheduled for July 1. In the situation in which we now find ourselves I would estimate that we would more likely get more expansion out of that kind of tax cut,

per dollar of immediate revenue sacrificed, than out of any other kind of tax cut.

Business investment is the currently and potentially weak sector of demand in the United States economy. This kind of tax cut would apply the stimulus where it is most needed and most likely to be effective. It will also be a reform that will tend to stimulate the growth of our economy. And I, among several contributors to the compendium, have been concerned about the fact that our real growth, even during the year 1957, was very slight—eight-tenths of 1 percent in real terms. Even if we do get some recovery toward the latter part of 1958, the year as a whole is going to end about 2 percent under last year. So we have had 2 years of subnormal growth or even decline, with a prospect of only a moderate expansion of consumer expenditure for the reasons I have cited.

This, I think, puts emphasis on the need for the encouragement of business investment.

Representative REUSS. I would like to ask a couple of questions bearing on the central theme of this symposium, as I interpret it, namely, how do we achieve the full employment and maximum growth and at the same time have something like price stability?

Let me start with Dr. Jacoby on that.

I take it you agree, sir, with the proposition that the technical independence of the Federal Reserve System whereby its members are appointed for long terms and whereby they can make their own decisions in the monetary and credit field is a proper allocation of governmental power?

Mr. JACOBY. Well, I have felt that the independence of the Federal Reserve authorities is probably a good thing. It does not, in and of itself, get in the way of a wise and felicitous monetary policy.

Representative REUSS. Now you also believe in the proposition, do you not, as I do, that the purpose of the Employment Act of 1946 was to centralize in the President, acting with the advice of the Council of Economic Advisers, the duty of coming forward with appropriate recommendations to the various segments, public and private, of our economy designed to secure the goals of the Employment Act of 1946?

Mr. JACOBY. As I read the act, it seems that it does place upon the President the burden of presenting to the Congress a program for achieving the purposes of the act.

Representative REUSS. I am also right in having heard you this morning point out a couple of historical examples where—whether by foresight or hindsight—the Federal Reserve erred—once in the case of being too inflationary at a time when they were supporting the Government bond market in days gone by, and more recently—if only by hindsight—in the case of being a little more deflationary than one would have liked in what they did with the discount rate as recently as last August—August of 1957?

Mr. JACOBY. That is right.

Representative REUSS. Now, let me ask you this question. Wouldn't we have a better functioning of presidential guardianship over the economy, if you will call it that, under the Employment Act of 1946, if while maintaining the complete independence of the Federal Reserve System to make its own decisions—a proposition on which you and I, I hope, agree—there was imposed on the President a duty of

speaking out on his program in the fields of monetary and credit policies, so that if the Federal Reserve is going to err, it errs with full knowledge that it is doing so in contradiction to what the President and his Council of Economic Advisers think is sound, overall, national policy?

Mr. JACOBY. Well, I have always thought, Mr. Chairman, that the reconciliation of views about appropriate monetary policy could occur internally.

It seems that the President, as the Chief Executive of the Nation, is in a sense responsible for the actions of the Federal Reserve despite its quasi-independence.

Representative REUSS. I didn't suggest he was responsible for the actions of the Federal Reserve. What I suggested was: Should he not be responsible for including in his program such action as he thinks the Federal Reserve ought to take, even though if the Federal Reserve refuses to take it since it is independent, he is not responsible for it?

Mr. JACOBY. Yes. I believe that the aggregate economic program of the President should include appropriate monetary actions along with appropriate fiscal and other actions. This is definitely true. It is all one ball of wax.

Representative REUSS. I am glad to hear you say that, because I feel quite deeply that a good monetary program isn't going to work if you don't have a good fiscal program, and vice versa.

Let me ask the panel generally if there is any disagreement with the proposition which Dr. Jacoby and I seem to have established to a meeting of our minds that the President should include in his program, not merely fiscal, tax, and other nonmonetary recommendations, but should also have the duty of including monetary and credit policies in the total economic program which he presents to the Nation.

Dr. Turner?

Mr. TURNER. I would not disagree with that statement, Mr. Chairman; but I think I would disagree with the statement that the Federal Reserve should be completely independent of the Executive.

After all the Federal Reserve does exercise 1 of the 2 major instruments of stabilization policy; and as you have just said, there is not much point in having a fiscal policy if it is not consistent with monetary policy and vice versa.

Therefore, I think there must be some coordination of these policies. And the Federal Reserve must be responsible in some way to the Executive as the determiner or recommender of overall economic policy.

Now, as to how that should be achieved, that is another question. I am not convinced that an autonomous independent Federal Reserve Board is in fact completely independent of the Executive.

Representative REUSS. But your disagreement with the proposition advanced here goes only to the assumption that the independence of the Federal Reserve should be continued?

Mr. TURNER. That is right. I think you can get coordination between the Federal and the President and still retain what is nominally an autonomous independent Federal Reserve Board, if you have the right kind of members.

Obviously they are working in the public interest too. They will consult with the President and with his staff or Council. And you

can get coordination. You are not sure of it. But you can get it that way.

Representative REUSS. I raised the point because I have felt increasingly that the failure of the Administration in the last 4 or 5 years to include any monetary or credit recommendations in its program, as a result of what seems to me some unnecessary mythology about the Federal Reserve, has been a disservice to the Nation, and it specifically has meant that the Federal Reserve in the last 2 or 3 years was overloaded with a responsibility that general monetary policy was unable to assume, and that, therefore, because it had sloughed off responsibility in the monetary and credit field, the Administration failed to develop a coordinated program of tax and fiscal measures in the last 2 or 3 years which might have made the attack on inflation more successful and, at the same time, tempered the recession that we are now in.

It is apparent that many of you want to comment on this point. We will start with Dr. Stein.

Mr. STEIN. I agree with everything you said. I don't think we should deduce anything from the fact that the Federal Reserve may have made certain errors in 1954 or 1957. I don't think it is to be assumed that a coordinating body or any other group of 3 or 7 people wouldn't have made as numerous and serious, although perhaps not the same, errors.

Representative REUSS. True. But if I may interrupt you right there: While any organ of the Government is perfectly capable of error—not excluding the one that I represent—it is important in a democracy to know who is responsible, and if we remove the area of monetary and credit policy entirely from the field of political responsibility, even to the extent of coming forward with recommendations, it seems we have a considerable gap in our economic armor.

Don't you agree?

Mr. STEIN. I agree perfectly.

I testified before this committee in February and criticized the President's Economic Report at that time for not containing recommendations for the conduct of monetary policy in this recession. So I am now in full agreement with that. I wanted to correct what I felt might be an implication of your questioning.

Another thing I think a reader of this discussion might get is the idea that the Administration has been more vigorous and alert in dealing with the recession and that the Federal Reserve has been dragging along. I wouldn't want to make any such comparison.

Representative REUSS. Let me say I would agree with that.

Dr. Rees?

Mr. REES. Mr. Reuss, I think I have a little bit of uneasiness about your proposal, to the extent that it refers to the formal economic program of the President as set out in the economic report.

That only comes once a year.

The essence——

Representative REUSS. Don't forget the next section of the act which requires the President to supplement his program whenever it needs supplementing. Under the act if there needs to be a new economic report every month, it is up to the President, as I read the act, to emit such a report.

Mr. REES. Well, I think I agree with something that Mr. Jacoby said at the very beginning of his answer to your question. There is an

advantage for informal channels, unless the President's disagreement with the Federal Reserve is over something very fundamental; but it would certainly be an unusual step. I happen to agree with Mr. Jacoby that the Federal Reserve acted a little too slowly this fall. Suppose we think that it should have really liberalized credit in October rather than in January or February, really, when they started to take substantial measures. It certainly would have been a drastic measure for the President to have issued a formal supplement to the economic report in October saying "I disagree with the position that the Federal Reserve System is taking."

And I am sure if that was the way the President's advisers felt, they communicated this view to the Federal Reserve authorities.

Representative REUSS. Let me comment at this point that of course the example you give would not have been worth a formal mandate from the President. And, of course, both as regards the Federal Reserve, as regards the Congress, as regards State and local governments, as regards business, and agriculture and labor, and as regards all the other elements of the economy and organs of Government, many of the President's economic suggestions should be conveyed by somebody picking up a telephone or somebody having lunch with somebody else, or some other less rigid means of communication.

The point I was raising is whether it is a sensible state we are now in, where the whole field of monetary and credit policy, the important questions as well as the day-to-day little questions, is somehow removed from the area of political responsibility.

Dr. Jacoby?

Mr. JACOBY. May I make two brief comments, Mr. Chairman?

First, I think a reading of the economic reports of the President in recent years will disclose that reference has been made to appropriate monetary policies, not only as to their operation in the past but as to the appropriate policy for the future. In other words, this subject has not been neglected in the economic reports. My recollection is that some very specific recommendations have been made as regards giving the President standby powers over consumer credit controls, and so forth.

The other point I would like to make is that, while I agree with the principle that the economic reports of the President must present comprehensive proposals of policy, both fiscal and monetary, and other policies that will achieve the ends of the Employment Act, it is rather difficult for the President to be very specific or detailed in his prescription of monetary policy. The essential requisite here is a flexible attitude. We need highly flexible monetary and fiscal policies. And in an uncertain world where we can't predict developments in advance with the great accuracy, it seems the only important thing the President can say is that we need flexibility. This, however, is not very illuminating by itself.

Representative REUSS. You yourself have just suggested—and I think it is an excellent suggestion—that in the tax field there ought to be considerable flexibility vested in the President with respect to depreciation, for example, and I daresay you might also agree with respect to certain aspects of the income tax and its impact on consumers. But if the President is required to be flexible in the tax field and in the spending field and in every other field, I don't know

why it is so much more difficult for him to be flexible in his recommendations in the monetary and credit field as well.

Mr. JACOBY. Well, with this one exception, sir, if I may qualify a bit. The tools and instruments of monetary action are, perhaps, more numerous and intricate in their interrelations than are the policy tools in other fields. And I think it would be unwise for the President to say in advance that in the coming year he thinks legal reserve requirements of the banks ought to be lowered by X percent. It may be that general liberalization of credit policy is the right line to take, but other actions would be a better means of effecting that result.

Representative REUSS. I couldn't agree with you more.

I don't think it would be a good idea for him to announce in January, if he had flexible tax laws on the books, that he is going to flex them in a particular way.

Let me change the subject to one other fundamental point that has been raised, particularly in Dr. Ackley's paper, though he didn't dwell on it this morning.

That is this question. Assume there is in the total inflationary picture something more than merely reflexes to demand, which you may call cost-push, or strategic, or sellers, or push-pull inflation, or administered prices, or wage-price pushes.

What about Dr. Ackley's suggestion that it is time, as a part of our national arsenal of anti-inflationary remedies, that we consider whether there should be some instrument for focusing public opinion on certain strategic kinds of price increases and associated wage increases with a view to tempering a bit those increases to the extent that they seem to go beyond what demand factors require that they go to.

To present it in a more modified form, let me ask this question of the panel.

Taking into account the predilections of the Presidents, past and present, for admonishing management and labor—as is repeatedly done to moderate their price and wage demands—would it not be more sensible either to stop the admonitions, or to accompany those admonitions with some analysis and information concerning a specific price increase or associated wage increase, so that management and labor know what the President is talking about?

Mr. STEIN. I think this is a wonderful example of what has always bothered me about admonitions.

It is like saying that lying leads to theft and theft leads to murder. The admonition seems harmless enough, but it always leads to this next and logical question you asked: Well, shouldn't we do something more? Shouldn't we set up standards and tell certain people what would be a good price to charge or a reasonable and fair and just price to charge? And then after you have begun telling them, when they don't do it, you say, well, why not throw them in jail if they don't do it?

I think this is the first step to price control. And I dislike that very much. And I would like to say something about the assumption—you asked us to assume that there is something in this cost-push argument. Or do we want to rule that out entirely?

I think those are not the alternatives.

I wouldn't rule this out entirely. Neither would I act on the assumption that it is a fact and exists. I think the only fact we know is that we really don't know. What should policy be in view of the fact that we don't know?

It seems it would be very unwise in the presence of this ignorance to commit ourselves to a policy which we certainly do not like and do not want; that is, policy of price control by moral persuasion or by law on the assumption that a condition exists which we are not sure does exist.

I think the only thing to do in view of the fact that we don't know is to do the things that would be safe to do, not to embark on irreversible commitments to policies that we don't like in the long run.

And we will see if we follow rigorously and vigorously the kind of demand restraining policy which on one assumption will succeed in preventing inflation; we will see whether it succeeds.

There will then be time enough, I think, to commit ourselves, if even then, to price control or to the acceptance of permanent inflation as a way of life.

So I wouldn't like to act on the assumption that, just because all of us are uncertain about whether there is anything to this cost-push argument, there must be a little to it.

Representative REUSS. Before we leave the point then: Your advice to the Nation is not only let's not have any public analysis and suggestion as to price-wage patterns, but let's cease Presidential admonitions of moderation, because they are deceptive?

Mr. STEIN. Well, I don't mind the admonitions if it is made perfectly clear that we don't propose to go further, to enforcement of these admonitions.

Representative REUSS. Why don't you mind them if it is made perfectly clear that they are meaningless?

It seems they are a waste of breath and paper.

Mr. STEIN. Well, that is not scarce.

Representative REUSS. Any other comments?

Mr. REES. Mr. Reuss, I would like to subscribe completely to everything Mr. Stein has just said. I think he has put the matter very well. If there is such a beast as push-pull inflation—and like Mr. Stein, I am not sure that this doesn't come from the same mythical zoo as Dr. Doolittle's "push-me pull-you,"—but if there is such a beast, the fodder for him seems to be administered prices, rigid, sticky prices under the control of sellers.

This is the kind of price, at any rate, that everyone proposes to investigate when and if it is raised.

Now, I am just absolutely certain that the result of a procedure of any kind of official Government review of price or wage increases, whether in the executive branch or in the legislative branch, would result in making these administered, sticky prices still more sticky, so they would be slower to go up when demand conditions warranted their going up, or cost conditions warranted their going up, and that they would be much slower to come down than they are at present. If you inhibit people from raising their prices when they think prices ought to be raised, they will get back at you by not cutting them when you think they ought to be cut; unless you would propose also to have hearings on why prices aren't being cut.

That would be a kind of difficult hearing to hold.

Representative REUSS. Of course, without such an apparatus now they don't show any great facility of going down. So, if it turned out that, without the apparatus there wasn't much of a going down anyway, that part of your argument would drop out, would it not?

Mr. REES. Well, there are other things we can do if we want to get greater price flexibility. And I think we should do them. They are along the lines of more vigorous antitrust policy, which we have already got on the books; and removing some of the Government controls that tend to support certain prices.

I agree with the remark that Mr. Jacoby made that the best way to help any group of people who need help from the Government is to help them directly on the income side and not by sustaining the prices of the things they have to sell.

Mr. JACOBY. I have one thought in addition to those already expressed.

I have no objection to the President opposing inflation. I believe this is a useful position for him to take publicly. And I have no doubt that the extent to which the President recently has inveighed publicly against inflation has had a good deal to do with the crystallization of public opinion and public attitude against inflation, and against actions that lead to it. For instance, it will have a modifying effect on the wage agreements that will be made during coming months in our country; not because the President personally wants them modified, but because he has helped to build up a strong public support of wage agreements that will not be inflationary in the future.

However, I also feel that exhortation by the President that is any more specific than this is is likely to be as harmful as beneficial. If the President gets very specific in his recommendations that prices in certain industries ought to be kept down, or that wages in certain industries should be kept down, he stands in danger of telling people to behave noncompetitively in a competitive economy. And this is a dangerous business. I am sure it is nugatory in its effect and possibly harmful.

Representative REUSS. Just one comment on that.

I agree that it is useful for the President, or anybody else, to point out the dangers of inflation frequently. However, when you ask businessmen and labor to use restraint in their price and wage policies, you are specifically recognizing that the cost factor plays a part in inflation.

And if you are doing that, if you recognize the fact that sellers of goods and services play their part and that the sole devil is not demand, then I am wondering whether it is really useful to ask sellers to behave uncompetitively if you aren't prepared to tell them wherein they shall walk and how they shall govern themselves, if they want to help world inflation.

Mr. JACOBY. What I am saying in essence, Mr. Chairman, is that I believe our economic policy should be such as to create vigorous competition in all markets, and to let the market itself—competition and bargaining in the market—determine wage rates and prices. Now, I am not yet convinced that there has been such a drastic decline in competitive forces in our labor markets in this country that we need radical new measures or governmental intervention in order to prevent what has been called cost-push inflation.

Representative REUSS. True. But then why ask labor and management to use restraint? If there is competition and if it is demand that causes the trouble they don't need restraint.

Demand will take care of it.

Mr. JACOBY. You are pointing to the danger I have mentioned of getting too specific. The public has been alerted to the fact that inflation is a bad thing. And large increases in wage rates are part of the process. A public opinion has been generated that makes this kind of wage settlement much less popular than it used to be.

Representative REUSS. Dr. Turner?

Mr. TURNER. I wanted to make one comment. That is that admonitions by the President may have the reverse effect by calling the attention of people to the fact that prices are going up, and persuade them they ought to get in and buy now rather than later and hence push prices up faster than they would otherwise go.

But on the point of whether or not there is cost-push inflation, it is difficult for economists who have been brought up on the doctrine of competitive economy to recognize that there might be a new kind of price and wagemaking process in our economy which doesn't fit into their neat and logical pattern, a new kind of process which has grown out of a change in the structure of our economy. I don't see how anybody can observe the wage- and price-making process in the last decade or two and not come to the conclusion that there is some sort of a cost-push process there.

I wouldn't want to argue that it is exclusive.

Demand still is a very potent influence in determining the levels of prices and wages. But we do have an element of cost-induced price increases which we must take into account.

Dr. Ackley suggests that we have some kind of governmental intervention in the price- and wage-making process. Whether or not that would work I am not sure. This is really a problem that goes beyond the scope of the economists.

It calls for experts in Government and psychology. I am a little bit skeptical of its working myself. But it might.

Representative REUSS. Any other comments on this point?

Mr. ACKLEY. I would like to comment only to the extent that I share a lot of the fears and worries that have been expressed here; and I have no great confidence in the particular measure I have suggested. I think Mr. Turner's colleague, John Lewis, may have had a better answer in suggesting that such governmental influence as might be wielded in this process of wage and price setting perhaps should not be in the form of public pronouncements, but through other, less formal avenues of making its influence felt. I simply don't know.

My analysis, I think like that of Professor Turner, does lead me quite definitely to the view that inflation is caused by more than just demand, and, therefore, that we have to look in new directions for its control.

Representative REUSS. Dr. Stein.

Mr. STEIN. May I say one thing about my previous reply which was somewhat flip about admonitions.

I think we should distinguish between admonition and education. I think there is an important educational function which the Presi-

dent or others may perform in reminding both business and labor, as he did the other night, that they are always in danger of pricing themselves out of the market if they raise prices or wage rates too much.

That seems to me a useful thing to always bring to public attention. I think we are also in a position where public opinion about these matters is very important. And the President obviously has to lead them.

So I don't want to deny the usefulness of statements on such subjects, but to deny it as a means for close control of the economic situation.

Representative REUSS. Thank you.

Mr. Curtis?

Representative CURTIS. I would like to just comment, Dr. Stein, on your last statement because the observation I was going to make is that it seems you differ between the cost-push phenomenon in a specific industry as opposed to the economy as a whole; I suspect that the economy as a whole will adjust. But certainly in a specific industry it can get involved in this cost-push thing which will price it out of the market.

Along that line an admonition of the President—that maybe some of them are doing it without pinning it down to the automobile industry or with just a general admonition to many industries, labor, and management that want to put the shoe on to see if it fits—will serve the purpose.

Have I captured what you were saying?

Mr. STEIN. Yes, I agree.

Representative CURTIS. There is one other thing I wanted to clear up, because I sort of heard this half out of one ear.

Did you say there, Mr. Jacoby—did you recommend in any way that there should be flexibility in taxes with the President having some authority to make taxes flexible?

I didn't hear you say just that, but I gathered from——

Representative REUSS. I thought you referred to that in talking of depreciation allowances.

Representative CURTIS. Not from the President, did you?

Or maybe you did? Let's hear it.

Mr. JACOBY. If my recollection is correct, the Chairman suggested this might be an appropriate application of the principle of flexibility. We were discussing flexible monetary policy at the time, as I recall.

Representative CURTIS. Yes, that is right.

Mr. JACOBY. I didn't really express myself beyond, I think, nodding assent. But I would like to say that I have come closer to the conclusion that there is great merit in Congress granting to the President certain limited power to adjust tax rates, in order to meet the exigencies of an economic situation which may develop rather rapidly in unanticipated directions. I haven't explored this fully. And it is a line of countercyclical policy that I have been inclined to resist in the past. But I am coming to the belief that, within limits, some authority on the part of the executive—not to change the structure of the tax system—but perhaps to have authority to move the entire rate structure up or down within 10 percent or 5 percent—might have some merit.

Representative CURTIS. I would like to speculate on a lot of things. But that is an area that I would surely hate to—I would have to change all of my basic thinking, as far as I can see. Certainty in taxes, as far as the taxpayer is concerned, is such a fundamental principle. One of the schools of belief is that we ought to be using taxes for revenue, and it is definitely not to affect economic results; and actually you will find that taxes do do that; we should do as best we can to minimize that effect.

I would hate to see our tax structure used that way.

We have got one item of flexibility in our tax laws now which, if I could get it out, I would right now, and that is these certificates of necessity. That is a flexibility that certainly puts tremendous power in the executive to channel investment funds into a certain area, really based not on whim, but on some sort of judgment, but certainly as it chooses.

Mr. JACOBY. Mr. Curtis, would you not agree that we are more interested in the stability of the consumer's income after taxes than we are in the particular tax rate that is applicable to his income?

Representative CURTIS. No, sir. In my judgment when you get into the tax power I think we should primarily be interested in what we are trying to accomplish in the governmental sector. And what we have to accomplish in the governmental sector is bound to affect the economy.

But we need to minimize that effect as much as we can rather than start on the other premise that because the Government is in so much, that it therefore is influencing all these things, and therefore it should influence them more, but do it in a better way.

That is—that is almost the argument used; because our tax take is so large today it is bound to affect the economy; therefore, let's affect it better. At least according to my thinking I would rather approach it still from another way: that, true, we do affect the economy; so let's minimize the effect as much as we can.

Mr. JACOBY. But a rigid tax rate may affect it adversely.

Representative CURTIS. But that is the one thing I am convinced of; that economically from the private sector we must do our best. The whole theme of trying to figure out life insurance taxation is to provide some sort of certainty.

And the very thing that is damaging to the industry in my judgment, and certainly in theirs, too, is the uncertainty of the thing.

Mr. JACOBY. But for the great majority of personal income receivers, I think the thing that they want to have most certainty about is the pay check at the end of the week. And perhaps they are not even conscious of the exact amount of the tax rate or withholding.

Representative CURTIS. And yet if you do what we are saying here we might make that really more uncertain if the economic laws are, as I see them at any rate, messing around with this.

Mr. JACOBY. Well, I would argue the contrary, sir; that we would make this pay check more certain if, by being willing to pursue a somewhat more flexible policy as regards the tax rate, we could help to stabilize the aggregate of income, and incidentally the aggregate of the revenue to the Government. I sometimes think we have the wrong semantics in talking about tax reduction. What we really ought to be talking about is revenue expansion. The President, in his speech the other night, called on businessmen to pursue a price policy designed

to bring about increasing volume. And he said that "pricing for volume" and "taking chances on profits" are policies that business must continue.

It seems this may also be good policy for the Government. Maybe we ought to tax on volume.

Representative CURTIS. As I say, speculation is interesting, and I am always glad to speculate. The power of taxing is such a great power that I am very reluctant to use it for anything other than the specific purposes for which we know we have to use it.

There is no question but that we could completely run this economy—in fact I think we have been unknowingly running this economy—through the tax structure. In my judgment unless we do something about it pretty soon we are going to be undermining the very system we are talking about.

Representative REUSS. Thank you, Mr. Curtis. The committee deeply appreciates the cooperation you have given us in this study.

With today's discussion, the present phase of the committee's study of the relationship of prices to economic stability and growth is brought to a close. A number of economists from labor and industrial organizations are being invited to submit papers commenting on the analyses and issues raised by the experts participating in the compendium and in these hearings. Their commentaries will be published in early fall. Together with some of the participants in these present hearings, these labor and industry economists will take part in panel discussions to be held late this year.

The committee appreciates the cooperation and contributions of all the participants in this study. I am confident that your analyses will affect Government and private economic policies for many years to come.

The hearings now stand adjourned.

(Whereupon, at 12:33 p. m., the committee was adjourned.)

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