

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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RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

MONDAY, DECEMBER 15, 1958

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

The committee met at 10 a.m., pursuant to notice, in room F-39, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Bolling, Curtis, and Reuss; Senator O'Mahoney.

Also present: John W. Lehman, clerk, and James W. Knowles, economist in charge.

The CHAIRMAN. The committee will please come to order.

This is the fourth stage of the Joint Economic Committee's study of the relationship of prices to economic stability and growth. This study has evolved out of the committee's continuous concern with the problems associated with prices during the past 10 years of its work.

The first stage of this particular study consisted of the compendium of papers by the 47 academic economists published March 31, 1958, as a committee print.

The second was a series of hearings in the form of panel discussions held May 12 through 22, 1958, in which these contributors participated.

As the third part of the study, the committee invited economists from labor and industry to submit comments on the issues raised by the academic economists. These commentaries were published in a volume released November 10, 1958. As the fourth (and present) phase of the study, panel discussions will be held today through Thursday of this week. On each day two of the experts from labor and two from industry will be joined by two of the academic economists who participated in the earlier compendium and hearings last spring.

Before we begin, I might point out again that the focus of this committee's interest, as the title chosen for this study indicates, is upon the relationship of prices to economic stability and growth. Prices and price policies can, of course, be studied from other points of view as has been and is being done by other committees of the Congress.

In contrast to more particularistic or specialized points of view, this study focuses upon the ways in which the behavior of prices, the operation of the market mechanism and private pricing policies are related to the rate at which the productive capacity at which our economy grows and to the 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.

Our first witness this morning will be Mr. Solomon Barkin, director of research, Textile Workers of America, AFL-CIO. We will be glad to hear from you, sir.

**STATEMENT OF SOLOMON BARKIN, DIRECTOR OF RESEARCH,
TEXTILE WORKERS OF AMERICA, AFL-CIO**

Mr. BARKIN. Thank you, Mr. Patman. I am awaiting the copies of this short statement. Apparently the roads are not conducive to fleet dispatch. The statement is a very short one in conformance with your instructions.

I have attempted to summarize, digest, and present the major thesis in the rather extended paper I had prepared for your committee. (Commentaries, p. 1.)

The current debate on inflation takes place at a time when we have experienced 7 months of price stability, and can anticipate no particular rise in Consumer Price Index for the next several months. The concern for inflation is promoted in part by the inflationary mood prevailing in business circles as reflected in the stock market and the problems faced by the United States Treasury in financing its \$10 to \$12 billion deficit. In this period of calm our consideration about the future price trends should be deliberate and painstaking and should not duplicate the anxious moods emanating from the White House and the financial circles. The administration's premature public statement about inflationary dangers in July and August of this year no doubt did much to stampede financial groups into the present speculative surge.

The second pressure force magnifying this issue is the business community, which is trying to make trade unions the scapegoat for the monopolistic inflationary price practices. In this connection, my statement builds very extensively on an analysis of the CED pamphlet on inflation issued in May of 1958 and the strange turnabout in the attitude and outlook of the CED as reflected in that pamphlet.

By concentrating employers' public attack on trade unions they have presumably been seeking to divert public attention from their own conduct. By lending support to such phrases as "cost push" and "wage-price spiral," because I do not believe their economic analyses would bear out these slogans of the day which have crept into careless economic thinking, they hope to make the American public believe that the fault lies with the union drive for higher wages.

Obviously in my longer paper I addressed myself to the substance of that issue, but interestingly enough, a similar effort was made, as all of us recall, back in 1946 and 1948. But that effort did not last long beyond the hysteria of that period. Independent economists soon began to uncover the multitude of causes behind the rising price level, and then submerged these hysterical arguments of 1946 and 1947 related to the cost push and similar catch phrases.

You may recall that Sumner Slichter at that time invented the term "laboristic age" to sanction the phrases of the day. But my statement here says that the term "laboristic age," the term invented by Sumner Slichter, soon evaporated into the phrase "business monopolistic age."

The Kefauver Subcommittee on Antitrust and Monopoly has done yeoman service in its release of its intensive study on steel and automobile industries, concluding that price policies followed by the giants of these industries are inflationary in character. And what is most interesting, I think, is the extensive statistical data presented by the subcommittee because they established that price margins in these industries have been spreading, and most crucially the break-even points have been dropping. Price increases have exceeded the cost increases. While the break-even point of the United States Steel Corp. was close to 50 percent of capacity a decade ago it has since declined to less than 35 percent. We have very extensive information from the OPA days on the break-even points in some 60 different industries. Similar studies for many other industries indicate a similar drop in break-even points. These data represent substantial confirmation of the fact that monopolistic price-setting policies have been spreading the margins enjoyed by these companies.

The inflationary character of the industrial price policies in the oligopolistic industries is reflected in the fact that unit labor costs in the durable goods manufacturing industries have risen by about 15 percent from 1947 to 1957. But the wholesale prices have gone up by 53 percent.

In my longer statement in appendix A, and table 1 (Commentaries, p. 39), these data are presented in both the original form and as percentage calculations. The source of the data is noted. These two figures present the great challenge to American policymakers. Unit labor costs have gone up in the durable goods manufacturing industries by 15 percent. Wholesale prices in these industries by 53 percent. In contrast in the industries which I know most about, the competitive ones—the basic nondurable ones, intermixed with some of a noncompetitive nature—unit labor costs went up 11 percent and wholesale prices 10 percent. In the durable goods industries, the comparison is 15 percent in the unit labor costs, 53 percent in prices.

Gentlemen, these facts, I think, highlight the challenge of the day, not the intricate data which are often presented for which there are excuses and apologies and technical difficulties. Here in one figure we have summarized this very significant contrast in behavior.

While the profit margins have grown considerably in the monopolistic industries, they had not increased in the highly competitive ones.

The major problem confronting this country is to achieve maximum employment, production and purchasing power, rather than to guarantee stable prices. We don't have that problem right at this moment. With the rise in the level of unemployment in the months ahead of us, as indicated by governmental authorities—I mean the administration's authorities—the main issue is how we are to provide new job opportunities for all people.

Changing the policy directives in the Employment Act by specifically spelling out the desire for stable prices would be tantamount to subordinating the present declared objectives for maximum employment. We cannot see that this addition to the act is needed, even to

satisfy its proponents of price stability, for we cannot contemplate any Federal administration giving it more priority than the present one.

We have already been told that Federal expenditures are to be curtailed despite the rise in unemployment in the months ahead. Isn't that very declaration a sufficient indication of the degree to which the purposes of this act can be disregarded by an administration so determined to do so? We should strengthen the priority given to the objectives of maximum employment and production rather than dilute their importance.

Widespread unemployment and less than maximum production is a waste of resources which we can ill afford in this era of competitive coexistence. While the Russian grouping is forging ahead and much of the burden of supporting the non-Communist bloc is upon our shoulders, it is lamentable to be losing production and permitting men to stand idle, not to speak of not expanding our economy.

We cannot fight creeping inflation with the tools we now have. Certainly the administration and the Federal Reserve Board have learned this simple lesson. We hope and we urge that they must become more receptive to the introduction of new specific controls designed to deal with the variegated nature of this phenomenon. The present monetary and fiscal devices are inadequate. Many in financial circles have declared so. Some of the most conservative members of this coterie of people have already come out with public statements calling for new decrees. The challenge is to find adequate tools and not to change the declared objectives of the Employment Act.

The Joint Economic Committee can perform a real service by initiating a series of hearings subsequent to this round, at which each of the specific proposed control techniques is individually evaluated and examined.

I have summarized here the detailed analysis which is contained in my longer statement. I put these items on the three panels.

The following are the specific controls we believe to be necessary for the handling of the problem of creeping inflation. You have heard enough testimony about the 4 or 5 different kinds of inflation that have been alleged, but the type we are currently most concerned with and which results from the slow rise in prices can be primarily and adequately dealt with by a program consisting of these items.

In the business sector, we think it is necessary for us to consider breaking up the conglomerate business giants. Going back to the bill that Senator O'Mahoney had originally offered, we should examine the merits of that proposal. Senator Kefauver's committee has pinpointed the problem of General Motors and its size.

The Federal incorporation of large corporations: We think that the kind of system we now have makes for a crazy quilt and does not permit the easy examination of the production and financial policies of these corporations, and a systematic grouping through a Federal incorporation charter would be helpful.

The Federal agency to hold public hearings on proposed price increases by large corporations.

Fourth, the variable depreciation allowances to regulate rates of capital investment, which would have been very helpful in holding down the expansion of 1956 and would have been offset during the current year.

For consumer services: In my statement I devote considerable time to the widely neglected area of the services. You know that if you examine the Consumers' Price Index, a disproportionate rise of the price of consumers' services as over against commodities is evident. Everyone has been most fatalistic about it. My proposal in my paper is to do for the services what our country does for foreign countries, namely, arrange a national productivity agency to stimulate the efficiencies of these services.

For the farmers, the one area in which we are in agreement is to lift the living standards of the low-income farmers.

On the labor sector, a number of us have been advocating for well over a decade the need of annual labor-management conferences to achieve a consensus on economic policy as a basis for periodic collective bargaining.

Then, in the Government sector, a number of these have been already suggested:

The coordination of Federal policies in monetary, credit, and public debt fields.

The authorization for use of specialized monetary and fiscal controls; consumer credit; bank portfolios; operations of nonbank financial institutions; margin requirements for all security sales. These have been in one form or another also proposed in the financial community.

Federal low-interest loans to groups adversely affected by tight-money policy at any one moment: I do believe that there must be relief to these specific groups whom we do not want to adversely affect. We can't have an indiscriminate tight-money policy.

Federal assistance to areas of chronic labor surplus.

Finally, authority for Federal allocation of key materials, such as steel, in boom periods, a proposal which I made to the Federal Reserve Board in 1956 and 1957, and I think might have helped us dampen this upsurge.

Thank you.

The CHAIRMAN. Thank you very much.

(The following letters were subsequently received for the record:)

DECEMBER 11, 1958.

HON. WRIGHT PATMAN,
*Joint Economic Committee,
Senate Office Building, Washington, D.C.*

DEAR CONGRESSMAN PATMAN: In his paper submitted to the Joint Economic Committee and published in "The Relationship of Prices to Economic Stability and Growth: Commentaries" Mr. Solomon Barkin makes a number of references to a policy statement "Defense Against Inflation" issued by the research and policy committee of CED in July 1958. I am writing to you to correct inaccuracies in Mr. Barkin's references to the committee's statement. It is not my intention here to enter into the substance of the issues raised by Mr. Barkin's paper but only to present an accurate picture of what the research and policy committee did and said. I shall be happy to supply copies of "Defense Against Inflation" for your committee if you want them.

I am sending copies of this letter to the other members of the Joint Economic Committee and to Messrs. Riley, Lehman, and Knowles of the committee staff. If you think that this letter would be a useful complement to Mr. Barkin's statement you have my permission to include it in the record of the Joint Economic Committee hearings which begin December 15, 1958.

1. Mr. Barkin says: "Some industrial and financial leaders in the current depression are also engaged in the act of deflecting attention from our serious unemployment problem to the issue of inflation. The ink was hardly dry on the proposals by the Committee for Economic Development to stimulate our economy

through tax reductions, when this group issued a sophisticated exposition of its views on inflation."

The preface to the policy statement pointed out that work on it began in the fall of 1955. The statement was issued when it was completed. The committee did not believe that the presence of a recession was cause for deferring publication of the statement. As the committee said:

"It is essential to winning the fight against long-run inflation to realize that the problem has not permanently vanished when it is obscured temporarily by the problems of combating a recession. In fact, we should take the opportunity afforded to us by the temporary slackening of inflationary pressures to think through and adopt policies necessary to avoid long-run inflation. Moreover, effective action to limit recessions requires the existence of an adequate program to prevent inflation, because fear of inflation is a major inhibition on forceful antirecession policy" (p. 7).

2. Barkin says: "Moreover, the committee seeking a scapegoat for its fears found it in the trade unions. Latching onto the new theory of inflation described as the 'wage-price' explanation, it declared that the 'main problem is in the field of labor where there is no law or not even a public philosophy or policy for the limitation of economic power.'"

The committee did not "latch onto" the "wage-price" theory of inflation. The committee considered this theory and concluded that it could not tell whether this theory has been or will be valid in the American economy. The committee said: "What we do not know, under present conditions, is this: If we had a long period in which money expenditures rose approximately in line with the ability of the economy to produce, would costs per unit of output rise? We cannot tell this from the postwar experience because we did not have that kind of a world" (p. 38). Again the committee said: "We do not definitely know—and we are not trying to prove—that costs and prices do or do not tend to rise in the American economy when demand is just adequate for satisfactorily high employment. Continuing analysis of this question is necessary. Meanwhile policy must be based on the information that is available" (p. 39).

Mr. Barkin's quotation beginning "main problem is in the field of labor" should be read as part of the whole paragraph of which it is a part:

"If the existing degree of competition in product and labor markets should prove to be inadequate, and the exercise of business and labor power insufficiently responsible, to preserve general price stability, we shall have to seek measures to strengthen competition. The laws to maintain competition in business need to be more vigorously enforced and constantly reviewed to assure their effectiveness. But the main problem is in the field of labor, where there is no law and not even a public philosophy or policy for the limitation of economic power. There is urgent need for objective consideration of the proper extent, character, and uses of union power in our society. Existing laws should be reviewed to see whether they give or leave a degree of power to labor organizations that is not in the public interest" (p. 16).

3. Barkin says: "The CED blithely assumes, in this and in past documents, that antitrust laws are sufficient to harmonize private business pricing policies with the public interest, in face of the repeated criticism of these laws by businessmen, academic economists, and government."

The paragraph quoted above under point 2 shows that the committee did not assume this.

4. Barkin says: "Most of these men supported the CED in proposing an amendment to the Employment Act of 1946, declaring that it is the Nation's objective to attain 'maximum production, employment, and purchasing power' through stable prices."

This is not the committee's recommendation. The committee is not suggesting that the objectives already enumerated in the Employment Act be attained through stable prices. It is suggesting that stable prices be added as an objective to those already enumerated.

On this point the committee said:

"We believe that the time has come for the Nation to commit itself explicitly to the long-run objective of stable prices, just as it has committed itself in the Employment Act of 1946 to the short-term objective of promoting 'maximum employment, production, and purchasing power.' Although it is generally agreed that the language of the act is sufficiently broad to provide the necessary basis for action to keep prices stable, it is our view that it would be worth while to write the commitment directly into the act.

"We recognize that a mere statement of the objective will not of itself produce stable prices. But we believe that it would be helpful in several respects.

"First, it would help to counteract the view that the commitment to high employment takes precedence over the commitment to stable prices.

"Second, it would strengthen the determination of public officials to adopt anti-inflation measures when they are needed.

"Third, it would require both the President, in his annual economic report, and the Joint Economic Committee of the Congress, in its report on the President's report, to place greater emphasis on recent and prospective price trends and to discuss in a more systematic manner methods of achieving price stability.

"Fears have been expressed that this proposal would precipitate a long and acrimonious debate over the objective of economic policy which, in the end, might result in a rejection of the stable price objective. However, it is our earnest conviction that a large majority of our citizens do not accept creeping inflation as a way of life and that the Congress will not reject this overwhelming view if given the opportunity. Moreover, we believe that the debate would, in itself, be helpful in clarifying our economic objectives. In fact, if the Employment Act were opened for amendments, we would urge that, aside from the stable prices, the objectives of promoting steady economic growth and productivity should also be added to the Employment Act" (pp. 52-53).

5. Barkin says: "The CED 'rejects governmental controls of prices and wages, in peacetime, to restrain inflation.' It is, however, quite ready to flirt with controls of labor unions in face of an explicit declaration in the Clayton anti-trust law that labor is exempt from the act in its union activities because it is not a commodity."

The committee makes a fundamental distinction between Government control of prices and wages, on the one hand, and Government policy to prevent excessive concentration of private power, on the other hand. The former suppresses the private market system, the latter preserves and strengthens it. The committee says:

"The problem of the proper limits to the character and extent of union power in a competitive, democratic, free society is one that urgently needs objective public discussion.

"We recommend that the basic laws of the country be reviewed to see whether they permit labor organizations to have a degree of economic power which is not in the public interest.

"We would hope that such a discussion would not degenerate into a prolabor, antilabor fight. Certainly no one can now want or expect to turn back the clock on the advances in labor relations made in this generation. But equally, no group can want, or expect to retain, power to force upon the community a choice among depreciation of the currency, unemployment, and abandonment of economic freedom. The leaders of organized labor have made constructive contributions to thought and action on many national policies, notably the recent issue of corruption in unions. They have an opportunity to make an especially great contribution here by presenting a clear and fundamental statement of their philosophy of the desirable extent, character, and use of union power in our society. Nothing could do more to keep discussion of this issue on a responsible level" (pp. 62-63).

6. Barkin asks: "Shall we accept the CED position that there is no conflict between the goals of maximum employment and price stability because our 'commitment to high employment is not * * * a commitment to keep unemployment lower than, say 4 percent of the labor force, or as ruling out larger unemployment for brief periods or in particular industries?'"

The three asterisks are in Mr. Barkin's text and stand for words omitted from the original.

The committee said: "The commitment to high employment is not regarded by a majority of our people as a commitment to keep unemployment lower than, say 4 percent of the labor force, or as ruling out larger unemployment for brief periods or in particular industries" (p. 38).

7. Barkin says: "The CED believes that price stability can be maintained if 'we were satisfied with, say 6 percent unemployment and if unionization were not widespread.' Do the American people want to live with these high levels of unemployment and stop the spread of unionism in order to achieve price stability?"

The expression "if we were" in the English language is commonly used to present a supposition contrary to fact. This is quite clear in the present case. The committee says:

"The possibility that we might be unable to have high employment and stable prices in our economy cannot be denied. But the facts are quite unclear. If the commitment to 'full employment' were a commitment to extremely low unemployment—for example, 2 percent—not only in total but also in each industry, if all firms were very large, and if all workers were organized in strong, industrywide unions, under these conditions such high employment would almost certainly break down price stability. On the other hand, if we were satisfied with, say 6 percent unemployment and if unionization were not widespread, these conditions of high employment would probably not conflict with price stability.

"We have in our economy neither the one nor the other set of conditions, but something in between" (pp. 37-38).

8. Barkin says: "Similarly, the CED suggests that the price of a stable price level is at least 4 percent of the labor force * * * [and] large unemployment for brief periods or in particular industries."

The complete sentence from which this extract is quoted has been presented above (point 6). There is no suggestion in the statement that at least these conditions are the price of a stable price level.

9. Barkin says: "The reason for the identification of the inflation with the 'cost-push' and 'wage-push' is explained very naively by the CED. An analysis of the distribution of corporate income from 1922 to date suggests that labor's share has been stable. Consequently, it concludes that labor 'in a free market is unlikely to change the share materially.' Therefore, any rise in wages not offset by a comparable increase in productivity must be automatically reflected in higher prices and cause inflation. Thus, our recent price increases have been caused by higher wages.

"Apparently, it did not dawn on the CED that many economists, congressional committees, and public leaders have long contended, and publicly declaimed, that profit margins and prices of many oligopolistic industries are excessive and basically inflationary and truly the root of many of our economic difficulties. Every effort to maintain prices must be economically disastrous. Yet the CED naively completed its syllogism by saying that American business enterprises were acting 'naturally' according to 'past performance' and only trade unions could be the cause for upsetting the applecart."

Several comments must be made about this:

(a) The committee does not identify inflation with the "cost-push" or "wage-push." It does not say that recent price increases have been caused by higher wages. It concluded that neither proposition could be demonstrated by existing evidence. (See point 2.)

(b) The committee did not say that business was acting "naturally" or according to "past performance." These quoted words, the implications of which are unclear, are not in the statement.

(c) The committee did not conclude that only trade unions could upset the applecart. It urged responsible behavior by both business and labor and strengthening of competition as a limitation upon both.

(d) It did, of course, "dawn on" the CED that many economists, congressional committees, and public leaders have taken the position which Mr. Barkin attributes to them.

(e) The committee's observations about labor's share of the national income refer to the total share of labor and not to the situation in particular industries and firms.

(f) Finally, the committee's words at the relevant point are these:

"The fundamental axiom is that, for the economy as a whole, real incomes—what incomes can buy—cannot rise faster than real output.¹ Money incomes can rise faster than real output, but only if prices rise. If prices are to be stable, money incomes in total cannot rise faster than real output.

"This is not only axiomatically true for the economy as a whole; it is also roughly true for the major segments of the economy in long-run conditions of general stability. In principle, so far as the arithmetic is concerned, the income of some groups in the economy can rise faster than real output if other groups pay for it by income that rises more slowly than output.

¹ This is so because all goods and services produced multiplied by the price for which they are sold equals total income of the economy. Therefore if income goes up but output does not rise, prices must rise, and the real value of the incomes will not have increased.

But the larger the groups we are talking about, the less realistic this possibility becomes.

"The important case is that of labor. In the 10 years 1947-57, the compensation of employees absorbed 77 percent of the income produced in the corporate sector of the economy; profits before taxes, 23 percent; and interest less than 1 percent. Corporate taxes took about half of the profits. Labor's share before taxes, 77 percent, was exactly the same as in the period 1922 to 1929. In no year of the postwar period was labor's share less than 74 percent or more than 80 percent. After deduction of the corporation income tax, the property-income part of total corporate income (profits plus interest, also before individual taxes) declined from 21 percent to 12 percent between the 1920's and 1947-57. This is illustrated in chart 10.

"Three things are clear from these figures. Even the arithmetical possibility of absorbing all profits after tax would add relatively little to labor's real income. If all profits after taxes were distributed as wages, total wages would rise only about as much as the increase that would be provided in 5 or 6 years by normal growth of productivity. Such an increase could happen only once, of course. To transfer to labor all of corporate profits after tax would clearly have disastrous effects on productivity, production, and employment. Moreover, the stability of labor's share suggests that feasible action in a free market is unlikely to change the share materially.

"Therefore, it is a reasonable conclusion that, for labor as a whole, real income cannot rise faster than real output. Also, real income per hour of work cannot rise faster than output per hour of work. And, if prices are to be stable, money income per hour of work cannot rise faster than real output per hour of work" (pp. 55-57).

10. Barkin says: "Employers who, like the CED, speak of the need of a 'review to see whether the existing laws give or leave a degree of power to labor organizations that is not in the public interest' are really raising questions about the propriety of the existence of unions."

It is not the committee's understanding that the existence of unions is identical with the possession by labor organizations of a degree of power that is not in the public interest or that it is impossible to question excessive power without questioning the existence of the unions. See the paragraphs quoted from the statement under point 5.

Sincerely yours,

HERBERT STEIN,
Director of Research, Committee for Economic Development.

TEXTILE WORKERS UNION OF AMERICA,
New York, N. Y., December 22, 1958.

HON. WRIGHT PATMAN,
*Joint Economic Committee,
Senate Office Building, Washington, D.C.*

DEAR CONGRESSMAN PATMAN: Thank you for sending me Mr. Herbert Stein's letter of December 11. Such an exchange helps to focus on specific problems. Unfortunately, the letter deals exclusively with my summary reference to the document rather than the substantive issues. Actually there is no substitute for a full reading of the text.

1. To complete the record of quotations I shall first reproduce William Benton's footnote to the CED summary statement which reflects his distillation as a committee member, of the import of the committee's statement.

Footnote by William Benton: "Regretfully I disassociate myself from point 9 above and from the body of the important statement which follows; regretfully, because I agree so completely with the preceding pages which brilliantly state the problem and the objectives of price stability in a growing economy.

"I cannot agree with the emphasis throughout the body of this statement which so largely equates rising prices with rising wages. Wages, of course, can be a measurable factor in rising prices, but many distinguished economists feel the business community is today putting excessive emphasis on so-called labor monopoly as the whipping boy for inflation. Example: Many economists attribute the rising prices of recent years in large part to the rise of investments; plant and equipment expenditures rose 26 percent from 1955 to 1957. This is

not even discussed in this statement. A further deficiency of this document, it seems to me, is that in its discussion of inflation it lumps together the inflation developing over a long period of years without separating for analysis the war years, the reconversion years, and the most recent years.

"I favor business competition and deplore the fact that the CED in its 16-year history has not devoted itself to the implementation of the Sherman and Clayton Acts. Point 9 above glosses over the problem of competition throughout our business economy.

"Finally, I regret that this statement does not sufficiently stress the urgent need for a high level of United States productivity, and the present need for national policies to implement the objectives of the Employment Act of 1946. I fear that the statement read by itself seems to elevate stability of prices over the national objectives of high employment and rapid economic growth. Some may feel that it is a rationalization for a position widely held in the business community—that we must have occasional unemployment and recession, including a receding or nonexistent rate of economic progress, because it is necessary for stability of prices.

"This seems to me a dangerous position, with the U.S.S.R. industries forging ahead 11 percent in the first quarter of this year while we were going backward with unemployment of 5½ million and part-time employment of 4 million.

"Of highest urgency are national policies which will help to create annual increases in productivity of at least 4 percent, in contrast to our 50-year average of 3 percent. Last month the Rockefeller brothers report urged as essential a goal of 5 percent. This problem seems to me not only central to our national security but to an examination of the problem of inflation and other questions discussed herein."

2. The denial that the committee has embraced the cost-push theory of inflation appears pointless. If it did not consider it critical, why did it place such emphasis in the document on the need of restraining labor unions' economic power? If business and labor are not to be charged with the responsibility of increasing demand, why conclude that "the basic recommendation of this policy statement is that we should try to halt inflation by balancing demand and output. * * * The direction in which a remedy would have to be sought would be vigorous, perhaps radical, measures to strengthen the forces of competition" (p. 61).

The entire statement skillfully clothes the argument in language reflecting sufficient doubt to negate its value for the declaration of policy and to provide Mr. Stein with his quotations. Committee statements are usually shaped by compromise and studded with qualifications. But the intent in this case is fully revealed in the structure, conclusions, and recommendations.

Despite its doubts as to facts, the statement concludes that "meanwhile policy must be based on the information that is available" (p. 39). The committee then offers its subjunctive conclusions which in fact reflect its fundamental thinking and the basis for its policy declarations respecting the need for curbing labor's so-called economic power. However much there may still be lingering doubts underlying the analysis, the final statement reads as follows:

"We believe a tendency may exist for prices to rise under such circumstances. We believe, moreover, that if such a tendency does not already exist, it may come into being in the future. That it may come into being, if we do not already have this tendency, is suggested by the persistent inflation in certain other countries, where industry is more highly concentrated, where unionization is more comprehensive, and where 'full employment' is more rigidly interpreted. In these countries there is fairly clear evidence that price stability is incompatible with the unrealistically rigid conditions of full employment society has decreed."

3. The document is replete with indications of satisfaction with the present antitrust laws and competitive forces in restraining business. The following is one such quotation which guardedly expressed this conclusion. "In most industries, except public utilities subject to regulation, there are several—often a great many—firms competing with each other whereas single unions covering an entire industry or market are common * * *. Most important we have a long-established public policy in favor of competition in business. The laws and machinery to implement this policy have been in effect for a long time, and in our view, have had a great deal to do with the growth of our economy and the improvement in our standards of living. There have been repeated national studies to see how these policies might be made more effective. As a con-

sequence we not only have a substantial business competition; we also keep exploring the route by which we can preserve or strengthen it" (p. 62).

True, there have been numerous studies and reports but little has been done with them and their findings. The concession on the need of study of business is a debater's gesture designed to quiet the opponent and not an admission of failings.

Mr. William Benton indicates that the CED itself has never studied the effectiveness of these measures and the report "glosses over the problem of competition throughout our business economy" (p. 16). Is it true that CED continues to do nothing about studying business conduct but has initiated studies on trade unions?

4. The CED believes price stability comparable with its concept of the tolerable level of unemployment and low levels of unionization. Price stability would break down if we sought to achieve "extremely low unemployment—for example, 2 percent not only in total but also in each industry, if all firms were very large and if all workers were organized in strong, industrywide unions" (p. 38). In its concept, the damage caused by inflation is so great that people will ultimately seek to stop it. Therefore, the present objectives of "maximum production, employment, and purchasing power" must be effected through and in a period of stable prices.

5. The burden of the committee's statement and Mr. Stein's letter is that there is no public policy respecting unions and the exercise of their "economic power." This is not true. Besides the labor laws, there is a public policy respecting unions as they affect commercial activities. The Clayton antitrust law specifically exempted union activities from the act and the courts have made it abundantly clear that union activities associated with employers in restraint of trade are as liable as business to the penalties of the act.

If the CED is concerned with the wage agreements reached with employers, its attention should properly be focused on the latter's price and profit policies. Labor's demands are derived from the environment in which workers live. Management's policies and patterns affect labor demands and shape the specific dollars-and-cents proposals submitted by unions. A more moderate price-and-profit policy will necessarily cut down on trade union demands.

6. It would appear from a reading of page 33, which declares that "We have in our economy neither the one nor the other set of conditions, but something in between" and the initial sentence in the subsequent paragraph, "What is the likely behavior of wages and profits under our intermediate conditions?" that the CED accepts as compatible with its views of "maximum employment" a state of 4 percent unemployment, with "larger unemployment for brief periods or in particular industries. Some industries are dominated by larger firms; others are not; and only about one-third of nonunionized workers are members of unions" (p. 38).

7. Unions are organized to represent employees. In this country, moreover, the legal system predetermines that they are to be composed of specific bargaining units approved by the NLRB. The association of local unions into large bargaining systems is largely determined by the nature of employer organizations and combinations. Where employers are large corporations, it is necessary to match them; where they follow uniform wage and labor policies, the union must parallel these systems.

The practice of pattern setting for wages and working conditions preceded the organization of present national unions in mass production industries and exists in many industries where unions are now weak. I am attaching an illustration of the latter as relates to the southern textile industry where unions have been fought by the brutal economic force of employers and their associated local political, business, and community interests.

To prevent unions finding the form of association which most nearly parallels the realities of economic power among employers is to insist upon keeping them weak and ineffective in matching the employer's power. To ask for weak unions is to make a mockery of the right to organize and freedom of association for the promotion of the interests of the citizens of our society. Unions organize to represent the interests of working people and offset the superior economic power of employers. This is a fitting function for any group in a democracy to assure a more perfect operation of the free market and concurrently realize

more democracy in industry. It is inappropriate to seek to deflate union effectiveness to help advance the powers of our large economic interest and aggregates of economic power.

Our most urgent need is to restrain business power in the manner proposed in my basic paper.

Sincerely yours,

SOLOMON BARKIN.

INDUSTRY PATTERN SETTERS DETERMINE WAGES FOR SOUTHERN TEXTILE INDUSTRY

Textile Workers Union of America, Research Department, New York, N. Y.

Mr. Spencer Love in his recent releases argued that the industry would not follow a wage increase which he granted. Historically, this position is unfounded. The two major pattern setters in the industry have been the Burlington and Cannon mills. At times we have been able to establish the pattern through a union mill. Prior to 1947, the only occasion when there was wage movement initiated directly through collective bargaining was in the fall of 1941, when a 10-percent increase resulted in the adoption of a 40-cent minimum. The industry broadly followed the northern union pattern.

The wage increases through 1946 were governed by Government directives or, in 1946, by approvals of negotiated rates. All of the wage movements from 1948 onward are covered by the following series of quotations bearing on the degree to which the wage pattern was followed in the South.

1. STATEMENTS IN BUREAU OF LABOR STATISTICS REPORTS

1948: "Wage adjustments spread through the southern textile industry in the wake of an 8-percent wage increase negotiated on July 31 by the Dan River Mills of Danville, Va., and the Textile Workers Union of America, CIO. Within a short time the 8-percent increase was instituted in other large organized mills and in many large nonunion mills. Numerous mills polled by southern newspapers announced that upward wage adjustments would be made without specifying the proposed effect on average rates" (Source: Monthly Report on Current Wage Developments, September 1, 1948, No. 9, pp. 1-2).

1950-51: "As in the North, southern mill operators granted a general wage increase in the late summer of 1950. The adjustment typically amounted to 8 percent or approximately 8.8 cents per hour. It was followed, in the spring of 1951, with an additional 1.85-percent increase (equal to 2 percent of the January 1950 rates) which averaged about 2.2 cents per hour" (Source: Cotton and Synthetic Textiles: Wage Trends 1950-53, BLS Report No. 50, p. 4).

1955-56: "By the end of October (1956), wage increases generally averaging about 10 cents an hour had been reported for an estimated 90 percent of the more than half million workers employed in southern textile manufacturing. * * * Wage rates for southern textile workers had generally been increased an average of about 5 cents an hour in August 1955 (Source: Monthly Labor Review, December 1956, pp. 1452-3).

2. BUREAU OF LABOR STATISTICS ON AVERAGE HOURLY EARNING

The actual increases in average hourly earnings in the basic southern spinning and weaving industry, including cotton, synthetic fiber, and wool, confirm the above reports on the degree to which the industry conformed to the pattern (table I). Each time a general wage increase was put into effect, the average hourly earnings in southern textile industries as reported by the U.S. Bureau of Labor Statistics, rose by an equal amount. This confirms the fact that the wage pattern was followed, by and large, by both the union and nonunion mills. The stragglers and chiselers were not sufficient to dilute the overall industry increase. Some mills took a little longer than others to conform to the pattern, but the substantial predominance of the mills, ranging usually over 90 percent, follow the pattern.

Comparison of southern textile wage pattern with increases in average straight-time hourly earnings

| Year | Round | Wage pattern | | Increase in average straight-time hourly earnings ¹ | | | | |
|-----------|-------|----------------|-----------------------------------|--|----------------|----------|-------------------|----------|
| | | Effective date | Increase | Amount | From— | | To— | |
| | | | | | Month | Earnings | Month | Earnings |
| | | | | | | | | |
| 1946..... | (1) | February..... | \$0.10..... | \$0.095 | January..... | \$0.676 | May..... | \$0.771 |
| | (2) | August..... | \$0.08..... | .081 | July..... | .771 | September..... | .852 |
| 1947..... | (3) | February..... | 10 percent (\$0.086 average)..... | .089 | January..... | .857 | April..... | .946 |
| | (4) | November..... | 9 percent (\$0.087 average)..... | .086 | October..... | .965 | December..... | 1.051 |
| 1948..... | (5) | August..... | 8 percent (\$0.082 average)..... | .081 | July..... | 1.026 | do..... | 1.097 |
| 1950..... | (6) | September..... | 8 percent (\$0.09 average)..... | .084 | August..... | 1.12 | January 1951..... | 1.206 |
| 1951..... | (7) | May..... | 2 percent (\$0.025 average)..... | .026 | April..... | 1.208 | June..... | 1.234 |
| 1955..... | (8) | August..... | \$0.05..... | .05 | July..... | 1.23 | September..... | 1.28 |
| 1956..... | (9) | October..... | \$0.10 average..... | .10 | September..... | 1.30 | October 1957..... | 1.40 |

¹ Prior to 1950 represents cotton textile industry; from 1950 on, represents cotton, silk, and synthetic broad-woven fabric mills.

Sources: Wage pattern—TWUA; average straight-time hourly earnings—computed from BLS data on gross hourly earnings by applying BLS factors to remove effect of overtime premium.

The CHAIRMAN. Next we will have Mr. Irving Beller, research associate, Industrial Union Department, AFL-CIO. We are glad to have you and to hear you.

**STATEMENT OF IRVING BELLER, RESEARCH ASSOCIATE,
INDUSTRIAL UNION DEPARTMENT, AFL-CIO**

Mr. BELLER. I am substituting for Mr. Kassalow, who is unable to be here today.

The CHAIRMAN. He is out of the country.

Mr. BELLER. Yes. I must apologize also for not having copies of my statement to present to the committee. When I realized that this was the practice, it was too late to do anything about it.

I would like to touch now on a few of the points in Mr. Kassalow's paper. (Commentaries, p. 49.)

First, it is quite clear that in spite of the widespread feeling that major depressions are a thing of the past, we can't take for granted the question of full employment and the attainment of a growth rate that is commensurate with our economic and other needs. The Federal Government has not truly demonstrated that it can and will act to maintain aggregate demand at a level necessary to fulfill the objectives of the Employment Act.

Almost as disturbing as the failure to achieve full and rapid recovery during the current recession is the knowledge that a good part of what recovery we have had must be attributed to something other than deliberate, conscious action. For one thing, the Russians unwittingly came to our rescue. Sputnik jolted us into increasing our defense orders by 80 percent in the first 6 months of 1958 as compared with the previous 6 months.

Increased highway spending, increased transfer payments, higher Federal payrolls—all of these flowing to a great extent from decisions unrelated to the current economic strains—bolstered demand during the year. A rise in farm income which also had little to do with countercyclical policy had the same effect.

In previous recessions as well, chance seems to have played a significant role. I am struck by the frequency with which respected economists, people like James Duesenberry, Albert Hart, John Davis, Seymour Harris, Sumner Slichter, have called attention to the large element of luck in our entire postwar record. The income-splitting amendment to the personal income tax in 1948, the payment of \$2.1 billion—\$8.5 billion at an annual rate—in dividends on national service life insurance in the first quarter of 1950, the \$4.7 billion cut in excess profits and personal income taxes in 1954—these and other measures have bailed us out of some tough spots in the past, but have added very little to any claim regarding our ability to consciously plan and achieve stability and growth.

Of course, we have made progress. We have avoided a catastrophic depression thus far. We have raised per capita income substantially. But the performance of our economy cannot be measured by obsolete standards. It must be measured by 20th century standards. It must be measured in the light of what we can achieve and not what we have achieved, in the light of aspirations of people everywhere for a higher standard of living and in the light of Soviet economic achieve-

ments. Complacency regarding our economic performance is a luxury we cannot afford.

A good part of the inability to lick the business cycle more decisively can be attributed to fear of inflation. Such fear has resulted in partial paralysis. We have been afraid to act with decisiveness against a current recession for fear of triggering a future inflation. I suggest that such fear reflects too great a willingness to accept at full face value some of the often repeated observations concerning inflation—that inflation always results in terrible inequities and economic distortions, that the economy has a powerful built-in inflationary bias, that creeping inflation inevitably becomes galloping inflation, and so on.

At the very least I suggest that these observations require some qualification. Professor Bach, in his paper published in the compendium in March, notes, "The economic impact on America of moderate creeping inflation has been substantial but hardly disastrous," and Sumner Slichter cites a number of offsets which minimize the effects of moderate inflation on people of fixed incomes.

The likelihood of moderate inflation being transformed into a serious inflation by a mass effort to buy now in order to avoid a future price increase, or to obtain a hedge against inflation, does point up a significant danger of creeping inflation. However, sooner or later people are bound to discover that such action is not invariably rewarding and free from risk even when the continuance of a high level of aggregate demand is assured.

As for the existence of a powerful inflationary bias in the American economy—another concept which we have tended to accept at full face value—while there is little question that we have a lower threshold to inflation than in earlier eras, it seems likely that the really inflationary situations will be confined to emergency periods as they have been in the past. The Rockefeller report declares:

Our experience with inflation when demand was neither excessive nor rapidly rising [as it has been during war or postwar periods] is too scanty to support fundamental conclusions about the inflationary bias of the American economy.

I am not saying that we have nothing to fear from inflation. I am saying that the kind of shock we have just experienced and from which we have not yet fully recovered has inflicted too much damage to the economy and to idle workers to be accepted as good anti-inflationary therapy. The determination to use unemployment to fight inflation shows a willingness to use remedies which may be worse than the disease. It shows a lack of planning and sensitivity as well.

One of the major assumptions underlying the fear that creeping inflation is here to stay is that increases in productivity which serve to relieve the pressure on prices are unlikely to be much greater in the future than they have been in the past. Here is where a resourceful, imaginative government can play an important role. It can contribute to productivity growth in innumerable ways. As Mr. Kassarof has pointed out:

The very execution of the mandate of the Employment Act, the maintenance of maximum employment and production, is a basic precondition of a sustained high rate of growth and of man-hour productivity.

However, government action can and must go beyond this. beyond just the general economic policies.

Mr. Kassalow has cited other ways in which government can help to increase productivity and lower costs and additional policies are suggested through other papers presented to this committee.

The concrete measures suggested in these papers can be far more meaningful than the addition of a general price-stability objective to the Full Employment Act. As a matter of fact, a price-stability amendment actually may be self-defeating if it results in shifting the focus from the objectives of maximum employment and production.

Even without such an amendment, there are signs that the objective of price stability has assumed an overriding importance. Certainly such a shift in focus is uncalled for at a time when we are operating at substantially less than capacity, when rapidly rising productivity is reducing the need for workers at any given level of production, when more than a million workers are expected to be added to the labor force each year during the coming period, and when at least for the next year the outlook is for relative price stability.

At this point, and for the foreseeable future, the need is for reaffirmation and vigorous implementation rather than a downgrading or weakening of the existing objectives of the Full Employment Act.

The CHAIRMAN. Thank you, sir. Mr. Ira T. Ellis. Will you identify yourself and proceed?

**STATEMENT OF IRA T. ELLIS, ECONOMIST, E. I. DU PONT
DE NEMOURS & CO.**

Mr. ELLIS. I am Ira T. Ellis, economist, E. I. du Pont de Nemours & Co.

It is a pleasure, Mr. Chairman, to appear before this committee to discuss the subject of the relationship of prices to economic stability and growth. It is a particular pleasure to be able to discuss this subject during a period of stable prices and rising business activity. There has been little net change in the level of nonfarm commodity prices over the past 16 months, and business activity has risen as sharply from its low level last spring as it did after the business growth interruptions of 1949 and 1954. It is confidently expected that business activity in the United States will rise to a new record high level next year.

As I stressed in the paper submitted to the committee last September (Commentaries, p. 43), I agree generally with the seven authors of an earlier series of papers published by the committee last March on the subject, "Employment Act Objectives and the Stabilization of Prices" (Compendium, pp. 1-75). They supported the thesis that we can have economic growth with price stability. By price stability we mean price-level stability, with individual prices free to move up and down; that is, the avoidance of an uninterrupted or persistent increase in the general price level.

The argument often has been made that our economy can function satisfactorily with a moderately rising price level, but such an argument overlooks the fact that people in their economic capacity as consumers, labor, or management and owners will try to hedge against this situation. Are we not seeing the results of just such hedging attempts in the current high demand for common stock in contrast to the low demand for bonds and other fixed-income securities?

I am not so much concerned with whether or not a specific statement on the desirability of stable prices is included in the Employment Act of 1946 as whether large numbers of the American people are or can be convinced that the factors which cause rising prices must be restrained and the purchasing power of the U.S. dollar maintained. We can have a stable price level if we want it.

The members of the Federal Reserve Board, and particularly the Chairman, Mr. Martin, have fought strenuously against rising prices which result from an excessive money supply in relation to business activity at a particular time; that is, against true "inflation"—inflation of the money supply. There I would like to pause and comment that I think in this discussion we make a mistake in equating inflation and rising prices. Rising prices are the *result* of inflation. They do not represent inflation. If today we are talking about rising prices, that is one thing. If we are talking about inflation of the money supply, that is something else. But let us keep them separate, because the solutions of our problem should be related to its causes.

They have also fought against raising the money supply to "float off" cost increases that cause price increases. It must also be noted in this connection that the money supply of the country is increased importantly by the current large Federal deficit, since it must be financed largely by selling securities to the commercial banking system. That does not mean every month or every quarter, but generally. The task of the Federal Reserve Board in maintaining price stability would be much easier if there were a real prospect for a corresponding Federal surplus in the near future to offset this year's deficit. This proper fiscal policy is a real challenge now to the administration and Congress as their part in the fight against rising prices.

Cost-raising factors also result in rising prices. Increased taxes for necessary defense expenditures, for more and better schools, for increasing salaries of teachers, for more and better roads, and so forth, are a part of our American way of life. That is the way we choose to pay for these services. We spend a substantial part of our incomes for these purposes. We should not ask that salary and wage rates be increased to offset these costs, that is, by shifting them to someone else.

The most important single cost of business is its payroll cost—salaries, wages, fringe benefits, and so forth. There is a strong upward trend in these items, and it should be so. But they must all be covered by the sales dollar, together with purchases of raw materials and services, Federal and other taxes, the allowance for depreciation, research costs, and profits—whether the business is large or small, incorporated or unincorporated, farm or nonfarm. Salaries, wages, and fringe benefits can be increased as we get more productivity per man or per hour. But if productivity rises because of more or better equipment, as it usually does, then the owners as well as employees should benefit from improved productivity. But these two claims on the sales dollar should not rise so rapidly that the customer is forgotten. Some benefit of increased productivity of labor and capital should go to the customer in lower prices or at least in stable prices as his income rises.

In summary, rising prices restrain consumption and economic growth. The adverse effects of rising prices may be offset for a while

by inflating the money supply, but such a policy only increases our problems in the future. American economic policy—personal, business, and government—should strive for growth with a stable price level. It can be achieved by restricting Government expenditures to the volume the American people are willing to support by their taxes, and by restraining business costs and stimulating the productivity of the individual efforts of all of us and of our capital investment. We can have both price stability and economic growth.

The CHAIRMAN. Thank you, sir.

Mr. Sprinkel, will you please identify yourself and proceed in your own way?

**STATEMENT OF BERYL W. SPRINKEL, ECONOMIST, HARRIS TRUST
& SAVINGS BANK, CHICAGO, ILL.**

Mr. SPRINKEL. Mr. Chairman, members of the committee, I am Beryl W. Sprinkel, economist of the Harris Trust & Savings Bank, Chicago, Ill.

The basic economic question facing the Nation is, Can we maintain full employment, promote growth and simultaneously achieve stable prices? Papers in the Compendium by Professors Bach, Baumol, and Friedman demonstrate rather clearly that historical evidence does not create a presumption of inconsistency between economic growth and stable prices.

Economic growth depends fundamentally upon increasing capital and labor resources available for production and more efficient utilization of those resources. In the United States savings-investment decisions are made by all spending units operating through the capital markets. In a competitive, consumer-oriented economy such as ours, where strong growth forces are evident, it appears undesirable for the Federal Government to make the bulk or even an increasing share of investment decisions.

However, Government policy has an important role to play in assuring more efficient use of resources. The effect of monopoly power in either unions or industry is to discourage employment and production in the monopoly areas. The Government problem in the monopoly area is not primarily one of preventing inflation, but rather one of encouraging maximum growth by promoting maximum output from the inputs of labor and capital. Greater efforts directed toward the identification of areas of monopoly power in labor as well as industry and the limitation of those powers by Government controls would yield fruitful results. Unfortunately, as pointed out by Rees and others, many Government programs discourage the efficient use of resources by creating artificial barriers to the flow of labor and capital.

Some observers contend there is an inconsistency in the dual objectives of full employment and price stability. If full employment is interpreted to mean unemployment of less than the "normal frictional" amount of perhaps 4 percent to 5 percent, inflation may well be unavoidable. The experience of the past 7 years suggests that approximate full employment and approximate price stability are feasible if policies designed to limit growth in demand to real growth in the economy are adopted.

At present there is too much effort on the part of various groups to place the blame for inflation on others. There is a real danger that such efforts will deflect attention from the more fundamental cause. Some labor unions assert rising business profits are the cause of inflation, while some businessmen maintain wage increases are really the prime mover. Careful studies of history in this and other countries demonstrate rather clearly that the source of all significant inflations has been excessive monetary demands for goods, services, and labor with respect to productive capacity. It is generally admitted that excessive monetary demand was the cause of the early post-World War II inflation and the Korean inflation, but other views are frequently expressed as to the cause of the modest and apparently short-lived price increases of 1956-57. A careful review of price trends during this period establishes that the bulk of price increases were concentrated in services where unionization is weak, finished producers' goods where the investment boom could have caused the old-fashioned inflation, and finally foods where special factors such as the livestock cycles, droughts, and floods caused upward pressures. Even though, under special circumstances (namely, excessive demand for goods, services, and hence labor), wage and profit increases can create upward price pressures, it is quite clear these pressures cannot be sustained in the absence of rising final demands. Consequently, it becomes critically important that stabilizing monetary-fiscal policies be followed in order to prevent excessive demands.

Since the adoption of a flexible monetary policy in 1951, the record of our economy in achieving price stabilization has been far superior to results in the early postwar period or the average record of the last half century. Approximate full employment has been maintained since 1951 with the exception of a few months during the 1953-54 and the 1957-58 recessions. Furthermore, there is reason to believe that our price indexes are biased upward due primarily to inadequate adjustment for quality improvement in goods and services produced. Also, it appears highly probable that actual prices are much more flexible over the business cycles than are prices reported by the various indexes. Increased research activities designed to improve our present price indexes might well yield superior price information for policymakers.

Although concern over current inflation dangers appears to be unduly high, this does not mean we should ignore the danger of long-run inflation. The Employment Act and the philosophies of both major political parties fortunately provide considerable assurance that prolonged depressions will not be permitted to develop. Yet, it was only in periods of prolonged depressions that prices declined significantly in this century. This probably means that, in effect, we have placed a floor under the general price level. Therefore, we must also establish a lid on the general price level if we are to prevent long-run inflation. This does not mean that prices of particular goods should be fixed, for it is only through fluctuations in relative prices that a growing economy can respond to the changing demands placed upon it.

Those that argue for Government investigation and regulation of price and wage changes, such as Professors Ackley, Lerner, and others, would place a straitjacket on the American economy, thereby

severely limiting resource adjustments to changing market conditions. Government regulation of particular prices and wages, either direct or indirect, is tantamount to bringing a centrally directed economy in the back door. Such a program would also discourage flexibility in prices over the business cycle. It would be indeed unfortunate if our concern over maintaining price stability resulted in more, rather than less, Government intervention in the pricing process.

Amendment of the Employment Act of 1946 to include price stabilization as a policy goal of equal (but not greater) importance as maximum employment and production would have a beneficial effect on private anticipations and would provide explicit guidance to policy-makers. There is currently considerable doubt among economists as well as the general public as to whether the act includes an anti-inflation plank. This ambiguity should be removed.

It is absolutely critical in any successful program for containing inflation that monetary policy and our Federal budget be designed to promote growth in total demands only so fast as our real economy grows. As indicated by Friedman:

There is perhaps no empirical regularity among economic phenomena that is based on so much evidence for so wide a range of circumstances as the connection between substantial changes in the stock of money and in the level of prices. (Compendium, p. 242.)

The Federal Reserve System has the power to control the stock of money through its monetary policy actions. In the main, these policies since 1951 have been of a stabilizing nature. Yet, strong political pressures are now developing for eliminating the power of the Federal Reserve to restrict credit when inflationary pressures exist. If a flexible money policy is abandoned, we may as well abandon all hope of preventing substantial long-run inflation. Even though it is desirable that monetary policy and the Federal budget exert a stimulating force during periods of recession, it is equally necessary that a tighter monetary policy and a budget surplus develop during periods of relatively full employment when inflationary pressures are reasserted. Unfortunately, the continuing pressure for more and more spending at the Federal level makes achievement of budget surpluses difficult but nonetheless desirable.

In summary: (1) The Employment Act should be amended to include the goal of price stabilization as an equally important objective of Government as the current goals of maximum employment and production; (2) removal of various monopoly and Government-imposed barriers to labor and capital movements from less efficient to more efficient lines would make a considerable contribution toward the goal of encouraging growth; (3) finally, the careful execution of a flexible monetary policy combined with a stabilizing budget provides the greatest assurance against significant long-run inflation.

The CHAIRMAN. Thank you, sir.

Mr. Bach, would you please identify yourself and proceed in your own way?

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

Mr. BACH. My name is G. L. Bach. I am dean of the Graduate School of Industrial Administration of the Carnegie Institute of Technology.

Mr. Chairman, I am sorry that I do not have enough copies here for everyone. I might say that I did send some out last week, but they have apparently miscarried.

The primary problem this morning is to consider the objectives of the Employment Act, especially the emphasis that should be placed on stabilization of the general level of prices.

1. These hearings, and other evidence, suggest there is substantial agreement on the major objectives of national economic policy. These are:

(a) Maintenance of "high level" or "substantially full" employment of men and machines.

(b) A somewhat more rapid rate of growth of total output than has characterized the past decade, especially in the light of the economic competition we now face with Russia.

(c) Maintenance of a substantially stable general price level.

(d) Maintenance of a high degree of economic freedom of the individual, for the individual business firm, and for other economic units.

(e) Allocation of a large, and possibly growing, amount of productive resources to Government use, especially for national defense.

The problem is how we can achieve these objectives simultaneously, and in particular whether maintenance of a substantially stable price level would aid or impede achievement of the other goals.

2. I previously argued before this committee, and presented supporting evidence, that the dangers of inflation in the present American scene are much less than is often claimed, but that the disadvantages of even moderate, or creeping, inflation are nonetheless substantial. In particular:

(a) There is no clear evidence, either from history or from economic theory, that a moderately rising general price level either increases or decreases substantially the output of the economy. There may be a slight presumption that a little inflation stimulates total output, but the evidence is inconclusive.

(b) There is no conclusive evidence, on either ground, that moderate inflation either increases or decreases substantially the rate of economic growth—that is, growth in total output of the economy—over extended periods. History, both here and abroad, shows mixed relationships on this score.

(c) While moderate inflation may not change greatly the size of the aggregate economic pie, it does affect the distribution of that pie. Contrary to many past expectations, inflation over the past 1 or 2 decades in America has seen the wage and salary share of the national income increase substantially; that going to corporate profits remain roughly stable (or decrease if underaccounting for depreciation is

taken into account); that going to unincorporated businesses decrease substantially; and that going to the interest and rent receivers remain relatively stable.

On the whole, the American economy seems to have become more adjusted to the process of moderate inflation than one might have predicted. The main large groups clearly suffering under the redistribution caused by inflation are creditors generally, the older people in the economy, and employees of nonprofit institutions like universities, hospitals, and governments at both the Federal and State-levels.

3. These inequities create a strong presumption that inflation should be avoided. The other effects of inflation have been less drastic than has often been argued mainly because the inflation has been moderate. The greatest danger involved in moderate inflation is that it may create expectations that lead to an upward spiral. But it is important to recognize that this is not inevitable, and that there have been many inflations that have stayed "moderate" over extended periods and have never run away.

4. Both history and analysis of the present American scene suggest that substantial, prolonged inflation under peacetime conditions is unlikely unless two conditions prevail. The first is a strong, persistent excess of income claims. This will occur if labor, business, farmers, and other economic groups demand in the marketplace and through the political process income shares for themselves larger than the real output available to be divided up. There is considerable evidence that such excess income claims have generally prevailed in the American economy since 1940, although with intermittent force. No one group in the economy can be blamed exclusively for such excess income claims. Looking ahead, I assess the likelihood as greatest that organized labor will be the primary, but not exclusive, driving force in this process, by seeking wage increases substantially in excess of productivity increases. Business and other economic groups will be equally anxious to protect and increase their income shares, but perhaps in a less strong position to initiate such actions.

The second force required for substantial, continuing inflation is an expansionary monetary-fiscal policy by the Federal Government. Without rising total money demand, excess income claims cannot generate much of an inflation. Higher wages and higher prices would instead gradually generate falling sales and unemployment. Indeed, if excess income claims occur, these are almost certainly the results of a restrictive monetary-fiscal policy that tries to maintain the purchasing power of the dollar. This is the great dilemma of monetary-fiscal policy today.

5. We know how to solve the problem of a traditional "excess demand" inflation. Restriction of the money supply and elimination of Government deficits will do the job, although there may be some temporary pain in the process. But for the Federal Reserve merely to maintain tight money in the face of growing excess income claims is almost certain to produce socially unacceptable results—in the form of restriction on the rate of growth and increasing unemployment of men and machines. This dilemma suggests that the solution must come through avoiding the conditions that create the dilemma, rather than trying to solve it through monetary policy once it has developed.

6. It is therefore important that the Federal Government announce firmly and clearly its acceptance of reasonably stable prices as a major goal of economic policy, in order to help create a climate of expectations that will discourage all economic groups from making excessive income claims through the market. In the absence of a clear recognition that Government policy will act to protect the values of the dollar, there is little to deter economic groups from raising prices and wages, especially for the sophisticated groups which strongly suspect the Federal Government will "bail out" their excess claims through expansionary monetary-fiscal policy. Addition of substantial stability of the general price level to the other objectives now in the Employment Act would surely be a step in the right direction, and one that involves no perceptible cost, even though it would not alone solve the problem.

7. I believe we face a continuing dilemma arising from excess income claims over the years ahead. Unless we act to lessen this likelihood, I foresee increasing pressures for direct Government controls over wages and prices, possibly first through "advisory" or "investigative" Government-sponsored boards. Since I dislike the implications of such steps, I believe all reasonably practicable steps along the preventive lines argued above should be taken to lessen the severity of the problem.

In summary, I believe avoidance of widespread underemployment of men and machines is the most important economic objective, but avoidance of inflation is important, too, and careful analysis suggests that inflation is neither a necessary nor even a useful aid to achievement of high level employment and output.

The CHAIRMAN. Thank you. Mr. Baumol, will you identify yourself?

STATEMENT OF WILLIAM J. BAUMOL, PROFESSOR OF ECONOMICS, PRINCETON UNIVERSITY

Mr. BAUMOL. I am Prof. William J. Baumol, of Princeton University, and with your permission I would prefer to speak from my notes, rather than read the prepared statement.

The CHAIRMAN. Without objection you may do so.

Mr. BAUMOL. We have recently become far more aware of the phenomenon of simultaneous inflation and unemployment. The fact that prices can and do continue to rise despite unemployment levels of 4 percent, 5 percent, and higher is a very serious problem, because it threatens to wreck our standard anti-inflationary and antirecession policy measures.

The anti-inflationary measures traditionally work by reducing demand, but if at the same time you have unemployment, this will also tend to increase the unemployment and similarly our antirecession measures would work by stimulating demand and so stimulate inflation. In other words, if you try to fight one of the problems, you are likely to increase the severity of the other.

Some have concluded that this is a new problem, that it is a problem of increased monopoly and increased union power. I don't believe that this is true. We know that there has been increasingly effective antitrust policy. Moreover, there is empirical evidence that there has

been no increase in this range of unemployment and inflation. A study in England going back over a century, for example, suggests that with amazing consistency the break-even point between price rises and price falls has occurred at the level of approximately 5 per cent unemployment. In fact, what seems to have occurred here is not that we have a new phenomenon, but that we have increased interest in our social welfare, in avoiding unemployment and avoiding all the things that go with it.

Now, in talking of inflation, there has been a tendency to stress two types of difficulty. First of all, the injustice which it produces, and, second, that it can lead to further inflation. But for our purposes I think these are not the major aspects. I think that what has been underemphasized is that inflation can have very serious effects on the national product and on the rate of growth of the national product. It can do this in two important ways: By reducing the quality of the output and by reducing the pressure for productivity increases. For example, one good way of hiding the fact that you are raising prices is to give the consumer less for his money. You give him a house which costs only a little bit more, but is really much less house. But if you are producing a house that lasts only 20 rather than 50 years, although the GNP figures show that house has been built, the economy has built much less than the figure would tend to show.

So this is point 1: That productivity is reduced because you tend to get shoddier goods produced as a result of inflation.

The second point is that businessmen who feel that they can sell and make adequate profits in periods of inflationary pressure tend not to worry about introducing unknown and untried productivity increasing methods. Again there seems to be evidence that the bulk of the increases in productivity have occurred not in periods of high demand and inflation, but in periods toward the ends of recessions.

The result is that we have to worry from the point of view of productivity not only about unemployment, but about inflation. I am not trying to deemphasize the seriousness of unemployment for production. I am not saying that we are justified in having large levels of unemployment in order to keep up economic growth. What I am saying is that we have here a very serious problem, a problem which is very difficult to solve, namely, that of dealing at the same time with inflation and with unemployment. Neither of these can be afforded from the point of view of growth of national product.

I repeat that there are no easy methods for dealing with this combination of difficulties. I would like to point out that each of the standard methods has its very important drawbacks. The standard monetary and fiscal policies, as I have indicated before, work very well, or at least can be depended on to a considerable extent, so long as we have either unemployment or inflation alone. When they both come together, they can only work in one direction, not against both at once.

Antitrust measures certainly are relevant and are good. They do tend to reduce the power of administered prices and other analogous difficulties which have lain behind these problems. But they are not enough.

Direct controls certainly have very serious objections, as has been pointed out. They can be the way we can destroy our free-market economy. They can lead to substantial wastes of bureaucracy. They

can lead to problems of rationing and all sorts of difficulties with which we are willing to put up with in times of great national emergency but which certainly we must avoid if at all possible.

Another method which has often been employed is so-called moral persuasion. Appeals to patriotism can retain their power for awhile. You can get trade union leaders to be moderate in their wage demands. You can get businessmen to hold back on prices. But after a while the strain that this puts on these individuals becomes intolerable. After all, the union leader's job is to do things for his union members and if month after month, year after year, he comes back reporting that he has held back in the national interest, he will find that he loses control over his own membership, as the European experience so clearly shows.

This means, then, that none of the standard techniques is really a dependable device for dealing with this distressing phenomenon, and that new methods must be explored. This really I think is the main problem. I think it might be well to introduce amendments to the Employment Act which emphasize the inflation problem, but more important, as a previous speaker has said, is the development of new techniques for coping with the problem.

I would just like to suggest that all sort of methods which have not been explored are worthy of investigation. For example, I suggest in my prepared statement that one might consider some changes in the tax structure which penalized those who raised prices when there is unemployment and excess capacity. All sorts of difficulties would doubtless occur in the working out of the details of such arrangements. At least I mention this merely to indicate that new approaches certainly are possible and worthy of exploration. Thank you very much.

The CHAIRMAN. Thank you very much, sir. We will insert your prepared statement in the record at this point.

(The statement referred to follows:)

STATEMENT BY W. BAUMOL

For brevity I will simply list a set of randomly ordered observations on the problem of simultaneous inflation and unemployment which has received so much attention from witnesses before the committee.

1. The reason this phenomenon is so distressing to policy makers is that it shows that standard fiscal and monetary policy measures may not be able to accomplish all that had been hoped of them. The use of such measures to combat inflation via reductions in excess demand is likely to produce an intolerably large amount of unemployment. When unemployment is at about 4½ percent level stricter garden variety fiscal and monetary measures are likely to increase unemployment, and milder measures are likely to lead to inflation. We are damned if we use them and damned if we do not.

2. There has been some inclination to accept the view that the ill effects of mild inflation are largely a matter of justice in the distribution of income and wealth. What has largely been ignored is inflation's real, and, I believe, very great cost in reduced output and economic growth. Chronic inflation makes for a progressive deterioration in the quality of output (as a means of disguising price increases). Perhaps even more important, it reduces greatly the motivation for maximum efficiency in production since it assures plenty of profit for all even with outmoded and inefficient production techniques. Neither of these important phenomena may be reflected clearly in output statistics—particularly not the deterioration in quality since gross national product and other similar data can only measure quantities. Nevertheless this means that the solution to the inflation-unemployment

dilemma does not lie in an acceptance of a little bit of inflation. A price level which creeps upward can be a fatal handicap in the crucial struggle to maintain our leadership in real production levels.

3. It has been suggested that simultaneous inflation and unemployment is a relatively new phenomenon produced by monopolistic business pricing practices and monopolistic union wage policies. In fact the evidence on this point is unconvincing. Antitrust legislation has certainly curbed the worst excesses of business monopoly which characterized the end of the 19th and the beginning of the 20th century and one may therefore suspect that the problem of administered prices which are raised in periods of excess capacity will not have grown much more acute.

Moreover, recent studies in the United Kingdom where much earlier unemployment data are available suggests that at least in Great Britain the situation has not varied for a century. The statistics on the relation between wage movements and the level of unemployment show a fantastic consistency during this period. Since 1861 the borderline between inflation and deflation seems to have been the 5 percent unemployment level (some data seem to indicate that in the United States inflation may characteristically continue until unemployment has risen as high as 7 or 8 percent).

There are therefore grounds for suspecting that the problem is not becoming more acute, but rather that we are becoming increasingly aware of its existence and that we are no longer prepared to tolerate levels of unemployment which a few decades ago might perhaps have caused little concern. These may be symptoms then of the progress in our policy goals rather than of a deterioration in our economic arrangements.

4. If it is (as I think it should be) deemed imperative to keep unemployment well below 5 percent and, at the same time, to stop price inflation, novel measures will have to be devised. However I do not consider this an invitation to those who would subject us to price controls and other measures which we found appropriate in times of true national emergency. Abandonment of the free market economy and the bureaucratic machinery which must be set up to administer direct regulation and the rationing and allocation procedures which are likely to result are not measures to be taken lightly.

No easy solution presents itself. Doubtless it is true that the difficulty lies in the area of administered prices and wages. Something must be done to persuade businessmen and wage setters to accept less inflationary price and wage levels when there is excess productive capacity and unemployment. But the proper instruments of persuasion are not direct controls. Nor can we rely exclusively on "moral suasion". Voluntary agreement to refrain from price and wage rises puts an intolerable strain on business management and union leaders who may have to explain their behavior to stockholders and union members. Rather, it would seem that the appropriate instrument for keeping price and wage setting in line with the national interest is the market mechanism itself, operating under the influence of carefully designed fiscal measures. For example, by offering adequate tax advantages to those who conduct their price setting as the national interest requires (or tax disadvantages to those who do not) it may be possible to achieve our goals with a minimum of direct governmental interference and coercion.

The CHAIRMAN. May we have just a brief discussion of strategy and time division for our panel discussion? It occurs to me that we should have some limitation of time on the first go-round. I would like to have suggestions from the members. I had in mind alternating from side to side, say 10 minutes at first, and after all members have had an opportunity to interrogate our witnesses, then the next time it will be unlimited as to time. Would any member like to make any suggestion about that?

Representative CURTIS. Mr. Chairman, why don't we just continue that way. We have done that before successfully. As you said, 10 minutes, and come back for 10. Usually what happens is that it works out pretty well.

The CHAIRMAN. You mean to have 10 minutes the second time, also?

Representative CURTIS. Yes, and then come back to the third time, if necessary. Usually we have enough time for all to ask questions.

The CHAIRMAN. There usually should be a time when it is unlimited, not that I am seeking an opportunity for myself.

Representative CURTIS. It usually ends up with one or two who still have questions and they will have the time.

The CHAIRMAN. Is there any objection to Mr. Curtis' recommendation as to the division of time? Without objection, it is so ordered.

I would like to call on the first chairman of this committee. This committee was organized in 1946, and Senator O'Mahoney was the first chairman of the committee. The Chair would recognize him at this time to interrogate the witnesses.

Senator O'MAHONEY. Thank you, Mr. Chairman. I am wondering whether we have fully discussed in this opening session all, or let me say rather the most important, factors which have to do with inflation, rising prices, and the stability of our economic system? For example, I have with me this morning the December issue of the monthly business and economic letter of the First National City Bank of New York. There is a paragraph here which I think should be made a part of this record. It will be the basis upon which I will ask 1 or 2 questions:

Many people see no objection to Treasury bill finance so long as the bills are placed outside of the banks and are not paid for with newly created deposits which inflate the money supply. The Treasury has had a great deal of success so far in placing the bulk of the \$11,500 million of short term securities sold for cash since July with corporations and other nonbank short term investors. The price of this has been higher rates, 91-day bill yields advancing from below 1 percent in July to an average of 2¾ percent in October and November.

One question, of course, is whether the market outside the banks can continue to absorb bills at the same scale in the future. In December and March when needs to cover tax and dividend payments narrow corporate demands for bills, bank support for the market may be needed if yields are not to rise unduly. In the longer perspective it would be surprising were corporate demands for bills to continue at the present scale when inventory building replaces inventory liquidation and capital investment spending turns up again. No less important is the often overlooked fact that Treasury bills represent an inflationary influence even when they are held outside of the banks. The corporate buyer of bills exchanges cash for what Federal Reserve Chairman Martin has called the closest equivalent to money that there is.

Some weeks or months later the holder has an undeniable right to cash from the Treasury. Meanwhile the Treasury spends the deposits it has received from the corporation, activating what were idle balances. In short, the turnover of the existing money supply is increased by Treasury bill finance permitting spending to go forward in spite of restrictive Federal Reserve credit policies.

In another spot in this story we find this statement:

In announcing terms for refunding in December the Treasury disclosed that it will raise \$2,600 million additional cash on Treasury bills over the 13 weeks beginning December 11.

This is the 15th and that is 4 days ago.

This would supply more than half of the \$4 billion to \$4½ billion the Treasury figures it needs to raise from December through March. The plan is to issue a new series of 182-day, 26-week Treasury bills. There are now outstanding 13 weekly issues of 91-day Treasury bills, each in the amount of \$1,800 million for an aggregate of \$23,400 million. Each week the Treasury auctions a new issue to raise money to pay off the one coming due.

I have failed to note that any of you gentlemen on the panel this morning has taken into consideration the state of the national debt as a factor in creating the dilemma which the Congress and the Executive must solve during the next year. Does anyone of the group wish to make any comment upon this fact that we are issuing the short-term bills and notes not only to repay or refinance outstanding bills and notes that are due, but also to raise new money which the Treasury needs to pay the bills accruing daily in the Treasury? May I ask you to comment?

Mr. BACH. I should be glad to comment. One reason I at least did not speak about this is that I thought the purpose this morning was a little more to look at the long-run objectives of the act and a little less the immediate short-run problems.

You are entirely correct, in my judgment, in pointing to the existence of very large and unfortunately increasing national debt as a major factor that makes this whole problem harder.

To come to the particular problem of the use of this new type of bills right now, without having any inside information at all, my guess would be that it is a compromise. The Treasury would like to have a longer debt and finds it a very hard time to get one, and the new situation reflects unhappiness on the part of the Treasury in paying the money it would cost to get the debt on a long-term basis.

My own judgment is that the Treasury should have shown more courage in putting out long debt when the inflation problem is the dominant problem.

Senator O'MAHONEY. Before you go to the second thing, did you not say in your statement here that monetary policy was not an effective way to meet the issue?

Mr. BACH. I said that monetary policy by itself in the traditional approach has serious problems that it has not had before. I don't like to accept your statement quite as strongly as you made it.

The second thing I was going to say does deal with your question, I think. I think the particular situation with the new Treasury bill reflects a divided judgment as to what the problem is today. It reflects the fact that inflation is with us in some sense. It reflects the fact that unemployment is still with us. It reflects the fact that we have gotten ourselves into this kind of dilemma we have all been talking about this morning, and don't have a very good way to get out. This is the reason, in my judgment, we must devote more attention to creating a climate of expectations that avoids this clash of interest—that is, between the pulling down of inflation and the pushing up of employment—because I don't think we have the tools to get out of the dilemma once we are in it. That is where the Treasury is caught, if I can put it that way.

Mr. SPRINKEL. The proper time to lengthen maturities of the Federal debt is during periods of rapidly rising business activity such as the present. There is currently little danger of interfering seriously with private financing and we can reduce the potentially inflationary liquidity that now exists while making the debt more manageable in future years. Interest rates are now rising due to the business upturn. If the Treasury is to attract longer term money from nonbank sources so as to limit inflationary pressures, a competitive interest rate must be offered. We should attempt to finance Treasury requirements at

as low a rate of interest as is consistent with the maintenance of price stability. Our objective should not be to minimize the interest cost of the debt irrespective of the inflationary consequences. Inflation, of course, leads to greater Government as well as private costs for the same physical purchases. If we are to take seriously our objective of price stability, prudent debt management requires that the Treasury currently pay whatever interest rate is needed to compete for longer term, nonbank, funds.

Senator O'MAHONEY. Don't you think it is possible that we are making the dilemma worse by not devoting most intensive study to the new policies which might rescue us from the dilemma? In other words, I take it that you agree that it is hardly likely that we can increase productivity and at the same time increase unemployment. There are many who contend that the way to avoid high prices is to reduce the cost of labor by keeping a substantial part of labor constantly unemployed, thereby making it possible for employers to obtain labor at a lower cost.

Mr. BACH. I do not like that alternative. I dissociate myself with any of my colleagues who want to have a little unemployment all the time to keep labor easily available.

Senator O'MAHONEY. Let us see how many others would care to dissociate on that subject. There is one hand rising.

Mr. BARKIN. We are all on that side, Senator. There may be only one gentleman who might object.

Mr. SPRINKEL. I certainly have no desire to maintain a substantial amount of unemployment for the purpose of keeping wages low. I think the question really becomes how much unemployment is a lot. It seems to me on the basis of the evidence in this country, and also the evidence submitted by Mr. Baumol, that something of the order of 4 to 5 percent is probably sufficient to prevent strong excessive demands on the market. I would think that should be our reasonable goal.

Senator O'MAHONEY. Do you feel that under the maximum employment law, it ought to be the policy of Congress and the Executive to maintain a situation in which 4 percent of the people are always unemployed?

Mr. SPRINKEL. I think we should not attempt to eliminate normal transitional unemployment if we are to take seriously the objective of price stabilization. That does not mean that any one person is out of a job over a long period of time. This is what I estimate to be the transitional unemployment, people changing jobs for various reasons. There is a constant turning over in the pool. If we attempt to get it much lower than that, it seems to me that the evidence indicates the only way is to encourage strong excessive demands which will lead to substantial inflation over the long pull.

Mr. BARKIN. Senator, I would like to dissent from that point of view. The point of view just expressed obviously is the one which is really at issue in these hearings. The men and groups in this country who are placing their accent on stable prices as having a greater priority to production have latched onto this 4 percent figure. Actually the 4 percent unemployment is far in excess of anything like this group to which reference has been made as necessary for shifting, for seasonal unemployment or for structural unemployment. We

know that during the last few years, even when we were down to 3 and sometimes lower levels of unemployment, we have had widespread structural unemployment in the United States, and vast groups of underemployed people. So that 4 percent is a rather extravagant margin which assumes a relatively depressed condition through this country.

Senator O'MAHONEY. If I may interrupt, I doubt whether the other panelist wanted to go definitely on record for the maintenance of 4 percent unemployment throughout a given period, and particularly so in view of the fact that we are now undergoing an extraordinary rise in population. The population is said to be exploding, so that 4 percent, or any definite percent of unemployment would merely mean that as more persons come out of school or college to join the labor force a larger number of persons would constantly be facing lack of employment, if we were to tie this theory to a definite percentage figure. Do you agree with that, sir?

Mr. SPRINKEL. Yes, sir. May I state it in a slightly different way?

Senator O'MAHONEY. Surely.

Mr. SPRINKEL. All I mean to say is that I believe the data indicate that the lower the level of unemployment that we insist upon, be it 2 percent, 1 percent, 3 percent, the greater the danger of long-run inflation. Historical data suggest to me that something around that general level is consistent with stable prices—the 4 or 5 percent level.

Senator O'MAHONEY. Do you desire to be understood as saying that there must be continuous unemployment of a certain degree—I have not mentioned the degree—to avoid inflation? You do not mean that, do you?

Mr. SPRINKEL. I mean to say that our objective should be to maintain as low a level of unemployment as is consistent with the objective of price stability. If there were no relation between the level of unemployment and the price trend, I would agree that unemployment should be as near zero as possible. However, in a dynamic, growing, shifting economy zero unemployment is not a practical goal. It was not achieved even during World War II when total demands were far in excess of the amount consistent with price stability.

Unfortunately, there is a relation between the level of unemployment and price trends. Data in this country and others indicate clearly that the lower the level of unemployment the greater the price rise resulting from excess demands and the insistence of labor to acquire wage increases in excess of productivity improvements. If it were necessary to maintain unemployment of 10 percent of the labor force to achieve price stability, we would all agree that the cost in terms of unemployed resources was too great. If we could have price stability with zero unemployment, we would all agree, perhaps, that we should strive for zero unemployment. Our postwar data suggest that the maintenance of unemployment at a level significantly below 4 to 5 percent of the labor force will inevitably be accompanied by rising prices. Since I am concerned about the loss of real purchasing power during an inflation among those elements of society least able to bear the burden—the old, pensioners, and other fixed-income recipients—I favor the maintenance of price stability.

In my opinion, I would be intellectually dishonest if I argued that we can have zero unemployment, as the Department of Labor defines the term, and price stability.

The CHAIRMAN. Senator, I believe your time has expired.

Senator O'MAHONEY. I am sorry.

The CHAIRMAN. That is perfectly all right. You can use my time if you want to. Before recognizing Mr. Curtis, I would like to make an observation about the phrase you cited from Chairman Martin in which you quoted him as saying, "closest equivalent to money that there is." He could properly have said, if he did not, that the exchange of short-term paper for bank credit is the closest equivalent to printing press money that there is.

Representative CURTIS. Thank you, Mr. Chairman. I have four general questions I am going to try to get to and then four specific ones. The general ones I am just going to review, and then ask them.

The first question will be along the definition, to see if the panel agrees on a definition of inflation. Then secondly, what agreement there might be on the damage that results from inflation once it has been defined. Third, the factor of increased productivity as it relates in this picture. That is my fourth question. The third would be on the effect of taxes in this entire picture.

Getting back to the first one, Mr. Ellis in his statement pointed out what he thought was a proper distinction—if I misquote you, please correct me—between inflation of money supply as distinct from the question of rising prices.

Would you restate that and see if the panel agrees? I want to find out if the panel agrees with the distinction that you are making.

Mr. ELLIS. Yes, Congressman, I would be glad to. The distinction I was making is that inflation technically means inflation of the money supply. The result of inflation is usually rising prices. But prices can be pushed up for reasons other than inflation of the money supply.

Representative CURTIS. Exactly. Is there any disagreement on that, or comment? Mr. Bach?

Mr. BACH. If I may comment, I think there is a serious problem here that we can't necessarily get agreement on whether a definition is right or wrong, but merely whether it is useful. I once had occasion to prepare an article for one of the encyclopedias on inflation, and I found utter chaos in my research. Out of this it became quite clear to me that you simply could not get a large number of economists or anybody else to agree on what inflation meant. About all you could do was to be sure you were clear how you used whatever term you were using. My own predilection is to call the rising prices themselves inflation for the simple reason that I think that this is what the man on the street is inclined to think of when the word "inflation" is used. I am perfectly willing to accept Mr. Ellis' proposition that this rise in prices may or may not be closely related to the rise in the money supply.

Representative CURTIS. In other words, you agree with the economic analysis that rising prices can occur from the money surplus or it could come from other economic reasons.

Mr. BACH. It could in some circumstances, but still going back to Mr. Sprinkel's point, if you look at the long run of history, you can't find any big inflations without big increases in the money supply.

Mr. BARKIN. The problem we are now confronted with is not the big inflations. That is the crucial distinction between our current problem and the historical evidence submitted by many economists. We

are concerned with the problems which for popular use we have identified as creeping inflation. Is the slow rise of our price level unassociated with catastrophic monetary manipulation or catastrophic monetary pressures? If we are to concern ourselves with the other three questions among the issues which you have raised, our focus should be on this area, rather than on the traditional concepts of inflation with which Mr. Ellis is dealing. They have been associated with wars and with irresponsible governments, and with unusual instability in our political society.

Mr. SPRINKEL. I agree with Mr. Bach's position if he means by "big inflations" both substantial prices as well as prolonged price increases. I know of no inflation either in this country or others that was not sustained by a rising money supply. Therefore, I maintain the objective of limiting monetary growth to the growth in the real economy is as relevant to preventing inflations of the creeping variety as it is to preventing other types of inflations. Prices of goods do not pull themselves up by their own bootstraps. Without excessive final demands emanating from excessive monetary growth, inflation, meaning a rise in the general price level of a fixed market basket of goods is impossible.

Representative CURTIS. I was thinking more in economic terms rather than political. To further this discussion, the elements that might bring about a rise in prices, aside from surplus money, could be perfectly normal economic occurrences, could they not? I can suggest many. Taxes is one. That becomes an increased item of cost that to a large degree the consumer is going to pay for in increased prices. There are many things that can raise prices economically. Increased quality could be one which the BLS statistics don't measure accurately. Are there any other comments on this first question as to our definition?

Mr. BAUMOL. I would like to make one comment. Even though, as Professor Bach emphasized, there is such a great diversity of opinion as to how we ought to define inflation, that this does not really necessarily indicate underlying disagreement. It is merely a matter of emphasis. I think we are all talking about the same thing. It is just when we get down to formalizing it and saying this is the thing that we will talk about that the disagreement comes in. I would go along with him. I think most of us would in saying let us pick any one of these definitions and stick to it as a common language, and then there will be no problem.

Representative CURTIS. Very good. Then I can come to the second question which will bring this out—the dangers of inflation. I believe your paper discussed that. I was very much struck with the fact which was pointed out of the damage resulting in inequities in the various segments of society. Then your statement that real damage and great cost is in reduced output and economic growth. Is that the inflation resulting from money surplus or could that be from other aspects or factors that contribute to a price increase?

Mr. BAUMOL. I would say that would come from almost any type of protracted inflation. I would like to emphasize that it could be a very mild protracted inflation. The main thing is its persistence which gives us time to adapt our behavior to it, and in which businessmen and workers have a continuous feeling of absence of pressure,

that they can make all the profits they need without doing much about productivity. There is then time to build in various devices for sweeping price increases under the carpet. So a sort of laziness or slackness creeps into the economy. This need not mean spectacular Hungarian- or German-type inflation. You have a different type of story there.

Representative CURTIS. To pinpoint it, let us take a specific area of price increase which has come from certain definable causes.

Let us take the cost of hospital care, which to a large degree has increased because of its increased quality. In other words, as I understand it, people used to go to the hospital, and the average hospital stay was 2 or 3 days, because they came out feet first. Now hospital care involves a longer stay, and they come out walking. That is an increased cost. But is that the kind of increased cost which would be reflected in what we might call increased prices? Is that the kind that creates the damage that we are discussing?

Mr. BAUMOL. No, sir. There we have two elements. I think we are dealing with a literal rendition of Professor Bach's suggestion in saying that any price rise is inflationary. You have to be careful and define your product. If you pay a 10-percent higher price for in some sense twice as much product—and I have difficulty defining the twice as much product—in fact, what you have had is a deflation rather than an inflation. So while I do believe there has been inflation in the price of hospital care for a number of other reasons—

Representative CURTIS. I posed that as a model.

The point I am getting at is that when we talk about damage of inflation we should try to define what specific inflation—or using it here for clarification, if it is clarification—increased prices. What increases in prices can be a damaging thing to our economy or may not be damaging? Would the panel agree with that?

Mr. BARKIN. Is the time up or may I make a comment?

Representative CURTIS. I will come back later.

Mr. BARKIN. I think our greatest test is to rise above this argument of semantics and enter upon a discussion of the real problem. What we are concerned about is a distortion in the allocation of resources and income. This kind of inflation begets a gross inefficiency in our economy. When we get an inappropriate price which is excessive, which is not offset by productivity, and isn't offset with a complete repulsion of demand, then, as is true in monopolistic situations, we are diverting too much income and too much of our national product to that industry. That is unhealthy and damaging.

Representative CURTIS. When I get my time again I will come back to that. I will leave it with this. It seems to me we should be distinguishing between what brings about increased costs, and we can do it in certain instances. We damage our cause in understanding by using generalities in some things which could be good. For instance, drugs. When I have my time I will come back and pursue it further.

The CHAIRMAN. Mr. Reuss.

Representative REUSS. Mr. Chairman, I would like to pursue the line of questioning that Senator O'Mahoney was getting into a moment ago, this question of what constitutes a tolerable percentage of unemployment, and I will address my question to the panel, although I think Mr. Ellis and Mr. Sprinkel will probably be particularly interested in it.

I have not heard anyone yet say that putting some of our present unemployed back to work—let us say 2 million out of the 4¼-million-odd unemployed—would in itself be a splendid method of combating inflation. Does anyone disagree with the proposition that the goods and services which they would produce would, by sopping up excess purchasing power, make our economy stronger rather than weaker?

Mr. ELLIS. I think we ought to look at purchasing power as coming from production. Production generates purchasing power. Putting a couple of million of the 3.8 million unemployed—I believe that is the figure in November—back to work is a very desirable objective. But it would not reduce excessive purchasing power created by the increased money supply. The earning of the newly employed people would rise, but so would products or services to be purchased. Reemployment and production would not increase purchasing power beyond the product produced because the sales dollar has all the costs in it.

The difficulty in inflating the money supply is that no additional goods and services are produced. The additional money claims merely push up prices. That is quite different from increased employment and production. Increased employment and production do generate additional purchasing power and inflation does not result, nor does it cure inflation.

Mr. BARKIN. There I think you have struck at one of the very crucial issues in our controversy, which explains why a number of us believe that specific controls are necessary. If a stimulus was provided to reemploy these people, we would like very much to see that the lower costs resulting from higher volume are reflected in lower prices. The burden placed upon the economy from taxes would also drop.

The possibilities for higher productivity are also reflected and offer a chance for lower cost. If our market system, or if our market system plus governmental techniques permit us to force a reduction in prices resulting from this higher productivity, we can keep going at a very, very much lower level of unemployment with greater stability. But the reason, gentlemen, Mr. Ellis and others take the position that they do, is that they assume that we will not create new mechanisms and controls which would be effective in reducing these prices and charges upon the economy.

Representative REUSS. Let me come back at Mr. Ellis, and then I will question some of the others until my time runs out. I, of course, had in my question the implicit assumption that greater volume does tend to produce lower unit cost, and hence will combat inflation. It seems to me the only way you can come back at me—although I invite you to disagree with this one—is by asserting, and maybe proving, that after you get below a certain point, there is a difference in the quality of the labor. They don't do things as well. They do them wastefully. Or by asserting that at a certain level the wage bargaining power of unions gets to be such that they tend to grab a disproportionate share, or by asserting that at some point you have to have the irreducible minimum of unemployed which actually constitutes those showing up at the unemployment service and going from one job to the other. Can we fill in some of this penumbra?

Mr. ELLIS. I shall be glad to comment further, Representative Reuss. It is true that a rising volume of business activity tends to

reduce costs through improved productivity of labor and capital. But employment and other costs can easily rise more than enough to absorb the cost reductions generated by rising volume. Mr. Barkin seems to expect that, since he proposes restraint on rising prices as costs rise. In effect, he is asking strongly for profit restriction. But the Employment Act of 1946 specifies that:

The Congress declares that it is the continuing policy and responsibility of the Federal Government * * * in a manner calculated to foster and promote free competitive enterprise and the general welfare, * * * to promote maximum employment, production, and purchasing power.

Profit is a residual in our kind of economic system after all costs and charge have been paid.

Let us look at the figures. Unemployment in November totaled about 3.8 million.

Representative REUSS. Change my 2 million to 1 million.

Mr. ELLIS. We have about 64.7 million people in civilian employment. A rise of a million in employment is desirable, but it would represent an increase of about 1.5 percent. Aren't we asking for substantial leverage if an increase of 1.5 percent in employment could make much difference in total business costs?

Representative REUSS. Can't you apply that all the way back? If we now have 4 million unemployed, what is worse about having 5, 6, 7, 15, or 20 million?

Mr. ELLIS. In reference to Mr. Barkin's argument for profit control I would like to call attention to the fact that the owners of manufacturing corporations are earning a return on their investment of only a little more than 6 percent in 1958. We need to lower unit costs to improve the profit results and eliminate the necessity to raise prices as costs rise.

At the same time, I would like to dissociate myself from any idea that a certain volume of unemployment in this country is necessary. Unemployment has a variety of causes. Nobody plans to cause unemployment. A great shift in employment between agriculture and industry is going on in this country. Employment is declining in agriculture, according to the figures that I follow carefully each month in "Economic Indicators," which, by the way, is an excellent collection of business figures. Employment in agriculture is going down. It is not possible immediately to absorb in nonagricultural employment these people who are released from agriculture. It must be done, but it takes time to retrain a man for a job in manufacturing, or construction, or a service industry, or Government. That is some of the transitional unemployment we spoke of.

Also, we have many unfilled jobs in this country. We need a lot more schoolteachers, a lot more members of college faculties, a lot more technically trained people, a lot more welfare workers, and many others. There are no figures on unfilled jobs in the country. We are engaged in making changes in the world's largest productive activity, American employment. There are 65 million people employed in the country, all working to improve their standard of living, to get a better job, to get a higher income. It takes time to make these adjustments. We are making them slowly, but in the meantime some people are moving from job to job. It is a case of providing for a variety of business activities, having certain training, and the result is at times

a level of unemployment of about 4 percent of the total labor force—and employment of 96 percent of the labor force.

Representative REUSS. What I was getting at, of course—and I guess my time is up—I would like somebody to tell me what a reasonable rate of frictional unemployment would be; what percentage it takes to get people off the farm and into the factory, to get through divinity school and medical school and teachers college. I have not found anybody trying to do that. It seems to me that we are groping in the dark and saying 2 to 4 percent is all right.

The figures for the countries of Europe, where I happen to have spent some of my time last month, are vastly different. There 1 percent is the figure generally considered the point at which a government will topple.

The CHAIRMAN. Mr. Ellis, I wanted to ask you a question about your theory that inflation is caused by the increase in the money supply. I assume by that, that if we were to have 10 percent of our business done by barter and 90 percent through the use of money, the 10 percent barter would not be inflationary?

Mr. ELLIS. You could have rising prices under a barter system just as well, Congressman, because under a barter system you trade the other fellow something for what he has.

The CHAIRMAN. You consider that the same as money supply?

Mr. ELLIS. No, we could have rising prices from the demand side that would not reflect changes in money supply. In our money system we use money instead of goods against goods. Therefore, if we increase the money supply, in effect we increase the claims against a given volume of goods and services.

The CHAIRMAN. Demand would enter into it and could cause inflation to that extent.

Mr. ELLIS. That is right.

The CHAIRMAN. You mentioned something about the selling of bonds to commercial banks. Have you given consideration to suggesting that the Treasury consider selling short-term bills to the Federal Reserve System open market account?

Mr. ELLIS. Congressman, wouldn't that result in an immediate increase in bank reserves?

The CHAIRMAN. Certainly, but there could be offsets. You can raise the reserve requirements of banks and a lot of things.

Mr. ELLIS. If you merely offset them, haven't you gotten right back to where you have started?

The CHAIRMAN. It would be no worse, would it? You would save the interest.

Mr. ELLIS. Wouldn't other people who now own the E bonds, for example—there are some \$42 billion of the E and H bonds outstanding—wouldn't they be concerned?

The CHAIRMAN. Why should they object? They have a rather direct contract that is reasonably generous.

Mr. ELLIS. All right for the specific situation. I have a feeling that some of the difficulty the Federal Government is having in selling the E and H bonds, for example, is the fear that commodity prices will go up and the purchasing power of those interest rates will go down. Financing Government deficits by creating credit would stimulate that fear.

The CHAIRMAN. I agree with you that ideally bonds should be sold to people who have the savings with which to buy them. Selling bonds—I am talking about the Treasury, of course—to individuals, corporations, insurance companies, pension funds, etc., having the money to pay for them is, of course, best.

Mr. ELLIS. Yes.

The CHAIRMAN. But when money has got to be created to buy the surplus bonds that have not been purchased by those having the money, why shouldn't a system be worked out where the Federal Reserve would take those bonds?

Mr. ELLIS. Congressman, isn't that exactly the printing-press money we were talking about?

The CHAIRMAN. It is no more than the commercial banks creating it, because they also create it upon the printing-press theory.

Mr. ELLIS. There is one distinction. Selling securities to the Federal Reserve would increase bank reserves, and hence the lending power of banks.

The CHAIRMAN. You can raise the reserve requirements. That is not an answer.

Mr. ELLIS. If you raise the reserve requirements then you may get back to one for one printing-press money instead of six for one.

The CHAIRMAN. I think a lot of people consider normal expansion and growth to be inflation, and I think they are wrong about it. I don't want any ruinous inflation. At the same time I feel that the service charge on the national debt, \$8 billion, is enormous. It is more than it used to cost to run the whole Government until the first term of Mr. Roosevelt. Whenever banks just create money on their books to buy Government obligations, that is as near printing-press money as you can make it.

Mr. ELLIS. That is right.

The CHAIRMAN. Remember, they have done that to the extent of \$64 billion on our direct Government obligations and to the extent of about \$14 billion on tax-exempt obligations of States, counties, and cities and municipalities.

Mr. ELLIS. Wouldn't the correct approach be to avoid having to sell the bonds rather than finding a way to sell them?

The CHAIRMAN. Certainly that would be best. I thoroughly approve of that. I think each Congress should make sure we balance the budget before we leave every year. If we can't, first reduce the amount of appropriation. If we can't do that, raise the taxes. It should be balanced every year. We should even try to pay something on the national debt. Don't you think we should pay something on the national debt every year?

Mr. ELLIS. I think particularly we should pay something on the debt over the cycle, and we should first reduce the bank-held debt.

The CHAIRMAN. Surely, because that is printing-press money. How many of you believe we should have a planned program for debt reduction that contemplates reduction every year when it is possible? Of course, in certain years you are in deficit financing necessarily in order to bring the country back. But we should have a planned program of balancing the budget and paying something on it every year. Do all of you agree to that?

Mr. BARKIN. No, sir.

Mr. BACH. No, sir.

Mr. BAUMOL. No, sir.

The CHAIRMAN. What do you say about it, Mr. Barkin?

Mr. BARKIN. I would make this comment. The major fact is that we must have an expanding Federal budget and level of expenditures. A technique which presumes that we are going to pay this debt off, and we are going to incur savings or establish savings in any one year runs counter to this other long-term trend. While the idea may have some attraction, as a practical matter we are going to be spending more and more. I do agree with your other proposition, and with Mr. Ellis, that we must have a much more frequent reconstruction of our Federal tax system to assure higher revenue. I also like the suggestion that you have offered of creating Federal funds through the technique of the Federal Reserve Board, and without incurring the large interest cost. The fundamental challenge that we have, and that is suggested by your proposal, is that we have to invent new types of monetary techniques.

The CHAIRMAN. Adequate growth I must include in my suggestion. Keep in mind adequate growth of our Nation at all times.

Mr. BARKIN. Yes, but the technique of reconciling these interests becomes a very, very difficult one. Consequently, the mere suggestion of a cyclical surplus on the high side of the cycle becomes an almost impossible practical fact, even though for purposes of argument we can separate the two.

The CHAIRMAN. Don't you think that our national debt is retarding progress? Under our economic system only so much money can be issued without risking inflation. Now, then, we have certain good projects we would like to put over. We would like to see the money spent. But we are told no, it will be inflationary. Why? Because of the enormous national debt. By reducing the national debt other people can go into private debt for other purposes and not have inflation.

Mr. BARKIN. Senator, I think if you took a canvass of our group right here—and this is a very dangerous thing to suggest—that only a minority would be very much concerned about the inflationary character of the current debt.

Mr. ELLIS. Dissociate me from that statement.

Mr. BARKIN. I don't know who else. Some of these gentlemen I have not discussed this type of problem with. You would find a very considerable portion of the American economists would not be frightened by our debt.

The CHAIRMAN. I think it is terrible that we have no planned program for the reduction of the national debt. During the last few years I think we are all disappointed in the fact that no effort has been made and no talk about reducing the national debt. It seems to me to be very profitable for certain people and certain concerns to hold the national debt, and they don't want it reduced. I wonder if that enters into it.

Mr. SPRINKEL. Mr. Chairman, I would like to register agreement with you and disagreement with Mr. Barkin on the inflation potential of a large Federal debt. It need not be inflationary if properly managed, but frequently we are unwilling to make the necessary sacrifice. We must offer attractive interest rates if we are to entice

investors into buying longer term Government bonds at times such as the present. Also, we must be willing to restrain spending at the Federal level and sometimes to raise taxes if a surplus for debt retirement is to arise in periods of prosperity. As you know, banks hold a substantial portion of the Federal debt as well as other debt obligations. Most bankers that I know would strongly support your contention that the Federal budget should yield a surplus for debt retirement during periods of prosperity. Monetary policy cannot do the whole job of maintaining price stability. It needs the support of a stabilizing budget and debt management policy.

Senator O'Mahoney, we have gotten back to you.

Senator O'MAHONEY. Mr. Ellis, you seem to be the center of most of the inquiries this morning. Did I correctly understand you to say a little while ago that production produces purchasing power?

Mr. ELLIS. Yes, sir.

Senator O'MAHONEY. Do you say it as bluntly and with such lack of qualification as that?

Mr. ELLIS. Yes, sir.

Senator O'MAHONEY. Do you think it is at all possible that a part of what production does is to result in accumulating inventories in manufacturing companies?

Mr. ELLIS. Yes, Senator, but remember, wages were paid for producing that inventory.

Senator O'MAHONEY. Yes; but there were not enough wages paid or salaries paid or interest earned among the bulk of the population to buy these accumulated inventories, and so the company stopped producing inventories. They began to liquidate inventories. Was that not characteristic of the recession?

Mr. ELLIS. Inventory reduction has been a major cause of the current business decline.

Senator O'MAHONEY. Then how can we say without qualification that the mere production of goods would result in increasing purchasing power and not at all result in laying workers off?

Mr. ELLIS. What I was speaking of, Senator, was that if you divide the cost of those inventories up, you find some of it went for raw materials, some went for labor, some went for salaries, some went for dividends, some went for interest. All that purchasing power was generated by the production of those goods which went into inventory. The producer thought he would eventually be able to sell that inventory and get his costs back. Isn't the difficulty you mentioned primarily a case of producing something that people don't want? That doesn't change the statement that production generates purchasing power.

Senator O'MAHONEY. Then you have to qualify it by saying that the increasing production of materials for which there is a purchasing market will have a beneficial effect.

Mr. ELLIS. No, I think the production process itself generates purchasing power—goods were produced and money was paid out for producing them to the value of goods produced. Isn't it correct that inventories are carried at cost?

Senator O'MAHONEY. Yes, of course, but when they are carried in excessive amounts, they constitute a frozen group of assets, do they not?

Mr. ELLIS. That is right, but that does not change the fact that when they were produced, somebody was paid for producing them.

Mr. BELLER. Its a question of how the income that was generated by the production was distributed. The kind of distribution will determine, to a considerable extent, whether the income so generated will be used to buy back what has been produced.

Senator O'MAHONEY. Of course, there is some purchasing power created by the payments on raw materials, for example, but that purchasing power so generated is not sufficient to offset the decline in purchasing power created by unemployment that results from this very thing that Mr. Ellis has spoken about.

Mr. ELLIS. Senator, isn't it a case of distribution? We can always produce things that we can't sell; that does not mean that the total value of the payment is irrelevant.

Senator O'MAHONEY. When we undertake to do something in a legislative way to correct the dilemma that everybody acknowledges here, we have to be guided by unqualified statements.

Mr. ELLIS. That is right.

Mr. SPRINKEL. The idea that production creates its own purchasing power is the principle developed by Mr. Say, a French economist, many, many years ago. Even though that is true, that does not mean that production-created purchasing power will come back into the market nor does it mean that is the only source of purchasing power. We can have sources of purchasing power over and above that resulting from production payments. So as I see it, the important thing is for Government to utilize its monetary fiscal tools to sometimes augment the purchasing power coming into the market and at other times restrict the purchasing power coming into the market.

Senator O'MAHONEY. Has it been successful?

Mr. SPRINKEL. I think since 1951 it has been rather successful. On the average, we have had very little inflation during this period.

Senator O'MAHONEY. Are you restricting your answer now to the mere question of inflation?

Mr. SPRINKEL. And full employment, sir.

Senator O'MAHONEY. I was about to say that even with restrictions that you have mentioned, I cannot understand how Congress can overlook the fact that our national debt now is greater than it ever has been. That is a factor which must, I think, control the judgment of every economist and certainly of every lawmaker. You nod affirmatively in response to that.

Mr. SPRINKEL. I would merely add it is not greater relative to the size of our economy.

Senator O'MAHONEY. Now, Mr. Ellis, may I read this statement of yours:

Cost-raising factors also result in rising prices. Increased taxes for necessary defense expenditures, for more and better schools, for raising salaries of teachers, for more and better roads, etc., are a part of our American way of life.

As I heard that sentence, and as I reread it now, I feel that you mean that necessary expenditures for defense, for more and better schools, for raising salaries of teachers, for more and better roads,

and so forth, are part of our American way of life, and therefore you feel that those expenditures should be made.

Mr. ELLIS. Yes, sir.

Senator O'MAHONEY. Is there agreement on that?

Mr. BARKIN. Yes, sir.

Senator O'MAHONEY. I think everybody has agreed on that. May I have a raising of hands of those in agreement? Yes; you do.

Mr. BELLER. I think certain cost-raising factors cited here can result in lower prices in the long run. Better schools, increased salaries for teachers, more and better roads, particularly better urban roads which reduce costs of delivery and transportation can, in the long run, result in higher productivity and lower prices.

Mr. BARKIN. You were not asking us about the first question. You were inquiring about the sentence "rising taxes" down to the words "American way of life."

Senator O'MAHONEY. No; I began with cost-raising factors. That was the sentence before that. Then I wanted to proceed to the last sentence in that paragraph which reads as follows:

We should not ask that salary and wage rates be increased to offset these costs, that is, by shifting them to someone else.

Then, Mr. Ellis, you say:

The most important single cost of business is its payroll cost—salaries, wages, fringe benefits, etc.

I think I can agree with that. Of course, the cost of wage benefits and salaries and so forth is the largest factor in the cost of business. But you don't mean by that statement to express the opinion that it is an improper cost.

Mr. ELLIS. No, sir.

Mr. BARKIN. Senator, taking that one paragraph I just want to say this. When you raise taxes you are not necessarily raising costs. There are many taxes which don't increase costs. For example, we pay a good deal of our taxes through our income tax, and certainly we don't consider that as a tax which necessarily raises costs.

Senator O'MAHONEY. I do.

Representative CURTIS. Surely.

Senator O'MAHONEY. I do.

Mr. BARKIN. It may very well be you do because of the practices of corporations in capitalizing.

Senator O'MAHONEY. I am thinking of one specific fact, and that is that the interest upon the national debt is now at its highest level, and the financing by the Treasury Department that has been going on since the 1st of December is increasing that interest upon the national debt.

In the September midyear review of the budget, Budget Director Stans reported that the estimated expenditure for interest on the national debt during fiscal 1959 would be \$7,568 million. There is no single category of Government expenditure that is as great as that except national defense in all its categories. So interest upon the national debt has become the largest burden upon the taxpaying public in the United States by reason of the fact that the Government,

executive and legislative, has failed as yet to find the solution for the overall problem.

Mr. Barkin, while I disagree with you about this interest on the national debt and the cost, I do agree with many of the recommendations which you have made. You have come here this morning with suggestions of a new policy. I think that much of the consideration that we have been giving to this problem has been based upon a failure to realize that we have moved completely out of the economic system that was based upon activities within the several States. As you have pointed out, Mr. Ellis, we are living in an era when employment in agriculture is declining rapidly, and employment in industry is not sufficient to take it up because industry is also marked with the development of labor-saving machinery that produces many items now with much less labor cost.

Mr. Chairman, instead of asking any more questions about this, I would like to get into the record at this point this fact. The Subcommittee on Antitrust and Monopoly had a study made in 1957 of the census of manufacturers. A committee print was made of the staff study on this concentration in American industry. When that study was published, I made this statement—this was on July 15, 1957:

While the report does not contain any recommendations for legislative action, it nevertheless shows a remarkable increase in the concentration of manufacturing in this country. For example, the report shows that 3 years ago, in 1954, the 100 largest manufacturing companies in the United States accounted for 30 percent in dollar value of all the manufacturing production in the country. This is an increase of more than 42 percent over the record in 1947 when the same 100 companies accounted for only 21 percent of the total.

I have a table here taken from that report which shows some extraordinary results.

The CHAIRMAN. Would you like to insert the table, Senator?

Senator O'MAHONEY. I would like to read one or two of the items and then insert it, if the chairman will permit me.

The CHAIRMAN. Certainly.

Senator O'MAHONEY. For example, there were 27 companies, according to the Bureau of the Census on manufacturers, who were engaged in 1954 in the manufacture of tires and inner tubes. The total value of their output that year was \$1,841,732,000. Of that total, of almost \$2 billion, the four largest companies produced 79 percent. The eight largest produced 91 percent. This extraordinary degree of

concentration is shown in some of the most commonly used items. Take cigarettes, for example. There were 12 companies manufacturing cigarettes according to the "Census of Manufactures" in 1954. The value of the total product that year was \$1,640,950,000. The four largest produced 82 percent of that.

There were 109 companies engaged in producing tin cans and other tinware, the output having a value of \$1,366,766,000; the four largest produced 80 percent. I could go through this whole list reading one after another of these extraordinary instances of concentration. It is clear from the hearings on the administered prices which the Antitrust Committee held under the chairmanship of Senator Kefauver that some of the big companies were raising prices while their cost of production was actually going down. This I think lies at the very base of the problem of inflation and the cost of living, and the cost of Government that we are facing.

The CHAIRMAN. Senator, don't you think, if you will pardon an interruption, that there is a serious problem, too, where prices are raised for the purpose of acquiring expansion capital? In other words, getting cost less capital from consumers in the form of increased prices.

Senator O'MAHONEY. Of course that is a factor. That undoubtedly is a factor. There are amazing incidents which have been revealed to us. I know, for example, in the manufacture of bread, that the concentration of economic power in the production of this basic food for the whole population has been increasing at an alarming rate. We first discovered it during the days of TNEC, when it was clear that the big companies would seek to purchase a competing rival in a different town because they wanted to go into that town.

If the rival companies would not sell, the big company would transport in interstate commerce, frequently, bread manufactured from a distant bakery and sell it at less than the price sold when they had no competition. In other words, the price of bread would be driven down to drive out competition and when the competitor sold out then the price of bread would go up again. This was discovered scarcely 2 years ago to an alarming degree in Oklahoma. The Antitrust and Monopoly Committee is going to go ahead with that later. I mention it only as a sideline.

Mr. Chairman, no doubt my time has expired. I will file this.

The CHAIRMAN. Without objection it is inserted in the record.

(The information referred to follows:)

TABLE A.—*Manufacturing industries in which the 4 largest companies accounted for 50 percent or more of total shipments in 1954*

[Shipments of \$300 million and over—56 standard industrial classification 4-digit industries]

| Industry (standard industrial classification) | Number of companies | Value of shipments (thousands of dollars) | Concentration ratio: Percent of value of shipments accounted for by— | | |
|---|---------------------|---|--|-----------|------------|
| | | | 4 largest | 8 largest | 20 largest |
| 3717 Motor vehicles and parts..... | 991 | (1) | 75 | 80 | 87 |
| 3312 Steel works and rolling mills..... | 102 | (1) | 54 | 70 | 85 |
| 3722 Aircraft engines..... | 202 | 3,188,950 | 62 | 81 | 93 |
| 3311 Blast furnaces..... | 34 | 2,753,998 | 65 | 82 | 96 |
| 2829 Organic chemicals, n.e.c..... | 202 | 2,198,687 | 59 | 73 | 87 |
| 3011 Tires and inner tubes..... | 27 | 1,841,732 | 79 | 91 | 99+ |
| 2111 Cigarettes..... | 12 | 1,640,950 | 82 | 99+ | 100 |
| 3614 Motors and generators..... | 266 | 1,389,078 | 50 | 59 | 75 |
| 3411 Tin cans and other tinware..... | 109 | 1,366,766 | 80 | 88 | 96 |
| 3351 Copper rolling and drawing..... | 64 | 1,320,608 | 53 | 71 | 90 |
| 2932 Byproduct coke ovens..... | 38 | 1,241,327 | 58 | 75 | 92 |
| 2825 Synthetic fibers..... | 20 | 1,240,942 | 80 | 97 | 100 |
| 3521 Tractors..... | 141 | 1,177,974 | 73 | 88 | 97 |
| 2141 Tobacco, stemming and redrying..... | 72 | 1,043,213 | 79 | 91 | 96 |
| 2841 Soap and glycerin..... | 267 | 959,679 | 85 | 89 | 95 |
| 2092 Shortening and cooking oil..... | 67 | 935,338 | 55 | 80 | 99 |
| 3352 Aluminum rolling and drawing..... | 77 | 874,408 | 88 | 92 | 96 |
| 3861 Photographic equipment..... | 428 | 867,597 | 63 | 73 | 84 |
| 2062 Cane-sugar refining..... | 16 | 864,113 | 67 | 86 | 100 |
| 3331 Primary copper..... | 10 | (1) | 86 | (2) | 100 |
| 3664 Telephone and telegraph equipment..... | 56 | 797,109 | 89 | 94 | 98 |
| 3621 Electrical appliances..... | 348 | 795,304 | 50 | 61 | 79 |
| 2052 Biscuits and crackers..... | 262 | 757,193 | 71 | 77 | 85 |
| 2822 Intermediates and organic colors..... | 83 | 715,602 | 58 | 82 | 93 |
| 2085 Distilled liquor..... | 98 | 711,313 | 64 | 79 | 93 |
| 3662 Electronic tubes..... | 112 | 709,183 | 64 | 81 | 94 |
| 2023 Concentrated milk..... | 166 | 688,212 | 55 | 68 | 80 |
| 3615 Transformers..... | 152 | 686,087 | 78 | 89 | 95 |
| 3221 Glass containers..... | 38 | 635,121 | 63 | 78 | 92 |
| 3571 Computing and related machines..... | 73 | 614,265 | 74 | 85 | 98 |
| 3334 Primary aluminum..... | 3 | 604,076 | 100 | | |
| 3641 Engine electrical equipment..... | 154 | 587,124 | 62 | 83 | 90 |
| 3811 Scientific instruments..... | 363 | 580,916 | 51 | 69 | 79 |
| 3593 Ball and roller bearings..... | 83 | 537,151 | 60 | 79 | 92 |
| 3581 Domestic laundry equipment..... | 48 | 527,535 | 68 | 85 | 99 |
| 3742 Railroad and streetcars..... | 47 | 495,767 | 64 | 81 | 98 |
| 2094 Corn, wet milling..... | 54 | 458,442 | 75 | 93 | 99 |
| 3511 Steam engines and turbines..... | 18 | 450,041 | 87 | 98 | 100 |
| 2095 Flavorings..... | 530 | 446,056 | 53 | 63 | 75 |
| 2072 Chocolate and cocoa products..... | 27 | 432,842 | 70 | 83 | 98 |
| 3741 Locomotives and parts..... | 25 | 428,281 | 91 | 98 | 99+ |
| 3229 Pressed and blown glass, n.e.c..... | 255 | 411,322 | 67 | 77 | 88 |
| 2812 Alkalies and chlorine..... | 17 | 399,908 | 69 | 90 | 100 |
| 2826 Explosives..... | 40 | 389,638 | 79 | 92 | 99 |
| 3231 Products of purchased glass..... | 833 | 372,383 | 56 | 61 | 68 |
| 2852 Inorganic color pigments..... | 73 | 371,395 | 67 | 83 | 96 |
| 3211 Flat glass..... | 16 | 370,503 | 90 | 99 | 100 |
| 2824 Synthetic rubber..... | 13 | 361,093 | 53 | 81 | 100 |
| 3292 Asbestos products..... | 74 | 346,206 | 59 | 73 | 93 |
| 2043 Cereal breakfast foods..... | 37 | 345,843 | 88 | 95 | 99+ |
| 3681 Storage batteries..... | 244 | 341,374 | 64 | 80 | 90 |
| 3651 Abrasive products..... | 290 | 332,512 | 50 | 58 | 71 |
| 3291 Electric lamps (bulbs)..... | 35 | 326,343 | 93 | 97 | 99+ |
| 3715 Truck trailers..... | 115 | 305,510 | 57 | 68 | 84 |
| 3359 Rolling and drawing n. e. c..... | 77 | 300,715 | 61 | 73 | 87 |
| 3332 Primary lead..... | 5 | (1) | (2) | 100 | |

1 Not published.

2 Not released lest data be disclosed re individual companies.

Source: "Concentration in American Industry," U.S. Senate, Subcommittee on Antitrust and Monopoly (1957).

The CHAIRMAN. Mr. Curtis.

Representative CURTIS. Thank you, Mr. Chairman. I will try to pick up on the second question that I was on where I was trying to get at the various damages resulting from various kinds of inflation. I jotted down a few items here.

Economic factors producing cost increases which may be damaging. One I think the panel has agreed, excessive monetary supply. I think everyone agreed that can produce damage. Whether it is is another question.

Mr. ELLIS. Exception; not cost increases. Wouldn't they be price increases coming from excessive demand?

Representative CURTIS. I beg your pardon. I wrote "cost" and meant "price" when I wrote it. Price increase.

The second one I have jotted down, we could have excess demand over supply for consumer goods and services. That is a traditional inflation which would not be the result of excess money. It could be.

Mr. ELLIS. Exception again. Isn't that how inflation results in rising prices?

Representative CURTIS. It could come from that. You could have the excess money if there were not the demand.

The third one, which I have not generally heard discussed a great deal, but in my judgment is certainly an element, "excess demand over supply of investment capital."

In fact, I felt in many ways that both recession and inflation came to a large degree from an excess demand over supply of investment capital. Whether they agree with that point, would the panel agree that could be a cause for price increase that might be damaging?

Mr. ELLIS. I would like to take the specific statement, excess demand for investment capital. Presumably it would result from an outlook for increased business activity and profit.

Representative CURTIS. Exactly.

Mr. ELLIS. Rather than from inflation or anything of the sort. It would not raise prices.

Representative CURTIS. I am not saying it is the result of inflation. I am saying it is a factor that could produce inflation or price increase.

Mr. ELLIS. No, because the price increase would already have occurred. It would then be attractive to produce these items. Business would be expanding to produce more of them.

Representative CURTIS. Just segregating the item. Suppose you were given a situation where you have an excess demand over supply of investment capital. That is going to raise the cost of investment capital.

Mr. ELLIS. That is right.

Representative CURTIS. That in turn will be passed on in prices?

Mr. ELLIS. Not necessarily, because presumably the excess demand for capital has occurred because of increased demand for some product or service whose production will be expanded by the increased capital.

Representative CURTIS. You are saying it has been produced because you had inflationary forces before. What I am trying to say, is it not inflationary in itself?

Mr. ELLIS. No; not unless there is a shortage of capital seeking investment, i.e., a shortage of savings.

Mr. BAUMOL. I am sorry I must disagree with Mr. Ellis. I can easily see that even where businessmen are only responding to an increased demand, their investment will make prices rise. They start a program of building factories and this causes a demand for bricks and labor, and that in turn causes increased prices. This can keep up the demand indefinitely.

Representative CURTIS. Thank you, sir.

Mr. SPRINKEL. It could keep on indefinitely so long as final demands continue to rise. Unless monetary fiscal policies continue to augment final demands, this would not continue indefinitely. I would certainly think that did happen for a while in 1956-57, excessive demands for capital. We properly in my opinion restricted from a budget and monetary point of view substantial growth in final demands and this did not continue.

Mr. BAUMOL. It is right and proper to separate out these various causes and ingredients of inflation. It must be emphasized however that they all to some extent have to occur together. If people were determined to hoard, increasing the money supply would not make a bit of difference, and if you did not have any money supply to smooth the wheels increasing demand might not make much long-run difference, and so on. What you have here is a bunch of things which happen all at once.

The same difficulty puzzles me when people try to separate cost induced and demand induced inflations. After all, you could not really raise costs unless the demand were there to back it up. Similarly, on the other side if there were extreme stickiness in prices, increased demands would not lead to price rises.

Representative CURTIS. It is helpful to me to try to separate these. I agree there is an interplay. I have another item I wrote down. Excessive demand over supply for skills which in my judgment has produced to a large degree the increased prices for services. Would the panel agree that is an area? That would be unskilled labor, too. It could be any excessive demand for labor over supply. But for the sake of being a little more practical, I think actually we have that, although we are in an area where there is unemployment. Wouldn't you all agree that there is a demand for certain skills beyond the supply?

Mr. SPRINKEL. The real danger, sir, it seems to me, in separating specific areas is that it becomes very difficult to tell what portion of the price increase in a particular area is due to general overall inflationary demands, and to what extent it is due to shifting relative demands and shifting costs. So it well may be that as our economy is becoming more mechanized, the price or the wage paid for skilled labor does go up in order to induce more people to get better training and hence be able to fill those jobs in the future.

Representative CURTIS. Right now I am just generalizing the first step. I am not trying to get into what the corrections are. I will mention the corrections for the excess demand over supply for any of these is to increase your supply. In skilled labor you have a real time lag involved. You have a geographical problem. You have a distribution problem. It would be in error in my judgment to try

to solve increased prices that result from this factor by changing your monetary system or whatever else there might be. Likewise, if there was an excess demand over supply for consumer goods and your money supply was adequate, and the demand was coming from tendencies to barter, as Chairman Patman said, the correction for that is increased production.

All I am trying to do is to separate those and then ask this question. There are certain economic occurrences that increase prices that are not damaging. Would you agree with that? I have hinted at a couple where I thought they were not damaging, like the increased quality. For instance, your antibiotic drugs which were not even on the market before have supplanted a lot of these patent medicines, and they cost a lot more. Although that shows up in the Consumer Price Index, that is a factor we could well say is not inflationary. I don't think we would call it inflation.

Mr. ELLIS. Exception. I don't think a change like that would cause an increase in the price index. Wouldn't the Bureau of Labor Statistics compare the same item then and now, rather than a new item now with an old item?

Representative CURTIS. I don't know how you do it. I know the overall market basket that they use, when you put in items that were not in there before, you are somehow going to show an increase in the cost of living.

I will add another thing. As far as the human beings are concerned, it may not make too much difference to an older person when he has to buy drugs or hospitalization, the fact that he is going to get better drugs and better medical attention if he can't afford it. So we get into the other element of the purchasing power. At least for the consideration of what is happening here, I would not regard that element of price increase as something that we would want to discourage.

Mr. BARKIN. Mr. Curtis, I think Mr. Ellis has pointed up the proper thing. When you factor in a new product under the index, it doesn't necessarily raise the level. It is factored into the index in such a way as to minimize its impact on the market basket. To get back to what I think is the purpose behind your questions, you and I are in agreement there, that while there may be a monetary mechanism which creates the flow of funds with which to finance many of these experiences and phenomena, on the other hand, this inflationary process, or the rise in the general price level, is composed of so many different factors and pressures that the older concepts or the concept of trying to associate it exclusively or primarily with the monetary system seems to be inadequate. In that respect I think there is a great virtue and value in sorting out specific causes and specific situations and seeking remedies and controls or specific policies relative to those individual areas.

Representative CURTIS. You are getting at what I am getting at. You are drawing a different conclusion than I would draw. What I am getting at is that these other elements, other than excess monetary supply, seem to me generally to have built-in regulatory features in our free enterprise system, and are in essence almost the interplay of the private enterprise system.

There is a fifth one that I did not mention that has already been referred to. This is administrative prices which, as far as I am concerned, is still an epithet rather than an economic fact. It may or may not be administered. On the other hand, I suggest what has been defined as administrative prices is simply business exercising judgment over economic factors. Whether it is or not, it could be, certainly. That is where we get our antitrust laws and various things there.

So there are two areas of these economic factors that seem to bring about price increases where I think the Government probably should be taking part. One is the excess monetary supply. The other is in the area of what might be administered prices. But these other factors we have discussed, it seems to me, have corrective features, and are in essence the operation of the private enterprise system. That is what I have been getting around to, to see whether the panel agrees or disagrees with that.

Mr. BARKIN. Obviously, as you noted, you and I drew two different conclusions from that analysis.

Mr. SPRINKEL. I certainly agree with that analysis. The long-term record strongly suggests to me that unless we have excessive growth in the money supply, we do not get substantial long-run inflation of the price level in general. The possible exception to that was 1956-57, and even there I am doubtful, since it did not last very long and special factors were operating, that you could even use that as an example of a cost-induced rather than an excess-demand inflation.

Representative CURTIS. I see my time has run out. I want to make one final comment.

It seems to me that some of this creeping inflation that we have been talking about is just a failure to analyze what the price indexes reveal, which actually include an improved standard of living, rather than cost.

Mr. SPRINKEL. Yes.

Mr. ELLIS. A good example of that would be the rise in food costs over the last 15 years. It is not entirely a rise in cost of specific food. Isn't there included also a large element of built-in service which the customer is perfectly willing to pay for?

Representative CURTIS. My time is up. I will come back, Mr. Chairman.

The CHAIRMAN. Mr. Reuss.

Representative REUSS. Mr. Barkin, I would like to ask a couple of questions about your specific program.

Under "Labor Sector" of your statement, you advocate an annual labor-management conference to achieve consensus on economic policies for collective bargaining. I take it the basis on which you call for such an annual conference is the reason set forth in your paper, particularly on page 25, where you point out that the participants in any single collective-bargaining situation are not likely to arrive at an understanding concerning national economic policies. Is that a fair statement?

Mr. BARKIN. Yes, sir.

Representative REUSS. If that is so, and I agree with you that it is unlikely that the participants in a single negotiation will have so broad a viewpoint, wouldn't it be useful to have not just a labor-management conference, but a conference at which were represented labor, management, and the public?

Mr. BARKIN. As a matter of fact, I have been offering this proposal for a number of years—and I have a rather large document on that subject. I may further say that the National Planning Association is moving in this direction. The concept is that you have your principals, labor representatives and management representatives, present at the conference, flanked, of course, by outstanding students and economists and public persons. But the primary purpose of such a meeting is for the two principals in the labor economic field, particularly in our industrial end of our society, to come to some understanding on modest or broad issues periodically so that their ultimate judgments of the agreement would be affected. Obviously, flanked by men of economic insight and public representation, they would participate and help. They would also prepare introductory documents to help the parties penetrate some of these difficult issues to assist them in coming to a consensus.

Representative REUSS. Wouldn't these public men or these flankers be quite helpful, indeed? As you pointed out since management is responsible mainly to its stockholders and since labor leaders are responsible mainly to their membership, the trouble with the collective-bargaining negotiation in the first place, under the system—and I am not suggesting that this be changed—the public interest is perhaps less well represented than the partisan interests of the two very legitimate parties to the bargaining table.

Mr. BARKIN. The virtue of such a conference is that it would focus on policy and not on resolutions of the specific controversy in an individual plant or industry. Consequently, it would have to be formulated primarily in terms of public interest and the interest of our national economy.

Representative REUSS. You then do not disagree with me in my thought that there is a public point of view, a consumer point of view, a national economy point of view, which can perhaps be better represented than through either of the immediate parties to the wage bargaining?

Mr. BARKIN. As a matter of fact, the public controversy on general economic issues concurrent with these negotiations is very often quite irrelevant and tangential to the immediate negotiations. Consequently, the only way of highlighting them would be through such a conference where the specific resolution does not have such immediate potency.

Representative REUSS. So the public flankers would have an important part to play?

Mr. BARKIN. Yes, sir.

Representative REUSS. Turning then to another recommendation of yours, No. 3 under the business sector recommendations, a Federal agency to hold public hearings on proposed price increases by large corporations, I have a question. On page 2 of your report you present what you correctly, I think, regarded as a very crucial observation, that labor costs in the durable goods industries rose by 15 percent in the 10 years, wholesale prices by 53 percent, and in the nondurable industries, unit labor costs rose by 11 percent, and wholesale prices by 10 percent.

Directing your attention to those comparisons, doesn't it appear as if labor costs in the durable goods industries outstripped the increase

in labor costs in the nondurable goods industries by almost 50 percent, and doesn't it further and even more dramatically appear, that prices in the durable goods industries went way, way, way beyond anything needed to absorb the increase in labor costs?

Having in mind both the disparity between wage increases and price increases in the durable goods industries, and having in mind the disparity between wage increases in the durable goods industry contrasted with those in the nondurable goods industries, don't you think that it might be useful to hold public hearings on proposed wage increases in certain key industries?

Mr. BARKIN. No, sir.

Representative REUSS. If not—and I see it is not—why not?

Mr. BARKIN. Fundamentally, I think that the economists and the public are not fully cognizant of the process by which wage demands are developed or negotiated. I attempted to do that in my paper. The title of that section says "Wage demands will be moderated in a noninflationary economy."

The essence—obviously I am trying to short-cut it in 2 or 3 sentences—is that wage demands are a byproduct of the behavior and profit record of the industry with which the workers are associated. It is typified and illustrated by Walter Reuther's dramatic proposal for a \$100 car reduction. It is typified by the complaints of the Steelworkers against the price increases in that industry.

On the other hand, it is illustrated by the experience of workers in my industry. In textiles where the industry is highly competitive and the general level of profit is low, we are unable to keep abreast even of the rise in cost levels. That is, the wages don't keep abreast of the cost of living. In the other industries, unions are able to effect their increases and their workers in the industry think of huge increases because the profits are good and the industry is raising prices constantly.

I think if we analyze the behavior of trade unions and workers, their behavior is a derived one and not an initiatory one.

Representative REUSS. Surely, and your figures seem to me to demonstrate that abundantly. In the strong industries, steel and auto, to take a couple, there is this capacity on the part of management to pass on wage increases and then some, doesn't that tend to bring about a situation where unit wage costs in those industries outstrip unit wage costs in nondurable industries?

The answer, of course, is obviously "yes." That was your point.

Mr. BARKIN. Yes. The solution that we are proposing is that a review of price increases in these large corporations would automatically effect a change in the level of wage demands and union aspirations and worker aspirations in these industries, and it would be automatically muffling or dampening the kind of requests that are made.

Representative REUSS. It might, to some extent. Unless your review of price increases is effective enough to break up the reason why that particular industry could make the price increases in the first place, that is, its enormous size, small number of participants, et cetera, I shouldn't think that you would achieve a complete dampening of the disproportionate wage demand.

Mr. BARKIN. I think you will. In this short colloquy, I am trying to give you the fundamental position from which I am convinced that a restraint on administered prices, a thorough review and public pressure on the price level will automatically bring your wage level adjustments into line.

Representative REUSS. You would say, Try point 3 on prices first, and if you should turn out to be too optimistic, then you would be ready to suggest, Turn the spotlight on wages, too, in these strong industries?

Mr. BARKIN. That is right. I have made that point in another way in the printed statement, where I have a discussion addressed primarily to Mr. Bach, on the question of the effect on the separate groups.

The stronger and active economic groups of labor and capital have held their own. They have easier access to resources. The weaker and more passive have suffered. Countervailing forces arise slowly and adequately and often not at all under the weak. Even when the Government undertakes to help the weak, the strong batter down the aids in legislation unfriendly, and the judicial process in the case of unorganized workers. The correction of inequity suffered by one weak group does not assure the benefits to all others.

I am addressing myself just to this question. We bring the price in line, and the wage schedule and wage demands will automatically moderate themselves.

Mr. SPRINKEL. I would like to agree with Mr. Barkin that the demand for labor is a derived demand resulting from the ability of labor to produce marketable goods and services to be sold at a profit. But I would also like to point out the prices of products and services produced are derived from the demands in the market place on the one hand and cost conditions on the other. Prices cannot be set and sustained by businessmen who disregard either of these two forces. Since Mr. Barkin's proposal for price hearings neither limits final demands for products nor increases the supply of goods, I fail to see how such action would protect us from inflation. In my view the proposal, if enacted, would not only fail to restrain inflationary pressures but would seriously limit the ability of the economy to adjust to changing demand-supply conditions. In our economy particular prices must be free to change. It is the average of all prices that we wish to stabilize. Granting to a Federal agency the power to fix particular prices is the same as Federal determination of what goods will be produced and in what volume, since price performs the allocation function in our present economy. Few of us are willing to say the Federal Government rather than the consumer should make most production decisions. Yet that is what we are in effect saying when we propose Federal determination of particular prices. I wish to register strong dissent from the position taken by Mr. Barkin because the proposal would not contribute to prevention of inflation and it would lead to a centrally directed economy.

Representative REUSS. Mr. Chairman, thank you.

The CHAIRMAN. I don't want to take up much time of the witnesses or the committee, but I do want to raise certain questions which I wish the members of the panel would consider elaborating on when each one of you will receive a transcript of the hearings this morning. When you are looking it over, if you want to elaborate on what you have said, it will be perfectly all right to do it.

I would particularly like for you to elaborate on the questions that I shall raise now.

One question involves one reason why the high national debt should be reduced. As more securities are issued by the Federal Government available funds are absorbed by National Government securities. Then if we have need for huge public works, such as school construction or things like that, interest rates will be higher and that retards progress in other fields. The national debt is accordingly in competition with the progress of the country. Every effort should therefore be made to reduce the national debt when it is proper to do so.

I recognize there are two schools of thought on "balancing" the budget before Congress adjourns. One school of thought harbors the belief that that would be a good way of arbitrarily reducing certain social benefits that they oppose. They would like to have it for the purpose of getting an arbitrary reduction that way. I do not have that in mind at all.

I have in mind that we should consider the progress of the country and if it is necessary to raise taxes at the end of a Congress to take care of the budget, we should do it. It should be our duty to raise taxes as much as it is to lower taxes, keeping in mind the lowest tax rate possible and the lowest tax burden possible, but not neglecting or forsaking our duty toward the progress and expansion of the Nation.

The other question that I would like you to think about involves tax-exempt securities. We have about \$55 billion worth of tax-exempt securities in our Nation today. Some of that has been absorbed or bought by commercial banks which have "created" money on the books of the banks with which to buy these tax-exempt securities. About \$14 billion are held by the commercial banks.

The \$55 billion is quite a haven for people who would like to place their funds in such a way that they would not have to pay any tax on them. In other words, it is a haven for people of great wealth.

I am not criticizing anyone who owns these tax-exempt securities under our present system. Anyone has a right to take advantage of any system that we have. But the question is whether or not we should have tax-exempt securities. I don't know of another country in the world that has tax-exempt securities.

We have a national debt that is higher than the aggregate debt of all nations on earth. Then we have \$55 billion in tax-exempt securities, and I don't think any other nation in the world issues any tax-exempt securities. If I am wrong about that, I would hope you would point it out. I would like to have the benefit of your knowledge on that subject.

(Mr. Sprinkel subsequently submitted the following:)

I have commented previously why I think we should run a surplus in good times and retire Federal debt. On the matter of tax-exempt securities, it should be recognized that not only are these investments a haven for receiving tax-free income, but the tax exemption reduces the cost of financing to State and local governments. Investors are willing to bid a higher price for tax-exempt securities and hence the cost of financing local improvements is reduced. The elimination of tax-exempt securities would not only eliminate a tax-free source of income but would also make State and local financing more costly.

(Answer by Mr. Ellis to the chairman's question about "Reasons why the high national debt should be reduced":)

It is important to reduce the Federal debt, and particularly that portion of the debt held by commercial banks, to release funds for private investment, and to ease the burden of the Treasury in refinancing the debt. It is appropriate for the Federal Government to finance some expenditures in a period of national emergency by selling securities to savers, and even to borrow short-term funds from the commercial banking system. But the short-term debt should be reduced to a minimum as soon as practical after the emergency to avoid the dangers that result from creation of excessive amounts of credit—and to prepare for a possible future emergency.

When the bank-held debt is reached to an amount desired by the economy, a start should be made on repaying funds borrowed from savers. These funds will then be available for consumer spending or investment. For example, repayment of Government securities owned by insurance companies could provide funds for mortgage lending.

The presence of a large volume of short-term debt, marketable debt, and debt redeemable on demand, renders difficult the task of the Federal Reserve Board in adjusting the money supply of the country to the needs at a particular time. Furthermore, this task is also made difficult by the necessity for frequent trips to the money market by the Treasury to refund maturing issues, and by the inexorable shortening of debt maturities by the mere passage of time. If the volume of outstanding Federal debt were being steadily reduced, some progress could be made in lengthening the average maturity.

The key to debt management, of course, lies in having a surplus in the Federal budget in some years to offset deficits which have occurred. It should be noted that fiscal years 1955-57, the most prosperous years in our history, resulted in a net deficit of \$1 billion. The budget should be balanced by reducing expenditures rather than by increasing taxes, although the growth of the economy will provide steadily rising revenues even with no change in tax rates. After the budget has been balanced a start can be made on tax rate reduction and reform to promote investment incentive.

(The following comments were sent by Mr. Ellis in answer to Mr. Patman's second question on the desirability of having tax-exempt securities:)

Tax-exempt securities are issued by State and local governments at relatively low rates of interest. The interest rates fall usually in the 2 to 3 percent range, although first quality corporate bonds require interest rates of 4 to 5 percent. Interest rates on securities of State and local governments are low largely because of the tax-exempt feature. Naturally, there is attraction in avoiding the top Federal tax rate of 52 percent on corporate income and the top rate of 91 percent on personal income. The attraction of tax-exempt securities would be lower if tax rates were lower.

Elimination of tax exemption for interest on State and local securities would increase substantially the cost of roads, schools, and other public works financed from borrowed funds.

While it is true that no other important country issues tax-exempt securities as we do, it is also true that no other country taxes capital gains as we do.

(Solomon Barkin subsequently submitted the following for the record:)

A number of issues were raised which should be commented upon. I shall state rather than argue my position.

(1) In our economy, an excess in the money supply in relation to business activity can be routinely created by our commercial banking system and credit institutions when big corporations carry on expansionist activities. They are not easily brought within the purview of the current system of monetary controls. The ability of other nonfinancial and nonbanking institutions to carry on independently of the Federal Reserve System explains why the latter's policies cannot be speedily enforced and will not reach the groups primarily contributing

to the inflationary pressures. If the Federal Reserve Board was able to invoke more specific and immediate controls on these areas, it would be more effective and discriminating. At present its policies damage smaller businesses and public bodies which should not be touched even in normal tight-money periods.

(2) If the creation of a Federal deficit threatens to spark an inflationary cycle the effect should be sterilized through new monetary techniques. Congressman Patman's proposal warrants close study and should be carefully reviewed at a special hearing by the Joint Economic Committee dealing with each of the specific new proposals.

(3) The assumption that a 4 percent unemployment rate is tolerable is unacceptable. As Congressman Reuss pointed out, the tolerance level in Europe is well below 1 percent. We cannot afford such a loss of manpower. When this country reduced its unemployment well below 4 percent in 1956 and 1957, many advocated specific legislation for area redevelopment to stimulate the economic redevelopment of the chronically depressed areas. Structural unemployment in the magnitude of 4 percent is beyond all limits of tolerance. The people in these depressed labor markets voted for action against high levels of unemployment. Similarly in the rural underdeveloped areas, people will not suffer continued unemployment and underemployment. The present administration has sponsored a relatively limited rural program in response to the demand for remedying these intolerable conditions.

Unfortunately, the men who have promoted the 4 percent level of tolerance are not fully aware of the size of the pockets of unemployment it will encourage and maintain.

(4) The assumption that European experience is relevant to the selection of the level of unemployment above which prices will be cut is unwarranted. Big business in this country acts differently than do European small and family enterprises and the cartels.

(5) Economic growth can take place in a stable price environment. Growth has also taken place in an era of creeping inflation.

(6) The fear that creeping inflation would impel speculative purchases and runaway inflation has been exploded by members of the panel and economists such as Sumner Slichter.

(7) Taxes become a cost only when the agent has the economic power to effect this end. The ability to shift a tax burden is a function of competition and power. We cannot and should not assume that taxes are necessarily shifted. If they are shifted, we must immediately examine the power structure and the ineffectiveness of the competitive process in those areas.

(8) Consumers should share in the rise of productivity. Unfortunately, they enjoy these benefits only in the highly competitive industries. In textiles, workers and management have not enjoyed a substantial proportion of the benefits of such advances. The consumer has obtained the major segment. Competitive fibers have forced price reductions in the synthetic yarn industry. If the prices are to be cut, the price decisions of the large corporations must be reviewed by a governmental body.

(9) Collective organization of workers cannot be considered a monopoly as several panelists have contended. Being business oriented spokesmen or economists, they are of course applying orthodox concepts of the discipline which have no relevance to the phenomenon of the labor market or wage determination. Labor organization is an institution for negotiations in the same way that management is an institution for an enterprise which negotiates with trade unions, buyers, and sellers. The very proponents of this point of view have quoted Milton Friedman who has repeatedly argued that unions do not get any more than the workers are otherwise entitled to. They merely make sure that it is delivered.

Wage proposals are a derived demand. The negotiations are a process of reconciling economic pressures. Wages are different from other prices and therefore must be understood and described with a different nomenclature.

(10) The concern for the inequities created by creeping inflation would be better directed toward correcting the social evils already existing in our society.

If the college professors feel themselves improperly dealt with, they should organize and bargain for themselves, rather than rely on outside forces. It is abdication of responsibility on the part of the teaching profession to permit its income to become so unattractive as to discourage men from coming into the field. The country needs highly competent teachers and the only way to assure this is by higher salaries and benefits. The existing members of the profession

should fight for them as an evidence of their belief in their own importance instead of waiting for the Ford Foundation or public outrage at the deterioration of the school systems, to force necessary raises upon the trustees and even the teachers.

(11) If the size of the national debt or the cost of the interest charges are troublesome, there are methods for removing these problems by legislation. Other countries have followed these courses in the past.

(12) The entire institution of tax-exempt securities needs review.

The CHAIRMAN. Mr. Curtis?

Representative CURTIS. I will try to finish.

I was going to move on to the third question which has already been answered, I think.

Mr. BELLER. I wanted to raise this question.

Representative CURTIS. I certainly want you to, Mr. Beller.

Mr. BELLER. I think you were pointing out, if I understood you, that the imbalance between excessive demand and supply, assuming it is not caused by any excessive money supply, should be met by market adjustments.

Representative CURTIS. That is right.

Mr. BELLER. I am wondering, if you would not agree that while market adjustments should play the major role, certain Government actions could facilitate this adjustment.

Representative CURTIS. I will pass it back to you. It is always possible that there can be clogs in that machinery. I have always felt that it is a proper function of the Government to be sure that any impediments to the market working freely should be removed. To that extent I would agree.

Mainly I was trying to point out for consideration as to whether in our discussions here and the papers and the main area for Government is in No. 1 and No. 5—the excess monetary supply and second the area of monopoly, or whatever you call it, where the Government traditionally has operated.

Mr. BELLER. These are the traditional areas, I think. I am wondering whether a new situation does not call for more imaginative and nontraditional acts on the part of Government. The Government can do much to bring about a shift of resources in the farm area, or a shift of resources from distressed areas to areas which have insufficient resources.

Representative CURTIS. And what they can do to be very sure that they don't make it worse, which I am more afraid of frankly.

Mr. BELLER. That is a danger.

Representative CURTIS. I think it is a very great danger. We conducted hearings on the foreign economic factors involved on the agriculture in this committee. I think it helped a lot. But I think there is a lot of economic nonsense discussed politically around the country ignoring the basic economic factors in this.

It is almost a matter of epithets, and regrettably when you get these things into the political arena you get into that kind of thing. That is the reason I hesitated bringing those things into the political arena unless there is no other course. Certainly I think in the field of monopoly control we have properly brought it into the Government sector. I certainly want to examine and would say an analysis of these things I have pointed out is important.

Certainly government has gotten into this fourth one I mentioned, excess demand for supply for skills. All this business of getting education is the result, in my judgment. How far we should go is another point. That is certainly one of them.

The third question I had which I think has been somewhat answered, although there is disagreement, was: Don't increased taxes increase prices? In other words, aren't the taxes just passed on in the price of goods and services to the consumer? I think Mr. Barkin is disagreeing. I wonder if any other panelists would agree with that observation.

MR. SPRINKEL. I disagree with one application of it. It seems to me if this is true, then the way to stabilize the price level is to cut taxes. Rather clearly we would not agree with that.

Representative CURTIS. No, I am not drawing any conclusions. I am simply making an observation. In fact, I would put that in the category of one of the things that is not detrimental in the price increase and judge the question of whether there should be the taxes on the basis of what the Government is doing with the taxes. Certainly we are going to have Government performing services presumably desirable, and that is going to be paid for in increased prices.

As Government takes more of a function I think we are bound to have increased prices. In my judgment that is nothing to be alarmed about from the fact that there are increased prices. Therefore, as your price index goes up, as the Government becomes larger, we can expect it as an economic phenomenon.

MR. SPRINKEL. In my opinion higher taxes for the purpose of financing higher Government spending need not result in higher prices. A shift in demand from taxpayers to the Federal Government would occur with no net increase in demand. On the other hand, the total supply of goods and services would not decrease but there would be a shift in composition from goods produced for private consumption to goods produced for public consumption. Since total demand would not rise and the supply of goods and services would not decrease, prices would not rise. In fact, the reason for meeting increased Government spending with higher revenues is for the explicit purpose of preventing inflation.

MR. BELLER. Except, I wonder if there is not a difference in the ability to shift the burden of these taxes as between workers and employers.

Representative CURTIS. There is the next point. We then come to what kind of taxes.

The next observation I was going to make is that economically speaking inflation is a form of tax. That is one way of paying for things. You can do it inasmuch as the Government is primarily the debtor.

Then I would come to the question which this whole thing hinges upon, what damage do the various kinds of inflation or things that produce price increase have on our economy?

Being on the Ways and Means Committee, it seems to me that we have not fully analyzed the damaging effects of the previous inflations on our Federal tax structure. In fact, on all of our tax structures. Let me illustrate in two areas:

One, the depreciation allowances in the Federal income tax has meant that business putting its capital investment on the books in

1940 at the 1940 dollar has had to replace that capital investment on the basis of the 50-cent dollar. In effect, from a tax angle, that has been a capital assessment.

That, in my judgment, has produced a tremendous demand on the investment capital market just to stand still, let alone to have improved machinery.

The second, I would suggest, is what has happened in all the local communities in the country that are based primarily on a real estate tax. Our school districts. Their real estate tax is based upon assessment. The assessment mostly on the books is on the 1940 dollar. The only way you could gain the revenue would be to increase the rate. But if you increased the rate all the new property coming on the books comes on at the inflated dollar.

So all over the United States you have seen this tremendous political pressure to try to reassess all the real estate in the entire country, which is a terrible political job, I can assure you, but also is quite a mechanical job.

Those are the kinds of damages I am referring to. Industry coming in urging to be put on the lifelong formula is another illustration.

When the costs seem to be held, they want to put on the formula.

One observation on this which is a mere theory but I expound it because I think it needs development. I have been intrigued with the fact that the industries—and there are three that I can mention—that happened to have had in their Federal tax formula a percentage figure rather than an absolute figure as far as their deductions are concerned, are those that have been able to finance their growth. The oil industry, percentage depletion. Life insurance, a percentage of free investment income; always percentage. Mutual banks and savings and loan, a percentage for reserves. The percentage figure has enabled them to go along as the value of the dollar was altered. That is an area that I have not seen developed by economists to the extent that I wish it was. How we extract the taxes from the people makes a tremendous difference, as you were just mentioning.

Mr. BARKIN. Mr. Congressman, do you think we individuals could have a percentage, too?

Representative CURTIS. I am not arguing for these, Mr. Barkin, except to say this: The reason for percentage depletions is a very obvious one. It is so you do not have a capital levy. The theory is that you are simply getting back your capital investment. When you apply industry average formulas to specific industries you can get out of kilter and you can also have your percentages wrong.

I want to go on, if I may, to the final area that I wanted to ask questions about. I am sure we don't have time, Mr. Chairman, so I will just mention them and ask for some brief comments, if we can.

In the discussion of inflation and rising prices, one thing that constantly recurs in your papers and other discussions is the increased productivity. That seems to be a solution to most of these things.

As someone has commented, you can, if you have increased productivity, pass on some of that economic gain to labor in wages and you can pass some on, which I regret to say is not often mentioned by labor groups, to capital, so we can get additional capital.

The third, I am happy was mentioned here, the consumer deserves some of it.

In discussing increased productivity it seems to me there has been a failure to mention this factor. I wanted to see if there is agreement.

Does not increased productivity almost always mean that we have to increase capital investment?

Mr. ELLIS. I mentioned that "if productivity rises because of more or better equipment, as it usually does * * *."

Mr. BARKIN. No, sir. I don't comprehend the agreement. Our data very definitely indicate that capital has become more and more productive per unit of capital.

Representative CURTIS. Let us get it down to a specific thing. If through research and development you have developed, which is a cost itself, a new machine, you are going to have to have investment capital in order to buy the machine.

Mr. BARKIN. You mean just to have it?

Representative CURTIS. Yes. That is all I meant. But if we do have increased productivity then we are going to have to have an increased capital base. That is what I am getting at.

Mr. BARKIN. You may not necessarily have to have an increased capital base. We are replacing old capital with capital-saving equipment of all kinds.

Representative CURTIS. What they are saving on, theoretically, or could be, is on labor cost.

Mr. BARKIN. No. They are saving on the amount of capital used. For example, in many industries at the present time in order to produce the same output you don't need as big a building. The process of manufacture and the machinery is so telescoped that you can have a very small building to produce the same output.

Representative CURTIS. I don't want to get into this, because I am trying to cut down the time. It does look as through this is an area that needs further review.

Does increased productivity always mean increased capital? You have raised some questions in my mind.

Mr. BARKIN. As a matter of fact, the common property of the economist at the present time is an index or a series of measurements on increased productivity of capital. The National Bureau of Economic Research has published a whole series of studies in this field.

Representative CURTIS. I am trying to limit myself in this one area because I can understand things as I go along.

The other observation is whether increased productivity does not also require increased labor skills. Then you have the production, the operation and maintenance, which all means increased skills.

Mr. BARKIN. Not necessarily so.

Representative CURTIS. That is why I am exposing it, to see what the observations would be. I can see some deviation from both of these, but I wonder if the overall picture is not essentially as I have stated.

Mr. ELLIS. Yes.

Mr. SPRINKEL. I agree with that.

Representative CURTIS. I think it is most important in order to understand what we can gain from productivity, as far as handling these inflationary problems is concerned, to understand this. If it is true you need increased investment capital then it is important that increased investment capital be available. Otherwise you are going to impose a demand where you haven't got sufficient supply.

Senator O'MAHONEY. May I make a comment, Mr. Curtis?

Representative CURTIS. Yes.

Senator O'MAHONEY. I have listened with interest to your question about productivity and capital investment. I am thinking of the rolling mills in the steel industry. We had some hearings some years ago. One of the causes of unemployment in Pennsylvania was the substitution of the rolling mill for the hand mill. Of course, the building of the rolling mills required a large investment of capital. These rolling mills displaced the hand rolling mill and they threw out of employment thousands of workers, many of whom were too old to learn any other trade. You would have to examine almost every industry, I think, to determine what the answer was. It would be rather difficult to generalize.

Representative CURTIS. Senator, I was not arguing the case.

Senator O'MAHONEY. I know you were not.

Representative CURTIS. I was trying to see what the economic features were. In that process we all recognize that there are some tremendous human problems. To analyze this from an economic standpoint I hope is the way you will go about really solving the human problems. I am satisfied that dealing with ignorance and epithets is one way we will not solve it.

One final point on this, and I believe I can finish this.

In this increased productivity, the company that is engaged in increasing its productivity hopes to finance it through increased quantity sale. Is that essentially right?

Mr. ELLIS. Yes.

Representative CURTIS. If it is, then it does depend upon an increased demand for the quantity.

Mr. ELLIS. It may also be financed through increased profit. If capital productivity can be increased, then there could be retained earnings which could be used to finance further expansion.

Representative CURTIS. That is very true. The recoupage or rather the reason it makes it economically feasible to go ahead and have increased productivity is essentially that you can gain from the increased quantity that you have manufactured. So, then don't we come to a very interesting and new economic problem in our society? Some people have said that we are no longer dealing in economics of scarcity but economics of abundance, where it is possible to reach a saturation point. I dare suggest that is the problem we have right now in agriculture to a large degree. Your economic values to be derived from increased productivity in a certain area cannot be paid for through the process of increased quantity.

Mr. BAUMOL. The thing to be emphasized there is the certain area. This is likely to happen in individual items but certainly we are not anywhere near abundance.

Representative CURTIS. Don't misunderstand me. New ideas, new products, things we have never thought of before. But certainly in certain specific things. I think our economy is composed of individual sticks that make up the bundle.

Mr. SPRINKEL. That is why it is necessary to do everything we can to increase the ability of labor and capital to move out of those areas where there may be excessive supplies and to other areas where there are limited supplies.

Representative CURTIS. Yes.

My final question is this, and this is to the panel :

What is the prospect of more inflation, in the panel's judgment, speaking now only of that inflation resulting from monetary surpluses which in turn would be generated, as Congressman Patman has pointed out, through increased Federal debt? Does the panel feel that we are facing a further problem of inflation resulting from that area?

Mr. ELLIS. I might speak first. I do feel we are definitely facing a threat of increased inflation next year. It won't be immediate. It won't be in December, or perhaps in the first half of 1959. But that kind of inflation, which I have defined as true inflation, operates most strongly when we approach capacity in use of our resources and manpower and raw materials. This threat is not immediate. That is the insidious part of it. We may use inflation of the money supply for temporary current improvement of our situation. But it stays with us unless we have a surplus at some time and withdraw the excess from the money supply.

Mr. SPRINKEL. That is why it is important, I think, that we not wait until we get into the problem maybe a year or a year and a half from now to start tightening up on our monetary growth, to start worrying about whether or not we should cut some types of expenditures or raise some taxes. I would agree that over the next few months the danger of inflation is probably overestimated by most people. We have excess capacity and rising productivity currently even though we have a sharp budget deficit. The deficit may not be too sharp a year and a half from now, providing spending does not rise further.

The important thing is that we not wait until we get the problem in our midst before we start getting our financial house in order. Unfortunately financial restraints work only with a lag.

Mr. BACH. I don't think economists are very good in saying what may happen over the next couple of years. It may be better to say what will happen in the next 10 years. There is strong reason to suppose that the price level will be substantially higher 10 years from now than it is now. It will be higher partly because there is more money and because of Government policies.

Now I come to Mr. Barkin. He has been a very vocal expositor of labor. I think there needs to be something said against what he is saying.

The implication of most of the talk this morning is that the administered prices are going to be the real devils. I don't see why. I don't see the evidence. Mr. Barkin's data are fine. I can pick some data out to show that labor has done awfully well and they have been the devils. Any economist knows you can pick the right year and you can make the picture look different. The relevance of your question is this: Why will the Government create too much money, so to speak, in the sense of creating this possible inflation? I think the answer is very simple. It comes back to the fact that labor unions will ask for more than there is to divide, businesses will put up their prices higher than is justifiable in terms of the existing level of demand.

The reason for the excess monetary supply will be the cost and price pushes that will put the pressure on the Government all the time to do it.

Mr. BARKIN. Mr. Chairman, just to meet the issue head on, I think Mr. Bach's comment illustrates the position of people who are plagued with present tools. Obviously, if the Government expends more money, as it is likely to do during the next year, there will be monetary pressures.

On the other hand, the pressures from that source are easily within the competence of the Federal Government. There are tax sources which are available by which to offset those expenditures. We have on various occasions before your committee presented alternative tax sources. The important issue which we are highlighting is obviously the fact, which was dramatized so well in July and August, when the large corporations were able to raise prices precisely at the time when their capacity operations were so low. It highlighted their ability and their power to force those price increases up. I have already made the point that fundamentally wage demands are derived demands and not initiatory ones.

Aside from that, I think Mr. Curtis pointed to an extraordinarily important fact. There are rises in the cost all along the line, many of them due to the inefficiencies in various sectors of our economy. That was the reason I thought we have to give more importance to this consumer service item.

The Government has a function in certain areas, such as science research, to initiate investigations, provide the seed capital for research in that area.

I consequently also urge your committee to consider the possibility of providing the seed money for research and increased productivity in our services. This is one of the pressures which we have not tackled which is quite independent of any monetary factors which might be enumerated.

Mr. Baumol made one statement which I would like to deal with merely to show that there are other points of view in this analysis. I would like to put my position positively.

When there is a shortage of labor and when there is a high productivity in our economy, or high production in our economy, we have as much stimulus to higher productivity as we do in other periods of our economy. High production and labor shortage does not induce sluggishness in performance. It may induce, in fact, the contrary—great stimuli to high productivity.

I presume we will have an opportunity of dealing through written memorandums to other matters raised so you can have the benefit of our observations.

Mr. SPRINKEL. I would like to suggest that time-tested remedies for inflation are not necessarily bad because they are conventional and old; and, conversely, new untried proposals are not necessarily good because they are new. We should be constantly striving for new and better ways to solve our economic problems but in this process we should not forget the lessons of history nor should we make substantial new errors that have been largely avoided in the past. Each generation is inclined to think the causes of its inflation differed from those of earlier years. Yet excessive final demands have been characteristic of all inflations. The most basic policy question is, "Do we have the political fortitude to see that excessive monetary demands are sup-

pressed in coming years while maintaining an essentially free, competitive economy?" Any new or old policy proposal that reduces our ability to progress toward that goal should be reviewed and rejected.

The CHAIRMAN. My suggestion is that each one of you when you get the transcript feel free to elaborate on anything that was said here. That way they can elaborate on Mr. Curtis' question.

Are there any other questions?

Representative CURTIS. No.

The CHAIRMAN. I would like to insert in the record an address delivered by the distinguished Senate majority leader, Senator Lyndon Johnson, in Texas last Thursday, in which he discussed inflation, high interest rates, economic system, and in one paragraph he said, Senator O'Mahoney:

Back in the 1930's, this Nation went through the most searching scrutiny of its economic system in history. It was handled by the Temporary National Economic Committee, headed by Senator Joseph C. O'Mahoney of Wyoming.

Another excerpt:

I have presented to you today one of the proposals which I hope will be considered in the next Congress. We have a base for it already in our Joint Economic Committee.

All that is required is expansion and plans for the study.

Without objection, the address will be inserted in the record.

(The address of Senator Johnson of Texas follows:)

ADDRESS BY SENATE DEMOCRATIC LEADER LYNDON B. JOHNSON BEFORE THE SAN ANGELO BOARD OF CITY DEVELOPMENT, SAN ANGELO, TEX., DECEMBER 11, 1958

My friends and fellow Texans, I take an unusual degree of pleasure in this visit with you today here in the heart of Texas.

This is the last public appearance I am scheduled to make in our State this year. And it is an appearance that brings me among some of my closest and most trusted friends.

Within a very few weeks, we will begin the first session of the new Congress. It is a Congress faced with heavy responsibilities which must be met under a set of totally new circumstances.

Those new circumstances have given rise to apprehensions in some quarters that the new Congress will be intensely partisan. There are those who believe that it will operate with its eyes fixed solely on 1960.

Personally, I believe that these prophecies are wide of the mark. I think they are based upon a misunderstanding of the way in which our Government works.

Our elections are of necessity partisan. But our elected officials find themselves faced with the responsibility of representing all their constituents.

Somehow, they must find ways and means of giving a thorough hearing to all points of view. And the legislation that emerges, as a general rule, reflects this kind of a hearing.

When it does not, the voters have an effective remedy which they can exercise within a 2-year period.

It is my belief that the next Congress will do the best it can with materials it has at hand to solve the problems of our times. I believe it will try to resolve, rather than to create, issues.

I have a great deal of confidence in the ability of Congress to find national solutions to national problems.

The solutions never please everybody and rarely please anybody completely. But they are solutions which help our country to grow stronger and more prosperous.

I have listed already some of the problems which I believe the next Congress must, and will, face. The list was admittedly incomplete. No man has a crystal ball which can peer into the future accurately—not even a year ahead.

Under no circumstances, would I presume to draw a blueprint of the next Congress or to plot its course step by step.

Furthermore, there is another point I would like to make today. It is that we cannot adopt a let-George-do-it attitude and leave everything to Congress.

There are many problems which require the cooperation of every level of government—Federal, State, and local. And whenever one of those levels fails to pull its share of the load, another will step in to do the work.

I am no scientist. But I am aware of the basic principle in physics that "nature abhors a vacuum." This principle holds true in government as it does in the natural sciences.

When a problem exists, the American people will insist that it be faced. And if it is ignored at one point, they will sooner or later secure action at another point.

There is a heavy responsibility upon the State and local governments to maintain their strength and integrity. No one feels this more keenly than I do.

Strength and integrity are maintained by meeting and discharging responsibilities. And when responsibilities are ignored, prerogatives usually meet the same fate.

Here in Texas, I believe we have maintained the strength of our local government because we have faced up to our responsibilities. As long as we continue to do so, we need have no fears.

We are facing one problem which is going to require the cooperation not only of all levels of government but of all Americans. I am referring to the problem of inflation.

It has become so much a part of our daily lives that it is not even necessary to cite statistics. The fact that the cost of living has gone to a "new record high" has become a commonplace of newspaper reporting.

And on the rare occasions when we see a headline "Cost of Living Drops," we find, on reading the fine print, that the index has gone down one-tenth of 1 percent.

Inflation hits practically every part of our population.

It presses upon the businessman who finds his costs mounting daily.

It presses upon the farmer who finds that the prices of the things he must buy go constantly up.

It presses upon the workingman who finds that his weekly paycheck provides fewer and fewer groceries.

It presses upon local governments who find that it is more and more difficult to float bonds for local improvements.

Inflation is like the weather. Everybody talks about it but nobody does anything about it. What is even more serious, nobody can agree with anybody else on what it is.

There are learned men who claim that the cure for inflation is tight money—high interest rates. Yet these same high interest rates have increased the cost of government.

There are many who believe that rising wage rates have forced up costs and cheapened the dollar. But others argue that higher wage rates are necessary to meet the higher cost of living.

Some people blame government spending. Others claim that if government spending were to stop, our whole economic system would be thrown out of gear and we would have widespread misery.

Meanwhile, it goes on—and takes cruel bites out of the livelihood of all those who live on fixed incomes.

Furthermore, it is not the kind of inflation that we studied in our schooldays. It does not fit what economists call the "classic pattern."

There was a period last year in which we had more than 6 million people unemployed. That means 6 million men and women who wanted work, who were looking for work, and who could not find work.

According to the academic scholars of economics, that was a situation which should have brought prices tumbling down. Instead, they hit all-time highs.

Throughout a great part of last year, our steel mills operated at only about half of capacity. According to some theories of economics, inflation is caused when supply cannot keep up with demand.

We had a greater ratio of supply over demand than the world has ever seen before. Still inflation continued.

The examples could be multiplied many times. The fact still remains that we have no clear-cut idea of what is causing inflation and what should be done to prevent it.

We are going to have to rid ourselves of preconceived ideas. We are going to have to approach this problem in the same mood that a surgeon approaches an unknown disease—not in the mood that a politician approaches an election.

Back in the 1930's, this Nation went through the most searching scrutiny of its economic system in history. It was handled by the Temporary National Economic Committee headed by Senator Joseph C. O'Mahoney of Wyoming.

That committee searched the highways and byways of the American economic system. It took volumes of testimony from businessmen, scholars, farm leaders, labor leaders—people from every walk of life.

It was nonpartisan to the core. It sought explanations rather than justifications. It tried to be constructive rather than destructive.

And its reports became the only source book on the economic system which was both comprehensive and authoritative.

It seems to me that we need to take the same kind of searching look once again. The situation with which we are confronted has no precedents. We are going to have to bring together our best minds to find solutions.

I can open my mail any day of the week and find 10 or even 30 proposals for handling the inflation problem. Many of them sound appealing and attractive.

But we cannot afford to "go for broke" in tinkering with our economic system merely because an idea is appealing and attractive. The idea must be tested in the market place of ideas.

It must be considered by men of skill and experience; it must be put up against counterideas; it must be assayed and weighed by critical minds.

The launching of such a study will, I hope, be one of the major activities of the coming Congress. We need light in dark corners; and we need it soon.

All my life, I have tried to avoid the fatal error of mistaking motion for action. And motion without forethought is rarely action—and never satisfactory action.

I have presented to you today one of the proposals which I hope will be considered in the next Congress. We have a base for it already in our Joint Economic Committee.

All that is required is expansion and plans for the study.

I will be leaving Texas shortly for the next session of Congress. I am leaving with a deep sense of the obligations that I have to you and Texas.

I will return next year to report to you on what has happened. And I am confident that I will come back from a Congress which has been constructive, vigorous, and alert to the problems of our times.

The CHAIRMAN. The committee has made arrangements to meet in the Banking and Currency Committee room of the House tomorrow, Wednesday, and Thursday. The room is 1301. We will meet there tomorrow morning at 10 o'clock.

Is there anything else that should be brought up before we recess?

Senator O'MAHONEY. Mr. Chairman, I would like to make a brief remark. I feel it would be very valuable to the committee and to all the committees of Congress, if those who participate in the discussion of the subjects that are before this committee now, would bear in mind the fact that we are engaged in an economic war with Soviet Russia. I think that there has been too great a tendency to overlook that fact and to judge the problems that come before Congress in terms of normal instead of the terribly abnormal conditions under which we are operating.

Everybody knows that the cost of national defense is more than half of the total budget. Everybody knows that the President, and the Director of the Bureau of the Budget, and the Treasury Department, are now engaged in a very complex problem of determining how expenditures can be reduced without injuring defense. I don't know that enough attention is being given to the desirability of such expenditures by Government as will promote the objectives which were outlined in the maximum employment bill.

These objectives include not only maximum employment, but also the stimulation of free competitive enterprise. We must make up our minds, and very quickly it seems to me, whether or not we can maintain the free competitive system.

The Russians are convinced that it can't be done. So the Kremlin has set up a dictatorship of the proletariat. The facts of the matter are that in Soviet Russia the bureaucrats who administer the industry and the business of all Russia are paid on the ratio of about 15 to 1, as compared with the workers.

The policy of Soviet Russia is to deprive the masses of the people of consumer goods while concentrating upon the production of war material, the conservation of water, the building of dams, and the like, the production of power by the Government. It is doing this in a manner which is intended to stimulate unwise financial operation in this country.

I think the Soviet Government believes that it can force the United States to go broke. Its leaders believe that through that collapse of our economy Soviet Russia and communism will conquer the world.

Stalin said, in one of his numerous books, that the Red army would not be used until the final chapter in the destruction of the capitalistic system occurred. I would like to use the words "the system of private property," rather than the capitalistic system, because I think the system of private property is really the system that the founders of this Government had in mind.

While the capitalistic system embraces necessarily the abuses of monopoly, everybody recognizes that monopoly is a problem. The Department of Justice during the last session of Congress and the session before, as I recall, has supported the idea, for example, of legislation to provide for the prenotification of intention to merge corporations. The mergers have been going on at a terrific rate.

Judge Hanson, the head of the Antitrust Division, in an address prepared for delivery at the University of Miami a week or two ago, pointed out that in the automobile industry in 1949 the three major companies produced, as I recall, about 75 percent of all the automobiles sold in America, whereas in 1954 these same major companies, three of them, were producing more than 90 percent of all the cars sold in America.

In this same speech he discussed the pattern of merger examination which the Department of Justice is carrying on. There was a rather unusual contrast in the policy followed by the Department of Justice in the case of the merger of Packard and Studebaker and the merger of Nash and Hudson with the pattern that was followed when Bethlehem Steel and Youngstown wanted to merge. The Department of Justice urged the merger of the four small companies because they thought that would stimulate competition in the manufacture of automobiles. They opposed the merger of Bethlehem and Youngstown because they believed that merger would reduce competition in the steel industry.

That case went to the Federal courts. The decision, within the month, supported the point of view of the Department of Justice. Whether or not Bethlehem and Youngstown are going to appeal, I don't know.

But it is always clear from an examination of antitrust cases that the defendant in an antitrust case, particularly when it is one of the giant corporations, can carry the case from the trial court up to the Supreme Court and down and back again. I have known cases which have taken years before a final consent decree was written.

So it would seem that it may be difficult for us to hope to cure the abuses of monopoly by trial in the courts because it takes so much time.

If we are to prevent monopoly from doing what Soviet Russia has done, to destroy the free enterprise system, we must find a more speedy solution. The chief characteristic of the dictatorship of the proletariat, as I understand it, is that it has destroyed the free market. The Government creates the market. It says what the prices are going to be. There is no such thing as competition. When monopoly gets control in any industry, monopoly also destroys the free market. That is the objective of monopoly, to suppress competition.

So I feel, Mr. Chairman, that it would be beneficial to all of us on the committee and all in Congress, if those who appear at our hearings and those who write further comments at our request, should bear in mind this central problem of our time, namely, what is the economic solution of the economic cold war that Russia is waging against us now.

The CHAIRMAN. I want to make this brief observation concerning the cold war. We had low interest rates for 15 years in this country. We will call it a wholesale rate of interest. That interest rate was pretty low. But it was maintained. It saved the taxpayers lots of money. The Federal Reserve officials have testified that they can fix the rate at any rate they want to and maintain it there through open market operations and other devices that they have under their control. There is no question that they can fix the rate and keep it there, whether it is low, high, or in between.

I think one of the major problems we have in dealing with neutral countries and trying to meet competition with Russia, or trying to surpass Russia, will be in interest rates. As it is, we have been increasing interest rates the last few years until now the interest rates are pretty high, 5½ and 6 percent on loans made by the World Bank and International Finance Corporation, and the recent Development Corporation, and the Export-Import Bank.

We are going in a direction of high-interest rates and Russia is going in the direction of low-interest rates. The Russian rate is a nominal rate, something like we maintained for 15 years in this country, around 2 or 2½ percent. What you might call the wholesale rate for money. I think we should very well give consideration to that, Senator, in considering the problems involved in this cold war with Russia. We are going to meet that head on one of these days.

It is a question of helping some country that Russia wants to help, we want to help because we want the good will of that country, Russia does, too, and Russia offers the money in large amounts at 2 or 2½ percent. Here we are fixing it 200 percent higher than that. We might as well keep that in mind; don't you think so?

Senator O'MAHONEY. I think you are right, Mr. Chairman. I think we don't all appreciate how close the crisis is in the cold war or the extent to which the Russians are carrying that on even in our own hemisphere.

During the present month, or during the last 4 weeks, there has been an interesting development in Argentina. There the Government—I am sure it is Argentina—asserts its ownership of the oil deposits that may exist in that country. They are attempting to secure foreign capital to develop this oil. The Export-Import Bank follows the policy of not loaning any money to any country which asserts the ownership of the natural deposits of that nation.

What has happened as a result is that the Argentine Government, being unable to borrow money from the Export-Import Bank, to buy oil machinery in the United States, has entered into a barter agreement with the Russians by which the latter have agreed to send to Argentina \$100 million worth of oil machinery in the next 3 years, at the end of which period the payments will be made, not in money, but in raw materials that Argentina produces and Russia wants.

The CHAIRMAN. Aren't you including Venezuela?

Senator O'MAHOONEY. Venezuela is coming to that soon. The new President is asserting ownership of the natural resources.

The CHAIRMAN. The reason the Export-Import Bank wants to make all these deals is because they finance only deals where the supplies are furnished by people in the United States. The World Bank does not restrict their loans that way. The International Finance Corporation, I am not sure, does not either. The Export-Import Bank restricts its loans to cases where the money will be spent in the United States.

Mr. SPRINKEL. Mr. Patman, may I make a brief comment on your statement?

The CHAIRMAN. Yes, sir.

Mr. SPRINKEL. You stated that the Federal Reserve could, and at some point in time did, peg interest rates at low levels. I agree with those statements. They achieved this pegging at the expense of continuously increasing the money supply which added to the inflationary pressures in the economy. They could do so again. I do not believe a substantial increase in the money supply would increase our ability to finance the cold war in which we are engaged. It seems to me that our domestic policy should be oriented not toward pegging interest rates at low levels regardless of the economic situation but should be toward regulating the monetary system in such a way as to, on the one hand, stop deflation, and, on the other hand, stop inflation.

If we want to subsidize foreign countries through loans, we can certainly do so at low rates of interest. I think that should be a decision that is made separately and should not require rapid inflation of our economy.

The CHAIRMAN. We are not helpless. There are other methods to offset the inflationary tendencies.

Without objection, we will stand in recess until 10 o'clock in the morning in the House Banking and Currency Committee room.

(Thereupon, at 1:25 p.m., the hearing recessed, to reconvene at 10 a.m., Tuesday, December 16, 1958.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

TUESDAY, DECEMBER 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 1301, New House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Bolling, Curtis, and Reuss; Senator O'Mahoney.

Also present: John W. Lehman, clerk; and James W. Knowles, economist in charge.

The CHAIRMAN. The committee will please come to order.

Yesterday we heard labor, industrial, and academic economists discuss Employment Act objectives and the stabilization of prices. Today we turn attention to consideration of the analysis of the causes of price changes and of the effects of price changes on economic activity.

Today's topic covers the questions discussed in parts II-V of the compendium and hearings last spring. These topics include the measurements of price changes and price relationships, past price behavior viewed in the context of cyclical and secular economic changes, interrelationships among prices, demand, and cost, and interrelationship among prices, employment, outcome, and resources.

We are interested in surveying these technical and historical matters in order to clarify our understanding and perhaps that of the public, of price-determining forces and mechanisms, and also the relation of changes in prices to changes in output, employment, income, and the use of resources.

We will hear from each panelist this morning without interruption for about 5 to 7 minutes. Upon completion of the opening statements the members of the committee will question the participants. I hope this discussion can be very informal 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 Mr. Peter Henle, assistant director of research, AFL-CIO. Mr. Henle, we are glad to have you, sir. You may proceed in your own way.

**STATEMENT OF PETER HENLE, ASSISTANT DIRECTOR OF
RESEARCH, AFL-CIO**

Mr. HENLE. Thank you, Mr. Chairman.

The problem of inflation continues to haunt the American people, even though today's prices do not seem to be following the pattern of inflation. A casual reader of the Nation's newspapers would hardly get the impression that prices at the retail level have been stable for the past 7 months, and at the wholesale level for almost a year.

In the eyes of many, the inflation issue has become an issue of wage inflation, and furthermore, largely, if not entirely, an issue of union wage inflation. Eminent economists and research organizations as well as employer groups, seem to have made up their minds that the villain in the piece is union wage policy.

I was asked by the Joint Economic Committee to write a paper for this session which deals with the measurement of price changes; past price behavior and interrelationships among prices, demands, and costs.

In tackling this assignment, I decided to focus primarily on the movement of the Consumer Price Index during the post-World War II period—June 1946—June 1958. I have tried to analyze not only the general trends of consumer prices during this period, but also, more specifically, the changes in prices of individual items in the index for the most controversial 2 years of this period—March 1956—March 1958. Naturally, I was interested in finding out to what extent, if any, the movement of prices supported the accusation that rising prices have been a product of union-determined wage policy.

Here, in brief, are my conclusions:

1. The record of the American economy regarding prices during the postwar period is a relatively good one. In the 12-year period, June 1946—June 1958, consumer prices have risen 55 percent, an average of 3.7 percent compounded annually.

While this is hardly a record of price stability, it should be noted that an annual increase of 3.7 percent is a far better record than that compiled during the same period by the economies of practically all other countries. In fact, an international comparison of price changes between 1947 and 1957 shows that the annual rate at which the value of money has depreciated in the United States is lower than 21 of the 24 nations being compared.

2. By far the largest proportion of price increases in the postwar period have been the result of special circumstances arising either from the aftermath of World War II or the Korean hostilities.

The postwar price increases have been concentrated in three relatively short periods of time:

(a) The 2 years from June 1946 to June 1948.

(b) The 1 year from June 1950 to June 1951.

(c) The 2 years from March 1956 to March 1958.

Thus, in these three periods covering less than half the 12-year period, the index rose 93 percent of the entire postwar rise. Thus, for more than half the postwar period, the price level has been relatively stable.

Moreover, 74 percent of the postwar price rise has occurred during the first two periods which were clearly the result of special inflationary demands arising from World War II or the Korean conflict.

3. Even if we focus more sharply on the 2-year period, March 1956–March 1958, when some economists have assigned the blame to “wage inflation,” most of the price increases recorded by the Consumer Price Index can be attributed to special circumstances, such as crop conditions, rather than to union-won wage increases.

In this paper I have included a breakdown of price changes for practically every individual item included in the Consumer Price Index for this 2-year period. When these items are divided into two groups, those in which unions play a prominent role in wage determination and those in which unions do not play such a role, the following comparison arises.

Average prices for the unionized sector increased 5.5 percent during the 2-year period, March 1956–March 1958, while for the non-unionized sector the increase was 10.2 percent.

While the unionized sector comprises over 61 percent of the total index, it accounts for only 45 percent of the total price increase.

Surely this comparison is a clear indication that the influence of union-won wage increases has played but a small role in the price movements during this 2-year period. Obviously, many other factors have been at work on the pricing process.

4. Economists have been concerned that real wages seem to have risen more than productivity during the 2-year period 1955–57. Although this may be true, when the figures are viewed in the context of the entire postwar period, it is clear the employees have not gained a greater share of the benefits of productivity than other groups in society.

Moreover, the fact that wages increased more than productivity in 1956 and 1957 was not caused by excessive wage rate changes that were above average, but rather by the fact that productivity change for these 2 years was below the average for the economy during the postwar period.

It appears likely that the relatively low rate of productivity increase in 1955–57 is a temporary phenomenon, already giving way to more rapid increases. Thus, any gap that may have developed between the rate of productivity advances and employees' compensation will be eliminated as productivity returns to its normal postwar level.

5. Even if it is desirable to stress the importance of productivity as the source for improvements in living standards, it is neither desirable nor practical to attempt to establish by government or private policy a fixed relation between the two.

It is certainly true that the concept of productivity has become better known among both management and trade union officials. At the bargaining table, both sides increasingly recognize the important role which productivity plays in making possible increased living standards.

However, this recognition of productivity at the bargaining table is a far different matter from requiring by Government regulation or otherwise that wage increases be tied to or limited by increases in productivity. Even granting that some way could be found on the theoretical level to relate wage increases to changes in productivity,

any formal effort to link directly wages with productivity would run into a maze of complex practical problems.

Any governmental attempt to tie wage increases to productivity would almost certainly lead to a full-scale wage stabilization program. If the attempt were limited to particular industries or collective bargaining situations, knotty questions would inevitably arise involving closely related firms and groups of workers.

Moreover, there should be some hesitation about tampering with the American system of collective bargaining which, though obviously not perfect, has proved an efficient and democratic mechanism for wage determination. While partisans from both the labor and management sides have been arguing for many years regarding the extent of Government intervention in the collective bargaining process, both groups demonstrably prefer the process of mutual accommodation in wage setting to a system with greater Government intervention.

The collective bargaining process has proved flexible to changing economic circumstances. The American system with its emphasis on local or company bargaining rather than national collective bargaining, as is the practice in Europe, yields a great diversity of wage settlements. In effect, most of the wage bargains have been fashioned with an eye to the specific conditions prevailing in the industry, locality, or firm concerned. Experience in the textile and coal industries, for example, demonstrates how collective bargaining results are affected by economic conditions. The extent to which particular wage settlements have become the pattern for other industries is probably less today than it was 10 years ago.

Of course, it will always be possible for economists to find particular collective bargaining settlements which they feel have increased wages at a higher rate than productivity. But the positive values of collective bargaining should not be lightly sacrificed. The crucial question is whether the system of collective bargaining—not an isolated case or even groups of cases—persistently produces a condition in which real wage advances as a whole outrun improvements in productivity and for price rises.

On the basis of the American experience since World War II, I do not see any compelling reason for altering the basically voluntary character of wage settlements negotiated through collective bargaining.

The CHAIRMAN. Thank you, sir.

Mr. Ben B. Seligman, director of research, Retail Clerks International Association, AFL-CIO.

Mr. Seligman, we are glad to have you, sir, and will be glad to hear from you.

STATEMENT OF BEN B. SELIGMAN, DIRECTOR OF RESEARCH, RETAIL CLERKS INTERNATIONAL ASSOCIATION, AFL-CIO

Mr. SELIGMAN. Mr. Patman, evidence seems to be accumulating that while the economy as a whole has been recovering in large measure from the last recession, this has not by any means restored all the affected workers to their previous state of well-being. It appears that the recession simply bolstered earlier tendencies toward higher

productivity and greater output per worker with the result that there still remain pockets of not inconsiderable unemployment.

How long this recovery itself will last is problematic. The expectation for housing construction at about 1.2 million units appears to be a little under current annual rates. Sales of automobiles leave much to be desired. The result is no burgeoning of consumer spending with unemployment still close to 4 million. The business community is working its way out of the recent difficulties by a great jump in output per man-hour.

Doubtlessly the remarkable affluence of our economy is able to carry the unemployed along with it. But it is small comfort indeed for those whose income flow has dwindled to a small dribble and who must dip into pitifully tiny reservoirs of savings which may have taken years to gather to be told that there is an ever-increasing quantity of goods available on the market. Their wherewithal is much too limited to permit them the dubious enjoyment of a second or third television set.

Thus, while our economy continues the even tenor of its prosperous ways, I cannot help but be troubled by a gnawing feeling that we invite difficulties for ourselves when we refuse to face up to the existence of low-income groups in the economy. And it helps the problem little to talk of those who are low-income recipients as mere economic cripples.

The retail employee is in this category. The material I offered in my more formal paper presented the evidence on that point. When 41 percent of women working in retail establishments earned, in October 1956, under \$1 an hour, when 78 percent of women employed in variety stores earned less than \$1 an hour, when 79 percent of women working in drugstores in our Southern States earned less than \$1 an hour, I assume that we have on our hands a condition that merits attention.

I cite these depressing facts, all too often relegated to the under-world of economic discussion, because we are so often told that business is faced with a price-cost squeeze, with the latter portion of this equation usually defined as wages. Now, aside from the fact that in retailing it is difficult to discover just where this supposed squeeze is taking place, the most calamitous oversight is the patent fact that a cost is also an income, or as my academic colleagues would say, a factor payment.

A very interesting problem to explore would be the degree of impact priority in such payments. This is no chicken-egg question: I think it fairly significant that in our highly integrated and complex economy a payment becomes a spendable income before it is embodied as a marketable cost.

Unfortunately, this insight into the mechanics of our economy has generally been lost on retailing entrepreneurs, whose comprehension of such recondite matters as the cost-income flow has lagged behind that of concerns in other areas. The failure to grasp problems of industrial efficiency in the retail industry has been an item of common, if notorious knowledge, although the recent installations of automated equipment, stimulated often by a conspicuous desire to maintain standards of operation observed elsewhere in the economy, may have a broader influence in this regard.

That a more enlightened view among the corporate merchants with respect to wage income will in time come about is a prospect much to be desired. That there is ample room in their present profit-and-loss statements for an upward movement of the price paid for the factor of labor generally seems to be the case. That this would have less effect on the pricing mechanism in retailing than we are led to think is also fairly obvious. For the fact of the matter is that in retailing there is little of the imaginative or dynamic in pricing policy. Aside from loss leaders or postseason sales—the pricing methods of which need a very close look—the common practice is the easy one of applying standard percentage markups, computed on either a sales or cost basis. As I have indicated, this could be described as the ratchet effect. Abnormal situations aside, such techniques, rooted in custom and habit, impose a rising price curve for the consumer to meet, without any necessary relation to direct labor cost.

In fact, the level of retail wages illustrates one of the numerous myths about labor which have entered into popular currency. I refer to the myth of the wealthy worker: This has him drowning in Byzantine opulence. But like the myth of the happy worker, which makes him supremely content in front of his television set, and the myth of the powerful worker, which makes him the most potent political baron since the days of Hanna and Tweed, this myth too must be given a place next to Sinbad the Sailor and the legendary Roc. Such opulence and power are to be found only in the tales of Scheherazade. In the economics of retailing the wages of the clerk are low and his power weak. The pricing problem in that area, I submit, needs to be studied with other foci in mind.

The CHAIRMAN. Thank you, sir.

We have as our next witness Mr. Walter D. Fackler, assistant director of economic research, Chamber of Commerce of the United States.

Mr. Fackler, we are glad to have you. You may proceed in your own way, sir.

STATEMENT OF WALTER D. FACKLER, ASSISTANT DIRECTOR OF ECONOMIC RESEARCH, UNITED STATES CHAMBER OF COMMERCE

Mr. FACKLER. Thank you, Mr. Chairman.

My commentary is not a comprehensive critique of the compendium of papers entitled, "The Relationship of Prices to Economic Stability and Growth"—nor even of the particular sections of the compendium assigned to me. It is simply an attempt to fill in some overlooked gaps, reinforce certain conclusions, and restate some of the issues.

First, what are "administered prices"? This term pervades a good deal of discussion throughout this presentation. The term has become a vicious piece of obscurantism, devoid of meaning for practical purposes because it means so many different things to different people and is often used inconsistently by the same people. By way of illustration, I set forth a nonexhaustive and overlapping list of nine definitions in current usage and examine some of their implications.

On analytical and empirical grounds there is no reason to expect the observed or observable price behavior to differ among firms with little or no market power and those with a significant degree of

market power. If the term "administered prices" is broadened to cover almost all industries except those where "auction prices" prevail, it is meaningless to talk about the "administered price sector" of the economy. Statistical comparisons of individual price movements for a variety of reasons—accuracy of the data, time factors, cost factors, et cetera—are by and large misleading or irrelevant to discussions of inflation. In short, the use of the term "administered prices" has compounded confusion and diverted attention away from the real problems of monopoly or market power in the system. I suggest that we should develop more meaningful substitutes and avoid the use of the term to the extent possible.

It is often argued or implied that administered prices are a semi-autonomous cause of inflation. To be sure, downward price rigidities, from whatever cause, may create an inflationary bias in the system. As some prices go up, others do not fall readily. But "administered prices," however defined, are not the cause of inflation. In fact, the evidence seems to point to the opposite conclusion—that where firms have some discretionary latitude in pricing policies, their price responses are conservative and tend to dampen both inflationary and deflationary price movements.

Turning to the question of wages, we ask whether monopoly wage increases exert an independent cost push on the general price level. The answer is that we do not know for certain. It can be shown, however, that such an outcome is logically possible under certain conditions. The problem of the wage-price spiral, to the extent that it is a real threat, boils down to a conflict over the distribution of real income, not so much between labor and capital, but among various labor groups themselves.

When large, well-organized unions exercise their monopoly powers to secure the lion's share of annual increases in national productivity, because they happen to be strategically placed in high-productivity industries, other workers—union and nonunion alike—will try to protect themselves by seeking roughly comparable increases in money wages. If they did not or could not obtain such increases, uneconomic wage differentials and intolerable inequities would develop in the labor market.

The question of whether there is such a spillover of wage pressures to sectors of the economy not directly related to those sectors where original push occurs, is an empirical one which is almost impossible to answer because there are complex interactions which cannot be sorted out neatly by statistical analysis.

In opposition to some earlier panelists, I would argue further that there is an important asymmetry between "administered prices" and "administered wages"—however these terms are defined—as to their inflationary potentials.

In the case of administered prices there is no powerful mechanism for spreading an autonomous price increase from one industry to unrelated industries, at least of the same kind, as there is in the case of pattern bargaining and wage spillover. Tremendous changes may take place in the structure of relative prices without causing inflationary problems, but for basic sociological reasons, society will not tolerate ever-widening wage differentials, and growing income inequality, for like or similar labor services.

I cannot do justice to the whole argument in a short summary, but I would like to emphasize that the main issues in the wage-price-spiral controversy are being obscured by too much superficial analysis and discussion.

I am not defending monopoly pricing in any form, nor do I argue that unions have been the major cause of our postwar inflation. On the contrary, we have been caught in a general inflationary situation compounded out of a whole series of elements and events—the wage problem being only one of them, and probably a minor one at that, at least until the past 4 or 5 years. But few economists now deny that, if union power is not a semi-independent inflationary force, at least it constitutes a very real threat as a conductor of inflation or as an impediment to effective anti-inflationary monetary and fiscal policy.

I suggest that biased charges and countercharges are a most serious obstacle to the development of rational and effective long-run policies which will help us maintain reasonably high levels of employment and economic growth without creeping inflation. If economic stability, perhaps even our economic freedom, is being jeopardized by a power struggle over the distribution of real income among different economic power blocs, including blocs within segments of the labor force itself, the problem should be dragged out into the open and faced squarely. Surely, candor and careful study do not endanger the legitimate goals of either organized labor or business enterprise. The individual citizen deserves nothing less.

The CHAIRMAN. Thank you, sir.

We have as our next witness Mr. George P. Hitchings, manager, economic analysis department, Ford Motor Co.

We are glad to have you, Mr. Hitchings. You may proceed in your own way.

STATEMENT OF GEORGE P. HITCHINGS, MANAGER, ECONOMIC ANALYSIS DEPARTMENT, FORD MOTOR CO.

Mr. HITCHINGS. Thank you, Mr. Chairman.

There is considerable confusion and disagreement as to the causes of price changes and their impact on economic activity. Careful examination of all the facts is essential in disentangling cause-and-effect relationships.

When prices rise, there is a simultaneous increase per unit of production in first, incomes; second, spending; and third, money usage. The reverse is true when prices decline.

This follows from the fact that price is income to producers and expenditure to purchasers, and that money is the medium of exchange between producers and purchasers. Thorough analysis is required to determine for a given period which are the causal factors and which are the result.

Cause-and-effect relationships are also fuzzy in the impact of price changes on economic growth and stability. Prices are both a symptom and cause of change in economic activity. If prices rise with expanding activity and fall with declining activity, it is far from clear whether they cause the change or reflect it.

There is no question, however, that price movements must be taken into consideration in Government economic policies. Changes in

prices of commodities and services relative to one another have an important bearing on the allocation of resources. Changes in aggregate prices affect the distribution of purchasing power among various groups in the economy and the desire to spend relative to current income.

Price inflation has been a common phenomenon in wartime. Increased demands for goods and services financed by expansion of the money supply are the driving force in bidding up prices. There was a further runup of prices after World Wars I and II because of expanded civilian demands financed by additional expansion of the money supply or a higher rate of turnover in idle funds accumulated during the war. Competition for labor and materials also built in higher cost structures. Collective bargaining pressures were also important in the cost rise after World War II.

The price rises in recent years have been different in many respects. Particularly in the period since mid-1955, demand pressures financed by expansion of the money supply have played a minor role. Increased turnover of the money supply to finance plant and equipment expansion was a factor in rising prices for capital equipment and materials in the last half of 1955 and in 1956, but even this demand pressure eased by early 1957. The rise in prices of consumer goods and services did not reflect increased demand pressures at any time during this period. Farm prices fluctuated largely in response to changes in supply rather than demand.

The different nature of the price rise in recent years is also illustrated in the attached chart on prices, costs, and profits for the total economy exclusive of Government and agriculture. Unit profits available to owners of business firms have not risen since 1948, despite a rise in average prices from 86.9 that year (1954=100) to 108.3 in 1957. Corporation profits per unit of production were reduced in 1949 by the recession, and declined further in 1950-51 because the excess-profits tax skimmed off the higher dollars generated by demand inflation after the outbreak of war in Korea. Unit profits receded further from the 1951 level, both on a before- and after-tax basis. Income of unincorporated business per unit of production has remained relatively unchanged since 1948.

The rise in nonfarm prices since 1948, therefore, has been associated entirely with higher unit costs. Of the 21.4-point rise in average prices from 1948 to 1957, increased unit labor costs contributed 12.4 points, or 58 percent. The remaining portion was accounted for by higher unit costs for depreciation, taxes, and interest.

In a general demand inflation, unit profits would rise at least on a before-tax basis. Such was the case up to 1948. In 1950-51, before-tax unit profits also rose. Since 1951, however, there has been no such rise. It is obvious that for the economy as a whole, the price rise during this period has not reflected either excessive aggregate demand or increased profit margins for business firms.

The problem has been largely one of expanding total wages and salaries—including fringe benefits—at a more rapid rate than production. This accounted for 68 percent of the rise in average prices from 1951 to 1957. The remainder reflected higher depreciation, indirect business taxes, and interest.

Expanded payrolls relative to output not only increased costs but also provided increased dollar incomes to pay higher prices. The initiating force, however, came from the supply side rather than the demand side. Because of this, there was no automatic pass-through of costs for particular producers or industries. Relative strength of demand determined success in passing on higher costs to customers.

Continuation of such cost increases could have a serious impact on future economic growth and stability. Absence of general demand pressures in the face of cost increases could put a damper on customer buying if prices are raised to cover costs, or a damper on business spending if profits are squeezed further. If a steady uptrend in prices generates demand pressures through speculative buying and investment, there is danger of subsequent collapse.

Economic growth and stability can be best achieved through development of (1) new and improved products, (2) improved methods of production and distribution, and (3) proper distribution of the fruits of production such as to encourage maximum consumption and investment.

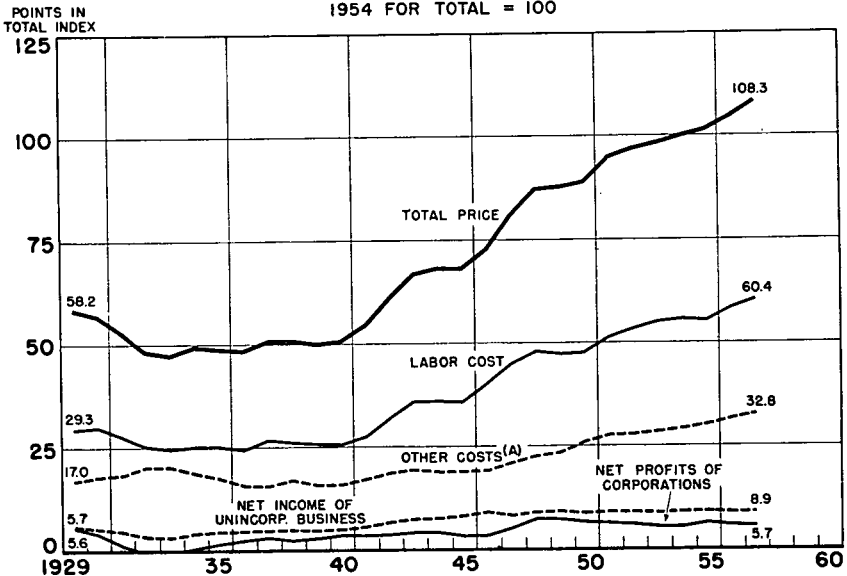
The goals of maximum production, employment, and purchasing power are not achieved through general price and cost inflation. They are achieved through balanced expansion of production and income with a minimum of fluctuation in aggregate prices, particularly over the long run.

The CHAIRMAN. Thank you, sir.

(The chart and supporting tables appended to Mr. Hitchings' statement are as follows:)

CHART III

PRICES, COSTS, AND PROFITS PER UNIT OF PRODUCTION
(PRIVATE NONFARM PRODUCT)
1954 FOR TOTAL = 100



SOURCE: DEPT. OF COMMERCE
(A) INCLUDES CAPITAL CONSUMPTION ALLOWANCES, PROFITS TAXES, INDIRECT BUSINESS TAXES, NET INTEREST, AND RENTAL INCOME.

Prices, costs, and profits per unit of production (private nonfarm product)

| | Total price (index 1954= 100) | Labor cost | Other costs ¹ | Net profits of corpora- tions ² | Net income of unincor- porated business ² |
|-----------|-------------------------------------|------------|--------------------------|--|---|
| | | | | | |
| 1929..... | 58.2 | 29.3 | 17.0 | 5.6 | 5.7 |
| 1930..... | 56.9 | 29.7 | 17.9 | 4.2 | 5.3 |
| 1931..... | 52.6 | 27.5 | 18.4 | 1.0 | 4.5 |
| 1932..... | 48.2 | 25.2 | 20.4 | -2.2 | 3.3 |
| 1933..... | 47.3 | 24.6 | 20.3 | -2.5 | 3.2 |
| 1934..... | 49.3 | 25.1 | 18.5 | .3 | 4.1 |
| 1935..... | 48.8 | 25.1 | 17.3 | 1.6 | 4.4 |
| 1936..... | 48.6 | 24.4 | 15.7 | 2.5 | 4.6 |
| 1937..... | 50.5 | 26.7 | 15.6 | 3.1 | 4.7 |
| 1938..... | 50.6 | 26.0 | 16.7 | 2.3 | 4.8 |
| 1939..... | 49.9 | 25.6 | 15.7 | 2.8 | 4.7 |
| 1940..... | 50.4 | 25.4 | 15.6 | 3.7 | 4.9 |
| 1941..... | 54.3 | 27.4 | 17.2 | 3.5 | 5.5 |
| 1942..... | 60.9 | 32.0 | 18.6 | 3.8 | 6.5 |
| 1943..... | 66.6 | 36.0 | 19.4 | 4.2 | 7.4 |
| 1944..... | 68.0 | 36.1 | 18.8 | 4.2 | 7.5 |
| 1945..... | 67.9 | 35.9 | 18.8 | 3.2 | 8.0 |
| 1946..... | 72.8 | 40.3 | 18.9 | 3.5 | 9.1 |
| 1947..... | 81.1 | 45.0 | 20.9 | 5.1 | 8.2 |
| 1948..... | 86.9 | 48.0 | 22.6 | 7.3 | 8.9 |
| 1949..... | 87.6 | 47.4 | 23.5 | 7.1 | 9.0 |
| 1950..... | 88.8 | 47.7 | 26.0 | 6.5 | 8.6 |
| 1951..... | 94.9 | 51.3 | 27.7 | 6.3 | 8.9 |
| 1952..... | 97.2 | 53.4 | 27.9 | 6.0 | 8.9 |
| 1953..... | 98.7 | 55.0 | 28.6 | 5.4 | 8.7 |
| 1954..... | 100.0 | 55.6 | 29.3 | 5.3 | 8.9 |
| 1955..... | 101.4 | 55.2 | 30.2 | 6.3 | 9.0 |
| 1956..... | 104.5 | 58.3 | 31.5 | 5.9 | 8.9 |
| 1957..... | 108.3 | 60.4 | 32.8 | 5.7 | 8.9 |

¹ Includes capital consumption allowances, profits, taxes, indirect business taxes, net interest, and rental income. Does not include business transfer payments, net subsidies of Government enterprises to non-farm business, and the statistical discrepancy between measures of income and production. Total costs, net profits, and net income of unincorporated business will differ from total price by the total of these excluded items.

² Excludes profits and losses from inventory revaluation.

Source: Indexes computed by the author from Department of Commerce data on national income and product.

(Supplement).¹—Components of "other costs" per unit of production (private nonfarm product)

[Points in total price index (1954=100)]

| | Total other costs | Rental income | Net interest | Capital consumption allowances | Indirect business taxes | Corporate profits taxes |
|-----------|-------------------|---------------|--------------|--------------------------------|-------------------------|-------------------------|
| 1929..... | 17.0 | 3.5 | 3.6 | 4.8 | 4.2 | 0.9 |
| 1930..... | 17.9 | 3.4 | 3.8 | 5.3 | 4.8 | .6 |
| 1931..... | 18.4 | 3.0 | 4.1 | 5.8 | 5.1 | .4 |
| 1932..... | 20.4 | 2.6 | 4.6 | 6.6 | 6.2 | .4 |
| 1933..... | 20.3 | 2.0 | 4.5 | 6.5 | 6.8 | .5 |
| 1934..... | 18.5 | 1.5 | 3.9 | 5.7 | 6.7 | .7 |
| 1935..... | 17.3 | 1.4 | 3.5 | 5.2 | 6.4 | .8 |
| 1936..... | 15.7 | 1.2 | 3.0 | 4.6 | 5.8 | 1.0 |
| 1937..... | 15.6 | 1.4 | 2.9 | 4.5 | 5.9 | 1.0 |
| 1938..... | 16.7 | 1.8 | 3.0 | 4.8 | 6.3 | .7 |
| 1939..... | 15.7 | 1.8 | 2.7 | 4.4 | 5.8 | .9 |
| 1940..... | 15.6 | 1.7 | 2.4 | 4.2 | 5.7 | 1.7 |
| 1941..... | 17.2 | 1.8 | 2.1 | 4.0 | 5.5 | 3.8 |
| 1942..... | 18.6 | 2.1 | 1.8 | 4.1 | 5.3 | 5.3 |
| 1943..... | 19.4 | 2.2 | 1.5 | 4.1 | 5.4 | 6.2 |
| 1944..... | 18.8 | 2.2 | 1.3 | 4.3 | 5.7 | 5.4 |
| 1945..... | 18.8 | 2.4 | 1.2 | 4.5 | 6.3 | 4.4 |
| 1946..... | 18.9 | 2.6 | 1.2 | 4.1 | 7.2 | 3.9 |
| 1947..... | 20.9 | 2.7 | 1.4 | 4.7 | 7.4 | 4.6 |
| 1948..... | 22.6 | 2.9 | 1.5 | 5.4 | 7.9 | 4.1 |
| 1949..... | 23.5 | 3.3 | 1.7 | 6.0 | 8.3 | 4.1 |
| 1950..... | 25.0 | 3.3 | 1.8 | 6.0 | 8.4 | 6.5 |
| 1951..... | 27.7 | 3.2 | 2.0 | 6.4 | 8.5 | 7.6 |
| 1952..... | 27.9 | 3.4 | 2.2 | 6.9 | 9.0 | 6.4 |
| 1953..... | 28.6 | 3.3 | 2.4 | 7.3 | 9.2 | 5.5 |
| 1954..... | 29.3 | 3.5 | 2.7 | 8.2 | 9.4 | 6.4 |
| 1955..... | 30.2 | 3.2 | 2.9 | 8.4 | 9.4 | 6.4 |
| 1956..... | 31.5 | 3.1 | 3.0 | 8.9 | 9.9 | 6.4 |
| 1957..... | 32.8 | 3.4 | 3.4 | 9.6 | 10.3 | 6.1 |

¹ See pp. 133-134 of hearings on "The Relationship of Prices to Economic Stability and Growth," Joint Economic Committee, Oct. 31, 1958.

Source: Indexes computed by the author from Department of Commerce data on national income and product.

The CHAIRMAN. We have as our next witness, Mr. John P. Lewis, professor of business economics and public policy, School of Business, Indiana University.

Mr. Lewis, we are glad to have you and you may proceed in your own way, sir.

STATEMENT OF JOHN P. LEWIS, PROFESSOR OF BUSINESS ECONOMICS AND PUBLIC POLICY, SCHOOL OF BUSINESS, INDIANA UNIVERSITY

Mr. LEWIS. Thank you, Mr. Chairman. I gathered from Mr. Knowles that the intent was for the academicians to act as end men in this group of hearings, and I am glad the physical arrangements here underscore that rule.

The joint committee's extensive investigation into the subject of general price behavior during 1958, it seems to me, has been a very worthwhile affair. But the very facts that the exercise has been an elaborate one and is now nearly ended mean that much of the topic has been pretty well worked over by now. Accordingly, I shall take time here only to record a few rather general net impressions without attempting to support them adequately or to make them a comprehensive summary of the ground the inquiry has covered.

The first—and a strong—impression is that the performance of our existing price system, so far as economic stability and growth are concerned, is not nearly as bad as much of our current rhetoric would suggest. There is no convincing evidence that the processes which determine factor and product prices have been distributing productivity gains between households and business in a fashion that threatens the maintenance of long-term economic growth. There is no sound basis for bewailing the impact of present pricing practice on short-run fluctuations; on the contrary, it helps to keep short-run declines from getting out of hand. The stickiness, especially the downward stickiness of wages and of many prices has helped to dampen the deflationary cumulative mechanisms in the economy that so typically used to snowball little downturns into big downturns.

A perpetuation of present price- and wage-making practice probably would pose the prospect of some average, gradual secular inflation—none of us knows at what rate, but I should doubt that the current long-term outlook in the United States is for average increases in excess of 2 to 3 percent a year.

Moreover, I am increasingly persuaded—more so, I might say, than when I testified last May—that those who tell us that such a gradual inflation cannot possibly remain gradual, that it must necessarily accelerate as the prospect of secular inflation gains a grip on buyers' expectation and causes anticipatory buying of capital goods and other commodities, are frightening us unnecessarily. There is no question that average 2-percent-a-year inflation would be undesirable. It would be inequitable. It could in the long run be very rough indeed on those savings institutions that continued to market only fixed dollar securities. It might complicate the problems of managing the public debt. But it would not necessarily prevent the maintenance of a steady, vigorous, and sustainable rate of economic growth. It would not be the worst of national calamities. If we decide we want to mount adequate measures to prevent such an inflation, we should, first, recognize that we have time to work out solutions carefully, experimentally, and dispassionately.

The situation does not require a crash program. Moreover, second, in designing a remedial program we should recognize that our affliction is gradual inflation itself, not some more dire consequences to which gradual inflation is supposed indirectly to lead; and we should be sure that the cure we choose is not worse than the disease.

My second impression is that there has been a wide scope of agreement among those who have appeared before the committee on this question this year that the inflationary problem which really nags at us as we confront the future is one which has imbedded itself most stubbornly on the supply side of the market. "Cost-push" is much too crude a characterization; obviously any change of price must involve the interaction of both demand and supply factors. But what really worries us is not the belief that too much government or private spending, facilitated by such things as deficit financing or loose monetary policies, will characteristically keep aggregate demand outrunning our capacity to produce at existing prices. It is rather that we have built ourselves a set of cost-structures and pricing, including factor pricing, practices that make satisfactorily high levels of output and employment inconsistent with through-going price stability. It

would be too early to call this view a consensus, but there have been many strong impressions of it to the committee. In these very broad terms, I take it that there may be some analytical consensus among the members of this panel, for example.

This general point has a policy corollary that also has been widely expressed, namely, that general monetary and fiscal-policy antidotes to the kind of inflation we anticipate are not only inadequate but can be positively perverse.

On top of everything else, I think we can say that such "solutions," which are really output- and employment-sacrificing solutions, simply aren't feasible politically. The recent election provides further suggestive evidence, I should say, that the American people aren't about to trade a little more unemployment for a little more price stabilization, and that, accordingly, any workable anti-inflationary policies are going to have to be worked out in a high employment framework.

My third general impression from the compendium, commentaries, and earlier hearings, is that we still have not surmounted our old habit of discussing the inflationary process as though we were debating sin and as though, therefore, every actor who admits he has any role in the process is a sinner. This difficulty is particularly evident in the papers submitted by the business and labor economists—and I would not, in this respect, absolve the able papers of my business and labor colleagues on this panel. Each is heavily preoccupied with casting the inflationary blame on the other fellow. Actually, the very essence of the process we are discussing is that there is no localizable blame.

Mr. Fackler finally makes this point—except, I should say, with too sinister a figure—when he says "union leaders and businessmen alike are forced to take part in a danse macabre, a vicious system of pattern bargaining and wage leadership"—and I think Mr. Fackler should also have added, "conventional business pricing procedures"—"about which they can do little, individually, even if they would like to stop the music."

I am sure this is right. The average union leader feels, and should feel, no more iniquitous about negotiating a cost-of-living adjustment than the average business executive feels about a routine application of the return-on-investment formula to a pricing decision, or the average retailer feels about applying a conventional markup, or the average Congressman feels about legislating a parity formula for farm price supports.

We are dealing with a situation in which none of the actors remotely resembles a power-drunk mogul who is exploiting the public. Nobody is throwing his weight around. The individual pricing practices appear perfectly reasonable in their individual contexts. The only trouble is that they have combined inadvertently into a less-than-perfect social result.

To be charged with participating in the current inflationary process should make one feel no more personally guilty than the driver who is charged with being a member of a traffic jam. Until business and labor leaders as well as the Government policy planners who confront them come to this view, our chances of developing sensible, level-headed anti-inflationary policies aren't very good.

The last impression that I shall list is that the committee's exercise has not been nearly as fruitful in developing new policy ideas for contending with the limited but significant problem of gradual inflation as it has been in the realms of diagnosis and prediction. There has been some helpful discussion of selective demand restraints and of possibilities for smoothing the supplies of internationally traded raw materials. But if, as I suspect, the ultimate solution can be found nowhere but in some alterations of present pricemaking and wagemaking techniques, we have scarcely gotten our feet wet yet in this subject. This may be because here too we got too emotional and pose ourselves excessively stark and simple alternatives.

Our present pricing system, which on the whole, I repeat, works quite well, already is an amalgam of many institutional influences and arrangements, some private and some public. It has been tinkered with a lot already, and there is no a priori reason to think that if Government tried to tinker with it any further, the result would be either disastrous or revolutionary. But we are going to have to become a little more matter of fact about the whole problem before much closely reasoned analysis of policy alternatives is forthcoming.

The CHAIRMAN. Thank you, sir.

Mr. J. Fred Weston, professor of finance, Graduate School of Business Administration, University of California, Los Angeles. We are glad to have you, Mr. Weston. You may proceed in your own way.

STATEMENT OF J. FRED WESTON, PROFESSOR OF FINANCE, GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA, LOS ANGELES

Mr. WESTON. Thank you.

The basic question here is whether you can have a high rate of growth in the economy without having undesirable rates of price increase. I would take exception with the view that because of the institutional structure of our economy now that you can't have high rates of growth without price increases.

The fears expressed about price inflation have been associated with events of the last several years in which very special developments have been taking place. I have referred to these in our previous sessions, namely, we had a business investment boom which took off at a very rapid rate in 1955, which was stimulated more than anything else by the accelerated depreciation allowances permitted by the Revenue Act of 1954. You had a very strong increase on the consumer demand side, associated with the relaxation of the length of time for making payments for consumer durable goods. This took place in 1955. I think it is the influence of special factors of this kind which are the main explanation for the price changes that took place in the last couple of years, rather than the institutional factors that have been frequently referred to.

In reviewing the other papers, one sees a tendency on the part of the papers presented by the labor people to argue that wage rate increases were not the cause of inflation, and therefore it must have been pricing through administered pricing practices that were the cause. Conversely, the business papers tend in the main to take the view

that it was not administered prices; therefore it must have been due to wage increases.

I should like to put in proper perspective by means of a framework the point that there are many facets to this, not just the two that are so frequently referred to.

You have the cost side, and you have the demand side. On the cost side you have the price of labor and the price of capital. On the demand side you have consumers, business, and government. Then you have a third special factor which might be referred to as expectational influences, the kind of price increases you got at the time of the outbreak of the Korean war, when people expected prices to go up and then they behaved in such a way as to make them go up.

Within this framework you can have a good many things operating at once, and within the framework you can have individual factors operating such as bottlenecks effects when you get an investment boom, or strong demand for particular kinds of consumer goods, as you did in 1955.

It seems to me that in view of the many factors that might influence prices, we made a major mistake in policy in being so negativistic in our approach to this program. We have been afraid of price inflation. We are trying to keep unemployment to a minimum level, instead of taking what we are justified in taking—a very positive, dynamic approach to achieving the kind of high level of growth of which our economy is capable.

I think that a major error of national economic policy has been the failure to establish consistent priorities on economic objectives. We replaced for a good part through 1957 the objective of full employment with the objective of balancing the budget, regardless of whether we were in a period of inflation or deflation. Because of this kind of approach to our national economic affairs, less than satisfactory performance has been achieved with respect to the growth objective we are most likely to achieve, the desired degree of price stability and other economic goals. By policies giving first priorities to a high rate of growth in the economy we could have achieved more price stability as well.

A target rate of growth in real gross national product of 4.25 per cent per annum would have significant advantages. It would permit the wage-bill to double every 15 years. This rate of growth would increase the likelihood of containing wage increases within productivity increases and hold price level changes to moderate movements.

The best attack on the problem of business fluctuations is to swamp them with growth. Cyclical policies subordinated to high growth goals will deal most effectively with the fluctuations problem. A 4.25 percent rate of growth and the productivity increases implied are also the best method of dealing with cost-push inflation. For wage pressure reflects improved standard of living aspirations as well as the unemployment level.

In general, consumption should be influenced through flexible tax policies. Business investment should be influenced through interest rate (index of loanable funds availability) policy and through policies which keep consumption growing in relationship to capacity increases.

An element in the relationships which is often neglected or misunderstood is the profit element. The rate of return on capital must be adequate to call forth the requisite rate of growth in capital formation.

A critical level of return on capital influences the pace of capital formation. A level below this critical point is likely to reflect a slack demand which appears to result in excess capacity. A level in excess of the critical point will be associated with the generation of a capital investment boom.

My studies yield the tentative conclusion that an 8-percent post-tax return on total capital is necessary for an adequate growth rate in the economy. The return on net worth would be higher than 8 percent; what it would be would depend on the characteristic debt-equity ratios industries that you are talking about. This implies a profit rate much higher in the more rapidly growing or higher risk sectors of the economy running up to 16 percent for large firms and lower rates (in fact, losses) in declining sectors.

The CHAIRMAN. Thank you, sir. Under our rules, each member will be recognized initially for 10 minutes when he is recognized. First I would like to recognize Mr. Bolling for questioning.

Representative BOLLING. Mr. Lewis, I think your last paragraph quite correctly diagnoses these hearings in being more fruitful in diagnosis and prediction than in new direction. I wonder if you would care to expand on that paragraph and very tentatively give some suggestions as to the direction of that exploration. What kinds of things should we be thinking about? As far as I am concerned one of the principal purposes of the timing of this particular investigation, which was quite deliberately, as far as I was concerned, set up for a time of recession when there would be less of the standard cliché between two parties who considered themselves interested, was that we could be somewhat dispassionate and might come up with more than a cliché approach to the problems. What are some of the noncliché approaches that might be useful?

Mr. LEWIS. Like a lot of people I can do a lot better saying what won't work instead of saying what will. For purposes of trying to define the area for exploration, I would say first, as I said very briefly in this summary, that it seems to me that the core of our problem is on the supply side—what technically I would call the shape and behavior of the aggregate supply function. It is not an excess demand problem. Therefore, I feel if we are going to find a really solid solution, they have got to be ones that somehow change the shape or behavior of our aggregate supply function. I think these may mainly alter some of the institutional factors.

Representative BOLLING. Before you go on, would you mind being specific and illustrative in this?

Mr. LEWIS. Yes, I will try to be. I do think that there are some things that can be done short of this. I think these have been the policy innovations that have been most discussed. For instance, I do think that there is some considerable point in a greater use of selective demand restraints than we have had recently, although I recognize that these are very difficult to administer with elegance and precision. But such things as consumer credit controls of the regulation W type, and possibly variable depreciation allowances, it seems to me, might be used to some advantage.

Then there was the point, as I recall, Mrs. Ruth Mack made in her presentation to the committee, that many of the impulses to the inflationary mechanism arise from international raw materials markets. There may be something that can be done through public policy to really smooth the supplies of such materials. But I would still argue that whatever can be done along these lines won't remove all of the impulses to the mechanism. It certainly won't destroy the mechanism which I see as a kind of inadvertent massive escalator that has been developed through a collection of perfectly respectable individual pricing policies.

This is the point at which many people then jump to the conclusion that what you are talking about is price and wage control. It seems to me this just obscures the problem. If you start to think about what government can do—let us say what anybody can do—to alter price-making and wage-making practices helpfully without losing many of the advantages that the present system has, it seems to me you have to screen out a whole lot of areas rather quickly. I would say purely on political grounds and technical grounds anybody who talks about a peacetime OPA is just talking through the top of his head. Also, I am convinced myself that the standby control device is not appropriate for this problem. It might be useful to forestall the kind of inflation that you got at the outbreak of Korea. In that sort of a sudden spurt, which is really an unexpected excess demand spurt, standbys might be helpful. But they won't deal with this sort of gradual creeping inflation.

I would be appalled at the idea of generalizing our present court-commission system of utility rate regulation. This seems to me to offer no solution.

Also I must say myself, and many economists disagree with me here, I am not very hopeful of an extension of antitrust policies as a solution to this problem. I am quite sympathetic to strong antitrust programs, but essentially for their attack on the fundamental problem of power distribution. I think it would take a terrific atomizing of our present producers' organizations to have much effect on these conventional pricing practices.

I am also not very optimistic myself with the suggestion you sometimes hear that we should set up some sort of national wage-bargaining conferences to decide how wages in general ought to go up this year, and presumably decide that prices should not go up, on the average. I don't see that these would do any harm, but I fail to see how any such very general agreements could be translated into particular decisions effectively.

So, I am forced, myself, back on the supposedly discredited area of moral suasion. I do think we have never really begun to exploit the possibilities for helpful Government use of the moral suasion approach. The experimenting that has been done with it both by the Truman and Eisenhower administrations has been doomed almost before it occurred. For one thing, the moral suasion has been broadcast from the housetops, has been diffused throughout the whole community, so people can always assume they are talking about the other fellow.

For another thing, the advice has always been delivered after the fact of the decision has jelled. After a corporation has made a price-

ing decision or after a collective bargain has been struck, there is no chance of dislodging it. I do think there might be a possibility of some very well staffed, directed, specific advice that could be addressed to specific pricing jurisdictions.

This may be called a Pollyanna approach, but I really think it is the only thing that is available when you consider the political realities in the situation.

Representative BOLLING. I would perhaps agree with that if it were not for one thing which you said, the implications of which I heartily disagree with, and which I think was pretty well covered yesterday, although I did not hear the excellent statement. I read it. This is when Senator O'Mahoney talked about the fact that we are dealing in a cold war, nonpeace situation. I don't believe that exhortation is going to have any possible effect as long as the American people and their leaders generally assume that we are dealing in a peacetime situation. I agree with you as long as we think we are at peace, there can be no direct controls. Senator O'Mahoney's point is made at somewhat greater length in Mr. Gilbert's paper, which I believe begins at 221 of the Commentaries. It seems to me that the control might have some hope if we begin to recognize that the situation we find ourselves in is not of peace. At least it is a cold war situation. The critical problem that confronts us in the facing of our economic problems was very well stated by Senator O'Mahoney yesterday when he pointed out that we face a very effective economic competition from the Soviet, and from the Communist bloc, a competition which may be designed—I don't say that it is, because I don't know—to destroy our particular economic system and probably will as long as we approach the problem of this competition with the view that we are at peace.

I think that the American people would be much more prepared to accept more radical, to use the word in its precise meaning, proposals to cure the economic problems that we face, to maintain full production, full employment, in the face of the Soviet's vast growth, and at the same time to maintain stability if not perhaps for reasons of selfish interest, but in terms of the incredible cost to defense and foreign policy of even a relatively slow inflation, particularly when looked at in the political content. It seems to me we don't have a chance of arriving at reasonable solutions in the economy of the future of this country, at least in the foreseeable future, until we accept generally the fact that this is not peace.

I think my time has run out, but I will give you a chance when I get back around.

The CHAIRMAN. Mr. Curtis.

Representative CURTIS. Thank you, Mr. Chairman.

I am happy with the point that has been made that the papers to date in the hearings have been along the line of diagnosing rather than prescribing either through surgery or through pills, because I think the function of this committee, not being a legislative committee, is to try to diagnose, and those who may be on legislative committees, where surgery or pills are administered, can at least perform that function with a little more enlightenment if our diagnosis has been well done.

In the previous panel I was trying to break down the term "inflation" into a definition and the point I think was well made that all price increase is not necessarily inflation. There can be other factors.

There is a second area that I always find it seems to me has not been broken down. There has been a tendency in all the papers to treat it in generalities. That is the term "unemployment." I notice Mr. Seligman has broken it down to a degree because he discusses the problem of unemployment in the area of retail clerks and so forth. Isn't it true that the unemployment comes from a variety of different economic reasons? Would the panel agree that is so? I think that is an obvious observation. I think if it does come from a variety of reasons, wouldn't it serve some function if we went into it a little more?

One thing I suggest is that I think there is overemployment in certain areas. There is a great demand for additional skills in certain areas and people could be employed if those skills were available. Is that a fair observation? Even in times of unemployment, such as now, there are certain areas where there are demands for more people to be employed. Is that an accurate observation? Does anyone care to comment?

Mr. HENLE. I think I certainly would agree with you, Congressman, that there are particular demands for particular skills that are not met even in a period of relatively high employment. However, I would say that those nowhere near give us as much trouble or require as detailed public intervention as does the problem of overall unemployment when it reaches a critical stage.

Representative CURTIS. I am not trying to argue. Again this is a diagnosis. I am not arguing as to whether the Federal Government needs to do anything—to give a pill or to perform some surgery. But in understanding what we are dealing with, I think it is important to understand the situation. It would serve a purpose, it would seem to me, to analyze where there are areas of demand for employees and what lies behind that. Certainly I can suggest several factors in breaking down unemployment.

One thing is the tremendous technological revolution which occurred in agriculture, which is not anybody's attempt to drive little people off the farm at all. It is an economic phenomenon. As soon as we start treating it as such, we might come up with the correct solution. But that is bringing with it unemployment of a group of people in that area, and that is further a geographical problem which also enters into an analysis of unemployment. You can have unemployment in certain areas and demand for employment in other areas; that is true, is it not?

Mr. HENLE. Yes. I think our experience shows even in times of relatively full employment, there will be some depressed areas of the country where unemployment is high.

Representative CURTIS. One of the most impressive things I have read in many years was a little booklet put out several years ago, I think, entitled, "European Impressions of American Workmen," by a group of British observers who came over around 1950 to look at our industrial picture. The booklet compared a similar observation by a team back around 1900.

One thing that impressed me with respect to their conclusions, which I never thought of, was that it said that one of the unique

things about the American workman was his flexibility in being able to learn new skills. The reference was primarily to the production line where there had been some dire predictions around 1900 that we were going to develop a race of automatons, along the line of Charlie Chaplin's film. But instead of that, we were developing a very adaptable man because they would be on the line for 6 months, perhaps, following a certain routine, but then the machinery would be all pulled down and a new setup would come about which they had to learn.

So in this unemployment thing, too, I think we have the job to do in the area of analyzing skills and shifts of skills.

Mr. Seligman, your paper makes a point throughout that retail clerks or retail employees have a wage scale considerably below that of some industrial employees. I would suggest possibly—and I don't want to have anyone take offense at this—one reason is that the skills required in retail employment field are not as great as those in these other areas. Is that possible?

Mr. SELIGMAN. I think, Mr. Curtis, that a good many retail clerks might take exception to the contention that their skills have a primitive or elementary character.

Representative CURTIS. I know they would, and that is why I hesitated in saying it. But as an economist in writing out the natural emotionalism that would go with anybody's abilities, isn't that a reason why over a period of time there have been lower wages paid?

Mr. SELIGMAN. No. I don't think I would subscribe to that contention, Congressman Curtis. During the great depression of the 1930's or the latter part of the 1930's, the wage level of the retail employees was relatively high in comparison with wage levels for various other occupations. Through the years the retail employee, together with the service employee, lost ground, so that today we find the retail employee in the unorganized areas at the bottom of the ladder. There are a variety of factors that account for this. I suspect a good deal of it is due to the fact that many retail areas lack union organization so that the retail employee is a single individual in a bargaining situation pitted against a large concern in many, many instances. On the other hand, I might point with pardonable pride to the organized areas of the retail industry, where wage rates reach more adequate levels.

In the recent recession in California when aircraft employees were laid off, in the Los Angeles region particularly, they made immediate application to the supermarkets for employment. These places are highly organized. The differential in wage levels between the aircraft plants and a Safeway installation is just a few dollars a week, so that they were delighted for employment opportunities in this area.

Representative CURTIS. It is possible for an employee in a supermarket where he is performing a different function to be required to have more skill. I am not sure it is so. I am simply saying it seems to me this is an area that we have to explore. I would ask you one general question. You do believe, do you not, that it is proper to have wage differentials based on different skills?

Mr. SELIGMAN. There is no question that you have wage differentials based on skills. We have wage differentials based on skill and ability to perform a job directly in a single retail establishment.

Again, if I may be permitted to go to the supermarket as an illustration, the job classification which we describe as a "box boy" or "carry-out boy" has the lowest wage rate as compared with a journeyman clerk. I don't question that within a given plant or within a given industry you will have wage differentials.

Representative CURTIS. I know we do have. I was wondering if you would agree that is a good economic process. It seems to me it is necessary if we are going to have the society we have.

Mr. SELIGMAN. I would not quarrel with you on that score. I do raise a question when we have an entire industry in which differentials exist, which is completely depressed so that the highest job classification in that industry is far below the lowest job of an industrial area.

Representative CURTIS. I think this is important and bears on the underlying problem if we could ever analyze it. One of the problems that is confronting our society today is to get people into the teaching profession. One of the problems there is that the wage differential is such that it is not attractive for them to go into that area. I know that the U.S. Congress, as an employer in one respect, in handling wage scales and classifications of postal and civil service employees, is constantly up against the problem that some of the union leaders don't want to have a reclassification. They want the wage increases, but to keep the differential between the skills has always been a difficult problem to resolve. That is why I wanted to emphasize that factor here. I think it should underlie our studies in this problem of employment and unemployment.

Mr. SELIGMAN. I certainly think I can speak for the officers of my organization on that point. I think they would go along with you, Congressman, for a further exploration of this particular problem. I know they are very much concerned with the problem of the level of wages in the retailing industry, particularly.

Representative CURTIS. Thank you.

The CHAIRMAN. Senator O'Mahoney.

Senator O'MAHONEY. Mr. Chairman, I would like to direct a general question to the panel as a whole in order to see if we can get a little discussion. Is it possible we are dealing here in the papers which have thus far been presented with results rather than with causes of the condition that Congress must deal with. Does anybody want to answer that question without further explanation by the inquirer?

Mr. WESTON. It seems to me that the discussion to a great extent has been in terms of results. The discussion of causes has been within relatively narrow boundaries. I think this goes back to the question raised by Mr. Bolling when he asked about the new directions in the analysis here. It seems to me that basically the new directions represent going back to the fundamentals. This is appropriate in terms of your raising the question, in that I think it is a recognition of the inherent strength that you get from the operation of a competitive system. It is my feeling that competitive forces in the economy are so inherently strong—this is due in a considerable measure to the anti-trust activity that we have had through legislative and administrative bodies since 1890—that you have competition expressing itself in industry after industry. For example, we have the steel industry and

the decline of United States Steel from a position of two-thirds of the market in 1901 to one-third of the market at the present. Take the automobile industry where you have had great changes in the relative shares of the market. Ford with 55 percent of the market in 1920, General Motors 17 percent of the market at that time, and their positions almost reversed some 25 years later. If people are willing to play the rules of the game and permit competition to operate and not seek protection from the Government from the effects of competition, you have one of the forces that will make for great growth.

I think that the anticompetitive forces are mainly to be charged to Government in the realm of fair trade, in the realm of import controls, in the realm of limitations on the production of oil, for example, under the guise of conservation, and in the realm of farm price supports. I would say that the greatest realm of your monopolistic elements which interfere with the effective functioning of what inherently could be a very strong operating economy is to be charged to the Government. This is the area in which efforts should be directed to combat the elements that oppose the operation of the competitive system.

Senator O'MAHONEY. In the course of your paper, Professor Weston, you said that a target rate might be established of $4\frac{1}{4}$ percent growth of the national product. How do you reach that conclusion of 4.25 percent as a good target rate, and how can it be brought about?

Mr. WESTON. I chose the figure of $4\frac{1}{4}$ percent because it seemed to me it was realistic in terms of our past patterns based on distant and recent history. Since the end of World War II we have had a growth in dollar terms of some 6 percent, and in real terms of some 4 percent.

Senator O'MAHONEY. By that I suppose you mean that the inflated dollar brings the 6-percent rate—that is to say, the current dollar—but the lower rate of growth is figured upon the value of the dollar at some time in the past?

Mr. WESTON. That is right, in terms of constant dollars taking the price inflation effect out.

Senator O'MAHONEY. Do you or do you not adopt the present figure of gross national product, as reported in the Economic Indicators?

Mr. WESTON. As a measure in actual dollars, I would certainly accept it. If you would raise the question of what growth it represents in real terms, it is appropriate to take the price level effect out.

Senator O'MAHONEY. On page 2, for example—page 2 of the Economic Indicators for November 1958—the gross national product for 1957 is set down at \$440,300 million.

Mr. WESTON. That is right.

Senator O'MAHONEY. But that is in current dollars, is it not?

Mr. WESTON. That is correct.

Senator O'MAHONEY. Would you apply your $4\frac{1}{4}$ percent growth to the current dollars or to the value of the dollars at some constant rate prior thereto?

Mr. WESTON. I think you have to start from where you are. I would apply the $4\frac{1}{4}$ rate to the point of time from which you are

starting. This would mean accepting whatever degree of price inflation you had up to that point, and going on from there. I think it is unrealistic to try to turn the clock back and talk in terms of what prices would have been if some other things had taken place.

Senator O'MAHONEY. I have seen many charts in the past showing the purchasing power of the dollar dating back even to the foundation of this Government. The conclusion of these charts is that the dollar is constantly losing value. Do you agree with that?

Mr. WESTON. Over a long period of time the price index has indicated that the purchasing power of the dollar has declined. Whether the indexes measure this accurately is another question. That is, the degree or extent to which this has taken place is probably exaggerated by the indexes because they do not adequately take into account changes in the quality and composition of the market basket that is available in 1958 versus 1900 or 1850 or 1790.

Senator O'MAHONEY. When I was going to school—that is a long time ago—a person who got \$2 a day in the industrial world was doing pretty well. I remember when Henry Ford startled the automobile world by raising the pay of automobile workers to \$5 a day. That was a very beneficent act. At least that is the way it was received. It was a great advance in compensation for the industrial worker. But it is not acceptable today, not even by economists, is it?

Mr. WESTON. No, I think that illustrates the point that you can have a considerable amount of price rise over a long time period at the same time you have a good record of growth in the economy as we have had in the United States economy. The two are compatible. I think the crucial matter here is that we don't get an expectation of a substantial amount of price rise from year to year. My feeling on that point is that we do not have an institutional structure in which there is any basis for predicting that year by year a 3 percent price rise will take place per annum or a 2 percent price rise will take place per annum. Our price rises have been sporadic.

Senator O'MAHONEY. If we are to prevent inflation or its results, should we not direct our efforts toward obtaining some sort of an institutional change?

Mr. WESTON. I do not think basic institutional changes are required. The price rises that we have had have been explainable mostly by episodic factors. Wars have been a major factor. Another causal factor has been abrupt changes in legislation—the Revenue Act of 1954, which stimulated a capital investment boom in 1955. I think it is true with the rigidities we have in the system, we have a ratchet effect operating whenever these sporadic events take place. I do not think that these influences would be sufficient to slow down our real growth rate if you have sound general policy. You raised the question of what would you do to promote a 4¼ percent growth rate per year. My answer would be that the main responsibility in this area is simply not preventing it. I think that the Federal Reserve actions in the last several years have been a factor which have slowed this growth rate.

There are inherent growth factors in the economy, they are fettered by inappropriate Government action at times, but the growth forces are strong enough to give us a 4¼-percent growth rate.

Senator O'MAHONEY. Gentlemen, I am advised that my time is up. I haven't even gotten started.

The CHAIRMAN. We will be back to you soon. Mr. Reuss.

Representative REUSS. Mr. Chairman, Mr. Fackler, you have a very provocative paper, and I would like to explore with you one of your central points, which, as I understand it, is that a considerable evil in this entire operation is the very considerable wage differential between high-wage industries and low-wage industries. You end up by saying that the struggle over the distribution of real income among different economic power blocs, including blocs within segments of the labor force itself, should be dragged out into the open and faced squarely.

I surely agree that it should be, and let us drag it out for 9 or 10 minutes.

Do I state your position correctly when I say that you feel that there are uneconomic or intolerable wage inequities?

Mr. FACKLER. I think you state it a little too strongly. I frankly don't know how strong the spillover effects, or as Peter Henle calls them, carryover effects, are. We can't get them out of the data or separate them in statistical analysis. It is my personal opinion that "spillover" is a factor. I think there is fairly general agreement that under certain circumstances it can be a factor. Congressman Curtis just talked about the tendency for wage differentials to become rigid and stratified. The problem becomes acute when there are differential gains in productivity among different sectors of the economy. There is quite a good deal of theoretical literature on this question and there has been some popular discussion, articles in the *London Economist*, for example, dealing with the problem of the services, the retail clerks, and the like.

Where you have productivity advancing fairly rapidly in industrial sectors, unions, or even nonunion workers, given the right general demand conditions, can get general wage increases which may not exceed productivity. In other words, you could get a considerable increase in wages in these industrial sectors with perhaps no increase in unit costs if productivity were also advancing very rapidly in those sectors. What this means is that the workers in particular occupations, particularly firms, particularly industries, are then getting considerably more, relatively, than other people, of the economic pie.

Representative REUSS. I couldn't sit here listening to the report of Mr. Seligman where he reports that 78 percent of the women in variety stores make less than a dollar an hour, without feeling that the retail clerks at least can be pardoned or understood if they hope for a little spillover.

Mr. FACKLER. Quite. I say these people quite justifiably try to redress wage differentials.

Representative REUSS. Your point is that if the wage spillover spills over into areas of industry where there has not been a productivity increase analogous to the productivity increase in the strong sectors, then you get inflationary pressures.

Mr. FACKLER. That is right. In a particular case, say automobiles, steel, or wherever the strategic wage increases are negotiated, if they can be absorbed by productivity fine, but what about the other employers who have to meet these increases in unrelated activities where productivity is not advancing? If they have to give rough comparable increases, the average wage for the economy as a whole must

increase more than average productivity for the economy as a whole. The results are produced, as Professor Lewis says, by a lot of complex relationships, not because there is a particular demon in the case. People pursuing their self-interest bring it about because of the kinds of institutional biases that we have in the system.

I would not argue that wage "spillover" was the most important inflationary problem in the immediate postwar period, 1948-49, and 1950. Certainly here there were clearly other causes as Mr. Hitchings and other panelists have shown. I think there is general agreement on this point. You could even make a case that union negotiated wage contracts in this period tempered wage increases. These were clearly excess demand situations. The evidence is much more difficult to interpret for the last 3 or 4 years.

Representative REUSS. Let me call your attention to the figures used yesterday by Mr. Barkin of the Textile Workers. He reported that in the durable industries, 1947 to 1957, labor unit costs increased 15 percent and prices 53 percent, whereas in the nondurable industries labor unit costs increased 10 percent, and prices 11 percent. This bears out in a general way, at least on the wage side, what you are saying.

What I want to put to you is this: In dragging this out in the open, you seem to suggest that the major focus of public policy and public inquiry ought to be on the wage side. I think you are saying this is something that labor people ought to get straightened out among themselves. I suggest to you that an important reason for the fact that this pace setting in wages seems to occur in steel, autos, and similarly strongly placed industries depends very largely on two factors, namely, the relatively small number of producers in both of those industries and the high cost of capital investment and thus their ability to set prices on some basis other than pure supply and demand.

Secondly, there is the policy of the Government in recent years in encouraging capital investment in durable goods industries which has brought peculiar inflationary pressures to bear. All of which, I put to you, has resulted in a more favorable climate for wage negotiations in these industries. If that is so, can one get at the jugular of this problem just by getting at the wage side? Don't you have to look at the total industrial picture?

Mr. FACKLER. Certainly you have to look at the total picture. One of the problems, as I tried to point out in my paper, is the asymmetry between the administered prices and administered wages, however we want to define these terms—and I am disturbed about the way they are used. In so-called administered price industries, if there is monopoly, I would certainly attack the monopoly directly.

I am not quite as pessimistic as Professor Lewis about attacking these institutional problems. I don't think we just have to accept existing institutions as acts of God, and go on from there indefinitely. I realize that to get rid of administered prices—in the sense they refer to pricing in industries which have a fairly high degree of concentration—would mean very earthshaking changes in the structure of industry, and also that it is very difficult to get some sort of rational approach to the question of union power. The whole problem is, it seems to me, that we don't want to face the real issues. Anyone who

suggests that maybe we ought to look at the kinds of restraints that operate—or do not operate—in a collective bargaining situation is immediately suspected or accused of trying to kill off unions. Right away you are kind of stymied from any kind of objective discussion of the problem—to what extent the problem really exists, and how significant it is.

Mr. HENLE. I wonder if I could get in a word here?

Representative REUSS. Do I have some time?

The CHAIRMAN. About 1 or 2 minutes.

Mr. HENLE. After all, this has been too peaceful up to now. We have to have some controversial elements this morning, and the hour is getting a little late.

Let me say first of all that I have no quarrel with Mr. Fackler's analysis on the theoretical level. In other words, I agree with him when we look at the economy as a whole; we on the labor side readily agree that the pace of wage advances should be roughly comparable to the advancement in productivity in the economy as a whole.

Mr. FACKLER. How about money wages?

Mr. HENLE. Just a second. Let me get through here. If we have a stable price level, it would be the same thing, in terms of money-wage increases or real-wage increases.

We further agree that since improvements are not even industry by industry we have some sort of problem here. Obviously we don't want a situation in which every worker or every union or every industry can boost wages up to the limit of productivity advances that are made in that particular industry. We would have a wage system that would be completely out of whack.

At the same time we must recognize that in those industries which, as Congressman Reuss has pointed out, have larger capital equipment, you have a different type of market situation, and you may end up with somewhat different wage increases than in other industries which have not had as high an increase in productivity.

My quarrel with Mr. Fackler is whether this has developed into a serious problem. He is concerned about what he calls the spillover effect. I assume that he means that the auto and steel boys go out and get heavy increases, and these are transferred to other industries and this boosts productivity up more than the average for the economy as a whole.

I don't think except in isolated instances it has worked out in this way. Take, for example, the textile industry or the apparel industry where there is very severe competition among the firms. That competition is translated into the wage bargaining. If you look at the wage bargains in those industries over the years, you will find that the workers in those industries just have not been able to negotiate the increases that have been won in some of the other durable goods industries. I cite that as an example to point out the spillover effect is of a limited character. Moreover, although there may be some instances that Mr. Fackler could point to wherein the wage increase was greater than productivity there has been insufficient publicity on the other side. There are many cases where wage increases have been less than the productivity.

Take for example the situation in the communications industry, the A.T. & T. Here we have a giant corporation, close to a monopoly, but

in a public utility industry where monopoly is permitted, in which advances in productivity have been quite substantial. They have been sizable. There have been improvements in terms of dialing, long-distance dialing, a reduction in telephone operators, and so forth. But on the wage bargaining side, there are two or three relatively weak unions in comparison to the strength of the A.T. & T. system, and the result is a bargaining situation that just does not yield the workers in that industry anywhere near the productivity benefits of their particular industry or even of the economy as a whole.

Representative REUSS. At this point I am trespassing over my time, and I do intend on the next round to return to this subject. I will question Mr. Fackler, too.

The CHAIRMAN. Mr. Bolling.

Representative BOLLING. Mr. Lewis, you had a comment when I was stopped before.

Mr. LEWIS. Yes. You were speaking about the need for growth and the fact that we are not in a conventional peacetime situation. Almost all of what you said and most of what you implied I certainly agree with. I do want to make my notions about policy priorities clear, because in my previous remarks I had been focusing on the particular question, that is, what can you do about this rather gradual escalating mechanism that I think we have. That is what I was talking to. Actually I don't think this should be a top priority problem for public policy at this juncture. My order of priorities would be roughly this:

In the first place, let us not get too nervous and hasty and frantic about the inflation problem. It is not nearly as serious as it is usually made out to be.

In the second place, I subscribe fully to Mr. Weston's remarks about growth, and the importance of promoting growth both on the ground that it is more important in terms of priorities, and secondly, that anything that interferes with growth probably does aggravate over the long run the inflation problem. Under the heading of what you do about this, I would also subscribe, as I take to be his position, that the very first thing that Congress should interest itself in is to somehow or other prevent the Federal Reserve Board from repeating its errors of 1957. I think this was an enormous error in public policy.

As for other ways of promoting growth, I can think of various things that Government should interest itself in, and I will give just one example. It seems to me that one of the real inhibitions to growth in the long run may be the failure of governmental services and facilities at the State and local level to grow in a way that accommodates sufficient private growth. Here the chief bottleneck is a purely fiscal one. The States and localities don't have the techniques for raising revenues easily to match growth and income. I don't know to what extent the U.S. Congress can interest itself in this, but it certainly has an interest.

Beyond this, if you get down to the matter of gradual escalating inflation, and you really want to do something about it, then it seems to me it is time to consider the development of effective consultative arrangements. I am not sure that it is not time to reexamine rather seriously Senator O'Mahoney's longtime suggestion of a Federal incorporation statute. If that were undertaken, I am not sure that it

would not be time to consider making access to some of our national labor legislation contingent upon acceptance of certain consultative arrangements. These are things I think we can explore rather calmly. Above all we should not feel that this price problem is just about ready to blow up in our faces. This, it seems to me, is just not the case.

Representative BOLLING. The basic reason I consider this problem of inflation has to be faced now is the field of policy. Because inflation is used as a club—a political club—to directly knock down the appropriations in the area of the public good both at the Federal level and the State level, and at the same time the fact of inflation further knocks down the value of those appropriations, at whatever level you choose, it seems to me that in this particular framework of policy unless we face, and fairly promptly, the realities of the inflation problem, that then we will fail at all levels in the competition of the private goods with the public goods. It seems to me that this is the urgency in facing inflation now.

I have never had a belief that inflation per se was going to promptly destroy us. It seems to me it is having the effect of destroying public policy at all levels.

That is all, Mr. Chairman.

The CHAIRMAN. Mr. Curtis.

Representative CURTIS. One of the other questions that I posed to the other panel was what effect they felt the fact we are in an economy of plenty, as opposed to an economy of scarcity, bears on these problems. The only meaningful definition of economy of plenty that I can see is that we have an economy where the consumer has choice and considerable choice. I think we have all seen it operating. I saw it operating in my own community where the housing industry was competing with the automobile industry actually to the extent of advertising, arguing that you should buy a home before you bought an automobile.

The reason I think that has bearing is that when we discuss increased productivity in a certain line, increased productivity is economically feasible because increased quantity pays for it. But if you could not market the increased quantity, it would be questionable as to how feasible would be the increased productivity. To bring it right at hand to the specific problem, it seems to me we see it in agriculture right now, where we have had a tremendous increase in productivity, probably accelerated by acreage control which puts considerable incentive on ingenuity as to how to get more per acre, but as far as our own society is concerned, we have a tremendous surplus. So, the fact that we have had a decrease in unit cost per bushel of wheat has not been passed on to the consumer. Certainly the society has found that it is a problem or it is a question whether it has created more problems than more benefits.

It seems to me if it occurs there, don't we have a similar situation in going through our entire economy which has direct bearing on this question of increased productivity, which is your increased growth, and which also affects your prices? I hope I have made it clear, but I would appreciate any comments that anyone would make as to whether an exploration of that area might be fruitful.

Mr. FACKLER. I would like to make a comment or two, Congressman Curtis. The problems you are describing come out of the process of

growth and change itself. This is another area in which I think we ought to sit back and look at the general problem of what the Government's posture should be, and particularly the Federal Government's posture, toward the whole question of growth and change in our economy.

These changes come about as a result of increased productivity, new techniques, changes in consumer taste, and such things. Agriculture is a good case in point; we can produce so much more with fewer man-hours and less labor input that what really is a blessing in some ways is a curse. Because the prices that the increased output will now sell for will not support all the people who previously were engaged in agriculture. This means that you have a problem of getting the extra people out of agriculture, where they are not needed, and finding them productive employment elsewhere, where they can increase the real output of society in some other occupation.

Representative CURTIS. Plus the fact that your price is supported in order to even continue the process, which means that the consumer has not gotten much benefit from the increased productivity.

Mr. FACKLER. Very little in terms of price. He is also charged taxes to pay for storage costs and price supports. The point I want to make is that the problem is much more generalized than that of agriculture. We see it in textiles. We see it in mining. We see it in all kinds of economic changes, industrial migration, for example. People in your position, the politicians, are in a very difficult position indeed, because the cost of economic change tends to be highly localized—in a textile mill in a southern town, or in an agricultural region—whereas the benefits are widely diffused across the economy and accrue primarily to the consumer. So we tend in our public policies to try to either stop change or to protect or insulate people from the effects of change.

Really there are three kinds of alternative courses of action which the Government could follow. One is to let the market forces grind themselves out. In other words, a complete hands-off policy. People will have to move from one occupation to another. Market forces do work, so let them work. The problem is that they work rather slowly in some cases.

Another alternative is to stop change or insulate particular producers from change; in other words to subsidize people to keep them in occupations and in areas doing things they should not be doing in terms of economic changed conditions.

The third kind of Government policy lies in programs which will promote normal change, let the changes take place, but ease the localized hardships that occur along with change without putting the Government into the position of allocating resources by political edict. In other words, let the market work, but speed it up or ameliorate its harsher personal effects.

Economic change is a very difficult problem. We see it clearly in the import controversy and proposals for freer international trade. We see it in the farm program. We see it in the depressed areas situation. In fact, economic change cuts across practically all of our major economic problems today, and we have not yet figured out what the proper posture of the Federal Government should be toward growth and change. It is something that we should seriously think

about, or we will end up with a hodgepodge of the worst kind of policies.

Representative CURTIS. I thank you because you are saying in different words what I am trying to say. Change costs money. I think it is still a desirable thing. When we consider the great technological advancement, which produces growth, it seems to me we are always going to be creating problems in employment and a shift in employment. Also we are going to have a problem of pricing. I think underlying this same thing, as an industry becomes established, the smaller ones tend to go out and there is a concentration, which is a normal economic process and not again the result of some demon directing and managing it.

Mr. FACKLER. I would agree that part of our long run inflationary problem, and this may be far more important than any wage spill-over for all I know, are the growing pains of growth itself. In other words, if we are going to have an economy growing at 4 or 4½ percent per year, this growth is going to be accompanied by great technological advance, industrial dislocations, migrations, and all kinds of other changes.

There are many rigidities built-in through the political side, through governmental programs which we now have and others which, I am sure, we will have. There are also all sorts of rigidities in labor and product markets which prevent prices from falling. Yet economic change will cause some prices to rise, while other prices resist downward pressure. I don't think we can have a very high growth economy without having a certain amount of chronic inflationary pressure. I wonder if Professor Weston would like to comment on this, but I am pretty sure I am right in such expectations.

Representative CURTIS. I wish he would.

Mr. WESTON. This is probably true for the reasons that have been described. I think the saving aspect of this is that you do not know how much and you do not know the timing. Because it is sporadic in its nature, you do not have people setting up expectations that prices will increase, let us say, 3 percent a year, so that this could be discounted in stock market price and real estate prices and so forth. You have differences in judgment as to the pace at which this may take place, and there may be 3- or 4-year periods of time when you don't have price rises, as we did from 1951 through 1955.

Because of this, if you get the area of Government not protecting certain segments of the economy against the changes that take place as a consequence of a growing economy; I think the rigidities in the industrial sector are not sufficient to cause price changes of a magnitude that would be disturbing. I think the real problem is the one referred to by Congressman Bolling when he said inflation is used as a club to knock down programs.

In this connection I think it is interesting to note that here you get, because we had \$12 deficit forecast for fiscal 1959, a cutback of defense programs, and the President asked certain of the administrative sections of the Government to examine very closely their spending policies. Then the indicated budget program was to spend an additional billion and a half, bringing up to \$6 billion, for farm price supports, which contributes to the deficit and keeps up the farm price sector. It is this kind of area where it seems to me the big push

toward price increases come, rather than in the area that you refer to when you say because of wage increases based on productivity increases, you get some spillover effects in some segments of the economy.

Representative CURTIS. I regret the use of the figure of speech of a club because certainly for this committee, I hope, we are trying to figure out whether it has an impact—inflation—and whether that is something we have to concern ourselves with. I would hope no one would use one thing alone, and certainly improperly, to knock it down. I think you will agree that the inflationary effects of these various things should be weighed in our consideration as to what we do at the Federal level.

Mr. HITCHINGS. High rates of growth for the economy are not necessarily associated with rising prices. Prices increase only when we attempt to move ahead in money terms more rapidly than in physical terms. Increasing physical output at a faster rate does not imply an acceleration in money demand and costs relative to production. On the contrary, a high growth rate achieved through more efficient use of resources (i.e., improved productivity) can lessen inflationary pressures. This makes it possible to pay equivalently higher incomes per unit of resource (labor, capital, or material) used without raising prices. Part of the problem with rising prices since 1955 has stemmed from the fact that productivity outside of agriculture has not improved to any appreciable extent. There was an increase of only about 1 percent a year for 1956 and 1957 in the ratio of output per man-hour worked in the private nonfarm economy (as published in the January 1958 "Economic Report of the President"). Extension of this series for 1958 will show no gain—in fact, a slight decline is indicated.

Representative CURTIS. You might not have a price rise in a shoe which you can't improve too much, but let us say in transportation, when I go from St. Louis to Washington—I used to go by foot—certainly there has been an increase in cost from transporting from Washington to St. Louis. Now they have jets. Isn't that going to require an increase in price? It seems to me growth because of new products and new things, things that we did not have before, is bound to be reflected in price increase.

Mr. HITCHINGS. If transportation use is increased because we manufacture more goods, productivity in the transportation industry is likely to improve.

Representative CURTIS. Yes, but the cost of taking an hour to go from St. Louis to Washington instead of 3 hours, can go up and usually does, and legitimately so, because of the cost factors, the research and development, and everything else that has gone into bringing that thing about.

Mr. HITCHINGS. The cost is determined by the amount and price of resources used to provide the commodity or service. Costs go up when there is an increase in combined labor, capital, and materials used per unit of production or when the price paid per unit for these resources is increased. Except where the quality of commodity or service is boosted, there is usually an increase over time in the ratio of output relative to input of resources.

Inflation arises when we are not content to move ahead in dollar terms at a pace consistent with our increases in physical production.

This is the real cause of rising prices over recent years, in answer to Senator O'Mahoney's earlier question as to the causes of inflation. The same was true of wartime inflation, but it is to be expected that people will not make the sacrifices in financial terms that are necessary to go with the limitation on physical production for civilian purposes during war periods. As a result, we pay out more dollars in wartime than we have production. In peacetime, there is no necessity for rising prices if we are content to move ahead in dollar terms only to the extent of the rise in physical output. Primary emphasis should be placed on moving ahead at a maximum amount in physical terms. It does not follow that a greater rate of physical growth will increase inflationary pressures. In fact, the pressure will be less if we do not try to move ahead still more rapidly in money terms.

Mr. SELIGMAN. I would like to ask Mr. Hitchings a question, if I may.

The CHAIRMAN. Senator O'Mahoney.

Senator O'MAHONEY. Mr. Seligman wants to ask Mr. Hitchings a question.

Mr. SELIGMAN. I would like to ask Mr. Hitchings how he would effect control on the money side of the equation he is talking about in a period of growth when you have a given set of resources which may or may not be used more effectively.

Mr. HITCHINGS. The first line of defense is to prevent an undue expansion of credit. This is the primary responsibility of the Federal Reserve. In conjunction with this, Government fiscal policy should avoid deficit financing at a time when there is already a high rate of utilization of economic resources.

The next problem is to hold total wage and fringe benefit increases to the amount consistent with rising output. I have not given up yet on the possibilities of public education as a restraining force. I think it has had some effect this year on both management and labor. The contract settlements in the auto industry are an example. I don't think we have necessarily reached the stage where we have to rely on more specific Government controls of wages and prices.

Monetary policies, fiscal policies, and public education to dampen excessive wage and fringe benefit increases should be supplemented by Government action to prevent monopoly control by either management or labor. The problem comes in defining what constitutes monopoly control.

Mr. SELIGMAN. I just want to make this comment. It seems to me in the case of the automobile industry, the educational impact that Mr. Hitchings talks about was purely economic.

Mr. HITCHINGS. It was primarily economic, but there has been a growing awareness of the problem. The discussions of rising prices before this committee and elsewhere in the past year or so have made a contribution toward public understanding of the problem. I think we must have public understanding before we can take action.

Senator O'MAHONEY. Mr. Chairman, I wonder if all the panelists have a copy of the Economic Indicators of November 1958 before them? May I ask you all, then, to turn to page 24, pages 23 and 25. I want to see whether or not there is an agreement among the panelists as to the facts which are set forth here, first on page 24 with respect to wholesale prices. The table and the chart seem to indicate

quite clearly that all wholesale prices have risen from an index of 111.6 based on 1947-49, as 100, to 118.5 in December 1957, and 119.1 as of September 1958, whereas farm prices have fallen from 107 in 1952 to 92.6 in 1957 and to 93.1 in September of 1958, and while processed foods have been rising, as the prices of farm products have been going down. Processed foods have risen from 108.8 to 105.6 for the whole of 1957 and 111.1 for September 1958, while industrial products have risen from 113.2 in 1952 to 125.6 for the whole of 1957, and 126.2 for September 1958. In other words, wholesale prices are generally rising from 1952 through 1958; processed foods, which are an industrial product, have seen prices rise generally. The chart would indicate that at the beginning of 1952 the prices of processed foods and of farm products were identical; they were at the same rate, 110. The prices of farm products have been falling pretty steadily with some variation, but the prices of processed foods have been rising steadily with some variations. Then, of course, industrial processes at the top of the chart are rising from the higher level to the highest level on the whole chart.

On page 26 you find that the prices paid by farmers have been rising during the same period, 1952 through 1958, and the prices received by farmers for all farm products have been falling.

On page 23, we find with respect to consumer prices, a general rise for all items, a very steady rise for rent, a substantial rise for transportation, a more general rise for food, and a slight rise for apparel.

Do these reports from the Department of Labor and the Department of Commerce, and so forth, portray results which are accepted or rejected by the panelists?

Mr. WESTON. I would like to comment on that. I would like to present an economic explanation for that. I think one could very easily draw some erroneous conclusions from these data.

Senator O'MAHONEY. First, before we draw any conclusions, are the data correct? Do you accept the data?

Mr. WESTON. Surely. Now, as to the explanation I think these relative movements are explained by the following factor. This trend started even earlier than 1952, but since you started with 1952, let us start the explanation there—

Senator O'MAHONEY. I started with 1952 because the chart starts with 1952. If I did use the earlier prices it was because they are on the tables below.

Mr. WESTON. Surely. The explanation would be the same if you took any year starting after World War II because any year after World War II you had farm-price supports. This means that the prices were set higher than the prices that would have obtained in free markets. Otherwise you would not have needed the supports. Having price supports, you stimulated further production of agricultural commodities, and therefore you had an aggravation of the excess supply of agricultural commodities. As a consequence, you have what any general economist would predict, when you set price supports, you stimulate supply. You have set a price in excess of the price that would have obtained in a free market, so you aggravate the problem. Therefore since this was associated with acreage control and stimulated the use of equipment and fertilizer, the output of commodities that were not supported increased even more because you

freed acreage for those. So an economist would predict that this is exactly what would happen to farm prices under conditions of farm-price support.

Farm-price supports themselves have resulted in a relative weakness in farm prices. One would expect this because you are attempting to prop up prices artificially high. But regardless of what you do, the fundamental influences of supply and demand under these conditions will tend to push farm prices down.

I think it is useful since you are looking at these data to observe the period September 1957 through March 1958, because the downturn started in September and presumably ended to a certain degree in March of 1958. During this period prices went from an index of 91 to an index of 100.5. During this period farm prices increased approximately 10 percent.

Senator O'MAHONEY. Where do you get those figures?

Mr. WESTON. The monthly data on page 24, farm products, the index September 1957, was 91; March 1958, it was 100.5, which would represent an increase of about 9 index points, which would be an increase of about 10 percent.

Senator O'MAHONEY. The month before the prices were 96.1 and in the month of April, the month after, the prices had gone to 97.7.

Mr. WESTON. Yes. I don't argue that there was anything sinister in farm prices having gone up. I don't argue that the farmers were monopolists during this period or anything of that sort.

Senator O'MAHONEY. I am not making any argument about it. I am merely pointing out that 100 seems to be an exceptional price.

Mr. WESTON. This reflected some cold weather freezes and some very temporary circumstances. However, this was a factor which pushed the all-commodity index up from 119 to 119.7 from February to March and gave rise to arguments that we had rampant inflation, and therefore somebody ought to do something about administered prices, and somebody ought to do something about labor unions when this particular price rise is explained by weather conditions in the agricultural sector. The reason I chose this period, if you look at industrial prices during the same period of time, September 1957 through March 1958—I think this is the significant thing—they went from 126 to 125.7. Industrial prices dropped during this period of time. This belies the argument that the price rise during the recent recession represented cost-push, or represented administered prices. It just does not jibe with the facts.

I think another interesting point to be drawn from this table to which you have directed our attention is that for the period you choose, 1952 through 1958, the price rise in processed foods is relatively small, reflecting the fact also that it is dependent upon the supply of goods coming from the agricultural sector, and these supplies were relatively abundant due to price supports, which meant that the supply-demand situation operated in such a way that the processed food sector price rises were relatively small in comparison to the industrial product sector. This reflects, it seems to me, fundamental demand-supply forces rather than these particular institutional factors that people seem to me to overemphasize.

Senator O'MAHONEY. It occurs to me to suggest, Professor Weston, that you have taken the intermediate changes. I was drawing attention to the change overall from the period beginning in the chart to the period ending in the chart. That seemed to make it clear that the wholesale prices of all commodities were steadily rising. The prices of farm products were steadily falling. The prices of processed foods were steadily rising. Of course, that explanation of Government supports is a good one so far as it goes on the whole economy. However, we must not fail to remember that the Government also spent huge sums to purchase the surplus products, and then distributed them in foreign countries in a way that has caused considerable confusion in the Congress; I know, as to the value of economic aid being extended to some of the foreign countries.

Mr. HITCHINGS. May I comment on your question, Senator?

Senator O'MAHONEY. Yes.

Mr. HITCHINGS. The reason for the differential movement in prices of farm products, foods, and other commodities is to be found in a comparison of my summary chart on prices, costs, and profits per unit of production for the private nonfarm economy with a similar one for the farm segment as shown in my full paper. Most of the farm product price goes to the farmer himself as return for his own labor and that of his unpaid family help and for income on his invested capital. The cost of hired labor and of depreciation, interest, and indirect taxes is a relatively small part of the total price. Unit costs for farm product were relatively steady after 1951. The decline in farm prices came at the expense of unit net income to farmers. Many farmers transferred to other types of work because of the reduced income. Those who did remain thus did not show as great a drop in income per unit of production, but the squeeze on them was still substantial. Production was continued at high levels despite falling prices because of low marginal costs of production, and an unwillingness or inability of remaining farmers to transfer to other occupations.

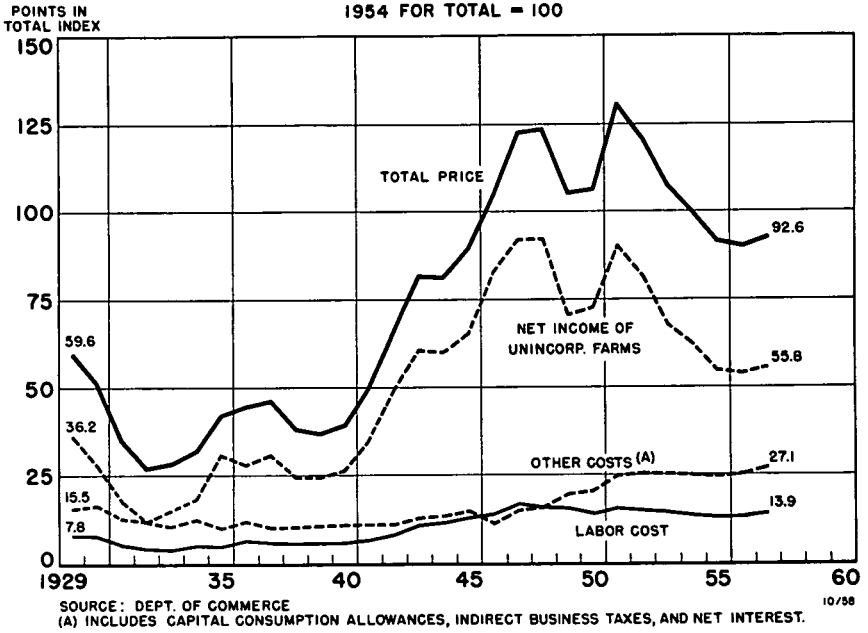
By contrast, the nonfarm chart shows that unit profits to owners of corporate and unincorporated businesses are a small part of the total price. Furthermore, unit costs were rising steadily for nonfarm production (including food processing and distribution) after 1951. There was not room for absorption of these increased costs out of profits without liquidation of many businesses and curtailment of production to levels consistent with demand at prices increased to reflect most of the rise in costs. Furthermore, demand for most nonfarm goods and services increased more than for farm products, thus tending to support higher prices.

(The material referred to follows:)

CHART IV

PRICES, COSTS, AND PROFITS PER UNIT OF PRODUCTION
(FARM PRODUCT)

1954 FOR TOTAL = 100



Prices, costs, and profits per unit of production (farm product)

| | Total price (index) (1954=100) | Points in total index | | |
|-----------|--------------------------------------|-----------------------|-----------------------------|--|
| | | Labor cost | Other costs ¹ | Net income of unincor- porated farms ² |
| 1929..... | 59.6 | 7.8 | 15.5 | 36.2 |
| 1930..... | 51.3 | 7.8 | 16.3 | 27.4 |
| 1931..... | 35.1 | 5.2 | 12.5 | 17.9 |
| 1932..... | 26.9 | 4.0 | 11.6 | 11.6 |
| 1933..... | 28.1 | 3.8 | 10.3 | 14.9 |
| 1934..... | 32.0 | 5.0 | 12.1 | 18.1 |
| 1935..... | 42.1 | 4.7 | 9.8 | 30.5 |
| 1936..... | 44.4 | 6.1 | 11.8 | 28.0 |
| 1937..... | 45.9 | 5.6 | 10.0 | 31.9 |
| 1938..... | 37.8 | 5.5 | 10.1 | 24.4 |
| 1939..... | 36.6 | 5.6 | 10.4 | 24.3 |
| 1940..... | 39.2 | 5.9 | 10.6 | 26.1 |
| 1941..... | 49.8 | 6.7 | 10.8 | 34.6 |
| 1942..... | 65.5 | 8.1 | 10.9 | 49.1 |
| 1943..... | 81.5 | 10.9 | 12.5 | 60.4 |
| 1944..... | 81.4 | 11.6 | 13.1 | 60.0 |
| 1945..... | 89.5 | 12.8 | 14.7 | 65.3 |
| 1946..... | 104.9 | 13.9 | 11.0 | 82.8 |
| 1947..... | 122.8 | 16.7 | 14.8 | 92.0 |
| 1948..... | 123.6 | 15.8 | 15.8 | 92.2 |
| 1949..... | 105.2 | 15.7 | 19.3 | 70.6 |
| 1950..... | 106.2 | 13.9 | 20.3 | 72.5 |
| 1951..... | 130.4 | 15.5 | 24.9 | 90.2 |
| 1952..... | 121.0 | 15.0 | 25.4 | 81.6 |
| 1953..... | 107.4 | 14.4 | 25.4 | 68.1 |
| 1954..... | 100.0 | 13.4 | 25.0 | 62.5 |
| 1955..... | 91.6 | 12.8 | 24.6 | 55.0 |
| 1956..... | 90.1 | 13.1 | 25.1 | 54.1 |
| 1957..... | 92.6 | 13.9 | 27.1 | 55.8 |

¹ Includes capital consumption allowances, indirect business taxes, and net interest. Does not include farm corporate profits after tax, profits taxes, and subsidies of Government enterprises to farms. Total costs and net farm income will differ from total price by the total of these excluded items.

² Excludes profits and losses from inventory revaluation.

Source: Indexes computed by the author from Department of Commerce data on farm income and product.

The CHAIRMAN. Senator, would you yield to me briefly for an observation along your line?

Senator O'MAHONEY. Yes.

The CHAIRMAN. Prices seem to go up and down in the last few years except one price—interest, the price charged for the use of money. I refer you to page 3 of the "Economic Indicators" for November 1958, and you will notice that in 1952 the part of the national income represented by net interest was \$7,100 million. That has been a consistent increase every month and every year since that time until the third quarter of 1958 when it is increased almost 100 percent or \$13,200 million.

On page 4 you will notice personal interest income that goes to make up the sources of personal income, and you will find there that the personal interest income in 1953 was \$12,100 million for the year 1952. It has increased consistently month by month and year by year, never lowering at any one time. The last quarter we have, October 1958, it has increased more than 60 percent to \$19,500 million. Evidently that enters into the farm problem because the farmer is not protected. He does not have any way to protect himself. As farm products move from the farmer to the consumer, and go through the many necessary middlemen, probably 15 or 20 involving transportation, finance, manufacturing, processing and different forms of middlemen, we will say—

and I insist that they are all necessary middlemen—the interest rate having gone up, each one of these middlemen will protect himself by taking into consideration his increased cost by reason of higher interest.

By the time the goods reach the consumer, the consumer has paid and paid, but the farmer has gotten less because being the only one unable to protect himself, that is taken out of his price. On the other hand let us take the case of an industrial product for instance, the things that are made of steel. From the ore mines in Minnesota to the ship that is loaded with the iron ore and comes down through the Great Lakes, and to the blast furnace, and is made into pig iron and then made into steel and fabricated into different products, and finally through transportation and distributors, all of whom are necessary, I insist, but probably 15 or 20 of them. When the product, let us say a tractor finally reaches the farmer, the increased interest rate has been added on every time. So the interest rates hit the farmer two ways. It is like the farmer down in my country said. He got along all right in the great depression until the Hoover "hard times" hit him at the same time. In this case he is hit at the same time with products coming to him because the interest has been added on and products leaving him going to the consumer, the interest is taken out of the price of his product. Don't you think that enters into it, too?

Senator O'MAHONEY. Of course it enters into it, but in raising these questions, I was not doing it in an argumentative sort of way, but to determine the answers of the panelists to two questions: First, have prices been rising, and has there been a dislocation of price rise in some instances, and secondly, is this evidence of the changing economy of which Mr. Fackler of the United States Chamber of Commerce has spoken, and is that changing economy good or bad? These are questions the answers to which must be found by the Congress if it tries to do anything realistically about the problem that is before us.

Mr. HENLE. If I may comment, I think you have posed the very crux of the problem. Looking at the figures here, we can ask, do the figures show us a situation about which we should be concerned? If we are concerned, what are the types of public policies which we can suggest to do something about?

Senator O'MAHONEY. Precisely.

Mr. HENLE. From my own point of view, and speaking personally—my individual point of view as an economist—I think the situation that is presented here on page 24 of "Economic Indicators" does not present an alarming situation. You pointed to the increase in prices from 1952 to 1958. For all commodities the index shows an increase from 111.6 to 119, the last figure on the table, for October. That is a slow but steady increase, as you pointed out. Yet, Senator, I think on the whole the United States economy is, if anything, to be commended for that type of price behavior. The increase there amounting to about 7.5 points over a 6-year period comes out to somewhere about 1 percent per year. I do not believe that would be considered excessive; certainly not by me, although I don't know about the other members of the panel.

There are problems of dislocation. There are problems of change. We in the AFL-CIO have been very concerned about some of the questions that Congressman Curtis raised. I would agree with his

remarks and also agree with the remarks that Mr. Fackler made about the importance of change to keep our economy going, to stimulate it, to make possible increased productivity.

At the same time, naturally, there are problems involved in the change. People have jobs. They don't like to change jobs. In many cases they are forced to change jobs. They may lose in terms of income as a result, but so far as the price picture that is portrayed here is concerned, I don't believe that it presents an alarming picture, Senator.

Mr. HITCHINGS. Senator, are you primarily concerned with the differential performance between farm prices so that by the time you get to the consumer you don't get your reduction? Is that your primary concern?

Senator O'MAHONEY. No. My concern is to find out what degree of agreement there is among the panelists that there is inflation. The representative of the AFL-CIO reaches the conclusion that while there has been an increase, it is not a dangerous increase, and apparently that would lead to the conclusion that we don't need to think about doing anything about it at all. I don't know, Mr. Henle, if that is what you really mean.

Mr. HENLE. There are serious problems that arise in terms of specific prices. That is what I tried to do in my paper. There are some items in the Consumer Price Index that over a 2-year period of time have jumped by 15 or 16 percent. These are not normally the items one thinks about when one thinks about inflation. There are some of Congressman Patman's problems, because one of the sharpest increases has been for mortgage interest payments. Some of the sharpest increases have been for medical care payments. Any attack on the problem of collective bargaining or even administered prices, I will say, is not going to solve the problem of what the hospital charges for a room or what Group Hospitalization charges for its insurance.

Senator O'MAHONEY. If you were to examine, Mr. Henle, the problem of the Department of Defense you would find that prices there have risen at a perfectly terrifying rate, according to the Secretary of Defense and his fiscal agents. A good part of that, perhaps most of it, is due to the fact that modern weapons are much more expensive than the weapons we used in World War II. But the result is that the money outgo from the Federal Government in defense, in farm supports, in the tax-exempt securities and the like, is steadily increasing. So that the Bureau of the Budget last September estimated that the cost of interest upon the national debt for fiscal 1959 would be \$7,578 million. Since that time the Treasury, in preparation for the due date on December 1 of some \$9,200 million worth of Federal securities, made exchanges and issued new notes and new bills, some for cash, some for exchange, which will increase the interest by at least \$100 million for fiscal 1959—\$7,678 million is the largest category of Government expenditure except national defense itself. All of this is placing a tremendous burden upon the Government to determine what should be done about the situation. I am trying to secure as best I may the basis of agreement among all of you gentlemen—I don't want to argue with any of you.

Mr. HENLE. Let me make my position clear. I think there is a very real problem about interest, and this is portrayed very sharply

in the points you made with regard to public debt. I think the American people also have a very real problem with regard to the price they pay for medical care which is the sharpest rising component in the entire "Consumer Price Index." I think there are problems concerning the administered price field. I think some of the larger corporations in this country have not adopted pricing policies which are in the best interests of the entire American people. But looking at our price record as a whole, taking the good with the bad, I don't think it is a serious record about which we should be alarmed. I think there are things that should be done, actions by the Federal Government and by private individuals and groups, and undoubtedly some by labor unions as well, to meet some of these particular pricing problems. I don't think in the aggregate, taking the good with the bad, the competitive industries with the noncompetitive, that we have an alarming situation that requires major changes in public policy.

The CHAIRMAN. Senator, may I elaborate on what you said concerning the amount paid annually for interest rates on the national debt? The figure I gave of the amount we are paying this year, between \$7.5 billion and \$8 billion, Senator, does not include interest payments that really bypass the national debt, like Commodity Credit and obligations like that. The amount paid this year on interest will be more than the total expenditures of our National Government for any one year preceding the second administration of President Franklin D. Roosevelt, except some deficit financing in 1918 amounting to \$12.7 billion and 1919 amounting to \$18 billion. The amount paid this year in interest is more than the total amount collected by the U.S. Government in taxes or the total income of the Government in any one year preceding 1942, during World War II. So it is an alarming figure.

Mr. WESTON. I would like to comment on that, if I may. I think these figures are impressive, but when one looks at their source, one realizes that at the outbreak of World War II the Federal debt was around \$48 billion, and when the war ended the Federal debt was around \$280 billion. So you had roughly \$230 billion of the increase that came about during World War II. This is the source of the bulk of that interest payment to which you are referring.

The Government has to compete in the capital markets for the use of capital and they ran up a debt increase of \$230 billion.

The CHAIRMAN. Might I interrupt you there—compete with the Federal Reserve which is supposed to represent the people's interest.

Mr. WESTON. That is another issue. The point I wanted to make was that while the interest figure looks large, pretty close to \$8 billion now on the Federal debt, what this amounts to is part payment for World War II. We hardly had any choice in the matter. It purchased the preservation of our freedom.

Senator O'MAHONEY. Professor Weston, you are overlooking a few basic facts there. It is true, of course, that when World War II ended the national debt was at a very great height. As I recall it, your figures are about correct.

Mr. WESTON. It was \$281 billion, but this was oversubscription on the last victory loan.

Senator O'MAHONEY. That was oversubscription. The last loan amounted to \$25 billion, and the President, as soon as that was sold

and the war was over, ordered that it be paid on the existing debt. Not a penny of that \$25 billion obtained by the Government through the victory loan was spent by the Government.

Mr. WESTON. The debt went down to about \$270 billion. I accept your correction. The amount should have been \$220 billion.

Senator O'MAHONEY. Ever since that time the debt has been increased in so-called times of peace. I say we are not living in times of peace. We are living in times of economic war, and modern war is economic war, even when it is a shooting war. It is an economic war now, and it is a very expensive war for the free governments of the world. That is something we must tend to. Don't you agree?

Mr. WESTON. Yes.

Senator O'MAHONEY. Nothing is to be gained by explaining away in details what the cause was. That is acknowledged. The cause was World War II, and the cause of major Government expenditures right now is the increasing expense of modern weapons. I was chairman of the Subcommittee on Defense Appropriations in 1951 and 1952 calendar years, and I know that the airplanes which we are buying now are immeasurably more expensive than the airplanes we were buying during World War II.

Mr. WESTON. I think there is danger that one will draw a wrong moral from this story. Even if one starts with the \$270 million figure, and goes to the present debt ceiling level of \$288 billion, the \$270 to \$288 billion represents at most a \$20 billion increase in the debt over a 10-year period of time, and we recognize this is associated with defense activity.

Then the question becomes, can we really afford the increased price of defense? My argument is that we can. With normal growth in our economy of something on the order of 4 percent, with a gross national product of roughly \$450 billion, this represents about a \$20 billion a year increase in gross national product. The Federal revenues get about 20 percent of the increase in gross national product. That is a \$4 billion increase in the capacity to spend each year. That is enough, it seems to me, to take care of the increased cost of defense and the increase in regular functions. I think it is remarkable that when you consider the cost of interest and the cost of defense, how little normal Government functions take as a portion of the total Federal budget.

Senator O'MAHONEY. May I interrupt you to ask you a question, pointing out first that the executive branch of the Government during this year, 1958, came to Congress twice to get a law passed to increase the permanent debt ceiling. The first request was made in January. The Congress passed a bill, not exactly the one which the Executive wanted, temporarily increasing the ceiling, and increasing, as I recall, the permanent ceiling also, but at a lower figure. That was not sufficient to meet the problem as the Executive looked at the problem. So in August of 1958, just a couple of months ago, the administration again asked for an increase. They asked for a permanent increase to \$288 billion. They did not get the permanent increase. They got an increase of the permanent ceiling, but they also got a temporary increase which added together makes the present ceiling of \$288 billion, as you recited. But yesterday, after a conference in the White House, Republican leaders of the Senate and the House expressed the opinion

to the newspaper reporters on the White House steps that the President's budget this year would hover around \$80 billion. That is what former Speaker Martin said, what Senator Bridges said, what Congressman Arends said; all said the budget would be about \$80 billion. The budget which the President sent to us in January 1958, this year, was less than \$74 billion. So here is testimony that Congress will be asked by the Executive next month to increase the expenditures of the Government by about \$6 billion. Do you think that is alarming or not alarming?

Mr. WESTON. No; not at all.

Senator O'MAHONEY. Or do you believe that by increasing the gross national product by a growth figure of 4.25 percent we can solve this problem?

Mr. WESTON. I think the points to be observed here are these. During this same period of time when the Federal debt at the end of the war to the present increased by about \$20 billion, total private debt, reading from page 170 of the President's last Economic Report, went from \$140 billion to \$436 billion. In other words, total private debt increased approximately by \$300 billion. I have never heard anyone talk about putting a ceiling on private debt or a ceiling on corporate debt during the same period of time.

Senator O'MAHONEY. You have not been reading all the articles I have been reading, articles which point out the terrific consumer debt which now exists in this country.

Mr. WESTON. Restricting ourselves to corporate debt, then, corporate debt increased by \$100 billion over this same period of time. It is natural that a growing enterprise handling increased activities will have a higher debt associated with it. The increase in the Federal debt associated with the increase in the responsibilities of Federal Government activities has been relatively small. The remarkable thing here is that the biggest part of the increase in the Federal debt has come about during the recent recession, fiscal 1959, with an estimated deficit of \$12 billion. We have not had a debt increase of that magnitude in years of good business activity when defense spending increased by much more than defense spending will have increased in fiscal 1959 compared to other years.

In other words, the increase in the Federal debt is not caused by the increase in defense spending. The increase in the Federal debt—the big increase taking place currently—is caused by the drop in revenues because the Federal Government has elected to attack the recession passively.

Senator O'MAHONEY. May I say to you, Professor Weston, that the testimony of Secretary Anderson before the Senate Committee on Finance was that the \$12 billion deficit was due to two factors. One, an increase of \$5 billion in Government spending, and second, a drop of \$7 billion in Government receipts.

Mr. Chairman, may I say I gladly accede to your request to take the Chair while you have to attend to a previous engagement. That in turn leads me to the conclusion, Mr. Reuss, that I have been allowing these panelists to take your time. I recognize you.

Representative REUSS. Thank you very much, Mr. Chairman, but won't you please proceed?

Senator O'MAHONEY. I think that we have gotten enough from this angle.

Representative REUSS. Mr. Chairman, I do want to return to the subject that particularly interested me; namely, the central subject raised by Mr. Fackler's paper, and commented on by Mr. Henle, having to do with the disparity in wages and labor costs between certain groups of industries. I would like to summarize what I have gotten out of the discussion so far and then put a specific question to you two gentlemen, and to anyone else in the panel who would like to comment.

It may well be that you both won't agree with everything I am going to say. It seems to me that there are certain so-called strong industries, of which steel and automobiles are repeatedly mentioned as members, where productivity has increased rather fast, where demand has been steady in part through governmental measures, where the structure of the industry is such that prices can be raised faster than you would think possible if the laws of supply and demand were the only governing factors, and where there are also strong labor unions. In these industries, wages appear in the last 10 years to have gone up farther and faster than wages in less strong industries, notably in the nondurable goods industries. Also in these industries prices have gone up a great deal higher and faster than in nondurable industries. The dilemma seems to be this: Where wages in these industries have gone up ahead of overall productivity—though perhaps not ahead of productivity in that particular strong industry and those wage increases spill over to the rest of the economy as stated by Mr. Fackler—and I tend to agree with him—this, then, causes overall total wages to increase faster than overall productivity and at a certain point, at least, contributes to inflation because you have more money being paid out than you have goods to answer the ensuing demand.

On the other hand, if this disequilibrium does not spill over—one has only to look at the position of the retail clerks testified to this morning to realize that the \$2.75 an hour in the steel and auto industries has not spilled over to the 90 cents per hour earned by retail clerks—you have an intolerable inequity, to use Mr. Fackler's phrase, but you have a factor which seems to me to make its contribution to the fact that neither the manpower nor the resources of this country are now fully employed.

One of the reasons I suggest is that a 90-cents-an-hour clerk has difficulty buying an automobile made by a \$2.75-an-hour auto worker. I suggest that one way out of the dilemma would be the setting up by statutory warrant some sort of an informal committee, the nature of which has been hinted at by panelist Lewis, made up of representatives of labor, including, if we were looking at steel and autos, steel and auto workers, representatives of managements, including, among others, representatives of these industries, plus a fair number of representatives of the public. Let this board or whatever you want to call it—it needs voluntary in its name as well as its constitution—sit down with these representatives and see if there cannot be hammered out in private or in public some policies which relate to this dilemma.

Specifically let congenial pressure be put on management to moderate their price increases. Let congenial pressure be put on the unions not only to moderate their wage demands, but also to marshal as much as possible of their request in the direction of such things as

profit-sharing plans which don't directly go into the wage picture. By doing that, I suggest you would tend to get either lessened price increases or—one may hope—price decreases in these important and somewhat sticky industrial sectors. You would narrow the disequilibrium between the wage picture in these industries and in weaker industries and to the extent that you did that you would avoid both the inflationary pressure that Mr. Fackler is worried about or at least potentially worried about due to the spillover and also the deflationary underemployment factor you get due to lack of sufficient purchasing power.

My question, then, which I will put first to Mr. Fackler, and then to Mr. Henle, and anybody else if time permits, is: What about this analysis and what about this proposed remedy? Are they good for the country or bad for the country?

Mr. FACKLER. Congressman REUSS, I think you overstate the case. I would take exception to some of your statements in posing the problem. It is not necessarily in a concentrated industry that wage pressures build up. This "spillover" phenomenon is not related to concentration. It could happen, and for all we know it does happen, just as well in a competitive industry where productivity is rising rapidly but somebody, workers on the spot, are able to preempt the productivity gains in the form of wage increases. I don't see how you could establish criteria for identifying wage patterns with this or that kind of industry, such as steel. I am not looking for particular culprits of this kind of thing. I don't think we know enough to say it is steel or autos or somebody else.

I am not very much impressed with the idea of wage-price surveillance or prenotification or voluntary restraints of the kind often mentioned. If the problem is real at all, I don't think that these proposals are going to be very effective in coping with it.

Representative REUSS. Passing that mechanism—I get the point you don't like that—would you be pleased or displeased if all by themselves labor in these industries, whatever they are, announced that because of the disequilibrium it was going to concentrate more on non-wage bargaining and management all by itself announced that it recognized there was a disequilibrium and in the public interest was going to concentrate on price reduction? Would this please you or displease you, if you read that?

Mr. FACKLER. I don't quite follow you.

Representative REUSS. If these policies were adopted by labor and management in these industries which you describe as strategically placed industries, would this please or displease you?

Mr. FACKLER. I am a little old fashioned about some of these things. I distrust, inherently, large aggregates of economic power. I would prefer to see us attack the business problem on an antimonopoly, antitrust basis—with whatever revisions we need in this area. Though we need not necessarily lump labor under the same legal restraints, we should examine the structure and economic power of labor unions and attack these as a separate problem. Given the proper market constraints we can let the competitive forces of the market work things out. I have much more confidence in this kind of approach than I do in these voluntary agreements or political decisions to do this or that.

Representative REUSS. I wanted to get past this hurdle with you, however. I said let us put to one side the mechanism used. My question to you is: Is the result I described a result which in your opinion would be for the good of the country or not?

Mr. FACKLER. As long as wages and prices are not tied to some sort of formula. I don't think you can use a national productivity formula in these things. It makes no sense at all in particular wage negotiations. Reverting to Mr. Henle's earlier point, I quite agree with him that the "spillover" may not spill over very much into particular sectors where there are other competitive forces at work in the opposite direction. I don't want to underestimate in any way the very strong competitive forces that work in particular situations to prevent "spillover" from occurring in this particular case or that particular case; textiles is probably a good example.

I would agree completely with him that wage increases should not necessarily be related to the productivity increases in per man-hour in a particular firm or industry. If people don't want to mine coal, I don't care if the price of mine labor, miners' wages, goes away up with no concurrent technological advance or no change in productivity. The scarcity of mine labor will be reflected in higher coal prices. You have three factors in every economic equation. The supply of different kinds of grades and skills of labor, the technological possibilities of obtaining output with various combinations of labor and capital inputs with various kinds of substitutions possible, and the demand conditions for product. You cannot get a determinate solution to the wage problem without taking all three factors into account. So if the supply of a particular kind of labor changes, I see no reason why those wages should not go up with no change in productivity in the particular case; or wages may go down with no change of productivity in a particular case. There is a tremendous amount of confusion on this score. What do we mean by productivity? The national average output per man-hour in no sense indicates productivity changes in an individual firm. Furthermore, in a particular firm the productivity may increase in such a way that there will be a reduction in the demand for labor—or at least substitution in the kinds of labor used. Congressman Curtis touched on this same point.

It may be that there will be a lot fewer people employed in a given industry after adjustments have been made—take the situation of the powerplant where there is now one operator and the work is all done by machinery—those people that were formerly employed should be moved out. Productivity increases may be laborsaving or labor-using. Prices of labor should go down in one case and up in another case. To try to gear wage determination in a particular industry or firm or collective bargaining situation to either a national formula or to some sort of industry formula just seems crazy to me. It is economic nonsense.

From page 116 (Commentaries) of Mr. Henle's paper on, I agree almost completely with what he says. Here he discusses these very problems and emphasizes the need for flexibility in the system.

Representative REUSS. Then the current policy of President Eisenhower and the Council of Economic Advisers, which, as I read it, uses just the one word "productivity," you would view as crazy?

Mr. FACKLER. It is misleading as can be. If they are referring to a national average, it is all well and good for discussing general stability conditions; but it gives no guidance to what wages or prices should be in a particular case. I don't see how you can transfer wage-price decisionmaking from the marketplace to a political board or the political sector, without creating a pretty chaotic situation—to say the least.

Representative REUSS. How is my time? I suspect it is not good.

Senator O'MAHONEY. You still have some time.

Representative REUSS. I did want to give Mr. Henle a chance. I wish you would concentrate your answer on the substantive phase of what I had to suggest rather than the procedure. The procedure was the idea of a labor management public forum which would use its good offices to produce certain policies in these industries that Mr. Fackler is talking about. Skip that, because I suspect from your other testimony that you don't like that idea. Address yourself to the substance. Would it not be good for the country, both from the standpoint of full employment and the avoidance of harmful inflation, if there were less of a disequilibrium between wages in various industries and is not one way of producing that happier equilibrium price reductions by managements in the strong industries and concentration on nonwage bargaining to a greater extent in these industries than in less favored and strong industries?

Mr. HENLE. Congressman, I certainly think you have concerned yourself with several real issues in discussing this question. I certainly agree with you, for example, that we need a broader exchange of views between the labor people and the management people directly involved in some of these critical industries on these issues. Part of that is wrapped up in your attitude on this question.

You suggested the possibility of a public board. I don't know that that would work out too well. There have been some suggestions actually from both sides of the table in recent months that perhaps there should be some type of forum where union people and management leaders could discuss these issues removed from the immediate problems of the bargaining table. I think this would create a better understanding of some of these economic questions and could lead to developments at the bargaining table that would be in the general interest.

I am not sure that I share your direct concern with this problem of disequilibrium in terms of wage rates and in terms of various sectors of the economy. However, we are concerned that in some cases wages are not responding to union and other efforts to provide workers with a decent living wage. One answer from our point of view is to raise the statutory minimum wage under the Fair Minimum Standards Act.

When you start examining what has been happening in textiles versus steel or auto versus telephone or something of that sort, it seems to me you are getting into very tricky business. This is a sort of swampy ground. One person's disequilibrium is another person's incentive. Some of these problems just have to work themselves out.

I was starting to look over some figures just by way of illustration here while you were talking. I find, for example, that in automobiles, which everyone considers as one of these tough areas where wages have

been going away out in front, that the wage increase in terms of hourly earnings of automobile workers from 1951 to 1958 is just about the same as the average for all manufacturing. As a matter of fact, it seems to be a little low if my figures are correct.

So I think we have to dig more deeply. There are problems of disequilibrium, but I would hate to have everyone saying in terms of a Government board or anyone else from up on high, this is wrong, this has to be changed. There might have been good market reasons, union reasons or labor market reasons, for the particular relationship which may appear to one person to be in disequilibrium, and to another person to be a problem that is in the process of ironing itself out.

Representative REUSS. Of course, the suggestion I made and which I wanted you to comment on less rather than more, the mechanical suggestion was not one for the Government or the board telling anyone the way it has to be. It was for a tripartite board to analyze the particular problem and make recommendations, perhaps private or perhaps public, of what would be in the public interest. However, I have trespassed, I am afraid, on my time.

Mr. FACKLER. May I make one more comment on your question. You are quite right in looking at the problem in this way. Some prices, particularly industrial prices where productivity is rising very rapidly (and in other sectors of rapid productivity improvement—agriculture, for that matter), should be going down if we are to improve the lot of retail clerks in real terms, if we are to improve teachers' salaries, if we are going to change some of these wage differentials and not have them stratified for all time henceforth. If some of the lower wage people are to be brought up, there must be sufficient market discipline to keep wage increases in rapidly rising productivity sectors down to less than the full or gross productivity increase, and so that the prices of these items can go down and allow other prices (and wages) to go up and, thereby, keep the general price level stable. If prices in rising productivity sectors never go down, then the other people never can come up in real terms.

Representative REUSS. The problem is that market discipline does not seem to be working in these areas.

Mr. FACKLER. I have been the devil's advocate on a particular point. I still would go back to what Professor Lewis said. Let us not exaggerate the problem. The cold fact is that on this wage push (spillover) versus money supply argument, there is no real way to get at the answers in an empirical sense. Basically the question is not one of theory but of empirical fact. There is a very lively controversy going on now in academic circles; and there is some research being done by academic people, notably at the University of Chicago and the Brookings Institution, on the question.

We need to find out in what circumstances the wage push is important and when it is not, if there is "spillover" or whether monetary factors always dominate, and so on. We don't know the answers on the basis of the fragmentary data we have, and our different analytical models may or may not fit the real facts. At least there is a mechanism by which inflationary wage "spillover" might occur. That is about as much as we can say.

Representative REUSS. Thank you, Mr. Chairman.
Senator O'MAHONEY. Mr. Curtis.

Representative CURTIS. Mr. Chairman, I am going to pose questions and then perhaps if the panel would supply any information or answers to them later, I would appreciate it.

I understand generalities best by digging into particulars. Of course, in a discussion which must deal with generalities, it is sometimes hard to get down to it. Therefore, I have thought in terms of recommendations for further studies that this committee might make, that might bring to light some of these problems. That is one of the reasons I had asked the questions in regard to possible studies of causes of unemployment.

I know that this committee did make studies previously. I think the last one was in 1950 or thereabouts. It seems to me that might be productive of something.

When Mr. Henle mentioned the fact that medical costs was one of the big rising costs, that suggests to me another area. By taking a particular area and studying the causes behind those costs might be helpful. I am satisfied that it will demonstrate quite clearly the thesis that I have, that when we do have growth and advancement, we are going to have increased costs to take care of it. Those costs are not inflationary at all. It is just the fact that it is something new.

In the area of hospital costs I think we are sure of one thing. I think most hospital boards are composed of people who look beyond their noses, and labor itself has gone into the business of hospitalization and they are beginning to realize that these are real costs. Certainly the results of modern hospitalization are much superior to anything before.

I am a little bit familiar with those costs from another angle, being on the board of trustees of a college where we are contemplating setting up a medical school in a little better way. I know that these things are very real. Possibly using that area as a model, we might learn something about what happens as we do advance in new products, new techniques, and so on. It would have a practical value because we certainly have this problem in our social security studies on the Ways and Means Committee. I have tried to get some studies going in that area.

The third area I think that it might be well if we investigated is this: I was very much impressed a couple of years ago when I by chance sat in on a lecture by one of these industry advisory groups, advising on the problems of marketing new products, and how some of the larger concerns went about their decision as to whether to spend money in research and development in an area and studied that process right on through to the point of actually marketing it. I suspect if our committee went into that kind of technique, studying how new products are marketed, whether it is a large company doing it consciously through planning to spend so much on research and development, or whether it comes through the small business sector of our society, I think we might learn a great deal.

I merely pose those as suggestions, because if the panel individually has some suggestions of areas that they think this committee might study which we could use as a model if you please, we might throw light on this general area that we are trying to reach conclusions on.

Mr. SELIGMAN. Mr. Curtis, if I may broaden your suggestions for further study somewhat, I am particularly concerned, representing

a particular organization in the AFL-CIO, the service and trades area, with the fact that there is really a very small body of factual, empirical information concerning this growing and important sector of the economy.

As our economy becomes more complex, as it grows, as we are concerned more and more with growing productivity and with the problem of inflation, we find a larger proportion of the labor force entering into the area described as the tertiary industries, the area of services and trade. We now have somewhere between 12 million and 16 million persons in the labor force involved in this sector of the economy. Every time we go to a Government agency and ask them for information about some aspects of price change or some aspect of productivity change for this sector of the economy, we come against a blank wall. It seems to me that all the empirical data we have, all the conversation and all the discussion we hold with respect to changing productivity and changes in prices concern themselves with the industrial and transportation sector of the economy. There is very little that we discover about the service and trades industries. Yet we have here an ever-increasing portion of the economy, a part of the economy which grows in significance and importance. I, for one, would urge the committee to engage in studies, not only with respect to the area that you have outlined, and they are important, but with regard to prices and productivity for the tertiary sector of the economy, and that itself would incorporate these particular problems you have just outlined.

Representative CURTIS. I am happy for your suggestion. Incidentally, you will find a ready advocate in me along those lines. One of my problems on the small business tax bill I proposed last year was to point out to my colleagues that 80 percent of small business was in the distributive and service fields. Everyone kept thinking in terms of manufacturing process which is only about 20 percent.

I might add I am happy to think that our advancements in the distributive area are equally miraculous to our advancements in our mass production, and without the two we would not go far. Too often the service and distribution becomes the whipping boy. Yet we have seen the largest increases in our price indices in the area of services. I would welcome any suggestions from the panel as to areas of further study for this committee so that maybe we can do a

little better job if we get away from the broad generalities and possibly into particulars.

Now, Mr. Chairman, if I may conclude with just one observation. The cold war came up yesterday and it came up today again. I just would not like any presumption from silence on my part that I agreed with statements of the need for emergency action. In my judgment, if it is a cold war, we are talking about something over a long period of time. I believe that our society today is perfectly capable of solving that calmly and collectedly just as previous generations have solved their problems. I worry very much when people try to whip up a great concern.

The one thing I worry about is ignorance. One place I am afraid we are allowing ourselves to remain ignorant is on Russia itself. It makes a great whipping boy, a great scarecrow to put up, but I think it is time we did a little more analysis of just what we are up against. This committee has done some study in that area. In my judgment we have something of real concern, but as far as I am concerned; from the analysis I have made of the thing, we are coping with it quite adequately, and if we keep our shirts on, we will be able to handle the thing, very, very well. In fact, I think we are doing so.

One thing that does concern me would be to ride off in all directions that sometimes our military establishment would have us do. I would simply get that on the record because I was afraid that silence might indicate consent or agreement.

Senator O'MAHONEY. I am tempted, Mr. Curtis, to insert in the record the speech that Allen Dulles, head of the Central Intelligence Agency, made to the United States Chamber of Commerce last April.

Representative CURTIS. I am familiar with the speech.

Senator O'MAHONEY. I have no doubt your are. I think there are a lot of people who are not familiar with the speech.

Representative CURTIS. I would prefer to have people read this committee's own study of Russia's economic growth which was an analytical study. I think that should be brought up to date. I am afraid that does not give a basis for Mr. Allen Dulles' speech.

Senator O'MAHONEY. Mr. Knowles, do you have some material to put in the record?

Mr. KNOWLES. Yes. By request of Senator Watkins who could not be here this morning, I ask unanimous consent that three articles by Prof. Jules Bachman be entered in the record.

Senator O'MAHONEY. Without objection, it is so ordered.

(The articles referred to follow :)

I. ADMINISTERED PRICES: THEIR NATURE AND MEANING

By JULES BACKMAN

UNTIL the early 1930's most economists presented their analyses of pricing within the simple framework of competitive (market) prices and monopoly prices. However, the increasing evidence that there was a wide gap between price theory and price practice resulted in a considerable amount of dissatisfaction with classical theory. The development of the theory of imperfect competition and the theory of monopolistic competition represented efforts to bridge the gap.¹ (See Appendix A for definitions.)

At the same time, the persistent Great Depression stimulated a search for its causes. To a small number of economists, the behavior of prices provided a major explanation for the continuing depression. Inflexible prices, rigid prices, insensitive prices—these were a few of the terms which were used to describe the behavior of certain prices which had failed to decline substantially in the depression years. Why did these prices fail to respond to depression influences as would be expected under market price theory? One reason was found in the method by which they were determined. Instead of being set in the auction type of market assumed for market prices in theory, many prices were set by company officials. It was in this connection that a new term, administered prices, was coined.

The first use of the term, "administered price," appears to have been in a special study prepared by Gardiner C. Means when he was Economic Adviser on Finance to the Secretary of Agriculture. An extensive analysis of the nature and effects of administered prices was contained in his pamphlet, "Industrial Prices and Their Relative Inflexibility." According to Dr. Means:

"An administered price . . . is a price which is set by administrative action and

held constant for a period of time. We have an administered price when a company maintains a posted price at which it will make sales or simply has its own prices at which buyers may purchase or not as they wish."²

He repeated substantially the same definition in his testimony before the Senate Subcommittee on Antitrust and Monopoly on July 12, 1957. This seems like a clear-cut definition which describes the price-making process in major sectors of the economy. Similar definitions have been used by the Committee on Price Determination of the National Bureau of Economic Research, E. G. Nourse, H. B. Drury, Oswald Knauth, and other students.³ (See Appendix A.)

On the other hand, some writers have used the term to describe a form of price behavior, usually one which they do not approve. Such writers tend to emphasize price behavior instead of price making. Some of the public discussion of administered prices implies or states that this is a method of pricing peculiar to big business or to large industries in

¹ E. H. Chamberlin, *The Theory of Monopolistic Competition*, Harvard University Press, Cambridge, Mass., 1933; Joan Robinson, *The Economics of Imperfect Competition*, Macmillan and Co., Ltd., London, 1933; Arthur R. Burns, *The Decline of Competition*, McGraw Hill Book Co., New York, 1936.

² Gardiner C. Means, "Industrial Prices and Their Relative Inflexibility," *Senate Document No. 13*, Washington, D. C., January 17, 1935, p. 1.

³ Committee on Price Determination, *Cost Behavior and Price Policy*, National Bureau of Economic Research, New York, 1943, pp. 273-274; Edwin G. Nourse and Horace B. Drury, *Industrial Price Policies and Economic Progress*, The Institute of Economics of The Brookings Institution, Publication No. 76, Washington, D. C., 1938, p. 9; Richard H. Leftwich, *The Price System and Resource Allocation*, Rinehart & Company, Inc., New York, 1955, p. 340; Oswald Knauth, *Managerial Enterprise, Its Growth and Methods of Operation*, first edition, W. W. Norton & Co., Inc., New York, 1948, p. 106; Myron H. Umbreit, Elgin F. Hunt, Charles V. Kinter, *Modern Economic Problems*, first edition, McGraw-Hill Book Company, Inc., New York, 1950, p. 346.

which production is concentrated in a relatively small number of firms.¹

Thus, Senator Estes Kefauver has stated that:

"Administered price industries . . . [are] those which because of their power have control over prices not affected by normal competitive forces. Examples are steel, newsprint, many types of food, automobiles, and farm machinery."²

According to John M. Blair:

"Most inflexible prices are inflexible because they are in one way or another determined by administrative control . . . We must study the phenomenon of price-setting by *corporate monopoly*, realizing in so doing that the larger is the percentage of our prices which are fixed by corporate monopoly as against the forces of competition, the higher will our price level probably tend to be, and the smaller will be the chances for any marked increase in real labor income to take place."³ (Italics added.)

These are fairly typical illustrations of the manner in which the term was used during the TNEC investigation just prior to World War II and in the recent attempts to pinpoint the cause of inflation in the postwar period.

The use of the term as an explicit or implied condemnation of pricing practice has created much of the confusion surrounding it. Dr. Jesse Markham appropriately has referred to the administered price as "that often discussed but as yet rather poorly defined economic virus."⁴ Similarly, Professor Edward S. Mason has noted that the term administered price "is neither a clear-cut nor a useful concept."⁵

Administered Prices: Alternative Terms

Because of this confusion in meaning, economists have not agreed that the term ad-

ministered prices is the most satisfactory one to describe this type of price making. A number of alternative terms have been proposed including the following:

1. *Quoted Prices.* Professor J. M. Clark prefers this term because administered price "carries implications of some degree of discretionary control. . . ."⁶

2. *Price Policies.* Professor Dudley F. Pegrum suggests that the term administered prices was too closely identified with inflexible prices and the latter was attributable "to the high degree of industrial concentration." Since "Subsequent analysis has failed to substantiate either contention . . . it seems wise to discard it [administered price] and use the much more inclusive and descriptive term 'price policies.'"⁷

3. *Policy Influenced Prices.* Saul Nelson and Walter G. Keim have emphasized that administered price has been used to describe two concepts: the process of price making and the behavior of prices "importantly influenced by business policy decisions. . . ." Since the use of the same term for two different concepts creates "confusion," they preferred the term policy influenced prices to describe the behavior of these prices.⁸

¹ Testimony of Nat Weinberg before the Joint Economic Committee, *Economic Report of the President, January, 1957*, Washington, D. C., 1957, p. 311; Persia Campbell, *The Consumer Interest; A Study in Consumer Economics*, Harper and Brothers, New York, 1949, p. 536; Charles H. Hession, S. M. Miller, Curwen Stoddart, *The Dynamics of the American Economy*, Alfred A. Knopf, New York, 1956, p. 166.

² Senator Estes Kefauver's Speech before Automobile Wholesalers Association of Tennessee, April 8, 1957.

³ John M. Blair, *Seeds of Destruction*, Covici, Friede, New York, 1938, pp. 90, 91.

⁴ Jesse W. Markham, *Competition In The Rayon Industry*, Harvard University Press, Cambridge, Mass., 1952, p. 3.

⁵ Edward S. Mason, *Economic Concentration and the Monopoly Problem*, Harvard University Press, Cambridge, Mass., 1957, p. 62.

⁶ J. M. Clark, "Toward A Concept of Workable Competition," *The American Economic Review*, June 1940, p. 244.

⁷ Dudley F. Pegrum, *The Regulation of Industry*, Richard D. Irwin, Chicago, Ill., 1949, p. 103.

⁸ Saul Nelson and Walter G. Keim, "Price Behavior and Business Policy," *Monograph No. 1*, Temporary National Economic Committee, Washington, D. C., 1940, p. 15.

4. *Internally Regulated Prices.* H. L. McCracken has suggested that a good classification of prices would be:

- (a) governmentally regulated prices
- (b) *internally regulated prices*
- (c) freely competitive, nonregulated prices.¹

While Professor McCracken made no specific reference to administered prices, his category "internally regulated prices" appears to cover that type of pricing.

5. *Managed Industrial Prices.* This term was used by the Temporary National Economic Committee (TNEC) in its final report.²

6. *Producer Price Jurisdiction.* Dennison and Galbraith conclude: "... where the output of a producer is large enough to have a bearing on the price of the product some measure of individual producer price influence must exist ... some degree of jurisdiction over price by producers is all but universal."³

7. *Administered Resources.* Dr. E. G. Nourse suggested in his testimony of July 9, 1957 that:

"In a sense, the expression 'administered prices' is a misnomer or carries a faulty emphasis. To speak of '*administered resources*' might better point the issue. It would focus attention on the fact that giant corporations are making administrative decisions that activate or withhold the use of the economy's capital plant or funds and that massive labor unions set 'withholding prices' on large and strategic blocks of the nation's labor supply. Let us visualize the impact of this centralized private administration of resources in a large and highly strategic area in our industrial system." (Italics added.)

These alternative terms are designed to describe the price making process. However, several are too limited in their coverage to

cover all non-market prices. This would seem particularly true for terms like managed industrial prices and *producer price jurisdiction*. The term, quoted price, is not too valuable since it has come to have a specialized meaning which is much narrower than required for non-market prices. Probably the most useful term remains administered prices—if it is confined to a description of the price making process and is not used to describe price behavior.

Administered Prices and Market Prices

In terms of their behavior as well as the nature of the markets in which they are set, several differences may be noted between market prices and administered prices. Market prices fluctuate more frequently under the impact of changing economic pressures. On the great commodity exchanges, these changes may take place every few minutes. In contrast, when administered prices are set, they may remain unchanged for substantial periods of time. When changes are made in administered prices, they usually take the form of step-like arrangements rather than the erratic movements found for market prices. The record of price changes for such products as rayon, bricks, potash salts, refrigerators, steel, automobiles, and many retail prices illustrates this tendency. Usually an accumulation of pressures is necessary before the administered price is changed.

The characteristics of a product determine whether its price will be administered. Nelson and Keim have pointed out:

¹ *The American Economic Review, Supplement*, March 1936, pp. 66, 67.

² "Final Report and Recommendations of the Temporary National Economic Committee," *Senate Document No. 35*, Washington, D. C., 1941, pp. 13, 14.

³ H. S. Dennison and J. K. Galbraith, *Modern Competition and Business Policy*, Oxford University Press, New York, 1938, pp. 25, 33.

"To some extent 'market' prices on the one hand, and 'administered' prices on the other, *relate to different kinds of commodities*. The former are typical of raw materials and particularly of agricultural raw materials, while the latter are commonly associated with manufactured products. It has long been observed that the price of raw materials tends to fluctuate somewhat more widely than is true of manufactured products."¹ (Italics added.)

Whether prices are determined in markets or by administrative action, they must perform two functions: a rationing function and a stimulating function. The level of prices must be such that available supplies will be divided among those who desire the product most intensely and who have the purchasing power required. The prices must be high enough to cut off the demand of the least necessitous bidders and low enough to dispose of the available supplies. This may be called the rationing function of price. Similarly, the level of prices helps to determine the availability and the flow of supplies to the market. This may be called the stimulating function of price. Both market prices and administered prices perform these functions. However, the responsiveness of price to changes in supply, costs, and demand will differ. Usually, market prices are more immediately responsive while administered prices respond more slowly.

Dr. J. K. Galbraith pointed out in his July 11, 1957 testimony before the Senate Subcommittee on Antitrust and Monopoly:

"In the competitive market demand immediately pulls up prices, or pulls them down. In the administered market there must be a decision to change prices. Demand will often be ahead of the decision to adapt to it. Moreover, without going into undue detail, there will frequently be a difference between short and long-run price strategy which makes it ap-

pear unwise to take full advantage of the current market.

"Thus, if demand is strong and the industry is operating at or near capacity, a very large price and revenue increase may be possible. But there is also the danger that such an increase may bring new wage demands, or that it may attract new capacity, or there may be some fear of an adverse public reaction. Therefore, the industry keeps some of its opportunity for higher prices and added revenue in reserve as it were.

"It follows from the foregoing that at any time when demand has been high and generally rising there is likely in the administered price sector to be an unused opportunity for gain. Prices and profits could be higher than they are."

When changes in cost or changes in demand take place for such products, it is not infrequent that adjustments are reflected in non-price factors. The expansion and contraction in the size of the five cent chocolate bar over the past two decades furnish a good illustration. Similarly, even though a price line remains unchanged, quality may be improved or deteriorated as costs change (apparel is a good illustration).

It is often a characteristic of the products for which prices are set by administrative action that there are fewer buyers and/or sellers than are found in the perfectly competitive markets. (See Appendix A.) Because of the type of market or business organization, the administered price is the only feasible one. Thus, retail prices by their nature tend to change less frequently and less violently and to be set by the decision of retailers. However, in some instances, even these prices fluctuate frequently and sharply, particularly for perishable foods. In any event, most businesses would find it difficult to change prices on a daily or weekly basis.

¹ Nelson and Keim, *op. cit.*, p. 34.

Period for Which Price Is Unchanged Not Meaningful Characteristic of Administered Prices

Sometimes emphasis is given to the fact that a price is set for a period of time as evidence that it is an administered price. Thus, Gardiner C. Means stated an administered price is one which is "held constant for a *period of time*."¹ Rufus S. Tucker noted that "The term 'administered' price has been invented to apply to prices which are kept rigid for an *appreciable period of time* . . ."² Alfred C. Neal, in his study, concluded that "It becomes obvious at once that not all prices which are 'set' by a person, company, or group are administered prices, since only those which are set and held constant for *shorter or longer periods* are administered."³

For how long a period must a price be set before it is considered to be administered? How long is a "shorter or longer period" of time? Or an "appreciable period of time?" Not much light is shed upon this problem in the available literature. Does it mean a price maintained for a day, a week, a month, a year? Gardiner Means referred to items which "averaged less than three changes a year" and concluded that "These items represent a type of price essentially different in its effects from the flexible market price on which the policy of *laissez-faire* has been founded."⁴ This standard suggests one change in prices on the average of every four months.

Actually, if a price were set by administrative action and kept unchanged for a few hours during a period when market forces would normally cause prices to fluctuate, it would be different from a "flexible market price." This is well illustrated by prices on the New York Stock Exchange. Normally, the price of an active issue will fluctuate many times during the course of a trading day. To fix the price of a stock every hour on

the hour would mean a substitution of administrative pricing for market pricing and would change the nature of the present system of market price determination.

At the other extreme, we find many small items in a drug store, hardware store or stationery store for which prices may not change over a period of months and sometimes for years. These would be and are the most rigid and inflexible administered prices. Yet the prices are determined by small retailers and often on products which are produced by small firms in industries in which there is little concentration of control of output. Products controlled under "fair trade" or resale price maintenance acts also are in this category.

These illustrations suggest that there is no meaningful time period which can be used to delineate so-called administered prices from market prices. The only significant basis for distinction must be the establishment of prices by administrative action rather than in an auction market. The length of time for which a price is maintained may help determine behavior patterns among administered prices but it cannot be used to determine whether it is an administered price. When a price is established by a company and the company offers to meet all demands (within its capacity to do so) at that price, it is administered. This is so whether the company sets the price for one week or for four months. In other words, the duration of the period for which the price is set does not determine whether it is an administered price or a market price. That is determined by the process of price making.

¹ "Senate Document No. 13," *op. cit.*, p. 1.

² Rufus S. Tucker "Reasons for Price Rigidity," *The American Economic Review*, March 1938, p. 41.

³ Alfred C. Neal, *Industrial Concentration and Price Inflexibility*, American Council on Public Affairs, Washington, D. C., 1942, p. 25.

⁴ "Senate Document No. 13," *op. cit.*, pp. 2-3.

The Term Administered Prices Often Has Been Misused

It is important to keep in mind what the term administered prices is *not* designed to describe. Some persons have used the term loosely as being synonymous with monopoly prices or big business prices or inflexible prices.

Administered Prices Are Not Monopoly Prices

Stanley Ruttenberg, economist of the AFL-CIO, has charged:

"... in our economy, where we have a very high degree of economic concentration in our basic industries, much of the competitive spirit is nonexistent. Prices are administered through the monopolies and oligarchies."¹

Clearly, such opinions place a very narrow construction on the term administered prices.

Gardiner Means was very explicit that such pricing was not a monopolistic device. He noted that:

"Administered prices should not be confused with monopoly. The presence of administered prices does not indicate the presence of monopoly nor do market prices indicate the absence of monopoly."²

"If administered prices are present in a major part of our economy and since *they exist in a great many areas which are not monopolized but in which there is active competition between a few units*, it is clear that they do not necessarily reflect monopoly conditions but something more wide-spread—namely, the reduction in the number of competing units in many industries."³ (Italics added.)

Nelson and Keim also noted that the administrative control over these prices "is not necessarily synonymous with monopoly power in the sense implied in the antitrust

laws . . . there is no necessary relation between price rigidity and monopoly, if 'monopoly' is used to denote collusion or coercive devices for restraining competition."⁴

According to Alfred C. Neal, "... although some control over price is necessary if there is an administered price, there is no implication of monopoly about an administered price."⁵

Similarly, Dr. E. G. Nourse in his July 9, 1957 testimony stated that an administered price "... is monopolistic in the sense that one has an area of power, of discretion and power. It is not monopoly. Monopolistic means that it has some power over the making of price."

Clearly, Dr. Means and others have recognized that administered prices are not inconsistent with "active competition." As is evident in many sectors of the economy, administered price industries may be characterized by vigorous competition. The appliance industry provides an outstanding illustration.

Frequently the question of price administration is confused with the number of competitors within an industry. Thus, in connection with the experience of the past two years, Dr. John Blair referred to "the difference between price behavior [in] what have been referred to as administered price industries and contrasted to market price industries, in more highly competitive fields. In the latter, that is, in industries such as agriculture, the textile industry, and lumber. . . ."⁶

The textile and lumber industries are characterized by large numbers of producers and

¹ Stanley H. Ruttenberg, "From the Point of View of Labor," *The Social Responsibility of Management*, New York University School of Commerce, Accounts, and Finance, New York, 1950, p. 43.

² "Senate Document No. 13," *op. cit.*, p. 1.

³ "Senate Document No. 13," *op. cit.*, p. 27; see also "Notes on Inflexible Prices," *The American Economic Review*, Supplement, March 1936, p. 34.

⁴ Nelson and Keim, *op. cit.*, pp. 15, 32.

⁵ Neal, *op. cit.*, p. 25.

⁶ Hearings before the Senate Subcommittee on Antitrust and Monopoly, July 16, 1957.

hence relatively low levels of concentration. Undoubtedly, this situation affects the nature of competition in those industries. Nevertheless, those prices are administered, not market determined. Textile producers set a price and maintain it for varying periods of time. Many types of lumber are sold on basing point or zone systems of pricing. These prices may change frequently or be responsive to pressures for advance or decline. Nevertheless, these responses are within the framework of price administration. They provide evidence that administered prices do have differing patterns of behavior.

Price administration as compared with market price determination is one basis for comparison. Fewness of sellers or large numbers of sellers is another basis. The two bases should not be confused.

Administered Prices Are Not Confined to Big Business

Actually, almost all prices in our economy are set by administrative action. This is true for the giant automobile industry and the smallest retail store. The most important exceptions are the prices of many farm products

on the commodity exchanges and in the produce markets and the prices of securities.

Table 1 shows the weights for various products included in the Bureau of Labor Statistics wholesale price index. A review of the components of this index shows that relatively few products are market price determined. Among the prices which may be in this category are the following:

| Group or Subgroup | Relative Weight in WPI (per cent) |
|------------------------------------|-----------------------------------|
| Farm products, except milk | 9.4 |
| Manufactured animal feed | 1.3 |
| Hides and skins | .8 |
| Crude rubber | .4 |
| Waste paper | .1 |
| Total | 12.0 |

Thus, about 12.0 per cent of the wholesale price index appears to be in the market price category. And even this proportion is probably an overstatement. For example, some farm products are sold through cooperatives and are differentiated by brand names. Sun-kist oranges and other branded fruits come to mind in this connection. An inspection of Table 1 will indicate the predominantly administered nature of wholesale pricing.

TABLE 1
Relative Weights of Groups and Subgroups in Wholesale Price Index, 1954*

| Group and Subgroup | Relative Weights | Group and Subgroup | Relative Weights |
|--|------------------|---|------------------|
| All commodities | 100.000 | Canned, frozen, fruits, vegetables | .994 |
| Farm products | 10.842 | Sugar and confectionery | 1.358 |
| Fresh, dried, fruits, vegetables | .971 | Packaged beverage materials | .793 |
| Grains | 1.693 | Fats and oils, edible | .883 |
| Livestock and live poultry | 3.130 | Other processed foods | .592 |
| Plant and animal fibers | 1.234 | Textile products and apparel | 8.302 |
| Fluid milk | 1.465 | Cotton products | 2.091 |
| Eggs | .472 | Wool products | .867 |
| Hay, hayseeds, oilseeds | .679 | Synthetic textiles | 1.204 |
| Other farm products | 1.198 | Silk products | .043 |
| Processed foods | 13.747 | Apparel | 3.951 |
| Cereal and bakery products | 2.724 | Other textile products | .146 |
| Meats, poultry, fish | 3.579 | Hides, skins, leather, and products | 1.409 |
| Dairy products and ice cream | 2.824 | | |

TABLE 1 (Continued)

| Group and Subgroup | Relative Weights | Group and Subgroup | Relative Weights |
|---|------------------|--|------------------|
| Hides and skins | .079 | Agricultural machinery and equip- ment | .919 |
| Leather | .274 | Construction machinery and equip- ment | .574 |
| Footwear | .804 | Metalworking machinery and equip- ment | 1.704 |
| Other leather products | .252 | General purpose machinery and equipment | 2.197 |
| Fuel, power, and lighting materials .. | <u>9.019</u> | Miscellaneous machinery | 1.229 |
| Coal | .744 | Electrical machinery and equip- ment | 4.713 |
| Coke | .099 | Motor vehicles | 5.734 |
| Gas | .977 | Furniture and household durables ... | <u>4.143</u> |
| Electricity | 2.375 | Household furniture | .928 |
| Petroleum and products | 4.824 | Commercial furniture | .298 |
| Chemicals and allied products | <u>6.537</u> | Floor coverings | .352 |
| Industrial chemicals | 2.439 | Household appliances | 1.112 |
| Paint and paint materials | .724 | Radio and television receivers ... | .577 |
| Drugs and pharmaceuticals | .734 | Other household durable goods | .876 |
| Fats and oils, inedible | .177 | Nonmetallic minerals—structural ... | <u>2.075</u> |
| Mixed fertilizer | .273 | Flat glass | .240 |
| Fertilizer materials | .231 | Concrete ingredients | .691 |
| Other chemicals and allied products .. | 1.959 | Concrete products | .339 |
| Rubber and rubber products | <u>1.753</u> | Structural clay products | .318 |
| Crude rubber | .401 | Gypsum products | .104 |
| Tires and tubes | .694 | Prepared asphalt roofing | .186 |
| Other rubber products | .658 | Other nonmetallic minerals | .197 |
| Lumber and wood products | <u>2.657</u> | Tobacco manufactures, bottled bever- ages | <u>2.396</u> |
| Lumber | 2.055 | Cigarettes | .635 |
| Millwork | .382 | Cigars | .132 |
| Plywood | .220 | Other tobacco manufactures | .055 |
| Pulp, paper, and allied products | <u>3.727</u> | Alcoholic beverages | 1.126 |
| Woodpulp | .551 | Nonalcoholic beverages | .448 |
| Wastepaper | .048 | Miscellaneous products | <u>2.753</u> |
| Paper | .938 | Toys, sporting goods, and small arms | .538 |
| Paperboard | .288 | Manufactured animal feeds | 1.301 |
| Converted paper and board products .. | 1.830 | Notions and accessories | .110 |
| Building paper and board | .072 | Jewelry, watches, photographic equipment | .525 |
| Metals and metal products | <u>13.565</u> | Other miscellaneous | .284 |
| Iron and steel | 5.844 | | |
| Nonferrous metals | 2.909 | | |
| Metal containers | .501 | | |
| Hardware | .528 | | |
| Plumbing equipment | .227 | | |
| Heating equipment | .363 | | |
| Fabricated structural products | 1.387 | | |
| Fabricated nonstructural products | 1.806 | | |
| Machinery and motive products | <u>17.070</u> | | |

* Based on 1952-53 weight diagram.

Source: U. S. Department of Labor, Bureau of Labor Statistics, *Relative Importance of Individual Commodities, December 1954*, issued August 1955, pp. 1-20.

All retail prices by their nature are administered. Thus, it seems clear that market price determination as postulated in economic theory is in operation in an extremely small proportion of the economy.

In fact, Gardiner Means has recognized that, "Most of the prices you come in contact with every day are administered—the prices in the Senate restaurant, at your barber shop, and in your local stores, the prices of steel

and automobiles at wholesale. In fact, most industrial prices are administered prices and so are a large portion of retail prices. Most wage rates would also be classed as a type of administered price . . . but . . . when you have the small enterprise, the importance of administration for the economy as a whole may be very much less than when you have a big enterprise."¹ Professor Richard Ruggles also testified that all prices, except possibly for agricultural products, are administered.²

Means also has recognized that prices may be administered by government. "Such administered prices may be set by act of Congress as in the case of postal rates; they may be set through a process of regulation in which utility enterprises, regulating commissions, and the courts all combine in a complex process of rate making."³

However, in a study published by the U. S. National Resources Committee in 1939, Mr. Means asserted that:

*"Only where the producer is large in relation to the market can he administer the prices of his product."*⁴ (Italics added.)

Clearly, this statement ignores the fact that many small independent producers use trademarks and brand names to differentiate their product and hence to administer prices. Similarly, in very highly competitive fields, which have many small producers, (for example, apparel and shoes), price lines have been established by habit and custom and all producers sell at those price lines. In these areas, the producer is not large in relation to his market and yet he is administering price.

In fact, every price charged in the local drug store or local bakery, or local stationery store, or local shoe store is set by administrative action. Prices charged by apparel manufacturers, in that highly competitive industry, are set by administrative action. And the same situation prevails throughout the length

and breadth of our economy. It is evident that the "administered price industries" actually embrace practically every industry and that the term does not describe the pricing process in big business alone.

Administered Prices Are Not Identical with Inflexible Prices

Although Gardiner C. Means described administered prices as those resulting from administrative action, he identified the prices that fall into this category by checking the number of times they were changed over a period of eight years. He described those which changed relatively infrequently as inflexible prices. He then contrasted what he called "flexible market prices and inflexible administered prices."⁵ In other words, he quickly moved from administered pricing as a method of price determination to pricing as a form of behavior.

The effort to identify administered prices solely within this framework places a limited construction on the term. An examination of the changes in prices over time will show that many prices which are set by administrative action show significant changes. Among the administered prices which were flexible, that is declined as much or more than the general price level, in the 1929-1933 decline were canned peaches, menthol, hosiery, crude petroleum, copper wire, rosin, gasoline, oleomargarine, canned corn, tartaric acid, distilled oleic acid, canned salmon, roofing slate

¹ Testimony of July 12, 1957 before the Senate Subcommittee on Antitrust and Monopoly.

² *Ibid*, July 13, 1957.

³ Gardiner C. Means, "Basic Structural Characteristics and the Problem of Full Employment," *The Structure of the American Economy*, Part II, National Resources Planning Board, Washington, June, 1940, p. 8.

⁴ National Resources Committee, *The Structure of the American Economy*, Part I. Basic Characteristics, A Report prepared under direction of Gardiner C. Means, U. S. Government Printing Office, Washington, June 1939, p. 110.

⁵ "Senate Document No. 13," *op. cit.*, *passim*.

(sea green), quicksilver, brass sheets, print cloth, etc.¹ The sharp declines in copper, lead, and zinc prices in 1956-1957 also may be noted.

Professor Richard Ruggles told the Senate Subcommittee on Antitrust and Monopoly on July 13, 1957, that his examination of price behavior had led him to the following conclusion:

"Specifically, the administered price industries were also the industries where direct costs were primarily wage costs. To the extent that materials entered, they were largely materials from the mineral industries, which in turn faced large and relatively inflexible wage costs.

"In contrast, the industries that were considered not to have administered prices were in general those processing agricultural materials with a relatively small proportion of labor cost, such as food processing and textiles. In brief, *I could find no support for the conclusion that prices were more inflexible in the administered price industries.*

"Instead, I found that in all industries prices tended to move quite closely with direct costs. In industries using agricultural raw materials, the greater fall in the prices of these agricultural materials than in wages permitted prices to fall more than wages. In industries where this influence was not present, prices fell roughly, in proportion to wages." (Italics added.)

Dr. Neal has suggested that prices should be divided into three categories, namely, "market prices, inflexible administered prices, and flexible administered prices."² This is a more useful description of the actual behavior of prices than the attempt to identify administered prices as being only inflexible.

Administered Prices Have Always Been Important in the Economy

The fact that the term administered prices was coined during the early 1930's does not

mean that this method of pricing first was introduced at that time. Actually, such prices have always been of primary importance in our country. Even when small business was of greatest importance, prices were administered. This was true of the country store, of the prices of various services, of public utilities, of government pricing such as the postal service, and of manufacturing industries.

The long term existence of administered prices has been recognized by many students as the following quotations show:

Thus, Rufus Tucker concluded:

"There can be no doubt that in this country *ever since 1790 our price structure has included a large number of prices that remained unchanged for months or years at a time, side by side with prices that changed monthly, weekly, daily, or in recent years even hourly.* Such figures as are available for England in the eighteenth and early nineteenth centuries show that there also the prices of manufactured goods frequently remained unchanged for long periods, and never fluctuated as widely as the prices of agricultural products. The prices paid by hospitals for milk, salt, blankets, hats and shoes remained unchanged for many years at a time . . . rigid prices always existed; . . . to a very large extent they were characteristic of the same articles of which they are now characteristic, and there is even very strong reason to believe that a hundred years ago . . . rigid prices were proportionally more numerous and more important to the consumer than now."³ (Italics added.)

Similarly, Professor Frederick C. Mills has noted:

¹ See Jules Backman, "Price Flexibility and Changes in Production," *The Conference Board Bulletin*, February 20, 1939, The National Industrial Conference Board, New York, pp. 52-54.

² Neal, *op. cit.*, p. 27.

³ Tucker, *op. cit.*, pp. 43, 47; see also Blair, *op. cit.*, p. 107.

"Rigidities, inflexibilities, *administered prices we have always had with us*, along with prices determined in greater or less degree by the play of competition among buyers and sellers . . . *it is probable that truly competitive prices never formed more than a small minority of the prices at which goods and services have actually changed hands through the ages.*"¹ (Italics added.)

Gardiner Means, in his July 12, 1957 testimony, recognized that "administered prices are not new. Even in Adam Smith's day, administered prices were known." However, he considered them to be "a minor factor in the largely agricultural economy" of those early years.

H. S. Dennison and J. K. Galbraith have pointed out:

"It is not a recent change from older forms of price making, but *something which has characterized most of our more modern industries since their birth*. The production of automobiles, steel, petroleum products, and a host of other goods has involved a measure of producer price jurisdiction from the beginning."² (Italics added.)

The American economy has expanded vigorously over the years despite administered pricing. In fact, the American economy made the adjustments required to achieve this growth under a system of administered prices, not under a system of free market prices, which existed primarily in economics text books. In evaluating the significance of administered pricing, this important point must be kept in mind.

Clearly, administered prices cannot be eliminated from the economy. Although Means has been concerned about the adverse effects of administered prices on the economy, he has recognized that their elimination would have very harmful effects. Thus, he indicated that if we were to "pulverize industry" in an

effort to eliminate this type of pricing, "productive efficiency would have to be greatly impaired and a *lower standard of living* accepted than is made possible by modern industrial organization and modern technology."³ (Italics added.)

In his July 12, 1957 testimony, Means stated that the measures required to eliminate administered pricing "would destroy the efficiency of modern industry. I do not believe that market prices, the maintenance of market prices, is consistent with modern industry."

There is general agreement, therefore, that administered pricing is an unavoidable and inevitable by-product of the developments which have contributed to the high American standard of living.

The Term Administered Prices Should Not Imply Criticism of the Pricing Process

The term administered prices describes a process of price making. It does not involve a judgment that either the process or the price charged is wrong. Critics and defenders of administered prices have agreed upon this point.

In his testimony before the Senate Subcommittee on Antitrust and Monopoly on July 9, 1957, Dr. E. G. Nourse stated, "It is my considered opinion that the economic institutions and business practices described as administered pricing grow naturally and properly out of the conditions of modern industrialism and that they may be so used as to promote both economic growth and business stability vigorously and consistently."

In an earlier study Nourse and Drury stated, ". . . 'administered price' is not a term of reproach. It is merely a convenient way of

¹ *The American Economic Review, Supplement*, March 1936, p. 64.

² Dennison and Galbraith, *op. cit.*, p. 32.

³ "Senate Document No. 13," *op. cit.*, p. 13.

describing the facts of economic life as lived in the modern industrial world."¹

The Committee on Price Determination of the National Bureau of Economic Research noted that "The term 'administered price' is illuminating if it is not interpreted to mean a particular kind of price behavior . . ."²

Gardiner Means testified on July 12, 1957 that "Administered prices represent a way of doing business that leads to greater efficiency and higher standards of living. . . . Without this method of pricing, big efficient industry would find it almost impossible to operate. Administered prices are an essential part of our modern economy."

In an earlier article he had stated, "I am not saying that inflexible, administered prices are wrong. They seem to me inherent in modern technology."³

J. K. Galbraith told the Senate Subcommittee on Antitrust and Monopoly on July 11, 1957 that:

"The analysis of the effect of this ability to administer the prices of an industry has been greatly handicapped by the conviction that it is somehow improper. Actually, such administration is not only possible but also inevitable when an industry is in the hands of a relatively small number of firms.

"And it is equally inevitable that a great many industries will be conducted by a comparatively small number of large firms. That is the nature of capitalism wherever it is found. *A large amount of price administration by private firms is thus part of the system. Those who deplore it are wasting their breath. The problem is to understand it and to live with it.*" (Italics added.)

The term administered prices is primarily useful as a method of describing the process of price making. As such it provides a description of the *method* by which a price is determined. It does not indicate *per se*

whether the price is too high or too low, whether it is fair or unfair. Instead of the interplay of large numbers of buyers and sellers determining the price in an auction market, an administrator or executive or a group of officials determines the price. But he doesn't determine this price in a vacuum. He is not free to set the price at any level he may capriciously determine. On the contrary, the penalty for errors in his judgment will be a loss of sales and of profits.

In setting the price, the administrator must consider a host of factors including demand, costs, capital investment, prices of substitute products, nature of the product, government controls, competitors' reactions, etc. The local grocer soon finds out that when he sets prices too high he loses business to the chain store and the supermarket. The steel industry finds that high prices mean a loss of volume to substitute materials. The railroad must be concerned about the trucker and the airplane. Natural rubber loses markets to synthetic rubber when prices are set too high.

The price administrator cannot and need not duplicate exactly the process performed by the market place. But he is narrowly circumscribed in his freedom of action by the broad forces of supply and demand affecting his products. Moreover, there is no choice as between administered prices and market prices for the overwhelming majority of products. The prerequisites for market price determination just are not present in our economy. Most industries do not have such a large number of buyers and sellers that a market price could be determined. Suppose, for example, that it were possible to "pulverize" the steel industry into the required large number of sellers (of course,

¹ Nourse and Drury, *op. cit.*, p. 9.

² "Cost Behavior and Price Policy," *op. cit.*, p. 273.

³ Gardiner C. Means, "Notes on Inflexible Prices," *The American Economic Review, Supplement*, March 1936, p. 35.

technological requirements make this impossible), would or could the railroads similarly be reduced in size so that the market for steel rails both for buyers and sellers could approximate the theoretical requirements of a market price economy? Or could the automobile industry be so splintered as to meet the requirement of a large number of buyers of steel sheets? To state these suppositions is to show how unrealistic they are.

How will the additional requirement of homogeneous products (which is met in the steel industry) be satisfied for furniture, automobiles, women's clothes, canned peaches, toothpaste and the host of other products which are predominant in the American way of life?

The apparel industry can qualify for another prerequisite, namely, ease of entry into and exit from an industry. But how could this condition be met in steel, aluminum, and automobiles, where a huge capital investment is required to enter the business and large past sunk capital investment restricts the

ease of exit. Modern technology requires such enormous amounts of capital in many industries that there is an effective barrier to the freedom of new firms to enter an industry—or to leave it.

It is clear that the conditions which modify perfect competition and theoretical market price determination will continue to prevail. Accordingly, prices will be set by administrative action in the future as they have been in the past. And it is desirable to have a term to describe this pricing. The term administered price can be a very useful one as a description of the price making process for the products and services for which the prices are not set in an auction market. This usefulness is impaired when the term is also used as a synonym for some type of price behavior which someone considers to be undesirable or anti-social. There are other adjectives to cover such behavior—adjectives which are more descriptive and more to the point than the term administered.

II. ADMINISTERED PRICES AND INFLATION

SENATOR Estes Kefauver has stated that the Subcommittee on Antitrust and Monopoly "... is trying to come to grips with what is probably the nation's current Number One domestic economic problem—the problem of inflation. We are concerned particularly with the extent to which administered prices in concentrated industries may contribute to this problem." Gardiner Means and J. K. Galbraith agreed with Mr. Kefauver that administered prices did contribute to the most recent price rise.¹ However, Means stated that he did "not believe that the area of discretion accompanying administered prices is likely to lead to runaway inflation unless a reckless monetary and fiscal policy is pursued."

Is inflation the result of rises in so-called administered prices? At the outset, it should be noted that this is a brand new theory.² So far as I know, no similar allegation was made in earlier periods of inflation, although administered prices also were of considerable significance during those periods. In fact, in the early postwar years the failure to raise these so-called administered prices as much as may have been warranted by the shortages then prevailing was a stabilizing influence which held down the magnitude of the postwar price rise.³ Before we can determine what contribution, if any, is made by administered prices to inflationary pressures, we must understand the nature of inflation.

Nature of Inflation

Historically, the major price inflations in this country and in the rest of the world have been associated either with an excessive expansion of money and credit or with large budgetary deficits for national governments or with some combination of both. The wartime and postwar inflations clearly were

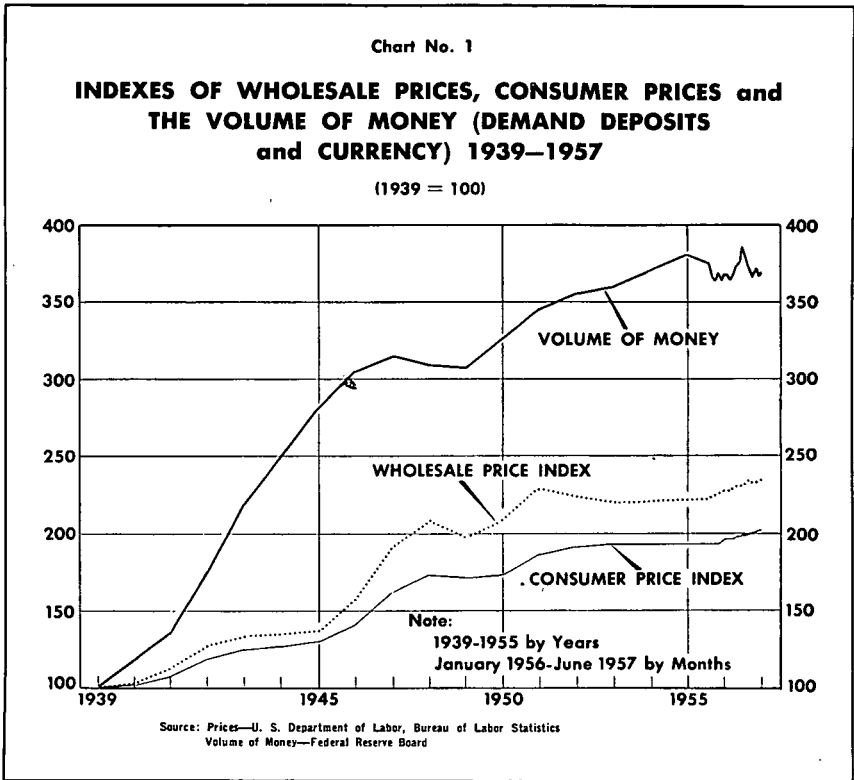
attributable to these forces. During the war and postwar years, our federal government accumulated budgetary deficits in excess of \$200 billion; and the money supply (demand deposits plus currency) of the country increased from \$36.2 billion in 1939 to \$134.7 billion in April 1957—a rise of 272 per cent. With this explosive expansion of money and credit accompanying huge federal budgetary deficits, it is not surprising to find that the consumer price index has about doubled and that wholesale prices have increased about 134 per cent. Approximately nine-tenths of this price rise had taken place prior to 1953 and was the result of the monetary and fiscal inflation. Chart 1 shows the changes in prices and money supply since 1939.

During the past two years these fundamental forces of monetary and fiscal inflation have not been developing in our economy. In the fiscal year 1955-56, the federal government had a surplus of \$1.6 billion in the executive budget and \$4.5 billion in the cash budget. In the fiscal year which ended June 30, 1957, the federal budget was in the black by \$1.6 billion, while the cash budget had a surplus of \$2.8 billion. Clearly, the most recent rise in prices cannot be attributed to an unbalanced federal budget. Some persons insist that the high level of government spending is a primary factor in the rise in prices. That it plays a role is probable. However, we

¹ See their testimony before the Senate Subcommittee on Antitrust and Monopoly, July 11 and July 12, 1957.

² Gardiner Means told the Subcommittee "This is a new phenomenon—I do not find it anywhere in our history of prices."

³ Dr. Means noted that during World War II "market prices were less effectively controlled than administered prices" and that "they had a very constructive influence." In the postwar period, he found that administered pricing "probably acted as a very considerable brake" on inflation and that "business can retard an inflation arising from too much buying power, as happened in the case of all prices immediately after the war." He also stated that after World War II, automobile companies "kept prices well below what the traffic would bear."



cannot ignore the fact that when the government on balance is taking more money from the private economy than it spends, which is the nature of a budgetary surplus, the government is acting as a deflationary, rather

than an inflationary, influence on the economy.

An examination of the changes in the volume of currency and bank deposits also fails to reveal renewed inflationary pressures.

TABLE 2

Changes in Currency, Demand Deposits and Total Bank Loans, All Commercial Banks, Selected Dates, 1939-1957

| | Demand Deposits Adjusted | Currency Outside the Banks | Total Loans |
|-----------------------|--------------------------|----------------------------|-------------|
| (billions of dollars) | | | |
| Dec. 1939 | 29.8 | 6.4 | 17.2 |
| Dec. 1945 | 75.9 | 26.5 | 26.1 |
| Dec. 1949 | 85.8 | 25.4 | 43.0 |
| Dec. 1954 | 106.6 | 27.9 | 70.6 |
| Apr. 1955 | 104.5 | 26.7 | 72.9 |
| Dec. 1955 | 109.9 | 28.3 | 82.6 |
| Apr. 1956 | 106.1 | 27.0 | 85.3 |
| Dec. 1956 | 111.4 | 28.3 | 90.3 |
| Apr. 1957 | 107.3 | 27.4 | 91.0 |

Source: Board of Governors of the Federal Reserve System

Between April, 1956 and April, 1957, currency outside the banks increased from \$27.0 billion to \$27.4 billion, an increase of about 1½ per cent, and demand deposits adjusted increased from \$106.1 billion to \$107.3 billion, or a rise of only 1 per cent. In the preceding year (April 1955 to April 1956), currency outside the banks had increased by 1.1 per cent and demand deposits by 1.5 per cent. (See Table 2.) An expansion of one per cent a year in money supply is about one-third the normal rate of increase. Hence, there has been no increase in inflationary pressures because of increases in the money supply.

However, the dynamic nature of that money supply has changed. During the same two year period, commercial bank loans increased from \$72.9 billion to \$91.0 billion.¹ The increase in loans has resulted in a more active use of demand deposits. This is shown by the increase in bank debits which indicate the velocity of demand deposits.

Bank debits increased from \$158.3 billion in April 1955 to \$176.8 billion in April 1956 and \$192.6 billion in April 1957, or an in-

TABLE 3

Bank Debits, All Reporting Centers, By Months, 1955-1957

| | 1955 | 1956 | 1957 |
|-----------------------|-------|-------|-------|
| (billions of dollars) | | | |
| Jan. | 163.4 | 187.4 | 204.4 |
| Feb. | 149.7 | 162.1 | 177.5 |
| March | 178.9 | 189.8 | 197.2 |
| April | 158.3 | 176.8 | 192.6 |
| May | 167.7 | 185.6 | 197.2 |
| June | 177.9 | 186.5 | |
| July | 161.7 | 181.3 | |
| Aug. | 167.3 | 183.8 | |
| Sept. | 169.0 | 167.2 | |
| Oct. | 175.8 | 193.1 | |
| Nov. | 173.2 | 185.2 | |
| Dec. | 200.5 | 201.9 | |

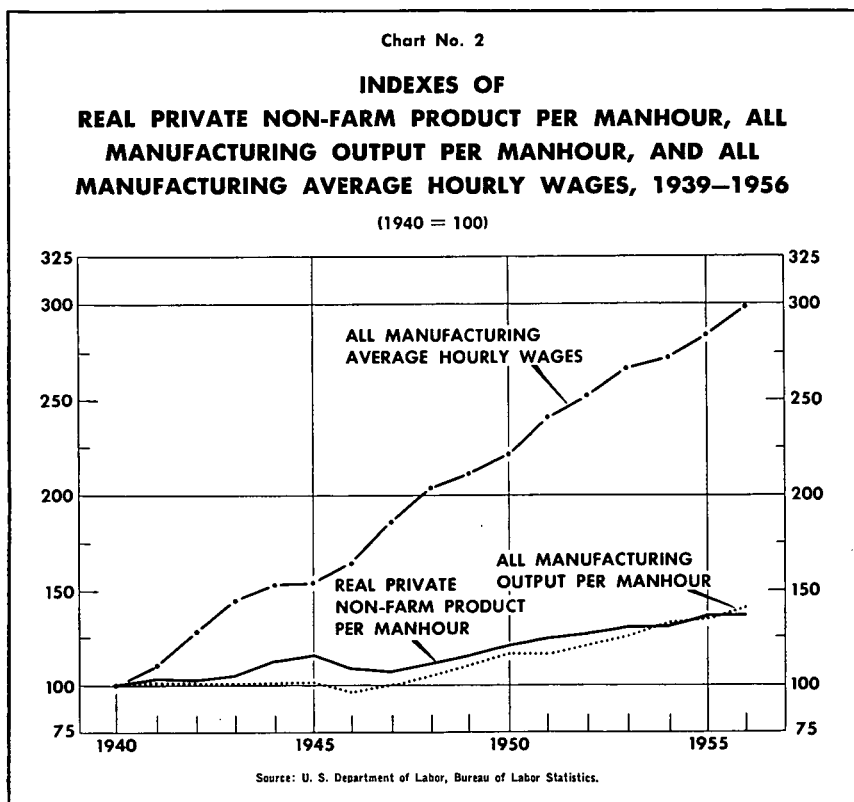
Source: Board of Governors of the Federal Reserve System

crease of 21.7 per cent for the two year period and 8.9 per cent for the year ending April 1957. This greater turnover of deposit money undoubtedly has contributed to the pressure for a price rise despite the relative stability of our total money supply. However, turnover of bank deposits is a *result* of business activity, not a cause of price rise. It is the boom which stimulates the velocity *and* the price rise. On balance it seems clear that there has been no significant impetus to inflationary trends as a result of the changes in the federal budget or in the supply of money and credit.

Factors Leading to Higher Prices

The failure of the traditional inflationary forces to develop has led to a feverish search for the reasons for the price rise during the past two years. Examination of the wholesale price index shows that the major

¹Other types of borrowings also have expanded sharply in the past two years. Mortgages on one to four family homes have increased from \$75.7 billion at the end of 1954 to \$99.1 billion at the end of 1956. During the same period consumer credit has risen from \$32.3 billion to \$41.9 billion. Total private debt increased from \$342.6 billion to \$415.7 billion.



areas of price rise have been in those industries which have been most affected by the boom and/or those industries which have the highest proportion of labor costs to total cost.

When wage and other labor cost increases are greater than productivity gains, the resulting higher unit labor costs create pressure for higher prices. Chart 2 shows the war and postwar trends in wages and productivity. The steadily widening spread as money wages have increased far more than productivity is readily evident. This situation has prevailed throughout the war and post-

war period. It was also true in 1956. The actual rise in labor costs has been greater than shown in Chart 2 because average hourly earnings do not include important fringe benefits.

According to the data now available productivity gains in 1956 were relatively small.¹

Output per manhour for the nonfarm private economy showed no change in 1956.

Output per manhour for all manufacturing industries increased 2.7 per cent.

¹ Joint Economic Committee, *Productivity, Prices, and Incomes*, Washington, July 1957, p. 89.

While productivity gains were lagging, wages and various fringe benefits rose substantially. Thus, average hourly earnings were \$1.88 in 1955 and \$1.98 in 1956, an increase of 5.3 per cent. In addition, pension and welfare programs were liberalized and other fringe benefits such as supplementary unemployment benefits (SUB) were paid. Total labor costs, therefore, rose by more than 5.3 per cent for all manufacturing industries in 1956. Clearly, labor costs rose more than productivity, thus leading to higher unit labor costs. According to estimates prepared by the U. S. Bureau of Labor Statistics, unit labor costs for the entire economy rose by 4.5 per cent in 1956.¹ In the

first five months of 1957, average hourly earnings in all manufacturing industries increased to \$2.05, or a further rise of 3½ per cent above the 1956 average level—and further increases in wages and fringe benefits became effective after May. These rising labor costs have played a significant role in the pressure for higher prices.

Price Trends, 1955-1957

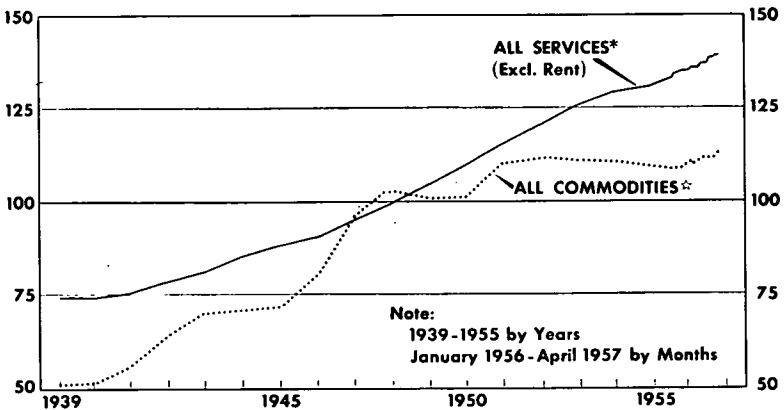
During the past two years (May 1955 to June 1957), the consumer price index has risen 5.3 per cent and the wholesale price index has risen 6.8 per cent. Most of this rise

¹ "Productivity, Prices, and Incomes," *op. cit.*, p. 280.

Chart No. 3

**PRINCIPAL COMPONENTS OF THE CONSUMER PRICE INDEX,
ALL COMMODITIES vs. ALL SERVICES (Excl. Rent) 1939-1957**

(1947-49 = 100)



Note:
1939-1955 by Years
January 1956-April 1957 by Months

Source: U. S. Department of Labor, Bureau of Labor Statistics

* All services includes such items as gas and electricity, dry cleaning and laundry, shoe repairs, telephone, public transportation, medical services, beauty and barber shop services, domestic service, auto repairs, auto insurance and registration, water rates, postage, and movie admissions. It does not include residential rent.

* All commodities includes such items as food, apparel, solid fuel and fuel oil, housefurnishings, radio and TV, prescriptions and drugs, toilet goods, automobiles, tires, gasoline and motor oil, tobacco products, alcoholic beverages, laundry soap and detergents, and newspapers.

in wholesale prices occurred by the end of 1956 as Table 4 shows.

TABLE 4
Wholesale Price Index, 1955-1957
(1947-49=100)

| | Total Index | Non Farm Non Food | Farm Products |
|-----------------|-------------|----------------------|------------------|
| May 1955..... | 109.9 | 115.5 | 91.2 |
| Dec. 1955..... | 111.3 | 119.8 | 82.9 |
| May 1956..... | 114.4 | 121.7 | 90.9 |
| Dec. 1956..... | 116.3 | 124.7 | 88.9 |
| Jan. 1957..... | 116.9 | 125.2 | 89.3 |
| Feb. 1957..... | 117.0 | 125.5 | 88.8 |
| Mar. 1957..... | 116.9 | 125.4 | 88.8 |
| Apr. 1957..... | 117.2 | 125.4 | 90.6 |
| May 1957..... | 117.1 | 125.2 | 89.5 |
| June 1957.... | 117.4 | 125.2 | 90.9 |
| July 30, 1957.. | 117.9 | 125.5 | 92.8 |

Source: U. S. Department of Labor, Bureau of Labor Statistics

During the first seven months of 1957, the non farm, non food index (industrial prices) was relatively stable within the narrow range of 125.2 to 125.5. The nominal rise in the total index in 1957 reflected the moderately higher prices for farm products and pro-

cessed foods due in part to seasonal forces. Clearly, there has been no significant inflation in wholesale prices since the end of 1956.

In contrast, the consumer price index has continued to move forward. The CPI rose from 114.6 in February 1956, the month from which the current rise started, to 118.0 in December. By June, 1957, the index had advanced to 120.2. The changes in the main components of the index are shown in Table 5.

From December 1956 to June 1957, the consumer price index rose 2.2 points. The major part of this increase was accounted for by the rise in food prices and housing (food, 1.0 point and housing 0.6 point). Transportation, medical and personal care, and reading and recreation accounted for the other 0.6 point increase reported during this period.

The continuing rise in the consumer price index in 1957 has reflected a combination of two forces: the delayed effects of earlier rises in wholesale prices and, secondly, the rise in prices of services, some of which are

TABLE 5
Consumer Price Index, 1956-1957
(1947-49=100)

| | Feb. 1956 | Dec. 1956 | June 1957 | Per Cent Increase | |
|------------------------------|--------------|--------------|--------------|---------------------------|---------------------------|
| | | | | Feb. 1956 to June 1957 | Dec. 1956 to June 1957 |
| All items | 114.6 | 118.0 | 120.2 | 4.9 | 1.9 |
| Food | 108.8 | 112.9 | 116.2 | 6.8 | 2.9 |
| Housing — total | 120.7 | 123.5 | 125.5 | 4.0 | 1.6 |
| Housing — rent | 131.5 | 134.2 | 135.0 | 2.7 | 0.6 |
| Apparel | 104.6 | 107.0 | 106.6 | 1.9 | -0.4 |
| Transportation | 126.9 | 133.1 | 135.3 | 6.6 | 1.7 |
| Medical care | 130.9 | 134.7 | 137.9 | 5.3 | 2.4 |
| Personal care | 118.9 | 121.8 | 124.2 | 4.5 | 2.0 |
| Reading & recreation | 107.5 | 109.3 | 111.8 | 4.0 | 2.3 |
| Other goods & services | 120.9 | 123.8 | 124.6 | 3.1 | 0.6 |
| Gas and electricity | 111.7 | 112.0 | 112.3 | 0.5 | 0.3 |

Source: U. S. Department of Labor, Bureau of Labor Statistics

primarily labor costs (e.g. medical care) and of others, which have been lagging behind the war and postwar inflation (e.g. public utility rates and rents). It does not appear to represent the emergence of new inflationary forces. Chart 3 shows separately the changes in the prices of goods and of services included in the consumer price index. The steady climb in the prices of services is readily apparent. It has been particularly important since 1951.

Anatomy of Price Changes, 1955-1957

Table 6 shows the changes in the *major components* of the wholesale price index between May, 1955 and May, 1957. The over-all price rise has been 6.6 per cent. But an examination of the anatomy of the price rise

shows it has been very uneven. Three major groups of prices have risen more than 10 per cent (machinery and motive products, metals and metal products, and fuel, power and lighting materials), while three major groups have actually declined (lumber and wood products, miscellaneous, and farm products). The industries with the largest price increases have been those most stimulated by the boom, particularly that in plant and equipment, and, in some instances, those industries with a relatively high labor content.

The lagging tendencies of farm prices reflect the huge surpluses accumulated in recent years while the decline in residential building was a primary factor in the price decline for lumber and wood products. Similarly, the relatively unchanged price level for textile products and apparel reflects the depressed conditions in those industries. Among the other industries with modest price rises,

TABLE 6
Changes in Wholesale Prices, Major Groups,
May 1955 to May 1957
(1947-49 = 100)

| Major Groups | Index | | Per Cent Increase or Decrease |
|---|----------|----------|-------------------------------------|
| | May 1955 | May 1957 | |
| Machinery and motive products | 126.7 | 145.1 | 14.5 |
| Metals and metal products | 132.5 | 150.0 | 13.2 |
| Fuel, power and lighting materials | 107.0 | 118.5 | 10.7 |
| Nonmetallic minerals, structural | 123.2 | 135.0 | 9.6 |
| Pulp, paper and allied products | 117.7 | 128.9 | 9.5 |
| Commodities other than farm products and foods..... | 115.5 | 125.2 | 8.4 |
| Hides, skins and leather products | 92.9 | 99.0 | 6.6 |
| All commodities | 109.9 | 117.1 | 6.6 |
| Furniture, other household durables | 115.1 | 121.6 | 5.6 |
| Rubber and rubber products | 138.0 | 144.7 | 4.9 |
| Foods, processed | 102.1 | 104.9 | 2.7 |
| Tobacco manufactures and bottled beverages..... | 121.6 | 124.5 | 2.4 |
| Chemicals and allied products | 106.8 | 109.1 | 2.2 |
| Textile products and apparel | 95.0 | 95.4 | 0.4 |
| Farm products | 91.3 | 89.5 | - 1.9 |
| Miscellaneous | 91.4 | 89.4 | - 2.1 |
| Lumber and wood products | 123.5 | 119.7 | - 3.1 |

Source: U. S. Department of Labor, Bureau of Labor Statistics.

rubber and rubber products reflected the decline in automobile output; tobacco manufactures and bottled beverages are industries with a very small labor content; chemicals and allied products also have less than average labor costs as a per cent of the sales dollar. Thus, *it appears that the level of prosperity in an industry and/or the relative importance of its labor costs provide the primary explanations for the price behavior of the past two years.*

Table 7 shows the changes for the same price groups for the year from May 1956 to May 1957. The picture is essentially the same.

Table 8 shows the changes for 92 subgroups

of products for the period from May 1955 to May 1957. This tabulation is particularly instructive concerning the behavior of administered prices during the period covered—and also the behavior of prices in concentrated industries as compared with others. As the table shows some administered prices have risen sharply, while others have declined.

An analysis of the May 1955-May 1957 price changes also shows that for several finished goods, the administered prices rose more or declined less than the market prices of their important raw materials.

TABLE 7
Changes in Wholesale Prices, Major Groups,
May 1956 to May 1957
(1947-49 = 100)

| Major Groups | May 1956 | May 1957 | Per Cent Increase or Decrease |
|--|----------|----------|-------------------------------|
| Fuel, power and lighting materials | 110.8 | 118.5 | 6.9 |
| Machinery and motive products | 136.5 | 145.1 | 6.3 |
| Nonmetallic minerals, structural | 128.6 | 135.0 | 5.0 |
| Furniture, other household durables | 118.0 | 121.6 | 3.1 |
| Commodities other than farm products and foods | 121.7 | 125.2 | 2.9 |
| Foods, processed | 102.4 | 104.9 | 2.4 |
| Tobacco manufactures and bottled beverages | 121.6 | 124.5 | 2.4 |
| All Commodities | 114.4 | 117.1 | 2.4 |
| Metals and metal products | 146.8 | 150.0 | 2.2 |
| Chemicals and allied products | 106.9 | 109.1 | 2.1 |
| Pulp, paper and allied products | 127.3 | 128.9 | 1.3 |
| Rubber and rubber products | 143.5 | 144.7 | 0.8 |
| Textile products and apparel | 94.9 | 95.4 | 0.5 |
| Hides, skins, and leather products | 100.0 | 99.0 | -1.0 |
| Farm products | 90.9 | 89.5 | -1.5 |
| Lumber and wood products | 128.0 | 119.7 | -6.5 |
| Miscellaneous | 96.1 | 89.4 | -7.0 |

Source: U. S. Department of Labor, Bureau of Labor Statistics.

TABLE 8
Changes in Wholesale Prices, Subgroups,
May 1955 to May 1957

| Subgroups | Per Cent Increase or Decrease | Subgroups | Per Cent Increase or Decrease |
|--|-------------------------------------|--|-------------------------------------|
| Coal | 22.8 | Wool products | 4.5 |
| Coke | 21.4 | Jewelry, watches and photographic equipment | 4.5 |
| Iron and steel | 20.1 | Alcoholic beverages | 4.3 |
| Prepared asphalt roofing | 18.9 | Other farm products ⁶ | 4.2 |
| General purpose machinery and equipment | 18.9 | Gypsum products | 4.1 |
| Metalworking machinery and equipment | 18.7 | Toys, sporting goods, small arms and ammunition | 3.8 |
| Construction machinery and equipment | 17.3 | Woodpulp | 3.7 |
| Electrical machinery and equipment | 17.2 | Vegetable oil end products | 3.6 |
| Petroleum and products | 16.4 | Paint materials | 2.9 |
| Metal containers | 16.1 | Other leather products ⁷ | 2.6 |
| Commercial furniture | 14.5 | Sugar and confectionery | 2.3 |
| Fabricated nonstructural metal products | 13.9 | Packaged beverage materials | 2.2 |
| Hardware | 13.8 | Apparel | 1.5 |
| Structural clay products | 13.1 | Nonferrous metals | 1.5 |
| Miscellaneous machinery | 13.1 | Cigars | 1.4 |
| Converted paper and paperboard products | 12.2 | Silk products | 1.2 |
| Other household durable goods ¹ | 12.0 | Animal fats and oils | 1.2 |
| Fats and oils, inedible | 11.3 | Crude rubber | 1.1 |
| Fabricated structural metal products | 11.3 | Plant and animal fibers | 0.9 |
| Paper | 10.5 | Nonalcoholic beverages | 0.8 |
| Motor vehicles | 10.4 | Other textile products ⁸ | 0.7 |
| Building paper and board | 9.3 | Cotton products | 0.4 |
| Agricultural machinery and equipment | 8.9 | Livestock and live poultry | 0.4 |
| Concrete ingredients | 8.8 | Drugs and pharmaceuticals | 0.1 |
| Footwear | 8.7 | Cigarettes | 0 |
| Prepared paint | 8.6 | Television, radio receivers and phonographs | 0 |
| Flat glass | 8.6 | Mixed fertilizer | - 0.4 |
| Household furniture | 8.2 | Canned and frozen fruits and vegetables | - 0.6 |
| Paperboard | 8.1 | Millwork | - 0.8 |
| Other rubber products ² | 7.3 | Household appliances | - 1.3 |
| Concrete products | 7.2 | Cereal and bakery products | - 1.5 |
| Heating equipment | 7.0 | Other chemicals and allied products ⁹ | - 2.2 |
| Floor coverings | 7.0 | Lumber | - 2.9 |
| Meats, poultry and fish | 6.8 | Electricity | - 3.0 |
| Dairy products and ice cream | 6.4 | Hay, hayseeds and oilseeds | - 4.9 |
| Other nonmetallic minerals ³ | 6.0 | Fertilizer materials | - 5.2 |
| Fluid milk | 5.5 | Other processed foods ¹⁰ | - 5.8 |
| Plumbing equipment | 5.5 | Man-made fiber textile products | - 5.9 |
| Other tobacco manufactures ⁴ | 5.2 | Crude vegetable oils | - 6.0 |
| Industrial chemicals | 5.1 | Grains | - 7.6 |
| Gas | 5.0 | Fresh and dried fruits and vegetables | - 8.2 |
| Other miscellaneous products ⁵ | 5.0 | Plywood | - 8.3 |
| Notions and accessories | 4.8 | Manufactured animal feeds | - 10.4 |
| Hides and skins | 4.7 | Refined vegetable oils | - 10.7 |
| Tires and tubes | 4.7 | Eggs | - 19.6 |
| Leather | 4.5 | Wastepaper | - 28.7 |

Sources: U. S. Department of Labor, Bureau of Labor Statistics.

¹ Includes dinnerware, glassware, glass containers, silverware, mirrors, lawnmowers, cutlery and metal household containers.

² Includes footwear, heels and soles, belts and belting, rubber cement, garden hose, camelback and foam rubber.

³ Includes insulation materials, asbestos cement shingles, and building lime.

⁴ Includes smoking tobacco, plug chewing tobacco, and snuff.

⁵ Includes caskets, matches, musical instruments, brushes, phonograph records, and fire extinguishers.

⁶ Includes green coffee, tea, cocoa, and leaf tobacco.

⁷ Includes men's two-suits, women's pullman cases, brief cases, men's wallets, men's and women's gloves, industrial belting and men's and women's cut soles.

⁸ Includes burlap, binder twine, baler twine, manila rope, and carpet yarn, jute.

⁹ Includes soaps, detergents, explosives, plastic materials, photographic materials, cosmetics, perfumes, shaving cream, and toothpaste.

¹⁰ Includes jams, jellies, pickles, processed eggs, flavoring syrup, gelatin base desserts, peanut butter, and spice.

Price administered meats, poultry and fish prices rose 6.8 per cent as compared with the rise of only 0.4 per cent for market price determined livestock and live poultry.

While market price determined grains declined 7.6 per cent, the price administered cereal and bakery products group fell only 1.5 per cent.

Market price determined fresh and dried fruits and vegetables recorded a price decline of 8.2 per cent, while price administered canned and frozen vegetables showed a small decline of 0.6 per cent.

Nevertheless, there are also a number of interesting contrasts in price behavior during that two-year period.

Coal¹ which has low concentration, high labor costs, and administered price had the largest rise, 22.8 per cent. Petroleum and products, a competitive product, with a higher concentration ratio rose 16.4 per cent. On the other hand, highly concentrated, low labor content, price administered cigarettes showed no change in price; and lumber, an industry with many producers and administered prices, had a price decline of 2.9 per cent.

Hides' and skins' prices, which are market determined, rose 4.7 per cent, while price administered leather prices increased 4.5 per cent.

Man-made fiber textile products' prices declined 5.9 per cent, while the wool products' prices advanced 4.5 per cent and cotton products rose 0.4 per cent. These products are all price administered and have similar degrees of concentration although man-made fibers are highly concentrated.

Electrical machinery and equipment prices increased 17.2 per cent while prices of television, radio receivers, and phonographs recorded no change and prices of household appliances fell 1.3 per cent. In many instances these products are produced by the same companies.

Iron and steel products rose 20.1 per

cent as compared with a rise of only 1.5 per cent for nonferrous metals although both are price administered.

Clay products' prices rose 13.1 per cent as compared with a rise of 4.1 per cent for gypsum products which are more highly concentrated.

Of the 22 groups of products for which prices did not increase between May 1955 and May 1957, 14 are price administered in industries with varying degrees of concentration.

| <u>Industry</u> | <u>Per Cent Change in Prices</u> |
|--|--|
| Television, radio receivers and phonographs | 0 |
| Cigarettes | 0 |
| Mixed fertilizer | -0.4 |
| Canned and frozen fruits and vegetables | -0.6 |
| Millwork | -0.8 |
| Household appliances | -1.3 |
| Cereal and bakery products | -1.5 |
| Other chemicals and allied products | -2.2 |
| Lumber | -2.9 |
| Electricity | -3.0 |
| Fertilizer materials | -5.2 |
| Other processed foods | -5.8 |
| Man-made fiber textile products | -5.9 |
| Plywood | -8.3 |

While price administered products recorded varying increases in this two-year period, it is significant that for fourteen industries, prices failed to rise despite the fact that they

¹ Bituminous coal accounts for about 84 per cent of the coal price index. From May 1955 to May 1957 bituminous coal prices rose 24.3 per cent while anthracite coal prices rose 14.3 per cent. Anthracite coal production is more highly concentrated than is bituminous coal output.

were administered. These industries accounted for 15.3 per cent of the wholesale price index as compared with 5.5 per cent for the market prices which declined.

Moreover, for six additional industries, prices rose less than one per cent. Only two of these industries had market determined prices (livestock and live poultry and plant and animal fibers) while the following four industries were price administered:

| | <u>Per Cent Increase</u> |
|---------------------------------|------------------------------|
| Drugs and pharmaceuticals | 0.1 |
| Cotton products | 0.4 |
| Other textile products | 0.7 |
| Nonalcoholic beverages | 0.8 |

In general, these 28 industries, with price rises of less than one per cent or price declines, did not participate fully in the 1955-57 boom. This fact, rather than price administration, explains price behavior in this area.

On the other hand, the ten industries with price increases of 15.0 per cent, or more, generally participated in the boom and were significantly affected by it.

If the analysis is confined to the experience in the year May, 1956, to May, 1957, the wide diversity of behavior for administered prices is again evident. The data are shown in Table 9. Some of the interesting exceptions to the administered price-inflation theme include the following:

One of the largest price rises was for meats, poultry, and fish (11.4 per cent) and one of the largest declines was for nonferrous metals (-12.6 per cent). Both groups of products have administered prices. Nonferrous metals are highly concentrated. Market determined egg prices also recorded one of the largest declines.

Fresh and dried fruits and vegetables, whose prices are largely market determined, declined 2.5 per cent while the

more concentrated price administered canned and frozen fruits and vegetables declined 5.3 per cent.

Coal recorded a price rise of 10.2 per cent while cigarettes were unchanged in price. Petroleum and products had a price rise of 9.7 per cent.

Motor vehicles had a price rise of 4.3 per cent while prices declined 1.8 per cent for tires and tubes. Both industries are highly concentrated and have administered prices. Prices of tires and tubes were adversely affected by the decline in automobile output.

Hides' and skins' prices, which are market determined, fell 5.4 per cent while closely related administered price of leather declined 4.4 per cent. However, administered price footwear rose 0.9 per cent. It should be noted that the latter is an industry with low concentration.

Cotton products' prices declined 2.6 per cent, prices of man-made textile fibers rose 1.9 per cent and prices in the wool products group increased 7.8 per cent.

Electrical machinery and equipment prices rose 8.2 per cent, while the similarly administered prices of television, radio receivers and phonographs rose 0.5 per cent, and household appliances a nominal 0.1 per cent. The difference in the demand for the two groups of products provided a more significant explanation of this diverse behavior than did the fact the prices are administered.

Of the 92 subgroups included in the BLS wholesale price index, prices declined for 31 groups, were unchanged for three groups, and rose one per cent or less for ten groups. Thus, in the year from May 1956 to 1957, 44 out of the 92 subgroups had a price rise of one per cent or less or declined in price. Thirty-two of these 44 industry groups had administered prices; they accounted for 21.1 per cent of the index as compared with 7.2 per

TABLE 9
Changes in Wholesale Prices, Subgroups,
May 1956 to May 1957

| Subgroups | Per Cent Increase or Decrease | Subgroups | Per Cent Increase or Decrease |
|--|-------------------------------------|--|-------------------------------------|
| Prepared asphalt roofing | 12.4 | Converted paper and paperboard products | 1.7 |
| Meats, poultry and fish | 11.4 | Toys, sporting goods, small arms and ammunition | 1.5 |
| Coke | 11.3 | Drugs and pharmaceuticals | 1.3 |
| Coal | 10.2 | Gas | 1.0 |
| Petroleum and products | 9.7 | Footwear | 0.9 |
| Other textile products ^a | 9.4 | Cereal and bakery products | 0.9 |
| Electrical machinery and equipment | 8.2 | Cigars | 0.9 |
| Fabricated nonstructural metal products | 8.1 | Nonalcoholic beverages | 0.8 |
| Metal containers | 8.0 | Television, radio receivers and phonographs | 0.5 |
| Iron and steel | 8.0 | Mixed fertilizer | 0.5 |
| Wool products | 7.8 | Household appliances | 0.1 |
| Construction machinery and equipment | 7.5 | Apparel | 0.1 |
| Metalworking machinery and equipment | 7.2 | Cigarettes | 0 |
| General purpose machinery and equipment | 6.8 | Gypsum products | 0 |
| Hardware | 6.7 | Woodpulp | 0 |
| Miscellaneous machinery | 6.4 | Paperboard | - 0.2 |
| Commercial furniture | 6.4 | Silk products | - 0.2 |
| Other household durable goods ¹ | 6.1 | Other farm products ⁶ | - 0.2 |
| Structural clay products | 6.1 | Fluid milk | - 0.5 |
| Livestock and live poultry | 5.8 | Millwork | - 0.7 |
| Prepared paint | 4.7 | Paint materials | - 1.4 |
| Agricultural machinery and equipment | 4.6 | Plant and animal fibers | - 1.5 |
| Paper | 4.6 | Other leather products ⁷ | - 1.7 |
| Other nonmetallic minerals ³ | 4.5 | Fertilizer materials | - 1.7 |
| Alcoholic beverages | 4.4 | Fats and oils, inedible | - 1.8 |
| Concrete ingredients | 4.3 | Tires and tubes | - 1.8 |
| Motor vehicles | 4.3 | Packaged beverage materials | - 2.0 |
| Other tobacco manufactures ⁴ | 4.2 | Animal fats and oils | - 2.2 |
| Concrete products | 4.1 | Other processed foods ¹⁰ | - 2.3 |
| Household furniture | 3.7 | Fresh and dried fruits and vegetables | - 2.5 |
| Heating equipment | 3.5 | Cotton products | - 2.6 |
| Flat glass | 3.5 | Plumbing equipment | - 3.6 |
| Crude rubber | 3.2 | Leather | - 4.4 |
| Other miscellaneous products ⁵ | 3.0 | Canned and frozen fruits and vegetables | - 5.3 |
| Sugar and confectionery | 2.9 | Hides and skins | - 5.4 |
| Other chemicals and allied products ⁹ | 2.7 | Grains | - 5.6 |
| Building paper and board | 2.6 | Plywood | - 5.8 |
| Dairy products and ice cream | 2.6 | Hay, hayseeds and oilseeds | - 6.3 |
| Jewelry, watches and photographic equipment | 2.5 | Lumber | - 7.5 |
| Floor coverings | 2.5 | Vegetable oil end products | - 7.7 |
| Other rubber products ² | 2.3 | Nonferrous metals | - 12.6 |
| Industrial chemicals | 2.3 | Manufactured animal feeds | - 17.9 |
| Fabricated structural metal products | 2.2 | Crude vegetable oils | - 20.0 |
| Man-made fiber textile products | 1.9 | Refined vegetable oils | - 20.2 |
| Electricity | 1.8 | Eggs | - 28.3 |
| Notions and accessories | 1.8 | Wastepaper | - 43.2 |

Source: U. S. Department of Labor, Bureau of Labor Statistics.
For footnotes, see Table 8.

cent for market prices which declined.

The various comparisons cited above have been stressed because they provide important exceptions to the role assigned to price administration. They show that there is no simple or certain relationship between concentration and price administration, on the one hand, and the direction or magnitude of price change on the other. *The depressed condition of demand (e.g. tires and tubes, lumber, non-ferrous metals), stimulation of demand (e.g. the influence of Suez on petroleum products), relatively large raw materials costs (e.g. meats, poultry and fish, leather), high relative importance of labor costs (e.g. coal, iron and steel), relatively low labor costs (e.g. cigarettes, chemicals), the plant and equipment boom (e.g. machinery and equipment), and other factors provide more significant explanations for the recent behavior of prices than does the fact that most prices are administered.*

Of course, there are products which are concentrated, have administered prices, and

also have had larger than average price rises. The point that is underlined by these many illustrations, however, is that there are also many concentrated industries in which administered prices have shown only small changes. Industries with low concentration and administered prices have recorded similar differences in price behavior.

In the light of the differences in behavior among "various concentrated industries with administered prices," it is difficult to understand how price administration *per se* can be responsible for the general price rise of the past year or two. Where other conditions have either favored or compelled the price rise, administered prices have risen. And where these other conditions have not favored a price rise, administered prices have failed to rise. Market determined prices have shown a similar responsiveness. *The primary pressures and responsibilities for price behavior, therefore, are found in these other factors, not in the fact of price administration.*

III. ADMINISTERED PRICES AND ECONOMIC STABILITY

A BASIC criticism of administered pricing has been the charge that such pricing impedes the automatic or self-correcting changes in the economy. It is suggested that the failure of administered prices to decline more sharply in periods of recession prevents the adjustments which can take place in a flexible market economy and leads to deeper depressions. Currently, this type of pricing is being criticized as creating inflationary pressures which in turn will lead to new instability in our economy.

Dr. Means has stated that administered prices "impede economic functioning."¹ In contrast, Professor Alvin Hansen has pointed out, "The price dispersion is not the cause of the depression. It is a result of the decline in the national income and in employment. . . ."²

That the disparity which develops between administered prices and market prices during periods of recession is not the cause of the recession was clearly indicated by Dr. Means in his summary of the behavior of the two types of prices before the Subcommittee on Antitrust and Monopoly on July 12, 1957:

"Indeed one might say that in the period of high employment and price stability from 1926 to 1929, market and administered prices were in relative balance with each other, that with depression they got out of balance, came back toward balance in 1937, were out of balance in 1938 and returned to balance along with full employment under the impact of war demand.

"I emphasize this matter of balance because it seems to me more than fortuitous. The two indexes were in nearly the same relation in the high employment and stable price period 1913-1914 as after the First World War in 1926 to 1929 in spite of the great price changes which occurred between these periods.

"And again after the Second World War and the Korean War, the two indexes assumed nearly the same relation in the high employment stable-price period of 1953 to 1955."

It is clear that recessions in economic activity develop despite the "balance" between the two sets of prices during periods of high-level activity. And recovery develops from depressed levels despite the lack of balance between the two sets of prices at such times. In the face of this historic record, it is difficult to understand how administered prices are the cause of wide economic fluctuations. It is evident that the required adjustments take place in our economy despite the inflexibility of some administered prices, although there is no way to determine whether the process of adjustment is faster or slower.

In connection with the various criticisms made of administered pricing, several points must be kept in mind in order to maintain some perspective concerning the significance of administered pricing:

1. Administered prices have always been the major type of pricing in our economy.
2. Nevertheless, despite periodic interruptions to the long term trend, our economy has experienced a rate of growth and a rising standard of living which is the envy of the world.
3. The interruptions to this growth, namely recessions and depressions, have usually been of brief duration. The major depressions have usually followed major wars and have been

¹ Gardiner C. Means, "Notes on Inflexible Prices," *The American Economic Review, Supplement*, March, 1936, p. 32.

² Alvin H. Hansen, "Price Flexibility and the Full Employment of Resources," in *The Structure of the American Economy, Part II*, National Resources Planning Board, Washington, June, 1940, p. 29.

the direct result of the dislocations accompanying those wars (for example, the 1870's and 1930's).

4. Most recessions have been small in depth and in duration. It is not true that small declines have been converted into deep depressions because of the alleged inflexibility of administered prices. The most recent illustrations are found in the modest recessions of 1948-49 and 1953-54.
5. Students of the business cycle usually attribute our periodic recessions to a wide variety of causes including excessive expansion of credit, excessive inventory accumulation, the relationship between savings and investment, underconsumption, wars, and other factors. Administered pricing is not given much significance in lists of causal forces of the business cycle.

Cyclical Price Behavior

It is sometimes stated that administered prices lag on the decline but rise more than other prices during periods of rising prices. John M. Blair, for example, has referred to "This practice of lowering prices less in depression and raising them more in prosperity. . . ." ¹ There is little historic support for this charge.

Unfortunately, data for administered prices alone are not readily available. But Means, Blair, and others have used this term interchangeably with inflexible prices. It is of interest, therefore, to check the changes in inflexible prices during past cyclical swings.

The relative changes of prices in terms of their inflexibility (defined in terms of the frequency of price change) was measured by the National Resources Committee for the 1920-21 depression and the 1921-23 recovery. The frequency of change was based on the 1926-33 experience. The estimated changes for five groups of products are shown in Table 10:

TABLE 10
Price Changes for Flexible and
Inflexible Prices,
1920-1923

| Group | Range of Price Change Frequency* | Per Cent Change | |
|--------------------------|--|-----------------|---------|
| | | 1920-21 | 1921-23 |
| A | 0-7 | -12.3 | -10.2 |
| B | 8-16 | -26.6 | -11.1 |
| C | 17-34 | -33.3 | 6.7 |
| D | 35-77 | -38.8 | 8.6 |
| E | 78-95 | -45.4 | 14.5 |
| Wholesale Price Index | | -36.8 | 2.7 |

* Based on the number of monthly changes in the eight year period, 1926 to 1933.

Source: National Resources Committee, *The Structure of the American Economy*, Part I, Washington, June 1939, p. 147.

In this tabulation the most inflexible prices are in Group A, the most flexible in Group E. It will be noted that Group A prices declined the least in the 1920-21 period. The magnitude of decline increased as we progress to the most flexible prices in Group E. The reverse experience occurred in the 1921-23 recovery. However, in that period, inflexible prices (Groups A and B) continued to decline while flexible prices increased. No support for the smaller decline-larger rise thesis is found in that experience.

In April, 1951, the U. S. Department of Commerce reported the movement of wholesale prices in three groups: inflexible, flexible, and neither flexible nor inflexible. The groupings were based on the classification set up by the National Resources Committee in the study cited above. The changes in these three indexes for selected dates are shown in Table 11:

¹ John M. Blair, *Seeds of Destruction*, Covici, Friede, New York, 1938, p. 124.

TABLE 11
Wholesale Prices, Selected Dates,
1929-1951

| | Inflexible | Neither | Flexible |
|------------|---------------|---------|----------|
| | (1926-29=100) | | |
| 1929 | 98.3 | 98.2 | 99.8 |
| 1932 | 87.3 | 71.4 | 49.6 |
| 1933 | 86.0 | 73.9 | 57.1 |
| 1937 | 94.5 | 89.0 | 83.6 |
| 1939 | 95.1 | 85.9 | 72.6 |
| June 1946 | 112.6 | 120.4 | 133.9 |
| Sept. 1948 | 147.7 | 167.0 | 191.3 |
| March 1949 | 150.5 | 164.8 | 178.7 |
| June 1949 | 148.8 | 158.9 | 168.3 |
| Sept. 1949 | 147.4 | 157.5 | 171.1 |
| June 1950 | 149.0 | 159.3 | 178.1 |
| Jan. 1951 | 168.2 | 187.4 | 213.5 |

| Period | Per Cent Change | | | |
|-----------------|-----------------|--------|--------|--|
| 1929-32 | - 11.2 | - 27.3 | - 50.3 | |
| 1932-37 | + 8.2 | + 24.6 | + 68.5 | |
| 1937-39 | + 0.6 | - 3.5 | - 13.2 | |
| 1939-Sept. 1948 | + 55.3 | + 94.4 | +163.5 | |
| Sept. 1948- | | | | |
| Sept. 1949 | - 0.2 | - 5.7 | - 10.6 | |
| Sept. 1949- | | | | |
| Jan. 1951 | + 14.1 | + 19.0 | + 24.8 | |

In the lower half of the Table, the changes in each of the three groups of prices are shown for the various periods of decline and expansion between 1929 and 1951, the last date for which these data were available. In every period, inflexible prices declined less or increased less than did flexible prices. The U. S. Department of Commerce commented on the 1929-37 experience as follows:

"Prices in the inflexible group tended to lag behind other prices in the downward phase of the business cycle, as in 1929-32 when prices in the inflexible group decreased somewhat more than one-tenth compared with one-half in the flexible group. The movement during an upturn was typically characterized during the 1936-37 recovery when prices in the in-

flexible group rose considerably less than prices in the other groups."¹

During the 1937-39 recession, the inflexible price group rose fractionally while flexible prices fell by 13.2 per cent. In the war and early postwar inflation which reached its pre-Korean peak in September, 1948, the rise in inflexible prices lagged far behind that for flexible prices; the respective increases were 55.3 per cent and 163.5 per cent. How much more severe would our war and postwar inflation have been if inflexible prices had joined fully the sharp rise in flexible prices? And how much greater would the possibility have been for a severe postwar readjustment instead of the mild recession we had in 1948-49? Certainly, during that period there was no support for the larger price rise theory.

In the 1948-49 recession, inflexible prices again fell less than did flexible prices—having risen only about one-third as much in the preceding inflation. That this development may have contributed to the shallowness of the 1948-49 decline (instead of accelerating it as the Means thesis would indicate), has been suggested by the U. S. Department of Commerce in its comment on these trends:

"The stability of these [inflexible] prices . . . was a bolstering factor in the renewal of business purchasing for inventories and of capital expansion programs which accompanied the upturn in industrial production in late 1949 and early 1950. Realization that the downturn in prices was limited in degree and scope and that many prices, such as those in the important iron and steel product group, remained unaffected meant that business purchasing could proceed without fear of losses incurred by price declines."²

Inflexible Prices and Stability

The U. S. Department of Commerce is not alone in its conclusion that the relative stability in inflexible prices may mitigate insta-

¹ *Survey of Current Business*, April, 1951, p. 9.

² *Ibid.*, p. 10.

bility in the economy. Thus, J. R. Hicks, the well-known English economist, has stated:

"In most communities there is a large number of prices which, for one reason or another, are fairly insensitive to economic forces, at least over short periods. This rigidity may be due to legislative control, or to monopolistic action (of the sleepy sort which does not strain after every gnat of profit, but prefers a quiet life). It may be due to lingering notions of a 'just price.' The most important class of prices subject to such rigidities are wage-rates; they are affected by rigidity from all three causes. They are particularly likely to be affected by ethical notions, since the wage-contract is very much a personal contract, and will only proceed smoothly if it is regarded as 'fair' by both parties. But, for whatever cause rigidity occurs, it means that some prices do not move upward or downward in sympathy with the rest—they *may consequently exercise a stabilizing influence.*"¹ (Italics added.)

Similarly, Professor Alvin H. Hansen has stated:

"If in industry as a whole, and particularly in the capital goods and durable consumers' goods industries, prices and wages were reduced drastically to an extent commensurate with the decline in the prices of cyclically flexible commodities—agricultural and other raw materials—it is to be expected that by and large such price and wage declines would merely reduce the gross volume of monetary expenditures made in the capital goods and durable consumers' goods area, without appreciably affecting the physical volume of output. Since these cost payments are also income receipts of individuals, incomes fall along with a decline in costs. *In these circumstances the effect of the price reduction is merely to accelerate the decline in the national income and thus intensify the downward movement in business activity.* Moreover, the uncertainty created by the dis-

ruption of reasonable stability and normality with respect to the industrial price and wage structure would only serve to intensify the already unfavorable business expectations engendered by the decline in investment. . . .

"Cyclical price flexibility all around, including administered prices and wage rates in addition to agricultural prices, under the conditions prevailing at the end of a boom, *might well accelerate the downswing.* The expectation by business and consumers that prices will fall tends to generate a cumulative decline in expenditures and to intensify the downswing. . . .

"The deflationary movements cannot be remedied by chasing administered prices and wage rates down to the level of agricultural and other flexible prices. . . .

"So far as the cycle is concerned, a downward adjustment of rigid prices for the economy as a whole is not an adequate remedy, and, indeed, *under many circumstances might well be positively harmful.*"² (Italics added.)

As Hicks and Hansen point out, price changes have effects upon income. The changes in income, in turn, influence the level and composition of demand. It must always be kept in mind that a business or industry experiences a two way flow of income: its receipts and its payments. Business receipts are determined by the combination of prices and volume. If prices are cut and volume does not increase in inverse proportion (that is, if the demand is not elastic), then the total receipts will decline. As the total amount available to be paid out is reduced, there is an accompanying reduction in incomes received either by workers, management, stockholders, material suppliers, by other income

¹ J. R. Hicks, *Value and Capital*, Second Edition, The Clarendon Press, Oxford, 1946, p. 265.

² Alvin H. Hansen, "Price Flexibility and the Full Employment of Resources," in *The Structure of the American Economy, Part II*, National Resources Planning Board, Washington, June 1940, pp. 29, 30 and 33.

recipients or by some combination of the groups connected with that industry.

The net impact on the economy will be determined by how the money saved by customers as a result of the lower price is spent as compared with how the recipients within the industry would have spent it. In any event, it is clear that the money *not* spent for a product by customers when prices decline is not all a net addition to total spending power. Consideration must be given to the offsetting curtailment of spending by other groups.

Moreover, the psychological effects of a spiral of declining prices cannot be ignored. Declining prices breed the hope of further price declines and encourage the withholding of new purchases both by industrial and private consumers. Such expectations may read-

ily accelerate the rate of downturn in the economy with the accompanying unemployment of resources. When consumers see price stability they are encouraged to purchase enough to meet their needs rather than to live off stocks or inventories and to postpone purchases.

The long term record of growth in our economy, the typical moderate recessions, and the identifiable nature of the forces which have led to the severe depressions (the imbalances arising from war and the resulting excessive expansion of money and credit), indicate that there is greater merit to the Hicks-Hansen appraisal of the constructive contribution made by inflexible prices than to the model of a downward spiral of contraction suggested by Means and Blair.

IV. CHANGES IN PRICES AND IN PRODUCTION

ADMINISTERED prices contribute to economic instability, it is claimed, because during periods of declining activity, these prices are inflexible. In turn, the argument runs, demand falls off and production is reduced excessively. The result is rising unemployment. Gardiner Means has stated, in connection with the post-1929 decline, "Indeed, the whole depression might be described as a general dropping of prices at the flexible end of the price scale and a dropping of production at the rigid end with intermediate effects between."¹

Comprehensive studies of these relationships were made for the 1929-1933 depression experience by Thorp and Crowder and Nelson and Keim for the Temporary National Economic Committee, by E. M. Doblin, and by the present writer for the National Industrial Conference Board. The conclusions of these studies are summarized in Appendix B. There was agreement that there had been little relationship between changes in production and prices during that depression and that other factors than price had played a more significant role in causing the differing patterns of reported production decline. The Crowder-Thorp study also showed that this conclusion applied to the experience during the 1933-37 recovery.

Comprehensive studies of price-production relationships are not available for subsequent periods of recession, such as 1937-38, 1948-49, or 1953-54. To fill this gap and to provide more recent data, studies have been made of the relationships in manufacturing and mining and in the steel industry.

Changes in Production and Administered Prices, Manufacturing and Mining Industries

The earlier studies of price-production relationships included products with admin-

istered prices and market prices. However, products falling in the former category were so much more numerous that they dominated the surveys and determined the results. It is probable, therefore, that if products with market prices were excluded from these studies, the conclusions would still apply to the remaining products with administered prices.

This assumption is supported by a study of the experience in the most recent two recessions, namely, 1948-49 and 1953-54. The relationships between changes in production, as shown by the components of the Federal Reserve Board index of industrial production, and changes in wholesale prices reported by the U. S. Bureau of Labor Statistics have been examined. All of the products included in this study have administered prices.

Annual data were used for both periods as was done in other studies made in the past (See Appendix B). The use of annual data avoided the problem of seasonal price movements for some products and the problem of adequacy of Federal Reserve Board seasonal adjustments in some instances. A check of the changes in the components of the FRB index from July 1953, when the total index reached its peak, to July 1954, when it was at its low point, results in essentially the same picture as is shown by the annual data.

In connection with this analysis, the following limitation of the data must be kept in mind. The coverage of the FRB and BLS indexes is not identical. The Federal Reserve Board² index includes *industry* groups and subgroups based on the Standard Industrial Classification.

¹ "Senate Document No. 13," *op. cit.*, p. 8.

² "Revised Federal Reserve Monthly Index of Industrial Production," *Federal Reserve Bulletin*, December 1953, pp. 1247-1328.

The U. S. Bureau of Labor Statistics wholesale price index¹ includes individual *products* and is not based on the Standard Industrial Classification. However, groups of related product prices tend to give a general picture of the trend in prices for an industry. Thus, even though many of the price and production indexes do not match precisely, there appears to be enough similarity in the various categories to make the comparisons valid.

This analysis started with the 175 industries contained in the monthly industrial production index. The descriptions of these industries and the products included in the wholesale price index were examined and the most closely related groups in the two indexes were matched.

In addition to the 175 groups, the FRB index contains a number of subgroups. Thus, for example, fabricated metal products is shown as one group. But the components of this group are structural metal parts, stampings and miscellaneous metal products, tin cans, and furnaces, gas ranges and heaters. Where price data could be obtained for such component groups, those production indexes were used. In the illustration cited above, both price and production data were available for the four component fabricated metal products and hence the data were shown for each group separately and the composite group was omitted.

Where such data were not available, the data for the broader group was used. Thus, for hosiery, subgroups are available showing production of full fashioned hosiery and seamless hosiery. However, the same breakdown was not available in the BLS price data and hence, comparisons were made for the entire group.

The present survey includes 49 of the major components of the FRB index. In addition, it includes 35 subgroups which are listed under 17 other components. Thus, 66

out of the 175 components are represented in this survey. These 84 industries and industry subgroups accounted for 64.4 per cent of the weighted importance of the industrial production index. The experience in the 1948-49 and 1953-54 recessions is discussed below.

1948-49 Period

During the 1948-49 recession, the Federal Reserve Board industrial production index declined 6.7 per cent, the nonfarm nonfood wholesale price index declined 2.0 per cent, and processed foods prices declined 9.8 per cent. Table 12 and Chart 4 show the changes in production and in prices for 83 related industries during that period. Prices rose for 40 groups of products and declined for 42 groups; price was unchanged for one group. Production increased for 19 industries, was unchanged for 5, and declined for 59 industries. As is clear from the data, there was little or no relationship between the changes in prices and the magnitude of changes in production.

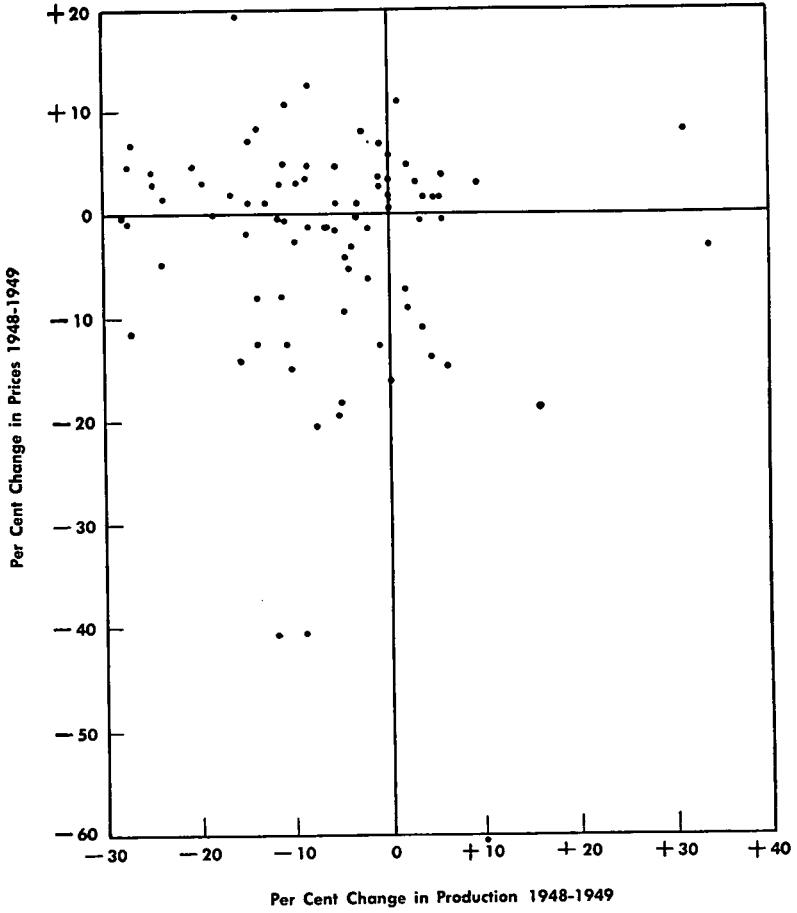
For the forty groups for which prices increased, output increased in nine industries and was unchanged in four others. In other words, for one industry in three with price increases, output did not decline. The forty-two price declines were accompanied by ten increases in output or fewer than one out of four.

Prices rose more than 5 per cent in eleven industries in which the changes in production ranged between an increase of 31.2 per cent and a decrease of 26.7 per cent. Production declined in eight of these industries, it was un-

¹ "The classification system of the wholesale price index is essentially based on products or commodities rather than on industry, source, or end use. It does not exactly match either the Standard Industrial Classification, the Standard Commodity Classification, or the United Nations Commodity Classification." U. S. Department of Labor, Bureau of Labor Statistics, "Techniques of Preparing Major BLS Statistical Series," *Bulletin No. 1168*, Washington, December 1954, p. 85.

Chart No. 4

**CHANGES IN PRODUCTION AND IN PRICES
MANUFACTURING AND MINING INDUSTRIES
1948-1949**



Source: Production—Federal Reserve Board
Prices—U. S. Department of Labor, Bureau of Labor Statistics

TABLE 12
Changes in Production and in Prices,
Manufacturing and Mining Industries,
1948-1949

| PRICES ¹ | | PRODUCTION ² | |
|---|-----------------|---|-----------------|
| Product | Per Cent Change | Industry | Per Cent Change |
| Iron ore | + 19.1 | Iron ore | - 15.7 |
| Glass containers | + 12.3 | Glass containers | - 8.2 |
| Tin cans #2 | + 10.7 | Tin cans | + 1.0 |
| Pig iron, basic | + 10.5 | Pig iron | - 11.4 |
| Semifinished and finished steel | + 8.3 | Steel | - 13.2 |
| Passenger cars | + 8.1 | Autos | + 31.2 |
| Aluminum ingot | + 8.0 | Aluminum | - 2.9 |
| Coke | + 7.0 | Coke | - 14.2 |
| Aluminum rods and sheet | + 6.8 | Aluminum mill shapes | - 26.7 |
| Agricultural machinery and equipment | + 6.8 | Farm machinery | - 0.9 |
| Oilfield machinery and tools | + 5.6 | Oil and gas well drilling | . 0 |
| Flat glass | + 4.9 | Flat glass vitreous products | - 8.5 |
| Inorganic chemicals | + 4.8 | Basic inorganic chemicals | + 2.0 |
| Fire clay brick | + 4.8 | Clay, firebrick, pipe and tile | - 10.5 |
| Face brick and building brick | + 4.4 | Brick | - 5.6 |
| Foundry and forge shop | + 4.1 | Ferrous castings and forgings | - 20.2 |
| Motor trucks | + 4.1 | Trucks | - 27.0 |
| Pennsylvania anthracite coal | + 3.9 | Anthracite coal | - 24.8 |
| Newsprint | + 3.5 | Newsprint consumption | + 5.9 |
| Commercial furniture | + 3.2 | Fixtures and office furniture | - 8.6 |
| Cigarettes | + 3.1 | Cigarettes | - 1.0 |
| Mixed fertilizers | + 3.0 | Fertilizers | 0 |
| Portland cement | + 2.7 | Cement | + 2.9 |
| Sugar, cane, granulated, domestic, refined | + 2.7 | Cane sugar | + 9.6 |
| Soft surface floor coverings | + 2.6 | Woven carpets | - 19.1 |
| Electrical machinery and equipment | + 2.5 | Electrical apparatus and parts | - 9.6 |
| Millwork | + 2.4 | Millwork | - 11.2 |
| Heating equipment | + 2.4 | Furnaces, gas ranges, and heaters | - 24.3 |
| Concrete products | + 2.3 | Concrete and plaster products | - 0.9 |
| Wool products, broadwoven fabrics | + 1.5 | Wool fabrics | - 16.2 |
| Building board | + 1.4 | Building paper and board | - 23.2 |
| Plastic materials | + 1.4 | Plastics materials | + 5.1 |
| Gasoline | + 1.4 | Gasoline | + 3.9 |
| Natural gas | + 1.2 | Natural gas | + 4.9 |
| Malt beverages | + 1.2 | Beer and ale | 0 |
| Printing paper | + 0.9 | Printing paper | - 5.8 |
| Wool yarn | + 0.9 | Wool apparel yarns | - 14.3 |
| Prepared paints | + 0.9 | Paints | - 12.5 |
| Cigars | + 0.8 | Cigars | - 3.0 |
| Nonalcoholic beverages | + 0.2 | Bottled soft drinks | 0 |
| Synthetic rubber | 0 | Synthetic rubber | - 18.1 |
| Ice cream | - 0.1 | Ice cream | - 3.1 |
| Prepared asphalt roofing | - 0.3 | Asphalt roofing and siding | - 11.1 |
| Sanitary papers and health products | - 0.4 | Sanitary paper products | + 5.9 |
| Distilled spirits | - 0.4 | Liquor distilling | - 27.6 |
| Canned and frozen fruits and vegetables | - 0.6 | Canned and frozen foods | + 3.0 |
| Writing paper | - 0.9 | Fine paper | - 11.7 |

¹ U. S. Department of Labor. Bureau of Labor Statistics.

² Federal Reserve Board.

TABLE 12 (continued)

| PRICES ¹ | | PRODUCTION ² | |
|---|-----------------|--|-----------------|
| Product | Per Cent Change | Industry | Per Cent Change |
| Bituminous coal | - 1.1 | Bituminous coal | -26.9 |
| Household furniture | - 1.3 | Household furniture | - 6.8 |
| Crude petroleum | - 1.3 | Crude oil | - 8.5 |
| Footwear | - 1.4 | Shoes and slippers | - 2.0 |
| Fabricated structural metal products..... | - 1.5 | Structural metal parts | - 6.7 |
| Synthetic fibers | - 1.6 | Synthetic fibers | - 5.6 |
| Laundry equipment and refrigerators and freezing units | - 2.0 | Laundry and refrigeration appliances.... | -14.9 |
| Tires and tubes | - 2.9 | Auto, truck and bus tires | - 9.7 |
| Paperboard | - 3.1 | Paperboard | - 3.9 |
| Television and radio receivers | - 3.5 | Radio and television sets | + 33.7 |
| Underwear and nightwear and knit outerwear | - 4.3 | Knit garments | - 4.8 |
| Copper water tubing | - 5.0 | Copper mill shapes | -23.9 |
| Apparel, men's and boys' | - 5.4 | Men's outerwear | - 4.0 |
| Paper bags and shipping sacks..... | - 6.5 | Shipping containers | - 2.0 |
| Apparel, women's, misses' and juniors'.... | - 7.8 | Women's outerwear | + 1.9 |
| Cattlehide leathers | - 8.1 | Cattlehide leathers | -11.0 |
| Lumber | - 8.5 | Lumber | -13.2 |
| Zinc, slab | - 9.2 | Zinc | + 2.0 |
| Wood pulp | - 9.6 | Wood pulp | - 4.8 |
| Pork, fresh, loins | -11.0 | Pork | + 3.1 |
| Secondary metal and alloy shapes..... | -11.7 | Secondary nonferrous metals | -26.9 |
| Copper ingot, electrolytic | -12.6 | Copper refining and smelting | -10.4 |
| Cotton products | -12.7 | Cotton consumption | -13.6 |
| Plywood | -12.7 | Soft plywood | - 1.0 |
| Beef | -13.8 | Beef | + 4.3 |
| Kerosene | -14.0 | Kerosene | -15.6 |
| Lead, pig | -14.9 | Lead | + 6.3 |
| Distillate fuel oil | -15.0 | Distillate fuel oil | -10.0 |
| Hosiery | 0 | Hosiery | 0 |
| Soap and synthetic detergents | -18.3 | Soap and allied products | - 5.0 |
| Butter | -18.6 | Butter | +16.3 |
| Synthetic textiles, broadwoven goods..... | -19.5 | Synthetic fabrics | - 5.6 |
| Milk, powdered | -20.9 | Concentrated milk | - 7.8 |
| Lubricating oil | -40.7 | Lubricating oil | -11.5 |
| Residual fuel oil | -40.7 | Residual fuel oil | - 8.7 |
| Tallow and grease | -60.6 | Vegetable and animal oils | +10.0 |

¹ U. S. Department of Labor, Bureau of Labor Statistics.

² Federal Reserve Board.

changed in one, and rose in two others.

Prices rose between 1.0 per cent and 2.0 per cent in six industries. The range of production changes was from an increase of 5.1 per cent to a decrease of 23.2 per cent. There were two increases in production, three declines, and one industry with no change.

Prices declined 15 per cent or more in nine industries in which the changes in production ranged between an increase

of 16.3 per cent and a decrease of 11.5 per cent. For six of the nine industries, production declined and one industry had no change; in four industries the decline was relatively *greater* than the average decline in total industrial production.

There were eight price declines between 10.0 per cent and 14.9 per cent. For these industries, the changes in output ranged between an increase of 6.3 per

cent and a decline of 26.9 per cent. For five of these eight industries, output declined despite the more than average declines in prices; for four industries the decline in production exceeded that in the total index.

There were eight price declines between 5.0 per cent and 10.0 per cent with an accompanying range of production changes between an increase of 2.0 per cent and a decline of 23.9 per cent. For six of these eight industries, output declined.

For eighteen industries with price declines up to 5.0 per cent, only three reported a rise in output.

These data show there was no relationship between the magnitude of the changes in prices and in production in the 1948-49 recession. Chart 4 shows this lack of relationship in graphic form.

1953-54 Period

From 1953 to 1954, the Federal Reserve Board industrial production index declined 6.7 per cent, the nonfarm nonfood wholesale price index rose 0.4 per cent, and the processed foods wholesale price index rose 0.7 per cent. Table 13 and Chart 5 show the changes in prices and production for 82 related industries during the period.¹ Again we find no relationship between the magnitude of changes in prices and in production.

For the forty-three groups of prices which rose, output increased in fifteen industries or in more than one out of every three cases. The thirty-eight price declines were accompanied by only ten increases in output. This was about one industry out of four.

Prices rose 5.0 per cent or more for eight groups of products. For the corresponding industries, the range of changes in production was from an increase of 5.1 per cent to a decrease of 7.9 per cent. Production actually rose

for two of these industries with the largest price rises.

Prices rose between 1.0 per cent and 1.9 per cent for twelve groups of products with accompanying changes in production ranging from an increase of 6.6 per cent to a decline of 26.9 per cent; production increased in four of these industries.

There were six price declines of more than 5.0 per cent. For these industries the production change varied between an increase of 11.6 per cent and a decline of 13.6 per cent. Output increased in three industries and was unchanged in one.

Six price declines between 1.0 per cent and 1.9 per cent were accompanied by changes in production ranging between an increase of 4.7 per cent and a decrease of 22.0 per cent.

These data are portrayed on Chart 5. There was no relationship between the magnitude of changes in prices and production in the 1953-54 recession.

This review of the changes in administered prices and production during the 1948-49 and 1953-54 recessions shows the same lack of relationship that was found in the studies covering the post-1929 depression. These data provide no support for the theory that a recession is characterized by "a general dropping of prices at the flexible end of the price scale and a dropping of production at the rigid end. . . ."

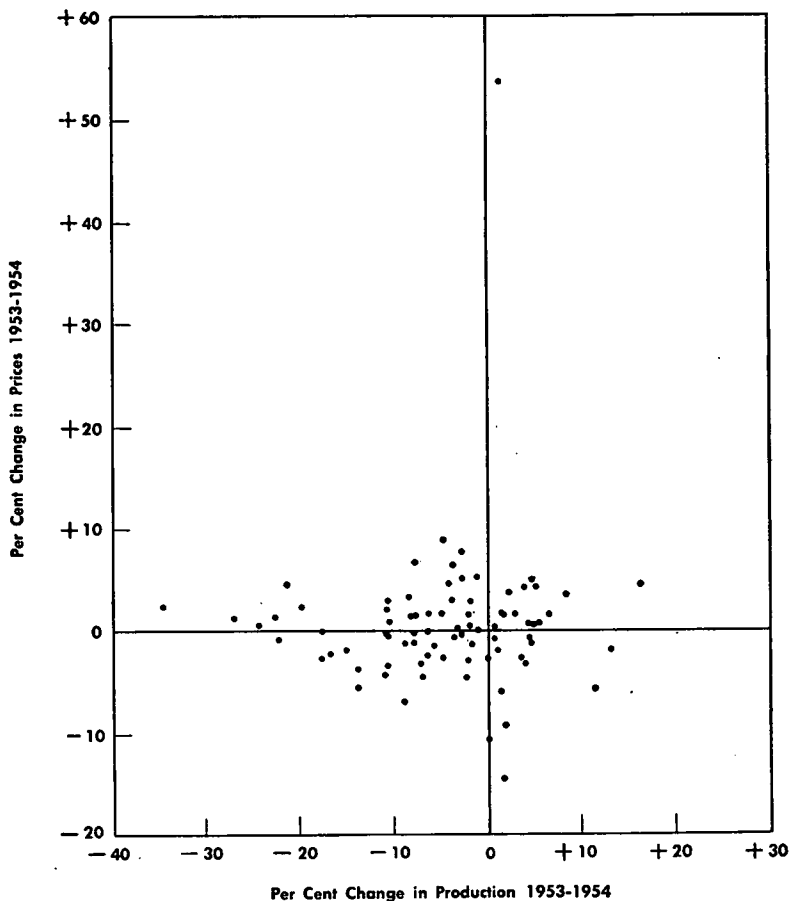
Changes in Steel Shipments and Steel Prices

Within many of the industries included in the above study, a number of additional comparisons could be made for individual prod-

¹ Federal Reserve Board production data were available for shoes and slippers and bottled soft drinks for 1948-49 but not for 1953-54. Bureau of Labor Statistics price data for confectionery were available for 1953-54 but did not appear to be adequate for 1948-49.

Chart No. 5

**CHANGES IN PRODUCTION AND IN PRICES
MANUFACTURING AND MINING INDUSTRIES
1953-1954**



Source: Production—Federal Reserve Board
Prices—U. S. Department of Labor, Bureau of Labor Statistics

TABLE 13

**Changes in Production and in Prices,
Manufacturing and Mining Industries,
1953-1954**

| PRICES ¹ | | PRODUCTION ² | |
|---|-----------------|--------------------------------------|-----------------|
| Product | Per Cent Change | Industry | Per Cent Change |
| Tallow and grease | + 53.7 | Vegetable and animal oils | + 1.7 |
| Soap and synthetic detergents | + 8.8 | Soap and allied products | - 4.4 |
| Confectionery | + 7.7 | Confectionery | - 2.9 |
| Residual fuel oil | + 6.8 | Residual fuel oil | - 7.9 |
| Fire clay brick | + 6.2 | Clay, firebrick, pipe and tile | - 8.5 |
| Building board | + 5.2 | Building paper and board | + 5.1 |
| Pork, fresh, loins | + 5.0 | Pork | - 1.0 |
| Glass containers | + 5.0 | Glass containers | - 2.5 |
| Semifinished and finished steel | + 4.5 | Steel | - 21.6 |
| Aluminum ingot | + 4.3 | Aluminum | + 16.7 |
| Malt beverages | + 4.3 | Beer and ale | - 3.9 |
| Lead, pig | + 4.3 | Lead | + 4.0 |
| Inorganic chemicals | + 4.2 | Basic inorganic chemicals | + 5.4 |
| Portland cement | + 3.6 | Cement | + 2.3 |
| Oilfield machinery and tools | + 3.5 | Oil and gas well drilling | + 8.4 |
| Aluminum rods and sheets | + 3.2 | Aluminum mill shapes | - 8.3 |
| Copper ingot, electrolytic | + 3.2 | Copper refining and smelting | - 8.3 |
| Flat glass | + 3.0 | Flat glass vitreous products | - 3.7 |
| Crude petroleum | + 2.8 | Crude oil | - 1.6 |
| Tires and tubes | + 2.7 | Auto, truck, and bus tires | - 10.3 |
| Iron ore | + 2.5 | Iron ore | - 34.4 |
| Foundry and forge shop | + 2.3 | Ferrous castings and forgings | - 19.8 |
| Electrical machinery and equipment | + 2.0 | Electrical apparatus and parts | - 10.6 |
| Concrete products | + 1.8 | Concrete and plaster products | - 1.2 |
| Cigarettes | + 1.6 | Cigarettes | - 4.5 |
| Natural gas | + 1.6 | Natural gas | + 3.0 |
| Tin cans #2 | + 1.6 | Tin cans | + 1.6 |
| Prepared paints | + 1.5 | Paints | - 1.7 |
| Distillate fuel oil | + 1.4 | Distillate fuel oil | + 1.9 |
| Commercial furniture | + 1.4 | Fixtures and office furniture | - 7.8 |
| Kerosene | + 1.4 | Kerosene | - 6.0 |
| Face brick and building brick | + 1.3 | Brick | + 6.6 |
| Pig iron, basic | + 1.3 | Pig iron | - 22.3 |
| Fabricated structural metal products | + 1.2 | Structural metal parts | - 8.0 |
| Synthetic rubber | + 1.0 | Synthetic rubber | - 26.9 |
| Passenger cars | + 0.8 | Autos | - 10.3 |
| Apparel, women's, misses', and juniors' | + 0.6 | Women's outerwear | + 5.8 |
| Wood pulp | + 0.6 | Wood pulp | + 4.2 |
| Sanitary papers and health products | + 0.4 | Sanitary paper products | + 5.1 |
| Coke | + 0.4 | Coke | - 24.3 |
| Cigars | + 0.4 | Cigars | - 1.9 |
| Newsprint | + 0.2 | Newsprint consumption | + 0.9 |
| Paperboard | + 0.2 | Paperboard | - 3.0 |
| Printing paper | 0 | Printing paper | - 0.8 |
| Sugar, cane, granulated, domestic, refined | - 0.1 | Cane sugar | - 6.2 |
| Agricultural machinery and equipment | - 0.1 | Farm machinery | - 17.7 |
| Canned and frozen fruits and vegetables | - 0.2 | Canned and frozen foods | - 7.4 |

¹ U. S. Department of Labor, Bureau of Labor Statistics.² Federal Reserve Board.

TABLE 13 (continued)

| PRICES ¹ | | PRODUCTION ² | |
|---|-----------------|--|-----------------|
| Product | Per Cent Change | Industry | Per Cent Change |
| Synthetic fibers | - 0.3 | Synthetic fibers | - 2.6 |
| Laundry equipment and refrigerators and freezing units | - 0.3 | Laundry and refrigeration appliances.... | - 10.9 |
| Heating equipment | - 0.4 | Furnaces, gas ranges, and heaters..... | - 3.2 |
| Household furniture | - 0.5 | Household furniture | - 10.2 |
| Millwork | - 0.7 | Millwork | + 4.2 |
| Plastic materials | - 0.9 | Plastics materials | + 0.5 |
| Motor trucks | - 1.0 | Trucks | - 22.0 |
| Secondary metal and alloy shapes..... | - 1.2 | Secondary nonferrous metals | - 7.9 |
| Mixed fertilizers | - 1.3 | Fertilizers | - 1.6 |
| Beef | - 1.3 | Beef | + 4.7 |
| Apparel, men's and boys' | - 1.3 | Men's outerwear | - 8.9 |
| Lumber | - 1.7 | Lumber | - 5.4 |
| Wool products, broadwoven fabrics..... | - 2.0 | Wool fabrics | - 14.7 |
| Milk, powered | - 2.0 | Concentrated milk | + 1.1 |
| Distilled spirits | - 2.1 | Liquor distilling | + 13.3 |
| Wool yarn | - 2.3 | Wool apparel yarns | - 16.5 |
| Synthetic textiles, broadwoven goods.... | - 2.6 | Synthetic fabrics | - 6.1 |
| Writing paper | - 2.8 | Fine paper | + 3.5 |
| Soft surface floor coverings | - 2.9 | Woven carpets | - 17.4 |
| Paper bags and shipping sacks..... | - 2.9 | Shipping containers | 0 |
| Hosiery | - 2.9 | Hosiery | - 4.4 |
| Ice cream | - 3.0 | Ice cream | - 1.9 |
| Prepared asphalt roofing | - 3.1 | Asphalt roofing and siding | + 4.0 |
| Zinc, slab | - 3.2 | Zinc | - 10.6 |
| Television and radio receivers | - 3.3 | Radio and television sets | - 7.0 |
| Underwear and nightwear and knit outerwear | - 3.7 | Knit garments | - 13.4 |
| Copper water tubing | - 4.4 | Copper mill shapes | - 10.7 |
| Cotton products | - 4.6 | Cotton consumption | - 6.7 |
| Gasoline | - 4.7 | Gasoline | - 2.1 |
| Bituminous coal | - 5.5 | Bituminous coal | - 13.6 |
| Plywood | - 5.7 | Soft plywood | + 11.6 |
| Pennsylvania anthracite coal | - 7.2 | Anthracite coal | - 8.8 |
| Butter | - 9.4 | Butter | + 1.9 |
| Cattlehide leathers | - 10.6 | Cattlehide leathers | 0 |
| Lubricating oil | - 15.1 | Lubricating oil | + 1.9 |

¹ U. S. Department of Labor, Bureau of Labor Statistics.

² Federal Reserve Board.

ucts if other sources than the Federal Reserve Board were used. This is illustrated by a special study made of changes in shipments or production and prices in the steel industry. The data for gross shipments and production are published by the American Iron & Steel Institute and the price data by the U. S. Bureau of Labor Statistics. In addition to the 1948-49 and 1953-54 periods, the relationships in the 1929-32 depression, 1937-38 recession, and 1954-55 recovery also were examined.

1929-32 Decline

Steel production data had to be used for the 1929-32 period because detailed data for gross shipments of steel products are not available.

Table 14 shows the relationship between changes in production and in prices for 11 steel product groups for which data were available for the 1929-32 period. These data are summarized in Table 15 and shown in Chart 6.

TABLE 14
Changes in Steel Production and in Prices,
1929 to 1932

| Products | Production (Thous. of Gross Tons) | | | BLS Price per 100 lbs | | |
|----------------------------------|--------------------------------------|-------|----------|-----------------------|---------------------|----------|
| | 1929 | 1932 | % Change | 1929 | 1932 | % Change |
| Bars, concrete reinforcing | 963 | 385 | - 60.0 | \$2.021 | \$1.558 | - 22.9 |
| Wire nails | 585 | 241 | - 58.8 | 2.667 | 2.050 | - 23.1 |
| Skelp | 3,366 | 576 | - 82.9 | 1.859 | 1.567 | - 15.7 |
| Bars, hot rolled | 6,305 | 1,285 | - 79.6 | 1.924 | 1.577 | - 18.0 |
| Plates | 5,022 | 830 | - 83.5 | 1.900 | 1.600 | - 15.8 |
| Rails | 2,662 | 393 | - 85.2 | 43,000 ² | 42,377 ² | - 1.5 |
| Sheets, hot rolled | 5,255 | 1,472 | - 72.0 | 3.000 | 2.300 | - 23.3 |
| Structural shapes | 4,778 | 937 | - 80.4 | 1.921 | 1.584 | - 17.6 |
| Tin plate | 1,816 | 986 | - 45.7 | 5.350 | 4.712 | - 11.9 |
| Pipe ¹ | 3,019 | 485 | - 83.9 | 4.261 | 3.950 | - 7.3 |
| Terne plate | 152 | 46 | - 69.7 | 11.143 ³ | 9.500 ³ | - 14.8 |

¹ Production includes lap weld and butt weld pipe and tubes.

² Per gross ton.

³ Per 220 lb box.

Source: American Iron and Steel Institute and U. S. Department of Labor, Bureau of Labor Statistics.

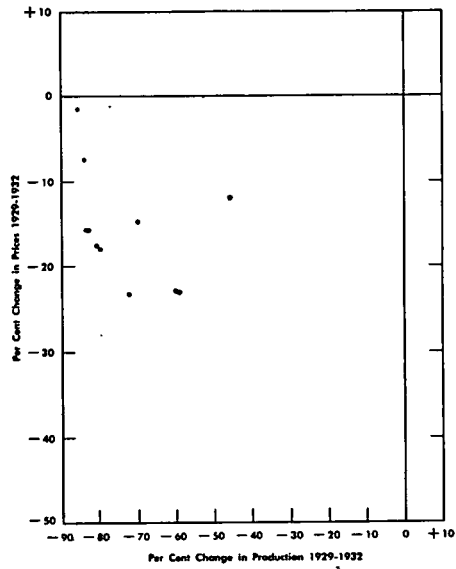
TABLE 15
Declines in Steel Production and
in Prices, 1929 to 1932

| Per Cent Decline in Prices | Per Cent Declines in Production |
|-------------------------------|------------------------------------|
| 0.1 - 5.0 | 85.2 |
| 5.1 - 10.0 | 83.9 |
| 10.1 - 15.0 | 45.7, 69.7 |
| 15.1 - 20.0 | 79.6, 80.4, 82.9, 83.5 |
| 20.1 - 25.0 | 58.8, 60.0, 72.0 |

That was a period in which steel production declined sharply for practically all products. Chart 6 shows a general tendency for the largest price declines to be accompanied by the smaller declines in production. Nevertheless, varying relationships are shown for this period. For example, output declined between 80.4 per cent and 85.2 per cent for five groups of products for which the price decline ranged from 1.5 per cent to 17.6 per cent. An 11.9 per cent decline in prices was accompanied by a 45.7 per cent decline in output (tin plate), while a 23.3

Chart No. 6

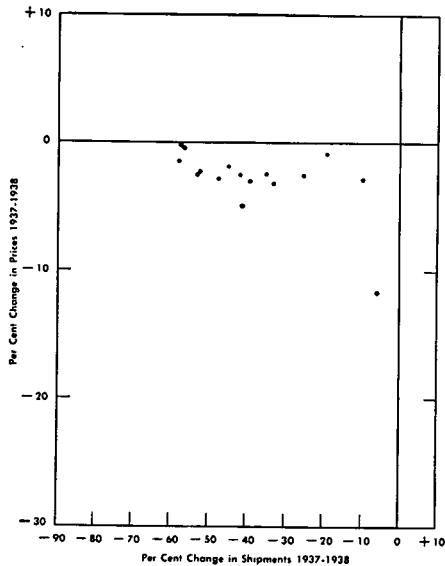
RELATION BETWEEN PERCENTAGE CHANGES IN PRODUCTION AND PRICES OF STEEL PRODUCTS BETWEEN 1929 AND 1932



Source: Production data—American Iron & Steel Institute
 Price data—U. S. Department of Labor, Bureau of Labor Statistics

Chart No. 7

**RELATION BETWEEN PERCENTAGE CHANGES IN
SHIPMENTS AND PRICES OF STEEL PRODUCTS
BETWEEN 1937 AND 1938**



Source: Shipments data—American Iron & Steel Institute
Price data—U. S. Department of Labor, Bureau of Labor Statistics

per cent price decline, the largest one, was accompanied by a decline of 72.0 per cent in production (sheets, hot rolled). During that depression, steel prices declined less than did the general level of prices while steel output declined more than production in the balance of the economy.

1937-38 Decline

The relationships between changes in prices and in gross shipments in the succeeding periods of recession were much less significant. Table 16 and Chart 7 show the data for the 1937-38 recession. Table 17 presents a summary of these data.

TABLE 16
Changes in Steel Shipments and in Prices,
1937 to 1938

| Product | Gross Shipments ¹ (Thous. of Tons) | | | BLS Price Index (1926 = 100) | | |
|---|--|------------------|-------------|---------------------------------|--------------------|-------------|
| | 1937 | 1938 | % Change | 1937 | 1938 | % Change |
| Bars, concrete reinforcing | 885 | 836 | - 5.5 | 122.1 | 107.8 | - 11.7 |
| Bars, hot rolled | 5,100 | 2,424 | - 52.5 | 120.6 | 117.5 | - 2.6 |
| Bars, cold finished | 813 | 346 | - 57.5 | 115.4 | 113.8 | - 1.4 |
| Nails and staples | 544 | 490 | - 9.9 | 100.8 ⁴ | 98.0 ⁴ | - 2.8 |
| Plates | 3,397 | 1,632 | - 52.0 | 118.1 | 115.4 | - 2.3 |
| Rails, standard | 1,430 | 619 | - 56.7 | 97.4 | 97.2 | - 0.2 |
| Wire rods | 758 | 462 | - 39.1 | 102.9 | 99.8 | - 3.0 |
| Sheets, hot rolled | 4,774 | 2,708 | - 43.3 | 102.2 | 102.2 | 0 |
| Sheets, cold rolled | 2,274 | 1,344 | - 40.9 | 82.2 | 78.2 | - 4.9 |
| Sheets, galvanized | 1,330 | 996 | - 25.1 | 94.4 | 91.9 | - 2.7 |
| Skelp | 678 | 442 | - 34.8 | 107.8 | 105.1 | - 2.5 |
| Strip, cold rolled | 817 | 429 | - 47.5 | 86.0 | 83.6 | - 2.8 |
| Structural shapes | 2,789 | 1,554 | - 44.3 | 113.1 | 111.0 | - 1.9 |
| Tie plates | 504 ² | 220 ² | - 56.4 | 98.0 | 97.6 | - 0.4 |
| Tin and terne plate, electric and hot dipped | 2,758 | 1,618 | - 41.3 | 102.7 ⁵ | 100.0 ⁵ | - 2.6 |
| Wire, drawn | 1,351 | 909 | - 32.7 | 111.0 | 107.5 | - 3.2 |
| Wire, barbed and twist | 414 { 181 ³ | 334 { 146 | - 19.3 | 98.5 | 97.7 | - 0.8 |
| Woven wire fence | 233 ³ | 188 | | 110.8 | 108.4 | - 2.2 |

¹ Shipments include all grades of steel.

² Includes joint bars.

³ 1937 wire, barbed and twist and woven wire fence is distributed on same ratio as 1938.

⁴ Price for common nails only.

⁵ Price for terne plate only.

Source: American Iron and Steel Institute and U. S. Department of Labor, Bureau of Labor Statistics.

TABLE 17
Declines in Steel Shipments and
in Prices, 1937 to 1938

| Per Cent Decline in Prices | Per Cent Declines in Shipments |
|-------------------------------|--|
| 0 | 43.3 |
| 0.1- 1.0 | 56.4, 56.7 |
| 1.1- 2.0 | 19.3, 44.3, 57.5 |
| 2.1- 3.0 | 9.9, 25.1, 34.8, 39.1, 41.3, 47.5, 52.0, 52.5 |
| 3.1- 4.0 | 32.7 |
| 4.1- 5.0 | 40.9 |
| 11.1-12.0 | 5.5 |

There were widely varying declines in gross shipments in relationship to the small price declines reported for the 1937-38 period.

Price declines of 1.1 per cent to 2.0 per cent were accompanied by declines in shipments ranging from 19.3 per cent to 57.5 per cent. Price declines of 2.1 per cent to 3.0 per cent were accompanied by declines in gross shipments which varied from 9.9 per cent to 52.5 per cent. In the 1937-38 recession, larger de-

clines were recorded in steel shipments than in the demand for all commodities. Chart 5 indicates there was not much relationship between changes in prices and gross shipments for specific groups of steel products.

1948-49 Decline

Table 18 and Chart 8 show the changes in the 1948-49 recession. These data are summarized in Table 19.

TABLE 18
Changes in Steel Shipments and in Prices,
1948 to 1949

| Products | Gross Shipments (Thous. of Tons) | | | BLS Price Index (1947-49 = 100) | | |
|--|-------------------------------------|------------------|-------------|------------------------------------|--------------------|-------------|
| | 1948 | 1949 | % Change | 1948 | 1949 | % Change |
| Bars, hot rolled—alloy | 2124 | 1589 | - 25.2 | 100.1 | 111.0 | + 10.9 |
| Bars, hot rolled—stainless | 29 | 21 | - 27.6 | 96.9 | 110.6 | + 14.1 |
| Bars, concrete reinforcing—carbon.. | 1549 | 1573 | + 1.5 | 100.6 | 112.1 | + 11.4 |
| Bars, hot rolled—carbon | 6820 | 5418 | - 20.6 | 100.9 | 109.3 | + 8.3 |
| Bars, cold finished—carbon | 1356 | 1024 | - 24.5 | 100.7 | 106.1 | + 5.4 |
| Nails and staples—carbon | 872 | 739 | - 15.3 | 106.4 ⁴ | 112.1 ⁴ | + 5.4 |
| Plates—carbon | 7178 | 5997 | - 16.5 | 100.7 | 109.3 | + 8.5 |
| Rails—standard—carbon | 1989 | 1773 | - 10.9 | 100.7 | 110.0 | + 9.2 |
| Wire rods—carbon | 908 | 809 | - 10.9 | 100.5 | 112.2 | + 11.6 |
| Sheet, hot rolled—carbon | 7340 | 6583 | - 10.3 | 100.8 | 109.9 | + 9.0 |
| Sheets, cold rolled—carbon | 6382 | 6746 | + 5.7 | 100.7 | 107.6 | + 6.9 |
| Sheets, galvanized—carbon | 1646 | 1755 | + 6.6 | 102.5 | 107.0 | + 4.4 |
| Skelp—carbon | 547 | 566 | + 3.5 | 103.6 | 111.9 | + 8.0 |
| Strip, cold rolled—carbon | 1539 | 1277 | - 17.0 | 100.8 | 108.5 | + 7.6 |
| Strip, cold rolled—stainless | 115 | 107 | - 7.0 | 99.2 | 106.2 | + 7.1 |
| Structural shapes—carbon | 4217 | 3631 | - 13.9 | 102.9 | 112.7 | + 9.5 |
| Tie plates—carbon | 490 | 373 | - 23.9 | 105.8 | 113.2 | + 7.0 |
| Tin and terne plate, electrolytic and hot dipped—carbon | 3953 | 3693 | - 6.6 | 100.3 ¹ | 114.7 ¹ | + 14.4 |
| Wire, drawn—carbon | 2799 | 2209 | - 21.1 | 100.1 | 108.5 | + 8.4 |
| Wire, barbed and twisted—carbon | 255 | 215 | - 15.7 | 103.3 ⁵ | 99.8 ⁵ | - 3.4 |
| Woven wire fence—carbon | 403 | 360 | - 10.7 | 103.4 | 108.8 | + 5.2 |
| Pressure tubing—carbon | 875 ² | 676 ² | - 22.8 | 101.8 | 109.1 | + 7.2 |
| Standard pipe—carbon | 2353 | 2264 | - 3.8 | 102.5 ³ | 110.3 ³ | + 7.6 |

¹Price for tinplate—hot dipped only.

²Includes mechanical tubing.

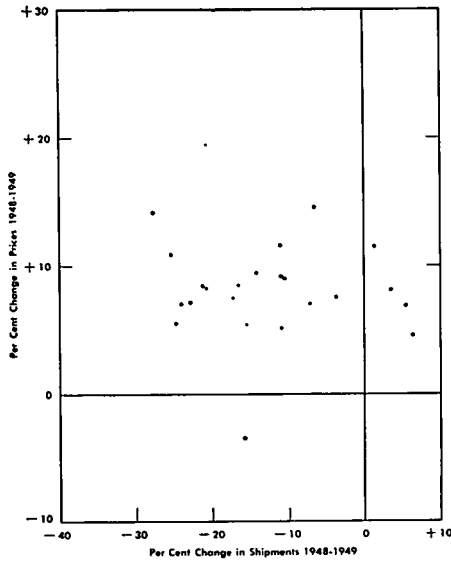
³Price for standard black carbon pipe only.

⁴Price for common nails only.

⁵Price for barbed wire only.

Source: American Iron and Steel Institute and U. S. Department of Labor, Bureau of Labor Statistics.

Chart No. 8
RELATION BETWEEN PERCENTAGE CHANGES IN
SHIPMENTS AND PRICES OF STEEL PRODUCTS
BETWEEN 1948 AND 1949



Source: Shipments data—American Iron & Steel Institute
 Price data—U. S. Department of Labor, Bureau of Labor Statistics

TABLE 19
Per Cent Changes in Steel Shipments and
in Prices, 1948 to 1949

| <u>Per Cent Increase in Prices</u> | <u>Per Cent Change in Shipments</u> |
|------------------------------------|-------------------------------------|
| - 3.4 | -15.7 |
| 4.1- 5.0 | +6.6 |
| 5.1- 6.0 | -10.7, -15.3, -24.5 |
| 6.1- 7.0 | +5.7, -23.9 |
| 7.1- 8.0 | +3.5, -3.8, -7.0, -17.0, -22.8 |
| 8.1- 9.0 | -10.3, -16.5, -20.6, -21.1 |
| 9.1-10.0 | -10.9, -13.9 |
| 10.1-11.0 | -25.2 |
| 11.1-12.0 | +1.5, -10.9 |
| 14.1-15.0 | -6.6, -27.6 |

Specific price changes were accompanied by a significant variation in the changes in shipments. For example, price declines from 6.1 per cent to 8.0 per cent were accompanied by shipment changes ranging from an increase of 5.7 per cent to a decrease of 23.9 per cent. Similarly, price increases of 4.1 per cent to 6.0 per cent were accompanied by shipment changes ranging from an increase of 6.6 per cent to a decrease of 24.5 per cent. Chart 8 shows there was absolutely no relationship between the magnitude of the price increases and the changes in gross shipments in the 1948-49 recession. The overall decline

of about 12 per cent in steel shipments was significantly greater than the decline of less than 7 per cent in total industrial production and of 1/3 of 1 per cent in total national economic activity as measured by real gross national product.¹

1953-54 Decline

Tables 20 and 21 and Chart 9 show the relationship between changes in steel prices and steel shipments in 1953-54.

¹ *Economic Report of the President, January, 1957, Washington, pp. 124, 152.*

TABLE 20
Changes in Steel Shipments and in Prices,
1953 to 1954

| Products | Gross Shipments (Thous. of Tons) | | | BLS Price Index (1947-49 = 100) | | |
|------------------------------------|-------------------------------------|-------------------|-------------|------------------------------------|--------------------|-------------|
| | 1953 | 1954 | % Change | 1953 | 1954 | % Change |
| Wire rods—carbon | 1151 | 1059 | - 8.0 | 149.3 | 159.1 | + 6.6 |
| Skelp—carbon | 655 | 507 | - 22.6 | 127.0 | 133.8 | + 5.4 |
| Rails, standard—carbon | 1868 | 1113 | - 40.4 | 141.0 | 151.1 | + 7.2 |
| Tie plates—carbon | 426 | 236 | - 44.6 | 138.8 | 145.1 | + 4.5 |
| Plates—carbon | 8035 | 5773 | - 28.2 | 135.2 | 141.9 | + 5.0 |
| Structural shapes—carbon | 4977 | 4489 | - 9.8 | 138.2 | 143.8 | + 4.1 |
| Bars, hot rolled—alloy | 2323 | 1445 | - 37.8 | 140.5 | 146.8 | + 4.5 |
| Bars, hot rolled—stainless | 46 | 34 | - 26.1 | 159.6 | 163.4 | + 2.4 |
| Bars, hot rolled—carbon | 7979 | 5364 | - 32.8 | 136.7 | 145.3 | + 6.3 |
| Bars, reinforced—carbon | 1876 | 1759 | - 6.2 | 141.0 | 153.7 | + 9.0 |
| Bars, cold finished—carbon | 1797 | 996 | - 44.6 | 142.6 | 153.5 | + 7.6 |
| Sheets, hot rolled—carbon | 8259 | 6307 | - 23.6 | 133.7 | 139.4 | + 4.3 |
| Sheets, cold rolled—carbon | 11060 | 9518 | - 14.0 | 130.8 | 132.4 | + 1.2 |
| Sheets, galvanized—carbon | 2296 | 2366 | + 3.0 | 128.7 | 131.3 | + 2.0 |
| Strip, cold rolled—carbon | 1960 | 1127 | - 42.5 | 145.6 | 152.8 | + 4.9 |
| Strip, cold rolled—stainless | 233 | 170 | - 27.0 | 130.4 | 133.3 | + 2.2 |
| Standard pipe—carbon | 2869 | 2376 | - 17.2 | 134.7 ¹ | 141.4 ¹ | + 5.0 |
| Tin plate, hot dipped—carbon | 1318 ² | 1307 ² | - 0.8 | 132.5 | 132.9 | + 0.3 |
| Wire, drawn—carbon | 2866 | 2454 | - 14.4 | 151.9 | 165.2 | + 8.8 |
| Nails and staples—carbon | 532 | 570 | + 7.1 | 137.0 ³ | 141.5 ³ | + 3.3 |
| Barbed wire | 164 ⁴ | 136 ⁴ | - 17.1 | 134.7 | 141.0 | + 4.7 |
| Woven wire fence | 246 | 300 | + 22.0 | 136.5 | 142.7 | + 4.5 |
| Pressure tubing—carbon | 390 | 223 | - 42.8 | 144.2 | 153.0 | + 6.1 |

¹Price for standard black carbon pipe only.

²Includes hot dipped terne plate.

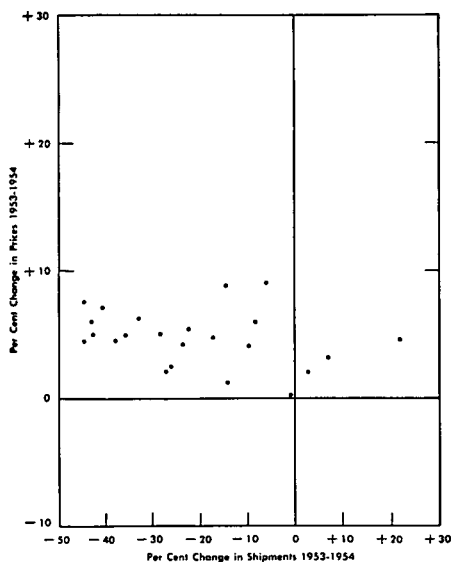
³Price for common nails only.

⁴Includes twisted wire.

Source: American Iron and Steel Institute and U. S. Department of Labor, Bureau of Labor Statistics.

Chart No. 9

RELATION BETWEEN PERCENTAGE CHANGES IN SHIPMENTS AND PRICES OF STEEL PRODUCTS BETWEEN 1953 AND 1954



Source: Shipments data—American Iron & Steel Institute
Price data—U. S. Department of Labor, Bureau of Labor Statistics

TABLE 21
Per Cent Changes in Steel Shipments and in Prices, 1953 to 1954

| Per Cent Increase in Prices | Per Cent Changes in Shipments |
|-----------------------------|--|
| 0.1-1.0 | -0.8 |
| 1.1-2.0 | +3.0, -14.0 |
| 2.1-3.0 | -26.1, -27.0 |
| 3.1-4.0 | +7.1 |
| 4.1-5.0 | +22.0, -9.8, -17.1, -17.2, -23.6, -28.2, -37.8, -42.5, -44.6 |
| 5.1-6.0 | -22.6 |
| 6.1-7.0 | -8.0, -32.8, -42.8 |
| 7.1-8.0 | -40.4, -44.6 |
| 8.1-9.0 | -6.2, -14.4 |

For example, increases in prices of 4.1 per cent to 5.0 per cent were accompanied by changes in shipments which ranged from an increase of 22 per cent to decreases of more than 40 per cent. Price increases of 6.1 per cent to 7.0 per cent were accompanied by declines in gross shipments of from 8.0 per cent to 42.8 per cent. Chart 9 shows there was no predictable or constant relationship between changes in prices and changes in shipments of steel products in the 1953-54 recession. Again the decline of more than 20 per cent in steel shipments contrasts with the moderate

decline of about 2 per cent in total economic activity and the decline of less than 7 per cent in industrial production.

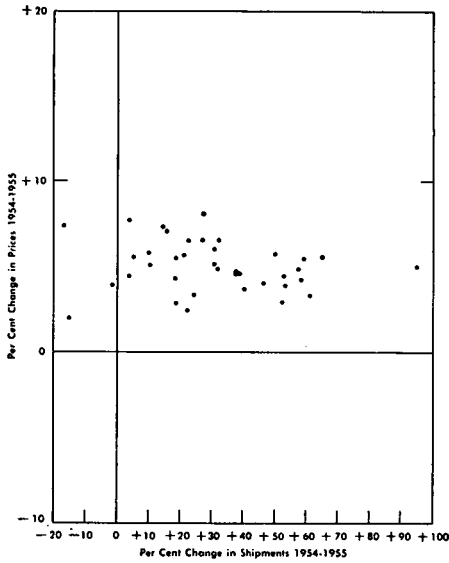
1954-55 Recovery

It is also informative to check what happened to prices and shipments during a

period of expansion. During the 1953-54 recession, the distribution of increases in steel prices was similar to that during the 1954-55 expansion. However, during the latter period, steel shipments were rising sharply, as is indicated in Tables 22 to 24 and Chart 10.

Chart No. 10

RELATION BETWEEN PERCENTAGE CHANGES IN SHIPMENTS AND PRICES OF STEEL PRODUCTS BETWEEN 1954 AND 1955



Source: Shipments data—American Iron & Steel Institute
 Price data—U. S. Department of Labor, Bureau of Labor Statistics

TABLE 22
Changes in Steel Shipments and in Prices
1954 to 1955

| Products | Gross Shipments (Thous. of Tons) | | | BLS Price Index (1947-49=100) | | |
|--------------------------------------|-------------------------------------|-------------------|-------------|----------------------------------|-----------------------|-------------|
| | 1954 | 1955 | % Change | 1954 | 1955 | % Change |
| Wire rods—carbon | 1059 | 1595 | + 50.6 | 159.1 | 168.3 | + 5.8 |
| Skelp—carbon | 507 | 648 | + 27.8 | 133.8 | 144.6 | + 8.1 |
| Rails, standard—carbon | 1113 | 1152 | + 3.5 | 151.1 | 157.8 | + 4.4 |
| Rails, light—carbon | 84 ¹ | 83 ¹ | - 1.2 | *5.842 | *6.067 | + 3.9 |
| Tie plates—carbon | 236 | 312 | + 32.2 | 145.1 | 152.1 | + 4.8 |
| Axles—carbon | 61 | 119 | + 95.1 | *7.375 | *7.750 | + 5.1 |
| Wheels—carbon | 191 | 305 | + 59.7 | *47.750 | *50.389 | + 5.5 |
| Plates—carbon | 5773 | 6858 | + 18.8 | 141.9 | 148.0 | + 4.3 |
| Structural shapes—carbon | 4489 | 4719 | + 5.1 | 143.8 | 151.9 | + 5.6 |
| Bars, hot rolled—alloy | 1445 | 2278 | + 57.6 | 146.8 | 154.0 | + 4.9 |
| Bars, hot rolled—stainless | 34 | 47 | + 38.2 | 163.4 | 170.7 | + 4.5 |
| Bars, hot rolled—carbon | 5364 | 7381 | + 37.6 | 145.3 | 152.1 | + 4.7 |
| Bars, reinforced—carbon | 1759 | 2186 | + 24.3 | 153.7 | 158.8 | + 3.3 |
| Bars, cold finished—carbon | 976 | 1527 | + 53.3 | 153.5 | 160.3 | + 4.4 |
| Bars, cold finished—alloy | 180 | 298 | + 65.6 | *11.148 | *11.771 | + 5.6 |
| Bars, cold finished—stainless | 39 | 54 | + 38.5 | *0.433 | *0.453 | + 4.6 |
| Sheets, hot rolled—carbon | 6307 | 9688 | + 53.6 | 139.4 | 144.8 | + 3.9 |
| Sheets, cold rolled—carbon | 9518 | 15064 | + 58.3 | 132.4 | 137.9 | + 4.2 |
| Sheets, galvanized—carbon | 2366 | 2869 | + 21.3 | 131.3 | 138.8 | + 5.7 |
| Sheets, cold rolled—stainless | 98 | 144 | + 46.9 | *0.548 | *0.570 | + 4.0 |
| Sheets, electrical—alloy | 499 | 660 | + 32.3 | *9.175 | *9.774 | + 6.5 |
| Strip, cold rolled—carbon | 1127 | 1477 | + 31.1 | 152.8 | 160.7 | + 5.2 |
| Strip, cold rolled—stainless | 170 | 275 | + 61.8 | 133.3 | 137.7 | + 3.3 |
| Strip, hot rolled—carbon | 1712 | 2400 | + 40.2 | *5.042 | *5.227 | + 3.7 |
| Standard pipe—carbon | 2376 | 3025 | + 27.3 | 141.4 ² | 150.7 ² | + 6.6 |
| Line pipe—carbon | 2611 | 3098 | + 18.7 | *144.382 | *152.314 | + 5.5 |
| Oil country goods—carbon | 2046 | 2261 | + 10.5 | *151.866 ³ | *159.668 ³ | + 5.1 |
| Oil country goods—alloy | 349 | 429 | + 22.9 | *221.503 ³ | *236.273 ³ | + 6.7 |
| Tin plate, hot dipped—carbon | 1307 ⁴ | 1101 ⁴ | - 15.8 | 132.9 | 135.6 | + 2.0 |
| Tin plate, electrolytic—carbon | 3681 | 4504 | + 22.4 | *7.158 | *7.333 | + 2.4 |
| Black plate—carbon | 674 | 800 | + 18.7 | *6.258 | *6.433 | + 2.8 |
| Wire, drawn—carbon | 2454 | 3211 | + 30.8 | 165.2 | 175.1 | + 6.0 |
| Wire, drawn—stainless | 21 | 32 | + 52.4 | *0.545 | *0.561 | + 2.9 |
| Bale ties—carbon | 52 ⁵ | 60 | + 15.4 | *5.757 | *6.167 | + 7.1 |
| Nails and staples—carbon | 570 | 652 | + 14.4 | 141.5 ⁵ | 151.9 ⁵ | + 7.3 |
| Barbed wire | 136 ⁶ | 113 ⁶ | - 16.9 | 141.0 | 151.3 | + 7.3 |
| Woven wire fence | 300 | 312 | + 4.0 | 142.7 | 153.7 | + 7.7 |
| Pressure tubing—carbon | 223 | 246 | + 10.3 | 153.0 | 162.1 | + 5.9 |

* Stated as price (dollars)

¹Includes all rails except standard tee rails over 60 lb. per yard.

²Price for standard black carbon pipe only.

³Price for oil well casings only.

⁴Includes hot dipped terne plate.

⁵Price for common nails only.

⁶Includes twisted wire.

Source: American Iron and Steel Institute and U. S. Department of Labor, Bureau of Labor Statistics.

TABLE 23

Per Cent Changes in Steel Shipments
1954 to 1955

| | |
|-----------------|------------------|
| <u>Decrease</u> | |
| 10.1-20.0 | 2 |
| 0.1-10.0 | 1 |
| 0 | 1 |
| <u>Increase</u> | |
| 0.1-10 | 3 |
| 10.1-20 | 7 |
| 20.1-30 | 6 |
| 30.1-40 | 7 |
| 40.1-50 | 3 |
| 50.1-60 | 7 |
| 60.1-70 | 2 |
| Above 70 | 1 |
| Total number | 40 |
| Total Range, | -16.9% to +95.1% |

From 1954 to 1955, gross shipments fell for only 3 groups of products, were unchanged for one group, and increased for 36 others. One of the interesting aspects of 1954-55 experience is the wide range of increases in shipments. It will be noted that the increases were fairly evenly distributed between 10 per cent and 60 per cent. For one group, the increase exceeded 70 per cent.

TABLE 24

Per Cent Changes in Steel Shipments
and in Prices, 1954 to 1955

| <u>Per Cent Increase in Prices</u> | <u>Per Cent Increase in Shipments</u> |
|--|---|
| 1.1-2.0 | -15.8 |
| 2.1-3.0 | 52.4, 22.4, 18.7 |
| 3.1-4.0 | 61.8, 53.6, 46.9, 40.2, 24.3, -1.2 |
| 4.1-5.0 | 58.3, 57.6, 53.3, 38.5, 38.2, 37.6, 32.2, 18.8, 3.5 |
| 5.1-6.0 | 95.1, 65.6, 59.7, 50.6, 31.1, 30.8, 21.3, 18.7, 10.5, 10.3, 5.1 |
| 6.1-7.0 | 32.3, 27.3, 22.9 |
| 7.1-8.0 | 15.4, 14.4, 4.0, -16.9 |
| 8.1-9.0 | 27.8 |

Table 24 shows the relationship between changes in gross shipments and prices during the 1954-55 period. For example, price increases of 3.1 per cent to 4.0 per cent were accompanied by increases in gross shipments ranging from 24.3 per cent to 61.8 per cent and by a decrease of 1.2 per cent. Price advances of 5.1 per cent to 6.0 per cent were accompanied by increases in gross shipments ranging from 5.1 per cent to 95.1 per cent. Table 24 and Chart 10 make it abundantly clear that there has been little or no relationship between changes in prices and in gross shipments during the 1954-55 period.

The 1953-54 and 1954-55 experience is significant in another connection. During the 1953-54 period, the designated increases in steel prices were accompanied by decreases in shipments in most instances. During 1954-55, a similar increase in steel prices was accompanied fairly generally by increases in steel shipments. These data suggest that the main factors determining the volume of sales of the steel industry are found in factors other than prices. Unless this were true, it would be impossible to obtain the completely diverse experiences for these two sets of years, as noted previously.

The demand for steel products is essentially derived and depends primarily upon the demand for the end products in which steel is used. For example, the large upsurge in automobile demand in 1955 was not checked because of the rise in prices of steel sheets and other products. Many other types of evidence illustrating this point could be cited.

The role of steel prices was well described by Dr. T. O. Yntema in his presentation before the TNEC:

"Steel is not sold directly to the ultimate consumer. It reaches him only as a part of the finished automobile, refrigerator, typewriter, apartment house, tin can, or safety pin, as the case may be. In other cases, steel is used only as part of the

machinery and equipment used in making the products which reach the man in the street. No matter how low the price, steel can be sold only if products which are produced from steel or by the use of steel are being sold. In the case of products produced from steel, the cost of the steel is usually so small a fraction of the total cost of the product that a reduction in steel prices, even if passed on to the ultimate consumer, would not result in a sufficient decrease in the price of the finished product to cause an appreciable increase in its sale. As far as steel for production equipment is concerned, it goes without saying that regardless of the price of steel, no one will invest in productive machinery unless he feels the prospects in his particular line of business justify such investment."¹

The relative importance of steel costs to the final product is too small to be the decisive factor in the pricing of such products or in the demand by the ultimate consumer. In fact, in many of these industries prices have risen because they have been subjected to the same influences as has the steel industry. One of the primary factors has been the sharp increase in labor costs as the rise in wage payments and fringe benefits has continued to exceed the gains in productivity.

This review of the experience in the four recessions since 1929 has revealed no relationship between the magnitude of changes in prices and in shipments of steel products. The different rates of change in steel production and shipments during periods of recession reflect the varying characteristics of steel products rather than price behavior. This conclusion is in accord with the findings covering the entire economy or all manufacturing industries reached in earlier studies by Thorp and Crowder, Nelson and Keim, Doblin, and the present writer (See Appendix B) and the more comprehensive study of the 1948-49 and 1953-54 experiences presented above.

Reasons for Production - Price Behavior

There is general agreement among most of the economists who have studied this problem that the differing production behavior of various products is attributable to their economic characteristics. Emphasis has been placed particularly upon the postponable nature of demand for durable goods and producers' or capital goods. As was pointed out in my NICB study:

"That factors other than price may be of paramount importance is indicated by the tendency for durable goods to record the larger declines in production and for non-durable goods to show the smaller declines, regardless of the respective changes in prices."²

Nelson and Keim concluded:

"It must be recognized then that for each individual commodity, price is but one of the factors determining its level of production. Postponability of demand must certainly be considered. The nature of the productive process is important. The effect of price changes upon production is necessarily different, too, for products whose demand is joint than for those whose demand is independent."³

Thorp and Crowder and Doblin reached similar conclusions as is noted in the excerpts reproduced in Appendix B.

Durable goods and producers' goods tend to have the least sensitive prices. When these two characteristics are combined for a product or group of products, the tendency toward price inflexibility is reinforced.

The nature of the demand for producers'

¹ Theodore O. Yntema, *An Analysis of Steel Prices, Volume, and Costs*, United States Steel Corporation TNEC Papers, 1939, p. 36.

² Jules Backman, "Price Flexibility and Changes in Production," *The Conference Board Bulletin*, The National Industrial Conference Board, New York, February 20, 1939, p. 37.

³ Nelson and Keim, *op. cit.*, pp. 41-42.

and consumers' goods tends to account for the differences in their behavior. The price paid for producers' goods is usually of less importance than the outlook for profits. Thus, when the "profit visibility" becomes poor, the demand for producers' goods becomes highly inelastic. Since sharp drops in price will tend to have little stimulating effect upon demand, manufacturers of producers' goods see only a reduction in profits or an increase in losses if sharp price declines are instituted.

In connection with consumers' goods the problem is different. During periods of depression, price becomes of primary importance to the consumer and hence price reductions are frequently reflected in more stable demand. However, the demand for all consumers' goods is not maintained. The postponability of the replacement demand for many goods, such as automobiles, is also important. These goods are made to yield a larger amount of service, while the smaller incomes are used for those necessities of life which are consumed in shorter periods of time. The type of good, whether producers' or consumers', therefore, appears to play a significant role in determining the flexibility of prices with the consumers' non-durable good tending to exhibit the greatest degree of flexibility and producers' durable goods being more often inflexible.

As Thorp and Crowder have pointed out in contrasting output changes for consumers' and producers' goods: ". . . changes in quantity output for equal changes in price must be accounted for in terms of the variation in the nature of economic characteristics of the goods themselves as reflected in the demand schedules for the products and not in terms of price policies."

Iron and steel products are durable and usually are producers' goods. It is not unexpected, therefore, that these prices tend to be inflexible. Nor is it surprising that iron and steel production tends to drop very sharply during periods of recession or depression. These declines in output reflect the postponability of demand for steel products, not the inflexibility of their prices.

While the magnitude of price change probably has some impact on sales under conditions of economic stability, during periods of recession or of sharp recovery, it is probable that other forces are much more significant in determining the level of output. These studies of the general experience in the economy in recent years and in the steel industry for selected periods since 1929, as well as the earlier more comprehensive studies, provide no factual support for the generalization that declining production and rising unemployment during a recession is attributable to price administration.

V. CAUSES OF PRICE INFLEXIBILITY

MANY reasons have been advanced to account for price inflexibility. However, Gardiner Means, John M. Blair and several others have insisted that the primary explanation is found in the concentration of control over production. Means supported his conclusion by the use of data for a selected group of industries. This conclusion was challenged by Rufus Tucker who showed that had all the data available in Means' study been used, no such relationship would emerge, by Thorp and Crowder who examined the relationships for 407 products, and by Alfred Neal who showed the importance of raw materials and labor content as factors in price behavior. (See Appendix C.)

John M. Blair has recently reexamined the Crowder—Thorp material in detail and the Neal approach in general terms.¹ He also has attempted to bolster the Means case by citing additional illustrations to prove the concentration-price inflexibility thesis.

In particular, Blair cited several alleged inadequacies in the Crowder—Thorp study.

1. Their failure "to eliminate products which are not meaningful for this type of analysis." Under this heading Blair is critical of the inclusion of "geographically isolated products," "freight absorption products," and "raw material affected products."
2. Inadequacies of census realization figures as a measure of price changes.

Blair claims that these inadequacies in the Crowder—Thorp data create biases which "operate against the appearance of a relationship" between concentration and price inflexibility (p. 433). While Blair illustrated the deficiencies, he made no attempt to determine their quantitative significance. No data were presented to show whether the elimination of the challenged products would

yield a more meaningful relationship between concentration and price inflexibility for the remaining products.

A review of average changes in BLS wholesale prices and in Census averaged realized prices and the changes in individual prices where data were available indicates that there is no warrant for excluding iron and steel products, chemical products, and non-ferrous metals from the Crowder—Thorp sample on the basis of freight absorption as Blair suggests. Where this factor played a role, it generally appeared to be a relatively unimportant one. No significant bias is introduced in the Crowder—Thorp material by the inclusion of these products. In fact, two of these industries provide major exceptions to the concentration-price inflexibility thesis. The nonferrous metals combined a high degree of concentration of production and price flexibility in the 1929-1933 period. For the chemical products, high concentration was accompanied by widely varying degrees of price flexibility and inflexibility.

"Raw material affected" products, which Blair also would exclude, tend to have high concentration of production. Out of 91 products, in this category, 19 had a concentration ratio of over 80 per cent and 41 products had a ratio between 50 per cent and 80 per cent—or a total of about two-thirds of the products in this category. These products also exhibited a high degree of price flexibility in the 1929-1933 period. Forty-six products or more than half the total reported price declines in excess of 40 per cent. Only 13 products or one-seventh of the total recorded price declines of less than 20 per cent. Thus, with some exceptions these "raw material affected" products tended to combine a sub-

¹ John M. Blair, "Means, Thorp, and Neal on Price Inflexibility," *The Review of Economics and Statistics*, November 1956, pp. 427-35.

stantial amount of concentration with a high degree of price flexibility.

The fundamental question, however, is why should products with a high raw material content be excluded from the sample? We are concerned with the relationship between concentration of control and price rigidity. "Raw material affected" products are in an entirely different category from "geographically isolated" products and "freight absorption" products. For the latter two groups the basic challenge concerns the adequacy of the statistics. For the "raw material affected" products, on the other hand, the challenge concerns the characteristics of the product. If industries characterized by high concentration of control cannot maintain inflexible prices, then some force more powerful than concentration must be at work. It is certainly proper to challenge data which may be statistically inadequate and to exclude them if they are found to be defective. But there is no warrant to exclude products merely because they are subject to influences which make it possible for their price behavior to vary from a preconceived pattern.

The "raw material affected" products properly were included in the Crowder—Thorp study in an effort to test the validity of the concentration thesis. The bias was created in Gardiner Means' material when he excluded such products. This follows from the conclusion cited earlier, namely, the tendency for highly concentrated "raw material affected" products to be among those with the greatest price flexibility. To reach his conclusions, Means had to exclude these non-conforming industries.

It is interesting to see what would be the effect of eliminating all the various categories of products which Blair criticized. Chart 11 is the original Crowder—Thorp chart while Chart 12 shows the 217 products which remain after eliminating the 190 products, including "raw material affected" products,

which create the "biases" about which Blair was concerned. This revised chart is little different in appearance from the original Crowder—Thorp chart. The coefficient of correlation for the remaining 217 items was only .178. This low coefficient shows that there was little significant correlation between concentration and price inflexibility even after eliminating the various categories of products which were challenged. Thus, after as well as before the elimination of the 190 products, we have a picture of little meaningful relation between concentration and price inflexibility.

To prove that concentration causes price inflexibility, Blair also cites from the National Resources Committee study a series of contrasts between what he calls "atomistic" industries products and "concentrated" products.

However, there are also many illustrations of high concentration combined with price flexibility and of low concentration combined with inflexibility which Blair does not mention. Included in the former category are the following:

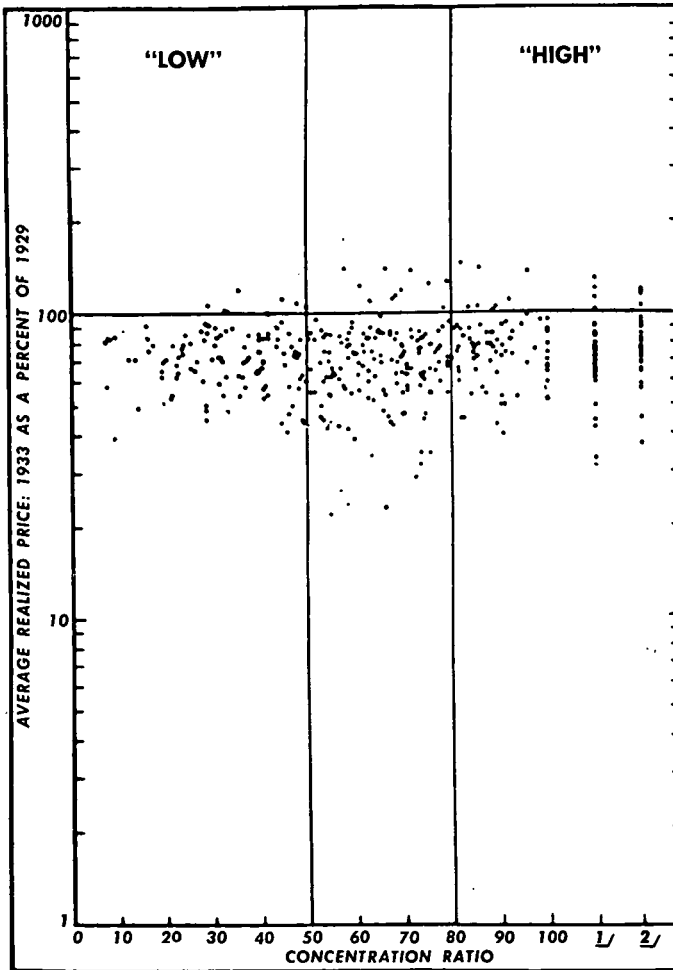
| | Concentration Ratio (per cent) | Price Sensitivity |
|-------------------|--------------------------------------|----------------------|
| Zinc pig | 70.4 | 52.8 |
| Tin | 89.6 | 61.6 |
| Steel scrap | 70.6 | 66.0 |
| Solder | 62.3 | 56.2 |

For these industries, prices were sensitive despite high concentration ratios.

Table 23 reproduces the data for iron and steel and their products which appear in the National Resources Committee-Means study. The tabulation covers mainly steel products rather than the so-called basic steel industry. With two exceptions (steam and hot water heating apparatus, and steel barrels, kegs, and drums), the 16 industries in this category had inflexible prices in the 1929-32 per-

Chart No. 11

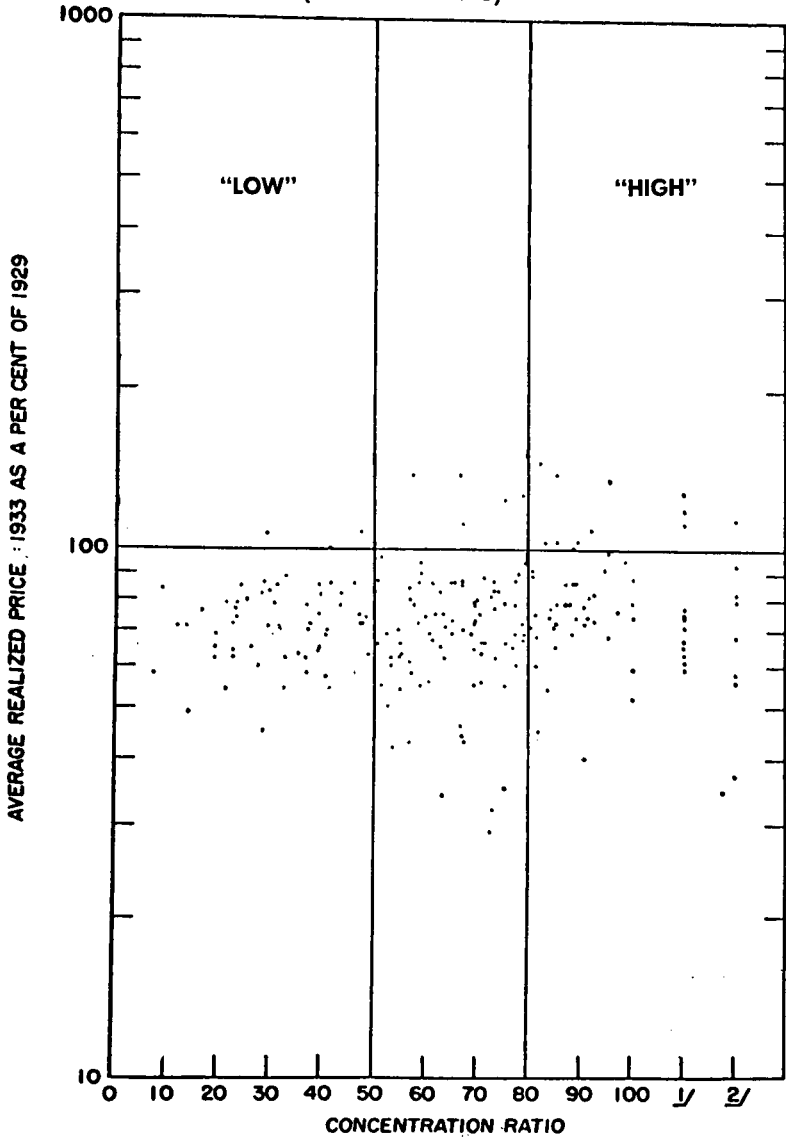
RELATION BETWEEN CONCENTRATION RATIO AND PERCENTAGE CHANGE IN AVERAGE REALIZED PRICE, 1929-33



Source: Willard L. Thorp and Walter F. Crowder, "The Structure of Industry", Monograph No. 27, Temporary National Economic Committee, Washington, D. C. 1941, page 358.

Chart No. 12

**RELATION BETWEEN CONCENTRATION RATIO AND PERCENTAGE CHANGE IN AVERAGE REALIZED PRICES, 1929-33
(217 PRODUCTS)**



iod. Yet 8 of these industries had concentration ratios below 40 per cent and an additional 4 industries had ratios between 40 per cent and 50 per cent. For most of these steel product industries, there was relatively low concentration combined with price inflexibility. The fact that these are all durable goods provides a more logical explanation of their price behavior than does the extent of concentration.

These illustrations of exceptions to the concentration-price inflexibility theme could be multiplied. Attention has been directed to them so that a better perspective may be obtained than is presented by Blair.

TABLE 25

Relationship Between Concentration and Price Decline 1929 to 1932, Iron and Steel and Their Products

| <u>Industry</u> | <u>Concentration Ratio</u> | <u>Price Decline 1929-1932</u> |
|--|----------------------------|--------------------------------|
| | (per cent) | |
| Stoves and ranges and warm air furnaces | 16.1 | 16.3 |
| Wirework, n.e.c. | 23.1 | 12.5* |
| Tools | 23.9 | 10.6 |
| Bolts, nuts, washers, and rivets. Plumbers supplies, not including pipe or vitreous sanitary chinaware | 33.6 | 18.2 |
| Cutlery and edge tools | 34.3 | 21.8 |
| Steel barrels, kegs, and drums . | 36.3 | 8.7 |
| Steam and hot water heating apparatus and steam fittings . | 37.0 | 30.0 |
| Cast iron pipe and fittings | 38.7 | 43.9 |
| Wrought pipe, welded and heavy riveted | 42.4 | 17.1 |
| Nails, spikes, etc. | 47.4 | 6.9 |
| Steelworks and rolling mill products | 48.3 | 20.3 |
| Saws | 49.3 | 17.7 |
| Blast furnace products | 63.4 | 4.9 |
| Tin cans and other tin ware | 66.0 | 23.5* |
| Files | 80.8 | 8.3 |
| | 85.8 | 0 |

* Reliability of price data in relation to Census classification considered to be poor.

Source: National Resources Committee, *The Structure of the American Economy*, Part 1, Washington, June 1939, p. 267.

The conclusion to be drawn from the above data seems clear. Price inflexibility may take place whether there is concentration of control

or not. Conversely, many commodities which are controlled by only a few sellers are highly flexible in price—as are many other commodities which are not subject to such concentration. That concentration of production may result in price inflexibility is clear. But such a relationship is far from universal. There are many other equally important factors which must be considered.

The price system is a composite of many different kinds of prices, all of which must be considered in any study of inflexibility. A survey of the causes of price inflexibility in the entire price system—which embraces wages, utility rates, retail prices, interest rates, as well as wholesale prices—reveals a wide myriad of factors which are important. No single cause dominates or is responsible for the entire area of inflexibility. Although in certain parts of the price system one of these factors may account for the prevailing inflexibility, in any appraisal covering the entire price system they all play a role.

In a comprehensive study published in 1940, the writer presented the following outline of the causes of price inflexibility:¹

I. CHARACTERISTICS OF THE PRODUCT OR INDUSTRY

A. In terms of factors affecting demand

1. Durability
2. Producers' or consumers' goods
3. Degree of processing—finished or semi-finished goods or raw materials
4. Joint demand
5. Availability of substitutes
6. Luxury or style goods or necessities
7. Standardized, unique, or differentiated
8. Number of buyers
9. Seasonality

¹Jules Backman, "Causes of Price Inflexibility," *Quarterly Journal of Economics*, May 1940, pp. 59-60.

- B. In terms of factors affecting costs
 - 1. Rigidity of wage rates
 - 2. Price rigidity of materials
 - 3. Nonpostponable overhead
 - C. In terms of factors affecting physical supplies
 - 1. Ease of entry for new producers
 - 2. Number of sellers (see also III)
 - 3. Time required to expand capacity and output
 - 4. Perishability of product
 - 5. Seasonality
- II. LAW OR ADMINISTRATIVE DECREE
- A. Governmental agencies—telephone, gas, railroad, electric and water rates
 - B. Minimum wage and maximum hour legislation
 - C. Tariff
 - D. Direct price control
 - E. Indirect price control
 - 1. Production control
 - 2. Loan programs
 - 3. Marketing agreements
 - F. Making it possible for private interests to control prices
 - 1. Patents and copyrights
 - 2. Resale price fixing—fair trade acts
 - 3. Limitations on sales below cost—unfair practices acts
- III. CONCENTRATION OF CONTROL
- A. Monopoly or oligopoly
 - 1. Producers
 - 2. Labor unions
 - B. Collusion—to restrict output, allocate production, share markets, etc.
 - C. Price leadership
 - D. Central sales agencies
 - E. Trade association activities
- IV. MARKETING TECHNIQUES
- A. Suggested prices on packages
 - B. Advertising of standard prices
 - C. One-price policy
 - D. Product differentiation
 - E. "In between" prices
- V. STRUCTURE OF THE MARKET
- A. Organized or "unorganized" markets
 - B. Scope of market area
 - C. Marketing channels used
- VI. HABITS AND CUSTOMS
- A. Price of professional services
 - B. Price lining
 - C. Coinage system
- VII. CONTRACTUAL ARRANGEMENTS—LONG-TERM
- Now, seventeen years later, after devoting considerable additional time to the study of prices and price behavior, I am even more convinced that diversity of price behavior is explainable only in terms of a wide variety of causal factors. In this area, as in connection with so many other economic problems, the simple answer has great attraction but little practical usefulness. Price inflexibility may result from concentration of control or monopoly power under some circumstances, but the causal relationship between them is not so close as to provide a useful guide for public policy.
-

VI. SUMMARY AND CONCLUSIONS

THE term administered price provides a useful description of the price making process in most segments of the economy. It does not involve a judgment that either the process or the price charged is wrong. The term does not indicate whether prices are fair or unfair, whether price behavior is good or bad, or whether prices are too high or too low. Unfortunately some writers have used the term to describe a form of price behavior—usually one which they do not approve.

It is useful to understand what administered prices are not.

- They are not monopoly prices
- They are not prices set only by big business
- They are not identical with inflexible prices

Approximately nine-tenths of the wholesale price index is in the administered price category. All retail prices by their nature are administered. Competitive market pricing as postulated in economic theory, therefore, is applicable in an extremely small proportion of the economy.

The suggestion that administered prices create inflation is a new one. It has not been offered as a theory of inflation in the past. The term inflation usually is associated with an excessive expansion of money and credit or with large budgetary deficits for the federal government. These were the factors primarily responsible for the substantial price inflation in this country during World War II and in the postwar period. However, the price rise in the past two years has not been accompanied by new inflationary stimuli from these sources.

An examination of the anatomy of the rise in wholesale prices shows that the major areas of increase have been in the industries

most affected by the capital goods boom and/or those industries with the highest proportion of labor costs to total costs. The policies required to limit a boom are found in the monetary and fiscal areas. The "tight" money policy is a proper one to limit a boom as is the policy of a federal budgetary surplus. This is the main justification for continuing the current burdensome level of taxation and for reducing the level of government spending.

Increases in wages and other labor costs have been substantially greater than the gains in productivity. The resulting rise in unit labor costs has created a cost-push for many products. Where this cost-push coincided with the impact of the boom, the largest price rises have developed. The steady rise in the service component of the consumer price index also is of interest in this connection because many services are predominantly labor costs and their higher prices reflect the rising level of those costs.

What to do about administered wages is a key problem. Certainly we cannot continue to have labor cost increases sharply in excess of gains in productivity without either price rises or increasing unemployment or some combination of both. In a period of expanding money supply, the higher price alternative was easily attained—to the serious disadvantage of the many citizens, particularly elder ones, whose incomes are fixed. But as the money supply fails to expand, there is a more serious threat of unemployment as consumers are priced out of the market. Wage control is not the answer since such controls are repugnant to our citizens, have never been used in peacetime in this country, and probably would fail if adopted.

In the 1955-1957 period, some administered prices have increased while others have

shown little change or have declined. The latter group of prices is found in the industries which have not participated fully in the boom. In light of these differences in behavior it is difficult to understand how price administration *per se* can be responsible for the general price rise during this period.

Similarly, no relationship was found between the extent of concentration and the magnitude of recent price rises. Many industries with low concentration ratios had larger price rises than industries with higher concentration ratios. Where other conditions have either favored or compelled a price rise, administered prices have risen. Where the reverse has been true, administered prices have failed to rise. The primary pressures and responsibilities for price behavior are found in these other forces rather than in the fact of price administration or in the extent of concentration.

Administered prices have been criticized as contributing to instability in our economy. Despite periodic interruptions to the long term trend, our economy has experienced a rate of growth and a rising standard of living which is the envy of the world. The interruptions to this growth, namely, recessions and depressions, have usually been of brief duration. The major depressions have followed major wars and have been the direct result of the dislocations accompanying those wars (for example, the 1870's and 1930's). Most recessions have been small in depth and in duration. It is not true that small declines have been converted into deep depressions because of the alleged inflexibility of administered prices. The most recent illustrations are found in the modest recessions of 1948-49 and 1953-54.

Students of the business cycle usually attribute our periodic recessions to a wide variety of causes including excessive expansion of credit, excessive inventory accumulation, the relationship between savings and

investment, underconsumption, wars, and other factors. Administered pricing is not given much significance in lists of causal forces of the business cycle.

The long term record of growth, the fact that most recessions are modest in depth and in duration, and the ready identification of the forces which have led to severe depressions (the imbalances arising from wars and the resulting excessive expansion of money and credit), indicate that inflexible prices may make a constructive contribution to economic stability rather than act as an unstabilizing force.

An examination of the changes in prices and production during the post-1929 decline provides no support for the alleged unstabilizing effects of price inflexibility. There has been no relationship between the changes in prices and in shipments in the steel industry in the four recessions since 1929 or in the 1954-55 recovery. This conclusion also applied to the more comprehensive study of experience in manufacturing and mining industries in the 1948-49 and 1953-54 recessions. There is no factual support for the generalization that declining production and rising unemployment during a recession is attributable to price administration.

Differing patterns of change in production or in shipments in the steel industry and in the economy generally are related to the economic characteristics of the individual products. Of particular importance is the postponable nature of demand for durable goods and for producers' goods.

Diverse experience with changes in output is not the result of the method by which prices are determined, whether by administrative decision or by market determination. While the extent of price change plays a role in determining effective demand during periods of relative stability, other forces appear to be more important during periods of recession or recovery.

Concentration of control is not the primary factor determining the extent of price inflexibility. Many commodities which are produced by only a few sellers are highly flexible in price while industries with many sellers often have inflexible prices. In fact, there is little relationship between price inflexibility and concentration. Nor is there any relationship between administered prices and concentration.

Actually, price behavior and inflexibility are affected by many causes. No single cause dominates or is responsible for the entire area of inflexibility. Among the major contributing causes are: characteristics of the product or industry, law or administrative decree, concentration of control, marketing techniques, structure of the market, habits

and customs, and contractual arrangements. Price inflexibility may result from concentration of control or monopoly power under some circumstances, but the causal relationship between them is not so close as to provide a useful guide for public policy.

Administered pricing is not new although the term has been used for less than a quarter of a century. Administered prices have always been important in our economy. It is also clear that administered prices cannot be eliminated from the economy. Any attempt to recreate in real life the theoretical world of large numbers of sellers competing in an idealized auction market would destroy the industrial machine which has made America great and would lead to a significant decline in the standard of living.

APPENDIX A

COMPETITION AND PRICES: DEFINITIONS

A NUMBER of terms usually are encountered in connection with discussions of competition and prices. The more important may be outlined as follows:

- A. Competition and Monopoly
 1. Pure Competition
 2. Perfect Competition
 3. Atomistic Competition
 4. Pure Monopoly
 5. Imperfect Competition
 6. Monopolistic Competition
 7. Oligopoly
 8. Workable Competition
 9. Nonprice Competition

- B. Price Concepts
 10. Market Prices
 11. Administered Prices
 12. Price Leadership
 13. Monopoly Price
 14. Price Flexibility and Inflexibility
 - a. Structural Price Flexibility
 - b. Cyclical Price Flexibility
 15. Price Discrimination

A. Competition and Monopoly

There are a great many prefixes which are, from time to time, attached to the term competition. Fritz Machlup has outlined the following:

"To the vocabulary employed in business language such as fair, sharp, keen, fierce, brutal, unfair, destructive, ruinous, and cutthroat competition, economists have added . . . free, atomistic, pure, perfect, effective, unrestricted, simple, complete, homogeneous, rigorous, unmitigated, restrained, restricted, limited, incomplete, modified, cautious, considerate, cooperative, intermediate, hybrid, monopolistic, imperfect, heterogeneous, friendly, civi-

lized, oligopolistic, controlled, regulated, discriminatory, predatory, potential, and workable competition."¹

Clearly, there are many shadings of meaning applied to the word competition. Only several of the more important meanings are outlined below.

Since the 1930's, and particularly with the work of Chamberlin² and Robinson,³ economists have been increasingly concerned about various modifications of the older theory of competition. The more important of these modifications include: oligopoly, monopolistic competition, imperfect competition, and workable competition. These newer concepts reflect recognition of the fact that certain modern trends toward large-scale enterprise, product differentiation, and advertising, have deprived the older theories of "pure" and "perfect" competition of some of their value.

Although it is relatively simple to present definitions of these new concepts, there is still considerable controversy concerning their applicability and their interpretations. Many of these disagreements turn around the problem of measuring *degrees* of monopoly or market power, a significant question for public policy.

1. Pure Competition

The major requisites for pure competition include the following:

- (a) *A large number of producers.* The number must be large enough so that no one company can exercise control over price.⁴

¹ Fritz Machlup, *The Economics of Sellers' Competition*, The Johns Hopkins Press, Baltimore, 1952, p. 81.

² Edward H. Chamberlin, *The Theory of Monopolistic Competition*, Harvard University Press, Cambridge, 1933.

³ Joan Robinson, *The Economics of Imperfect Competition*, Macmillan and Co., London, 1933.

⁴ George J. Stigler, *The Theory of Price*, The Macmillan Co., New York, 1949, pp. 21 ff.

- (b) *All producers are producing the identical good and selling it in the identical market.* This means that a standardized or homogeneous product is being sold.
- (c) *Free entry into the industry.* New producers are free to enter the industry and old ones to withdraw.

Although the above are the most commonly cited requisites of pure competition, there are others which are often noted.

- (d) *Knowledge* "on the part of each buyer of the prices at which transactions are being carried on, and of the prices at which other buyers and sellers are willing to buy or sell."¹
- (e) *No discrimination.* Sellers do not differentiate among buyers on any grounds, analogous to the way that buyers are supposed not to differentiate among sellers.

This combination of factors is not found too often in practice.

2. Perfect Competition

The terms perfect competition and pure competition often are used interchangeably. However, there are some technical distinctions between the two terms. Perfect competition usually involves all the assumptions of pure competition with the following modification. Since we are now considering the entire system of markets, a large number of buyers is also required. Not only must there be a "large number" on each side of the market but it is also necessary that no single seller or buyer be able to exert perceptible influence on market price, i.e., that each be concerned in producing (or buying) only a small fraction of the total product. The *smallness* of the individual buyers and sellers in this sense is again an essential requisite.²

As was true for "pure competition," variations in or additions to this list of assump-

tions frequently are made. Professor Knight, for example, elaborates and expands the list as follows:³

- (a) *Complete "rationality."* Economic units "know what they want" and seek it "intelligently." Motivations are stable and firms "are supposed to know absolutely the consequences of their acts when they are performed, and to perform them in the light of the consequences."⁴ Both *knowledge* and *rationality* are essential to perfect competition.
- (b) *Absence of economic "habits" (preferences).* Economic decisions must be more or less continuously subject to review, so that adjustments of the economic unit to price or preference changes occur instantaneously.
- (c) *Assumption of a "static" economic universe.* "Under static conditions every person would soon find out, if he did not already know, everything in his situation and surroundings which affected his conduct."⁵ The "static" conditions provide for no changes in (1) population growth, (2) the stock of capital, (3) methods of production, (4) forms of industrial establishments, and (5) consumers' wants.⁶

3. Atomistic Competition

This term is used whenever "large numbers" of producers (sellers) and buyers are present in a market. Competition is then said to be "atomistic." It cannot be stated precisely how many producers are necessary in order that there be "large numbers." One qualification is that the number is large

¹ K. E. Boulding, *Economic Analysis*, Revised Edition, Harper & Brothers, New York, 1948, p. 50.

² Stigler, *op. cit.*, p. 21.

³ F. H. Knight, *Risk, Uncertainty and Profit*, Houghton Mifflin and Co., Boston and New York, 1921, pp. 76-81.

⁴ *Ibid.*, p. 77.

⁵ *Ibid.*, p. 79.

⁶ *Ibid.*, p. 83.

enough so that no single buyer or seller can determine the price. However, in other respects there may be differences as compared with pure or perfect competition.

4. Pure Monopoly

Three conditions are essential for pure monopoly.¹

- (a) There is only *one firm* in the industry.
- (b) The monopolist turns out a product that is unlike the product of any other firm. Some hold that, like the theory of pure competition, pure monopoly is a case without any reference to the real world where no producer is without his competitors, however well he may appear to be insulated from them.
- (c) *No freedom of entry*. Actually, this requirement is a corollary of (b) since freedom to enter implies that the buyer will have an alternative to the monopolist's product, and all economists exclude alternatives from the pure monopoly case.

5. Imperfect Competition

The term imperfect competition is used to refer to the absence of certain conditions in a market—conditions to which the term “perfect” is applied as a prefix. Absence of “perfect” knowledge, or of “perfect” mobility of resources, or of “perfect” mobility of buyers among sellers (for any reason whatsoever), etc., results in a market which is “imperfect.” It does not necessarily imply that “imperfection” is “undesirable.”

A second approach defines imperfect competition by the *results* of market performance. An illustration is found whenever market conditions produce prices which are different from those which would develop under perfect competition. This definition of imperfect competition is preferred by those economists who adhere to perfect competition as the “ideal type” of market for policy pur-

poses, holding that antitrust action should be directed to “restoring” or “creating” perfect markets.

6. Monopolistic Competition

Monopolistic competition is another term applied to types of markets which are sometimes grouped under the heading of “imperfect competition.” A monopolistically competitive market is characterized by:

- (a) *Product differentiation—heterogeneous products*. Although products differ in some respects, they are “close substitutes” for each other. “Close substitution” refers to the relation between the demand for the product of one producer and demands for all other producers’ products, considering all others as a single group. “Heterogeneity of product” has a peculiar consequence which explains why the adjective “monopolistic” is applied to this kind of industry although in terms of the numbers of producers involved, it is in the “competitive” category. Assuming that the differences in product involve “consumer attachments” (which is invariably assumed in this case), each seller is somewhat in the position of a monopolist.
- (b) *A large number of independent producers*. The individual units are sufficiently large in number and small in terms of capacity so that “the policy of one firm does not appreciably affect the policy of another firm producing a *similar* product.”² (Italics added.) The business unit is supposed to be independent from others in the industry insofar as being able to affect the demand for its rival's product.
- (c) *Free entry* is cited as one of the conditions of monopolistic competition,

¹ Boulding, *op. cit.*, p. 523.

² *Ibid.*, p. 571.

on the grounds that in fact entry is relatively easy into industries of this kind.

7. Oligopoly

This term refers to an industry in which there is a small number of rival producers. The number must be small enough so that output or price variations by one will have an effect on sales of rival producers. Professor Bain states:

"In its simplest form oligopoly is found in an industry in which the competing firms (producing either close or perfect substitute outputs) are several, but are few enough and large enough so that each controls enough of the total industry output that a moderate extension of its output will reduce the sales of rival firms by a noticeable amount."¹

In contrast to pure competition we have small numbers of firms with each one having a large aggregate capacity. These industries are usually characterized by Big Threes and Big Fours. Price leadership usually characterizes oligopolistic markets. Frequently a homogeneous product is involved as in the case of many steel products. However, differentiated products may also be sold as in the case of automobiles.

Various other conditions often are suggested. In view of the size of these firms it is reasonable for the oligopolist to ask himself how his rival will react to changes in price, or, alternatively, to changes in output. As a result, it is generally assumed that "each entrepreneur acts on the supposition that any change in prices which he initiates will immediately be followed by a like change in the prices of his competitors."²

Among the factors which enter into the oligopolists' calculations are the following:

- (a) The speed with which rivals react to changes in policies.
- (b) The relative sizes of the firms.

- (c) The mobility of buyers.
- (d) Whether or not price concessions can be kept secret.

8. Workable Competition

Most definitions of workable competition³ involve "acceptable" modifications of the assumptions of pure and perfect competition. While no single list of postulates of workable competition will be accepted by all economists, there is probably fairly wide agreement on the type of market factors which need to be weighed in determining whether or not a given market is "effectively competitive." The Report of the Attorney General's National Committee contains the following list:⁴

- (a) *The number and relative strength of firms.* These "cannot be compressed into a formula," the Committee reports. It depends upon the particular market and where number is small "special study would usually be needed . . . to determine the optimum number."
- (b) *Opportunity for entry.*
- (c) *Independence of rivals.* ". . . genuine independence . . . so that each firm pursues its own individual advantage."
- (d) *Predatory preclusive practices.* Tactics which permit one rival to eliminate another without regard to the latter's economic efficiency are "predatory."
- (e) *Rate of growth of the industry or market.* "Rate of growth [of the industry] . . . is often important in determining the significance to be attached . . . to numbers and reasonable opportunity for entry."

¹ Joe S. Bain, *Price Theory*, Henry Holt, New York, 1952, p. 70.

² Boulding, *op. cit.*, p. 581.

³ J. M. Clark, "Toward a Concept of Workable Competition," *American Economic Review*, Vol. 30, June, 1940, pp. 241-256.

⁴ *Report of the Attorney General's National Committee to Study the Antitrust Laws*, Washington, March 31, 1955, pp. 323-336.

- (f) *Character of market incentives to competitive moves*: "Competition may be effective or ineffective, depending upon how the market is organized and behaves, and according to what incentives there are for independent competitive actions."
- (g) *Product differentiation and product homogeneity*. Product homogeneity establishes a presumption that the industry is workably competitive. "The impact of product differentiation on the effectiveness of competition will . . . have to be judged in each case in its market setting. . . ."
- (h) *Meeting or matching the prices of rivals*. "It is of the essence of effective competition that competitors should try to meet, or offer an equivalent for, any superior inducement which one of them offers . . . a reasonable variety and variability in pricing practices" is to be permitted.
- (i) *Excess capacity*. "The practice of a company purchasing and dismantling unused capacity in this sense—that is, capacity which could be utilized at normal costs—has always and rightly been considered strong evidence of attempt to monopolize."
- (j) *Price Discrimination*. "Some types of price discrimination may stimulate effective competition; others may be evidence of effective monopoly. . . ." Price differentials, for example, are not evidence of price discrimination.

9. Nonprice Competition¹

Nonprice competition refers to all of the actions which are designed to attract business through means other than direct price change. The emphasis is upon such factors as quality, packaging, style, service, performance, advertising, and credit terms rather than upon price. In other words, the use of nonprice competition is an attempt by these means to increase sales at a given price or within a given range of prices. It often takes

the form of differentiating the product or service from that of a competitor. Nonprice competition, therefore, involves a departure from perfect or pure competition because it results in competing products or services which are not homogeneous or standardized.

The explanation for the emphasis upon nonprice factors is found in the institutional evolution of our economy. Thus, for example, the increasing complexity of many products and the consequent difficulty of comparing them directly makes price differences a less significant yardstick than in a more simple type of economy. Our knowledge of machinery, for example, is so limited that most of us cannot compare directly the relative merits of different refrigerators or of different automobiles. Our decisions to buy such products often are more significantly influenced by the reputation of the seller or the effectiveness of his advertising rather than by differences in price. In other words, the inadequacy of our knowledge as buyers stimulates businessmen to differentiate their products and to expand their sales efforts in order to secure our patronage.

The modifications of price competition, as a result of such devices as price leadership, freight equalization plans, government controls, fair trade acts, and so on, also contribute to an emphasis upon nonprice factors. Similarly, businessmen attempt to preempt a share of the market by the use of trademarks and brand names. If these can be developed successfully, they frequently play a more important role in consumers' decisions than the price because of the confidence created in a given product. Perhaps the outstanding illustration of this development is found in the field of drugs.

Businessmen prefer nonprice competition to price competition in many instances because:

¹ Adapted from Jules Backman, *Price Practices and Price Policies*, Ronald Press, 1953, Chapter 4.

- (a) They generally believe that good will derived from nonprice factors will be more lasting than that based upon price appeal.
- (b) Competitors find it more difficult to match nonprice factors than to match price changes. In effect, the businessman attempts to set off a share of the market for himself by emphasizing the special attributes of his product.

B. Price Concepts

The term price also is used in a number of different contexts. It may serve to indicate how prices are determined (for example, market prices or administered prices) or how prices behave (for example, flexible or inflexible prices) or the relationship among prices (for example, price discrimination, price structures, etc.). As in the case of competition, only several of the more important concepts are described below.

10. Market Prices

In the technical sense, market price refers to a price determined by the interplay of demand and supply under conditions where there are so many buyers and so many sellers, that no one of them can determine the price. It is a two way auction market. It is best illustrated by the prices determined on the commodity exchanges and on the securities markets. Market price fluctuates continuously. It is the price that exists in a competitive market—usually pure or perfect competition is assumed. Nourse and Drury have described market prices as “primitive price making” and as a “largely automatic price mechanism.”¹ Means and Ware claim that market prices are the result of a “sort of impersonal price making process.”²

11. Administered Prices

A number of economists have adopted definitions of administered prices similar to

that used by Gardiner Means. Several of these definitions are reproduced below.

Committee On Price Determination, National Bureau of Economic Research

“‘Price administration’ is here used to denote the application, by officials of a concern, of a set of rules or policies relating to the pricing of the firm’s products. The policies in question will be influenced to a greater or less degree by the character of the market in which the firm operates, and by the kind of cost data available to executives.”³

Edwin G. Nourse and Horace B. Drury, The Brookings Institution

“... they are prices established by the decision of executives who have power to decide in advance the price at which goods shall be sold and to back up that decision by expanding or contracting operations in volume large enough to have a significant effect on the market.”⁴

Richard H. Leftwich, Associate Professor of Economics, Oklahoma Agricultural & Mechanical College

“Administered prices are prices fixed by law, fixed by groups of sellers, fixed by groups of buyers, or fixed by collective action of buyers and sellers. They are the antithesis of free market prices established by free interactions of buyers and sellers in the market places.”⁵

Oswald Knauth

“An administered price is one that is fixed by management after a careful survey of all the factors involved—the expected demand, the cost of production and of selling, the price of similar articles, the general price level, the pricing

¹ E. G. Nourse and H. B. Drury, *Industrial Price Policies and Economic Progress*, The Brookings Institution, Washington, 1938, pp. 252, 254.

² Gardiner C. Means and Caroline F. Ware, *The Modern Economy In Action*, Harcourt, Brace and Company, New York, 1936, p. 130.

³ Committee on Price Determination, *Cost Behavior and Price Policy*, National Bureau of Economic Research, New York, 1943, pp. 273-274.

⁴ Nourse and Drury, *op. cit.*, p. 9.

⁵ Richard H. Leftwich, *The Price System and Resource Allocation*, Rinehart & Company, Inc., New York, 1955, p. 340.

policies of the concern and its position in the trade. Management's hope is that this price will remain unchanged for a considerable period—say a season or a year."¹

Myron H. Umbreit, Professor of Business Economics, Northwestern University; Elgin F. Hunt, Lecturer in Economics, Northwestern University; Charles V. Kinter, Lecturer in Economics, Northwestern University

"Prices determined by producers are often called 'administered prices.' We observe that they may also be called 'sticky' prices, since they do not respond quickly or freely to changes in supply and demand."²

Edwin G. Nourse, Formerly Chairman, Council of Economic Advisers

"The distinctive feature of an administered price situation is that prices, instead of being registered automatically by the interaction of supply and demand forces in an open market, are formulated in executive offices as matters of operating policy or economic planning by officials of corporations or unions who, through their control over blocks of capital resources or labor resources, have considerable power to implement the price schedules they adopt."³

12. Price Leadership

"Price leadership exists when the price at which most of the units in an industry offer to sell is determined by adopting the price announced by one of their number."⁴ Usually, the price leader is one or more of the large companies in the industry. Different companies may act as the price leader from time to time. There is no inference that a policy of "follow the leader" involves collusion among the companies. Nor is it implied that each follower will always charge the same price as the leader. Some smaller companies may set their prices at a fixed differential with the leader's price.

13. Monopoly Price

Monopoly means control of the entire output of a product by a single seller. The term monopoly price refers to the price set by such a seller. The late Professor William Kiehofer of the University of Wisconsin stated:

"The monopolist is not primarily concerned with the highest possible profit per unit of sales that he can make, whatever the price may be, for at this price his volume of sales may be light. What interests him most is *setting the price of his product at such a figure in relation to the probable volume of sales that his aggregate profits will be largest*. His problem is to estimate the price at which his marginal revenue equals his marginal cost. By marginal revenue is meant the net addition to total revenue obtained from each successive unit sold, and by marginal cost the additional cost outlay resulting from an increase of one unit in the supply."⁵ (Italics added.)

Whether the monopoly price will be a high one or not depends upon the availability of substitute products and government regulation. The outstanding illustrations of monopoly are found in the public utility industries which have their rates closely regulated by various government agencies.

14. Price Flexibility and Inflexibility

Flexibility in the economic sense refers to the responsiveness of price to changes in the factors affecting it. The price-determining

¹ Oswald Knauth, *Managerial Enterprise, Its Growth and Methods of Operation*, First Edition, W. W. Norton & Co., Inc., New York, 1948, p. 106.

² Myron H. Umbreit, Elgin F. Hunt, Charles V. Kinter, *Modern Economic Problems*, First Edition, McGraw-Hill Book Company, Inc., New York, 1950, p. 346.

³ Testimony before the Senate Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, July 9, 1957.

⁴ Arthur R. Burns, *The Decline of Competition*, McGraw-Hill Book Company, Inc., New York, 1936, p. 76.

⁵ William H. Kiehofer, *Economic Principles, Problems, and Policies*, Fourth Edition, Appleton-Century-Crofts, Inc., New York, 1951, pp. 459-460.

factors fall into two broad categories: those affecting only a particular commodity (internal or specific impacts) and those affecting all products (external or general impacts). The first group—structural price flexibility—is concerned with all the forces which determine the relative level of a given price in the hierarchy of prices and includes such factors as technological developments, competitive position, availability of substitute products, and plant capacity. Unfortunately, it is practically impossible with the available data to measure the full effect of these impacts upon an individual commodity, and hence the flexibility of any given price in terms of these factors cannot readily be indicated.

Professor Alvin H. Hansen has defined *structural price flexibility* as follows:

"By structural price flexibility I mean the long-term secular adjustment in the price structure. It is concerned not with the *level* of prices but with the *interrelation* of individual prices. Thus, for example, changes in technology and the methods of production continually alter the unit cost of production of one commodity relative to other commodities. . . . Structural price flexibility implies an adjustment of prices to changes in unit costs springing from unequal rates of technological progress in different industries or from shifts in the pattern of wants. Without structural price flexibility the full gains of economic progress could clearly not be realized. Structural price flexibility implies that the price system is functioning in a manner to yield the largest possible product of goods and services which a given stage of technique makes possible. A structurally flexible price system operates to direct the productive resources into channels which will yield the largest social product. Without structural price flexibility an uneconomic allocation of resources would prevail."¹

The second group of factors includes those

affecting the general price level. The problem here is the extent to which the prices of specific commodities conform to the general movement (*cyclical flexibility*). For a wide variety of reasons, all prices do not respond equally or simultaneously to the impact of the general forces of inflation or deflation. In the circumstances, those prices which advance less or decline less than the average may be considered as inflexible, while flexibility would be exhibited whenever commodities had the tendency to equal or exceed the average price change. There are different degrees of flexibility and inflexibility, since usually there are modest gradations in the extent of change rather than two sharply divided groups of prices. Relative inflexibility in this sense is measurable by the amplitude of change recorded for the price of a given product during the course of the economic cycle. Means has emphasized frequency of change in his studies.

Inflexible prices are frequently described as *rigid*, *insensitive*, or *sticky*. These terms all imply the failure of the price to reflect changing conditions. The term "sticky prices," however, often has another connotation in that it refers to the *timing of a price change* and hence must be used more carefully than the others.

15. Price Discrimination²

Price discrimination arises when at any given time a firm sells a homogeneous commodity or service to different buyers in a given area at different prices. Under some conditions, selling to different buyers in different localities at the same price may be considered discriminatory, as under delivered price systems. Price discrimination may be

¹ Alvin H. Hansen, "Price Flexibility and the Full Employment of Resources," *The Structure of the American Economy: Part II, Toward Full Use of Resources*, National Resources Planning Board, Washington, June, 1940, p. 27.

² Adapted from Backman, *op. cit.*, pp. 273-74.

exercised in several different forms: as to use of the product, geographic location, the time of purchase, or the quantity bought. Actually the term price discrimination means difference in price.

Use of product discrimination takes place when different prices are charged for the same product depending upon its use. An outstanding illustration is electric power. Customers are grouped into major categories (for example, domestic, industrial, commercial) and the rate charged depends upon the category.

Geographic discrimination is alleged to arise when differences in prices at different locations do not reflect corresponding differences in transportation costs. Evidence of such discrimination is supposed to be shown when the seller receives varying mill-net prices after deducting transportation costs. The absence of geographic discrimination is evidenced when a mill sells at uniform prices to all purchasers at the mill.

Prices may vary according to the time of purchase; this has been called *temporal discrimination*. There are many familiar illus-

trations of this type of price differentiation: lower prices for the movie matinee than for the evening show; long distance telephone calls which are cheaper in the evening or on Sundays. These special rates are designed to encourage the purchase of goods or services in "off peak" periods.

Prices may vary depending on the *quantity bought* or the *trade status* of the buyer. The special discounts for large purchases illustrate the quantity discount, while variations in prices for retailers, jobbers, or wholesalers usually are described as functional discounts. It is these phases of price discrimination with which the Robinson-Patman Act deals.

It must be recognized that differences in prices charged are not bad *per se*. Variations in price in accordance with use or with the time of purchase may result in a more efficient use of resources. There is considerable difference of opinion as to whether uniform delivered prices or uniform mill-net prices are more important. Variation in prices in accordance with trade status has considerable sanction in the services performed by wholesalers and jobbers.

APPENDIX B

Quotations Concerning Relationship Between Changes
in Production and in Prices1. Saul Nelson and Walter G. Keim
(TNEC Monograph No. 1)

"WHEN the relationship between prices and production declines during recession is examined commodity by commodity, no strikingly consistent trend is revealed. . . . [See Chart 13]

"(1) Considering all the commodities together, there is some tendency for small declines in price to be connected with large declines in production and vice versa. (The Pearsonian coefficient of correlation is -0.32 ; the standard error of this coefficient is 0.09 .)

"(2) For nondurable goods alone there is a similar broad tendency. (The coefficient of correlation is -0.44 ; standard error 0.12 .)

"(3) For durable goods and semidurable goods considered separately, there is little if any evidence of such a relationship. (Coefficients of correlation are -0.12 and $+0.01$ respectively; standard error in each case 0.18 .)

"(4) There was a marked tendency for increasing durability to be associated with smaller declines in price and greater curtailments of production. . . .

* * * *

"It must be recognized then that for each individual commodity, price is but one of the factors determining its level of production. Postponability of demand must certainly be considered. The nature of the productive process is important. The effect of price changes upon production is necessarily different, too, for products whose demand is joint than for those whose demand is independent.

"It is apparent, however, that any appraisal of the influence of price policies upon production must pay due regard

to the interrelated character of the economy. The effect of a change in price for any single commodity upon its production is influenced by, and in turn influences, the markets for many other commodities."¹

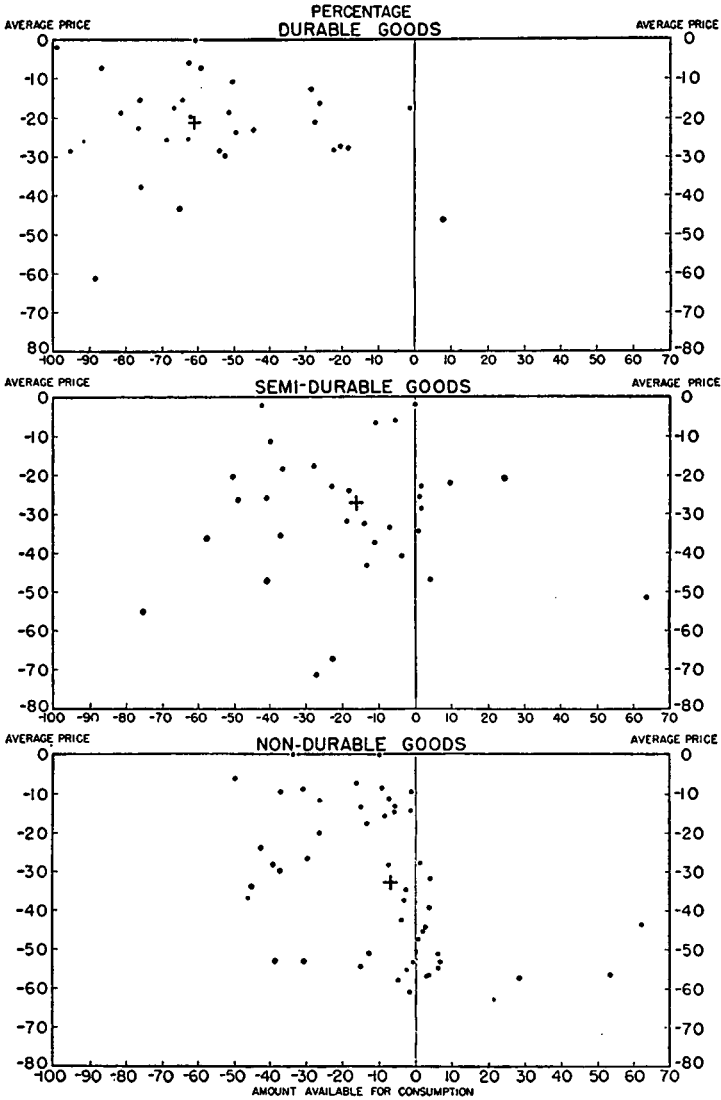
2. Jules Backman
(National Industrial Conference Board)

"An examination of 264 specific commodities, however, indicates that the price-production relationship is far more complex than has been assumed. Diversity of behavior, rather than conformity to any uniform pattern, appears to be the outstanding feature of the price-production relationship of specific commodities. There is no general rule that production may be regulated by price manipulation. Durability of product is frequently a more important factor than price. . . . [See Charts 14 and 15]

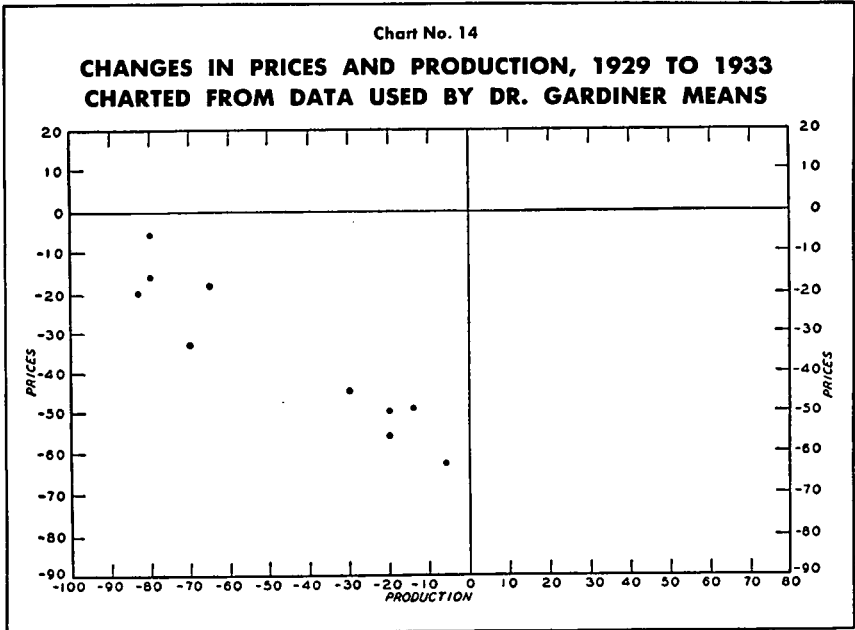
"An analysis of the available data indicates that no simple and clear-cut relationship prevails between specific commodity price and production changes. Within very broad limits there is evident some tendency for inflexibly-priced products to be accompanied by greater decreases in production than those which were more responsive to the impact of outside forces. But the relationship is not so close, nor so surely accounted for, as to warrant the general conclusion that sharp reductions for particular inflexible prices would have been effective in maintaining demand, and hence the output, for these products. Certainly it seems unlikely that this result could have been achieved in connection with capital goods, the demand for which is determined largely by the outlook for

¹ Saul Nelson and Walter G. Keim, "Price Behavior and Business Policy," *Monography No. 1*, Temporary National Economic Committee, Washington, D. C., 1940, pp. 38, 41-42.

Chart No. 13
**CHANGE IN AVERAGE WHOLESALE PRICE AND
 QUANTITY AVAILABLE FOR CONSUMPTION**
 111 COMMODITIES—1929 TO 1933



U.S. BUREAU OF LABOR STATISTICS
 SOURCES: PERCENTAGES COMPUTED BY THE BUREAU OF LABOR STATISTICS AND THE BUREAU OF AGRICULTURE ECONOMICS FROM DATA COLLECTED BY THESE AND OTHER GOVERNMENT AGENCIES
 Source: Saul Nelson and Walter G. Keim, "Price Behavior and Business Policy", Monograph No. 1, Temporary National Economic Committee, 1940, Washington, D. C., p. 39.



future profits rather than by the current cost of new capital equipment—especially during times of depression when the demand schedule for such goods becomes extremely inelastic. That factors other than price may be of paramount importance is indicated by the tendency for durable goods to record the larger declines in production and for non-durable goods to show the smaller declines, regardless of the respective changes in price. The postponable nature of the demand for durable goods is a familiar phenomenon which furnishes a more logical explanation for the production behavior of many goods than does the extent of price decline.¹¹

3. Willard L. Thorp and Walter F. Crowder
(TNEC Monograph No. 27)

"The statement has frequently been made that depression adjustment in the

case of agricultural products has been mostly in price, and the adjustment in the case of manufactured products mainly in quantity output. This position appears to oversimplify the situation, since within the field of manufacturing itself there were extremely wide differences in the price and production behavior of products. . . . [See Charts 16 and 17]

"When the products are analyzed in terms of particular characteristics, however, it appears that different types of behavior were associated with the varying characteristics of the products. Durable goods, the replacement for which is postponable, tended to experience much more severe contractions in production in the 1929-33 period than nondurable

¹¹ Jules Backman "Price Flexibility and Changes in Production." *The Conference Board Bulletin*. The National Industrial Conference Board, New York, February 20, 1939, pp. 45, 51.

goods. These durable products were largely producers' capital goods and equipment. In periods of business recession when the profit outlook is uncertain the demand for these items evidently becomes extremely inelastic and even large price concessions would not be a sufficient inducement to retard the drop in buying. The contractions in the prices of durable and of nondurable goods were of approximately the same magnitude, but the quantity behavior of products in each of these groups was significantly different. This points to the conclusion that the different quantity behavior was associated with some element in the situation other than the price changes of the products.

"If this behavior is taken as truly characteristic of manufactured products in a period of recession, then these products should be characterized by a complementary type of behavior in a period of increasing economic activity. Such was the case. The quantity output of the durable producers' capital goods was increased greatly while the price changes experienced by these goods were about in line with the price changes of other goods. Although the data as developed here are not available on a monthly or quarterly basis, information available from other sources would indicate that as the recovery progressed and demand was strengthened, average realized prices increased owing to the fact that

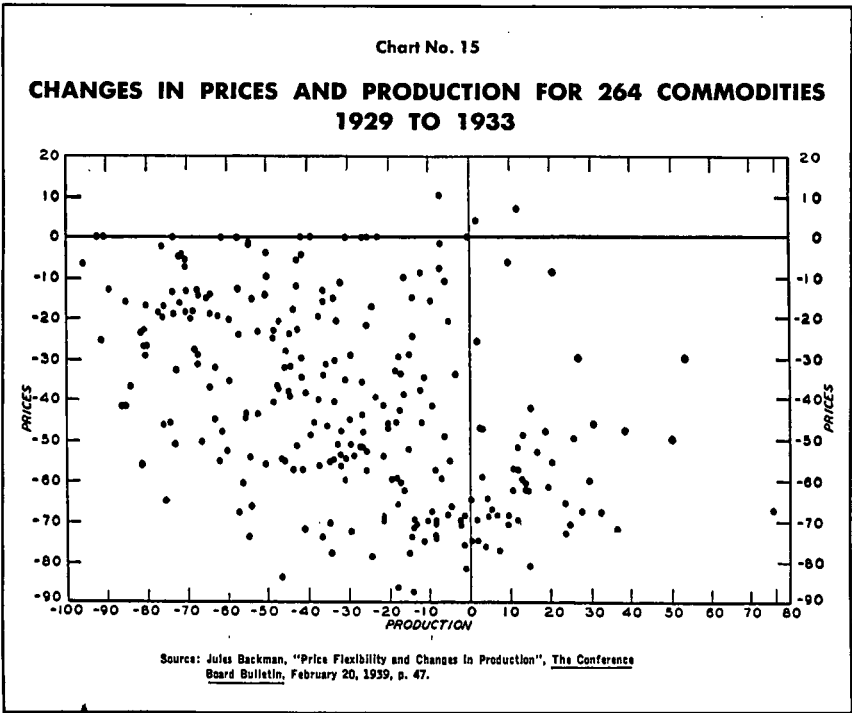
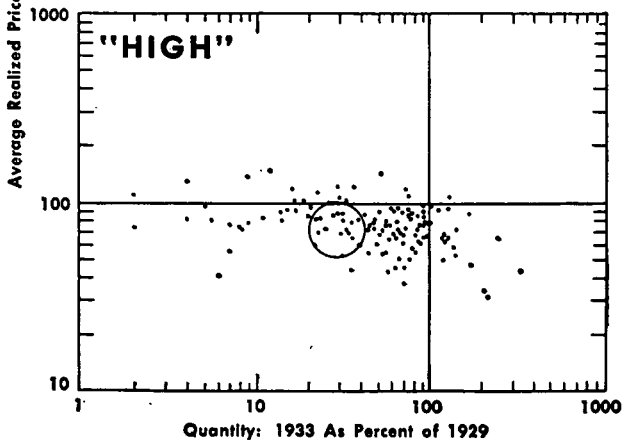
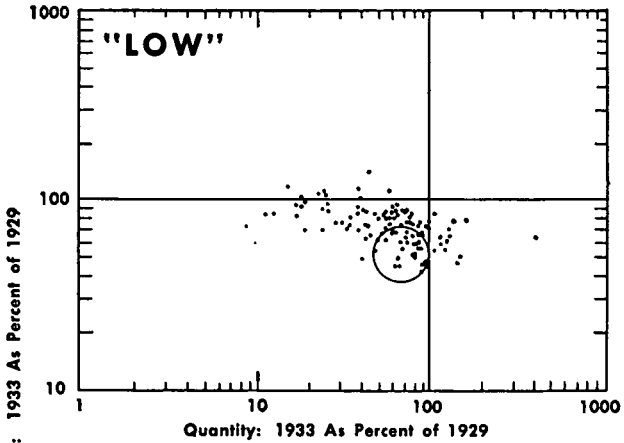


Chart No. 16

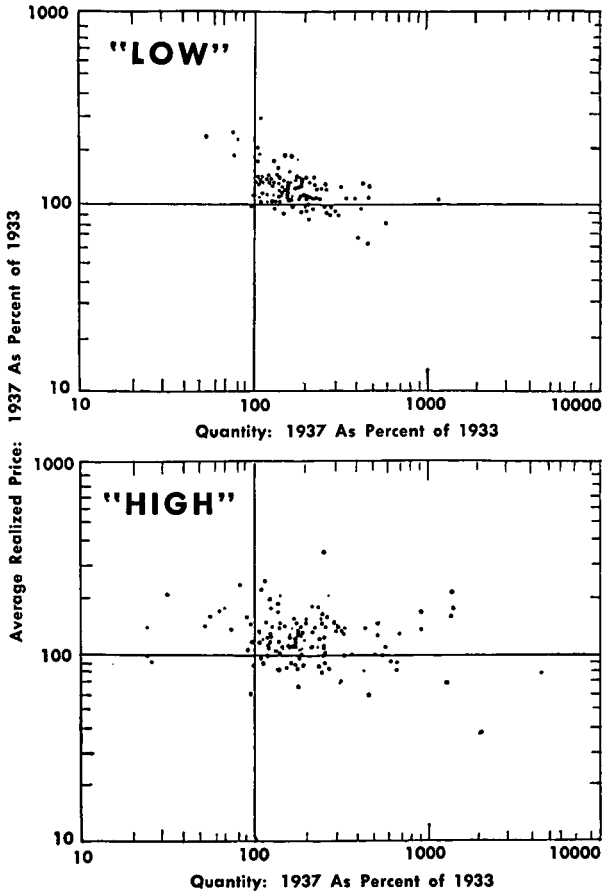
RELATION BETWEEN PERCENTAGE CHANGE IN QUANTITY PRODUCED AND PERCENTAGE CHANGE IN AVERAGE REALIZED PRICE, 1929-33



Source: Willard L. Thorp and Walter F. Crowder, "The Structure of Industry," Monograph No. 27, Temporary National Economic Committee, Washington, D. C., 1941, p. 370.

Chart No. 17

**RELATION BETWEEN PERCENTAGE CHANGE IN QUANTITY
PRODUCED AND PERCENTAGE CHANGE IN AVERAGE
REALIZED PRICE, 1933-37**



Source: Willard L. Thorp and Walter F. Crowder, "The Structure of Industry," Monograph No. 27, Temporary National Economic Committee, Washington, D. C., 1941, p. 371.

quoted prices were adhered to more stringently (assuming there had previously been price concessions in the way of special discounts, etc.). The timing of actual increases in quoted prices would probably coincide with the attainment of capacity or near-capacity operations.

"The different nature of the demand for goods ultimately to be used by consumers from that for goods ultimately to be used by producers accounts in large measure for the different behavior patterns of these two types of products. Producers' goods are usually desired when profits are increasing and the demand for them becomes greatly restricted or nonexistent in a period of decline. On the other hand, the demand for consumers' goods is relatively steady. The desire for food and clothing persists in periods of decline and is not greatly increased in periods of expanded business activity. Price reductions on consumers' goods may result in the transfer of purchase from one type of goods to another, but the aggregate quantity is not greatly affected by such transfers. Price reductions on producers' goods, on the contrary, would probably not induce purchases if profit prospects were hazy. Closely connected with the type of user is, of course, the degree to which the purchase may be postponed. Producers' and consumers' durable goods experienced much wider declines in quantity, price being more or less constant, than the large number of nondurable consumers' goods.

"The nature of the raw materials entering the manufactured products also appears to be a determining factor in their quantity and price behavior. Those products whose chief material comes from agricultural sources experienced more violent price fluctuations in periods of both recession and recovery, while quantity fluctuations were less severe than for those items manufactured from mineral products. This situation may be accounted for in large part by the

different production and marketing structures of these two types of raw materials.

"A logical explanation of price and quantity behavior of manufactured products would thus of necessity appear to run in terms of the product characteristics such as durability, use to which the products are put, and the nature of the raw materials from which they are fabricated. For some products, the concentration in the control of their production is undoubtedly an important factor, but for manufactured products in general there is no close relationship between control and any particular price and quantity behavior."¹

4. Alfred C. Neal

"For the 1929-1931 comparison between price change and production change, data could be obtained for 106 industries or industry groups, including almost all the major ones. These accounted for 41.6 billions of the 70.4 billions value of manufactured products in 1929, or 59 per cent of the total for that year. For the 1929-1933 comparison, data could be obtained for 85 industries or industry groups, which accounted for 40.1 billions of the 1929 value of products, or 57 per cent of the total value of products for that year. It is obvious that the industries dropped for the 1929-1933 comparison were unimportant ones.

"It will be seen from Chart 18 that for the 1929-1931 comparison *there is no marked tendency for change in manufacturing price and change in manufacturing production to be associated*. For the 1929-1933 comparison (see Chart 19) a tendency toward inverse association is apparent, thus confirming the findings of Thorp and Crowder for individual commodities and of Means for selected industries. Whether the

¹ Willard L. Thorp and Walter F. Crowder, "The Structure of Industry," *Monograph No. 27*, Temporary National Economic Committee, Washington, 1941, pp. 403, 405, 406.

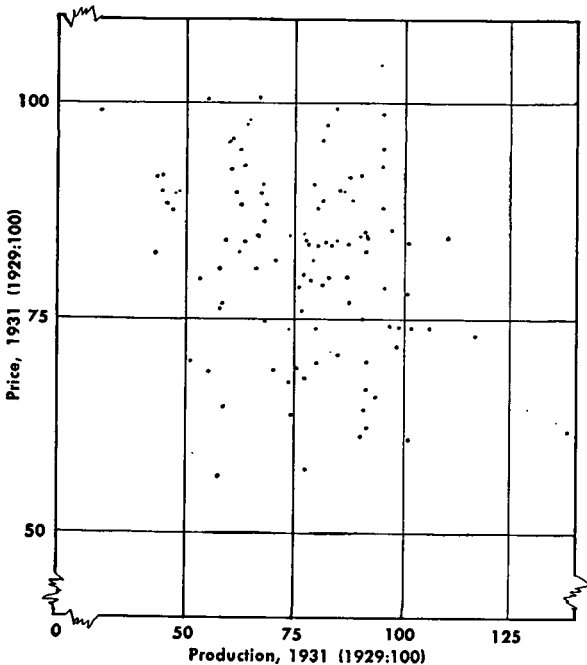
association between price change and production change for the 1929-1933 comparison is due to concentration can be determined by the method employed by Thorp and Crowder. If concentration explains this association, then both price

change and production change will be associated with concentration." (*Italics added.*)¹

¹ Alfred C. Neal, *Industrial Concentration and Price Inflexibility*, American Council on Public Affairs, 1942, p. 114.

Chart No. 18

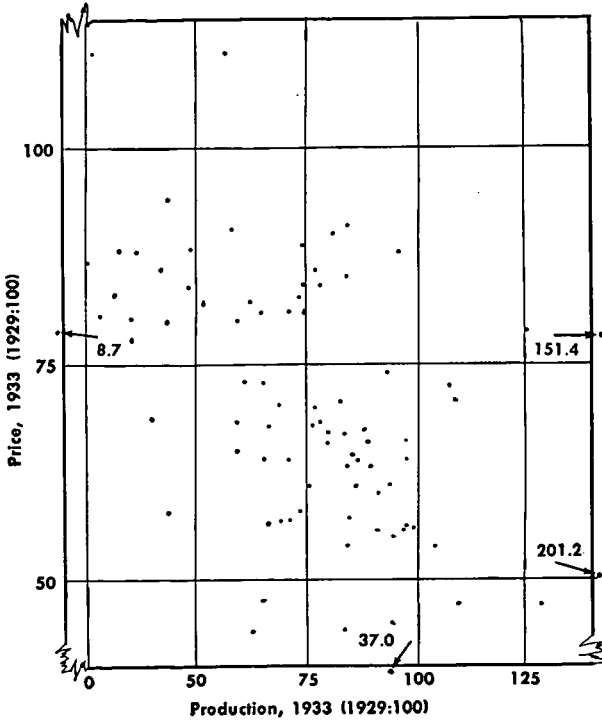
**RELATION BETWEEN CHANGE IN PRODUCTION, 1929-1931,
AND CHANGE IN PRICE, 1929-1931,
106 MANUFACTURING INDUSTRIES**



Source: Alfred C. Neal—*Industrial Concentration and Price Inflexibility*, American Council on Public Affairs, Washington, D. C., 1942, p. 115.

Chart No. 19

**RELATION BETWEEN CHANGE IN PRODUCTION, 1929-1933,
AND CHANGE IN PRICE, 1929-1933,
85 MANUFACTURING INDUSTRIES**



Source: Alfred C. Neal—Industrial Concentration and Price Inflexibility, American Council on Public Affairs, Washington, D. C., 1942, p. 116.

5. Ernest M. Doblin

PRICE FLEXIBILITY AND CHANGES
IN PRODUCTION

"It is not unusual to hold the lack of flexibility of prices responsible for the instability of production. The whole de-

pression might be described as general dropping of prices at the flexible end of the price scale and dropping of production at the rigid end, with intermediate effects between.¹

¹ Gardiner C. Means, *Industrial Prices and Their Relative Inflexibility* (Senate Document No. 13, Washington, D. C., 1935), p. 8.

"This theory seems to assume, first of all, that a more equal price fall in the depression would prevent price dislocations. But those dislocations which the boom itself has caused already would be perpetuated by an equal all-around price reduction. Furthermore, a general decline in total demand tends to reduce prices for individual products at different rates, and this situation necessarily leads to a price structure which is at variance with that

appropriate under more prosperous conditions. The elasticity of demand varies from commodity to commodity. An equal rate of price reduction would therefore be followed by changes in production varying in extent from product to product. For all these reasons, this suggested straight inverse relation between price reduction and production in the depression is improbable. The view is confirmed by some statistical evidence. . . .

TABLE 26
PRICE AND PRODUCTION CHANGES, BY TYPE OF COMMODITY, 1929 TO 1933*

| DURABLE GOODS | | | | | | | | | NONDURABLE GOODS | | | | | | | | |
|---|--|--------------------------|---|--|--------------------------|---|--|--------------------------|---|--|--------------------------|---|--|--------------------------|---|--|--------------------------|
| Unfinished and unfinished | | | Finished | | | Unfinished | | | Finished and unfinished | | | Finished | | | Unfinished | | |
| Average price change, 1929 to 1933 (per cent) | Average production change, 1929 to 1933 (per cent) | Number of items in group | Average price change, 1929 to 1933 (per cent) | Average production change, 1929 to 1933 (per cent) | Number of items in group | Average price change, 1929 to 1933 (per cent) | Average production change, 1929 to 1933 (per cent) | Number of items in group | Average price change, 1929 to 1933 (per cent) | Average production change, 1929 to 1933 (per cent) | Number of items in group | Average price change, 1929 to 1933 (per cent) | Average production change, 1929 to 1933 (per cent) | Number of items in group | Average price change, 1929 to 1933 (per cent) | Average production change, 1929 to 1933 (per cent) | Number of items in group |
| -4.6 | -72.6 | 19 | -1.9 | -78.3 | 8 | -11.8 | -69.4 | 12 | -5.5 | -29.5 | 31 | -18.0 | -20.1 | 14 | -2.1 | -34.2 | 24 |
| -18.4 | -68.3 | 18 | -12.5 | -74.7 | 7 | -24.9 | -60.3 | 11 | -28.2 | -30.2 | 32 | -39.9 | -15.7 | 14 | -29.0 | -36.4 | 24 |
| -29.0 | -64.8 | 19 | -20.6 | -62.7 | 7 | -42.5 | -63.3 | 11 | -44.4 | -23.0 | 32 | -51.2 | -10.4 | 14 | -48.1 | -28.1 | 24 |
| -52.5 | -57.1 | 19 | -32.4 | -59.3 | 8 | -56.7 | -53.6 | 11 | -54.6 | -25.4 | 31 | -60.1 | +4.9 | 14 | -65.9 | -4.0 | 24 |
| .. | .. | .. | .. | .. | .. | .. | .. | .. | -66.8 | +3.2 | 32 | -72.3 | -3.7 | 14 | -73.0 | -9.9 | 23 |
| .. | .. | .. | .. | .. | .. | .. | .. | .. | -73.6 | -10.1 | 31 | .. | .. | .. | .. | .. | .. |

* I am indebted to Mr. H. Gregg Lewis (University of Chicago) for this table.

"C. The Role of the Durability Factor

This connection between durability and state of production on the one hand and price flexibility on the other hand is brought out in very clear form if the material is separated into subgroups with a view to analyzing the differences in the reaction of their production to price changes. For Table 4 the 264 commodities were divided, with the aid of the classification given in Professor Mills' *Prices in Recession and Recovery*, into 75 durable and 189 nondurable commodities. In both groups the price ratios were arrayed in decreasing order of magnitude, and they were divided into four classes in the durable group, and six classes in the nondurable group. Averages were formed of the five or six

(in the case of an even number of items) central items of the price ratios in each class, as well as of the five or six central items of the production-change ratios associated with the commodities in each class. Table 26 shows the relation between changes in production and price changes for the commodities in question. It shows, first, a slight tendency for production to decrease less, the greater the price decline. The relative rise in production is, however, only moderate, and the tendency is by no means clear, as indicated by the behavior of prices and production in the nondurable goods category for price decreases from five to fifty-five per cent. Moreover, gains in production associated with growing price decreases are relatively

small; in the durable-goods group a price cut from five to thirty per cent below the 1929 level is associated with an increase in production from twenty-seven per cent to thirty-five per cent of the level of 1929.

"A second conclusion is much more important: The same price decline has more far-reaching consequences for nondurable than for durable goods. Price cuts may help to increase volume as far as nondurable products are concerned; for durable goods, even huge price reductions seem to have but little effect

on volume. The stimulus of a price cut is apparently highly limited, and volume is mainly determined, on account of the postponability of demand, by general business conditions, on which individual price reductions have hardly any influence. As already demonstrated the difference in price flexibility in the two groups cannot be attributed to a different degree of monopolistic practice or control in the two sectors of industry."¹

¹ Ernest M. Doblin, "Some Aspects of Price Flexibility," *The Review of Economic Statistics*, November 1940, pp. 186-188-189.

APPENDIX C

Quotations Concerning Relationship Between Concentration and Price Inflexibility

1. Willard L. Thorp and Walter F. Crowder (TNEC Monograph No. 27)

"IN order that the possible relationship between the extent of concentration in the control of the production of manufactured products and their price and production behavior in periods of recession and recovery might be studied, all products in the 1,807 sample for which comparable classification existed at the time of the Census of Manufactures for 1929, 1933, and 1937 and for which quantity data were available were subjected to further intensive analysis. There were 407 products which met these requirements. The distribution of the concentration ratios of these products followed very closely the pattern of the 1,807 sample.

"An investigation of the behavior of the products in this presentative sample over the 1929-33 period and over the 1933-37 period reveals several interesting relationships: [See Charts 11 and 20]

"1. Concentration in the control of production of the products does not appear to be associated with any particular and unique price or quantity behavior in either the cyclical downswing from 1929 to 1933 or in the upswing from 1933 to 1937. Products with high concentration ratios and products with low concentration ratios experienced strikingly similar changes in price and quantity.

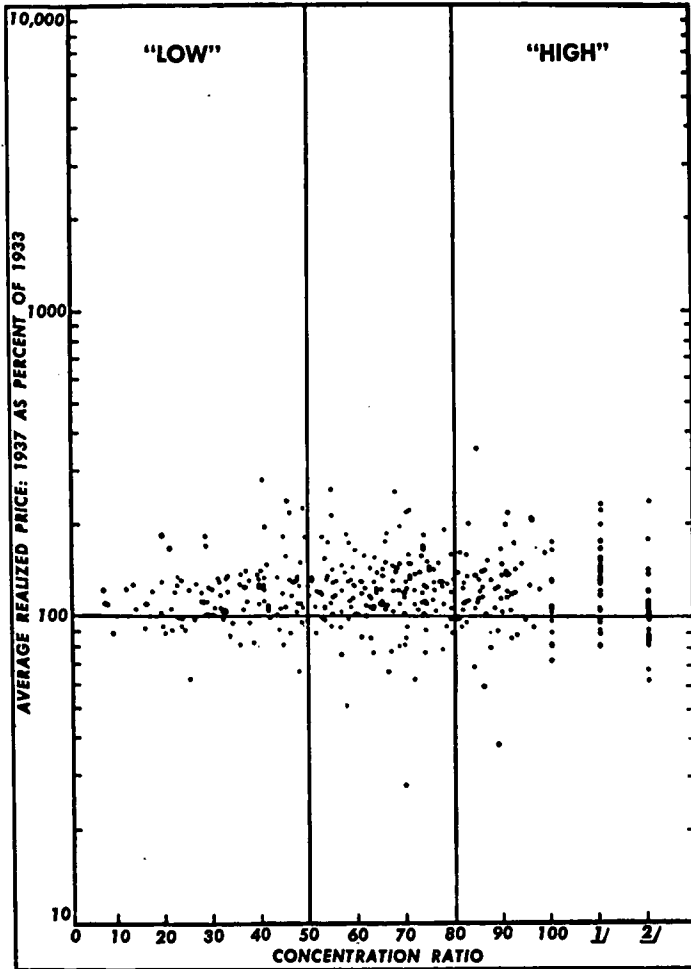
"2. For products manufactured under conditions of low concentration there tended to be an inverse relation between changes in price and changes in quantity; that is, relatively large decreases in quantity in the recession period, for example, tended to be associated with relatively small changes in price, while relatively small changes in quantity out-

put tended to be associated with relatively large changes in price. The association was by no means close, however, and lends support to only the most general sort of inference. The association is not nearly so apparent among products with high concentration ratios. There, large and small changes in quantity appear with large and small changes in price as if by chance.

"3. These two observations concerning the behavior of products in the sample point to a third conclusion, namely, product characteristics such as the degree of durability, the type of ultimate user (consumer or producer), the degree of fabrication, and the source of raw material appear to be factors of greater significance in any explanation of particular price and quantity behavior than the extent of the concentration of control under which they were produced. Thus, the production of durable producers' goods experienced a sharp contraction in the downswing in business activity from 1929 to 1933 and conversely experienced a large expansion in output in the ensuing upswing. On the other hand, nondurable goods experienced much more moderate declines in the downswing and more moderate advances in the upswing. The explanation of this divergent quantity behavior lies in the postponable nature of the demand for durable goods. The behavior of the prices of durable and nondurable goods was quite similar in magnitude of change; thus price change may be viewed as one of the constants in the analysis. Another factor whose influence is inextricably interwoven in the chain of causation which gives rise to distinct behavior patterns is the nature of the ultimate user. No appraisal of the relative influence of any particular factor on the behavior of products may be made. In

Chart No. 20

**RELATION BETWEEN CONCENTRATION RATIO AND
PERCENTAGE CHANGE IN AVERAGE
REALIZED PRICE, 1933-1937**



Source: Willard L. Thorp and Walter F. Crowder, "The Structure of Industry", Monograph No. 27, Temporary National Economic Committee, Washington, D. C. 1943, page 359.

fact, the influences of all these factors on the demand for the various products are so intermingled that no single factor can stand alone. Furthermore, one factor may be of more importance in determining the behavior of one group of products and another may be more significant in another group. This mingling of the influences of the various factors makes the relationships less close than would be desirable if the association could be fully accounted for on the basis of a single factor.

"4. When the products are grouped on the basis of the degree of durability into durable and nondurable goods, on the basis of their ultimate user into producers' and consumers' goods, on the basis of the degree of their fabrication into semifinished and finished, etc., it is apparent that for certain of the groupings there was an inverse relation between price and quantity changes in the 1929-33 period and again in the 1933-37 period. But here, too, the relation, while observable in many cases, was not always strongly marked. For the products in a few groups, however, the changes in price and changes in quantity of products appear as if by chance.

"In conclusion, certain findings of this study bear repeating. The evidence presented here leaves no doubt that the great majority of manufactured products are produced under conditions of relatively high concentration — conditions under which a few producers account for the major portion of the output of a product. This concentration, however, does not appear to result in any particular, strongly marked or unique behavior pattern. Products produced under conditions of high concentration show about the same changes in quantity and in price over periods of recovery and recession that are shown by products with low concentration. When the behavior patterns of products are analyzed in terms of their various product characteristics, changes in price are quite similar regardless of the prod-

uct characteristic, but the changes in quantity vary widely. This divergent quantity behavior, however, appears to be more closely associated with the varying economic characteristics of the products themselves than with the different conditions of competition under which they were produced."¹

2. Alfred C. Neal

"The supposed relationship between depression drop in price and concentration has been tested and found wanting. Likewise, the explanation of the price-quantity relationship in terms of concentration appears to be unsubstantiated by the facts, although an inverse price-quantity relationship cannot be denied. In fact, one must be excused for wondering why so much ink has been spilled in debating these issues when there has been so little theoretical presumption in favor of the conclusions under dispute. There is, perhaps, much truth in Du Brul's remark that if Mr. Means' thesis had not been useful as a tool of politics, it would have died an early death.

"Surely it is unreasonable to suppose that concentration is a dominant factor in explaining price movements of different industries in depression, when different industries are so diversely affected with regard to the prices of their input factors—to mention but one source of differential behavior. Annual average raw materials prices fell from 100 in 1929 to 57 in 1932. Is it conceivable that even two equally concentrated industries should have shown the same depression drop in selling prices if one had costs consisting of 90 per cent raw materials and the other but 30 per cent? Labor costs per unit of output, as calculated from the Census of Manufactures, fell from 100 in 1929 to 75 in 1933. This is simply the average for all manufacturing; considerable variation prevails among industries. Is it imaginable that

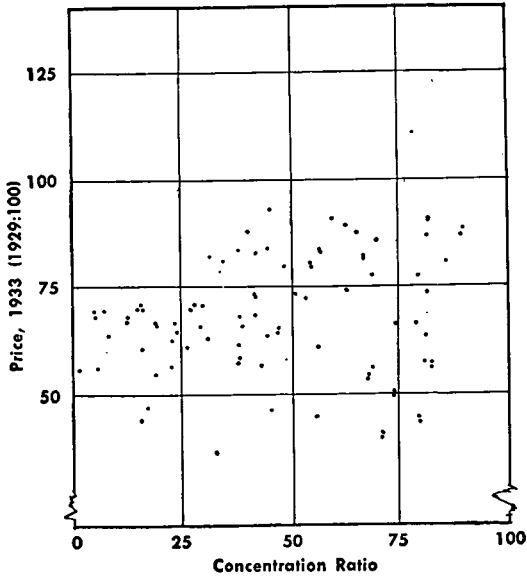
¹ Willard L. Thorp and Walter F. Crowder, "The Structure of Industry," *Monograph No. 27*, Temporary National Economic Committee, Washington, 1941, pp. 411-412.

the influence of concentration was so strong as to offset all the possibilities of variation due to varying proportions of raw material and labor costs between industries? Fantastic as such a supposition seems, yet that is the assumption which lies behind the attempt to explain diverse price movements in terms of concentration. We should hardly be surprised to find an absence of association between price decline in depression and concentration. On the contrary, it is cause for amazement that anyone should expect, on any reasonable grounds, to discover any association.

"The price inflexibility writings have, in fact, done great disservice to the concentration thesis . . . there are strong *a priori grounds* for suspecting that concentration will have some influence upon the decline in price *relative to the decline in direct cost*; . . . But the presumption has nothing to do with the thesis that the amount of price change in depression can be explained by concentration. The explanation of the amount of price decline in depression, as has been so often emphasized, depends upon an investigation of cost structures, demand conditions, changes

Chart No. 21

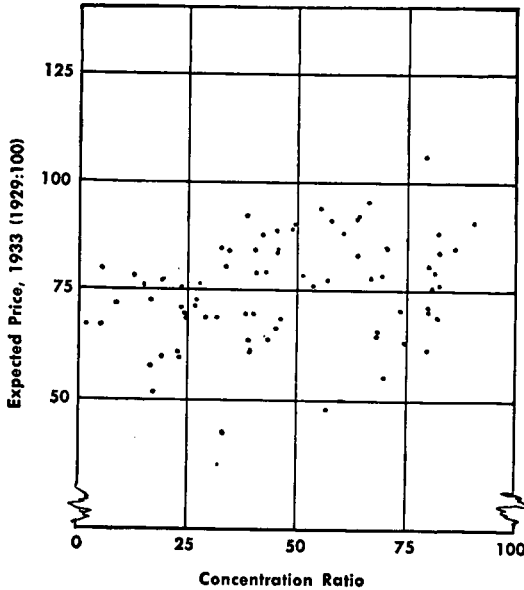
RELATION BETWEEN CONCENTRATION AND CHANGE IN PRICE, 1929-1933, 68 MANUFACTURING INDUSTRIES WITH NATIONAL MARKETS



Source: Alfred C. Neal—Industrial Concentration and Price Inflexibility, American Council on Public Affairs, Washington, D. C., 1942, p. 118.

Chart No. 22

**RELATION BETWEEN CONCENTRATION AND CHANGE IN
EXPECTED PRICE, 1929-1933, 68 MANUFACTURING
INDUSTRIES WITH NATIONAL MARKETS**



Source: Alfred C. Neal—*Industrial Concentration and Price Inflexibility*,
American Council on Public Affairs, Washington, D. C., 1942, p. 119.

in input prices (which in turn have to be explained, since they too are prices), market structures, and similar considerations. No broad generalization can be made concerning the causes of depression price changes, and it appears certain that 'concentration' does not provide a satisfactory explanation."

* * *

"As to the relationship between concentration and price change for the 1929-1933 comparison, Chart 21 shows that there was a slight tendency for price to

decline more in those industries with low concentration ratios than in industries with high concentration ratios. This finding is at variance with that of Thorp and Crowder for individual commodities and seems at first sight to support Means' thesis.

"However, this slight association between concentration and price change is but an example of spurious correlation. *It is due to the fact that price change is closely associated with direct cost change, and is not due to concentration.*

This view is borne out by Chart 22, which shows the relationship between 'expected price' and concentration for the same 68 industries employed in Chart 21. 'Expected price,' it will be remembered, is the price which would have resulted had actual prices changed equally with actual direct costs. Chart 22 shows that the expected price indices are about as closely associated with concentration as the actual price indices.¹ Therefore the differential price behavior can be better explained by differential direct cost behavior than by concentration. This explanation seems especially reasonable when it is noted that any influence which concentration might have on direct costs would be the reverse of that which actually exists. One might expect, for instance, that the monopsonistic power of the highly concentrated industries would result, *ceteris paribus*, in a greater lowering of direct costs for highly concentrated industries than for less highly concentrated industries. Actually, the relationship is the reverse of such a result. Expected price drop, which is based on direct cost drop, was less for the highly concentrated industries than for those not so concentrated."²

3. Richard Ruggles

"The major patterns of price behavior in the economy can be adequately explained in terms of factors other than industrial concentration. This is not to say that in some instances the consideration of the industrial organization of an industry might not be necessary, nor that in explaining wage-price relationships monopoly and monopolistic relationships need not be explored. What can be said, rather, is that *even if monopoly did not exist* a price system very similar to the existing one would emerge as long as wages were less flexible than agricultural prices and some mineral prices."³

4. Rufus S. Tucker

"The N.R.C.'s attempt to associate price-maintenance during the depression

with industrial concentration is proved a fallacy by their own statistics. In comparing price-decline from 1929 to 1932 with concentration in industries the N.R.C. left out certain highly concentrated industries on the ground that raw material makes up a large part of the value of their products. Having omitted those concentrated industries that were best able to reduce their prices, and thus prejudge the case, they then prepared a chart which they said showed a correlation between price-maintenance and concentration. To emphasize this correlation they drew in a regression line which makes the diagram seem scientific and convincing to the unwary. . . .

"But really there is no logical justification for omitting the other industries for which statistics of price and concentration were available. The question is whether concentrated industries that could reduce their prices did so to the same extent as non-concentrated industries; that question can only be answered by studying all industries. If the 93 industries for which the necessary information is available in Appendix 8 of the Committee's report are taken together, the coefficient of correlation between price-maintenance and concentration is .06 with a standard error of .10. I do not believe that there is a professional statistician in the world who would maintain that a coefficient of correlation smaller than its standard error has any significance. *The statistics compiled by the N.R.C. show therefore that there was no association whatever between concentration in manufacturing industries and the rigidity of the prices of manufactured products.* But the per-

¹ It will be shown later how close the correlation is between actual and expected price for both the 1929-1931 and 1929-1933 comparisons.

² Alfred C. Neal, *Industrial Concentration and Price Inflexibility*, American Council on Public Affairs, 1942, pp. 87-88, 117-119.

³ Richard Ruggles, "The Nature of Price Flexibility and the Determinants of Relative Price Changes in The Economy," *Business Concentration and Price Policy*, National Bureau of Economic Research, Princeton University Press, Princeton, 1955, pp. 488-489.

son or persons who wrote the N.R.C. report insisted that the association of price-maintenance with concentration was the chief explanation of price rigidities during the depression." (Italics added).¹

5. Ernest M. Doblin

"Concentration of Production and Price Flexibility. Price flexibility is, on the whole, more closely associated with raw materials, nondurable goods, and standard commodities, than with fabricated goods, durable goods, and differentiated commodities. The attempt has been made to find the common root for the price insensitivity of durable and fabricated commodities in the high degree of price control which results from the relatively small number of concerns dominating particular markets in these groups.² Neither the degree of fabrication nor durability is supposed to be primarily responsible for the price insensitivity: Among the durable products, which as a group are insensitive, are various items with a high degree of price sensitivity, originating mainly from highly competitive industries.³ Similarly, the raw-material group, which is generally regarded as price sensitive, contains a number of less sensitive items from highly concentrated industries. The real determining factor, according to this view, is the more or less monopolistic control over production and prices, rather than the character of the goods.

"This theory is supported by a scatter diagram showing the relation between concentration and 'depression drop' in prices of 37 manufacturing industries.⁴ The concentration is measured by the proportion of the output of the industry contributed by the largest four producers to the total production of the industry. The underlying figures are not given.⁵ The line of average relationship indicates that the higher degrees of concentration are associated with smaller price decreases than are the smaller degrees of concentration.

"The differences, however, between the percentage price decreases for various degrees of concentration are rather modest. In the chart in question a 10 per cent smaller concentration ratio is associated with a 2.5 per cent larger price drop. While, roughly, prices decreased by about 20 per cent in industries where 50 per cent of production was concentrated in the four largest firms, the price decrease was 30 per cent for industries where only 10 per cent of the total output was produced by the four largest concerns.⁶

"Moreover, a broader selection of industries from the same list which included these 37 industries shows a quite different picture. If these price decreases and concentration ratios are plotted together, the items are scattered in a rather irregular fashion, and a straight line fitted through them indicating the average relationship is almost horizontal for both the durable and the nondurable groups. On the basis of these figures the concentration factor does not seem to be an important element in determining the size of price decreases during a depression.

"This fact can be supported by further evidence. If the higher concentration of production in the durable-goods group, rather than the durability of the product, were responsible for the price insensitivity in the group of durable prod-

¹ Rufus S. Tucker, "Concentration and Competition," *The Journal of Marketing*, April 1940, pp. 359-360.

² *The Structure of American Industry, op. cit.*, p. 143.

³ *Ibid. op. cit.*, p. 142.

⁴ *Ibid.*, Chapter XXII, p. 145. The "depression drop" is defined as per cent change in price from 1929 to 1932.

⁵ The industries are selected from a list of about 250. They are described as producing a relative homogeneous product at least one-third of the value of which is believed to come from manufacturing activity, the product itself is believed to be produced for the national or international market where reasonably reliable data are available as to the prices of the product (*Ibid.*, p. 142).

⁶ This, of course, cannot mean that if large concerns were dissolved into smaller units and the share of the four largest producers were reduced from 50 per cent to 10 per cent, a price which under 1929-33 conditions dropped 20 per cent would then automatically decrease by 30 per cent.

ucts,¹ then a considerable difference in the average concentration rate between products of different durability should be expected. This is not the case.

"From an inclusive list in Table I of Appendix 8 of *The Structure of American Industry*, one can select those industries which are producing for a national rather than for a regional or local market. With the help of the classification supplied by the same table, they are here subdivided into nondurable, semidurable, and durable goods groups. Table 27 gives the average concentration ratios

for the three classes, together with the number of industries on which each group is based. The average concentration ratios for durable and nondurable products are practically the same. The ratio for semidurable goods is considerably lower than the other two. The difference in price behavior between the durable and nondurable products cannot be explained by the factor of economic 'control' over production.

"The same conclusion applies to the distribution of industries into those producing semi-manufactured and those producing finished goods. Their average concentration ratios, taken from the same list in *The Structure of American Industry*, are 44 per cent and 43 per cent, again without any significant difference."²

TABLE 27—AVERAGE CONCENTRATION RATIOS BY CLASSES

| Class | Number of Items | Concentration Ratio |
|------------------------|-----------------|---------------------|
| Durable goods | 90 | 46 |
| Semidurable goods..... | 54 | 34 |
| Nondurable goods..... | 80 | 48 |

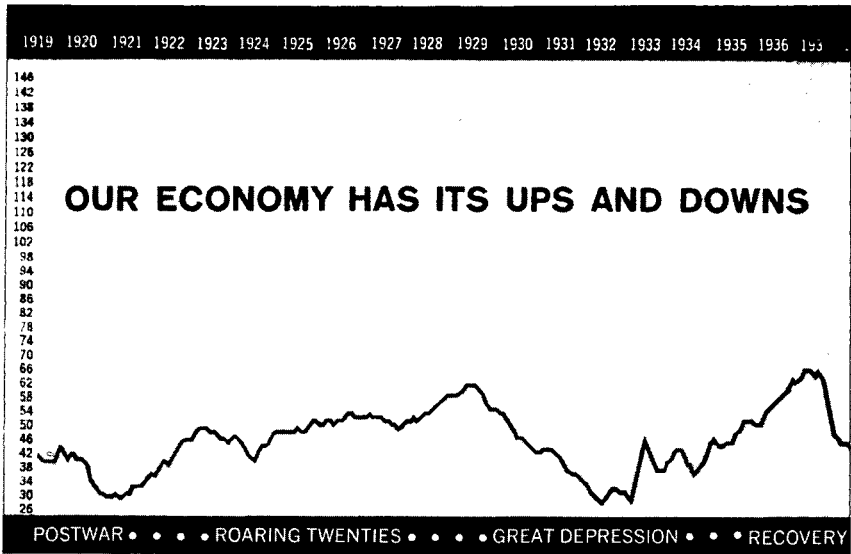
¹ As claimed in *The Structure of American Industry*, op. cit., p. 143.

² Ernest M. Doblin, "Some Aspects of Price Flexibility," *The Review of Economic Statistics*, November 1940, pp. 185-186.

What's happening to

U.S. BUSINESS





Where is our economy headed today? Finding the answer to this question requires looking at the business situation from all angles, taking into account all the factors present in our economy.

I have tried to do this in the pages that follow. As you will see, some of the elements in today's economic picture are encouraging. Others will have little or no effect on the over-all situation in the months ahead. But some factors, if not controlled or corrected in time, can make our position worse.

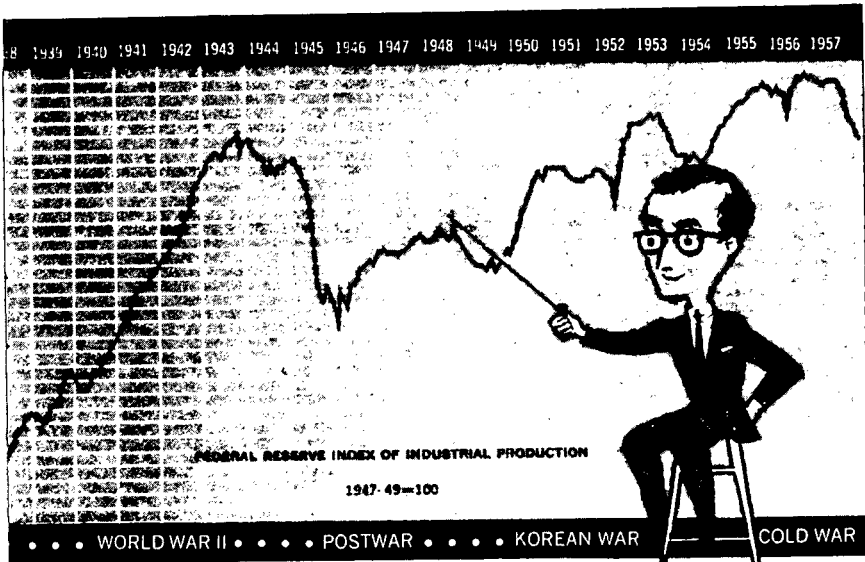
Obviously, the better we understand the reasons for economic ups and downs, the better able we'll be to keep our economy healthy. I hope this booklet will contribute to that understanding.

In describing today's economic situation I have concentrated on the short-term aspects—the events of the past few years and the outlook for the rest of 1958. I have not gone into detail on the long-term growth in our economy which is bound to result from population increases and improved technology and research leading to new products and processes.



Jules Backman — Economist, author, and Professor of Economics at New York University

Jules Backman



The above chart is not a cross section of the Rockies. It is a picture of the changes in U. S. economic activity since 1919. Our economy does not climb steadily. It sometimes pauses to catch its breath. Sometimes it slips back a little before resuming its march upward.

During some periods everyone is optimistic. The future looks bright indeed. As a result, the consumer often buys more than he can afford. To meet the immediate demand, business is encouraged to add new factory space, buy more machines, produce more and more goods. Bankers may lend too much money to poor risks. And many of us may pay too much money for stocks and for real estate. Then, when things get out of hand, as in the late 1920's, we wake up with a bad economic hangover. And it sometimes takes a long time to get back on our feet, as was true in the 1930's.

Not often does our economy nose-dive the way it did then. And it's unlikely that it will again; we learned our lesson—the hard way. Time and again—and most recently in 1949 and 1954—economic activity drops off, and then snaps back pretty quickly. In both these periods, there was a decline in production and in the number of jobs. Shortly thereafter, we moved forward again to new high levels of prosperity.

It is important to remember that what we do about such declines helps to determine how long they last. If we try to cure the decline in business with more of the same things that caused it, we may make it last longer. Therefore, we must understand what caused the current decline if we are to avoid continuing the same mistakes and prolonging it.

This is the third decline since the end of World War II. How bad were the first two? How do they compare with the present one? A few key charts tell the story. The solid

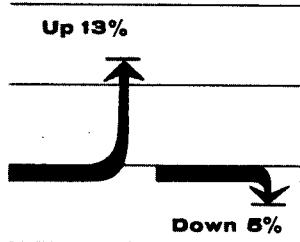
UNEMPLOYMENT FEBRUARY 1950 MARCH 1954 MARCH 1958

Numbers of people without jobs looking for work, and the percentage of these groups as compared with the total of all employed and unemployed workers. Even in boom times, the number of unemployed seldom falls below two million.



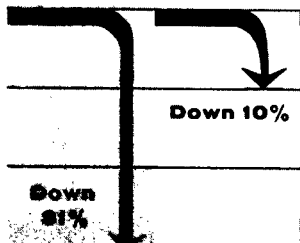
CONSUMER SPENDING 1949 1954 1958

Spending for such things as autos, refrigerators, TV sets, ranges, etc.



BUSINESS SPENDING 1949 1954 1958

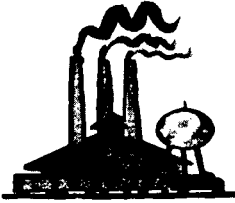
Spending for new plants, tools, machines, other capital goods, and changes in business inventories.



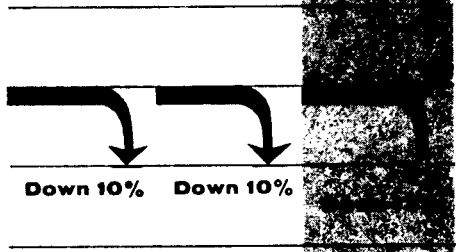
WHERE HAVE WE BEEN?

black arrows indicate total changes from the preceding peaks of prosperity to the lowest points reached during the 1949 and '54 recessions. The arrows for 1958, however, indicate only the changes from the prosperity peaks of 1957 through March 1958. Will they go down? Will they level off? Or will they go up during the rest of this year?

PRODUCTION 1949 1954 1958

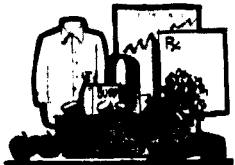


Total output of manufactured goods and products of mines.

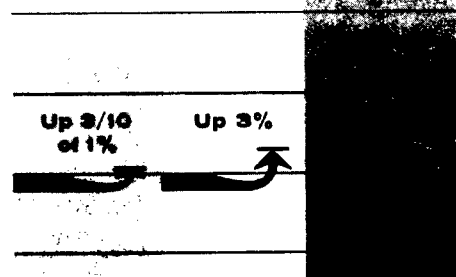


CONSUMER SPENDING 1949 1954 1958

Spending for such items as clothing, food, and cigarettes and payments for such services as rent, auto repairs, hair cuts, medical treatment, and entertainment.



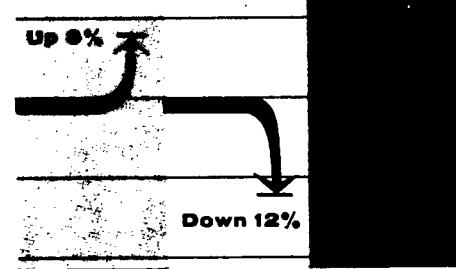
Spending for such items as clothing, food, and cigarettes and payments for such services as rent, auto repairs, hair cuts, medical treatment, and entertainment.



GOVERNMENT SPENDING 1949 1954 1958



Expenditures of federal, state, and local governments for goods and services.





Too Many Goods on Hand

In the two years prior to the peak of the 1956-57 boom, American industry produced about \$10 billion in goods which were not immediately sold. As a result, warehouses began to bulge.

In the course of producing these goods, jobs were made and workers received wages and salaries. Raw materials and parts were bought, so suppliers, too, received incomes. But as the amount of unsold goods increased, companies had to cut production *below* the current level of sales to dispose of their unsold goods. This cut in output meant less overtime and more unemployment.

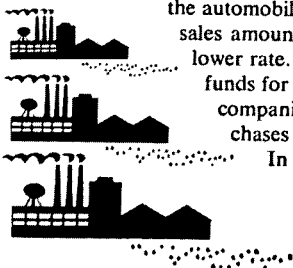
This oversupply of goods in warehouses (inventories) played a very important role in the decline in economic activity and in jobs during the last months of 1957 and the early months of 1958. When the excessive inventories are sold, companies will have to increase production again in order to meet the current level of sales. In this respect the events of 1957-58 followed the pattern of the two earlier postwar setbacks in 1949 and 1954.

Plant Capacity Temporarily Overbuilt

Another important factor contributing to the business boom in 1956-57 was the large increase in orders for new factories, new machines, new tools, and other equipment. These were to meet the anticipated demand by consumers and to increase production efficiency. From 1955 to 1957, total business spending for these purposes rose from \$28.7 billion to \$37.0 billion.

However, many companies found that their capacity to produce exceeded the declining current demand for their products. For example, at the end of 1957 the U. S. could produce about 141 million tons of steel; the maximum amount ever purchased in one year was only 117 million tons. Similarly, the automobile industry can now produce some 8 million cars; in 1957, sales amounted to only about 6 million and currently are at a much lower rate. In industries hardest hit by the decline, such as railroads, funds for additional plant and equipment are not available to many companies and cannot be obtained from investors. Hence, purchases must be cut drastically.

In some segments of our economy, such as electric power

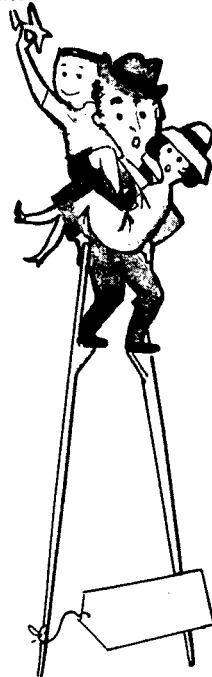


companies, spending for new plant and equipment is still growing rapidly. In others, we have more plant facilities than we can use at this time. There is no question that these surplus plants will be needed for the long pull. However, business has found it necessary to adapt to current conditions and current markets and has therefore reduced its annual rate of spending for new plants and equipment by about \$4 billion at the time of the present writing. And government surveys indicate that expenditures will drop further.

Too Much Borrowing

Many individuals borrow in order to buy refrigerators, television sets, automobiles, and houses. Business concerns borrow to buy goods or to meet part of the cost of new factories and machinery. States and local communities borrow to build new schools, highways, and hospitals. In periods of prosperity, some borrowers in all these groups borrow too much because they view the future too optimistically.

This is exactly what has been happening in our economy. For example, in 1956, business increased its debt to banks by about \$5½ billion. In 1957, the figure was about \$1½ billion. In 1955, consumers increased their installment debt by \$5½ billion; in 1956, by about \$3 billion; in 1957, by \$2¼ billion. Many consumers found that an increasing share of their current income was owed to the installment credit collector. As a result, they reduced their purchases late in 1957 and early in 1958. To some extent, our economy was built up on debt stilts which were too weak to support this high level of economic activity. The smaller increase in borrowings which developed in 1957 pulled out one of the props which had been supporting our economic boom.



Foreign Trade Is Slowing Up

Late in 1956 and early in 1957, sales of U. S. products in foreign countries (exports) received two shots in the arm. When Egypt seized the Suez Canal, Europe had to turn to us for oil products. The big increase in our shipments resulted in an increase in jobs and prices. To get rid of our surplus farm products, our government paid subsidies to sell them at low prices abroad.

Now these two situations have changed. At the same time, some foreign countries are also having a slowdown in business activity. Hence, sales of U. S. products abroad have fallen to the level that prevailed in 1956—and may be heading lower.

Wages and Productivity

"Wage inflation," a term introduced in recent years, describes a situation in which wages and the cost of fringe benefits are increased more than the workers' output. The result is a higher labor cost for each unit produced. For example, if a worker turns out 5 units a day and is paid \$5, the average cost of wages is \$1 a unit, not including fringe benefits. If his output increases to 8 units and his wages increase to \$16 a day, the average wage cost is \$2 a unit, or twice as much. This may seem like an extreme example, but it shows what has happened in the war and postwar years.

From 1939 through 1957, output per hour for workers in manufacturing industries rose about 50%, but average hourly earnings exclusive of fringe benefits increased 227% (from 63 cents to \$2.07 an hour). As a result, unit labor costs more than doubled. From 1955 to 1957, output per hour barely increased 1%, while hourly wages rose about 10%. And these figures do not show the added costs for pensions, welfare funds, and other benefits received by many workers during this period.

This rise in wages and other labor costs created pressure leading to higher prices. But many groups in our economy—schoolteachers, pensioners, government workers, and others—could not afford to pay the higher prices. They had to cut back their buying. Some workers gained, partly at the expense of less favored groups, and helped weaken our prosperous situation.

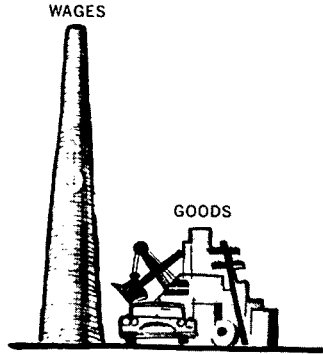
Wages and Profits

Some persons say the recession was caused because profits rose too much and wages too little. Official government figures in the chart at the right show the facts.

Between 1950 and 1957, total labor income *rose* by \$96 billion while profits after taxes *fell* by \$2.1 billion. Furthermore, since 1950, American corporations have spent more than \$200 billion for new plants and equipment. Yet profits have not increased; instead they have gone down. From 1950 to 1957, total national income rose \$118 billion, with most of this increase going to labor.

And what has happened in the past two years?

From 1955 to 1957, corporate profits after taxes declined by \$1 billion. But during this same period, total labor income *increased* by almost \$30 billion. Clearly, worker purchasing power rose considerably, but this did not



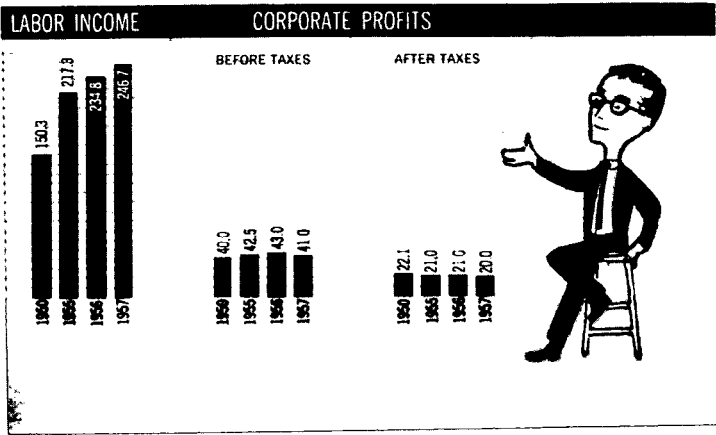
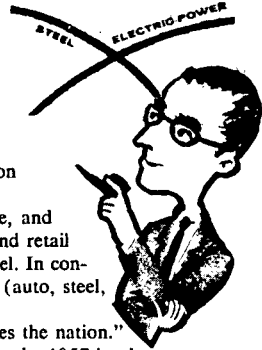
prevent a downturn in the general economy. It requires more than consumer purchasing power to make jobs. Investors must have incentives in the form of reasonable profits if the economy is to grow. But since 1955, profits have declined despite sizable expenditures for additional productive facilities.

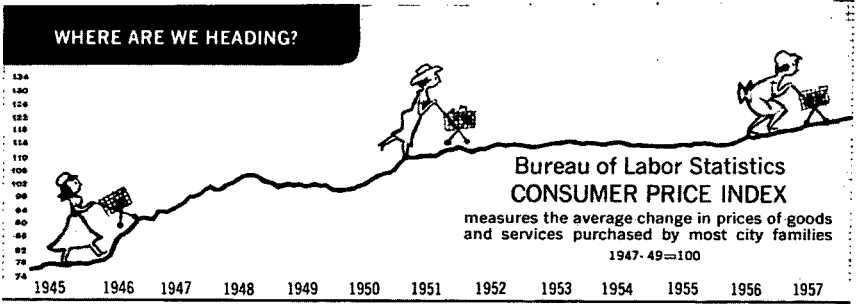
Look at the Entire Picture

It is important to examine the *entire picture* if we are not to be misled. Parts of the economy respond differently to basic forces.

- Look at steel output and it appears that the economy has declined more than 40%. Look at electric power consumption and it appears that the economy is moving upward.
- Early in 1958, the number of jobs held by federal, state, and local government employees and by workers in wholesale and retail trades was *larger* than a year earlier and was at a record level. In contrast, one out of every eight workers in the durable goods (auto, steel, machinery) industries had lost his job.
- Many persons think that "as auto production goes, so goes the nation." In the first three months of 1958, auto sales were 30% below the 1957 level. But consumers spend only about 5% of their income for autos. The fall of 30% in auto sales has cost the job of less than one worker out of every 100 in our economy.

When we look at the entire economy we find that early in 1958 the number of jobs had been reduced by about 2%. In addition, some persons who were not looking for jobs last year are now job hunting—mainly recent graduates and some housewives. Most workers have not been affected by the decline in employment. Of course, we must never forget that to the worker who has lost his job, the decline is 100%.





Where Are Prices Going?

During the past two years the cost of living has risen about 7%. Most of this rise had occurred by the summer of 1957. Why did prices go up? And why have they failed to drop as business declines? The biggest price increases are found in personal services such as auto and home repairs, beauty and barber shops, medical care, and recreation, which are largely labor costs. In these services, wage inflation has had an obvious effect upon price inflation.

Food is a second area of large price increases—amounting to almost 11% in the past two years. This results primarily from the increased costs of processing foods and the government program to hold up farm product prices. And early in 1958, the deep freeze in Florida resulted in a 15% rise in prices of fresh fruits and vegetables.

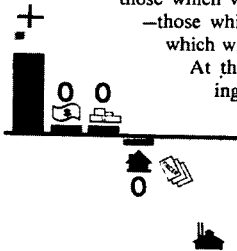
Apparel, furniture, and appliances have shown only small increases. Some appliances have actually declined in price. The discount house has become an important outlet in many parts of the country.

What are the prospects? So long as labor costs rise, the prices of services will continue to move upward. And service items account for about one-third of the cost of living. Food prices will be affected by higher wage costs for processing and transportation as well as by the size of crops and government programs. Prices of apparel and house furnishings tend to be held down by weaker demand during a period of business decline. On the whole, it appears that the cost of living should show only small changes for the rest of 1958.

Factors Affecting the Outlook

What is the outlook for business for the remainder of 1958? The main forces affecting business can be divided into three groups: (a) the plus factors—those which will tend to push our economy higher; (b) the neutral factors—those which will have little effect; and (c) the negative factors—those which will tend to pull our economy down further.

At the outset, one warning must be underlined. Business forecasting is not an exact science. In many areas, we can only “guesstimate” the forces at work. Thus, from here on the author is climbing out on the well-known limb with the hope that it will not be sawed off behind him.



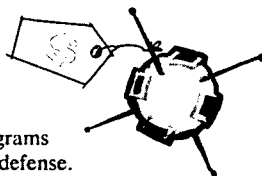
WHERE ARE WE HEADING?

† Government Spending Is Rising

To catch up with Russia in the missile and satellite programs our government is increasing its spending for national defense. Most estimates suggest a rise of \$2 to \$4 billion this year; it may be even greater. At the same time, the federal government is increasing other spending to help offset the slide in business activity.

During the postwar period, local and state governments have been increasing their expenditures between \$2 and \$3 billion each year for highways, schools, and other activities, and it appears that this local spending will continue to rise.

Thus, it seems likely that spending by all government units will increase by at least \$4 to \$6 billion in the next year. This increase will be the most important plus factor supporting the economy during 1958.



O Consumer Incomes and Spending Hold Up

After paying their taxes in 1957, consumers were left with about \$300 billion—the largest amount in our history.

Consumer spending, of course, is determined largely by consumer income. The largest single source of that income is wages. On an annual basis, labor income fell from \$250 billion in August 1957 to \$241 billion in March 1958. This decrease was due to shorter work weeks, elimination of overtime pay, and unemployment. The first two factors accounted for more of this decline than did the third. With overtime pay virtually ended, the reduction due to this cause is largely behind us. Wage increases promised under long-term contracts will offset to some extent the over-all reduction in income due to job losses. In addition, most of the unemployed receive unemployment compensation. About one-third of lost labor income is offset by such payments.

Lower corporate profits mean lower dividend payments to stockholders. Already many companies have reduced their dividends or cut them out entirely. Further cuts will take place in the months ahead.

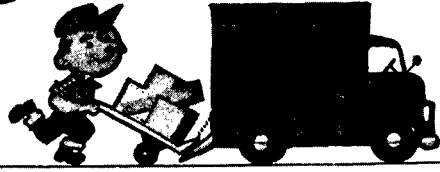
Farm income may show a small rise. This forecast is supported by the recent increase in prices of farm products.

Interest income has been rising at the rate of about \$1 billion a year. This rise probably will continue.

On balance, it appears that the decline in total income will be relatively small. This should be a most important factor limiting the size of the business decline. Consumer spending is the largest single factor in our economy. Stability in this area provides an important protection against a bad downward spiral.



WHERE ARE WE HEADING?



O Inventories Are Being Reduced

While stocks of new autos have been increasing, inventories of other goods are being used up.

When new orders are filled out of the warehouse instead of by production, the number of job opportunities falls. We are currently reducing the unsold products in our warehouses at the rate of about \$7 to \$8 billion a year. For example, production of such items as steel appears to be far below the rate of consumption. At some point, production will have to be increased in order to meet current orders.

It is probable, however, that the sale of goods from overstocked warehouses will continue through most of 1958. But the worst effects of selling from inventories are behind us. It does not appear that this factor will cause much additional unemployment.

O Residential Housing Holds Up

Many observers expect the volume of new housing to remain at last year's level of 1,041,000 housing units or to increase a little because:

- More credit is being made available for housing, and interest costs are again falling.
- The number of new families needing housing each year is now around 700,000.
- More government subsidies are being paid to increase the supply of low-cost housing.
- About 300,000 houses a year are destroyed by fires, floods, hurricanes.

As against these factors, which lead to greater volume, there is the uncertainty that develops during periods like the present one. Some families postpone buying a new home until the outlook becomes less cloudy.

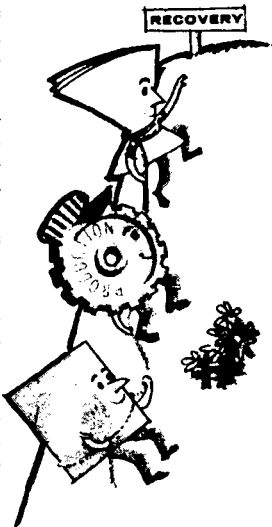
After considering these conflicting forces, most authorities on housing predict that between 1,000,000 and 1,100,000 new dwelling units will be started in 1958. A continuation of this volume of new housing would be an important factor supporting the sale of furniture, appliances, hardware, and related products.



New Orders Still Below Current Output

The volume of new orders received by manufacturers provides a very important clue to the future trend of business activity. Usually, they drop first. They also lead the recovery. The peak in new orders received by manufacturing industries was \$30 billion in November 1956. Long before the economy turned down, the volume of new orders began to slide off. By spring of 1957, the total had decreased to about \$28 billion a month. By March 1958, new orders totaled only about \$24 billion. Most of this decrease has been in orders for durable goods—transportation and electrical equipment, machinery and related lines.

Meanwhile, companies continued to ship goods at a rate higher than that at which new orders were received. This was possible because, at the end of 1956, unfilled orders exceeded \$64 billion. By March 1958, as a result of continued output while the volume of new business was falling, unfilled orders had dropped to \$47 billion. Further declines in production and deliveries will take place until they are in line with new orders. The increase in defense spending, highway construction, and other government spending may slow up or even stop the business decline. But until orders rise, it will be difficult to have much recovery.

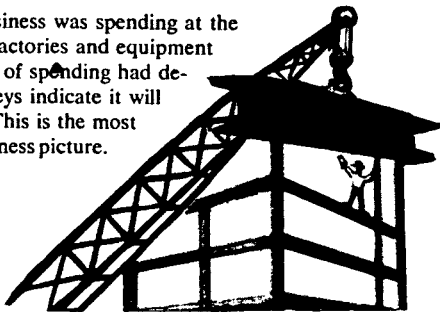


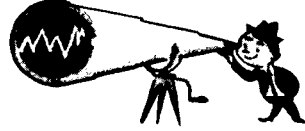
Spending for New Factories and Machinery Will Decline

The role of new factories and equipment in the 1956-57 boom was pointed out earlier. We now face a sharp decline in this type of business spending because:

- (1) Capacity in many industries is too great for current needs.
- (2) Corporate profits have been declining. This means less money available for new plants and less incentive for investors to buy stocks and bonds in these corporations.
- (3) Construction costs have risen a great deal.
- (4) Certain tax advantages for plants built for defense work are no longer available.

According to government estimates, business was spending at the rate of almost \$38 billion a year for new factories and equipment in the fall of 1957. Early in 1958, the rate of spending had declined to \$34 billion and government surveys indicate it will fall to about \$31 billion later in the year. This is the most significant negative factor in the current business picture.





The Business Outlook

At this time (May 1958), there are many crosscurrents in our economy. Areas of increasing activity are present alongside those that are declining. How do they balance out? It appears to the writer that the major part of the business slump has already taken place. Consumer spending, almost two-thirds of the economy, faces only a minor drop. Government spending, one-fifth of the total, is certain to expand. Most of the cuts in production due to excessive inventories already have occurred. The main weakness appears to be the probable decline in business spending for new factories and equipment.

The net effect of these forces is likely to be a little decline from the present level. Then business probably will remain substantially unchanged for some time before the recovery starts. The speed with which we bounce back will depend upon how rapidly our problems are cleared up, what action is taken by government, and what is done by individuals and business.

What Business Can Do

During a boom, business gets complacent, as do individuals. Companies fail to watch costs as closely as they should. The easy way to cover higher costs is to raise prices, which can be done in prosperous times. Overoptimism may lead to too much borrowing from banks, and a piling up of unsold goods. Increases in volume of production and sales help to overcome various problems during the boom. But when volume begins to decline, the reduction in profits is prompt. What must business do under these conditions?

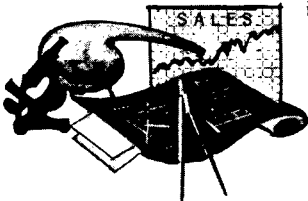
1. Cut costs. Usually this means a review of previous methods of producing and doing business. Possibly new materials can be substituted at lower cost.

New and better machines may reduce costs. The sales force may need a shot in the arm. Unnecessary operations must be dropped. Ineffective operations must be improved. New methods must be tried. The key is often found in greater output per worker (productivity).

2. Reduce prices where possible, to expand markets and to reverse declining sales volume. Price cuts often are impossible if costs continue to rise. This is particularly true of products in which labor costs bulk large.

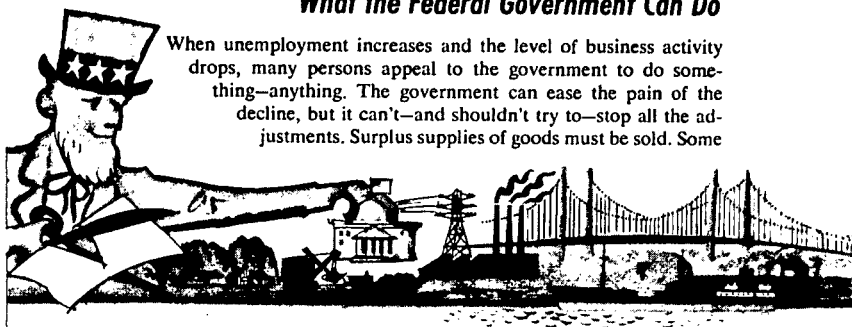
3. Sell excessive inventories, pay off bank loans.

4. Increase research. The development of new products opens up new markets and creates new jobs. New methods of production can cut costs. "Better products at lower prices" becomes the goal.



What the Federal Government Can Do

When unemployment increases and the level of business activity drops, many persons appeal to the government to do something—anything. The government can ease the pain of the decline, but it can't—and shouldn't try to—stop all the adjustments. Surplus supplies of goods must be sold. Some



debts must be repaid. Those who overspeculate in the stock market must pay the penalty of losses. We must grow up to overexpanded plant capacity.

But government has a responsibility, spelled out in the Employment Act of 1946, to prevent the decline from going too far. What can it do?

1. It can make more credit available at lower prices (a policy called "easy money"). The Federal Reserve Board is already doing this. But that does not mean there will be a rush to the banks to borrow money. Businessmen borrow only when they expect to make a profit from the money. Consumers borrow only when they anticipate being able to repay the loans.

2. It can spend more money for essential public works. This spending increases the number of workers required and helps to stimulate the economy.

3. It can cut individual and business taxes. Those who advise this measure say that such tax cuts increase buying power of individuals and provide incentives for business firms to bring out new products and devices, thereby creating additional jobs.

Ordinarily, the easy money policy comes first, followed by some increase in government spending. The real questions are: When should a *crash program* be adopted? . . . and . . . What form should it take?

Some economists suggest holding off until unemployment remains above the five million mark in months other than February and March, when unemployment usually reaches its seasonal high. (April was 5.1 million.) They believe that when unemployment is at or below 5 million, the easy money policy combined with some increase in government spending is all that is required. Others feel the most effective action is a tax cut because it takes effect promptly. However, a crash program is likely to include a combination of more government spending and tax relief. But in any crash program we should not resort to large-scale deficit spending, with government expenditures far in excess of income. This could bring on another inflationary spree and send prices climbing again.

What the Average Citizen Can Do

All of us as individuals can help limit a decline in business.

As consumers, we should not hold back on buying because of fear that some unknown hardship is about to hit. The most helpful thing we can do is to continue to buy the goods we need within the limits of our pocketbooks. We are *not* facing another depression like the 1930's. This decline seems likely to be much less severe.

As employees, we must remember that wages are costs as well as buying power. When our wages rise more than our output, the result is wage inflation. Many consumers are priced out of the market. The result is fewer goods sold, hence fewer jobs. This is especially true in a period of decline.

As citizens, we must stop turning to government to solve all our problems every time our economy has a modest sinking spell. We must recognize that the errors made during a boom must be corrected. You and I cannot continue to live beyond our means and add to our debt each year.

Attacks on profits do not add to jobs. Profits provide the main incentive for creating new jobs. When someone sees a chance to "make a buck" by going into a new business, he also makes new jobs.

This country was made great by the actions of individuals seeking new opportunities. This remains the road to a future rise in our living standards.



Western Electric

Steel Prices, Profits, Productivity, and Wages

by **JULES BACKMAN**, Professor of Economics
NEW YORK UNIVERSITY

655

JULES BACKMAN
59 CRANE ROAD
SCARSDALE, NEW YORK

April 22, 1957

Mr. Robert C. Tyson
Chairman of Finance Committee
United States Steel Corporation
71 Broadway
New York 6, New York

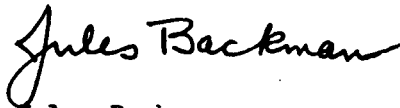
Dear Mr. Tyson:

In accordance with your request, I have examined the two documents prepared by the United Steelworkers of America:

1. Steel in the National Economy 1956
2. Facts On Steel: Profits, Productivity, Prices and Wages 1956

Attached are my findings. You will note that I have analyzed the main arguments and supporting data rather than attempting to make a line by line evaluation of the reports. I trust you will find this report of some value.

Sincerely yours,



Jules Backman

JB:ew

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Summary and Conclusions

Steel Price Increases Have Not Caused Inflation

1. The steel industry, during the war and postwar period, has been much more a victim than a cause of inflation. This fact is clearly revealed by an examination of the diverse trends of general prices, steel prices, and steel costs during the past eighteen years. During this period, steel material costs have risen faster than steel prices. Steel labor costs have risen substantially more than steel output per manhour.

Steel Price Increases Have Little Effect on General Prices

2. Depending on the basis used for comparison, the steel industry accounts for 2.5 per cent to 4.7 per cent of the national economy. The steel industry is a giant industry. But it is only one of many giant industries in a giant economy. The use of absolute dollar totals running into billions of dollars naturally creates an illusion of impact which far exceeds the actuality. It is only when the \$14 billion steel industry is measured against the \$400 billion economy that a proper picture is obtained of its relative significance.

3. Changes in steel prices undoubtedly affect very significant areas of the economy. However, they do not determine changes in the general level of wholesale prices or in the cost of living.

4. The accepted measure of the impact of inflation upon the individual is the consumer price index. Because steel accounts for a relatively small part of final product costs for many important products, changes in steel prices can have only a minor effect upon the consumer price index.

5. Consumer prices have repeatedly moved quite independently of steel prices. From 1940 to 1944, finished steel prices failed to increase by as much as 1 per cent in any year. Yet during that same period, the consumer price index rose as much as 10.8 per cent in 1942 alone. In 1946, steel prices rose about as much as the consumer price index, but in 1949 steel prices rose while consumer prices declined. In 1953-1955, the annual increases in steel prices ranged between 4.3 and 7.6 per cent while the consumer price index remained about unchanged. From 1955 to 1956, consumer prices rose only 1.5 per cent while steel prices rose 8.4 per cent. Clearly, there is little causal relationship between steel prices and the cost of living in this record.

6. There was also no relationship between changes in steel prices and the wholesale price index for the various periods between 1939 and 1956. The record of diversity between changes in steel prices and the wholesale price index is

similar. For the period 1939 to August 1945, steel prices rose only 3.8 per cent while wholesale prices rose 37.1 per cent. From 1939 to 1956, steel prices rose 138.4 per cent or only slightly more than wholesale prices—up 128.1 per cent.

Steel Costs for Purchased Products and Services Have Risen Substantially More Than Steel Prices

7. There has been a major rise in the cost of materials bought by the steel industry. This increase in material costs has contributed to the pressure for higher prices for finished steel during the war and postwar years. To a large extent, increases in raw material prices have reflected the rise in labor costs. This is particularly evident in connection with such key products as coal and iron ore.

8. In the 1947-49 period, United States Steel paid an average of 106.7 per cent more for raw materials than it did in 1939. If petroleum, oxygen, gas, and electricity are included in the total, then the combined rise in raw material and fuel costs was 85.4 per cent between 1939 and 1947-49. During the same period, the Bureau of Labor Statistics index of finished steel prices rose only 47.1 per cent. Taking the longer period, from 1939 to the end of 1956, the rise in raw material costs and fuels was 169.1 per cent compared with a rise of 148.2 per cent in finished steel prices. As a result, the share of the steel industry sales dollar spent for products and services has risen from 44.3 per cent in 1939 to 45.8 per cent in 1956. For United States Steel the rise has been from 34.7 per cent to 35.2 per cent.

Steel Labor Costs Have Risen Substantially More Than Steel Output Per Manhour

9. Steel productivity has been increasing at a slower rate in recent years than before 1940.

10. Between 1940 and 1956, steel industry average hourly earnings rose by 201.2 per cent and average hourly earnings plus pensions and welfare fund costs rose by 211.2 per cent in contrast to steel productivity which increased only 56.3 per cent. Between 1947 and 1956, average hourly earnings rose 75.7 per cent and total employment costs by 85.9 per cent while steel productivity increased only 28.2 per cent.

11. The result has been a sharp rise in unit labor costs which doubled during the war and postwar years with the consequent pressure for higher prices. Between 1952 and 1956, the increase in unit labor costs was 16.9 per cent. Clearly, increases in labor costs in recent years could not have been absorbed out of increases in productivity. On the contrary, labor costs have outstripped productivity by such a wide margin that there has been considerable pressure for price increases.

Real Steel Wages Have Risen More Than National Productivity

12. Increases in steelworkers' real income have been much greater than in national productivity since 1940-1941. The rise in national productivity has been 35.5 per cent as compared with 55.6 per cent for steelworkers' real income. Regardless of which year since 1940-41 is used as a basis for comparison, steelworkers' wages have outstripped national productivity gains.

Increases in Steel Labor Costs Cannot Be Paid Out of Profits Without Price Increases

13. It is sometimes stated that higher steel labor costs could easily be paid out of steel profits without any increase in prices. This charge ignores the fact that labor costs have risen much more sharply than productivity. In addition, for the steel industry, costs of products and services have increased \$1.43 for every \$1 increase in labor costs for the period 1939-56. For United States Steel, the increases in both types of costs have been almost equal.

14. Employment and raw materials costs have moved in the same direction in *every year* since 1939 both for United States Steel and the steel industry. While the magnitude of the changes for both types of costs have not been precisely the same in each year, they have been of similar magnitude in many years and have tended to have closer relationships over a two or three year period.

15. Clearly, any claim that wage increases could have been paid out of profits without an increase in prices is without foundation in fact.

If, since 1945, steel prices had risen only enough to cover the additional direct labor costs incurred in producing finished steel, the steel industry would have experienced a loss in excess of two billion dollars in 1955.

If prices had risen only enough to permit the industry to break even in 1955, a price rise of 86.0 per cent since 1945 would have been required. This would have been more than seven tenths of the actual rise—and the industry would still have had no profits.

Even if the steel industry had maintained its 1947 profits ratio, the price rise would have had to be 113.1 per cent or only 3.4 per cent lower than the level which actually prevailed.

16. Wage costs are an important element in total costs in the steel industry and changes in total costs are considered when making price adjustments. However, other factors also have been important. Among those which may be cited are: the desire to earn a fair return on investment, the need for funds for expansion, strong demand for steel which is reflected in the ability of customers to pay higher prices, and changes in the prices of substitute products. Changes

in wages certainly may influence the *timing* of price changes—but not their magnitude.

Steel Industry Profit Ratios Are Not High Relative to the Sales Dollar

17. The steel industry earned 7.8 cents on each dollar of sales in 1955, compared with 6.7 cents for all manufacturing industries. However, ten other major manufacturing industries reported *larger* profit ratios than the steel industry.

18. But the steel industry's investment in facilities is so large in relation to dollar sales compared to manufacturing industries generally that, in order to show a comparable return on its investment, the steel industry must realize a larger-than-average profit ratio on its sales dollar.

Steel Industry Profits Are Overstated Because Depreciation Is Understated

19. Profits in most industries have been exaggerated in years of inflation because of the accounting practice of valuing assets at historical rather than replacement costs. In more recent years, the differences between depreciation on original and replacement cost bases have tended to narrow but even in 1955 current cost depreciation was still running 36.7 per cent above the corresponding original cost depreciation. The understatement of depreciation in 1955 led to a significant *overstatement* of actual profits.

20. Costs of steel producing facilities have increased so rapidly in recent years—from 200 to 300 per cent since the nineteen thirties for major equipment items—that actual replacement costs have risen far above the historical values assigned on the steel industry's balance sheets. Therefore, the depreciation allowable under conventional accounting methods and chargeable to expenses in tax statements seriously understates the capital costs of producing steel.

21. It seems apparent that accelerated amortization has offset only part of the underdepreciation of assets. But even this partial relief will exact its price tomorrow. When this accelerated amortization is completed over the next few years, the result will be an increase in the magnitude of underdepreciation and a rise in the magnitude of phantom profits.

22. The dollar profits reported by the steel industry include phantom profits, which actually are a consumption of capital. These phantom profits are, however, subject to income taxes. From 1940 to 1956, the deficiency in depreciation charges has been \$904.0 million for United States Steel alone. Since depreciation allowances are *understated*, the funds for facility replacement programs must be obtained in part from retained earnings.

23. While inadequate depreciation allowances are not exclusively a steel in-

dustry problem, the large and expensive facilities which steel production requires and their durability accents the difficulty of financing replacement facilities out of depreciation charges.

Inflation Impairs Net Worth Comparisons

24. Purported high returns on net worth are completely misleading. They reflect an inevitable fiction which arises during a period of inflation. Profits are stated in current inflated dollars; net worth is stated in good part in old or "hard" dollars. In recent years, profits have been overstated for the steel industry because of the understatement of depreciation. Of equal significance, net worth is drastically *understated*. The return on net worth, therefore, gives no indication whatsoever of how much can be earned on dollars invested currently.

Steel Profits Must Be Related to Level of Business Activity

25. Steel profits have not been "exorbitant." They have been at record high levels because national economic activity and steel production also have been at record levels. In an industry like steel, which has experienced wide fluctuations in output over the years, it is dangerous to assume that the level of profits in a boom year like 1955 represents normal earning power. This was one of the best years ever experienced in the steel industry, as it was for virtually all industry. Merely because steel profits achieved these record levels does not prove that they are too high any more than record levels of hourly earnings of steelworkers provides evidence that they are too high. Even moderate declines in volume can mean sharp declines in profits as was evident in 1952 and 1954. Steel profit margins are widest at the peak of a boom and lowest or nonexistent in periods of recession or depression.

26. It is dangerous to hold that the 1955 experience represents a level of profits which could have been reduced safely. To reduce profit margins obtained at boomtime levels to some assumed average level would increase the steel industry's *vulnerability* to any future declines in volume. To repeat, the actual historic record of the past decade provides no basis for the conclusion that the steel industry's profits are not inseparably linked to changes in volume from the trough to the peak of the business cycle as well as from peak to trough.

Dividends to Steel Stockholders

27. There has been no marked upward trend in the share of the sales dollar paid as dividends during the 1939-56 period. Rather, the ratio has tended to move sidewise within a range of about 1.5 percentage points during the period. These data do not support the inference that dividend payments were unusually high when the volume of business is considered. The distribution of the sales dollar prevailing in 1955 reflected primarily the record volume of sales and

output in that year. The pattern did not differ significantly from that in other years of high volume.

Funds for Steel Expansion Are Obtained from Internal and External Sources

28. A survey of 16 steel companies reveals that, from 1946 to 1956, they sold approximately \$1.5 billion in securities, one-third of which was convertible bonds and common and preferred stock; additional funds were borrowed from insurance companies and from customers. However, the bulk of the financing of new steel facilities for expansion and replacement of productive capacity has been from internal sources. As is true in other industries, steel companies have had to decide what proportions of new financing properly should be obtained by increasing debt and what share from the sale of stocks. Each company has made the decision in terms of its own special situation.

29. The reinvestment of corporate earnings and depreciation allowances—which the steel industry has utilized as a major source of funds—is a recognized method of financing. It has been so extensively used by American business that in the ten year period ending in 1956, about two thirds of all corporate funds for investment came from these sources. Internal sources, now as in the past, continue to provide the major funds for financing plant and equipment in manufacturing industries. The practice of the steel industry in this connection is fairly typical rather than unique.

30. Retained earnings which are reinvested in a business are *not* “riskless” or “costless” capital; they represent a risk and a cost to the stockholder. Retained earnings do *not* constitute a levy on a corporation’s customers; they represent a use of sales receipts which could otherwise be paid out to the stockholder as dividends.

31. A steel company cannot set prices arbitrarily without any relationship to market forces. Prices set excessively high without regard to market conditions would result in a shift to substitute metals and to other materials and would be accompanied by a reduction in sales and in the volume of profits. Such a price would be self defeating and fail to achieve its objective. Paradoxically, the funds such higher prices were allegedly designed to obtain would not be forthcoming. Moreover, they would not be required because of the idle capacity which would develop in the industry. A steel company is as much concerned as unions should be that it does not price its products out of the market. The consumer makes his decision to buy or not to buy a product in terms of the price asked. He does not make his decision on the basis of what a company will do with the funds received.

Steel Prices, Profits, Productivity, and Wages

IN July 1956, the United Steelworkers of America published two documents which purported to show significant facts and trends for the steel industry and for the national economy. These documents were:

1. "Steel and the National Economy 1956"
2. "Facts On Steel: Profits, Productivity, Prices and Wages 1956"

These volumes were designed to show that steel prices have been increased unnecessarily and excessively and hence have contributed to inflation and that these increases have been due to the desire by the industry to earn exorbitant profits. The Union denied that past price increases have been the result of past increases in labor costs and in other costs. The Union also claimed that real wages, in terms of purchasing power, of steelworkers have risen less than steel productivity and hence higher wages have created no

pressure for price increases.

To reach these conclusions, the Union relied upon data related to base periods which in many instances had little economic relevance. It also relied upon projections and exaggerations which find no support in the past experience of the industry. It relied upon meaningless comparisons with other industries. It had to ignore pertinent facts concerning the economic nature of the industry.

The present study is designed to "set the record straight." No effort will be made to correct every factual error in the Union briefs. Rather, attention will be directed primarily to the key charges made by the Union concerning price increases and their effects on the economy, cost-price relationships, productivity changes, price policy and profit margins, the level of steel profits, and past methods of financing expansion.

I. SELECTION OF BASE PERIODS

THE selection of 1939 and 1947 as base periods, affects many of the Union's conclusions. It is important at the outset, therefore, to indicate when the use of these dates is improper.

The Use of 1939 as a Base Period

IN many of its comparisons, the Union document, "Facts On Steel," shows the changes since 1939. The use of 1939 is misleading in

connection with financial comparisons. That was a year in which both the national economy and the steel industry were still depressed. For example, total unemployment was approximately 9.5 million. The operating rate in the steel industry was only 64.5 per cent of capacity as compared with 82.1 per cent in 1940, 97.3 per cent in 1941 and 93 per cent in 1955. Since profits are a residual item, they tend to contract very sharply during periods of recession. Accordingly, in

1939, steel profits were low, dividends were low, and the return on net worth was low. At page 15 of "Facts On Steel," it is pointed out that "the number of these [25] companies paying cash dividends to their stockholders has increased sharply since 1939. In that year, only 7 of these companies made a cash payment to their common stockholders." Clearly, a year in which fewer than one company out of three can pay dividends is not a very useful or significant one for purposes of financial comparison. Comparisons with such a year will tend to show exceptional percentage increases because of the relatively low base from which they are measured.

A low level of profits also affects the significance of comparisons of the distribution of the sales dollar over time. In a year of depression, wages and salaries tend to take a higher proportion of the fewer sales dollars because profits are much lower than in a period of prosperity. A few simple figures illustrate the point. Suppose that wages and salaries account for 45 cents out of each dollar of sales or a ratio of 45 per cent. Now assume that profits before taxes decline the equivalent of 10 cents of the sales dollar and employment costs remain the same. Then employment costs are 45 cents out of 90 cents, or 50 per cent of the sales dollar. The same tendency is true for other components of the company's costs.

Thus, it is not surprising to find that the share of the sales dollar accounted for by steel industry employment costs declined from 39 cents in 1939 to 33½ cents in 1955. The change in the level of operations and the impact on profits was a significant factor in this decline. It is interesting to note that in 1941, when the steel industry was operating at high level rates, employment costs were 34.1 per cent of the sales dollar or not too different from the ratio in 1955 when a relatively high proportion of

capacity also was being used.

The selection of 1939 as a base date also affects the magnitude of increases in productivity and tends to exaggerate them. This is so because volume is an important element in short term changes in output per manhour. When volume declines, the most effective organization of resources and of manpower is more difficult to obtain and hence output per manhour is lower. On the other hand, when the economy moves up, as it has from depressed to boom levels, output usually rises more rapidly than does employment since workers are used more efficiently. As a result, output per manhour rises more than its long term rate of increase.

The effects of the volume factor were clearly reflected in the very sharp increase in productivity in 1955 from the 1954 level. The 11 per cent rise in productivity in that year occurred in large part because the rate of steel operations rose from 71.0 per cent to 93.0 per cent of capacity.

This fact also was recognized by the Steel Industry Fact Finding Board in its report on the 1949 wage dispute. That Board concluded "the companies were correct in contending that the union's emphasis on the change in manhour productivity from 1939 to 1948 and 1949 was misplaced. Because the rate of operation is such an important factor in productivity, valid comparisons can be made only for years of similar rates of operation, such as 1941 and 1948."¹

For productivity and financial comparisons to be meaningful, they must relate to years when activity is at comparable levels. The comparisons have greatest value when they can be made between a number of years of comparable activity rather than between single years when such volume may have been attained.

¹ *Report to the President of the United States on the Labor Dispute in the Basic Steel Industry by the Steel Industry Board appointed by the President, July 15, 1949, p. 45.*

While the year 1939 involves many distortions when used as a base period for financial and productivity comparisons, it does have validity for price and wage rate comparisons. In the immediate pre-World War II years, for example, hourly wages had shown little change after the 1937 increase and prices had recorded relative stability. Under these conditions, 1939 can be used to determine the magnitude of wartime and postwar inflation in wages and in prices without the problem of distortion that attends the use of that year as a base in connection with financial and productivity data.

The Use of 1947 as a Base Period

MOST of the Union's charts and tables as well as many of the long term comparisons use 1947 as a base date (see, for example, "Facts On Steel," page 8, 11, 14, 15, 17, 22, 23, 27, 30, 35, 36, 49, 50, and 51). The use of 1947 as a base period has the effect of ignoring the substantial pressures on steel costs which were not accompanied by a corresponding rise in steel prices in the preceding war and the early postwar years. The following tabulation shows the changes in the finished steel price index from 1939 to 1947 and the comparative changes in several selected price indexes:

Increases in Wholesale Price Index, Industrial Price Index, Selected Steel Costs, and Finished Steel Prices, 1939-1947

| | 1939 | 1947 | % Increase |
|--|---------|---------|---------------|
| Finished steel prices (1947-49 = 100) | 68.0 | 89.1 | 31.0 |
| Wholesale price index (1947-49 = 100) | 50.1 | 96.4 | 92.4 |
| Nonfarm, nonfood index (Industrial prices) (1947-49 = 100) | 58.1 | 95.3 | 64.0 |
| <i>Steel Costs</i> | | | |
| Steel scrap | \$16.39 | \$36.36 | 121.8 |
| Employment costs | \$ 0.89 | \$ 1.49 | 67.4 |
| Construction costs (ENR) (1947-49 = 100) | 52.1 | 92.2 | 77.0 |

The rise in finished steel prices of 31 per cent between 1939 and 1947 was less than half as large as the rise in all industrial prices and only about one-third of the 92.4 per cent increase in the general wholesale price index. Similarly, important ingredients of steel costs had also increased substantially more than had finished steel prices. By 1947, steel scrap prices had more than doubled, construction costs had risen by 77 per cent, and employment costs per manhour by 67 per cent.

By emphasizing the changes which have taken place since 1947, the Union document ignores the fact that the changes since that date reflect in part a catching up of steel prices with the inflation which had developed on a significant scale in virtually all the rest of the economy during the World War II years and the first two postwar years. Moreover, in terms of any significant economic criteria, there are good reasons why the year 1947 should not be used as a base period. The postwar inflation was still in effect, the readjustments from the war economy were still taking place, there were the growing pressures of our early postwar aid programs to Europe, many goods were still in scarce supply, and the economy was still in its first postwar phase of expansion reflecting in part the deferred demand of World War II. This combination of factors as well as other pressures at work indicate that the year 1947 has many limitations or defects as a basis for determining the significance of subsequent price increases and their relationships.

II. FINISHED STEEL PRICES AND THE GENERAL PRICE LEVEL

CONSIDERABLE public attention has been devoted to the rise in the general price level. Some groups blamed this rise on the steel industry. Since mid-1955, finished steel prices have risen, as have many other prices. But is it true that changes in finished steel prices determine or play a primary role in the direction or magnitude of changes of the general price level? The validity of this thesis may be determined by comparing changes in finished steel prices and the indexes of wholesale prices and consumer prices since 1939.

Table 1 and Chart 1 show the changes in finished steel prices and the two comprehensive price indexes since 1939. The increase in finished steel prices lagged behind the rise in the index for all commodities

throughout the war and postwar period. It wasn't until 1956 that the cumulative increase in finished steel prices exceeded that for all wholesale prices. The rise in finished steel prices was 138.4 per cent as compared with 128.1 per cent in the wholesale price index.

Consumer prices usually fluctuate much less than wholesale prices. Both the all-commodity index and the finished steel price index rose more than the consumer price index. It is interesting to note that the lag in finished steel prices was so marked in the World War II and the early postwar period that it was not until 1953 that the over-all rise in finished steel prices from 1939 exceeded that in the consumer price index. This was a very unusual relationship.

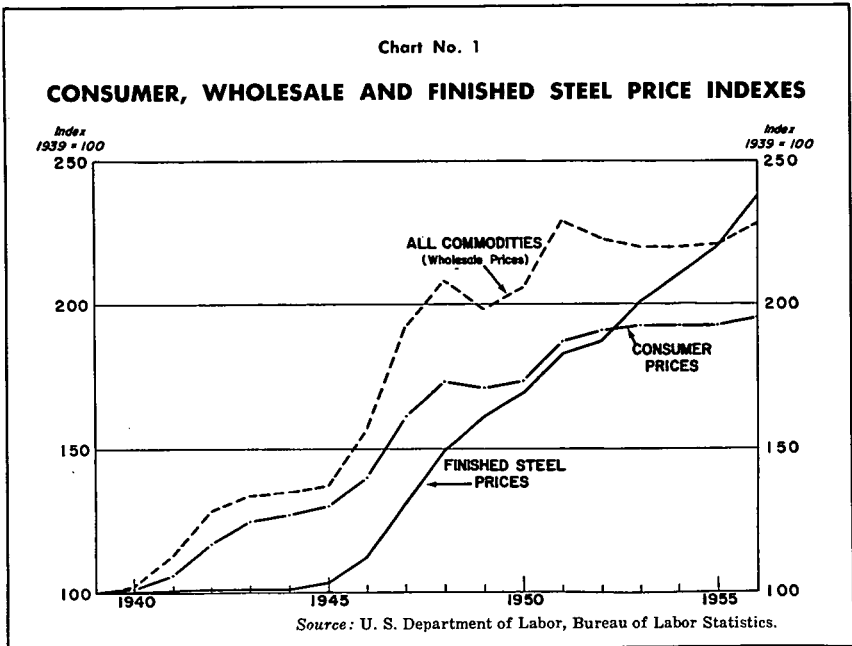
TABLE 1
Consumer Price Index, Wholesale Price Index,
and Finished Steel Prices, 1939—December 1956
(1939 = 100)

| Year | Consumer Price Index | Wholesale Price Index | Finished Steel Prices |
|-----------|----------------------|-----------------------|-----------------------|
| 1939 | 100.0 | 100.0 | 100.0 |
| 1940 | 100.8 | 102.0 | 100.1 |
| 1941 | 105.9 | 113.4 | 100.6 |
| 1942 | 117.3 | 128.1 | 100.7 |
| 1943 | 124.6 | 133.7 | 100.9 |
| 1944 | 126.6 | 134.9 | 100.9 |
| 1945 | 129.5 | 137.3 | 103.2 |
| 1946 | 140.4 | 157.1 | 112.4 |
| 1947 | 160.8 | 192.4 | 131.0 |
| 1948 | 173.1 | 208.4 | 149.0 |
| 1949 | 171.4 | 198.0 | 161.3 |
| 1950 | 173.1 | 205.8 | 169.4 |
| 1951 | 186.9 | 229.1 | 183.1 |
| 1952 | 191.1 | 222.8 | 187.1 |
| 1953 | 192.6 | 219.8 | 201.3 |
| 1954 | 193.3 | 220.2 | 210.0 |
| 1955 | 192.8 | 221.0 | 219.9 |
| 1956 | 195.6 | 228.1 | 238.4 |
| Dec. 1956 | 198.7 | 232.1 | 248.2 |

Source: U. S. Department of Labor, Bureau of Labor Statistics.

An examination of Chart 1 reveals little relationship between the changes in finished steel prices and in the general level of prices. This lack of relationship is more clearly em-

steel prices rose 8.8 per cent or about the same as the rise for the consumer price index. However, this rise was less than the rise in the wholesale price index. In 1947,



phasized when the changes are examined on a year to year basis, and for selected periods within the span of 17 years.

Table 2 shows the year to year changes for each of these indexes. It will be noted that in the years 1940 to 1944, finished steel prices failed to increase by as much as 1 per cent in any year. During that period, the wholesale price index recorded annual increases ranging from less than 1 per cent to 13 per cent. The consumer price index showed changes which reached as much as 10.8 per cent in 1942.

In 1946, the first postwar year, finished

similar relationships prevailed with the rise in finished steel prices lagging significantly behind the increase in wholesale prices.

While all of the indexes rose in 1948, the steel price index rose by about 5 percentage points more than did the wholesale price index. In 1949, steel prices rose while the other price indexes declined.

In 1950, all of the indexes rose with the rise in steel prices somewhat greater than that in the more comprehensive indexes. In 1951, when all the indexes rose, finished steel prices lagged behind wholesale prices.

In 1952, the steel index rose by about 2

TABLE 2
 Year to Year Per Cent Changes in Consumer Price Index,
 Wholesale Price Index, and Finished Steel Prices,
 1939—December 1956

| Year | Consumer Price Index | Wholesale Price Index | Finished Steel Prices |
|-----------|----------------------|-----------------------|-----------------------|
| 1940 | + 0.8 | + 2.0 | + 0.1 |
| 1941 | + 5.0 | + 11.2 | + 0.4 |
| 1942 | + 10.8 | + 13.0 | + 0.1 |
| 1943 | + 6.2 | + 4.4 | + 0.1 |
| 1944 | + 1.6 | + 0.9 | 0 |
| 1945 | + 2.3 | + 1.8 | + 2.3 |
| 1946 | + 8.5 | + 14.4 | + 8.8 |
| 1947 | + 14.5 | + 22.5 | + 16.6 |
| 1948 | + 7.6 | + 8.3 | + 13.7 |
| 1949 | - 1.0 | - 5.0 | + 8.3 |
| 1950 | + 1.0 | + 3.9 | + 5.0 |
| 1951 | + 8.0 | + 11.3 | + 8.1 |
| 1952 | + 2.3 | - 2.8 | + 2.2 |
| 1953 | + 0.8 | - 1.3 | + 7.6 |
| 1954 | + 0.3 | + 0.2 | + 4.3 |
| 1955 | - 0.3 | + 0.4 | + 4.7 |
| 1956 | + 1.5 | + 3.3 | + 8.4 |
| Dec. 1956 | + 1.5 | + 1.7 | + 4.1 |

Source: U. S. Department of Labor, Bureau of Labor Statistics.

per cent while wholesale prices generally declined by about the same percentage. In 1953-1955, the annual increase in steel prices ranged between 4.3 per cent and 7.6 per cent while the consumer price index and the wholesale price index remained about unchanged. In the year 1956, all indexes rose with finished steel prices showing a larger increase than did the wholesale price index.

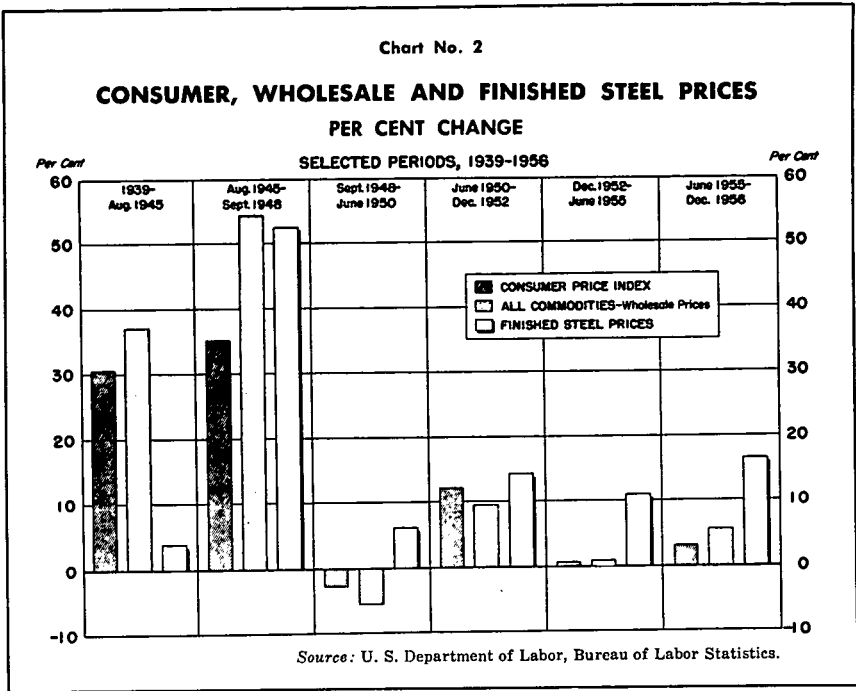
These comparisons show that since 1939 the change in finished steel prices has rarely been closely related to that in the general wholesale price index or to changes in the consumer price index. Of the 18 comparisons shown, the percentage change in finished steel prices was within one percentage point of the change in the wholesale price index in only two years (1944 and 1945); it was that close to the consumer price index in five years (1940, 1945, 1946, 1951, and 1952).

It may be thought that the reason for the

absence of any close relationship was because it took more than a year for the pressure of steel prices to work its way through the economy. Accordingly, it is helpful to examine the changes in these general price indexes and in finished steel prices for longer periods of time. The data are shown in Table 3 and Chart 2.

The first period, 1939 to August 1945, covers the World War II years. During that period, the wholesale price index rose 37.1 per cent and the consumer price index by 30.5 per cent despite the rise of only 3.8 per cent in finished steel prices. The fact that steel prices were held down more effectively by wartime price controls did not prevent the substantial rise in the general price indexes during that period.

The period from August 1945 to September 1948 covers the deferred price inflation which culminated when the comprehensive indexes reached their peak in September



1948. During this period, the rise of 52.5 per cent in finished steel prices was slightly smaller than the rise for the wholesale price index. It compared with a rise of 35.2 per cent in the consumer price index.

The period September 1948 to June 1950 covers the 1948-49 recession and the recovery which had taken place prior to the Korean War. During this period, despite a rise of 6.1 per cent in finished steel prices, the other comprehensive indexes declined 2.9 per cent and 5.6 per cent. The rise in finished steel prices did not cause a rise in the general price level during this period.

The period June 1950 to December 1952 covers the Korean War. While it is true that the Korean War was terminated for-

mally several months later, the price indexes, which had experienced a sharp rise and then a decline during the Korean War had reached a level in December 1952 about which they were to fluctuate for the following 2½ years. During the Korean War period, finished steel prices rose 14.3 per cent or slightly more than the increases of 9.4 per cent and 12.1 per cent shown for the two comprehensive indexes.

The period from December 1952 to June 1955 was characterized by relatively stable prices in the economy. During this period, the wholesale commodity price index and the consumer price index recorded only nominal changes. This relative stability in wholesale and retail prices took place de-

TABLE 3

Changes in Consumer Price Index, Wholesale Price Index,
and Finished Steel Prices, Selected Dates, 1939-1956
(1947-49 = 100)

| Year | Consumer Price Index | Wholesale Price Index | Finished Steel Prices |
|------------|----------------------|-----------------------|-----------------------|
| 1939 | 59.4 | 50.1 | 68.0 |
| Aug. 1945 | 77.5 | 68.7 | 70.6 |
| % Change | + 30.5 | + 37.1 | + 3.8 |
| Aug. 1945 | 77.5 | 68.7 | 70.6 |
| Sept. 1948 | 104.8 | 106.1 | 107.7 |
| % Change | + 35.2 | + 54.4 | + 52.5 |
| Sept. 1948 | 104.8 | 106.1 | 107.7 |
| June 1950 | 101.8 | 100.2 | 114.3 |
| % Change | - 2.9 | - 5.6 | + 6.1 |
| June 1950 | 101.8 | 100.2 | 114.3 |
| Dec. 1952 | 114.1 | 109.6 | 130.6 |
| % Change | + 12.1 | + 9.4 | + 14.3 |
| Dec. 1952 | 114.1 | 109.6 | 130.6 |
| June 1955 | 114.4 | 110.3 | 144.8 |
| % Change | + 0.3 | + 0.6 | + 10.9 |
| June 1955 | 114.4 | 110.3 | 144.8 |
| Dec. 1956 | 118.0 | 116.3 | 168.8 |
| % Change | + 3.1 | + 5.4 | + 16.6 |

Source: U. S. Department of Labor, Bureau of Labor Statistics.

spite the rise of 10.9 per cent in finished steel prices which were still catching up on the lag in prior years.

The final period shown is from June 1955 to December 1956, the period during which general price indexes rose and new fears developed concerning the inflation spiral. Although finished steel prices rose 16.6 per cent during this period, the rise in the consumer price index was only about 3 per cent and that for wholesale commodities was 5.4 per cent. Much of the rise in living costs was in the service sector rather than in the prices of manufactured goods. In fact, the prices of some electrical appliances are the same or lower than they were a year and a half ago.

Whether the comparisons are made on a year to year basis or for significant periods

within the past 17 years, it is clear that there has been no consistent relationship between the changes in finished steel prices and those recorded either for consumer prices or for wholesale prices. However, there has been a general inflation in prices during this period. In one period, World War II, a substantial rise in the general level of prices occurred despite the relative stability in finished steel prices. The situation was just the reverse in the period of price decline from September 1948 to June 1950 and in the period of general price stability from December 1952 to June 1955. In both these latter periods, despite rises in steel prices, the comprehensive price indexes either declined or showed only nominal changes. In the period of postwar inflation from August 1945 to September 1948, and

from June 1950 to December 1952 the rise in finished steel prices did parallel closely the rise in other wholesale prices. Changes in steel prices undoubtedly affect very significant areas of the economy but they do not determine changes in the general level of wholesale prices or in the cost of living.

Relative Importance of Steel in The National Economy

THERE is good reason for the fact that steel prices do not determine the general level of prices. Although the steel industry is a giant industry, it accounts for only a small proportion of the national economy. Total sales for the leading steel companies aggregated \$14,049.3 million in 1955. Included in this total is a substantial amount of nonsteel activity including shipbuilding, cement, coal mining and other activities. Nevertheless, if we use this figure as the total sales of steel, the following percentages can be derived as measures of the relative impact of steel price changes on the entire economy.

Total corporate sales in 1955 were \$568.9 billion—steel sales were only 2.5 per cent of this total.

Total gross national product in 1955 was \$390.9 billion—steel sales were equal to 3.6 per cent of this total.

Total gross national product less services bought by consumers aggregated \$298.8 billion in 1955—of this total steel sales accounted for 4.7 per cent.

According to the United States Bureau of Labor Statistics, the iron and steel component of the wholesale price index is given a weight of 5.8 per cent. Of this total, 3.8 per cent is represented by finished steel products and .9 per cent by foundry and forge shop products. If the latter are excluded, the iron and steel weight in the wholesale price index becomes 4.9 per cent.

It is because steel accounts for a relatively small part of the final product prices for many important products that changes in steel prices can have only a minor effect upon the general price level. The steel industry is a giant industry. But it is only one of many giant industries in a giant economy. The use of absolute dollar totals running into billions of dollars naturally creates an illusion of impact which far exceeds the actuality. It is only when the \$14 billion steel industry is measured against the \$400 billion economy that a proper picture is obtained of its relative significance.

III. COST-PRICE RELATIONSHIPS

THE Union insists that finished steel prices have risen much more than steel costs. To prove its point, the Union compares changes in finished steel prices with changes in selected raw material costs since 1947. It then compares separately the estimated revenue yield from finished steel price increases with the cost of wage increases and concludes that the average increase in finished steel prices yielded more than three times as much as the cost of the wage increase.

A significantly different picture emerges when changes in finished steel prices are compared with *all* increases in steel costs and when the comparisons are made for the entire World War II and postwar period. As the following analysis shows, the increases in the costs of goods and services bought by the steel industry have been somewhat *greater* than the rise in finished steel prices since 1939. Similarly, it is shown that steel labor costs have risen far more than the gains in steel productivity and hence, have created considerable pressure for steel price increases.

Finally, the Union theory that price increases should be confined at most to the cost of wage increases is checked against the level of steel profits and it is shown that any such policy would have resulted in considerable losses to the steel industry despite the tremendous increase in volume and in its contribution to the economy in recent years.

In the following sections, there is considered first, the relationship between changes in steel material costs and finished steel prices, then the changes in steel productivity, wages and prices, and finally, the alleged gains from price increases as compared with wage increases.

Steel Materials Costs Have Risen More Than Finished Steel Prices

THE Union brief presents selected data to prove that the costs of steel materials have risen significantly less than finished steel prices.

"The cost of the materials purchased by the steel industry has risen *somewhat* in the postwar period. But this rise has been moderate in relation to the rise in the price of steel products sold by the industry . . . The rise in steel prices since 1947 has dwarfed the rise in the 2 major steel cost items—materials and labor—by almost 3 to 1." ("Facts On Steel," pp. 35, 36.) (Italics added.)

To reach this conclusion, the Union had to confine its comparisons to price changes for *selected* materials during the period since 1947.

A significantly different conclusion is reached if the comparisons cover the entire war and postwar period and include *all* the items which are important ingredients of steel material costs.

The raw material price data presented in the Union brief are incomplete and, in some instances, inaccurate. Thus, for example, the Union failed to include price changes for iron ore, coke, manganese ore, and many other raw materials—some of which had considerably larger price rises than the items it listed. On the basis of United States Steel's price experience, from the Union's base period, 1947-49 to March 1956, iron ore prices had risen 130.2 per cent, coke by 18.3 per cent, and manganese ore by 133.2 per cent. The Bureau of Labor Statistics price indexes of the three important raw materials selected by the Union had increased as follows: steel scrap, 22.3 per cent, tin, 10.4 per cent, and coal, 7.0 per cent. United States Steel's experience showed increases of 35.9 per cent, 10.8 per cent, and 0.3 per cent, re-

spectively for these raw materials. The difference in rate of increase is due to the fact that the combination of actual grades used by United States Steel differed from the weightings used by the Bureau of Labor Statistics.

The composition of raw materials acquired by steel companies varies depending upon the items they produce and the degree of integration of operations. The significance of the Union's data may be checked by using the experience of United States Steel Corporation. On the basis of that experience, the items *excluded* from the Union's tabulation increased an average of 48.3 per cent between the 1947-49 base period and March 1956. In contrast, the items cited by the Union showed a rise of only 22.2 per cent. To determine the average rise, the individual commodities have been weighted by their relative importance in United States Steel's purchasing in 1955. Data are not available to make similar estimates on the basis of industry-wide purchases.

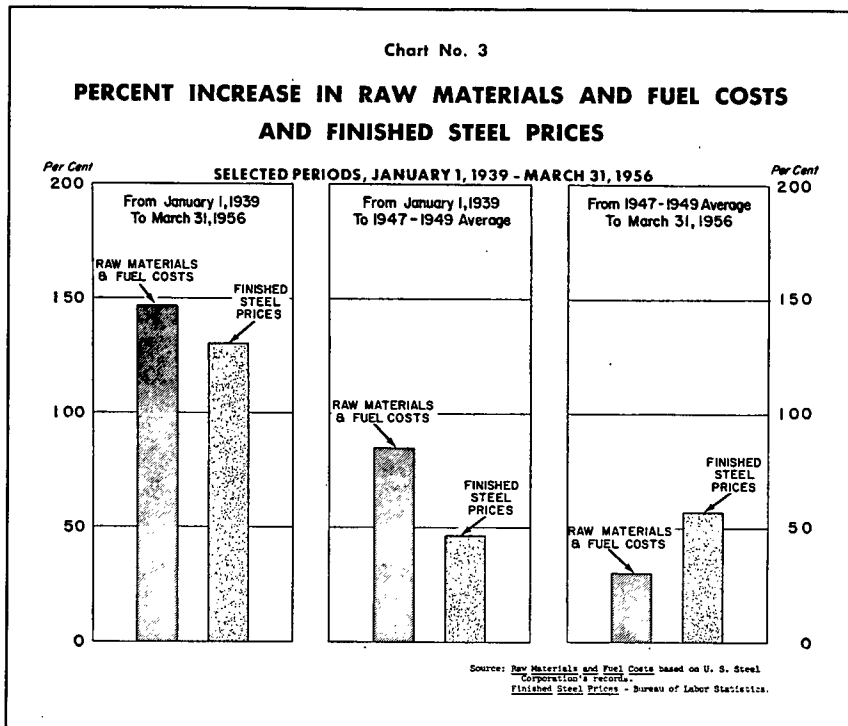
By presenting an incomplete list of the raw materials used in steel making, the Union has attempted to create the impression that in the postwar period, raw material costs have increased only "somewhat," while prices of finished steel have increased substantially. It is true that finished steel prices have risen more than raw material costs since the 1947-49 period. But here again, we have an illustration of the results of careful selection of base periods. By starting the comparison with 1947-49, the Union blots out the significant distortion which had developed in the years prior to those dates. Thus, for example, in the 1947-49 period, United States Steel paid an average of 106.7 per cent more for raw materials than it did in 1939. If petroleum, oxygen, gas, and electricity are included in the total, then the total rise in raw material and fuel costs was 85.4 per cent between 1939 and 1947-49.

During the same period, the Bureau of Labor Statistics index of finished steel prices rose only 47.1 per cent. (See Chart 3.)

A rough check on the relationship between the prices paid for materials and the selling price for finished steel is provided by the share of the sales dollar used to pay for materials. Because of changes in technology this relationship is not a perfect test. Nevertheless, it is useful to note that in 1939, products and services bought accounted for 34.7 per cent of the United States Steel sales dollar while in 1947-49, the proportion had risen to 39.6 per cent. This change reflected the lag in the rise of finished steel prices behind the wartime and early postwar rise in raw material costs. For the entire basic steel industry, the costs of materials, supplies, freight, and other services increased from 44.3 per cent of the sales dollar in 1939 to 47.8 per cent in 1947-49.

A significantly different picture from that portrayed by the Union emerges if the comparisons are made for the entire 1939-1956 period. Table 4 presents the changes prior to 1947-49, since 1947-49, and for the entire period combined. From 1939 to March 1956, the prices of raw materials used by United States Steel Corporation rose 179.8 per cent, the prices of fuels rose 59.5 per cent and the combined total rose 144.8 per cent. This was a moderately greater rise than that of 131.0 per cent recorded for finished steel prices. If the comparison is moved forward to the end of 1956, the rise in raw material costs and fuels is 169.1 per cent as compared with a rise of 148.2 per cent in finished steel prices.

Again, the changes in the share of the sales dollar spent for raw materials confirms these trends. For United States Steel, the proportion was 34.7 per cent in 1939 and 35.2 per cent in 1956; for the steel industry the ratio was 44.3 per cent in 1939 and 45.8 per cent in 1956 (43.6 per cent in 1955). It will be noted that the Union has emphasized



the decline in the proportion of the sales dollar spent for materials since 1947 ("Facts On Steel," p. 35) as evidence that material costs have risen less than finished steel prices. But it ignores the increase in the proportion of the sales dollar for material costs which would prove the opposite relationship prevailed between 1939 and 1947. When the comparison is made for the entire period 1939 to 1956, the distorted relationships created during World War II and the early postwar years are eliminated and a more realistic and more significant comparison emerges.

Clearly, there has been a major rise in the costs of materials bought by the steel indus-

try. This rise in material costs has contributed to the pressure for higher prices for finished steel during the war and postwar years. To a large extent this rise in raw material prices has reflected the rise in labor costs. This is particularly evident in connection with such key products as coal and iron ore which are produced to a large extent by many steel companies.

The Union claims that "Steel prices have exceeded [material] cost increases by a ratio of nearly 3 to 1." ("Facts On Steel," p. 35.) The data cited above indicate that this is a fantastic distortion of what has been happening to raw material cost—finished price relationships. Since 1939, the rise in steel

prices and raw material costs has been in a ratio of about one for one rather than three to one as alleged by the Union. The relative changes have been of similar magnitude for the entire period. However, for some selected pairs of dates, the rates of advance have differed significantly. It must

be added that there is no reason why in any designated short term period, steel prices should move exactly parallel to raw material costs. However, over longer periods of time, raw material costs, which account for between one-third and one-half of the sales dollar, will be an important factor in steel

TABLE 4
Per Cent Change in Raw Material and Fuel Prices—United States Steel Corp.
1939, 1947-49, Mar. 31, 1956, Dec. 31, 1956

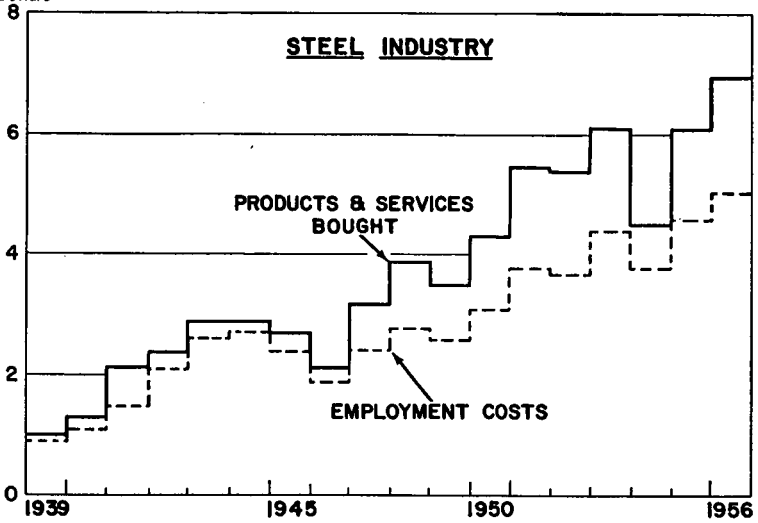
| Raw Materials | % Increase from 1/1/39 to: | | | % Increase from | |
|--|----------------------------|---------|----------|------------------------|----------|
| | 1947-49 Average | 3/31/56 | 12/31/56 | 1947-49 Average to: | 12/31/56 |
| Iron and Steel Scrap | 158.0 | 250.6 | 333.8 | 35.9 | 68.1 |
| Coal | 170.7 | 171.6 | 202.6 | 0.3 | 11.8 |
| Coke | 140.9 | 185.1 | 201.8 | 18.3 | 25.3 |
| Iron Ore | 22.1 | 181.1 | 194.1 | 130.2 | 140.9 |
| Manganese Ore | 35.4 | 215.8 | 259.4 | 133.2 | 165.4 |
| Zinc Ore | 169.6 | 182.8 | 182.8 | 4.9 | 4.9 |
| Other Minerals—Total | 61.0 | 103.9 | 110.8 | 26.6 | 30.9 |
| Dolomite Raw | 92.3 | 134.3 | 135.7 | 21.8 | 22.6 |
| Fluorspar | 99.8 | 85.0 | 85.0 | - 7.4 | - 7.4 |
| Limestone | 31.4 | 68.7 | 73.2 | 28.4 | 31.8 |
| Sulphur | 10.4 | 75.1 | 75.1 | 58.6 | 58.6 |
| Lime | 61.9 | 119.4 | 135.1 | 35.5 | 45.2 |
| Gypsum | 74.2 | 94.7 | 97.2 | 11.8 | 13.2 |
| Nonferrous Metals—Total | 85.9 | 142.5 | 129.4 | 30.4 | 23.4 |
| Deoxidizing Aluminum | 10.9 | 66.4 | 39.6 | 50.0 | 25.9 |
| Brass and Bronze | 63.0 | 226.4 | 178.3 | 100.2 | 70.7 |
| Copper | 92.7 | 314.7 | 223.1 | 115.2 | 67.7 |
| Lead | 231.5 | 228.3 | 228.3 | - 1.0 | - 1.0 |
| Nickel | 22.5 | 113.7 | 114.4 | 74.4 | 75.0 |
| Terne | 157.9 | 199.4 | 156.2 | 16.1 | - 0.7 |
| Tin | 98.1 | 119.5 | 119.4 | 10.8 | 10.8 |
| Zinc | 151.1 | 170.0 | 170.4 | 7.5 | 7.7 |
| Zinc Dross & Ashes | 188.7 | 212.2 | 277.0 | 8.1 | 30.6 |
| Nickel Base Alloys | - 1.2 | 400.0 | 455.6 | 406.1 | 462.3 |
| Zinc Base Alloys | 141.0 | 170.0 | 170.4 | 12.0 | 12.2 |
| Ferroalloys—Total | 49.9 | 109.8 | 124.5 | 40.0 | 49.8 |
| Ferrocrome | 38.6 | 84.2 | 99.1 | 32.9 | 43.7 |
| Ferromanganese | 95.2 | 155.1 | 175.7 | 30.7 | 41.2 |
| Ferromolybdenum | 3.1 | 63.8 | 73.8 | 58.9 | 68.6 |
| Ferrosilicon | 57.2 | 116.9 | 129.7 | 38.0 | 46.1 |
| Silicomanganese | 68.8 | 154.7 | 179.1 | 50.9 | 65.3 |
| All other Ferroalloys | 28.3 | 126.3 | 131.8 | 76.4 | 80.7 |
| Total Raw Materials | 106.7 | 179.8 | 211.3 | 35.4 | 50.6 |
| Fuels | | | | | |
| Petroleum and Products | 114.8 | 150.9 | 173.9 | 16.8 | 27.5 |
| Oxygen | - 23.3 | - 29.0 | - 28.3 | - 7.4 | - 6.5 |
| Gas | 16.9 | 51.4 | 52.9 | 29.5 | 30.8 |
| Electricity | 5.2 | 31.5 | 31.8 | 25.0 | 25.3 |
| Total Fuels | 33.5 | 59.5 | 66.3 | 19.5 | 24.6 |
| Combined Raw Materials and Fuels | 85.4 | 144.8 | 169.1 | 30.8 | 43.0 |
| FINISHED STEEL PRICES (BLS) | 47.1 | 131.0 | 148.2 | 57.1 | 68.8 |

Chart No. 4

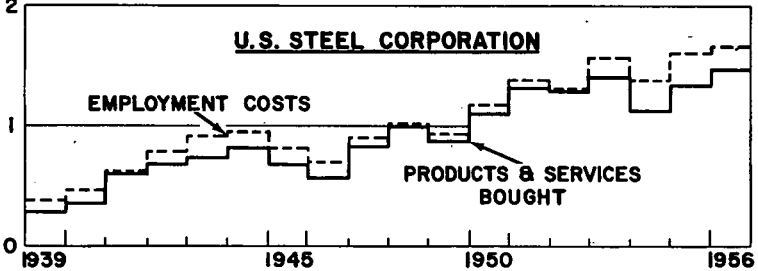
TOTAL EMPLOYMENT COSTS AND PRODUCTS AND SERVICES BOUGHT

1939-1956

Billions
of Dollars



Billions
of Dollars



Source: American Iron & Steel Institute

price determination. This is particularly true when the other important element of steel costs, namely labor, also records sharp changes.

Raw Material Cost Increases Parallel Those in Employment Costs

THE Union insists that raw material costs do not rise as much as wage costs and hence there is no justification for the industry's past efforts to increase steel prices twice as much as wage costs at the minimum. ("Facts On Steel," p. 37.) It claims this "is a 'formula' unrelated to reality." To prove its point, the Union cites comparative changes in materials and employment costs in United

States Steel Corporation between 1940 and 1952.

It is instructive to examine the year to year changes in these two major items of costs for United States Steel and for the entire steel industry. The changes are shown in Tables 5 and 6 and Chart 4. For United States Steel, employment costs account for a relatively larger share of the sales dollar (39.4 per cent) than for the rest of the industry (33.5 per cent). The reverse is true for cost of services and products bought: United States Steel (33.1 per cent) and the steel industry (43.6 per cent). The data are for 1955 but similar relationships prevailed in other years.

From 1939 to 1956, employment costs in-

TABLE 5
Year to Year Changes in Employment Costs
and Costs of Products and Services Bought,
The Steel Industry—1939 to 1956

| Year | Employment Costs | | Costs of Products and Services Bought | |
|---------------------|------------------|---------------------|---------------------------------------|---------------------|
| | Total | Year to Year Change | Total | Year to Year Change |
| millions of dollars | | | | |
| 1939 | 913.1 | | 1,036.0 | |
| 1940 | 1,116.0 | 202.9 | 1,331.0 | 295.0 |
| 1941 | 1,595.0 | 479.0 | 2,093.4 | 767.4 |
| 1942 | 2,127.0 | 532.0 | 2,399.2 | 300.8 |
| 1943 | 2,666.8 | 539.8 | 2,976.0 | 576.8 |
| 1944 | 2,729.2 | 62.4 | 2,985.8 | 9.8 |
| 1945 | 2,413.4 | - 315.8 | 2,755.6 | - 230.2 |
| 1946 | 1,983.1 | - 430.3 | 2,173.8 | - 581.8 |
| 1947 | 2,464.0 | 480.9 | 3,197.2 | 1,023.4 |
| 1948 | 2,831.8 | 367.8 | 3,931.5 | 734.3 |
| 1949 | 2,600.8 | - 231.0 | 3,517.0 | - 414.5 |
| 1950 | 3,150.8 | 550.0 | 4,356.0 | 839.0 |
| 1951 | 3,828.6 | 677.8 | 5,487.8 | 1,131.8 |
| 1952 | 3,788.9 | - 39.7 | 5,401.2 | - 86.6 |
| 1953 | 4,476.6 | 687.7 | 6,087.6 | 686.4 |
| 1954 | 3,888.0 | - 588.6 | 4,577.9 | - 1,509.7 |
| 1955 | 4,709.5 | 821.5 | 6,131.7 | 1,553.8 |
| 1956 | 5,064.4 | 354.9 | 6,977.1 | 845.4 |
| 1939-1956 | | 4,151.3 | | 5,941.1 |
| 1947-1956 | | 2,600.4 | | 3,779.9 |

Source: American Iron & Steel Institute.

TABLE 6
Year to Year Changes in Employment Costs
and Costs of Products and Services Bought,
United States Steel Corp.—1939 to 1956

| Year | Employment Costs | | Costs of Products and Services Bought | |
|-----------|-----------------------|---------------------|---------------------------------------|---------------------|
| | Total | Year to Year Change | Total | Year to Year Change |
| | —millions of dollars— | | | |
| 1939 | 386.5 | | 293.5 | |
| 1940 | 464.3 | 77.8 | 358.3 | 64.8 |
| 1941 | 628.3 | 164.0 | 604.6 | 246.3 |
| 1942 | 782.7 | 154.4 | 673.4 | 68.8 |
| 1943 | 912.9 | 130.2 | 730.6 | 57.2 |
| 1944 | 957.2 | 44.3 | 814.4 | 83.8 |
| 1945 | 825.5 | - 131.7 | 670.1 | - 144.3 |
| 1946 | 704.5 | - 121.0 | 560.4 | - 109.7 |
| 1947 | 903.6 | 199.1 | 839.4 | 279.0 |
| 1948 | 1,035.7 | 132.1 | 1,008.9 | 169.5 |
| 1949 | 945.9 | - 89.8 | 885.7 | - 123.2 |
| 1950 | 1,179.4 | 233.5 | 1,118.8 | 233.1 |
| 1951 | 1,374.5 | 195.1 | 1,327.9 | 209.1 |
| 1952 | 1,322.1 | - 52.4 | 1,307.6 | - 20.3 |
| 1953 | 1,569.2 | 247.1 | 1,418.7 | 111.1 |
| 1954 | 1,387.0 | - 182.2 | 1,134.3 | - 234.4 |
| 1955 | 1,614.9 | 227.9 | 1,355.2 | 220.9 |
| 1956 | 1,681.0 | 66.1 | 1,487.5 | 132.3 |
| 1939-1956 | | 1,294.5 | | 1,194.0 |
| 1947-1956 | | 777.4 | | 648.1 |

creased \$1,294.5 million and costs of products and services bought increased by \$1,194.0 million for United States Steel. Thus, for every \$1 increase in labor costs, material costs rose by 92.2 cents. This ratio is only somewhat less than the one for one relationship criticized by the Union. (Up until 1953, the rise in material costs was somewhat greater than for employment costs from 1939.)

For the steel industry, costs of products and services rose \$5,941.1 million and employment costs by \$4,151.3 million between 1939 and 1956. Thus, raw material costs rose \$1.43 for every \$1 rise in employment costs over the 17 year period. It is interesting to note that a similar relationship has prevailed since 1947, the year which the Union used for many of its comparisons. The

rise in raw material costs of \$3,779.9 million between 1947 and 1956 was equal to \$1.45 for every \$1 increase in employment costs. This is a higher ratio than the one to one relationship which the union stated is "unrelated to reality." This ratio supports the industry claim that such a ratio between employment costs and materials is a *minimum one*. If it is "unrelated to a reality," it is because the one to one relationship has been much too low for the steel industry since either 1939 or 1947.

An examination of Tables 5 and 6 shows that employment and raw materials costs have moved in the same direction in *every year* since 1939 both for United States Steel and the steel industry. While the magnitude of the changes for both types of costs have not been precisely the same in each year, they

have been of similar magnitude in many years and have tended to have closer relationships over a two or three year period. Thus, out of 17 comparisons, employment costs increased more or fell less than raw material costs in 7 years for the entire steel industry. For United States Steel Corporation, the rise in employment costs was greater or the decline was less than for raw materials in 9 out of 17 years.

It is evident that over the years, the steel industry has had good reason to anticipate that an increase of \$1 in employment costs would soon be accompanied by at least a similar rise in the costs of products and services bought. This relationship is not a casual or random one. When steel wages rise, wage patterns are established which spread promptly to iron ore, coal, coke, and other important raw materials. Since the steel companies produce many of these ma-

terials, they incur these higher costs rather promptly. Similarly, railroad wages and in turn railroad rates move upward. The net effect is a rise in both steel wages and other costs in amounts which in the past have tended to be similar.

The Union's efforts to prove that prices of finished steel have risen much more than prices of raw materials and that rises in raw materials costs have been much less than those in employment costs are not supported by the available data. Use of incomplete data for carefully selected periods is no substitute for all the facts. Certainly, the steel companies cannot use such partial data in compiling their financial results. On the basis of all the facts, it is clear that the Union's claims concerning raw material costs and their relationship to prices of finished steel are completely without substance.

IV. STEEL PRODUCTIVITY AND WAGES

THE Union brief asserts that increases in wages have not led to higher steel prices because "the increases received—and more—could have been met from the gains in productivity." ("Facts On Steel," p. 29.) Moreover, it is stated that the rise in productivity "has had the result of lowering sharply the unit labor costs of the [steel] industry." (*Idem.*, p. 26.) It is also claimed that "The industry has taken as its share [of productivity] in profits far too much of what should have gone to the workers in the mills and to the public." (*Idem.*, p. 28.) (See also "Steel and the National Economy," p. 12.) Finally, it is stated that "productivity is growing at an accelerating rate." (*Idem.*, p. 29.)

These assertions are intended to cut the tie between tremendous increases in labor costs and higher steel prices. They are disproven by the material contained in the Brief itself. Let us examine the facts. Throughout this discussion productivity refers to output per manhour rather than the productivity of all the factors of production including capital equipment.

Could the increases in labor costs in recent years have been absorbed out of increases in productivity? To answer this question, it is necessary to compare the percentage changes in productivity with the changes in total labor costs in the steel industry. When both increase at the same rate, unit labor costs remain unchanged. When labor costs outrun productivity, unit labor costs rise. The Union brief recognizes this relationship when it notes that "if the cost of each hour of labor is increased by wage rate increases proportionate to rising productivity, these increases can be *absorbed* out of the gains in productivity." ("Facts On Steel," p. 29.)

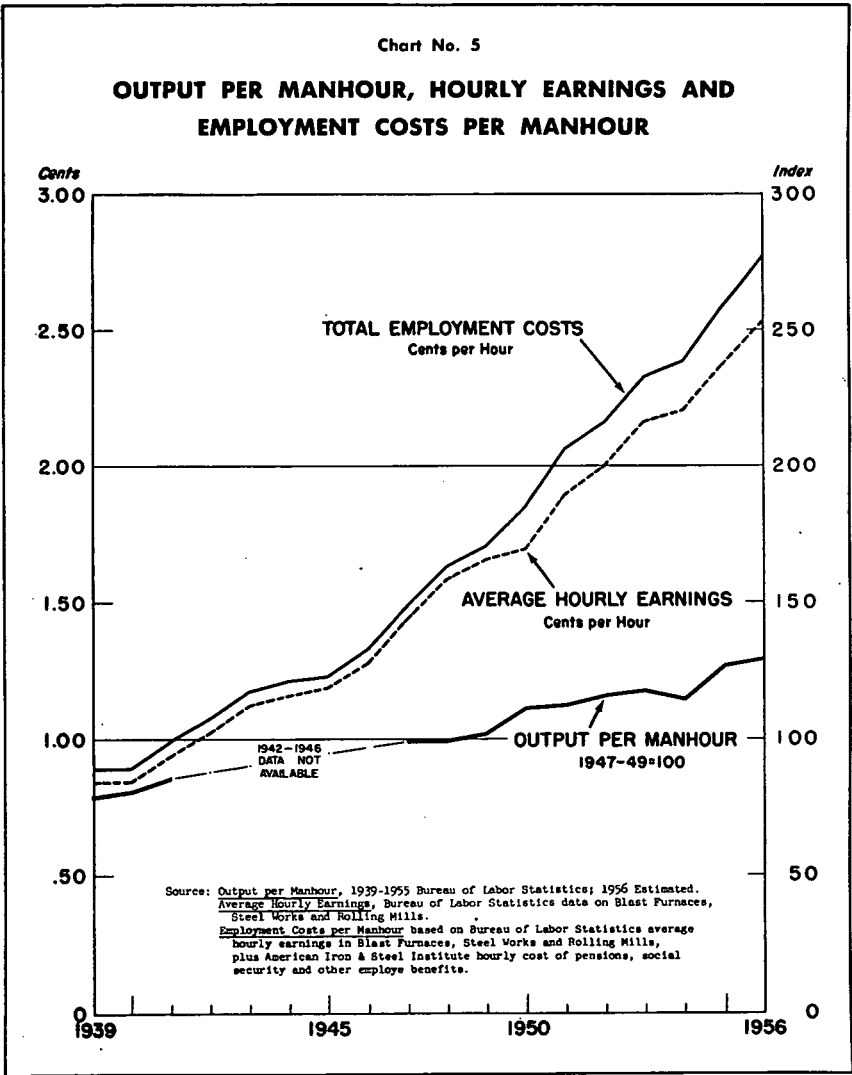
This proposition may be illustrated in

simple terms as follows. Assume a worker produces 100 units an hour and that this involves total labor costs of \$2 an hour. The unit labor cost is then 2 cents. If productivity increases so that 102 units are produced in an hour and labor costs increase to \$2.04 an hour, the unit labor cost remains unchanged at 2 cents. Productivity and wages each have risen by two per cent. But if total labor costs rise more than 4 cents an hour or 2 per cent, then unit labor costs will rise. Thus, if the 2 per cent rise in productivity (to 102 units) is accompanied by a 10 per cent rise in labor costs (to \$2.20 an hour), the unit labor cost will increase from 2 cents to 2.16 cents. Under these conditions, the rise in labor costs is greater than the rise in productivity and hence can not be met solely out of the rise in productivity. The result is increased pressure for price rises, reduction in profits, or some combination of both.

In making these comparisons, it is important to consider all labor costs, not only average hourly earnings. Included in total labor costs are such outlays as payments for pensions, insurance, health and welfare, social security, and workmen's compensation. These, too, must be paid out of gains in productivity. Since most of these so-called fringe payments have increased sharply in recent years, the longer term percentage increases in total labor costs are significantly greater than those in average hourly earnings alone. The changes in labor costs and in productivity since 1939 are shown in Table 7 and Chart 5.

Between 1940 and 1956, steel productivity increased by 56.3 per cent as compared with the rise of 201.2 per cent in average hourly earnings and 211.2 per cent in average hourly earnings plus pensions and welfare fund costs.

Between 1947 and 1956, steel productivity increased by 28.2 per cent as compared with



the rise of 75.7 per cent in average hourly earnings and 85.9 per cent in total employment costs. (See Chart 6.)

A similar picture of steel labor costs rising far more than steel productivity is shown when 1956 is compared with other years since

1940. (See Table 8.) Regardless of which year is used as the base, the rise in steel wages has far outstripped the rise in steel productivity.

The result has been a sharp rise in unit labor costs during the war and postwar years with the consequent pressure for higher prices. Table 9 shows the changes in unit labor costs since 1939. From 1940 to 1956, unit labor costs rose by 99.0 per cent. The data are shown graphically in Chart 7.

Despite its statements that higher wage costs could have been met out of increasing productivity, the Union brief shows a rising index of steel unit labor costs for the years 1947 to 1956. ("Facts On Steel," p. 51.) The Union's 1956 figure for unit labor costs is

understated because it projected productivity on the basis of the Union's first quarter estimate of a gain of 4.7 per cent (in contrast to actual rise of only 0.2 per cent in 1956) and because it could not allow for the rise in wages which occurred after the table was prepared. Nevertheless, the Union's table does show a rise of 28.0 per cent in unit labor costs between 1947 and the first quarter of 1956. (The actual rise between 1947 and 1956 was 45.1 per cent. See Table 9.)

The Union brief attempts to explain away wage increases in excess of productivity gains by saying that:

"In the past, the Union has often been forced to demand wage increases which in dollars and cents amount have ex-

TABLE 7
Output Per Manhour, Average Hourly Earnings,
and Total Employment Costs, Basic Steel Industry,
by Years, 1939-1956

| Year | Output Per Manhour (1947-49 = 100) | Average Hourly Earnings | Total Employment Costs* |
|------|---------------------------------------|-------------------------|-------------------------|
| 1939 | 78.6 | \$.84 | \$.89 |
| 1940 | 81.4 | .84 | .89 |
| 1941 | 86.3 | .94 | .99 |
| 1942 | n.a. | 1.02 | 1.07 |
| 1943 | n.a. | 1.12 | 1.17 |
| 1944 | n.a. | 1.16 | 1.21 |
| 1945 | n.a. | 1.18 | 1.23 |
| 1946 | n.a. | 1.28 | 1.33 |
| 1947 | 99.2 | 1.44 | 1.49 |
| 1948 | 99.4 | 1.58 | 1.63 |
| 1949 | 101.6 | 1.65 | 1.70 |
| 1950 | 110.8 | 1.69 | 1.85 |
| 1951 | 111.5 | 1.89 | 2.06 |
| 1952 | 116.0 | 1.99 | 2.16 |
| 1953 | 117.0 | 2.16 | 2.33 |
| 1954 | 114.0 | 2.20 | 2.38 |
| 1955 | 127.0 | 2.37 | 2.58 |
| 1956 | 127.2 (p) | 2.53 | 2.77 |

* Based on Bureau of Labor Statistics average hourly earnings in blast furnaces, steel-works, and rolling mills plus American Iron & Steel Institute hourly cost of pensions, social security, and other employe benefits.

n.a. Not available.

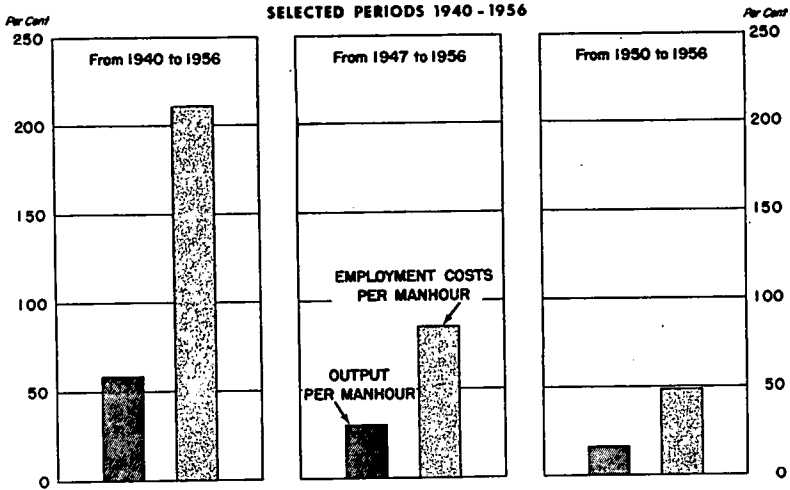
(p) Preliminary.

Sources: U. S. Department of Labor, Bureau of Labor Statistics; American Iron & Steel Institute.

Chart No. 6

PER CENT INCREASE IN STEEL INDUSTRY

Output Per Manhour and Employment Costs Per Manhour



Source: Output per Manhour, 1939-1955 Bureau of Labor Statistics; 1956 Estimated. Employment Costs per Manhour based on Bureau of Labor Statistics average hourly earnings in Blast Furnaces, Steel Works and Rolling Mills, plus American Iron & Steel Institute hourly cost of pensions, social security and other employe benefits.

ceeded the percentage increase in productivity. This has been forced on the Union because of the Industry's Price Policy which has caused inflation in steel and has contributed greatly to it in the economy and has, thereby, robbed the workers of the wages they were already receiving. They and their Union have been forced to pursue these rising prices—the cost of living—just to *maintain* their 'real' wage position, i.e., their existing standard of living. This purely defensive role of a significant portion of many of the Union's wage proposals in recent years is generally unknown or overlooked." ("Facts On Steel," p. 29.)

Two observations may be made in connection with the foregoing explanation.

tion with the foregoing explanation.

1. The Union admits that wages have risen more than productivity and thus negates its charge that steel "wage increases negotiated up to now have been less than warranted by productivity growth."

2. The Union never defines what it means by "recent years." However, in the period 1952 to 1955, the consumer price index showed only minor changes:

| | |
|------|--------------------|
| | <u>1947-49=100</u> |
| 1952 | 113.5 |
| 1953 | 114.4 |
| 1954 | 114.8 |
| 1955 | 114.5 |

TABLE 8
Per Cent Increase to 1956 from Preceding Years for Output Per Manhour,
Average Hourly Earnings, and Total Employment Costs,
Basic Steel Industry

| To 1956 | Output Per Manhour | Average Hourly Earnings | Total Employment Costs |
|---------|--------------------|-------------------------|------------------------|
| From: | | | |
| 1939 | 61.8 | 201.2 | 211.2 |
| 1940 | 56.3 | 201.2 | 211.2 |
| 1941 | 47.4 | 169.1 | 179.8 |
| 1942 | n.a. | 148.0 | 158.9 |
| 1943 | n.a. | 125.9 | 136.8 |
| 1944 | n.a. | 118.1 | 128.9 |
| 1945 | n.a. | 114.4 | 125.2 |
| 1946 | n.a. | 97.7 | 108.3 |
| 1947 | 28.2 | 75.7 | 85.9 |
| 1948 | 28.0 | 60.1 | 69.9 |
| 1949 | 25.2 | 53.3 | 62.9 |
| 1950 | 14.8 | 49.7 | 49.7 |
| 1951 | 14.1 | 33.9 | 34.5 |
| 1952 | 9.7 | 27.1 | 28.2 |
| 1953 | 8.7 | 17.1 | 18.9 |
| 1954 | 11.6 | 15.0 | 16.4 |
| 1955 | 0.2 | 6.8 | 7.4 |

n.a. Not available.

Sources: Derived from data in Table 7.

TABLE 9
Changes in Unit Labor Costs, Basic Steel Industry, by Years,
1939-1956

(1947-49=100)

| Year | Output Per Production Worker Manhour | Average Hourly Earnings | Total Employment Costs | Unit Labor Costs as Related to | |
|------|--------------------------------------|-------------------------|------------------------|--------------------------------|------------------------|
| | | | | Average Hourly Earnings | Total Employment Costs |
| 1939 | 78.6 | 54.0 | 55.4 | 68.7 | 70.5 |
| 1940 | 81.4 | 54.0 | 55.4 | 66.3 | 68.1 |
| 1941 | 86.3 | 60.4 | 61.6 | 70.0 | 71.4 |
| 1942 | n.a. | 65.5 | 66.6 | n.a. | n.a. |
| 1943 | n.a. | 71.9 | 72.8 | n.a. | n.a. |
| 1944 | n.a. | 74.5 | 75.3 | n.a. | n.a. |
| 1945 | n.a. | 75.8 | 76.5 | n.a. | n.a. |
| 1946 | n.a. | 82.2 | 82.7 | n.a. | n.a. |
| 1947 | 99.2 | 92.5 | 92.7 | 93.2 | 93.4 |
| 1948 | 99.4 | 101.5 | 101.4 | 102.1 | 102.0 |
| 1949 | 101.6 | 106.0 | 105.7 | 104.3 | 104.0 |
| 1950 | 110.8 | 108.5 | 115.1 | 97.9 | 103.9 |
| 1951 | 111.5 | 121.4 | 128.1 | 108.9 | 114.9 |
| 1952 | 116.0 | 127.8 | 134.4 | 110.2 | 115.9 |
| 1953 | 117.0 | 138.7 | 144.9 | 118.5 | 123.8 |
| 1954 | 114.0 | 141.3 | 148.0 | 123.9 | 129.8 |
| 1955 | 127.0 | 152.2 | 160.5 | 119.8 | 126.4 |
| 1956 | 127.2 (p) | 162.5 | 172.3 | 127.8 | 135.5 |

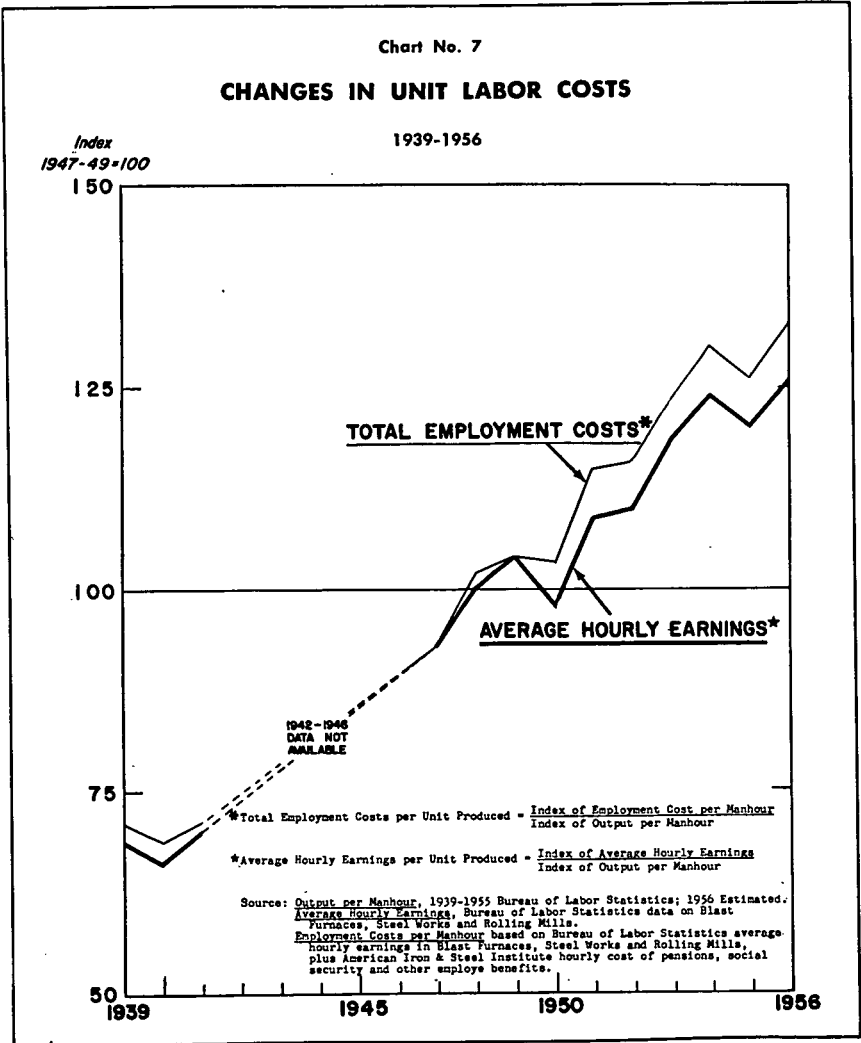
n.a. Not available.

(p) Preliminary.

Sources: Derived from data published by the U. S. Department of Labor, Bureau of Labor Statistics and The American Iron & Steel Institute.

The consumer price index reached 114.1 in July 1952 and fluctuated within a very narrow range until the Spring of 1956. Certainly, during these most "recent years," the

Union cannot claim that its insistence upon increases in wage and fringe benefits in excess of the rise in productivity were attributable to a rise in living costs. Despite the rise



in steel prices between 1952 and 1955, the consumer price index remained about unchanged and hence could not have "robbed the workers of the wages they were already receiving," to use the words of the Union brief. During the 1952-1955 period, steel productivity rose by 9.5 per cent while average hourly earnings increased by 19.1 per cent and labor costs per hour increased by 19.4 per cent. From 1952 to 1956, steel productivity rose by 9.7 per cent, average hourly earnings by 27.1 per cent, and labor costs per hour by 28.2 per cent.

This is a record of steel labor cost increases far in excess of gains in steel productivity despite the relative stability in living costs. The result was a rise in unit labor costs of 9.1 per cent between 1952 and 1955 and 16.9 per cent between 1952 and 1956 with the resulting pressure for steel price rises.

The Union concedes that "the Steelworker's standard of living has risen during the last few years. But the increases received—and more—could have been met from the gains in productivity." The data presented above show how misleading and inaccurate is this statement.

Steel Real Wages and Steel Output Per Manhour — A Meaningless Comparison

THE pressure exerted upon total steel costs is determined by the number of dollars expended by the industry for its labor costs—not by what its workers can buy with those dollars or his real wages. Thus, if the steel wages are increased to compensate for a rise in living costs (and productivity is unchanged), the net effect is an increase in steel unit labor costs even though there might be no change in the real wages of the worker. Pressure for a steel price rise will have developed as a result of this wage increase

because it is changes in *money wages* which create the pressure for price rises regardless of what happens to real wages. No amount of double talk can change the inevitable operation of simple arithmetic.

Yet, to prove its point that labor cost increases did not lead to a rise in prices, the Union brief compares what it calls increases in "real productivity in steel" and in "real straight time average hourly earnings in steel." ("Facts On Steel," p. 29.) This is a completely meaningless comparison. Wage-productivity comparisons on a *national basis*—that is, for the entire economic system—are correctly drawn on a *real-wage* basis. At an industry (or company) level, wage-productivity comparisons—that is, using an industry's record of productivity and the real wages of its employees—are not very meaningful. This distinction was noted by the Steel Industry Board in the 1949 wage case when it stated:

"The union's contention was based on the notion that, because the productivity index is a physical or 'real' one, the earnings index must be stated in similar terms. On this point we agree with the union. The difficulty is that there is in fact no available measure of labor's share in the increased physical productivity of any particular industry. It would be incorrect to do as the union urges, namely, to deflate the index of money average hourly earnings with the general cost-of-living index, which in part measures labor's (and other groups') contribution to the national output of all products and not only of steel. *It is only in respect to the economy as a whole that the real average hourly earnings of labor can validly be compared with an index of man-hour productivity; then both indices apply to all labor.*

"In any event the companies were correct in contending that the union's emphasis on the change in man-hour pro-

ductivity from 1939 to 1948 and 1949 was misplaced. Because the rate of operation is such an important factor in productivity, valid comparisons can be made only for years of similar rates of operation, such as 1941 and 1948.

"Using as the proper base the period 1940-41 for comparison with the first quarter of 1949, and finding that the rise in steelworkers' real hourly earnings approximately matched the rise in labor productivity for the economy as a whole during that period, we conclude that the union failed to establish that labor's share of the steel industry's output has become inequitable." (Italics added.)¹

This conclusion is still true today.

The fundamental defect of comparisons between *real wages and productivity within an industry* is that such comparisons ignore the changing position of a company or an industry in the national economy. In a dynamic economy, the relative value of an industry's services, as reflected in the prices for its products or services, changes over time. Under some conditions, it may become more valuable; under other conditions, it may become less valuable. The consumer price index is a composite measure of prices, with some groups of prices changing less than the average while others change more. These price relationships, as well as productivity changes, must be kept in mind.²

Productivity increases in the steel industry do not indicate that real wages of steelworkers "can rise significantly without increasing steel costs or necessitating an increase in steel prices." ("Facts On Steel," p. 29.) The level of real wages for steel workers is determined by the relationship between changes in

their *money wages* and in the *consumer price index*. It is not determined by changes in steel productivity and steel prices. As was indicated earlier (see pages 100 to 105), there has been no close relationship between changes in finished steel prices and in the consumer price index.

Steelworkers' Real Wages Have Risen More Than National Productivity

TABLE 10 shows real employment costs and real hourly earnings for the basic steel industry and productivity for the national economy from 1939 to 1956. The productivity data cover the private nonfarm sector of the economy. Table 11 shows the percentage changes to 1956 for each year since 1939. For example, the increase in productivity from 1940 to 1956 was only 38.0 per cent as compared with the increase of 54.6 per cent in steelworkers real average hourly earnings and 59.7 per cent in real average hourly earnings plus fringes. If the recommendation of the Steel Industry Board is followed and the 1940-41 average is used as the base for comparison the changes were as follows: (See Chart 8.)

| | Per Cent Change 1940-41 to 1956 |
|---|------------------------------------|
| Real hourly wage nonfarm product per manhour | 35.5 |
| Steelworkers, real average hourly earnings | 50.3 |
| Steelworkers, real employ- ment costs | 55.6 |

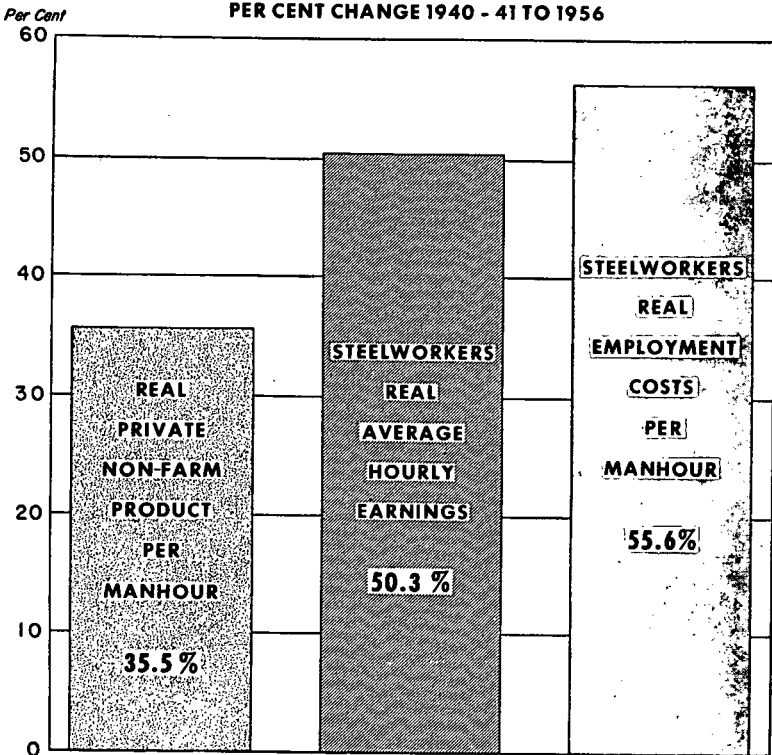
Real hourly earnings of steelworkers have far outstripped the rise in national productivity since the pre-World War II years. If pension and welfare gains are added to hourly earnings—as is appropriate—then the relative magnitude of the gains of steelworkers is even greater. As Table 11 shows, *regardless of which year since 1939 is used as a basis for comparison, steelworkers' wages have outstripped national productivity gains.*

¹ "Report to the President of the United States on the Labor Dispute in the Basic Steel Industry," by the Steel Industry Board, submitted September 10, 1949, pp. 44-45.

² Adapted from Jules Backman, "Wage-Productivity Comparison," *Industrial and Labor Relations Review*, October 1954, pp. 65-66.

Chart No. 8

**REAL PRIVATE NON-FARM PRODUCT PER MANHOUR,
STEELWORKERS' REAL AVERAGE HOURLY EARNINGS,
STEELWORKERS' REAL EMPLOYMENT COSTS PER MANHOUR**



Sources: Data on real private non-farm product per manhour from 1939-1952 are revisions by the Joint Committee on the Economic Report of estimates of John W. Kendrick, "National Productivity and Its Long-Term Projection," a paper before the Conference on Research in Income and Wealth, published in Long-Range Economic Projections, Studies in Income and Wealth, Volume Sixteen, National Bureau of Economic Research, 1954; The National Industrial Conference Board further revised the series by using later data from the Department of Commerce and Agriculture and by shifting the gross national product data from 1953 to 1947 prices; data for 1953-1956 were linked to those of prior years by using "Report of the Joint Economic Committee on the January 1957 Economic Report of the President," p. 48; wage data were obtained from the U. S. Department of Labor, Bureau of Labor Statistics; American Iron and Steel Institute.

TABLE 10
Real Private Non-Farm Product Per Manhour,
Real Average Hourly Earnings and Real Employment Costs for the
Basic Steel Industry—by Years—1939-1956

| Year | Real Private Non-Farm Product Per Manhour | Real Average Hourly Earnings | Real Employment Costs* |
|------|---|---------------------------------|---------------------------|
| | (in 1947 dollars) | (1947-49 dollars) | |
| 1939 | 1.692 | 1.41 | 1.50 |
| 1940 | 1.778 | 1.40 | 1.49 |
| 1941 | 1.843 | 1.49 | 1.57 |
| 1942 | 1.828 | 1.46 | 1.54 |
| 1943 | 1.868 | 1.51 | 1.58 |
| 1944 | 2.010 | 1.54 | 1.61 |
| 1945 | 2.075 | 1.53 | 1.60 |
| 1946 | 1.940 | 1.53 | 1.59 |
| 1947 | 1.904 | 1.51 | 1.56 |
| 1948 | 1.969 | 1.54 | 1.59 |
| 1949 | 2.045 | 1.62 | 1.67 |
| 1950 | 2.172 | 1.64 | 1.80 |
| 1951 | 2.200 | 1.70 | 1.86 |
| 1952 | 2.251 | 1.75 | 1.90 |
| 1953 | 2.310 | 1.89 | 2.04 |
| 1954 | 2.359 | 1.92 | 2.07 |
| 1955 | 2.460 | 2.07 | 2.25 |
| 1956 | 2.453 | 2.18 | 2.38 |

* Based on Bureau of Labor Statistics average hourly earnings in blast furnaces, etc. plus American Iron and Steel Institute hourly cost of pensions, insurance, etc.

Sources: Data on real private non-farm product per manhour from 1939-1952 are revisions by the Joint Committee on the Economic Report of estimates of John W. Kendrick, "National Productivity and Its Long-Term Projection," a paper before the Conference on Research in Income and Wealth, published in *Long-Range Economic Projections, Studies in Income and Wealth, Volume Sixteen*, National Bureau of Economic Research, 1954; The National Industrial Conference Board further revised the series by using later data from the Department of Commerce and Agriculture and by shifting the gross national product data from 1953 to 1947 prices; data for 1953-1956 were linked to those of prior years by using "Report of the Joint Economic Committee on the January 1957 Economic Report of the President," p. 48; Wage data were obtained from the U. S. Department of Labor, Bureau of Labor Statistics; American Iron and Steel Institute.

Rise in Steel Output Per Manhour Is Not Accelerating

THERE is no basis for the claim that "Output per hour worked by each Steelworker is increasing at an accelerating rate." ("Facts On Steel," pp. 27, 29.) In fact, this is an amazing statement in light of the material contained in the Union brief itself. Thus, on page 28 of "Facts On Steel," it is stated that steel productivity "had risen by 167 per cent

in 20 years [between 1919 and 1939], or at a rate approximately 5 per cent compounded annually over a period which included the Great Depression." In the following paragraph on the same page, it is claimed that in the 16 years since 1939, the annual rate of increase has been 3.2 per cent or lower than in the preceding twenty years.

The long term trend may be shown in terms of manhours required per unit of steel output. According to the Bureau of Labor Statistics,

the annual rate of decrease in this measure has been as follows for the indicated periods:

| Years | Per Cent Annual Decrease |
|-----------------|--------------------------|
| 1919-1929 | 5.9 |
| 1929-1939 | 3.1 |
| 1939-1947 | 2.8 |
| 1947-1955 | 2.8 |

Source: U. S. Department of Labor, Bureau of Labor Statistics, "Man-Hours Per Unit of Output in The Basic Steel Industry, 1939-55," *Bulletin No. 1200*, September 1956, p. 6.

This tabulation shows a lower rate of decline in the number of manhours required in the war and postwar years than in the two preceding decades.

Thus, on a long term basis, it is clear that the rate of increase in steel productivity has been *decelerating* not accelerating as the Union claims.

What about shorter term trends? To prove shorter term acceleration, the Union states the rise in steel productivity since 1939 has

been at the annual rate of 3.2 per cent, the increase in 1953-55 was at the rate of 4.2 per cent per year, and in the first quarter of 1956 it was 4.7 per cent higher than in 1955. ("Facts On Steel," pp. 28-29.) It also presents a chart on page 27 covering the 1947-1956 period. The Union bases its conclusion upon the unusual and relatively large increase in productivity in 1955 from the depressed level of 1954 and upon a projected rise of 4.7 per cent in 1956 based on alleged first quarter results. (At one point it assumes "a modest 4 per cent rise" in 1956—"Facts On Steel," p. 25.) Actually, the increase in steel productivity in 1956 is estimated to have been only 0.2 per cent rather than the 4.7 per cent projected by the Union. This is an excellent illustration of the danger in using very short term experience as a basis for projecting steel trends.

The annual rate of increase in steel produc-

TABLE 11
Per Cent Increase to 1956 from Preceding Years for Real Private Non-Farm Product Per Manhour, and Real Average Hourly Earnings and Real Employment Costs for the Basic Steel Industry

| To 1956 From: | Real Private Non-Farm Product Per Manhour | Real Average Hourly Earnings | Real Employment Costs |
|---------------|---|------------------------------|-----------------------|
| 1939 | 45.0 | 54.6 | 58.7 |
| 1940 | 38.0 | 55.7 | 59.7 |
| 1941 | 33.1 | 46.3 | 51.6 |
| 1942 | 34.2 | 49.3 | 54.5 |
| 1943 | 31.3 | 44.4 | 50.6 |
| 1944 | 22.0 | 41.6 | 47.8 |
| 1945 | 18.2 | 42.5 | 48.8 |
| 1946 | 26.4 | 42.5 | 49.7 |
| 1947 | 28.8 | 44.4 | 52.6 |
| 1948 | 24.6 | 41.6 | 49.7 |
| 1949 | 20.0 | 34.6 | 42.5 |
| 1950 | 12.9 | 32.9 | 32.2 |
| 1951 | 11.5 | 28.2 | 28.0 |
| 1952 | 9.0 | 24.6 | 25.3 |
| 1953 | 6.2 | 15.3 | 16.7 |
| 1954 | 4.0 | 13.5 | 15.0 |
| 1955 | - 0.3 | 5.3 | 5.8 |

Source: Derived from data in Table 10.

tivity for the three year period, 1953-56, was 2.8 per cent or somewhat lower than the rate of increase for the entire war and postwar period. Clearly, the available data show a lower rate of productivity increase since 1939 than before that year.

Reported Rate of Increase in Output Per Manhour Is Overstated for Steel Industry

IN fact, the data reported by the U. S. Bureau of Labor Statistics *overstate* the actual rise in steel productivity in recent years. This situation has developed because the Bureau of Labor Statistics uses only hours for production workers in relationship to total output to measure the gains in productivity instead of using the total number of man-hours for *all* workers in the industry. The latter is the appropriate comparative but unfortunately adequate data are not available to measure total manhours. Since the relative importance of production workers in the basic steel industry has been declining, the result is an overstatement of the rise in productivity in the steel industry in recent years. In its Report on Productivity in the Basic Steel Industry, the Bureau of Labor Statistics discusses this problem as follows:

"The productivity trends described in this report are based on the employment and hours of production and related workers. As in many other industries, production workers have been declining relatively to all workers in recent years. According to BLS statistics, the proportion of production worker employment to total employment in the steel industry remained fairly constant between 1939 and 1947, at 88.0 and 87.9 per cent, respectively. However, the proportion dropped to 85.7 per cent between 1947 and 1955.¹ Consequently, *the number of employees per unit of output declined less than the number of production workers per unit of output, from 1947 to 1955.*

"It would be desirable to construct measures of productivity using the hours of *all* employees in order to study the change in total manpower requirements of an industry, and to compare the results with trends for production workers alone. However, man-hours for nonproduction workers are not generally available. In an effort to obtain some general indications of trend, two experimental measures have been constructed, by combining the man-hours of production workers with the estimated man-hours (employment multiplied by estimated weekly hours) for other employees. In one measure, the weekly hours of other employees were assumed to be the same as for production workers; in the other, a constant 40-hour workweek was assumed for other employees.

"The two assumptions about weekly hours yield approximately the same results. Using 1947 as a base (i.e. 1947=100) an index of unit man-hours for production workers would be 127.3 in 1939, compared with 125.3 for all employees assuming a 40-hour week, and 123.9 assuming the same work-week as production workers. In 1955, the unit man-hour index for production workers would be 78.1 compared with 79.6 and 80.0 for all employees depending on concept of hours worked for all employees."² (Italics added)³

If we convert the unit manhour indexes

¹ Source: For 1950-55, BLS Employment and Earnings, Annual Supplement Issue, June 1956; for earlier years, summary sheet for blast furnaces, steel works, and rolling mills, 1932-50, February 1953. Census figures for 1939 and 1947 show proportions of 89.1 and 87.5 per cent, respectively. Statistics of the American Iron and Steel Institute (AISI) reveal a greater trend toward employment of other than production workers. These data indicate that 'employees receiving wages comprised 88.1 per cent of the work force in 1939, 85.3 per cent in 1947, and 83.1 per cent in 1955.

² "AISI man-hour data for all employees and for 'employees receiving wages' showed similar differences. The hours of 'other' employees are generally scheduled hours reported to the AISI."

³ Source: U.S. Department of Labor, Bureau of Labor Statistics, *Man-hours Per Unit of Output in the Basic Steel Industry 1939-55*, Bulletin No. 1200, September 1956, U.S. Government Printing Office, Washington, D. C., pp. 16 and 17.

cited above into output per manhour, the rise in productivity on the basis of production worker manhours alone was about 62 per cent from 1939 to 1955 as compared with an increase of 55.0 per cent to 57.5 per cent when *all manhours* are used. As the Bureau of Labor Statistics indicated, this difference has developed since 1947. In 1956, there was a decrease in productivity based on all manhours as compared with an increase of 0.2 per cent based on production worker manhours alone.

The proper basis for determining changes in output per manhour is to relate total output to the total number of manhours of all workers—in the mill, in the office, in the sales department, in the research laboratory, etc. All employees in a company or in an industry contribute as a team to the productivity gains achieved. It is all the manhours combined with the contributions of capital investment and the efforts of management which yield the productivity achieved.

The Bureau of Labor Statistics has pointed out:

“Man-hours per unit of output (and its reciprocal, output per man-hour) measures the relationship between one factor of input—labor time—and production

in physical units. This productivity ratio does not measure the specific contribution to output of labor or of capital or of any other factor of production. Changes in the ratio may reflect the joint effect of a large number of separate, though interrelated, influences, such as technological improvements, the rate of operation, the relative contributions to production of plants at various levels of efficiency, the flow of materials and components, as well as the skill and effort of the work force, the efficiency of management, and the status of labor relations.”¹

When allowance is made for the increase in the relative importance of nonproduction worker manhours, the conclusion is reinforced that the Union is in error in its assertion that productivity has been increasing at an accelerated rate in recent years.

This review of trends in labor costs and productivity makes it evident that the tremendous rise in steel labor costs during the war and postwar years could not be met out of rising productivity. On the contrary, labor costs have outstripped productivity by such a wide margin that there has been considerable pressure for price increases.

¹ *Ibid.*, pp. 1 and 2.

V. STEEL PRICE INCREASES AND WAGE INCREASES

THE Union brief alleges that since 1945, the steel industry has increased steel prices \$3.19 for every \$1 increase in steel wages and that these "unjustifiably big price increases" have yielded the industry "a bonanza from steel price increases out of all proportion to increased costs." ("Facts On Steel," p. 8.) The alleged "Total Gain" as a result of these price increases is \$3,914.0 million (pp. 8, 31 to 35).

This fantastic statement, which implies that the steel industry has made tremendous profits as a result of large increases in labor costs in the postwar period, has no relationship to reality. For example, this alleged gain of \$3,914.0 million from price rises for finished steel is almost double the profits before taxes of \$2,038.5 million for the 25 companies (p. 9). And part of these latter profits before taxes represented earnings on coal, shipbuilding, cement, and other activities included in the steel industry sales and profits totals. The fantasy that underlies this claim by the Union is readily exposed by examining the impact on the industry's profits figures if these price increases were eliminated or if they were limited to other objectives concerning profits which the Union seems to approve. This analysis is based on the data shown on page 33 of "Facts On Steel" in comparison with the AISI profits data adjusted as indicated below. (See Appendix A.)

According to the Union's claim, the price of finished steel was \$122.45 (\$55.20 in 1945 plus \$67.25 increase). This was 121.8 per cent higher than in 1945. Actually this rate of increase is on the high side because the \$55.20 figure for 1945 did not include extras. This price was used by the Union to determine the alleged gain of \$5,697.2 million in revenues for the entire industry as a result of the increase in prices. The BLS index of finished steel prices rose by 120.5 per cent

from 1945 to December 1955. The companies in the AISI survey accounted for 93.7 per cent of the shipments of finished steel in 1955. On this basis their gain in revenues flowing from higher prices was \$5,338.3 million (93.7 per cent of \$5,697.2 million).

The total value of finished steel shipments on this basis for all companies would have been \$10,373.7 million (\$122.45 times shipments of 84,717,444). The AISI sample would have had 93.7 per cent of this volume or \$9,720.2 million. It must be recognized, of course, that the precise total would have varied depending upon the composition of sales but the data are useful as a rough measure of the relationships to be discussed. Moreover, this total probably understates the receipts from finished steel shipments since the actual price appears to have been moderately higher than \$122.45 which price does not include all extras.

The AISI companies had total receipts of \$14,049.3 million. After deducting estimated finished steel receipts of \$9,720.2 million, the revenues from other activities would have equalled \$4,329.1 million.

If it be assumed that the profitability of finished steel sales and of other sales was the same percentage, then the profits would have been divided as follows:

| | Before Taxes | After Taxes |
|------------------------|-----------------------|----------------|
| | (millions of dollars) | |
| Finished Steel | 1,526.1 | 758.2 |
| Other Activities | 677.4 | 340.4 |
| Total | 2,203.5 | 1,098.6 |

If the AISI sample accounted for 93.7 per cent of the labor costs, their increase in labor costs would have been \$1,670.8 million (93.7 per cent of \$1,783.2 million) for finished steel products between 1945 and 1955.

On the basis of the above data several interesting comparisons can be made to show

the underlying fallacy in the Union's claim concerning the magnitude of the alleged gains from price rises. *It must be emphasized that these are rough approximations rather than precise calculations and are intended primarily as a framework of reference against which to measure the significance of the allegations in the Union brief.*

1. Price Rise to Cover Only Direct Steel Labor Costs

LET us assume first that finished steel prices by 1955 had increased only enough to cover the higher steel labor costs since 1945. The profits record in 1955 would have been as follows:

| | Millions of Dollars |
|---|---------------------|
| Revenues from price increases | 5,338.1 |
| Subtract increase in employment costs | <u>1,670.8</u> |
| Alleged gain according to Union formula | 3,667.3 |
| But total profits before taxes in 1955 were only | <u>1,526.1</u> |
| Therefore, if the yield from the price rise had only been equal to the rise in employment costs, the companies would have shown a net loss of | 2,141.2 |

Thus, if prices had risen by 37.7 per cent above the 1945 level or enough to cover only the direct labor costs incurred in producing finished steel, the steel industry would have experienced a loss in excess of \$2.1 billion in 1955—assuming, of course, that all the other increases in costs would have been incurred under these conditions. It must be recognized that under the assumed conditions, employment costs could not have been increased as much as they have been, that expansion in capacity would have been impossible, and that the steel industry would probably be

bankrupt. These data also provide an answer to Otis Brubaker's (steelworkers' economist) astounding statement before the Congressional Joint Economic Committee on January 31, 1957 that "Wage increases in steel have not caused even a single steel price increase since the formation of the Steelworkers Union 20 years ago." In "Steel and the National Economy," the Union stated "Experience has proved that wage increases have not caused inflation, that wages can be increased without prices being raised . . ." (p. 1). Certainly there has been no such "experience" in the steel industry. Despite large gains in productivity and the economies attending an expanding volume of production, a rise of 37.7 per cent in prices would have been required to cover only the *direct* labor costs in the steel industry.

2. Price Rise Required to Break Even In 1955

HOW much of a price rise would have been required to enable the industry to break even—no profits and no losses—in light of all the cost increases which were incurred during this 10 year period? The following data tell the story:

| | Millions of Dollars |
|--|---------------------|
| Revenues from price increases | 5,338.1 |
| Profits before taxes | <u>1,526.1</u> |
| Revenue from price rise required to break even | 3,812.0 |

In order to meet the higher labor and other costs since 1945, it would have been necessary to use up all profits before tax in that year and in addition obtain a price rise which yielded revenues of \$3,812 million. It must be emphasized that many of these other cost increases reflect higher labor costs for coal, iron ore, railroad transportation, and other goods and services used by the steel indus-

try. As is discussed elsewhere, these other costs have risen sharply. To obtain additional revenues of \$3,812.0 million would have required a price rise of 86.0 per cent instead of 120.5 per cent—and the industry would still have had no profits.

3. Price Rise Required if Steel Profit Margin Had Declined as Much as That for All Manufacturing Industries

THE Union briefs cite the decline in the profit margin in all manufacturing industries as a more favorable development than the changes in steel ("Facts On Steel," pp. 8 and 23; "Steel and the National Economy," pp. 2, 14, 15). The reasons why there is no relationship between these trends in all manufacturing and in steel is discussed in a later section. What would the impact on steel prices have been if the trend of steel profit ratios had paralleled those in all manufacturing industries. All manufacturing profits declined from 5.7 per cent to 4.3 per cent of the sales dollar or by 24.6 per cent between 1947 and 1956 (p. 8). If the steel profit ratio had shown a parallel decline it would have been reduced from 6.1 per cent in 1947 to 4.6 per cent or 3.2 percentage points lower than the actual rate in 1955.

It should be emphasized that in an industry like steel, expansion in volume during periods of recovery should be accompanied by *increasing not decreasing profit margins*. This is so because the steel industry requires heavy capital investment and uses much specialized equipment. As volume expands, this equipment can be used more efficiently and thus there is a decline in unit costs. The industry then experiences the full benefits of mass production.

Nevertheless, we are testing the results that would have taken place in terms of the theory in the Union's brief. Profits before

taxes would have been lower by 6.4 per cent of estimated sales of finished steel. To state it differently, a price rise of 106.4 per cent would have been required to earn this smaller ratio of profits postulated by the Union. If prices had risen by 106.4 per cent, steel prices prevailing at the end of 1955 would have been 6.4 per cent lower.¹ This means that every price increase between 1945 and 1954 would have had to take place but that only the increases in 1955 would have been unnecessary. This is particularly interesting because the Union has been insisting throughout the post-war period that wages could be raised without the need for a price increase. Yet every one of these earlier and allegedly unnecessary price increases were required in order to meet even the low profit goal apparently set by the Union.

4. Price Rise Required if Steel Profit Margin in 1955 Remained the Same as in 1947

IN 1947, the year used as a base by the Union in most of its comparisons, steel profits were equal to 6.1 per cent of the sales dollar. If this ratio had prevailed in 1955, how much of a price rise would have been required since 1945. Profits after taxes as a percent of the steel sales dollar would have been 1.7 percentage points lower than was actually earned. Profits before taxes would have been 3.4 percentage points lower. The price rise would have had to be 113.1 per cent instead of 120.5 per cent. On this basis, steel prices would have been 3.4 per cent lower than the level that actually prevailed.² This means that every price rise from 1945 to 1954 would

¹ On the basis of the 1956 results, the profit margin would have been 2.7 percentage points lower and the level of steel prices would have been about 5.4 per cent lower than the level prevailing.

² On the basis of the 1956 experience, the profit rates would have been 1.2 percentage points lower and steel prices would have been 2.4 per cent lower than the level that actually prevailed.

have been necessary plus about half of the increase in steel prices in 1955.

In light of the relationships described above, it is evident that there is no basis for the Union's statement that price increases have yielded a "bonanza" nor its implication that the gain has equalled almost \$4 billion. Nor is there any support for its charge that "the record high profits result in part from increased productivity and in part from higher steel prices charged by the steel companies for their products. . . . Actually, those presumed 'costs' have already been *absorbed* by productivity gains and by high level operations." ("Facts On Steel," p. 12.) Clearly, productivity and high level operations did not absorb cost increases since 1945. The combination of these two factors together with an 86.0 per cent increase in prices would not have covered all cost increases and would have required a wiping out of 1945 profits before taxes.

Even in terms of the so called "standards" used in the Union brief, the question boils down to whether steel prices might have been 3 per cent to 6 per cent lower than actually prevailed at the end of 1955.¹ This is a far different question from that which is implied in the use of descriptions such as "unjustifiably big price increases"; "inordinately large Price increases" ("Facts On Steel," pp. 8 and 29); "highly arbitrary and inflationary pricing policies"; "skyrocketing steel prices," etc. ("Steel and the National Economy," 1956, pp.

¹ On the basis of the 1956 experience, these figures would be 2.4 per cent to 5.4 per cent.

2, 15.) Note, we are not saying that steel prices should have been 3 per cent to 6 per cent lower. Rather, that is the total reduction that would have been necessary if the highly unrealistic profits standards in the Union brief were followed.

Any yield from a price rise which would enable the steel industry to recover more than its increase in labor costs after allowing for productivity gains is considered by the Union to contribute to profits. Wage costs are an important element in total costs in the steel industry and changes in total costs are considered when making price adjustments. However, other factors also have been important. Among those which may be cited are: the desire to earn a fair return on investment, the need for funds for expansion, strong demand for steel which is reflected in an ability of customers to pay higher prices, and changes in the prices of substitute products.

The combination of factors which will be important at any one time varies. But it is doubtful whether there is any time when wage costs alone determine steel prices. In fact there are many times when steel prices may be changed even though wages have not been changed. The increases in the late Fall of 1955 and decreases during the Thirties may be cited as illustrations. Changes in wages certainly may influence the *timing* of price changes—but not their magnitude. The Union in its attempt to forge a wage-price chain of causation has misrepresented the price making process in the steel industry.

VI. DISTRIBUTION OF THE STEEL SALES DOLLAR

THE Union offers a breakdown of the steel sales dollar to support its charge that profits have increased excessively, that wages have been lagging, and that raw material costs have failed to rise as much as finished steel prices. The data presented on pages 20 to 24 of "Facts On Steel" are for varying numbers of companies and cover only selected years. Comparisons are made primarily with 1939 and 1947 and no data are given for the other years between 1939 and 1950. No effort is made to relate the experience in 1955 with years of comparable volume.

Table 12 shows the distribution of the sales dollar for the steel industry (AISI data) from 1939 to 1956 with the shares accounted for by employment costs, material costs and profits before and after taxes. The table also shows the ratio of steel operations to capac-

ity. The distribution of the sales dollar in any year is affected significantly by the relative level of production. In years of low production, profit margins tend to be low as a percent of sales and employment costs tend to be high; in years of high operations, these relationships are reversed. For the purposes of this analysis, the World War II years are ignored because of the many government controls and special factors which distorted normal relationships during that period. Excluding those years, volume has been in excess of 90 per cent of capacity in six years in addition to 1955, namely, 1941, 1947, 1948, 1950, 1951, and 1953. It is fruitful to examine the distribution of the sales dollar in those years in order to determine the significance of 1955 relationships.

TABLE 12
Steel Industry: Employment Costs, Products and Services,
Profits Before and After Taxes as Percent of the Sales
Dollar, and Operating Rates—1939-1956

| Year | Operating Rate (% of capacity) | Employment Costs | Products and Services (Material Costs) | Profits Before Taxes | Profits After Taxes |
|------|-----------------------------------|------------------|---|----------------------|---------------------|
| 1939 | 64.5 | 39.0 | 44.3 | 6.4 | 5.1 |
| 1940 | 82.1 | 36.6 | 43.7 | 10.7 | 8.0 |
| 1941 | 97.3 | 34.1 | 44.9 | 14.0 | 6.0 |
| 1942 | 96.8 | 38.0 | 42.9 | 12.5 | 3.3 |
| 1943 | 98.1 | 40.1 | 44.8 | 9.0 | 2.9 |
| 1944 | 95.5 | 41.3 | 45.1 | 7.2 | 2.7 |
| 1945 | 83.5 | 40.8 | 46.6 | 5.1 | 3.1 |
| 1946 | 72.5 | 41.2 | 45.2 | 8.3 | 5.5 |
| 1947 | 93.0 | 36.7 | 47.7 | 10.3 | 6.1 |
| 1948 | 94.1 | 34.9 | 48.4 | 11.4 | 6.6 |
| 1949 | 81.1 | 35.0 | 47.3 | 12.2 | 7.1 |
| 1950 | 96.9 | 33.0 | 45.7 | 16.2 | 8.1 |
| 1951 | 100.9 | 32.3 | 46.3 | 16.5 | 5.7 |
| 1952 | 85.8 | 34.9 | 49.8 | 9.5 | 5.0 |
| 1953 | 94.9 | 34.0 | 46.3 | 13.2 | 5.6 |
| 1954 | 71.0 | 36.7 | 43.2 | 11.6 | 6.0 |
| 1955 | 93.0 | 33.5 | 43.6 | 15.7 | 7.8 |
| 1956 | 89.8 | 33.3 | 45.8 | 14.2 | 7.3 |

Source: American Iron and Steel Institute.

Employment Costs

DURING the seven years of high level activity, employment costs ranged between 32.3 per cent and 36.7 per cent of the steel sales dollar. The ratio of employment costs to sales in 1947—the year used as a base period by the Union—was 36.7 per cent, the highest prevailing in any year in which steel operations exceeded 90 per cent of capacity. In no other nonwar year of high level operations was the ratio as high as 35 per cent. In every year in which the operating rate fell below 90 per cent of capacity, except 1956, the ratio of employment costs to sales was higher than it was in 1955. (See Chart 9.)

On page 24 of "Facts On Steel," it is stated that "Wages and salaries and material costs, have moved downward. Profits, not the consumers, have benefited." This conclusion is derived largely by comparing 1955 results with those reported in 1947 and 1939. Obviously, it is a conclusion that would have little meaning and could find no support if the comparisons were made properly with other years of high level activity other than those affected by World War II. The ratio of employment costs to sales for the steel industry was moderately higher in 1955 than in 1950 and 1951 and fractionally lower than in 1941 and 1953, the other years of high level steel activity.

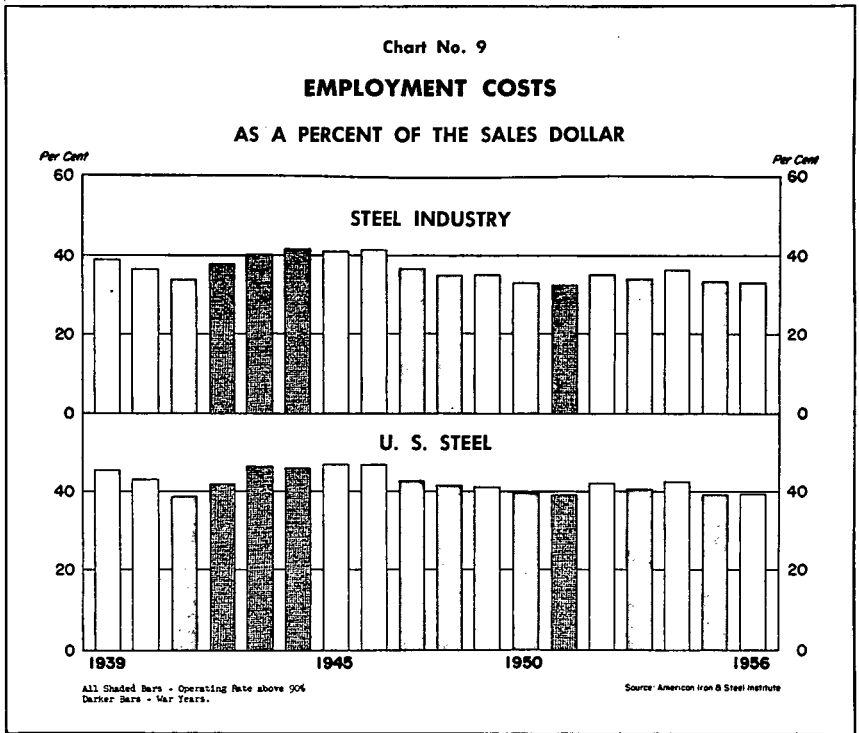


TABLE 13
Employment Costs, Products and Services Bought, Profits Before and after Taxes as Percent of Sales Dollar, and Operating Rates, United States Steel Corporation, 1939-1956

| Year | Operating Rate (% of Capacity) | Employment Costs | Products and Services Bought | Profits Before Taxes | Profits After Taxes |
|------|--------------------------------|------------------|------------------------------|----------------------|---------------------|
| 1939 | 61.0 | 45.7 | 34.7 | 6.4 | 4.9 |
| 1940 | 82.5 | 43.0 | 33.2 | 11.9 | 9.5 |
| 1941 | 96.8 | 38.7 | 37.2 | 14.5 | 7.2 |
| 1942 | 98.1 | 42.0 | 36.2 | 12.0 | 3.8 |
| 1943 | 97.8 | 46.3 | 37.0 | 7.5 | 3.2 |
| 1944 | 94.7 | 46.0 | 39.1 | 6.0 | 2.9 |
| 1945 | 82.0 | 47.2 | 38.4 | 5.0 | 3.3 |
| 1946 | 72.9 | 47.1 | 37.5 | 8.0 | 5.9 |
| 1947 | 96.7 | 42.6 | 39.5 | 10.3 | 6.0 |
| 1948 | 93.8 | 41.7 | 40.7 | 9.6 | 5.2 |
| 1949 | 82.5 | 41.1 | 38.5 | 12.7 | 7.2 |
| 1950 | 98.2 | 39.9 | 37.8 | 15.2 | 7.3 |
| 1951 | 101.3 | 39.0 | 37.7 | 16.5 | 5.2 |
| 1952 | 85.0 | 42.1 | 41.7 | 8.3 | 4.6 |
| 1953 | 98.4 | 40.6 | 36.7 | 14.2 | 5.8 |
| 1954 | 73.2 | 42.7 | 34.9 | 11.8 | 6.0 |
| 1955 | 90.8 | 39.4 | 33.1 | 17.9 | 9.0 |
| 1956 | 85.2 | 38.7 | 35.2 | 16.0 | 8.2 |

The trend for United States Steel paralleled that for the entire industry. Table 13 shows the pertinent data. The ratio of 39.4 per cent for employment costs in 1955 was about in line with the ratios in the other 6 years of high volume since 1939. In 1947, employment costs for United States Steel accounted for a higher proportion of the sales dollar than in any of the other years of high volume.

This is a significantly different picture for relative employment costs from that which the Union emphasizes in its comparisons between 1939 and 1955 and its conclusion that since 1939 "the wage earner's portion of the sales dollar has grown smaller and smaller" ("Facts On Steel," p. 23).

Product and Service Costs

THE ratio of *product and service costs* to the sales dollar has shown little relationship

to the level of operations. For the 18 year period, the ratios varied between 42.9 per cent (1942) and 49.8 per cent (1952) of the sales dollar for the steel industry. The ratio was between 43 per cent and 46 per cent in 10 of the 18 years. The ratio of 43.6 per cent in 1955 was close to the lowest ratio for the entire period. (See Chart 10.)

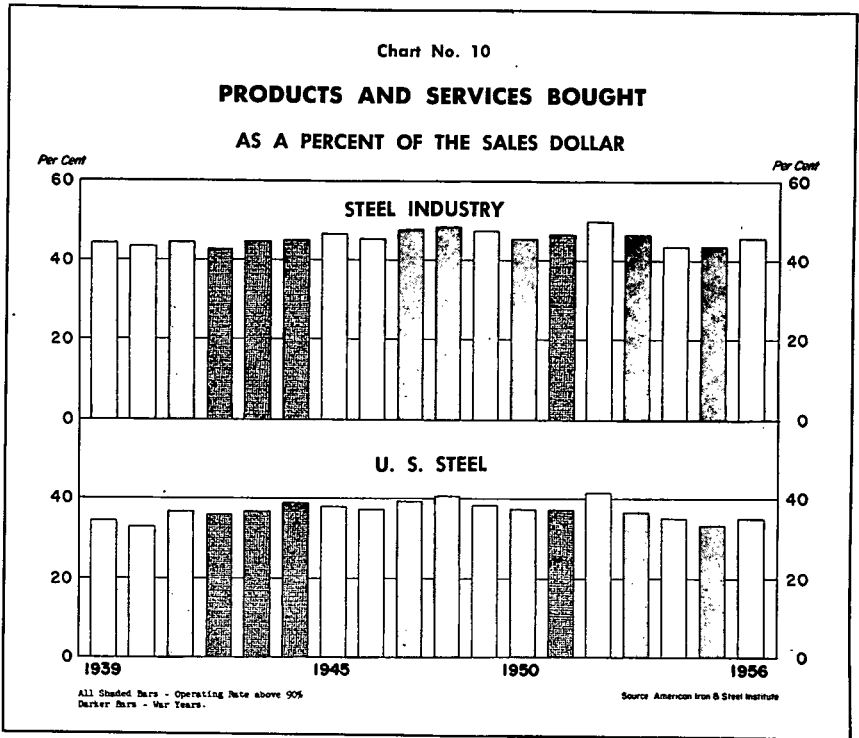
For United States Steel a similar picture is shown. In 1955 the ratio of 33.1 per cent for products and services was the smallest in the 1939-56 period. (It was 35.2 per cent in 1956.) The only other year in this period in which it was that low was in 1940 (33.2 per cent). However, a review of the record prior to 1939 (for which similar data are not available on an industrywide basis) indicates that through most of the war and postwar years, these ratios have been relatively higher than in the prewar years. Since 1939, the ratio of products and services to sales has ranged between 33.1 per cent and 41.7 per cent and has

been 37.0 per cent or higher in 11 out of 18 years. In contrast, from 1925 to 1929, the ratio ranged between 31.9 per cent and 33.6 per cent. During the 1930's, excluding 1932 and 1933, the range for United States Steel was between 28.3 per cent and 37.4 per cent.

The Union document states that "as a direct result of the inflation which followed the weakening of price controls," the ratio of material costs to sales rose until 1947 and "since then they have dropped sharply reaching lows . . . in 1954 and . . . in 1955." ("Facts On Steel," p. 24.) It fails to recognize that the effects of the acknowledged inflation in costs resulted in a disproportionately high propor-

tion of the sales dollar being used for that purpose throughout most of the war and postwar period. The changes since 1947 and 1948 have brought the materials cost ratio to the sales dollar back to the levels which prevailed before World War II.

The year 1947, used for comparative purposes to show relatively declining materials costs, was the year when the ratio was close to its peak "as a direct result of the inflation" in the early postwar period. If the 1955 experience is compared with 1939 or 1940, the last of the prewar years ("Facts On Steel" shows only the 1939 data, see pages 23 and 24), it is clear that profits have not risen because of a



decline in the relative importance of material costs. Such a conclusion can be reached only by a carefully selected comparison with the postwar year, namely 1947, when the ratio was close to its peak. Such a comparison is completely devoid of significance.

The fact that material costs as a percentage of the sales dollar in 1955 approximated the prewar relationship means that the total costs of products and services have risen about in line with the increase in total revenues of the steel industry since 1939 or 1940. Increasing output usually requires an increasing volume of products and services, except to the extent that the total is affected by technological change. It follows, therefore, that the rise in the unit costs of these products and services has about equalled the rise in steel prices for the entire war and postwar period, as was noted in an earlier section. Of course, this was not true for every year to year comparison. Product and service costs for the steel industry appear to have risen more than steel prices in most of the years and particularly in 1947, 1948, 1949, and 1952 due to the inflation previously noted.

"Facts On Steel" concludes its discussion of the distribution of the sales dollar by combining material costs and payroll costs for United States Steel and then comparing the combined ratios in 1947 and 1955. It emphasizes that there was a decline by 1955 of 9.6 cents per dollar of sales in these combined costs and claims that "This decline was used largely by the corporation to increase profits before taxes which accounted for 11.5 cents of the sales dollar in 1947 and 18.0 cents in 1955—a rise of 6.5 cents." Here is an outstanding example of the technique of selecting base periods in order to create a picture of excessive profits. The Union's Table 13 (p. 24) shows that the combined total for payroll and material costs in 1947 was the highest with one exception (1952) for the years listed. The combined payroll and material costs for Unit-

ed States Steel in 1929 was 69.3 per cent; in 1930 it was 73.2 per cent. In contrast, the 1947 ratio was 82.1 per cent.

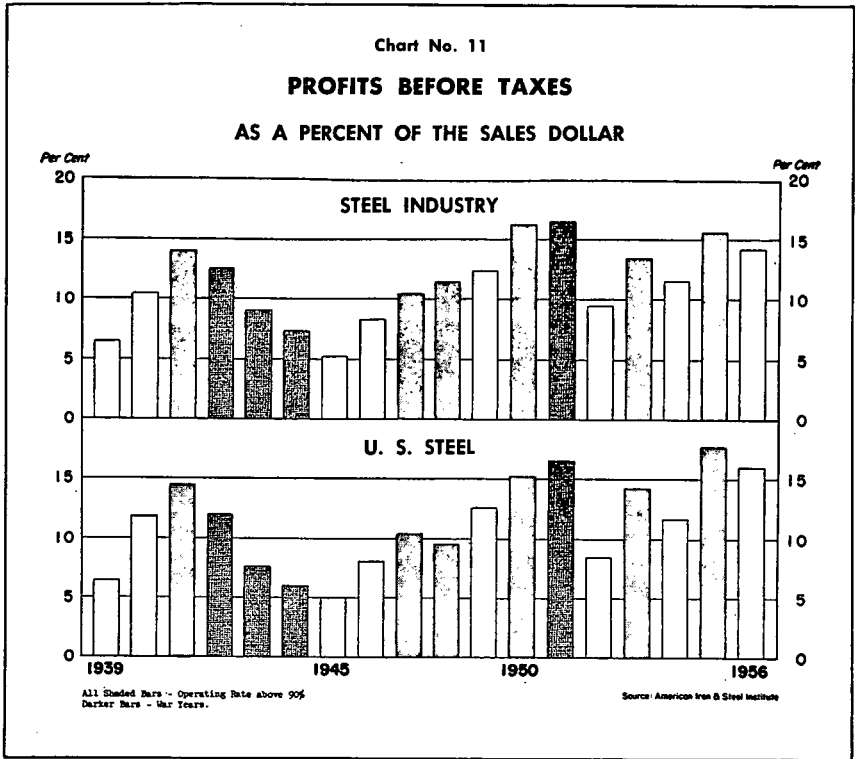
It was shown earlier that the ratio of material costs in 1947 was one of the highest in the postwar period and, therefore, not representative of the relationship which has prevailed in the past. Moreover, throughout most of this period, material costs have taken a disproportionately large share of the sales dollar in terms of past experience. Similarly, it was shown that the labor costs were a relatively higher share of the sales dollar in 1947 than usually prevails in years of high volume like 1955. Under these conditions, the combined total in 1947 would be far above any normal relationship and hence comparisons between 1947 and 1955 are meaningless.

Profits Before Taxes

IN every year, excluding the World War II years, in which the operating rate exceeded 90 per cent, profits before taxes of the steel industry accounted for more than 10 per cent of sales. (See Chart 11.) The range has been between 10.3 per cent and 16.5 per cent. In the years in which the operating rate fell below 90 per cent, the range of profits before taxes has been between 6.4 per cent and 14.2 per cent of sales. In four of the eight years in which that situation prevailed, the ratio fell below 10 per cent.

Again, it is interesting to note that the lowest ratio of profits before taxes in the seven years of high level activity was in 1947, the year used as a base period by the Union. The ratio of 15.7 per cent in 1955 was exceeded by the ratios in 1950 and 1951. The 1955 record was not out of line with that achieved in past years of high volume activity.

The record is similar for United States Steel. Years of high volume have been years of higher ratios of profits before taxes to



sales than years of low volume. The record in 1955 was more favorable than in the other six years of high volume since 1939. (However, the ratio in 1955 fell short of the 19.6 per cent on sales earned in 1929 and of the ratios in many of the earlier years in United States Steel's history.)

Profits after Taxes

THE data for *profits after taxes* for the steel industry show a range of 5.6 per cent to 8.1 per cent in the seven years in which operations exceeded 90 per cent of capacity.

The ratio of 7.8 per cent in 1955 was exceeded by the 8.1 per cent ratio in 1950. In most of the other years of high level operations, the ratio was around 6 per cent. In three years of below 90 per cent of operations, profits after taxes accounted for more than 7 per cent of the sales dollar: 8.0 per cent in 1940, 7.1 per cent in 1949, and 7.3 per cent in 1956. (See Chart 12.)

United States Steel profits after taxes in years of high volume since 1939 have ranged between 5.2 per cent and 9.0 per cent. The highest ratio was recorded in 1955. However, this rate of profits was a little lower than the

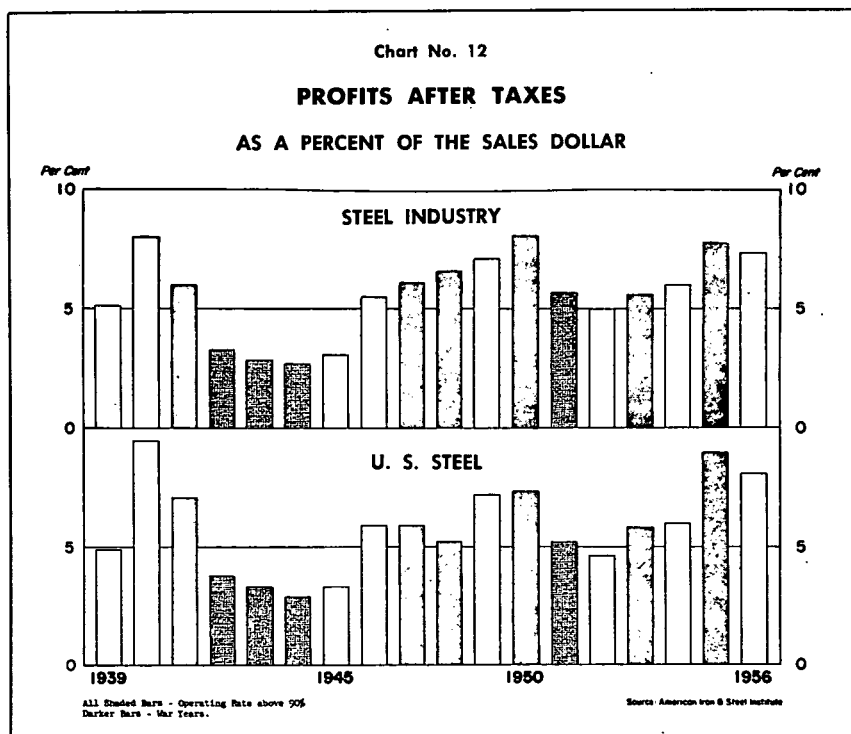
9.5 per cent earned in 1940 and fell far short of the record achieved in many earlier years in the company's history.

| | <u>Per Cent</u> |
|---------------------|-----------------|
| 1930 | 12.6 |
| 1929 | 18.0 |
| 1928 | 11.4 |
| 1927 | 9.2 |
| 1926 | 10.8 |
| 1925 | 8.9 |
| 1924 | 9.2 |
| 1923 | 9.9 |
| 1902 to 1922 (Avg.) | 13.9 |

The importance of volume as a factor in steel profits was well illustrated in the 1930's.

With relatively low operating rates, the steel industry as a whole operated substantially in the red in the early 1930's. According to data compiled by the United States Department of Commerce, losses were reported in each of the years 1931 to 1933, while the industry barely broke even in 1938. United States Steel operated in the red in 1932, 1933, 1934, and 1938 and just about broke even in 1935.

A review of the past distribution of the sales dollar for the steel industry and U. S. Steel reveals that "Facts On Steel" relies upon distorted relationships derived from comparisons with carefully selected years. To



prove that declines had taken place in the relative importance of material costs and labor costs, it was necessary for the document to ignore the impact of inflation on material costs (although the inflation was recognized as being a factor) and the effect of volume upon the proportion of the sales dollar used for employment costs. Similarly, the relationship between high volume and profits was ignored. The distribution of the sales dollar prevailing in 1955 reflected primarily the record volume of sales and output in that year. The pattern did not differ significantly from that in other years of high volume.

Dividends to Steel Stockholders

THE Union brief claims that steel stockholders "have fared extremely well" and have been "handsomely rewarded." To support its position, it claims that the annual rate of cash dividends in 1956 was "some 25 times the level of 1939" and in 1955, 21½ times the 1939 level. ("Facts On Steel," pp. 8, 15, 16.) It is also claimed that since 1947, steel dividends have increased 1.8 times as much as for all corporations.

The Brief contains data which show how meaningless such comparisons are. Thus, it notes that only 7 out of 23 steel companies paid cash dividends to their common stockholders in 1939. In light of the very poor profits position of the steel industry in 1939, it is not surprising that fewer than one company out of three could pay dividends.

It is difficult to believe that the Union seriously offers the 1939 experience as a satisfactory base period against which to measure the significance of 1955 or 1956 results. Of course, more steel companies paid dividends in 1955 than in 1939. And of course, they paid higher dividends than in that depressed year. It would be amazing if they had not done so. Incidentally, in 1955 total steel dividends were 7.5 times as large as in 1939, not

21½ times as the Union shows. This rate of increase must be considered against the background that few companies paid dividends in 1939 and the sixfold increase in sales volume in the steel industry since that year.

Table 14 shows the share of the sales dollar distributed as dividends by the steel industry and United States Steel annually since 1939. Included in the total are preferred and common dividends. The relatively small portion of the sales dollars paid as dividends is evident.

For the *steel industry*, the ratio of dividends to sales has ranged between 2.1 per cent (in the war years 1943 and 1944) and 3.8 per cent (in 1940). The ratio has been 3.0 per cent or higher in 8 of the 18 years—including 1955 when it was 3.1 per cent. The 1955 ratio was equalled or exceeded in 1940, 1946, 1950, 1954, and 1956.

For *United States Steel Corporation*, the ratio has ranged between 2.7 per cent and 4 per cent (excluding 1940 when it was 5.6 per cent). In 7 years, including 1956, the ratio has been 3.5 per cent or higher. The 1955 ratio of 3.6 per cent was exceeded in 1940, 1946, 1950, and 1956.

The fact is that there has been no marked upward trend in the share of the sales dollar paid as dividends during the 1939-56 period. Rather, the ratio has tended to move sidewise within a range of about 1.5 percentage points during the period. These data do not support the inference that dividend payments were unusually high when the volume of business is considered.

Dividends: Steel Companies and All Corporations

THE Union complains that 1956 steel dividend payments (based on the first quarter results), had increased 223.1 per cent since 1947 as compared with an increase of only

TABLE 14
Dividends as Per Cent of Sales Dollar
1939-1956

| Year | Steel Industry | U. S. Steel |
|------|----------------|-------------|
| 1939 | 2.5 | 3.0 |
| 1940 | 3.8 | 5.6 |
| 1941 | 3.0 | 3.7 |
| 1942 | 2.4 | 3.2 |
| 1943 | 2.1 | 3.1 |
| 1944 | 2.1 | 2.9 |
| 1945 | 2.4 | 3.4 |
| 1946 | 3.1 | 4.0 |
| 1947 | 2.7 | 3.3 |
| 1948 | 2.5 | 3.1 |
| 1949 | 3.0 | 3.5 |
| 1950 | 3.3 | 4.0 |
| 1951 | 2.6 | 2.9 |
| 1952 | 2.9 | 3.3 |
| 1953 | 2.5 | 2.7 |
| 1954 | 3.2 | 3.4 |
| 1955 | 3.1 | 3.6 |
| 1956 | 3.3 | 4.0 |

Source: American Iron and Steel Institute and United States Steel Corporation.

80.0 per cent for all corporations ("Facts On Steel," p. 8). From 1947 to 1955, the alleged increases were 176.9 per cent and 72.3 per cent respectively ("Facts On Steel," p. 50). Such comparisons are not meaningful because they ignore the lack of comparability in 1947, the base year for comparison, the difference in coverage of the two series, and the greater rate of increase in steel industry sales as compared with that for all corporations.

The data for all corporations include dividends on common and preferred stock while the steel industry data used by the Union cover *only* common stock. Because of the greater stability of dividends on preferred stock, it would be anticipated that a total including such dividends would fluctuate *less* than the more volatile dividends on common stock. Unfortunately, there is no breakdown between dividends on common and preferred stock for all corporations. Hence, the only way the two series can be compared is by including dividends on preferred stock in the

steel dividend total. When the comparison is made on this basis—even for the period used by the Union—the results are substantially different from what the Union shows. For the steel industry, the increase between 1947 and 1955 becomes 137.6 per cent (from \$184.2 million in 1947 to \$436.5 million in 1955) instead of 176.9 per cent as alleged by the Union.

This is still a greater rate of increase than that of 72.3 per cent for all corporations during the same period. However, sales also rose more sharply for the steel industry as the following figures show:

| | Sales in Billions of Dollars | | |
|--------------------------------|------------------------------|-------|------------|
| | 1947 | 1955 | % Increase |
| All corporations | 347.8 | 557.0 | 60.1 |
| All manufacturing corporations | 177.8 | 289.8 | 63.0 |
| Steel industry | 6.7 | 14.0 | 109.0 |

Between 1947 and 1955, sales in the steel industry increased by 109.0 per cent as compared with a rise of 60.1 per cent for all cor-

porations. In light of this substantially greater increase in sales what is so unusual about the fact that dividends also rose more in the steel industry in the same period? Certainly, the Union cannot mean that expanding volume should not be accompanied by higher earnings and in turn higher dividends? With a 60.1 per cent increase in sales, *all corporations* have increased dividend pay-

ments by 72.3 per cent or about one-fifth more. With a 109.0 per cent increase in sales, *steel companies* have increased dividends by 137.6 per cent or about one-fourth more. Certainly, this is not a wide discrepancy in experience as alleged by the Union. The Union obtained its conclusion by failing to use comparable data and by failing to note the greater expansion in steel sales.

VII. PROFIT MARGINS AND PRICE POLICIES IN OTHER INDUSTRIES

THE Union briefs cite with approval the decline in profit margins for all manufacturing industries from 5.7 per cent in 1947 to 4.3 per cent in the first quarter of 1956, a period during which steel profit margins rose. It is then stated that "Steel is out of step with the rest of the economy." In effect this statement suggests that steel profit margins should have followed a pattern similar to that for all manufacturing industries. ("Facts On Steel," pp. 8 and 23; "Steel and the National Economy," pp. 2, 14, and 15.) It is also stated that "The contrast between the price policies of the steel industry and price policies of all

manufacturing industries combined is rather startling." ("Steel and the National Economy," p. 15.)

Underlying these statements is the assumption that the relationship between the level of steel profit margins and that for all manufacturing industries was proper in 1947 and that a continuation of that relationship was desirable. It further makes the incredible assumption that there exists a "price policy" for all manufacturing industries combined and that this "price policy" provides a proper guide for price policy in the steel industry. Let us examine the merits of these assumptions.

TABLE 15
Per Cent Changes in the Major Components of the
Wholesale Price Index, 1939 to 1947
(1947-49 = 100)

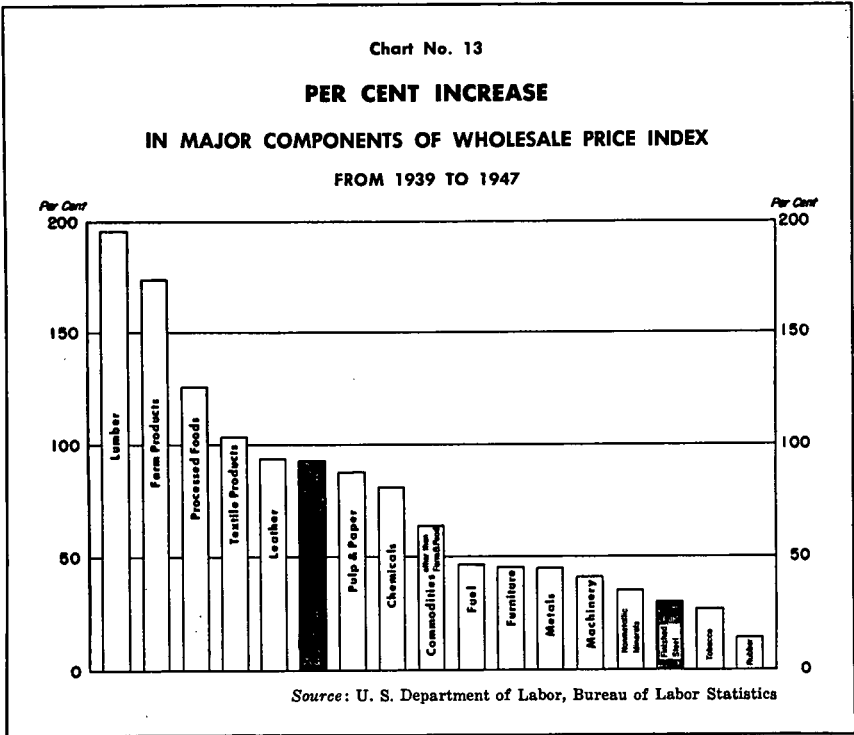
| | 1939 | 1947 | Per Cent Increase |
|---|------|-------|-------------------|
| Lumber and wood products | 31.6 | 93.7 | 196.5 |
| Farm products | 36.5 | 100.0 | 174.0 |
| Processed foods | 43.3 | 98.2 | 126.8 |
| Hides, skins and leather products | 52.0 | 101.0 | 94.2 |
| All commodities | 50.1 | 96.4 | 92.4 |
| Chemicals and allied products | 55.8 | 101.4 | 81.7 |
| All commodities other than farm products and foods | 58.1 | 95.3 | 64.0 |
| Fuel, power and lighting materials | 61.8 | 90.9 | 47.1 |
| Furniture and other household durables..... | 65.4 | 95.6 | 46.2 |
| Metals and metal products | 62.6 | 91.3 | 45.8 |
| Machinery and motive products | 65.3 | 92.5 | 41.7 |
| Nonmetallic minerals | 69.5 | 93.9 | 35.1 |
| Finished steel mill products | 68.0 | 89.1 | 31.0 |
| Tobacco manufactures, bottled beverages.... | 76.4 | 97.2 | 27.2 |
| Rubber and products | 86.3 | 99.0 | 14.7 |

Source: U. S. Department of Labor, Bureau of Labor Statistics.

Note: On the basis of the old wholesale price index (1926 = 100) textile products rose from 69.7 in 1939 to 141.7 in 1947, or an advance of 103.3 per cent while pulp and paper increased from 82.4 in 1939 to 155.1 in 1947, or a rise of 88.2 per cent.

Profit margins in 1947 were affected by a variety of factors including the magnitude of the cost-price increases during World War

II and in the first two postwar years. Table 15 and Chart 13 show the changes in the main components of the wholesale price index be-



tween 1939 and 1947. By 1947, the index of wholesale industrial prices (non-farm, non-food) had risen by 64.0 per cent as compared with a rise of only 31.0 per cent for finished steel prices. In fact, the only industries with a price rise smaller than that for finished steel were tobacco manufactures and bottled beverages (27.2 per cent), industries with low labor content, and rubber and products (14.7 per cent). Since most companies were affected by the same types of increases in labor costs and large increases in raw material prices, these data showing larger price rises would suggest that total profits in all manufacturing industries were better sustained than for the steel industry in 1947.

In the period since 1947, steel prices have risen more than other industrial prices as they overcame the war induced lag reflected in 1947 relationships.

There Is No Combined Manufacturing Price Policy

THE assumption that there is a price policy for all manufacturing industries is contrary to fact. This can be shown readily by use of the profits margin data to which the Union briefs refer. The Union used the average manufacturing margins shown in the National Income Accounts prepared by the United States Department of Commerce.

However, the breakdown of those data for individual industries is available only through 1953. Detailed data are published quarterly on a more current basis by the Securities and Exchange Commission and the Federal Trade Commission for large companies in 23 manufacturing industries. The trends of the two series are not significantly different for the period covered. Thus, the SEC-FTC profit margin for manufacturing industries declined from 6.7 per cent in 1947 to 5.4 per cent in the first quarter of 1956 or 1.3 percentage points as compared with the estimated drop from 5.7 per cent to 4.3 per cent or 1.4 percentage points in the Commerce series. The Union's price policy assumption, therefore, can be checked against

the SEC-FTC data for the period used by the Union.

Price policies vary widely among manufacturing industries, for different products sold by the same company, and at different times for the same company. Table 16 shows the profit margins reported for 23 different industries by the SEC-FTC for 1947 and the first quarter of 1956.

In 1947, the profit margins after taxes ranged between 0.3 per cent for other transportation equipment and 11.4 per cent for lumber and wood products, excluding furniture.

In the first quarter of 1956, profit margins were as low as 1.5 per cent for apparel and related products and as high

TABLE 16
Changes in Profits After Taxes to Sales, by Industry Group,
1947 and First Quarter of 1956
 (in cents per dollar of sales)

| | 1947 | First Quarter of 1956 | Per Cent Change |
|---|------------|--------------------------|--------------------|
| All private manufacturing corporations..... | 6.7 | 5.4 | - 19.4 |
| Lumber and wood products | 11.4 | 4.2 | - 63.2 |
| Furniture and fixtures | 6.0 | 3.0 | - 50.0 |
| Stone, clay, and glass products..... | 7.9 | 7.5 | - 5.1 |
| PRIMARY IRON AND STEEL INDUSTRIES..... | 6.6 | 7.4 | + 12.1 |
| Primary nonferrous metal industries | 8.8 | 9.8 | + 11.4 |
| Fabricated metal products | 7.4 | 4.0 | - 45.9 |
| Machinery (except electrical) | 7.2 | 5.4 | - 25.0 |
| Electrical machinery, equipment, and supplies..... | 6.3 | 3.9 | - 38.1 |
| Motor vehicles and equipment | 6.0 | 6.0 | 0 |
| Other transportation equipment | .3 | 3.4 | + 1033.3 |
| Instruments and related products | 7.8 | 5.0 | - 35.9 |
| Miscellaneous manufacturing (including ordnance)..... | 6.2 | 3.2 | - 48.4 |
| Food and kindred products | 4.2 | 2.2 | - 47.6 |
| Tobacco manufactures | 4.1 | 4.6 | + 12.2 |
| Textile mill products | 8.2 | 3.2 | - 61.0 |
| Apparel and related products | 4.6 | 1.5 | - 67.4 |
| Paper and allied products | 10.7 | 6.2 | - 42.1 |
| Printing and publishing (except newspapers)..... | 6.1 | 4.5 | - 26.2 |
| Chemicals and allied products | 8.7 | 8.3 | - 4.6 |
| Petroleum refining | n.a. | 10.4 | |
| Products of petroleum and coal (except petroleum refining)..... | n.a. | 3.7 | |
| Rubber products | 4.4 | 4.4 | 0 |
| Leather and leather products | 4.3 | 2.0 | - 53.5 |

Note: In 1947, petroleum refining and products of petroleum and coal were combined.

Sources: Federal Trade Commission and Securities and Exchange Commission.

TABLE 17
Per Cent Relationship of Corporate Profits
Before and After Taxes to Sales in
Manufacturing Industries, 1947 and 1953

| | Profits Before Taxes | | Profits After Taxes | |
|---|----------------------|------|---------------------|------|
| | 1947 | 1953 | 1947 | 1953 |
| Manufacturing | 9.3 | 7.7 | 5.7 | 3.2 |
| Food and kindred products | 5.2 | 3.9 | 3.1 | 1.7 |
| Tobacco manufactures | 6.8 | 9.2 | 4.0 | 3.7 |
| Textile mill products | 13.3 | 4.3 | 8.0 | 1.7 |
| Apparel and other finished fabric products..... | 5.8 | 1.7 | 3.6 | 0.7 |
| Lumber and furniture products | 12.1 | 5.5 | 7.5 | 2.7 |
| Paper and allied products..... | 16.3 | 11.2 | 9.9 | 4.7 |
| Printing, publishing, and allied industries..... | 10.8 | 7.4 | 6.5 | 3.2 |
| Chemicals and allied products | 12.7 | 12.1 | 7.6 | 4.7 |
| Products of petroleum and coal | 9.7 | 7.0 | 7.1 | 4.7 |
| Rubber products | 6.0 | 7.2 | 3.5 | 2.8 |
| Leather and leather products | 6.6 | 3.5 | 4.0 | 1.5 |
| Stone, clay, and glass products | 12.4 | 12.7 | 7.5 | 5.6 |
| Metals, metal products and miscellaneous..... | 9.9 | 8.5 | 6.0 | 3.6 |
| Machinery, except electrical | 11.1 | 9.0 | 6.5 | 3.4 |
| Electrical machinery | 9.4 | 9.3 | 5.4 | 3.4 |
| Transportation equipment, except automobiles..... | 0.4 | 6.7 | 2.5 | 2.3 |
| Automobiles and automobile equipment..... | 10.6 | 10.7 | 6.5 | 3.7 |

Source: U. S. Department of Commerce.

as 10.4 per cent for petroleum refining. Three other industries had profit margins larger than the steel industry at that time: primary nonferrous metals (9.8 per cent); chemical and allied products (8.3 per cent); and stone, clay and glass products (7.5 per cent).

Table 17 shows similar data for the United States Department of Commerce series for 1947 and 1953. Again there is shown a wide variation in profit margins as between industries for each date.

These data for industries show only part of the story because they cover very broad industry groups. For example, there is no single price policy for all types of foods. The food industry is a composite of many different types of operation with widely varying price policies and profit margins. Detailed data are not available to show the breakdown for the food industry in the SEC-FTC data. However, the First National City Bank of New York does publish profit margins as a

percentage of sales for several different food industries. The 1955 data show the following:

| Industrial Group | Profit Margins as Per Cent of Sales |
|---------------------------|--|
| Soft drinks | 8.6 |
| Other food products | 4.0 |
| Baking | 3.4 |
| Sugar | 3.2 |
| Dairy products | 2.5 |
| Meatpacking | 0.8 |

Thus, in 1955 profits as a percentage of sales ranged between 0.8 per cent for meat packing and 8.6 per cent for soft drinks. Similar variations in profit margins will be found in other industries. The actual profit margin required in an industry to earn any designated return on investment or net assets is determined by the volume of sales in relationship to investment; this is known as capital turnover. This turnover varies widely among industries. Tables 18 and 19 show the estimated turnover of net assets in terms of

sales for the industries covered in the First National City Bank data in 1955. The estimates were obtained by dividing the reported

margin on sales into the return on net assets. For the iron and steel industry, sales were equal to 1.9 times the net assets. At the ex-

TABLE 18
Margin on Sales, Return on Net Worth and
Turnover Ratios of Major Manufacturing
Groups in 1955

| | % Return on Net Assets | % Margin on Sales | Turnover Ratio |
|--|---------------------------|----------------------|-------------------|
| Meat packing | 6.7 | 0.8 | 8.4 |
| Aircraft and parts | 24.7 | 3.9 | 6.3 |
| Dairy products | 12.2 | 2.5 | 4.9 |
| Autos and trucks | 29.1 | 7.4 | 3.9 |
| Baking | 11.9 | 3.4 | 3.5 |
| Tires, rubber products | 15.1 | 4.5 | 3.4 |
| Shoes, leather, etc. | 11.5 | 3.5 | 3.3 |
| Printing and publishing | 12.9 | 4.3 | 3.0 |
| Soap, cosmetics, etc. | 16.0 | 5.3 | 3.0 |
| Other food products | 11.7 | 4.0 | 2.9 |
| Electrical equipment, radio and television | 12.8 | 4.4 | 2.9 |
| Automobile parts | 15.3 | 5.3 | 2.9 |
| Other metal products | 12.8 | 4.8 | 2.7 |
| Miscellaneous manufacturing | 11.8 | 4.6 | 2.6 |
| Household appliances | 11.6 | 4.6 | 2.5 |
| Paint and varnish | 16.4 | 6.7 | 2.4 |
| Office equipment | 16.9 | 7.0 | 2.4 |
| Building, heating, plumbing equipment | 11.5 | 4.9 | 2.3 |
| Instruments, photo goods, etc. | 17.7 | 7.8 | 2.3 |
| Tobacco products | 11.7 | 5.0 | 2.3 |
| Clothing and apparel | 7.0 | 3.1 | 2.3 |
| Glass products | 20.5 | 9.0 | 2.3 |
| Furniture, wood products | 12.6 | 5.8 | 2.2 |
| TOTAL MANUFACTURING | 15.0 | 6.7 | 2.2 |
| Brewing | 6.5 | 3.1 | 2.1 |
| Machinery | 11.6 | 5.7 | 2.0 |
| IRON AND STEEL | 15.2 | 7.8 | 1.9 |
| Hardware and tools | 10.7 | 5.7 | 1.9 |
| Railway equipment | 9.0 | 4.7 | 1.9 |
| Nonferrous metals | 16.7 | 9.5 | 1.8 |
| Other stone, clay products | 16.4 | 9.0 | 1.8 |
| Chemical products | 17.7 | 10.0 | 1.8 |
| Distilling | 6.4 | 3.5 | 1.8 |
| Sugar | 5.5 | 3.2 | 1.7 |
| Agricultural implements | 8.8 | 5.2 | 1.7 |
| Textile products | 7.1 | 4.1 | 1.7 |
| Paper and allied products | 13.8 | 8.3 | 1.7 |
| Drugs and medicines | 18.3 | 10.5 | 1.7 |
| Soft drinks | 14.1 | 8.6 | 1.6 |
| Lumber | 14.2 | 9.1 | 1.6 |
| Petroleum products and refining | 14.2 | 10.6 | 1.3 |
| Cement | 20.3 | 16.5 | 1.2 |

Source: First National City Bank of New York, *Monthly Letter on Business and Economic Conditions*, April 1956, p. 43.

Note: "Profit margins computed for all companies publishing sales or gross income figures which represent about 90 per cent of total number of reporting companies..."

TABLE 19
Margin on Sales, Return on Net Worth and
Turnover Ratios of Major Nonmanufacturing
Groups in 1955

| | % Return on Net Assets | % Margin on Sales | Turnover Ratio |
|---|---------------------------|----------------------|-------------------|
| Chain stores—food | 13.4 | 1.2 | 11.2 |
| Wholesale and miscellaneous trade | 8.5 | 1.8 | 4.7 |
| Department and specialty | 10.6 | 2.9 | 3.7 |
| Construction | 12.6 | 3.7 | 3.4 |
| Chain stores—variety, etc. | 10.6 | 3.7 | 2.9 |
| Restaurant and hotel | 11.5 | 3.9 | 2.9 |
| Air transport | 13.9 | 5.0 | 2.8 |
| Mail order | 12.3 | 4.4 | 2.8 |
| Other business services | 16.1 | 7.4 | 2.2 |
| Amusements | 8.6 | 4.4 | 2.0 |
| Miscellaneous transportation | 12.2 | 6.9 | 1.8 |
| Traction and bus | 4.6 | 3.1 | 1.5 |
| Coal mining | 5.6 | 4.2 | 1.3 |
| Shipping | 9.5 | 8.2 | 1.2 |
| Other mining, quarrying | 26.2 | 23.5 | 1.1 |
| Metal mining | 13.7 | 13.4 | 1.0 |
| Telephone and telegraph | 9.5 | 12.6 | 0.8 |
| Electric power, gas, etc. | 9.9 | 13.9 | 0.7 |
| Class I Railroads | 5.7 | 9.2 | 0.6 |

Source: First National City Bank of New York, *Monthly Letter on Business and Economic Conditions*, April 1956, p. 43.

Note: "Profit margins computed for all companies publishing sales or gross income figures which represent about 90 per cent of total number of reporting companies . . ."

tremes, for *manufacturing industries* the meat packing industry had sales equal to 8.4 times net assets while the cement industry had a turnover of 1.2 times. For *nonmanufacturing industries*, the extremes were food chain stores with a turnover of 11.2 times and Class I Railroads with a turnover of 0.6 times.

Of the 41 manufacturing industries covered, 25 had a greater turnover and 13 industries had a smaller turnover than the steel industry; 2 other industries were the same.

Of the 13 *manufacturing industries* with a smaller annual turnover than the steel industry in 1955, 9 had a higher profit margin on sales. Of the 9 *nonmanufacturing* industry groups which had a lower annual turnover in 1955 than the steel industry, 6 reported a higher margin on sales.

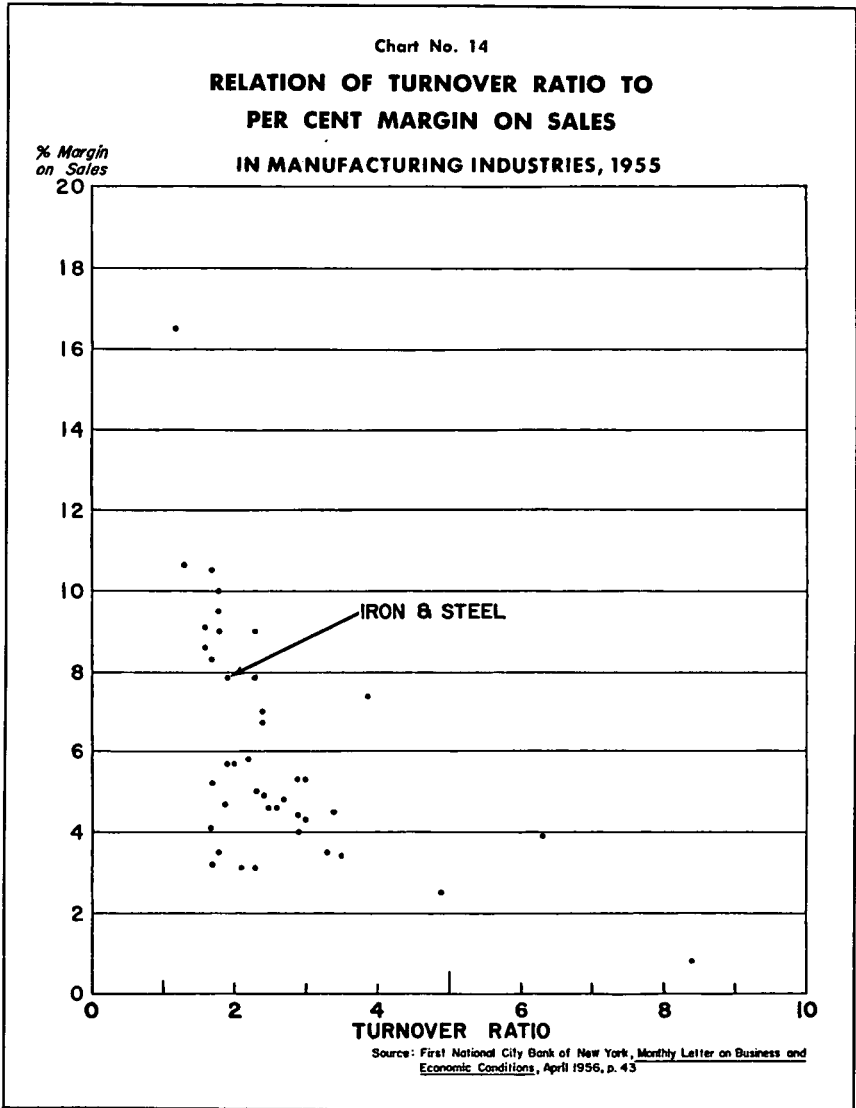
In general, the lower the turnover of net assets, the higher the profit margin on sales. This is shown by Chart 14 which relates the turnover ratio and profit margin for the 41 manufacturing industries reported by the First National City Bank of New York. The fact that the steel industry profit margin is higher than the average for all manufacturing is not surprising since turnover of net assets in the steel industry is lower than for all manufacturing industries. In connection with these comparisons, it must be kept in mind industry turnover figures reflect the widely varying price policies within an industry as noted earlier.

Not only do industries have widely varying profit margins and differing price policies, but the same may be true within a company depending on the products involved.

Company pricing policies also may change

over time as a product grows to maturity in terms of its market. In this connection, the

difference between price policies of electrical appliance companies for television, which is



a product with an expanding market, and for radios, for which the market is well saturated, may be cited.

The foregoing data indicate that the alleged combined price policy for manufacturing industries is a figment of the Union's imagination. The proper profit margin for any industry can only be determined by analyzing the factors affecting its products. An adequate or a low margin for one industry may be an exceptionally high margin for another industry. For example, no one would suggest seriously that the 0.8 per cent profit margin on sales for meat packing in 1955 would be satisfactory for many other industries. Actually, the experience of different industries varies widely from the average experience. That is the nature of an average.

Other Industries Also Have Maintained or Increased Profit Margins Since 1947

ONE might almost conclude from the presentation in the Union brief that the steel industry alone failed to reduce profit margins between 1947 and the first quarter of 1956. But as Table 16 shows, profit margins were not reduced between these dates for the following industries reported in the SEC-FTC data.

| | 1947 | First Quarter of 1956 |
|---|------|-----------------------------|
| Primary nonferrous metal industries | 8.8 | 9.8 |
| Other transportation equipment | 0.3 | 3.4 |
| Tobacco manufactures . . . | 4.1 | 4.6 |
| Rubber products | 4.4 | 4.4 |
| Motor vehicles and equipment | 6.0 | 6.0 |

Similarly, the First National City Bank's profits data included the following industries

in which profit margins remained the same or rose between 1947 and 1955.

| | Profit Margins As Per Cent of Sales | |
|------------------------------------|--|------|
| <u>Manufacturing Industries</u> | 1947 | 1955 |
| Dairy products | 2.5 | 2.5 |
| Tobacco products | 4.5 | 5.0 |
| Tires, rubber products | 4.4 | 4.5 |
| Chemical products | 9.6 | 10.0 |
| Paint and varnish | 6.0 | 6.7 |
| Cement | 11.5 | 16.5 |
| Glass products | 8.2 | 9.0 |
| Iron and steel | 6.2 | 7.8 |
| Autos and trucks | 6.4 | 7.4 |
| Aircraft and parts | -4.0 | 3.9 |
| <u>Nonmanufacturing Industries</u> | | |
| Metal mining | 12.7 | 13.4 |
| Class I Railroads | 5.5 | 9.2 |
| Air transport | -3.0 | 5.0 |
| Telephone and telegraph | 7.2 | 12.6 |
| All industries | 6.8 | 6.8 |

Source: First National City Bank of New York Monthly Letter on Business and Economic Condition, April 1949 and April 1956.

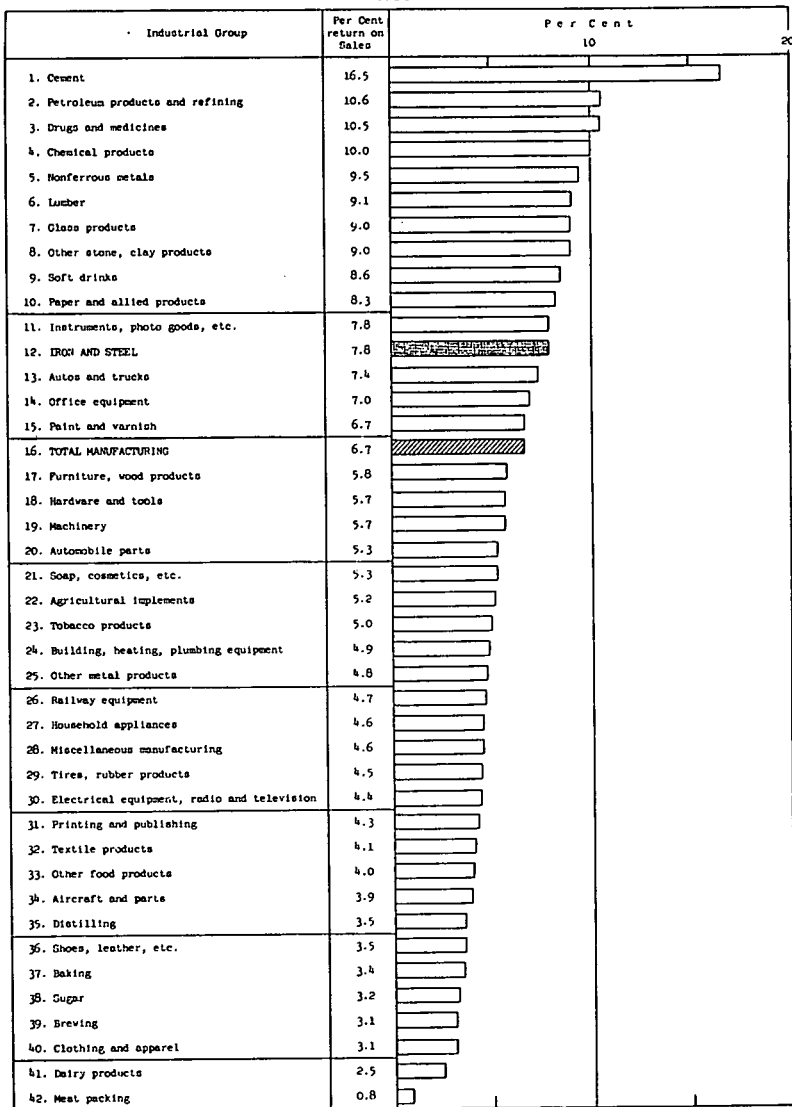
Thus for 9 other manufacturing industries and 4 nonmanufacturing industries in this sample, the profit margin rose (12 industries) or remained unchanged (1 industry) between 1947 and 1955. Clearly, an increase in profit margins between 1947 and 1955 was not unique to the steel industry.

Some Industries Have Higher Profit Margins Than Steel

TABLE 18 shows that 10 out of 40 other manufacturing industries in the First National City Bank sample reported a higher return on sales in 1955 than the iron and steel industry; one other industry reported the same return. (See Chart 15.)

Chart No. 15
PROFIT MARGIN AS PER CENT OF SALES - MAJOR MANUFACTURING INDUSTRIES

1955



Source: First National City Bank of New York, Monthly Letter on Business and Economic Conditions, April 1956, p. 43.

| <u>Manufacturing Industry</u> | <u>Profit Margin as Per Cent of Sales</u> |
|--|---|
| Cement | 16.5 |
| Petroleum products and refining | 10.6 |
| Drugs and medicines ... | 10.5 |
| Chemical products | 10.0 |
| Nonferrous metals | 9.5 |
| Lumber | 9.1 |
| Glass products | 9.0 |
| Other stone, clay products | 9.0 |
| Soft drinks | 8.6 |
| Paper and allied products | 8.3 |
| Instruments, photo goods | 7.8 |
| Iron and steel | 7.8 |

According to Table 18, each of the industries (except glass products) with a higher profit margin on sales than steel had a lower turnover ratio. In addition, Table 19 lists 6 nonmanufacturing industries with a higher profit margin than the iron and steel industry in 1955. Thus, higher profit margins were reported in 16 out of 60 other industries or almost 3 out of every 10 industries for which the First National City Bank reported data.

Other Factors Affecting Trend of Profit Margins

MOREOVER, profit margins declined for some industries from 1947 to the first quarter

of 1956 because of changes in their economic well being rather than because of any price policy designed to lower profit margins. Thus, the textile industry which benefited from the early postwar boom had a profit margin of 8.2 per cent in 1947. However, as a result of economic adversity, the margin had declined to 3.2 per cent early in 1956. Similarly, in the same period the apparel profit margin fell from 4.6 per cent to 1.5 per cent and the profit margin for lumber and wood products fell from 11.4 per cent to 4.2 per cent.

The decline in the profit margin for all manufacturing reflected a number of cross currents which influenced the economic positions of the individual industries in the two selected periods rather than any price policy designed to narrow profit margins. In some instances, these economic forces resulted in high profit margins in 1947 while in other instances they acted to depress profit margins early in 1956. It was the combined influence of these forces which resulted in a lower profit margin rather than a "combined price policy" aimed at lowering margins. In light of these factors there is no reason why the trend of the profit margin in the steel industry should have paralleled that for all manufacturing industries as the Union suggests.

VIII. STEEL PROFITS IN ECONOMIC PERSPECTIVE

THE Union devotes considerable attention to its allegation that steel profits are excessively high. It is able to reach this conclusion by a careful selection of base dates and by making comparisons which have little meaning because of the inadequacies of the data used. In its presentation, the Union passed over rather quickly the phantom profits which have developed in the steel industry as well as in other industries as a result of inadequacy of depreciation allowances to cover the cost of replacing plant and equipment at today's highly inflated prices. The Union then proceeds to paint a picture of excessive returns on net worth by relating the profits inclusive of phantom profits to a net worth which fails to reflect the effects of inflation.

That steel profits in recent years have not been out of line with the expanding role of steel in our national economy is indicated when these profits are related to the expanding economy in which they are earned. The increases in the profit margin as a per cent of sales from the depressed levels used by the Union as base periods was found in an earlier section to be a normal development and to reflect similar experience in past periods of boom. When steel profits are set against the economic environment in which they are earned, a significantly different picture emerges from that presented by the Union.

In this section, we shall consider the impact of inadequate depreciation allowance upon reported profits, the inadequacies of net worth comparisons, and the factors which have contributed to reported increases in profits.

Inadequacy of Depreciation Allowances Creates Phantom Profits

IN both "Facts On Steel," and "Steel and the National Economy," the Union closes its

mind completely to the influence of inflation upon the adequacy of legal depreciation allowances. This is a particularly important problem in an industry with so heavy an investment in plant and equipment as is characteristic of basic steel. The Union does not explore the extent to which book profits have been *overstated* because of inability of the industry to charge off true capital consumption as an operating expense. Instead, the Union attempts to dismiss the problem cavalierly as an attempt "to sell the proposition that the Administration's refusal to revise the tax laws pertaining to depreciation along the lines desired by the steel companies requires the industry to raise its prices again in order to have sufficient funds to maintain and replace its properties." ("Facts On Steel," p. 38.)

Again, without any supporting evidence, it is contended that "from 1952 through most of 1955, prices in general, except for steel prices, were relatively stable—i.e., the cost of maintaining steel facilities, replacing outworn and obsolete equipment, etc. was not appreciably different in 1953, 1954, and 1955." (*Idem.*, p. 39.) This quick dismissal of recent price changes completely ignores the increase in prices of producers finished goods and in construction costs from 1952 to 1956.

With no attempt whatsoever to offer supporting evidence, it is stated in doctrinaire form that "Total depreciation charges now are probably too high, even on the basis of replacement cost in relation to the life of depreciable assets. In any case, the old argument on this point is not presented any more except as a last resort type of exhortation." ("Steel and the National Economy," pp. 17 and 18.) In fact, in its summary, the Union flatly states its position. "High and accelerated depreciation charges permitted generally

under the new 1954 tax law and specifically for plants related to national security, *have resulted in a probable understatement of reported profits relative to actual profits.*" (*Idem.*, p. 2.) There is no support for this conclusion.

Measuring Capital Consumption

HISTORICALLY, depreciation has been determined by charging off the *original* cost of plant or equipment over its anticipated useful life. This so-called straight-line method was designed to measure the wearing out of fixed capital from physical use and obsolescence combined. The measure of capital consumption was then deducted as a cost of doing business in arriving at corporate profits. In recent years depreciation (on an original cost basis) in manufacturing industries has been running at about \$5 billion annually and for all corporations at more than three times that amount. Obviously, the adequacy of depreciation charges has an important bearing on the accuracy or realistic character of profits not only in the steel industry but in all industries with a high fixed investment per dollar of sales or gross receipts.

The purpose behind such deductions is to keep the real capital of the enterprise intact. In a period of stable prices, the cumulative charge-offs for a given item of plant or equipment will be sufficient to permit its replacement at the end of its stipulated productive span. In a period of rising prices, however, depreciation based upon original cost would become increasingly inadequate in maintaining *real* capital intact.

Reported profits are determined on the basis of conventional accounting procedures, which are well suited for years of relative price stability.¹ During a period of inflation, the net effect of these procedures is an *over-*

¹ Adapted from testimony of Jules Backman before the 1952 Steel Wage Board.

statement of reported profits. Professor W. A. Paton, a leading authority on accounting, described the problem to the 1949 Steel Wage Board as follows:

"The underlying reason for the overstatement of corporate earnings in the postwar years is found in the fact that ordinary accounting procedure is based on the assumption that the measuring unit used, the dollar, is a stable quantum, not subject to fluctuation. Actually, as we all know, the value of the dollar—its economic significance—varies continuously. As long as the variation moves within narrow limits, over a period of years, the tendency of accounting to overstate periodic earnings (when prices are rising) or to understate periodic earnings (when prices are falling) is not of serious consequence. When, however, the movement in the price level is severe and persistent the limitations of the accounting data become more pronounced and the problem of the interpretation of financial statements is a serious matter. We are in such a period now, and accounting showings of current earnings based on recorded dollar costs are materially overstated.

"... the primary adjustment needed in present-day income statements of industrial concerns is a revision upward of depreciation charges in the case of plant acquired at a substantially lower price level than that now prevailing. *Without such adjustment corporate earnings as reported are generally overstated, in some cases very substantially.*" (Italics added.)

Professor R. C. Jones of Yale University has pointed out:

"The fact is that current charges for depreciation are too low, not because of any real or imaginary connection with current replacements, but rather because the postinflation dollars in which costs are recovered have substantially less value than did the preinflation dollars in which the costs were incurred. *The fail-*

*ure to recognize this purchasing power deficiency results in an overstatement of taxable income, excessive income taxes, and an exaggerated rate of return on book investment."*¹ (Italics added.)

Similarly, the United States Department of Commerce has recognized this development as the following statement shows:

*"Business profits, which make up the largest part of property income, are determined by the deduction from gross receipts of the costs of doing business, among them being depreciation. Property income is thus dependent in part on the manner in which depreciation is computed. In estimating national income, the depreciation deducted is that reported for tax purposes by business, and is based on the original cost of the assets being depreciated. If current-year values of depreciation are substituted for the reported values, a measure of business profits and of total property income results that is more meaningful in many ways because all costs as well as gross receipts are expressed at a uniform current valuation."*² (Italics added.)

The manner in which this situation develops may be illustrated as follows. Straight line depreciation ordinarily is calculated by taking the original cost of plant or equipment, deducting its anticipated salvage value, and dividing the remaining amount by the number of years the plant or equipment is expected to be used. If a plant costs \$1,000,000, has a salvage value of \$100,000, and has a life of 20 years, the average annual charge for depreciation would be \$45,000. While there are exceptions to the use of this method of straight line depreciation, basically it does illustrate the manner in which depreciation reserves are established. Suppose at the

time the plant is replaced, the cost of its replacement by a plant which can produce the same volume of goods has risen to \$2 million, instead of the original cost of \$1 million. Under these conditions, it is clear that the company will not have made adequate provision to maintain its real capital—its plant and equipment—intact. Thus, for example, assume that the plant has two machines, each of which originally cost \$1 million. Presumably a total of \$2 million normally would be accumulated over the years as depreciation (plus salvage) for these two machines. If at the time they were used up, the cost of the machines had doubled, the company would be able to buy only one machine with these funds and thus, in effect, would have had its real capital reduced by one machine.

It must be recognized, of course, that companies usually do not buy identical machines when such replacement occurs. The new machines undoubtedly incorporate technological changes developed after the original machines were acquired. Nevertheless, the company is still faced with the problem of providing through depreciation reserves, funds for the purchase of machines having at least equivalent capacity to those which are used up.

Not too many attempts have been made to measure the deficiency in depreciation for specific companies. However, Professor R. C. Jones has made such a detailed study for four companies. His study concluded:

"The average deficiency in the purchasing power of the depreciation charges of each of the four companies studied in this project is shown below for the five postwar years, 1947-51.

| | <u>Per Cent</u> |
|-------------------------------------|-----------------|
| Armstrong Cork Company.... | 30 |
| New York Telephone Company | 27 |
| The Reece Corporation..... | 28 |
| Sargent & Company..... | 29 |

¹ Ralph Coughenour Jones, *Effects of Price Level Changes on Business Income, Capital, and Taxes*, American Accounting Association, 1956, pp. 80 and 81.

² U. S. Department of Commerce, *Survey of Current Business*, November 1956, p. 19.

TABLE 20
 Depreciation on Privately Owned Structures and
 Equipment in Manufacturing Establishments,
 1929-55
 (Billions of dollars)

| Year | Original Cost | | | Current-year cost ¹ | | | Ratio of Current-year Cost to Original Cost ² | | |
|------|--------------------------|------------|-----------|--------------------------------|------------|-----------|--|------------|-----------|
| | Structures and Equipment | Structures | Equipment | Structures and Equipment | Structures | Equipment | Structures and Equipment | Structures | Equipment |
| 1929 | 1.4 | 0.5 | 1.0 | 1.7 | 0.6 | 1.0 | 1.17 | 1.37 | 1.08 |
| 1930 | 1.5 | .5 | 1.0 | 1.6 | .6 | 1.0 | 1.08 | 1.20 | 1.02 |
| 1931 | 1.5 | .5 | 1.0 | 1.5 | .5 | 1.0 | .99 | 1.03 | .97 |
| 1932 | 1.5 | .5 | 1.0 | 1.4 | .5 | .9 | .92 | .93 | .92 |
| 1933 | 1.4 | .5 | .9 | 1.3 | .5 | .8 | .92 | .94 | .91 |
| 1934 | 1.4 | .5 | .9 | 1.4 | .5 | .9 | 1.02 | 1.09 | .97 |
| 1935 | 1.4 | .5 | .9 | 1.4 | .6 | .9 | 1.02 | 1.10 | .98 |
| 1936 | 1.4 | .5 | .9 | 1.5 | .6 | .9 | 1.04 | 1.15 | .98 |
| 1937 | 1.4 | .5 | .9 | 1.6 | .7 | 1.0 | 1.13 | 1.27 | 1.05 |
| 1938 | 1.5 | .5 | .9 | 1.6 | .7 | 1.0 | 1.11 | 1.23 | 1.05 |
| 1939 | 1.5 | .5 | .9 | 1.6 | .6 | 1.0 | 1.09 | 1.18 | 1.04 |
| 1940 | 1.5 | .5 | 1.0 | 1.7 | .7 | 1.0 | 1.13 | 1.24 | 1.07 |
| 1941 | 1.6 | .6 | 1.0 | 1.9 | .8 | 1.2 | 1.22 | 1.36 | 1.14 |
| 1942 | 1.7 | .6 | 1.1 | 2.1 | .9 | 1.2 | 1.27 | 1.52 | 1.13 |
| 1943 | 1.7 | .6 | 1.1 | 2.2 | 1.0 | 1.2 | 1.29 | 1.63 | 1.11 |
| 1944 | 1.8 | .6 | 1.2 | 2.2 | .9 | 1.3 | 1.26 | 1.55 | 1.11 |
| 1945 | 1.9 | .6 | 1.3 | 2.4 | 1.0 | 1.4 | 1.27 | 1.62 | 1.10 |
| 1946 | 2.0 | .6 | 1.4 | 2.8 | 1.2 | 1.6 | 1.38 | 1.87 | 1.15 |
| 1947 | 2.3 | .7 | 1.6 | 3.6 | 1.5 | 2.1 | 1.54 | 2.06 | 1.30 |
| 1948 | 2.7 | .8 | 1.9 | 4.2 | 1.7 | 2.5 | 1.58 | 2.18 | 1.33 |
| 1949 | 2.9 | .8 | 2.1 | 4.5 | 1.7 | 2.8 | 1.52 | 2.05 | 1.32 |
| 1950 | 3.2 | .9 | 2.3 | 4.8 | 1.7 | 3.0 | 1.49 | 1.99 | 1.31 |
| 1951 | 3.5 | .9 | 2.6 | 5.5 | 1.9 | 3.6 | 1.58 | 2.14 | 1.38 |
| 1952 | 3.9 | 1.0 | 2.9 | 5.8 | 2.0 | 3.8 | 1.50 | 2.08 | 1.31 |
| 1953 | 4.2 | 1.0 | 3.2 | 6.1 | 2.0 | 4.0 | 1.44 | 2.01 | 1.27 |
| 1954 | 4.5 | 1.1 | 3.5 | 6.4 | 2.0 | 4.4 | 1.41 | 1.87 | 1.27 |
| 1955 | 4.9 | 1.1 | 3.7 | 6.7 | 2.1 | 4.6 | 1.38 | 1.84 | 1.25 |

1. Cost prevailing in each year of period.

2. Computed from unrounded figures.

Source: U. S. Department of Commerce, Office of Business Economics, *Survey of Current Business*, November, 1956, p. 11.

"These deficiencies, it should be noted, are in terms of general purchasing power and not in terms of replacement costs. No attempt has been made to compute current or replacement costs because the effect of technological change cannot be determined, but the rapid rise in index numbers for construction costs and machinery prices suggests that the deficiencies on a replacement cost basis would be higher than they are in terms

of general purchasing power."¹

During virtually all of the postwar period, the United States Department of Commerce has stressed the conceptual desirability of adjusting corporate profits in the national income accounts for the inadequacy of depreciation allowances, as it does currently to remove the effect of changes in inventory

¹ Jones, *op. cit.*, p. 85.

values. Until recently, however, it had not developed an acceptable procedure for correction of the under-depreciation.

We now have official formalized measures for depreciation in manufacturing industries on a current-year value basis. These estimates reveal the extent of the divergence between depreciation as reported for tax purposes and actual depreciation required to keep the real stock of corporate assets intact.¹ These figures show that in the years selected by the Union as being devoid of under-depreciation because of "price stability," current-year cost depreciation exceeded original cost by almost \$2 billion annually just for manufacturing establishments alone. (See Table 20.)

| Year | Original Cost | Current-Year Cost | Ratio of Current-Year Cost to Original Cost |
|------|-----------------------|-------------------|---|
| | (billions of dollars) | | |
| 1952 | 3.9 | 5.8 | 1.50 |
| 1953 | 4.2 | 6.1 | 1.44 |
| 1954 | 4.5 | 6.4 | 1.41 |
| 1955 | 4.9 | 6.7 | 1.38 |

Source: United States Department of Commerce.

In presenting these estimates, the United States Department of Commerce notes:

"The using up of fixed capital, which is a result of wear and tear in the process of production and of obsolescence, is conventionally measured by depreciation. The usual business practice is to allocate the original cost of depreciable assets over the estimated useful life (generally by the straight-line method in the period covered by this study). Depreciation accumulated in the previous periods is subtracted from the original cost of the stock of depreciable assets to arrive at its net value.

"When the prices of capital goods change, computation of depreciation on the original cost of fixed assets yields estimates of capital consumption and net

*asset values which are inappropriate for our purposes. An original-cost-estimate for any given year will reflect, not the price level for any one year, but a mixture of the prices of preceding years. This makes it difficult to combine or compare it with estimates of other economic magnitudes for the same year or with estimates of the same item for different years."*² (Italics added.)

What the Department of Commerce has done is to estimate depreciation at constant cost (1947 prices) as well as original costs "by applying information on useful lives to the respective current and constant dollar purchases of structures and equipment." After computing depreciation by the straight-line method, depreciation at constant cost was converted to *current-year cost* by multiplying the depreciation for each year by the construction and equipment price indexes for that year. The Department warns that in the use of price indexes, adequate allowance may not be made for quality changes or for the greater efficiency of capital goods because of improved plant layout, better organization, etc.

There are also offsets in the other direction, however. Thus, the Department adds that "in an expanding industry such as manufacturing, the straight-line method again overstates the level of net assets *and in addition understates depreciation.*" (Italics added.) Again another offset, particularly in the light of the bulge in investment in recent years, is the point advanced by the Department to the effect that "the straight-line method of allocating depreciation over the useful life of the capital goods tends to *understate* the use derived from the structures and equipment in the early years of life and to overstate the use obtained in later years."³ (Italics added.) Finally, revolutionary technological developments can also shorten the

¹ "Manufacturing Investment Since 1929 in Relation to Employment, Output, and Income," *Survey of Current Business*, November 1956, pp. 8-20.

² *Ibid.*, p. 11.

³ *Ibid.*, p. 12.

lives of existing assets through extraordinary obsolescence.

How do the Union's contentions measure up with the findings of the United States Department of Commerce, keeping in mind the reservations as to both over-statement and under-statement even in the Department's estimates? Viewed over the longer-term, the Department's figures show the significant extent to which under-depreciation has affected manufacturing profits. Selecting the period so frequently cited by the Union, 1947-1955, manufacturing depreciation on an original cost basis is found to aggregate about \$32 billion. The corresponding total on a current-year cost basis is about \$47.5 billion. The difference of about \$15 billion or 50 per cent is large and meaningful despite the reservations earlier cited as to inability to correct for quality change. Indeed, in the period of price stability cited by the Union, namely, 1952-1955, the traditional form of depreciation allowance fell about \$7.5 billion short of replacement costs.

Even without further pressure from new price increases, replacement costs were still running well over 40 per cent above depreciation measured on the basis of original costs. What the Union has obviously failed to comprehend is that, despite short-term price stability, the inadequacies of depreciation on an original cost basis still remain. The need for correcting for inventory profits may well be eliminated by stable prices over the short-term. But much of our existing plant and equipment was purchased before the war or immediately after. The index of wholesale prices of producers' finished goods advanced by 55.2 per cent between 1947 and December 1956. Even with stable prices, therefore, durable equipment purchased less than a decade ago would cost \$3 to replace for every \$2 of original cost. Depreciation determined on an original cost basis would be just about as inadequate as it was previously shown to

be by the Department's actual estimates for all manufacturing.

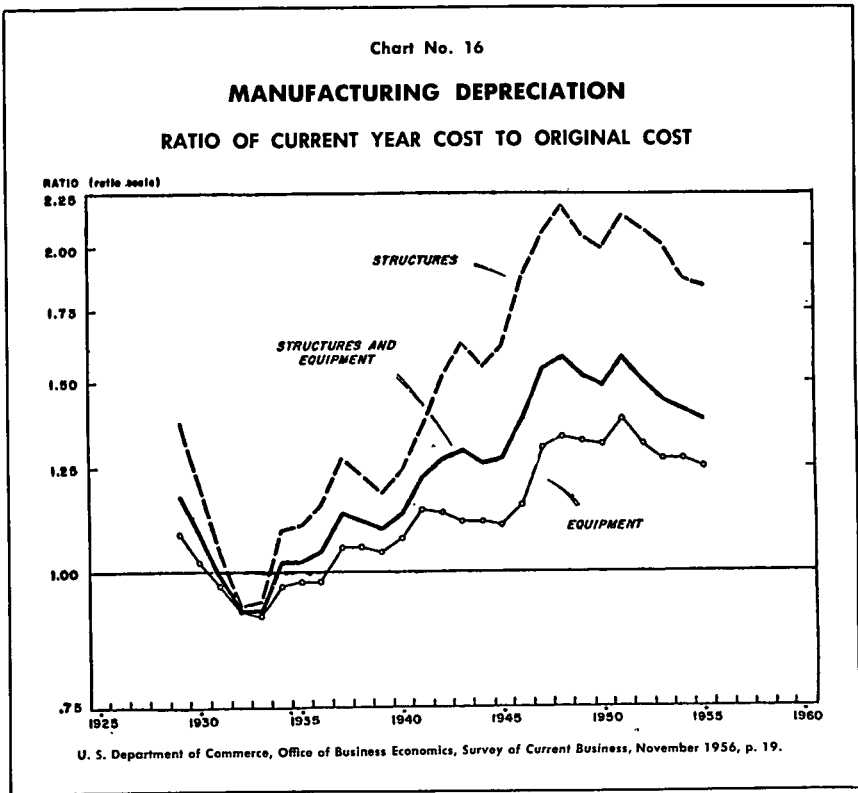
The Union's charge, given wide publicity, in its summary statement and elsewhere is that depreciation has been overstated and that, hence, this has "resulted in a *probable understatement* of reported profits relative to actual profits." The official figures completely cut the ground from under this charge. It is true that as industry has added more modern and higher-priced equipment, the impact of under-depreciation upon profits has been reduced. The zenith of replacement cost relative to original cost was apparently reached in 1948-1951.

In more recent years, the differences between depreciation on original and replacement cost bases have tended to narrow but even in 1955 current cost depreciation was still running 36.7 per cent above the corresponding original cost depreciation. (See Chart 16.) Since manufacturing income before taxes in 1955 was about \$24 billion, it can be seen that the understatement of depreciation even in that year led to a significant *overstatement* of actual profits, rather than the understatement claimed by the Union.

For the long-term, the Department of Commerce has these conclusions to offer:

"To convert reported manufacturing depreciation into current values it must be adjusted upwards in all years in the period, 1929-1955 save 3 during the trough of depression; and even in those years, the downward adjustment is less than 10 per cent. The size of the adjustment increases persistently from 1933 to 1948—to a maximum of about 60 per cent—because of the almost continuous increase in prices that occurred during these years. With prices considerably more stable thereafter, the prices underlying book value depreciation gradually catch up with current year prices and the ratio of current to original cost tends to decline."¹

¹ *Idem.*, p. 19.



Accelerated Amortization Does Not Provide Full Offset to Under-Depreciation

THE Union attempts to make particular capital of the offsets to under-depreciation arising from accelerated amortization "during World War II and during and after Korea." ("Steel and the National Economy," p. 17.) "Further, the tax laws of the United States have been revised to allow all plant and equipment outlays to be depreciated at a more rapid than *normal* rate." Without offering any evidence as to how widespread

has been the adoption of the "more rapid" rate or of the actual amounts involved, the conclusion is then offered that "normal depreciation charges would have been far less. The larger depreciation allowances might be looked upon as extra profits."

The facts concerning the impact of rapid amortization contradict the Union's unsupported contention that "Total depreciation charges now are probably too high, even on the basis of replacement cost, in relation to the life of depreciable assets." ("Steel and the National Economy," p. 17.)

Instead, the United States Department of

Commerce finds that even after allowance for rapid amortization, economic depreciation continued to outstrip legally permissible depreciation in recent years.

"Beginning in 1941, the upward adjustment in property income because of rapid amortization tends to offset the depreciation revaluation and because of its increasing importance through 1945, the net effect is up in 1944 and 1945. From 1946 to 1951, the amortization adjustment changes direction and works to decrease property income thus reinforcing the effect of the depreciation revaluation, although the latter is quantitatively much the more important. *Again in 1952 as in 1941, the advent of rapid amortization mitigates the downward depreciation valuation adjustment, but through 1955 the net adjustment has continued to diminish the relative share of manufacturing property income.*"¹ (Italics added.)

Data are not available to show for the entire steel industry the extent to which accelerated amortization has offset the under-depreciation of other property.

Estimates made by United States Steel Corporation show that the total depreciation charges, inclusive of accelerated amortization, have fallen short of the amounts required to replace the assets used up in each of the post-war years. In its Annual Report for 1956, the Corporation reported:

"Thus U. S. Steel's wear and exhaustion recorded for 1956 was \$278 million, or about \$67 million short of the \$345 million needed for buying power recovery. Included in recorded wear and exhaustion is \$140 million of amortization which will decline and virtually disappear after 1958.

"As that happens the depreciation deficiency will actually increase and income will seemingly increase. Since taxes will increase by over half the decline in amor-

tization, a curious and serious situation will result: At the very time that the business appears to have greater income the cash with which to conduct it is diminished; and cash is what is required to cover the ever-mounting costs, to supplement the inadequate depreciation permitted, and to meet the expanding working capital requirements in a period of continuing cost inflation."²

Chart 17 shows the picture since 1940 for United States Steel. The aggregate deficiency for the 1940-56 period has been \$904.0 million. As a result of this deficiency, profits have been *overstated*, not understated as alleged by the Union.

It seems apparent that accelerated amortization has offset only part of the under-depreciation of assets. But even this partial relief will exact its price tomorrow. When this acceleration disappears over the next few years, the result will be an increase in the magnitude of under-depreciation and a rise in the magnitude of phantom profits.

Higher Replacement Costs

ADEQUATE data are not available on a year to year basis to determine the changes in costs of steel plant and equipment because many facilities are acquired only periodically. W. A. Walker, Vice President and Comptroller of United States Steel Corporation, has described the magnitude of increases in the cost of steel facilities as follows:

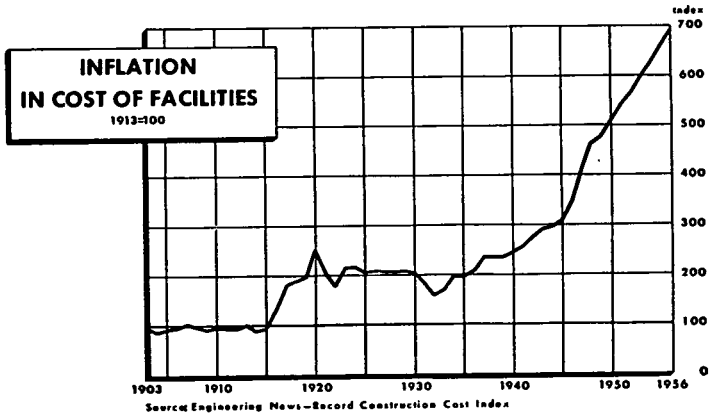
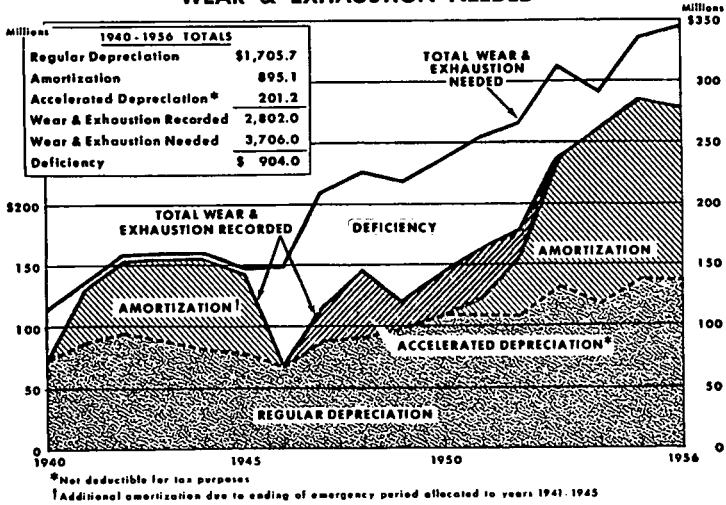
"Let me give you some examples of how the cost of the tools of production which we buy has gone up. In EXHIBIT I the first column describes the asset. The second column shows the year of original acquisition. In the third column is given the latest year in which we purchased a similar facility. In order that you may have some idea of how rapidly the costs of these specific items have risen, I have re-

¹ *Survey of Current Business*, November 1956, p. 20.

² United States Steel Corporation, *Annual Report 1956*, p. 27.

Chart No. 17

WEAR & EXHAUSTION RECORDED
vs.
WEAR & EXHAUSTION NEEDED



corded percentages in the last column. *These are the compound rates of increase in cost per year.* If you run your eye down that last column, you will see that for these individual items the compound percentage rate of increase per year ranges from 4.4 per cent to 19.6 per cent per year."

EXHIBIT I

Specific Fixed Asset Cost Increases

| Asset | Original Year | Latest Year | % Per Year Increase |
|-------------------------------|---------------|-------------|---------------------|
| 100 ton ladle | 1912 | 1956 | 5.0 |
| Structural mill & aux. | 1926 | 1956 | 4.4 |
| 6 stand billet mill | 1925 | 1951 | 5.5 |
| Blast furnace .. | 1948 | 1952 | 19.6 |
| O.H. charging machine | 1929 | 1951 | 6.9 |
| Electrolytic clean. line | 1946 | 1951 | 16.5 |
| Boring mill | 1945 | 1956 | 7.7 |
| Coke battery | 1927 | 1952 | 5.6 |
| Cold reduction mill | 1940 | 1950 | 8.9 |
| 1750 hp reversing motor | 1945 | 1955 | 7.8 |

W. A. Walker, *Inadequate Depreciation in the Metals Manufacturing Industry*, October 1956, pp. 2 and 3.

Roger Blough, Chairman of the Board of United States Steel Corporation, has illustrated the problem of higher replacement costs as follows:

"During the past 10 years alone, our plant and equipment costs have more than doubled. . . . Let me give you an actual example of this problem as we face it today:

"Back in 1930 we built an open hearth plant which cost about \$10 million. Today it will cost us about \$64 million to replace that plant. Through depreciation we have recovered the original \$10 million that we spent on this facility. The remaining \$54 million, however, will have to come out of our profits—our profits after taxes.

"But in order to earn \$54 million in

profits after taxes, we have to earn \$112½ million before taxes. And last year it took the profit on 600 million of the dollars we received from our customers—about one-seventh of our total sales—to pay for that one open hearth plant.

"So every penny of profit we made on one-seventh of our total sales last year will be wiped out in replacing this open hearth. And that, of course, is only one facility. We have many other furnaces, mills, and machines which must be replaced each year.

"In this connection, however, I should point out that many new facilities we buy today are better and more productive than the old ones they replace; and the new open hearth shop I have just described will produce about one-third more steel than the present one does. But taking this into full account, it will still cost more than 4½ times as much, per ton of capacity, as the original facility did."¹

Russell L. Peters, Chairman of the Finance Committee of Inland Steel Company has pointed out:

"It now costs us about 3½ times the original price to replace a given facility installed 25 years ago. If this inflationary trend continues as it has during the past 15 years, it will in the next 10 years cost us 5.43 times the original price to replace a facility that was constructed 25 years earlier.

"New financing is not the answer to the replacement of facilities needed just to maintain present capacity levels. You cannot borrow money which must be paid back out of earnings, or sell stock, just to stand still. This would represent a dilution of equity in its worst form.

"This leaves only one source of funds for the amounts needed to supplement inadequate depreciation allowances and

¹ Formal remarks at the annual meeting of stockholders, May 7, 1956.

for the purpose of keeping present capacities intact—higher prices.”

Benjamin Fairless, President of the American Iron and Steel Institute, estimated in 1956 that “at 1955 prices the industry must spend somewhere between a billion and 1.2 billion dollars a year for facilities in order to stay even. This does not include anything for major capacity expansion. Ten years ago the corresponding estimate was from \$400 to \$500 million. Call it \$450 million. . . . Part of the reason for the big increase that has occurred in the stay-even cost over the past ten years is that capacity was expanded.”

The Union’s claim that “the cost of maintaining steel facilities, replacing outworn and

obsolete equipment, etc. was not appreciably different in 1953, 1954, and 1955,” (“Facts On Steel,” p. 39) is not supported by the available data. Table 21 shows the changes in the prices of producers’ finished goods and construction costs. Between 1952 and 1955—the period of so-called stability in costs—the Engineering News Record’s index of construction costs rose from 126.4 to 146.2 or by 15.7 per cent. By the end of 1956, the index was 156.3, thus making the total rise 23.7 per cent since 1952. (See Chart 17.) The Bureau of Labor Statistics index of producers’ finished goods rose by 5.9 per cent between 1952 and 1955; by the end of 1956, the level was 18.7 per cent above the 1952 level.

TABLE 21
Changes in Prices of Producers’ Finished Goods,
Non-Farm—Non-Food Commodities and Construction Costs,
1939-1956
(1947-49 = 100)

| Year | Wholesale Prices | | Construction Costs | |
|-----------|---------------------------------|--------------------------------------|----------------------------|---------------------------|
| | Producers’ Finished Goods | Non-Farm— Non-Food Commodities | Engineering News Record | Department of Commerce |
| 1939 | n.a. | 58.1 | 52.1 | 51.0 |
| 1940 | n.a. | 59.4 | 53.6 | 51.8 |
| 1941 | n.a. | 63.7 | 57.2 | 55.0 |
| 1942 | n.a. | 68.3 | 61.3 | 61.4 |
| 1943 | n.a. | 69.3 | 64.2 | 64.7 |
| 1944 | n.a. | 70.4 | 66.1 | 64.4 |
| 1945 | n.a. | 71.3 | 68.2 | 66.7 |
| 1946 | n.a. | 78.3 | 77.7 | 76.5 |
| 1947 | 92.8 | 95.3 | 92.2 | 93.3 |
| 1948 | 101.1 | 103.4 | 102.4 | 104.0 |
| 1949 | 106.1 | 101.3 | 105.4 | 103.0 |
| 1950 | 108.7 | 105.0 | 113.4 | 106.5 |
| 1951 | 119.3 | 115.9 | 120.1 | 115.4 |
| 1952 | 121.3 | 113.2 | 126.4 | 119.1 |
| 1953 | 123.1 | 114.0 | 132.9 | 121.8 |
| 1954 | 124.7 | 114.5 | 139.2 | 121.6 |
| 1955 | 128.5 | 117.0 | 146.2 | 124.6 |
| 1956 | 138.1 | 122.2 | 153.4 | 130.7 |
| Dec. 1956 | 144.0 | 124.7 | 156.3 | 132.8 |

n.a. Not available.

Sources: *Economic Report of the President*, January 1957, p. 163; United States Department of Commerce, *Business Statistics*, 1955 Biennial Edition, pp. 27, 38, 39; *Survey of Current Business*, July 1956, p. S-8; February 1957, p. S-8.

The most recent observations of the Council of Economic Advisers on price trends are also directly pertinent.

"Prices of most commodities and services rose during 1956. Industrial prices, which had begun to increase in the second half of 1955, continued their upward movement in 1956. . . . The increase in machinery and equipment prices was accelerated. . . . *By December, prices of producer equipment had risen 13 per cent above those at mid-1955, intermediate materials for durable goods manufacturing 10 per cent, construction materials prices 7 per cent, consumer durables 6 per cent, consumer nondurables 3 per cent, and the average of all industrial prices 8 per cent.*" (Italics added.)¹

These are significant increases in costs for a relatively short period of time and suggest that the costs of new steel plant and equipment have been far from stable since 1952. The forces creating under-depreciation and phantom profits have continued to operate.

In summary, it seems clear that inadequate depreciation continues to lead to an overstatement of profits of American industry, particularly for steel and other manufacturing industries with a relatively high fixed investment in capital facilities and equipment.

Short term price stability may resolve the problem of inventory revaluation but the need for depreciation revaluation would continue even if prices of capital goods were to remain stable for even a decade. Actually, prices of producer finished goods rose by 13 per cent from June 1955 to December 1956; construction costs have also continued to move upward unbrokenly. Thus, the problem of under-depreciation and the resulting overstatement of book profits continues critical rather than an "old argument . . . not presented any more except as a last resort type of exhortation," as the Union contends.

¹ *Economic Report of the President, 1957, pp. 30, 32.*

Inadequacies of Net Worth-Profit Comparisons

THE Union brief is replete with references to steel profits relative to net worth. The reader is never informed about the limitations and reservations which surround the conclusions drawn from such comparisons. It is stated that "*net profits (after taxes)* as a rate of return on net worth for 1955 were 13.8 per cent, which is considerably higher than the rate for any year in the last quarter of a century (except for 1950) and more than *double* the 6 per cent rate which normally and traditionally has been considered to be a fair and reasonable rate of return on stockholder investment." ("Facts On Steel," p. 12.) (Italics added.)

It is also stated that:

"While the steel industry constantly complains of an inadequate return on its investment, the actual figures do not bear this out. It has long been accepted in accounting and financial circles that net profits after taxes at 6 per cent on net worth represent a fair and reasonable rate of return. In 1939 the steel industry did not quite reach this standard. The rate of return that year was 4.2 per cent. Since then the rate of return has exceeded 6 per cent in every year except during World War II. In most peace-time years since 1939, the rate has been in excess of 10 per cent. In 1955, the over-all rate for the Industry (25 companies) was a phenomenal 13.8 per cent with only 2 companies earning a rate of less than 6 per cent and 17 companies earning more than 10 per cent." (*Ibid.*, pp. 18 and 19.)

For manufacturing industries, it is pointed out that:

"In only one year since 1947, namely, the 1954 recession year, did the rate of profits after taxes fall below 10 per cent of stockholder's equity. In only two years did the rate of profits before taxes on

stockholders' equity fall below 20 per cent. These are truly very high profit rates and it is clear that manufacturers can cut profit margins much more and still earn handsomely on their investment." ("Steel and the National Economy," p. 14.)

In both reports profits are thus found to be higher than prewar, relative to net worth. They are also found to be above 6 per cent—a so-called "fair and normal return," in the Union's judgment. From this the Union leaps to the conclusion that the return on investment in steel and all manufacturing is excessive. No attention whatsoever is paid to (a) the meaningfulness of such comparisons in a period of inflation or (b) the warrant of holding the rate of return of 6 per cent as "fair and normal" in such a period or for industries other than public utilities to which such standards have been applied in the past.

How Inflation Impairs Net Worth Comparisons

PURPORTED high returns on net worth are completely misleading. They reflect an inevitable fiction which arises during a period of inflation. Prices for current output necessarily respond more promptly to inflationary pressures than do book values of plant and equipment. Only as plant and equipment are retired and replaced are the higher price levels reflected on the books of the company. This necessarily is a slow process which takes a long period of years to complete. It is this lag which is largely responsible for the reported large returns on net worth. Profits are stated in current inflated dollars; net worth is stated in good part in old or "hard" dollars. The return on net worth gives no indication whatsoever of how much can be earned on dollars invested currently.

In arriving at the rate of return on net

worth, it is imperative to recognize the distortions introduced by inflation in both the numerator and denominator of the equation; the base called net worth and the share called profits $\frac{\text{profits after taxes}}{\text{net worth}} = \text{rate of return}$.

Unless the rate of return is corrected for the two types of bias (which are reinforcing), it is so distorted that the comparisons are virtually meaningless, particularly over the longer-run.

In this connection, Professor R. C. Jones has noted:

"It is now evident, however, that this ratio [of net business income to capital employed] can be quite *misleading* if it is computed in nonuniform historical dollars when the value of the dollar itself is changing at a significant rate. When the general level of prices is rising, that is, when the value of the dollar is falling, revenues are made up entirely of small current dollars while both expenses and invested capital are stated at least in part in older and larger dollars. This condition combined with the fact that net profit is usually a small percentage of gross revenues creates a *strong upward bias in nominal or apparent rates of return*. There seems still to be a tendency to underestimate the amount of bias in earning rates based on conventional statements, but the fact that a bias does exist is now generally admitted."¹ (Italics added.)

Turning first to the inadequacies of the net worth base, the pivotal point here is that the figures on investment as taken from company books relate to the past cost in years in which prices were significantly lower. In a period of inflation, prices for current output respond far more quickly to price changes than does the book value of fixed assets, particularly when, as in the case of the steel industry, there is a relatively low turnover of investment per dollar of sales. A significant pro-

¹ Jones, *op. cit.*, pp. 1 and 2.

portion of net worth continues to be comprised of investment in old or "hard" dollars and the return on net worth as a result gives no indication of what can be earned from a comparable investment of today's "soft" dollars.

This disparity in the respective time spans of the numerator and denominator of the rate of return equation can be more clearly seen if the frame of reference becomes not the cumulative total of past investments but instead, the cumulative total of the physical assets into which past dollars of investment were transformed. These investments appear on company books on the basis of *original cost*—in many instances in the hard or harder dollars of the prewar or immediate postwar years. Thus, net worth becomes a melange of assets that are always underpriced in a period of inflation and especially so in industries such as steel where assets are long-lived in character and where the net addition to fixed assets in any given year is but a small fraction of the total existing stock of capital assets.

Some measure of the extent to which the denominator (net worth) is affected by the use of original costs can be gained from a recent study by the United States Department of Commerce.¹ In terms of 1947 as 100, the prices of manufacturing structures and equipment in 1939, 1947 and 1955 were:

| Year | Structures | Equipment | Structures & Equipment |
|------------|------------|-----------|------------------------|
| 1939 | 46 | 69 | 61 |
| 1947 | 100 | 100 | 100 |
| 1955 | 129 | 139 | 135 |
| % Increase | | | |
| 1939-1955 | 180.4 | 101.4 | 121.3 |

These figures suggest that the original cost of a structure built in 1939 would have to be increased by 180 per cent to bring its value into line with the purchasing power of today's

dollar of earnings with which it is being compared. Similarly, all fixed assets acquired in 1939 and in being today would have to be raised by 121 per cent to restate them in 1955 costs as compared with original costs. Even in the case of more recently added plant and equipment, the influence of inflation tends to bias downward the net worth figures. Equipment purchased as recently as 1947 generally cost nearly 40 per cent more to replace in 1955 while total fixed assets acquired would have to be raised 35 per cent to be stated in the same dollars as the 1955 profit figures. In addition, prices of producers' equipment rose 13 per cent from June 1955 to December 1956 so that early in 1957 the cost of replacement is considerably higher than in 1955.

The influence of this accumulated stock of capital goods valued at lower price levels upon estimates of current net worth is an item of major importance in profit-net worth comparisons. As estimated by the United States Department of Commerce, the total real net value of privately owned structures, equipment and inventories in manufacturing in 1939 was \$58.5 billion (in 1947 dollars). The corresponding totals for 1947 and 1955 were \$78.1 billion and \$101.5 billion, respectively.² Thus, prewar and immediate postwar assets still represent a sizable proportion of today's physical assets in manufacturing industries. And what is directly in point, these are carried on the books of manufacturers at an original cost from a half to a third below their costs in today's market prices.

The longer life span of facilities employed in the production of steel aggravates the imperfections of the net worth base as developed above for all manufacturing. In 1939, total steel ingot capacity was 81.8 million tons ("Facts On Steel," p. 38), which was acquired at the price levels prevailing then and in earlier years. By 1947, steel ingot capacity had

¹ *Survey of Current Business*, November, 1956.

² *Survey of Current Business*, November, 1956, p. 14.

been raised to about 91 million tons, or about 10 million more than in 1939. Some old capacity had been retired but the preponderant bulk of the facilities then in being had been built at prices 26 per cent to 55 per cent below those prevailing in 1955. By 1956, capacity had been increased to 128.4 million tons or about 37.5 million tons above the 1947 total and 46.6 million tons more than in 1939. Even after allowance for facilities that have been retired over this period, it would appear that existing fixed assets in the steel industry would have to be increased significantly in value, in order to render the base of the profit-net worth ratio comparable with the current profit figure.

We have shown, therefore, that serious imperfections exist in the net worth data when employed as a basis for determining profitability in a period of sustained inflation or accelerated price increases in the cost of manufacturing structures and equipment. The use of original cost in the valuation of past investment significantly *understates* today's costs of plant and equipment to which today's profits are to be related and hence contributes toward the "phenomenal" rate of return criticized by the Union.

In contrast to the understatement of true net worth, a period of inflation leads to an overstatement of reported profits of corporations. First, legally permissible depreciation charges fall steadily behind the true costs of capital consumption in such periods. The extent of this profit overstatement and the significant degree to which profits of manufacturing corporations in general and steel companies in particular are overstated for reasons of depreciation inadequacy has been demonstrated above.

Secondly, the profits data may be overstated in a period of price inflation because the price rise contributes toward a fictitious element in book profits through the rising values of inventories. To the extent that the

last in first out (lifo) method of handling inventory is used, this factor is not of importance. It does not affect the figures for United States Steel because the Corporation uses lifo.

Perhaps a simple illustration may indicate the nature of the problem created by inflation of prices. Let us assume a plant cost \$100,000 before the war and had a life of twenty years. Also assume that the reported net worth of the company on the basis of the book figures is \$100,000 and that reported profits after taxes in 1956 totaled \$15,400, or an apparent return of 15.4 per cent on net worth based on prewar costs. In deriving this profit, \$5,000 was deducted for depreciation. Actually, the plant would cost \$200,000 to reproduce today and if allowance were made for this higher cost, there would be a doubling of depreciation charges to \$10,000 and net worth would be increased to \$200,000. After allowing for this increase in depreciation costs, the company would have profits after taxes of \$12,960. But this would represent a return of only 6.5 per cent on the net worth at today's cost of \$200,000, as compared with the 15.4 per cent apparent return on net worth based upon prewar costs. The following tabulation shows these calculations:

| | Return on Recorded Net Worth | Return on Net Worth Adjusted to Reflect Replace- ment Cost |
|---|------------------------------------|--|
| Net Worth | \$100,000 | \$200,000 |
| Gross income | 100,000 | 100,000 |
| Costs, other than depreciation | 63,000 | 63,000 |
| Depreciation | 5,000 | 10,000 |
| | 32,000 | 27,000 |
| Taxes (52%) | 16,640 | 14,040 |
| Profits after taxes | 15,360 | 12,960 |
| Return on Net Worth | 15.4% | 6.5% |

The reported returns on net worth not only involve a relationship to an understated value

of net worth, but also involve the overstatement of profits which results from the understatement of depreciation charges.

That the changes shown in the above hypothetical illustration may not be too far from reality is indicated by the results of a study of four companies made by Professor R. C. Jones of Yale University. When he allowed for the effects of inflation on the accounts of four companies, he found the following differences between reported profits and profits adjusted for the effects of inflation:¹

| | Average Rate of Return | |
|----------------------------|------------------------|----------|
| | Reported | Adjusted |
| | (per cent) | |
| Armstrong Cork Company | | |
| 1946-48 | 10.4 | 5.0 |
| 1949-51 | 10.1 | 5.8 |
| The Reece Corporation | | |
| 1946-48 | 9.6 | 4.7 |
| 1949-51 | 7.3 | 4.3 |
| Sargent & Company | | |
| 1946-48 | 9.5 | 3.3 |
| 1949-51 | 6.7 | 3.4 |
| New York Telephone Company | | |
| 1946-48 | 6.3 | 3.3 |
| 1949-51 | 5.5 | 2.8 |

In connection with his evaluation of the New York Telephone Company, Professor Jones described the factors accounting for the difference between reported and adjusted average rates of return as follows:

"There are two principal reasons why this economic or adjusted earning rate is only half as high as that shown by the historical or book figures. Adjusted expenses, principally depreciation, are higher (and net income lower) because preinflation costs are converted into their current-dollar equivalents. The adjusted investment is substantially larger than book investment because of a similar conversion of plant costs and capital contributions."²

¹ Jones, *op. cit.*, p. 6.

² Jones, *op. cit.*, pp. 17 and 18.

Thus, it is clear that it is mainly because of the impact of inflation upon the adequacy of depreciation charges and the level of net worth that Professor Jones found the adjusted average rate of return so much lower than that which was reported.

In other words, a considerably different picture emerges when *today's profits* based on *today's real costs* are related to *today's costs of plant and equipment* than is shown when profits are related to investment in terms of original prewar costs. *Returns on net worth largely reflect a comparison of overstated reported profits with understated net worth.* In terms of incentives for new investment, the 6.5 per cent figure, not the 15.4 per cent figure in the hypothetical case, represents the realistic alternative facing the executive and investor who must make decisions on the basis of such figures.

This problem is not unique to the steel industry. Thus, the Mountain States Telephone and Telegraph Company observed in its 1956 *Annual Report* (page 9):

"New plant to serve each new telephone is costing more on the average than has already been invested to serve each existing telephone. The volume from the new telephone is no more than from the existing telephone, but expenses such as property taxes and depreciation are greater. Thus *net earnings from the new telephone are less in the face of larger investment which calls for larger net earnings—a double barreled effect which we call attrition.*" (Italics added.)

In summary, in the years in question profits are *overstated* because of (a) the inclusion of inventory profits which are not economically meaningful and (b) the understatement of depreciation by not allowing for the higher replacement costs in both instances. Of equal significance, the estimates of net worth are drastically *understated*. The inherent defects in the numerator and de-

nominator are not offsetting. Instead, they are reinforcing so that the inevitable result is a reported rate of return which the Union misinterprets as evidence that current profits are far above a "fair and normal" return.

Actually, the comparisons can have no economic meaning over the period the Union selects, unless profits and net worth are both expressed in a common price level. As was shown above, when correction is made for the influence of inflation not only are profits sharply reduced through warranted depreciation and inventory adjustments, but also the value of past investment is greatly raised in terms of today's prices. The two types of corrections when applied go far to deflate the Union's conclusions about "phenomenal" rates of return on investment.

A final brief comment may be offered on the Union's advocacy of a return of 6 per cent as "fair and normal" reward or incentive to investors. Where this rate has been employed in the past for public determination of a warranted return on investment, it has been confined to public utilities and related industries. The industries in question are subject to public regulation, have monopoly or quasimonopoly powers, and are not exposed to the same cyclical vulnerabilities as are most manufacturing industries, and especially steel. The element of risk is far less significant in public utilities than in manufacturing. The services rendered are necessities, surrounded with the public interest and with little opportunity for resort to substitute services or materials.

These elements of economic distinction are so well known that it seems unnecessary to do more than outline the basic differences between the function of profits of a publicly-regulated industry and the function of profits in freely competitive enterprise. In this connection, one can only repeat the telling criticism by Sumner Slichter of the failure of Robert Nathan in his 1946 report to grasp

the true purpose of profits in our economy. As Dr. Slichter so aptly put it, "One of the most unsatisfactory parts of Mr. Nathan's report is its failure to understand the role of profits in the modern economy. Profits are the reward for two peculiarly useful activities. They are the return which business owners receive on equity capital and they are the yardstick by which managers demonstrate their efficiency to their employers by developing new methods and new products. Hence, the opportunity to make a profit is an incentive for investors to put more equity capital into industry and for managements to make more innovations. The striving of the owner operators and the managers of more than ten million business enterprises, agricultural and non-agricultural, to make more profit is what makes the American economy the most progressive and dynamic in the world."¹

Return on Net Assets: Steel and Other Manufacturing Industries

DESPITE the limitations of returns on net worth, the Union brief has given such emphasis to this concept that it is of interest to compare the record in the steel industry and in other industries. The First National City Bank of New York publishes data for the iron and steel industry and other industries showing the return on net assets each year. The 1955 data appeared in the Bank's Monthly Letter for April 1956. The tabulation covered 56 iron and steel companies with book net assets of \$7,181 million as of January 1, 1955. The survey showed a return of 15.2 per cent for the iron and steel industry. The average return for *all manufacturing* was 15.0 per cent or 0.2 percentage points lower than for iron and steel. Out of 40 other *manufacturing groups* for which data were reported, the return on net book assets was

¹ *New York Herald Tribune*, December 20, 1946.

TABLE 22
Returns on Net Assets¹ for All Manufacturing Industries
and the Iron and Steel Industry, 1925-1956
(After Taxes)

| Year | All Manufacturing | per cent | | Excess for all Manufacturing over Iron and Steel |
|------|-------------------|----------|----------------|--|
| | | | Iron and Steel | |
| 1925 | 10.7 | | 5.8 | 4.9 |
| 1926 | 10.8 | | 7.3 | 3.5 |
| 1927 | 9.0 | | 5.3 | 3.7 |
| 1928 | 11.6 | | 7.0 | 4.6 |
| 1929 | 12.8 | | 11.2 | 1.6 |
| 1930 | 6.4 | | 4.5 | 1.9 |
| 1931 | 2.3 | | - 0.5 | 2.8 |
| 1932 | - 0.5 | | - 4.0 | 3.5 |
| 1933 | 2.5 | | - 1.9 | 4.4 |
| 1934 | 4.3 | | - 0.4 | 4.7 |
| 1935 | 6.7 | | 1.3 | 5.4 |
| 1936 | 10.4 | | 4.7 | 5.7 |
| 1937 | 10.8 | | 6.9 | 3.9 |
| 1938 | 4.8 | | - 0.2 | 5.0 |
| 1939 | 8.5 | | 4.5 | 4.0 |
| 1940 | 10.3 | | 8.5 | 1.8 |
| 1941 | 12.4 | | 9.6 | 2.8 |
| 1942 | 10.1 | | 6.5 | 3.6 |
| 1943 | 9.9 | | 5.6 | 4.3 |
| 1944 | 9.8 | | 5.2 | 4.6 |
| 1945 | 9.3 | | 5.1 | 4.2 |
| 1946 | 12.1 | | 7.5 | 4.6 |
| 1947 | 17.1 | | 11.3 | 5.8 |
| 1948 | 18.2 | | 13.9 | 4.3 |
| 1949 | 13.8 | | 11.5 | 2.3 |
| 1950 | 17.1 | | 15.3 | 1.8 |
| 1951 | 14.4 | | 12.3 | 2.1 |
| 1952 | 12.3 | | 8.8 | 3.5 |
| 1953 | 12.5 | | 11.6 | 0.9 |
| 1954 | 12.4 | | 9.4 | 3.0 |
| 1955 | 15.0 | | 15.2 | - 0.2 |
| 1956 | 13.9 | | 13.9 | 0 |

¹Net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. (Italics added.)

Source: First National City Bank of New York, *Monthly Letter On Economic Conditions*, April issue of each year.

higher in 13 industries; lower in 27 industries. The manufacturing industries which

reported return on net assets of 15 per cent or more in 1955 were the following:

| | <u>Per Cent Return on Net Assets</u> |
|------------------------------------|--|
| Autos and trucks | 29.1 |
| Aircraft and parts | 24.7 |
| Glass products | 20.5 |
| Cement | 20.3 |
| Drugs and medicines | 18.3 |
| Chemical products | 17.7 |
| Instruments, photo goods, etc. . . | 17.7 |
| Office equipment | 16.9 |
| Nonferrous metals | 16.7 |
| Other stone, clay products | 16.4 |
| Paint and varnish | 16.4 |
| Soap, cosmetics, etc. | 16.0 |
| Automobile parts | 15.3 |
| Iron and steel | 15.2 |
| Tires, rubber products | 15.1 |
| Total Manufacturing | 15.0 |

In connection with these data, the Bank warns:

"Since the book net assets, or excess of total reported assets over liabilities, are carried on the balance sheets in most cases far below present-day values, the rates of return thereon are correspondingly higher than if computed on the basis of actual replacement costs." (p. 42.)

As was noted earlier, this qualification is more important for the steel industry than for many other manufacturing industries. This situation has contributed to the relatively more favorable reported return on net assets for the steel industry as compared with all manufacturing industries in recent years. Table 22 shows the First National City Bank data since 1925. The Union in its Brief, has emphasized the changes since 1947 ("Facts On Steel," p. 8), and noted that the return for all manufacturing has declined while that for the steel industry has increased since 1947.

An examination of Table 22 indicates that the 1947 return of 17.1 per cent on net assets for all manufacturing has been exceeded only once in the 32 years for which the statistics have been compiled. In fact, the spread of 5.8

points for all manufacturing as compared with the steel industry in 1947 was the *widest* for any year for which the data are available. Thus, by using 1947 as a base period, the Union was able to show the maximum contraction of spread between all manufacturing and the steel industry.

Actually 1955 was the only year in which the return on net assets for steel companies exceeded that for leading manufacturing companies. Thus, the 1955 results were relatively favorable because the steel industry finally reported a return on net assets equal to all manufacturing industries. However, if corrections could be made for the inadequacies of these data, it is questionable whether the steel industry would have such a favorable relationship. The return on net assets for the steel industry in 1955 was fractionally below the previous peak in 1950. Even in boom years like 1929 (1.6 per cent), 1950 (1.8 per cent), and 1953 (0.9 per cent) the return on net assets for all manufacturing was moderately higher than for the steel industry.

The Level of Steel Profits

STEEL profits are described by the Union as being "at a fabulous and exorbitantly high level. . . . The steady and almost uninterrupted increase in the profits of the industry," the report continues, "are readily apparent from even a cursory inspection of its own financial reports." ("Facts On Steel," p. 9.) In the evidence advanced to support this contention little or no mention is made of the expanding economy in which the steel industry has operated. Indeed, the whole section labeled "The Financial Position of the Steel Industry" is seemingly designed to focus attention upon profits in the steel industry as if they were completely divorced or detached from the inflation-stimulated economy in which such profits were earned. The so-termed "unparal-

lede prosperity" of the industry assumes quite different dimensions when viewed against the unparalleled growth which also characterized virtually every other type of economic activity during the period chosen by the Union for its appraisal of steel profits alone.

With total national economic activity in dollar terms nearly five times what it was pre-World War II, the Union's conclusions that steel profits are unprecedented, unparalleled or unmatched in any previous year is obviously meaningless. These same terms could be applied to many other industries. Profits by their very nature, particularly in the steel industry, are the most volatile of all payments for the factors of production. They contract far more than does any other share of national income in a period of recession or depression. Traditionally, too, they rise more rapidly than other factors of production in periods of boom or expansion.

At the outset, it should be noted that the Union's projections of profits for 1956 were not realized. As compared with the projected increase of 15.3 per cent for 1956, profits increased only 1.4 per cent for the steel industry. For United States Steel Corporation, profits for 1956 were estimated by the Union at \$416.8 million on the basis of first quarter results. As compared with this projected rise of 12.6 per cent, profits actually *declined* from \$370.1 million to \$348.1 million or by 5.9 per cent in 1956. Here is a dramatic illustration of the dangers inherent in attempts to project steel trends on the basis of very short term experience. (The steel strike in the third quarter of 1956 affected these comparisons.)

Clearly, 1955 was one of the best years ever experienced in the steel industry, as it was for virtually all industry. National income in that year was higher in dollar terms than in any preceding year, as was the income originated by corporate business. In evaluating the significance of these data, therefore, it is im-

portant to keep in mind the expansionary environment which brought total revenues and total production in the steel industry to record levels along with the rest of the corporate economy—as well as the phantom profits included in the steel industry total.

The following observations serve to set steel profits in 1955 in necessary economic perspective:

1. Steel production and total revenues reached all-time record levels in 1955. This was not a unique development within the steel industry but rather, our entire economy moved forward from a gross national product of little more than \$367.1 billion at the start of 1955 to slightly above the \$400 billion level at the year end. Corporate profits before taxes were at an all-time high in 1955. The United States Department of Commerce in its annual review for 1955 offered this commentary on total corporate profits in that year:

"Corporate profits before taxes as measured for national income purposes, excluding inventory gains and losses, recovered sharply last year. The advance from 1954 amounted to one-fifth, or more than \$7 billion, and carried the total for 1955 past the \$41 billion mark, \$4 billion above 1953 and *more than \$1 billion above the previous all time high for 1951*. . . . During 1955 . . . increased profits in almost every segment of corporate business accompanied the spreading of recovery and the transition from recovery to net new growth in the national income."¹ (Italics added.)

Under these conditions, with demand and output rising so sharply, it would be anticipated that steel profits should also be at a record level.

Merely because steel profits achieved these record levels does not prove that they are too high any more than record levels of hourly earnings of steelworkers provides evidence that they are too high. The Union's emphasis

¹ *Survey of Current Business*, February 1956, p. 15.

is primarily upon the income flowing to the steel industry with little recognition of the enlarged contribution of the industry which called forth this larger return.

The Union's approach in effect ignores the sharp rise in steel capacity in recent years (from 99.4 million tons on January 1, 1950 to 128.4 million tons on January 1, 1956). It pays only lip service at best to the accompanying investment of billions of dollars in new and improved facilities. By stressing the absolute size of profits it implies that the steel industry should not be earning larger profits as its physical contribution to the nation's total product is enlarged.

2. Total production of steel in 1955 was 28.7 million tons more or 32.5 per cent greater than in 1954 and 20.2 million tons more or 20.9 per cent higher than in the previous record profit year of 1950. Sharp increases in profits would be anticipated under these conditions.

In connection with the expansion in physical output in the entire economy, the United States Department of Commerce again offers desirable economic perspective:

"Industrial production advanced steadily through most of 1955 under the stimulus of rising consumer and business demand. The physical volume of production for the year as a whole was 11 per cent higher than in 1954 and 4 per cent above the previous peak reached in 1953. . . .

"Automobiles and the primary metals industries, with approximately one-eighth of the weight in the Federal Reserve index, accounted for roughly one-third of the 10 per cent rise in total industrial output and for two-thirds of the rise in the durable goods group from the third quarter of 1954 through April 1955, when the peak rate of automobile production was reached.

"The enlarged manufacturing output was made possible by a record flow of materials and supplies. During the

course of the year, industries producing basic raw materials geared operations upward in line with the rising demands.

"Thus production of primary metals expanded sharply in 1955 to meet the large requirements from motor vehicles and other metal fabricating plants. *Steel-making facilities turned out a record 117 million tons of steel ingots and castings, over 5 million tons more than in 1953, the previous top.* An equally impressive tonnage of finished steel products was produced. *The total of 84.7 million tons of finished steel exceeded the high 1953 volume by 4.5 million tons. . . .*

"For the ninth consecutive year, the industry added to its steel-making capacity. The net expansion of capacity of 2.5 million tons of steel ingots and castings brought total rated capacity to 128.4 million tons as of January 1, 1956. This total represents a net gain of over 37 million tons, or two-fifths in the 9 year period since 1946."¹ (Italics added.)

3. Total revenues of the steel industry from all sources in 1955 were \$14.0 billion, or 32.6 per cent greater than in 1954. However, it was only 6.8 per cent greater than in 1953 or about the same rate of increase as in the physical output of finished steel products cited by the Department of Commerce (5.7 per cent). In fact, the increase in profits after taxes since 1950 (40.1 per cent) has been about in line with the increase in revenues (47.3 per cent) since that year.

4. It is to be expected that steel profits would increase sharply in years such as 1955 when output and revenues were rebounding from the contracting phase of the business cycle and were rising to record levels. The importance of overhead costs in the steel industry would normally mean that profit ratios would increase much more sharply than volume during years in which the latter increases.

¹ *Survey of Current Business*, February, 1956, p.21.

The converse is also true. Sharp and abrupt declines in volume touch off a shrinkage in profits more marked than the decline in either volume or revenues. Except when changes in the Federal income tax have acted to reduce the level of profits after taxes (for example, 1951) changes in volume have had a significant impact upon reported profits. In 1954, a decline of 19.5 per cent in total revenues and 20.9 per cent in production was accompanied by a decline of 29.0 per cent in profits before taxes. Because of the elimination of the excess profits tax in that year, however, profits after taxes fell only 13.3 per cent.

The large percentage increase in profits in 1955 reflected not only the tremendous increase in total revenues and steel production but also the relatively low base from which the profit increase was measured, namely, the depressed level of 1954. The recession in 1954 was far more marked in manufacturing than it was for the national economy as a whole. The United States Department of Commerce has observed:

*"Manufacturing, mining and transportation, in which the decline after mid-1953 was mainly concentrated, showed a marked resurgence, with the first two of them rising to even higher levels than before the downturn. The declines in these industries had reflected the drop in expenditures for hard goods that had resulted primarily from the cutbacks in national defense outlays and in business inventory investment. Their subsequent resurgence mirrored the recovery last year [1955] in hard goods production, which was of civilian origin, and the advance in other types of output as well."*¹ (Italics added.)

Gross national product declined only nominally (0.7 per cent) during 1954, as did national income (1.3 per cent). But corporate profits before taxes fell by 10.3 per cent and

¹ *Survey of Current Business*, February 1956, p. 13.

profits in manufacturing by 15.1 per cent.

| | Per Cent Change | |
|------------------------|-----------------|-----------|
| | 1953-1954 | 1954-1955 |
| Gross national product | - 0.7 | + 8.4 |
| National income | - 1.3 | + 8.6 |
| Corporate profits | | |
| before taxes | - 10.3 | + 28.6 |
| Manufacturing profits | | |
| before taxes | - 15.1 | + 34.4 |

Source: *Survey of Current Business*, January 1957, pp. 4 and 5, and *Economic Report of the President*, January 1957, pp. 123, 132.

Steel profits before taxes fell by 29 per cent in 1954 relatively twice as much as the profit decline for all manufacturing. They rose more rapidly than did all manufacturing profits in 1955, in part because steel output was expanded far more sharply than the corresponding rise in total industrial production. The Federal Reserve Board's index of manufacturing production advanced from 127 (1947-49 = 100) in 1954 to 140 in 1955 or by 10.2 per cent. Steel output, in contrast, was expanded by nearly one-third or three times the rate of manufacturing industry. All manufacturing profits suffered from the recession of 1954 and showed the cyclical rebound in profits from 1954 to 1955. Steel profits in terms of percentage increase over 1954 also reflect the influence of the cycle but in addition were affected by the sharper rate of growth in physical output from 1954 to 1955 than for all manufacturing industries.

5. In an industry which has experienced wide fluctuations in output over the years, it is dangerous to assume that the level of profits in a boom year like 1955 represents normal earning power. Even moderate declines in volume can mean sharp declines in profits as we have seen several times in recent years. It should be borne in mind that these figures relate to the full employment economy of the past decade.

It is useful to recall what happened be-

tween 1937 and 1938. The pertinent data were as follows:

| | 1937 (millions) | 1938 | Per Cent Change |
|--------------------------------------|--------------------|--------|--------------------|
| Steel production (tons) | 56.6 | 31.8 | - 43.8 |
| Total sales (dollars) | 2688.0 | 1605.3 | - 40.3 |
| Profits before taxes (dollars) | 251.7 | -14.4 | -100.0 |

The 1937-38 recession witnessed a decline of 43.8 per cent in steel production and 40.3 per cent in total sales. As a result of this decline in volume, profits before taxes were wiped out and a deficit was incurred.

In 5 of the 12 years since 1944, steel production has declined. These annual declines have ranged from a minimum of 11.0 per cent to a maximum of 20.9 per cent. (If the changes were measured from the peak to bottom month or week, the magnitude of declines would be considerably greater.)

Percentage Changes From Preceding Year
For Steel Industry In:

| Year | Production | Total Revenues | Profits Before Taxes |
|------|------------|----------------|-------------------------|
| 1945 | -11.1 | -10.5 | -36.4 |
| 1946 | -16.4 | -18.7 | +30.5 |
| 1949 | -12.0 | - 8.4 | - 2.5 |
| 1952 | -11.4 | - 8.3 | -47.8 |
| 1954 | -20.9 | -19.5 | -29.0 |

Gross national product is most frequently cited by those who say that the economy is becoming more stable. The most severe decline in total national economic activity during this period came in 1946, when gross national product declined by only 2.0 per cent. In 1948-49 and 1953-54, the correspond-

ing declines in gross national product (in current dollars) were nominal.

In constant dollars, there was somewhat less stability; the percentage declines in gross national product (in 1947 dollars) were: 11.1 per cent in 1945-46; 1.0 per cent in 1948-49; 1.5 per cent in 1953-54. The declines would be greater on a quarterly basis, from peak to trough, in terms of real gross national product.

It is significant to note that output in the steel industry continues to record wider fluctuations than for the economy as a whole. Moreover, the 1954 decline in steel output was greater than the preceding four declines. The declines in total steel revenues have closely paralleled the declines in steel output. For purposes of comparison, profits before taxes are used so that the relationships are not influenced by changes in corporate tax rates. In three of the five years of recent experience with a decline in output, steel profits before taxes fell by more than 25 per cent. Included in this category are the two most recent declines, 1952 and 1954.

In light of the record for this industry, even in as favorable an economic environment as the first decade following World War II, it is dangerous to hold that the 1955 experience represents a level of profits which could have been reduced safely. To reduce profit margins obtained at boomtime levels to some assumed average level would increase the steel industry's *vulnerability* to any future declines in volume. To repeat, there is little warrant in the actual historic record of the past decade for the conclusion that the steel industry's profits are not inseparably linked to changes in volume from the trough to the peak of the business cycle as well as from peak to trough.

IX. FINANCING EXPANSION

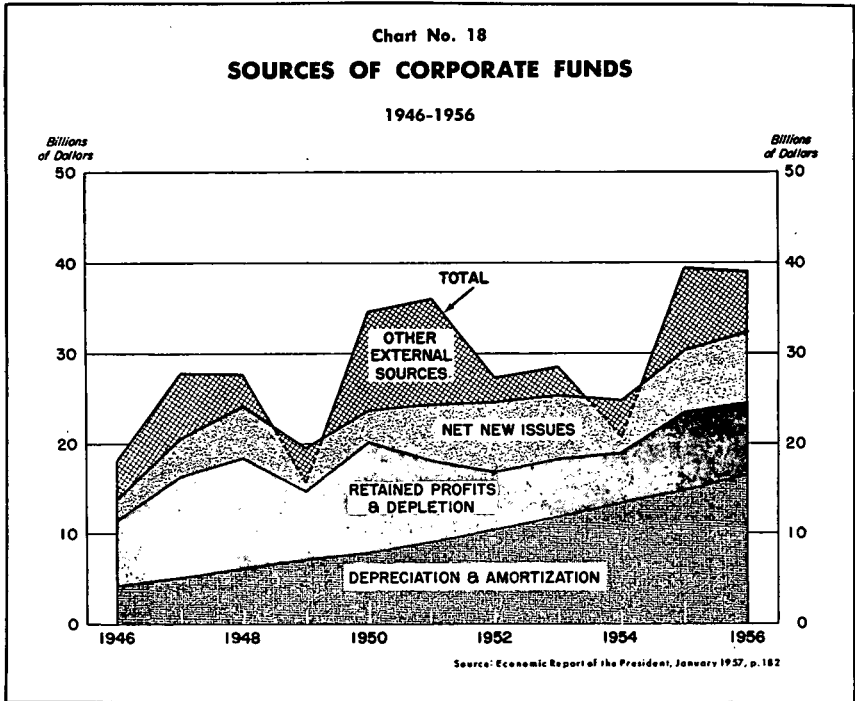
THE Union brief claims that:

"Risk capital, according to most business spokesmen and economic textbooks, is the source of funds for business investment in the American economy. A business firm that seeks to expand its productive capacity floats new stock issues and sells them to investors. In that way, the company increases its funds for expansion and spreads its ownership." ("Steel and the National Economy," p. 17.)

The Brief then states "This is a good theory, but it does not seem to be working in practice."

Neither in theory nor in practice does busi-

ness depend solely on the sale of stocks to obtain funds required to finance expansion in productive capacity. In fact, in recent years, the major sources of funds have been internal. An examination of leading textbooks shows that they all emphasize that conventionally and traditionally funds are raised from both internal and external sources. The major *internal sources* are retained profits and depreciation allowances. The main *external sources* are the sale of new security issues (bonds, preferred stock, or common stock) and borrowing from financial institutions (banks and insurance companies). It will be noted that stocks, which the Union empha-



sizes, provide only one form of external financing.

Depreciation allowances may improve the cash flow or liquid position of a company. But they do not form the basis for new investment or expansion. They are used largely to replace existing plant and equipment. In fact, as was noted in a previous section, under present tax laws depreciation allowances often are inadequate to replace at present prices assets earlier acquired at sharply lower price levels.¹ Thus, part of the retained earnings in recent years has been required to meet the inadequacy of depreciation to replace equipment at today's higher prices.

The excerpts cited in Appendix B show that the various authorities do not agree that American business has relied or should rely solely or primarily upon new stock issues in order to finance expansion in productive capacity. In fact, the Union brief recognizes that these other sources of capital have been

¹ See, for example, George Terborgh, *Realistic Depreciation Policy*, Machinery and Allied Products Institute, Chicago, 1954.

important when it states:

"The major source of corporate funds for expansion is *internal financing*—retained profits after the distribution of dividends and depreciation allowances. There has been some borrowing from banks and insurance companies and very limited flotations of corporate bonds. The overwhelming portion of funds for corporate expansion has come from retained profits and depreciation charges." ("Steel and the National Economy," p. 17.) (Italics added.)

The Union purports to find that this situation is contrary to theory. Actually, it is in accord with theory and is a well accepted practice as an examination of past experience shows.

Sources of Financing for American Industry

INTERNAL sources of financing have provided a relatively significant proportion of the total financial needs of American industry

TABLE 23
Sources of Corporate Funds, 1946-1956

| Year | Total | Depreciation and Amortization Allowances | Retained Profits and Depletion Allowances | External Sources | |
|---------------------|-------|--|---|--------------------|----------------|
| | | | | Total ¹ | Net New Issues |
| billions of dollars | | | | | |
| 1946 | 18.2 | 4.2 | 7.2 | 6.8 | 2.4 |
| 1947 | 27.9 | 5.2 | 11.4 | 11.3 | 4.4 |
| 1948 | 27.7 | 6.2 | 12.4 | 9.1 | 5.9 |
| 1949 | 15.6 | 7.1 | 7.6 | 0.9 | 4.9 |
| 1950 | 34.7 | 7.8 | 12.4 | 14.5 | 3.7 |
| 1951 | 36.1 | 9.0 | 9.1 | 18.0 | 6.3 |
| 1952 | 27.4 | 10.4 | 6.4 | 10.6 | 7.9 |
| 1953 | 28.5 | 11.8 | 6.5 | 10.2 | 7.1 |
| 1954 | 20.8 | 13.3 | 5.7 | 1.8 | 5.9 |
| 1955 | 39.5 | 14.8 | 8.8 | 15.9 | 7.0 |
| 1956 | 39.0 | 16.5 | 8.0 | 14.5 | 8.0 |
| 1946-56 | 315.4 | 106.3 | 95.5 | 113.6 | 63.5 |

¹In addition to net new issues (\$63.5 billion) includes changes in bank loans and mortgages (\$27.8 billion) and changes in Federal income tax liability (\$6.8 billion) and other liabilities (\$15.5 billion).

Source: *Economic Report of the President*, January 1957, p. 182.

over the years. Table 23 and Chart 18 present data showing the sources of corporate funds for all businesses for the years 1946 to 1956. For the entire period, the three main sources of funds, namely, depreciation, retained profits, and external sources, were almost of equal importance.

It will be noted that the sale of securities accounted for only one-fifth of the total corporate funds available to finance replacement and expansion for the 1946-56 period. If depreciation allowances are excluded, then the sale of securities yielded 30 per cent of the

funds available for expansion. The ratios were approximately the same in 1956.

| | Per Cent of Total |
|--|----------------------|
| <u>Internal Sources</u> | <u>64.0</u> |
| Depreciation and amortization allowances | 33.7 |
| Retained profits and depletion allowances | 30.3 |
| <u>External Sources</u> | <u>36.0</u> |
| Net new issues | 20.1 |
| Other external | 15.9 |
| Total | 100.0 |

TABLE 24
Gross Proceeds of Corporate Securities
Offered for Cash—1934-1956*

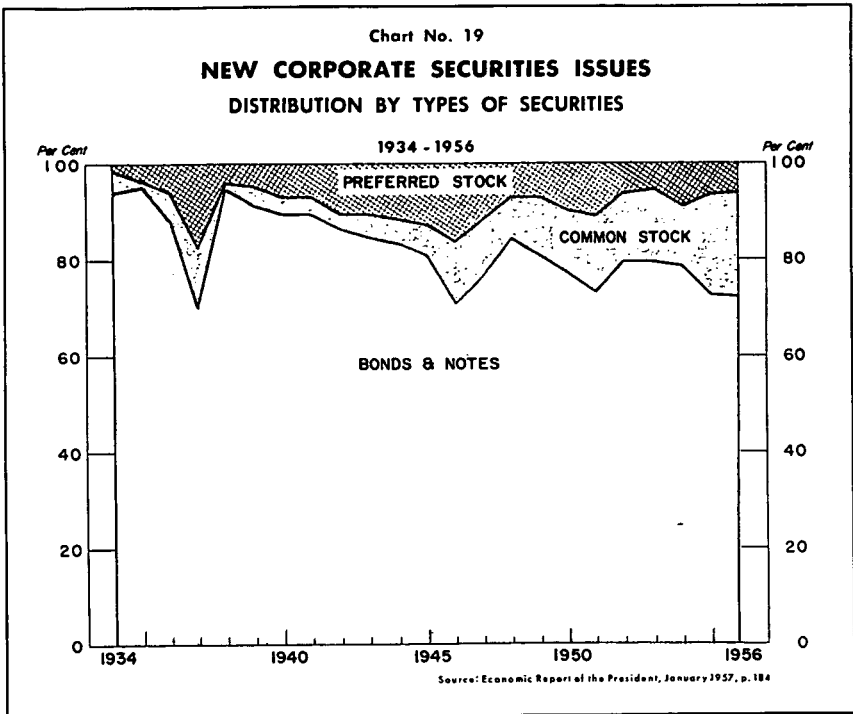
| Year | Common Stock | Preferred Stock | Bonds and Notes | Total |
|---------------------|-----------------|--------------------|--------------------|--------|
| millions of dollars | | | | |
| 1934 | 19 | 6 | 372 | 397 |
| 1935 | 22 | 86 | 2,224 | 2,332 |
| 1936 | 272 | 271 | 4,028 | 4,572 |
| 1937 | 285 | 406 | 1,618 | 2,310 |
| 1938 | 25 | 86 | 2,044 | 2,155 |
| 1939 | 87 | 98 | 1,980 | 2,164 |
| 1940 | 108 | 183 | 2,386 | 2,677 |
| 1941 | 110 | 167 | 2,390 | 2,667 |
| 1942 | 34 | 112 | 917 | 1,062 |
| 1943 | 56 | 124 | 990 | 1,170 |
| 1944 | 163 | 369 | 2,670 | 3,202 |
| 1945 | 397 | 758 | 4,855 | 6,011 |
| 1946 | 891 | 1,127 | 4,882 | 6,900 |
| 1947 | 779 | 762 | 5,036 | 6,577 |
| 1948 | 614 | 492 | 5,973 | 7,078 |
| 1949 | 736 | 425 | 4,890 | 6,052 |
| 1950 | 811 | 631 | 4,920 | 6,361 |
| 1951 | 1,212 | 838 | 5,691 | 7,741 |
| 1952 | 1,369 | 564 | 7,601 | 9,534 |
| 1953 | 1,326 | 489 | 7,083 | 8,898 |
| 1954 | 1,213 | 816 | 7,488 | 9,516 |
| 1955 | 2,185 | 635 | 7,420 | 10,240 |
| 1956 (p) | 2,380 | 660 | 7,910 | 10,950 |

* These data cover substantially all new issues of corporate securities offered for cash sale in the United States in amounts over \$100,000 and with terms to maturity of more than 1 year.

(p) preliminary.

Note: Detail will not necessarily add to totals because of rounding.

Source: *Economic Report of the President*, January 1957, p. 184.



Common stock and preferred stock have accounted for only a small proportion of the 20.1 per cent of the funds obtained from the sale of securities. For example, in 1956, according to the estimates of the Securities and Exchange Commission, total new security issues amounted to \$10,950 million. Of this total, \$2,380 million or 21.7 per cent was common stock and \$660 million or 6.0 per cent was preferred stocks. The total for all stocks was \$3,040 million or 27.8 per cent. (See Table 24.)

The funds obtained from the sale of stocks accounted for only 7.8 per cent of the total funds raised by American corporations from all sources in 1956. If depreciation allowances are excluded, the sale of stocks provided 13.5

per cent of the funds required to finance the expansion in corporate productive capacity in 1956.

It should be noted that the data for total net security issues and the data upon which the estimates for the relative importance of stock are based are not strictly comparable. However, they do show the approximate magnitudes involved.

Table 25 and Chart 19 show the proportions of stock and bond financing for all corporations since 1934. Clearly, only a small part of the securities sold to finance the expansion of American industry during the past two decades has been in the form of new stock issues. Moreover, it should be noted that in many years a large proportion of the

stocks were sold by public utility and communications companies rather than manufacturing companies. (See Table 26.) For example, public utility and communications companies accounted for \$790.8 million out of \$2,440.9 million of new stock issues sold in 1955. In 1954, those industries accounted for \$765.2 million out of a total of \$1,658.2 million.

Illustrations of Major Reliance Upon Internal Financing

THE growth of a number of large companies has been financed very substantially from internal sources of capital. Included in this group are such companies as: Ford Motor Company, International Business Machines Corporation, Campbell Soup, General Motors Corporation, General Electric Corporation,

F. W. Woolworth & Company, and the Aluminum Company of America. Unfortunately, detailed data concerning these developments are not readily available although some studies have been made for selected purposes.

The dependence upon internal sources of capital is not a development of the post-World War II years. It has been a typical situation in this country for many years. For example, O. J. Curry studied the methods of financing expansion for 72 companies for the period 1922-1930. Table 27 shows his findings. The tabulation also shows the magnitude of the expansion in assets financed by retained earnings between 1922 and 1930. The Curry study lists 22 companies which financed their entire expansion from retained earnings. There were 10 additional companies for which four-fifths or more of the expansion was financed out of retained earnings. Of the remaining

TABLE 25
Per Cent Distribution of Gross Proceeds of Offerings of Corporate Securities, 1934-1956

| Year | Common Stock | Preferred Stock | Bonds and Notes |
|------|--------------|-----------------|-----------------|
| 1934 | 4.8 | 1.5 | 93.7 |
| 1935 | 0.9 | 3.7 | 95.4 |
| 1936 | 6.0 | 5.9 | 88.1 |
| 1937 | 12.3 | 17.6 | 70.1 |
| 1938 | 1.2 | 4.0 | 94.8 |
| 1939 | 4.0 | 4.5 | 91.5 |
| 1940 | 4.0 | 6.9 | 89.1 |
| 1941 | 4.1 | 6.3 | 89.6 |
| 1942 | 3.2 | 10.5 | 86.3 |
| 1943 | 4.8 | 10.6 | 84.6 |
| 1944 | 5.1 | 11.5 | 83.4 |
| 1945 | 6.6 | 12.6 | 80.8 |
| 1946 | 12.9 | 16.3 | 70.8 |
| 1947 | 11.8 | 11.6 | 76.6 |
| 1948 | 8.7 | 6.9 | 84.4 |
| 1949 | 12.2 | 7.0 | 80.8 |
| 1950 | 12.7 | 9.9 | 77.4 |
| 1951 | 15.7 | 10.8 | 73.5 |
| 1952 | 14.4 | 5.9 | 79.7 |
| 1953 | 14.9 | 5.5 | 79.6 |
| 1954 | 12.7 | 8.6 | 78.7 |
| 1955 | 21.3 | 6.2 | 72.5 |
| 1956 | 21.7 | 6.0 | 72.3 |

Source: Derived from *Economic Report of the President*, January 1957, p. 184.

TABLE 26
New Stock Issues of Public Utility and Communication Companies
in Relation to All Corporations, 1939-1955

| Year | Public Utility and Communication Companies | All Corporations | Public Utility as Per Cent of Total |
|------|--|---------------------|---|
| | millions of dollars | | |
| 1939 | 5.5 | 96.8 | 5.7 |
| 1940 | 27.9 | 135.3 | 20.6 |
| 1941 | 25.7 | 172.9 | 14.9 |
| 1942 | 33.5 | 118.8 | 28.2 |
| 1943 | 2.4 | 91.7 | 2.6 |
| 1944 | 23.2 | 224.0 | 10.4 |
| 1945 | 26.3 | 664.7 | 4.0 |
| 1946 | 142.9 | 1,480.3 | 9.7 |
| 1947 | 283.6 | 1,233.1 | 23.0 |
| 1948 | 379.0 | 912.3 | 41.5 |
| 1949 | 706.8 | 973.6 | 72.6 |
| 1950 | 723.8 | 1,233.8 | 58.7 |
| 1951 | 775.6 | 1,665.0 | 46.6 |
| 1952 | 860.0 | 1,772.8 | 48.5 |
| 1953 | 939.3 | 1,606.5 | 58.5 |
| 1954 | 765.2 | 1,658.2 | 46.1 |
| 1955 | 790.8 | 2,440.9 | 32.4 |

Source: Commercial and Financial Chronicle.

40 companies included in the study, only two financed solely through external means. All of the others used varying proportions of in-

ternal and external financing. As the table shows, the experience of steel companies varied widely.

TABLE 27
Methods of Financing Expansion—Seventy-Two Companies, 1922-1930

| Name of Company | Per Cent from Retained Earnings | Extent of Expansion From Retained Earnings* |
|----------------------------------|---------------------------------------|---|
| | | (per cent) |
| Allied Chemical & Dye Corp. | 100 | 42 |
| American Can Co. | 100 | 51 |
| Coca-Cola Co. | 100 | 117 |
| Deere & Co. | 100 | 37 |
| General Electric Co. | 100 | 44 |
| Hart, Schaffner & Marx | 100 | 44 |
| Hershey Chocolate Corp. | 100 | 121 |
| Hudson Motor Car Co. | 100 | 383 |
| Motor Wheel Corp. | 100 | 66 |
| Nash-Kelvinator Corp. | 100 | 268 |
| National Acme Co. | 100 | 5 |
| New York Air Brake Co. | 100 | 28 |
| Packard Motor Car Co. | 100 | 80 |
| Quaker Oats Co. | 100 | 63 |
| Reo Motor Car Co. | 100 | 78 |
| R. J. Reynolds Tobacco Co. | 100 | 107 |
| Sears, Roebuck & Co. | 100 | 85 |
| Spicer Manufacturing Corp. | 100 | 70 |
| Timken Roller Bearing Co. | 100 | 207 |
| United States Steel Corp. | 100 | 15 |

TABLE 27 (continued)

| Name of Company | Per Cent from Retained Earnings | Extent of Expansion |
|--|---------------------------------|---------------------------------------|
| | | From Retained Earnings* (per cent) |
| F. W. Woolworth Co. | 100 | 108 |
| Worthington Pump & Machinery Corp. | 100 | 6 |
| Wm. Wrigley, Jr. Co. | 98 | 137 |
| Corn Products Refining Co. | 97 | 21 |
| Pittsburgh Plate Glass Co. | 97 | 56 |
| Otis Elevator Co. | 95 | 98 |
| California Packing Corp. | 92 | 47 |
| American Brake Shoe & Foundry Co. | 89 | 45 |
| Electric Storage Battery Co. | 89 | 27 |
| Loose-Wiles Biscuit Co. | 86 | 39 |
| International Harvester Co. | 81 | 34 |
| General Motors Corp. | 80 | 119 |
| S. S. Kresge Co. | 78 | 228 |
| General Cigar Company, Inc. | 75 | 29 |
| May Department Stores Co. | 74 | 59 |
| United States Rubber Co. | 74 | 13 |
| Mathieson Alkali Works, Inc. | 71 | 75 |
| Westinghouse Electric & Manufacturing Co. | 71 | 40 |
| Mack Trucks, Inc. | 70 | 87 |
| Commercial Solvents Corp. | 69 | 38 |
| Lima Locomotive Works | 69 | 16 |
| American Tobacco Co. | 67 | 41 |
| Liggett & Myers Tobacco Co. | 66 | 58 |
| Chicago Pneumatic Tool Co. | 65 | 18 |
| J. I. Case Co. | 64 | 43 |
| J. C. Penney Co. | 64 | 371 |
| Owens-Illinois Glass Co. | 61 | 35 |
| Goodyear Tire and Rubber Co. | 58 | 32 |
| Fairbanks, Morse & Co. | 58 | 34 |
| National Biscuit Co. | 54 | 30 |
| Chrysler Corp. | 53 | 117 |
| Union Carbide & Carbon Corp. | 52 | 37 |
| Mullins Manufacturing Corp. | 50 | 57 |
| Allis-Chalmers Manufacturing Co. | 49 | 13 |
| Air Reduction Company, Inc. | 45 | 114 |
| Inland Steel Co. | 42 | 46 |
| Continental Can Company, Inc. | 41 | 108 |
| B. F. Goodrich Co. | 41 | 27 |
| Pillsbury Flour Mills Co. | 38 | 159 |
| E. I. du Pont de Nemours & Co. | 37 | 23 |
| Firestone Tire and Rubber Co. | 36 | 103 |
| Borden Co. | 35 | 104 |
| Crucible Steel Co. of America | 32 | 2 |
| Consolidated Cigar Company, Inc. | 29 | 91 |
| Wheeling Steel Corp. | 27 | 13 |
| Baldwin Locomotive Works | 27 | 9 |
| American Cyanamid & Chemical Corp. | 19 | 36 |
| Gulf States Steel Corp. | 18 | 16 |
| Bethlehem Steel Corp. | 18 | 17 |
| Republic Steel Corp. | 8 | 5 |
| American Locomotive Co. | 0 | - 18** |
| American Car and Foundry Co. | 0 | - 3** |

* 1922-30 retained earnings as a per cent of 1921 assets.

** Net liquidation.

Source: O. J. Curry, *Utilization of Corporate Profits in Prosperity and Depression, Michigan Business Studies*, Vol. IX, No. 4, University of Michigan, Ann Arbor, 1941, pp. 37 and 38.

It is clear, therefore, that during the rapid expansion of the 1920's many companies met their requirements for expansion largely out of retained earnings while other companies had varying degrees of dependence on retained earnings.

Richard J. Gonzalez has summarized the use of internal financing in the *petroleum industry* as follows:

"Earnings retained in the business and funds recovered from previous expenditures by depreciation and similar charges are mainly relied upon in the financing of new investments in the petroleum industry. It is *exceptional* among the large oil companies for the amount of outside funds secured (through new equity financing or borrowing) to amount to as much as 25 per cent of the capital expenditures over a five-year period. Even during the postwar years of heavy capital expenditures, 1946-1950, twenty principal oil companies raised from outside sources an amount equal to only 15 per cent of their capital expenditures."¹ (*Italics added.*)

One of the outstanding illustrations of growth through internal financing has been the Ford Motor Company. Throughout its long history, this company was privately owned. However, in 1956, the company's common stock was sold to the public by the Ford Foundation. None of the proceeds went to the Ford Motor Company. As of September 30, 1955, the company reported total assets of \$2,483 million. Its earned surplus at that time was \$1,310 million plus \$415 million which had been transferred to capital surplus, or a total of \$1,725 million.²

As these illustrations show, there is nothing unique about relying heavily upon internal financing. The statements in the Union

¹ Richard J. Gonzalez, "Regularizing Petroleum Investment." *Regularization of Business Investment*, A Conference of the Universities—National Bureau Committee for Economic Research, Princeton University Press, 1954, p. 138.

² *Prospectus, Ford Motor Company*, January 17, 1956, pp. 31 and 35.

brief reflect a complete misunderstanding of the "financial facts of life."

In contrast to this heavy dependence on internal sources of capital for manufacturing companies, public utility and communications companies have relied much more heavily upon the sale of bonds and stocks to meet their needs for funds to finance growth. The American Telephone and Telegraph Company, for example, has sold issues involving hundreds of millions of dollars periodically during the post-World War II period. Similarly, the offering of rights to subscribe to new common stock has been a familiar development among electric utility companies in recent years.

Sources of Steel Industry Financing

IN a table on page 39 of "Facts On Steel," the Union purports to show the money available for replacement and expansion of facilities in the basic steel industry for the years 1953-55. According to the data presented the sources of funds were as follows:

| | Millions of Dollars |
|--|------------------------|
| Charges for depreciation | 2,304 |
| Undistributed profits | 1,663 |
| Cash available from operating profits | 3,967 |
| Increase in long term debt | 167 |
| Total | 4,134 |

The Union improperly includes charges for depreciation as "cash available from operating profits." Depreciation charges are a proper operating expense and hence are not part of operating profits. Such profits are calculated *after* depreciation and after taxes. The total cash available for reinvestment from operating profits was \$1,663 million not \$3,967 million as shown in the Union brief.

The Union states that only 4 per cent of the cash available for reinvestment "represented borrowed 'outside' capital." ("Facts On Steel," p. 39.) Actually, the sum of outside financing was considerably larger than shown.

The Union obtains the result shown by limiting its comparisons to the 1953-1955 period and by ignoring some transactions, such as the conversion of convertible bonds into common stock. For example, \$14,181,100 of Wheeling Steel Corporation bonds were converted into common stock in 1955 (*Annual Report*, 1955, p. 5). Inland Steel Co. converted \$21.3 million in bonds into 402,412 shares of common stock in 1954 and 1955 (*Annual Reports*, 1954, pp. 5, 7 and 1955, p. 7). A \$60,000,000 convertible bond (less \$4,616,000 paid off in 1953) sold by Republic Steel Corp. to insurance companies in 1951 was fully converted into common stock in 1954 and 1955. Similar conversions took place for other companies. The result was to reduce the total funded debt shown on a company's books but there was an offsetting increase in common stock.

Tables 28 and 29 summarize the bonds and stocks sold by 16 steel companies from 1946 to 1956. The data were obtained from annual reports and prospectuses issued by these companies. This tabulation is not a complete record of all external financing because it omits all short term borrowing from insurance companies and banks, borrowing from customers (for example, by Pittsburgh Steel Co., Republic Steel Corp., and Jones and Laughlin Steel Corporation), issuance of securities to acquire other properties (for example, by Colorado Fuel & Iron Corp., Crucible Steel Co., and Sharon Steel Co.), and sale of stock under employee options (for example, National Steel Corp. obtained \$3.7 million from the sale of common stock to employees from 1946 to 1955; United States Steel Corporation obtained about \$30 million from the sale of

common stock to employees from 1954 to 1956).

As against these exclusions which hold down the total shown, the tabulation does not show the extent to which debt was retired as a result of sinking fund operations and repayments of serial obligations.

In the three years, 1953 to 1955, used in the Union brief, the 16 steel companies sold \$555.4 million in stocks and bonds or a considerably larger amount than the increase of \$167 million in funded debt reported by the Union.

In the eleven year period, 1946 to 1956, these 16 steel companies sold \$1,498.5 million of securities. This total was divided as follows among different types of securities:

| | Millions of Dollars |
|-------------------------------------|------------------------|
| Bonds | 1,002.5 |
| Convertible debentures... | 324.5 |
| Common and preferred stock | 171.5 |
| Total | 1,498.5 |

TABLE 28
Total Stocks and Bonds Sold,
16 Steel Companies
1946-1956

| Year | Amount |
|-------------------------------------|---------------|
| 1946 | \$ 67,163,660 |
| 1947 | 51,300,000 |
| 1948 | 71,500,000 |
| 1949 | 60,800,000 |
| 1950 | 113,720,000 |
| 1951 | 227,341,833 |
| 1952 | 203,096,000 |
| 1953 | 29,624,867 |
| 1954 | 300,000,000 |
| 1955 | 225,756,800 |
| 1956 | 148,275,080 |
| Total | 1,498,578,240 |
| Bonds | 1,002,540,527 |
| Convertible bonds | 324,491,700 |
| Common and preferred stock | 171,546,013 |
| Total | 1,498,578,240 |

TABLE 29
Sales of Bonds and Stocks, 16 Steel Companies
1946-1956

| | | |
|-----------------------------------|---|---------------|
| 1946 | | |
| Crucible Steel Co. | 1st mortgage 3-1/8/66 (\$24,300,000 of which \$12,461,340 were to retire bonds)—net | \$ 11,838,660 |
| Inland Steel Co. | 2.65/76 | 50,000,000 |
| Sharon Steel Co. | 150,000 shares of common at \$35.50 | 5,325,000 |
| | Total | 67,163,660 |
| 1947 | | |
| Jones & Laughlin Steel Corp. | 2-3/4/67 (\$60,000,000 of which \$28,700,000 were to retire bonds)—net | 31,300,000 |
| Wheeling Steel Corp. | 3-1/4/67 | 20,000,000 |
| | Total | 51,300,000 |
| 1948 | | |
| Armco Steel Corp. | 3/68 | 35,000,000 |
| Inland Steel Co. | 3/78 | 20,000,000 |
| Sharon Steel Co. | 3-3/8/52-68 | 6,000,000 |
| Allegheny Ludlum Steel Corp. | 107,383 shares of preferred stock | 10,500,000 |
| | Total | 71,500,000 |
| 1949 | | |
| Bethlehem Steel Corp. | 3/79 | 50,000,000 |
| Colorado Fuel & Iron Corp. | 4/64 | 10,800,000 |
| | Total | 60,800,000 |
| 1950 | | |
| Colorado Fuel & Iron Corp. | 4/64 | 3,000,000 |
| Granite City Steel Co. | 99,414 shares of common | 3,400,000 |
| Jones & Laughlin Steel Corp. | 3/75 | 10,000,000 |
| Kaiser Steel Corp. | 1,600,000 shares of preferred and 800,000 shares of common | 37,320,000 |
| Kaiser Steel Corp. | 3-3/4/57-70 | 60,000,000 |
| | Total | 113,720,000 |
| 1951 | | |
| Armco Steel Corp. | 819,737 shares of common | 32,500,000 |
| Crucible Steel Co. | 3-1/2/66 | 5,000,000 |
| Granite City Steel Co. | 284,060 shares of common | 6,000,000 |
| | 102,265 shares of convertible preferred | 9,700,000 |
| Pittsburgh Steel Co. | 3-3/4/71 | 5,000,000 |
| Republic Steel Corp. | 3/66 convertible bonds | 60,000,000 |
| Sharon Steel Corp. | 174,137 shares of common | 6,852,933 |
| Wheeling Steel Corp. | 3-1/2/55 convertible bonds (converted in 1955 into common) | 14,238,900 |
| Youngstown Sheet & Tube Co. | 3-1/4/76 | 25,000,000 |
| Allegheny Ludlum Steel Corp. | 81,347 shares of pfd. | 7,800,000 |
| Jones & Laughlin Steel Corp. | 3/75 | 30,000,000 |
| Jones & Laughlin Steel Corp. | 1,000,000 common at \$25.25 per share | 25,250,000 |
| | Total | 227,341,833 |

TABLE 29 (continued)
Sales of Bonds and Stocks, 16 Steel Companies
1946-1956

| | | |
|-----------------------------------|---|--------------------|
| 1952 | | |
| Inland Steel Co. | 1st mortgage 3.20/82 | \$ 25,000,000 |
| | convertible 3-1/4/72 | 24,496,000 |
| National Steel Corp. | 3-1/8/82 (\$55,000,000 of which \$40,000,000 used to retire bonds)—net..... | 15,000,000 |
| Youngstown Sheet & Tube Co..... | 3-3/8/82 (\$43,100,000 of which \$27,000,000 in exchange for 1st mtg. 2-3/4/70)—net | 16,100,000 |
| Armco Steel Corp. | 3/64 | 25,000,000 |
| Colorado Fuel & Iron Corp. | 4-1/4/72 | 30,000,000 |
| Colorado Fuel & Iron Corp. | 4-3/4/66 convertible bonds | 10,000,000 |
| Crucible Steel Company | 3-1/2/66 | 17,500,000 |
| Granite City Steel Co. | 4-1/4/54-67 | 20,000,000 |
| Pittsburgh Steel Co. | 3-3/4/71 | 20,000,000 |
| | Total | <u>203,096,000</u> |
| 1953 | | |
| Youngstown Sheet & Tube Co..... | 3-3/8/82 | 6,900,000 |
| Armco Steel Corp. | 4/56-60 | 1,224,867 |
| Granite City Steel Co. | 4-1/4/54-67 | 5,000,000 |
| Granite City Steel Co. | 4-5/8/67 | 3,500,000 |
| Kaiser Steel Corp. | 4-3/4/73 | 8,000,000 |
| Pittsburgh Steel Co. | 4-3/4/73 | 5,000,000 |
| | Total | <u>29,624,867</u> |
| 1954 | | |
| U. S. Steel Corp. | 1.30 to 2.65 per cent debentures due serially to 1964 | 300,000,000 |
| 1955 | | |
| Colorado Fuel & Iron Corp..... | convertible 4-3/4/66 | 5,000,000 |
| Granite City Steel | 4-1/2/73 | 10,000,000 |
| Bethlehem Steel Corp. | convertible 3-1/4/80 | 191,659,000 |
| Wheeling Steel Corp. | convertible 3-3/4/75 | 19,097,800 |
| | Total | <u>225,756,800</u> |
| 1956 | | |
| Crucible Steel Co. | 164,117 shares of common at \$40 | 6,564,680 |
| Inland Steel Co. | 1st mtg. bonds 3-1/2/81 | 50,000,000 |
| Allegheny Ludlum Steel Corp. | 4/81 | 16,377,000 |
| Bethlehem Steel Corp. | conversion of 3-1/4/80 into common stock .. | 20,333,400 |
| National Steel Corp. | 3-7/8/86 | 55,000,000 |
| | Total | <u>148,275,080</u> |

The changes in long term debt in the steel industry can be checked against the composite balance published by the American Iron & Steel Institute each year. On December 31, 1945, the long term debt maturing in more than one year was \$472.6 million for 56 com-

panies. As of December 31, 1955, the total was \$1,538.1 million for 51 companies. Thus, in that 10 year period, net long term debt increased by \$1,065.5 million. The American Iron & Steel Institute balance sheet data reflect the effect of bond retirements and sink-

ing fund operations and also exclude bonds or notes due in less than one year. During this same period the 16 companies sold \$1,205.6 million in notes and bonds including convertible bonds. Many of the convertible bonds had been converted into common stock by the end of 1955 as was noted earlier while some of the bonds and notes had been retired through the operation of sinking funds. It is clear, that even after retirement of debt and conversions into common stock, there has been a sizable increase in the long term indebtedness of the steel industry.

The balance sheet data for common stock do not indicate the magnitude of new financing because they also reflect the payment of stock dividends. For what it is worth, the increase in common stock for the companies in the American Iron & Steel Institute sample increased by \$547.9 million in the 10 year period following December 31, 1945.

Steel companies have obtained some of the funds they required by selling common stock or by selling convertible bonds. The postwar experience has shown that the issuance of convertible debentures has really involved the sale of common stock in a two step operation. *On this basis, the steel industry appears to have obtained about one-third of the proceeds from security financing through the sale of stocks in the postwar period.* It is clear, therefore, that the Union brief was completely in error when it concluded that "Raising funds for expansion through the sale of common stock to the public is rejected by the steel companies." ("Facts On Steel," p. 39.)

As is true in other industries, steel companies have had to decide what proportions of new financing properly should be obtained by increasing debt and what share from the sale of stocks. Each company has made the decision in terms of its own special situation. In making these decisions, management in every industry has been fully aware of the tax advantages attending debt financing. But

whether it was in the form of debt or equity, the steel industry in the postwar years has gone into the capital markets to raise about \$1.5 billion of long term capital.

The Concept of "Costless Capital"

THE Union brief's criticism of reliance upon internal financing sets the stage for its complaint that the industry wants to raise prices in order to pay for new steel plants. In its words:

"Steel companies' stockholders, under this plan are to receive a gift—new steel plants and enlarged facilities which will increase their equity in their company, and, eventually, increase their dividends—all at the expense of American consumers who will pay the costs by paying higher prices for steel products. Gone, apparently, is the concept of 'risk' capital, of financing industrial expansion through flotation of stock or by means of borrowing on bond issues. Instead, the steel industry argues its right to collect 'riskless' capital from unwilling consumers by forcing upon them higher prices." ("Facts On Steel," pp. 38 and 39.)

Sometimes, the use of internal financing is described as a device for obtaining "costless capital." The practice of financing expansion through internal sources of funds is not unique as was indicated earlier. The use of such retained earnings is not "costless capital." As Professor McFerrin has noted:

"... there appears to be some tendency to regard retained earnings as 'costless.' This is valid only from the very limited aspect of flotation costs. Actually, they should be used in such a way as to yield essentially the same rate as that earned by existing common equity, and this 'rate' is at least an approximate indication of their cost."¹

¹ John B. McFerrin, "Financing Corporation Expansion During the Postwar Decade," *Georgia Business*, Vol. XVI, No. 4, The Bureau of Business Research, College of Business Administration, The University of Georgia, October 1956, p. 5.

It is true that all earnings of a company are derived from the revenues received from its customers. Retained earnings represent that part of the revenues which, together with dividends, comprise the earnings on stockholder capital invested. When earnings are not distributed, the stockholder foregoes dividend income and hence, there is a real cost to him. It is risk capital—not "riskless capital."

When these earnings are paid as dividends and then stocks are sold to a corporation's stockholders, there apparently is no criticism. But if the same funds required for expansion are retained in the business then the Union finds that there is something wrong with the process. Actually, both procedures yield substantially the same result. However, it must be recognized that when dividends are paid and then new stock is sold, the stockholder has greater choice in deciding whether to use the income obtained to reinvest in the business or in some other way. Many firms provide for periodic stock dividends to give the stockholder tangible evidence of his reinvested earnings. Of course, if the stockholder wants to sell these stock dividends, he is free to do so and thus, at such times, does have a choice as to how to use those funds.

It is interesting to note that when Citizens Utilities gave its stockholders an alternative of cash dividends or stock dividends in 1956, about three-fourths of the stockholders elected the latter alternative.

As the need for funds to finance expansion increased in 1956 and early 1957, many companies paid stock dividends instead of cash dividends in order to retain the cash to finance their plant and equipment programs. United Air Lines, for example, early in 1957, reduced its cash dividend and paid a stock dividend for this specific purpose.

According to Professor Arthur Stone Dewing:

"The reinvestment of surplus earnings is, in the end, a question of the anticipated relative return on capital. It was pointed out, in connection with the disposal of the surplus, that the proportion of net earnings retained in the business, rather than paid out in dividends, is entirely a matter of expediency. Hence, barring fraud and misrepresentation, the directors may keep for the use of their corporation as much of the earnings as they wish. Their action is, in the end, a reconciliation of two motives—a desire to gratify the stockholders, thereby maintaining the investment credit of the corporation, and a desire to secure additional capital without increasing the liability to the public, thereby strengthening the credit of the corporation with the banks. The particular balance between these two motives will rest, very largely, upon the policy of expansion then being followed by the directors. A static business, having no plans for enlargement, can distribute all its earnings as dividends without seriously affecting its credit. An expanding business cannot." (Italics added.)

The Union contends that "The public is called upon to provide the funds, but it is shut out of participation in the profits to be realized from the use of these funds." ("Facts On Steel," p. 39.) The Union brief further claims that "Corporate executives, in essence, admit that they can fix prices at will, irrespective of market conditions, and they propose to 'fix' prices higher and higher." ("Steel and the National Economy," p. 18.) These statements represent a complete misreading of the pricing and investment process. This claim apparently assumes that an individual steel company is free to charge any price for its product and then take the "extra money" obtained and buy new plants and equipment.

In the first place, it must be emphasized that an individual steel company cannot set

¹ Arthur Stone Dewing, *Financial Policy of Corporations*, Fifth Edition, Vol. II, Ronald Press, New York, 1953, p. 853.

prices arbitrarily without any relationship to market forces. Prices set excessively high without regard to market conditions would result in a shift to substitute metals and to other materials and would be accompanied by a reduction in sales and in the volume of profits. Such a price would be self defeating and fail to achieve its objective. Paradoxically, the funds such higher prices were allegedly designed to obtain would not be forthcoming. Moreover, they would not be required because of the idle capacity which would develop in the industry. An individual steel company is as much concerned as unions should be that it does not price its products out of the market.

During most of the postwar period, this has not been the problem for steel. On the contrary, steel prices apparently have been too low in terms of how much users were willing to pay. Otherwise, how would one explain the "gray markets" for steel, conversion deals, and other evidences that at the prevailing price level there was not enough steel produced to satisfy the enormous demand?

Secondly, there is considerable confusion in the Union brief concerning who is providing the funds for reinvestment. Such funds are not supplied by the consumer. They are supplied by the stockholder when he foregoes dividend income.

Professor McFerrin of the University of Florida describes retained earnings as "new equity funds."¹ The funds are supplied by the public or the consumer only in the sense that all funds received by a corporation from its sales must come from its customers. If the price is set too high, the consumer will not buy as much and there will be no funds forthcoming. *The consumer makes his decision to buy or not to buy a product in terms of the price asked. He does not make his decision on the basis of what a company will do with the funds received.*

¹ McFerrin, *op. cit.*, p. 4.

Similarly, Professor William A. Paton of the University of Michigan has pointed out that:

"Actually earnings retained in the corporate enterprise are a part of capital, in the over-all administrative and economic sense. They are just as much a part of the shareholder's stake in the business as are the funds which he originally invested. They are a part of the total layer of risk funds, supporting the claims of creditor-investors. If the earnings were disbursed to the shareholder through dividend action, and later the same funds (or what was left after taxes) were invested in additional shares, there would be no question as to the propriety of treating the new investment as capital. There is no material difference in the situation when the funds are invested directly by corporate management, without being passed through the hands of the stockholders. It is true that earnings may be unnecessarily or unwisely retained, but it is also true that original investments of capital may be unnecessary or unwise." (Italics added.)

It is interesting to note that the various authorities who have dealt with the question of reinvestment of retained earnings do not appear to have been informed that these funds were diverted from consumers as the Union brief alleges. Rather, they usually recognize that the reinvestment of these funds instead of the payment of dividends involves a decision by the Board of Directors concerning funds earned on the stockholder's investment.

The Union's claims and interpretations concerning the relationship between price policy and financing expansion do not find support either in theory or in fact. Internal sources now as in the past continue to provide the major funds for financing plant and equipment in manufacturing industries. The practice of the steel industry in this connection is fairly typical rather than unique.

² William A. Paton, *Shirtsleeve Economics*, Appleton-Century-Crofts, Inc., New York, 1952, p. 249.

APPENDIX A

American Iron and Steel Institute Income Statement for the Steel Industry

THROUGHOUT the volume "Facts On Steel: Profits, Productivity, Prices and Wages 1956," reference is made to various data showing the relative importance of steel profits before and after taxes, wages and material costs. In most tables, these data are shown only for the years, 1939, 1947, and 1950 to the first quarter of 1956. All of the tables do not cover the same number of companies. Thus, Table 2 (p. 9), Table 3 (p. 10), Table 4 (p. 13), tabulation on page 15, Table 5 (p. 16), Table 6 (p. 18), Table 7 (p. 19), and Table 8 (p. 20) cover data for 25 companies. In contrast, data shown in Tables 9 and 10 on page 21 cover 22 companies, Table 11 (p. 23) covers 11 companies and Table 12 on page 23 covers 9 companies. In light of the difference in coverage as between the tables, it is difficult to combine the different tables even though most of them are designed to show either profits, wages and salaries or materials as a percentage of the sales dollar. In order to fill in the missing years and to determine the distribution of the sales dollar, it would require a complete reworking of the Union's data plus the collection of data for the missing years.

There is no need to undertake such a comprehensive statistical survey since usable data are already available in compilations prepared by the American Iron and Steel Institute. The AISI data are available since 1939. For the period 1939 to 1942, the AISI series covers 31 companies. Since 1943, the number of companies covered in any particular year has ranged between 48 and 59. It is clear, therefore, that the Institute's figures have a somewhat broader coverage than do the figures contained in the United Steelworkers'

document since the AISI includes the 25 companies as well as a number of smaller companies. The AISI data do not show a significantly different picture as to trends from the figures compiled by the Union. Thus, the net profits as a percent of sales shown by the two series is as follows:

Profits After Taxes as Percent of Sales Dollar

| Year | AISI | Union Study 22 Companies |
|------|------|-----------------------------|
| 1939 | 5.1 | 5.3 |
| 1947 | 6.1 | 6.2 |
| 1950 | 8.1 | 8.0 |
| 1951 | 5.7 | 5.7 |
| 1952 | 5.0 | 4.9 |
| 1953 | 5.6 | 5.6 |
| 1954 | 6.0 | 6.1 |
| 1955 | 7.8 | 7.9 |

It will be noted that in no year was the difference more than two-tenths of a percent between the two series and it was that wide in only one year (1939). A similar picture is shown when the AISI data for employment costs are compared with the Union's data for 11 companies as shown on page 23.

Employment Costs as Per Cent of Sales Dollar

| Year | AISI | Union Study 11 Companies |
|------|------|-----------------------------|
| 1939 | 39.0 | 40.5 |
| 1947 | 36.7 | 38.8 |
| 1950 | 33.0 | 35.2 |
| 1951 | 32.3 | 34.7 |
| 1952 | 34.9 | 37.8 |
| 1953 | 34.0 | 36.4 |
| 1954 | 36.7 | 38.7 |
| 1955 | 33.5 | 35.5 |

It will be noted that in general, the AISI data show a somewhat smaller percentage of the sales dollar devoted to employment costs than do the Union data. However, the trends shown by the two series are generally the same.

A comparison of the material costs as a percent of sales also shows the same type of picture with the data in the AISI series, showing material costs about $3\frac{1}{2}$ percentage points higher than the data for the 9 steel companies used by the Union in such years as 1939, 1954, and 1955. In the other years, the AISI ratio also was higher than the Union's figure but by a little less than $3\frac{1}{2}$ per cent.

In light of the comparisons shown above, it is clear that the AISI figures can be used to check the experience in the missing years. In addition, the AISI figures give a more comprehensive picture of what happened in the industry and make possible a comparison of the various elements in the sales dollar on a more consistent basis than do the Union's data.

APPENDIX B

What the Authorities Say About Financing Expansion

The following excerpts by leading authorities show that they consider internal financing of expansion to be of considerable importance and a perfectly proper and conventional method to be used.

H. G. Guthmann and H. E. Dougall

"Many businesses, especially small concerns, find retained earnings the only source of equity funds because of the difficulty or impossibility of selling stock. Even large industrials and railroads have found retained earnings a far more important source than the sale of stock. Only in the public utility field has the reverse been true. In the prosperous expansion period after World War II, 1946-1953, approximately a half of corporate capital structure growth was retained earnings, and a half security financing; of the latter, about two-thirds were bonds and notes, and one-third stocks. Current debt, in the forms of bank loans, accounts payable, income tax liability, and accrued expenses, accounted for about as much growth as security financing." (Italics added.)

Neil H. Jacoby and J. Fred Weston

"Economic theorists have recognized the importance of the availability of internal funds for the volume of business investment . . . the uses of internal funds are crucial for investment regularization, both because *they finance a large proportion of business asset expansion* and because they are under the control of business managements to a considerably larger degree than are external funds."² (Italics added.)

¹ H. G. Guthmann and H. E. Dougall, *Corporate Financial Policy*, Third Edition, Prentice-Hall, Inc., New York, 1955, p. 507.

² Neil H. Jacoby and J. Fred Weston, "Financial Policies for Regularizing Business Investment," in *Regularization of Business Investment*, A Conference of the Universities—National Bureau Committee for Economic Research, Princeton University Press, 1954, pp. 395-396.

Arthur Stone Dewing

"A corporate enterprise may grow large by the construction of new plants, by additions to already existing plants, by bringing into existence subsidiary enterprises to be coordinated—so far as operating control is concerned—with the main business of the corporation. *The capital necessary to meet the cost of a policy of internal growth may come from the continuous reinvestment of surplus earnings.* This is the source of new capital to be relied upon by corporations during the years of youth and adolescence when the rate of return on the invested capital is exceedingly large.³ If the corporation is engaged in an unusually hazardous business, this may be the only available source of new capital. The inherent risks are too great to enlist the aid of new capital."⁴ (Italics added.)

³ "The Carnegie Steel Company, the Ford Motor Company, the Atlantic and Pacific Tea Company—in fact, all the chain store corporations during the periods of their early growth—conform to this pattern. On the other hand, it is doubtful if there is a single instance of internal growth to any considerable size by the reinvestment of surplus earnings alone. In the vast majority of cases this source of new capital is supplemented at irregular intervals by at least some investment of capital from the outside. Although most of the capital used by F. W. Woolworth for the expansion of his chain of stores came from earnings, numerous instances are on record in which he took in, as partners, men who brought to the chain of expanding stores new stores which they had developed. An understanding of these subordinate sources does not minimize the paramount importance of earnings as a source of new capital; they show how improbable it is for a large business to develop out of mere earnings alone.

"As the corporation grows larger by the liberal and constant investment of surplus earnings, an increasing proportion of capital is brought in from outside the corporation. Sometimes (as with the Boston Edison Company) it is capital continually subscribed by the stockholders, sometimes (as with the Southern California Edison Company) it is capital obtained by the constant emission of new bonds; and sometimes (as with the American Telephone and Telegraph Company) it is through many expedients, all designed, and designed with skill, to encourage new investment from old stockholders, from employees, and from the public. As new capital from the reinvestment of earnings is the chief means for the expansion of corporations during the period of their youth, before their securities have acquired an investment standing, so the investment of new capital derived from the sale of stocks and bonds belongs especially to the period of maturity of a corporation, when its securities have attained a high standing among investors."

⁴ Arthur Stone Dewing, *Financial Policy of Corporations*, Fifth Edition, Vol. II, Ronald Press, New York, 1953, pp. 852-853.

Financial Handbook

"Factors Determining Need of Financing.—*The need of financing in expansion depends upon the amount of cash derived from depreciation, retained earnings, and surplus working capital, in relation to the new capital required.* Where public financing is practical, or combinations can be effected by exchange of stock, there is added incentive to expand aggressively as opportunity offers.

"In the railroad, public utility, and other heavy industries, where a heavy plant investment is required and the rate of earnings on capital investment is relatively low, expansion almost always results in financing. In the manufacture of aluminum a large supply of cheap electrical power is needed, so that a heavy investment in hydro-electric properties has been necessary. *The Aluminum Co. of America has never paid large dividends on its common stock, using earnings for expansion. Additional capital has been obtained through the sale of its preferred stock and bonds.*"¹ (Italics added.)

Joel Dean

"A company, in addition to exploring and measuring its demand for capital funds, must face the problems of determining where the money will come from. Two sources, internal and external, may be distinguished. A company's chief internal sources of supply of funds for capital expenditures are depreciation and retained net profits. To distinguish between these two in the apportionment of internal investment is illusory. The chief managerial problems in respect to internal sources are forecasting the amount of cash that will be generated, and deciding how much of earnings to pay out in dividends and how much to plow back in capital expenditures. . . .

"Retained earnings are a major source of capital funds. Plow-back policy is affected by many considerations, such as opportunities for investment inside the company as opposed to opportunities out-

side, regularity of stockholders' income, reserves for contingencies and growth, and the effect of plowing back on cost of capital from outside. . . ."²

Joseph Howard Bonneville and Lloyd Ellis Dewey

"Many businesses prefer to grow gradually and normally from the inside; such growth is effected by continually reinvesting in the business considerable portions of its earnings. This *plowing in* of profits necessarily reduces the possible dividend payments by exactly the amount put back into the business."³

John B. McFerrin

"As here defined, internal funds account for about 75 per cent of the gross volume of funds absorbed by corporations. It seems appropriate at least to raise the question as to whether or not non-financial businesses are becoming self-sustaining and will in time be freed from the guiding influence of the capital market mechanism altogether.

"That they have not yet done so is seen from the fact that some 25 per cent of the gross volume of funds absorbed by corporations during the 1946-1955 period were from external sources. Bank loans and mortgages amount to some \$22 billion, or about 7 per cent of the gross. This is hardly excessive. Numerous smaller corporations can look to these sources alone for external funds."⁴

² Joel Dean, "The Concept and Economic Significance of Regularization of Business Investment," in *Regularization of Business Investment*, op. cit., pp. 46 and 47.

³ Joseph H. Bonneville and Lloyd E. Dewey, *Organizing and Financing Business*, Fifth Edition, Prentice-Hall, Inc., New York, 1952, p. 184.

⁴ John B. McFerrin, "Financing Corporation Expansion During the Postwar Decade," *Georgia Business*, Vol. XVI, No. 4, The Bureau of Business Research, College of Business Administration, The University of Georgia, Athens, Georgia, October 1956, p. 3. See also: Hiram L. Jome, *Corporation Finance*, Henry Holt & Company, New York, 1948, Chapter 14; Floyd F. Bartchett and Clifford M. Hicks, *Corporation Finance*, Harper & Brothers, New York, 1948, pp. 546-550; William H. Husband and James C. Dockeray, *Modern Corporation Finance*, Third Edition, Richard D. Irwin, Inc., Chicago, 1952, Chapter 25; Sergei P. Dobrovolsky, *Corporate Income Retention, 1915-48*, National Bureau of Economic Research, 1951.

¹ Jules I. Bogen, Editor, *Financial Handbook*, Third Edition, Ronald Press, New York, 1948, p. 831.

Mr. KNOWLES. Also, by unanimous consent, the additional tables and charts of Mr. Hitchings will be inserted in the record where they were referred to by him. (Pp. 506-508, 533, 534.)

Senator O'MAHONEY. It is so ordered.

The committee is grateful to the members of the panel for their readiness to appear and to give their views, and for the promptness with which they have engaged in the discussions here today with the members of the committee, and among themselves. I am sure that the record will be helpful to all of us studying this matter.

When the committee adjourns, it will adjourn until tomorrow morning at 10 o'clock, and will meet in this room to discuss private pricing policy and the effects of public policies with six panelists who will participate.

The committee now stands in recess until tomorrow morning at 10 o'clock.

(Thereupon at 1:20 p.m., a recess was taken until Wednesday, December 17, 1958, at 10 a.m.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

WEDNESDAY, DECEMBER 17, 1958

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

The committee met at 10 a.m., pursuant to recess, in room 1301, New House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Bolling, Reuss, and Curtis; Senators Douglas and O'Mahoney.

Also present: John W. Lehman, clerk; and James W. Knowles, economist in charge.

The CHAIRMAN. The committee will please come to order.

This morning we approach the subject of prices from another direction. Yesterday the panel of experts were asked to concern themselves mainly with determining prices and the way in which price changes affect income and the allocation of resources.

Today's panel will be concerned with private pricing policies, their formulation and effects, and our Government policies entering into private pricing decisions.

Today's discussion should lay the groundwork for tomorrow's panel, which will be concerned with the general problem of formulating public policies for economic stability and growth.

As in previous sessions, each participant will be given 5 to 7 minutes for an opening statement and will summarize his views without interruption. The hearing will then continue with an informal discussion in which we want all members of the panel to participate freely along with the members of the committee, commenting upon papers in the Commentaries as well as upon questions posed by members of the committee.

Our first panelist this morning will be Mr. Nat Weinberg, who is the director of the special projects and economic analysis department of the United Auto Workers.

Mr. Weinberg, we are glad to have you and you may proceed in your own way, sir.

STATEMENT OF NAT WEINBERG, DIRECTOR, SPECIAL PROJECTS AND ECONOMIC ANALYSIS, UNITED AUTO WORKERS, AFL-CIO

Mr. WEINBERG. Thank you, Mr. Chairman.

Insofar as the automobile industry is concerned, most of the specific questions raised by the Joint Economic Committee with respect

to private pricing policies have been exhaustively answered in a recent report of the Senate Subcommittee on Antitrust and Monopoly.

Much more significant than any points of agreement or disagreement that might be expressed in relation to that report is the fact that two congressional committees should find it necessary to concern themselves intensively with private pricing policies. This is an illustration of the extent to which the actualities of economic organization and practice today have departed from the model of the classical economists upon which much of our economic thinking still seems to be based.

In the classical model of a pure competitive economy there would be no such thing as a private pricing policy. Each firm's policy, of necessity, would be to charge the price determined by market forces. All of us know, however, that our present-day economy is very different from this model.

The prevalence of administered prices in important sectors of our economy is no longer open to serious question. What remains to be determined is whether we can safely permit private power over prices to be exercised without any safeguards to protect the public interest and, if not, what form the safeguards should take.

The men who wield the power to administer prices have been raised on an oversimplified version of Adam Smith. They sincerely believe that pursuit of their self-interest serves the common interest, and therefore see nothing wrong in proclaiming that "What is good for the XYZ corporation is good for the Nation." Thus, they feel not only free, but actually obligated to set prices at levels that will maximize their profits.

But while accepting Smith's conclusion, these executives overlook the fact that the very existence of their power to administer prices has made Smith's premise obsolete. In his view the harmonization of self-interest with the general welfare was to be achieved through the mechanism of the competitive market, where supply and demand alone would determine price and no individual would have sufficient influence over the total supply to affect the price.

No one would have been more alarmed than Adam Smith over present-day industry's power to administer prices. He was deeply fearful and suspicious of what businessmen would do if they could free themselves from the restraints imposed by the impersonal forces of the market. In one of his most famous passages he noted that—

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.

Today even such meetings are unnecessary. Corporations big enough to dominate whole industries need not consult with competitors in order to apply price policies by which they dictate what consumers shall pay. Neither the market nor any other mechanism intervenes to assure that the prices so set are in harmony with the public interest.

Smith, whose primary concern was the general welfare, would have been the first to deplore such a situation.

Once we accept the fact that administered prices are in large part insulated from ordinary market pressures, it becomes easier to understand why some of the countermeasures applied against inflation have

failed. An outstanding example has been the attempt to control inflation through monetary policy. Such an attempt assumes that the inflationary situation results from an excess of demand over supply. But the experience of 1957-58 proves that administered prices can continue to be inflated in the face of curtailed demand and even a sharp economic recession.

Certainly a tight money policy will reduce demand. In the recent past it has effectively repressed demands of high social priority such as the demand for adequate housing, for vitally needed schools, and hospitals, and other community facilities. It has been an important contributing factor to a slowing down of the economy which has caused serious damage to employment and output, and thus to the strength and prestige of our Nation. Ultimately it has reduced effective demand for nearly everything we produce—but administered prices have continued to rise nevertheless.

A tight-money policy which produces such effects is clearly in conflict with the purposes of the Employment Act. Yet those who would amend the Employment Act to make price stability at least an equal goal with maximum employment, production, and purchasing power apparently expect to reach that goal through monetary policy. To attempt it would merely insure failure to achieve full employment, without any practical effect on the problem of inflation—except that by retarding normal economic growth, a misguided tight-money policy would tend to create conditions leading to future inflationary shortages of needed goods.

Another false approach has been to assert loudly that prices are increased only as a result of wage increases, and to demand even more loudly that new legislation be passed to curb unions. These demands have continued in the face of evidence from the Bureau of Labor Statistics that during the critical period of postwar inflation nonlabor costs—including profits—were running ahead of prices while wages lagged behind. Evidence produced by other participants in this investigation has also exploded the wage-push theory.

Proposals of corporate spokesmen to curb inflation by tying the hands of unions should be examined in the light of the warning given by Adam Smith with respect to legislative proposals emanating from “merchants and master manufacturers.” He said :

The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.

How then should administered price inflation be attacked? Since such inflation stems directly from the private price decisions of a relatively few big corporations our efforts must be directed toward influencing those decisions. Our objective should be to substitute for the restraints formerly imposed by the competitive market place another form of restraint which, like competition, depends for its effectiveness not upon compulsion but simply on the painful consequences of any attempt at resistance.

When I last appeared before the committee I submitted a proposal for public hearings in advance of price increases by certain major cor-

porations, along lines that, I later learned, were similar to a bill introduced years earlier by Senator O'Mahoney. I am glad to learn from this morning's paper that the Senator plans to reintroduce such a bill.

In the face of such a procedure, I submit, corporations tempted to impose unjustifiable price increases on the public would be impelled to a measure of self-restraint.

Such a procedure would also impose similar self-restraint on unions in administered price industries. If union demands were to go beyond a corporation's ability to pay without a price increase, the corporation would be able to take its case before the same public agency by simply filing notice of a proposed price increase. The union would then have the choice of justifying its demands, reducing them to what could be paid without a price increase, or being held responsible for contributing to inflation. In the overwhelming majority of cases, I believe, trade unions would welcome an opportunity to have the economic facts behind a wage dispute placed publicly on record.

The effectiveness of the proposed hearings would be immensely increased if, in addition to the agency charged with conducting the hearing, there were to be created an Office of Consumers' Counsel authorized to intervene on behalf of the consumer interest. Such a Consumers' Counsel would not only have power to insure that all the pertinent facts are brought out, and to examine and cross-examine witnesses, but might also be empowered to initiate a hearing before the price agency where a strong case could be made to justify a price decrease.

Let me emphasize that the proposal contemplates factfinding only. It does not involve price controls. The purpose would be exclusively to put the facts of each case on public view. In short, the pressures of the marketplace, which in the administered price industries have lost their effectiveness, would be replaced by the pressures of an informed public opinion, to which even the largest corporations are sensitive.

While no one can guarantee that these mechanisms would be fully effective in suppressing administered price inflation, the encouragement of self-restraint, which is their purpose, is certainly worth a trial in order to avoid the legislative compulsion that the public will inevitably demand if abuse of private pricing power continues to jeopardize the stability and growth of the economy.

Mr. Chairman, my qualifications, amplifications, and further explanations are all in the footnotes, and I would appreciate it if the entire paper were placed in the record.

The CHAIRMAN. It will be made a part of the record.

(The document referred to follows:)

PRIVATE PRICE POLICY AND THE PUBLIC INTEREST

(Statement submitted by Nat Weinberg, director, special projects and economic analysis department, UAW)

Insofar as the automobile industry is concerned, most of the specific questions raised by the Joint Economic Committee with respect to private pricing policies have been exhaustively answered in a recent report of the Senate Subcommittee on Antitrust and Monopoly.¹

¹ U.S. Senate Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary. "Administered Prices Automobiles," Washington, Nov. 1, 1958.

Much more significant than any points of agreement or disagreement that might be expressed in relation to that report is the fact that two congressional committees should find it necessary to concern themselves intensively with private-pricing policies. This is an illustration of the extent to which the actualities of economic organization and practice today have departed from the model of the classical economists upon which much of our economic thinking still seems to be based.

In the classical model of a purer competitive economy there would be no such thing as a private pricing policy. Each firm's policy, of necessity, would be to charge the price determined by market forces. All of us know, however, that such an economy no longer exists, if it ever did. The prevalence of administered prices in important sectors of our economy is no longer open to serious question. What remains to be determined is whether we can safely permit private power over prices to be exercised without any safeguards to protect the public interest and, if not, what form the safeguards should take.

The case for safeguards does not rest on any judgment that administered prices as such are evil, or that the men who administer them are any worse than the general run of humanity. We can accept administered prices as unavoidable in many areas of the economy, and recognize that without price administration many types of business would be seriously hampered, without relinquishing our insistence that the power to administer prices can be and has been abused, and that appropriate measures must be taken to protect the public.

The men who wield the power to administer prices have been raised on an oversimplified version of Adam Smith. They sincerely believe that pursuit of their self-interest serves the common interest, and therefore see nothing wrong in proclaiming that, "What is good for the XYZ corporation is good for the Nation."² Thus, they feel not only free but actually obligated to set prices at levels that will maximize their profits.³

But while accepting Smith's conclusion, these executives overlook the fact that the very existence of their power to administer prices has made Smith's premise obsolete. In his view the harmonization of self-interest with the general welfare was to be achieved through the mechanism of the competitive market, where supply and demand alone would determine price and no individual would have sufficient influence over the total supply to affect the price.

No one would have been more alarmed than Adam Smith over present-day industry's power to administer prices. He was deeply fearful and suspicious of what businessmen would do if they could free themselves from the restraints imposed by the impersonal forces of the market. In one of his most famous passages he noted that, "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."⁴

Today even such meetings are unnecessary. Corporations big enough to dominate whole industries need not consult with competitors in order to apply price policies by which they dictate what consumers shall pay. Neither the market nor any other mechanism intervenes to assure that the prices so set are in harmony with the public interest.

Smith, whose primary concern was the general welfare, would have been the first to deplore such a situation.⁵

² For a recent expression of this belief, note the following interchange between the then president of General Motors and the chairman of the Senate Subcommittee on Antitrust and Monopoly:

"Senator KEFAUVER. Mr. Curtice, do you regard the growth of your company from about one-third in 1929 or 1930 to over one-half and the decline by the independents from one-fourth to less than 5 percent as a healthy trend in the economy and in the automobile industry?"

* * * * *

"Mr. CURTICE. I regard that as a healthy situation as far as General Motors is concerned: yes.

"Senator KEFAUVER. Not so far as General Motors is concerned, Mr. Curtice. I am talking about the country and the industry generally.

"Mr. CURTICE. I think it is a healthy situation for the country and the industry in general" (from the subcommittee's hearings on administered prices, pt. 6, "Automobiles," 1958, pp. 2502-2503).

³ Maximization may be sought either in the short or the long run. In either case the justification is the same.

⁴ "The Wealth of Nations," book I, ch. X, pt. II.

⁵ Smith wrote, for example:

"The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public. To widen the market and to narrow the competition, is always the interest of the dealers. To widen the market may frequently be agreeable enough to the interest of the public; but to

Once we accept the fact that administered prices are in large part insulated from ordinary market pressures, it becomes easier to understand why some of the countermeasures applied against inflation have failed. An outstanding example has been the attempt to control inflation through monetary policy. Such an attempt assumes that inflation is invariably the result of an excess of demand over supply. But the experience of 1957-58 proves that administered prices can continue to be inflated in the face of economic recession and sharply curtailed demand.

Certainly a tight money policy will reduce demand. In the recent past it has effectively repressed demands of high social priority such as the demand for adequate housing, for vitally needed schools, and hospitals, and other community facilities. It has been an important contributing factor to a slowing down of the economy which has caused serious damage to employment and output, and thus to the strength and prestige of our Nation. Ultimately it has reduced effective demand for nearly everything we produce—but administered prices have continued to rise nevertheless.⁶

A tight money policy which produces such effects is clearly in conflict with the purposes of the Employment Act. Yet those who would amend the Employment Act to make price stability at least an equal goal with maximum employment, production, and purchasing power apparently expect to reach that goal through monetary policy. To attempt it would merely insure failure to achieve full employment, without any practical effect on the problem of inflation—except that by retarding normal economic growth, a misguided tight money policy would tend to create conditions leading to future inflationary shortages of needed goods.

Another false approach has been to assert loudly that prices are increased only as a result of wage increases, and to demand even more loudly that new legislation be passed to curb unions.⁷ These demands have continued in the face of evidence from the Bureau of Labor Statistics that during the critical period of postwar inflation nonlabor costs (including profits) were running

narrow the competition must always be against it, and can serve only to enable the dealers, by raising their profits above what they naturally would be, to levy, for their own benefit, an absurd tax upon the rest of their fellow citizens" ("The Wealth of Nations," book I, ch. XI, Conclusion).

⁶ Obviously it would be possible, by pushing the tight money policy far enough, to bring about such an economic collapse that even administered prices would fall. Equally obviously, the cure would be far worse than the disease.

⁷ The proposal most in vogue is that unions be brought under the antimonopoly laws. This proposal was cogently analyzed and answered by Prof. Nathan P. Feinsinger in an address at the Michigan State University Industrial Relations Center on Nov. 21, 1957:

"An appeal to Congress to cut down the power of unions is really an appeal for Government intervention in the bargaining process, for some form of wage control and corresponding limitation on the right to strike. If the power of unions to bargain for and to strike over wage increases is to be reduced by Congress, various questions immediately present themselves. What form should the legislation take? Is it intended that Congress, in order to 'prevent a single union from dominating and dictating the wage terms in an industry,' should limit any particular union in an industry to bargaining with a single company, so that if union A should bargain only with company X, some other union, if any, let us say B, must bargain with company Y, and so on? This would mean, to begin with, that employees would lose their freedom to select unions of their choice to represent them. Again, unless union B were to be compelled to adopt the wage package negotiated by union A and company X, union B would be free, according to the usual competition between unions, to seek a better deal. If union B succeeded, the result would be different wage levels within the same industry, a departure, in the main, from the practices followed in the mass production industries even before the advent of unions.

"Other questions may properly be asked. How much power is too much power? Where is the line to be drawn and who is to draw it in a particular case? Unless management is to be given unilateral control over wages, which no one has suggested, what is to happen after the unions have been 'cut down to size'? Who is then to determine, and by what standard, what amount of wage increase is too much or just enough? Suppose that an atomized union still has sufficient striking power to demand and obtain an 'inflationary' wage increase? What then? In those instances where the power of management to resist is greater than the union's power to strike, is management, too, to be 'cut down to size'? In a period of deflation, is management to be told that its proposed increase is too little? Is the growth of associational bargaining among employers to be reversed?

"The issue is not whether it is 'the responsibility of business to contain the demands of labor.' The issue is who is to assume the responsibility, and by what method, to appraise the justness of a wage proposal in the interest of all concerned, labor, management, and the public. In my opinion, the responsibility in peacetime is and should remain that of labor and management and the method is and should remain that of collective bargaining. If management be convinced in any given case that a particular wage demand would push up prices and is therefore inflationary, it ought to say so, and take a strike. If it be argued that strikes also are harmful to the economy, then the answer is for Congress to prohibit strikes. That means, of course, compulsory arbitration of contract making disputes and wage and price controls, practices which are abhorrent in a free-enterprise economy operating in a democracy. But we cannot eat our cake and have it, too."

ahead of prices while wages lagged behind. Evidence produced by other participants in this investigation has also exploded the wage-push theory.⁸

Proposals of corporate spokesmen to curb inflation by tying the hands of unions should be examined in the light of the warning given by Adam Smith with respect to legislative proposals emanating from "merchants and master manufacturers." He said:

"The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it."⁹

How, then, should administered price inflation be attacked? Since such inflation stems directly from the private price decisions of a relatively few big corporations¹⁰ our efforts must be directed toward influencing those decisions. Our objective should be to substitute for the restraints formerly imposed by the competitive marketplace another form of restraint which, like competition, depends for its effectiveness not upon compulsion but simply on the painful consequences of any attempt at resistance.

In the course of an earlier hearing before this committee I proposed that any company which controls a substantial proportion, say more than 20 percent, of the sales in its industry be required to give advance notice and public justification of price increases it proposes to put into effect.¹¹ It would be required to produce the pertinent economic facts in public hearings before a governmental agency having power to demand all the relevant data, to hear opposing contentions, and after the hearings to publish the facts as it had determined them. In the face of such a procedure, I submit, corporations tempted to impose unjustifiable price increases on the public would be impelled to a measure of self-restraint.

Such a procedure would also impose similar self-restraint on unions in administered price industries. If union demands were to go beyond a corporation's ability to pay without a price increase, the corporation would be able to take its case before the same public agency by simply filing notice of a proposed price increase. The union would then have the choice of justifying its demands,¹² reducing them to what could be paid without a price increase, or being held responsible for contributing to inflation. In the overwhelming majority of cases, I believe, trade unions would welcome an opportunity to have the economic facts behind a wage dispute placed publicly on record.¹³

The effectiveness of the proposed hearings would be immensely increased if, in addition to the agency charged with conducting the hearing, there were to be created an Office of Consumers' Counsel authorized to intervene on behalf of the

⁸ Such a practical businessman as C. E. Wilson, of General Motors, discarded it long since. In *Reader's Digest* for September 1952 he wrote: "I contend that we should not say 'the wage-price spiral.' We should say the 'price-wage spiral.' For it is not primarily wages that *push* up prices. It is primarily prices that *pull* up wages" (emphasis in original).

⁹ "The Wealth of Nations," book I, ch. XI, Conclusion.

¹⁰ "Big" is used here in a relative sense based upon the industry involved.

¹¹ I first presented this proposal, in highly tentative fashion, on Jan. 31, 1957. It grew out of discussions with my colleagues in the UAW. Subsequently we discovered that Senator O'Mahoney had introduced a bill embodying a somewhat similar proposal as early as 1948. While I was embarrassed at my failure to give him proper credit for the idea when I first presented it, it was encouraging to learn that his intensive study of administered prices had led to a conclusion similar to ours. Public discussion of this proposal and of the administered price problem generally over the past 2 years has not, to my knowledge, either produced any better suggestion to meet the problem or revealed any serious defect in the proposal. I therefore urge it with more confidence now than when I last appeared before this committee.

¹² There are many circumstances under which wage increases are justified even though they may necessitate price increases. This is certainly true where existing wage levels are substandard. It is equally true where, due to the slow pace of technological advance in a given industry, its workers cannot be given their fair share of the fruits of the Nation's progress in productivity without raising prices. We would expect the resulting price increases, however, to be balanced by price reductions in industries where profits are inordinately high or technological advance faster than average. Such disparate price movements are to be expected in a dynamic economy and are perfectly consistent with stability of the general level of prices.

¹³ Unions in the public utilities field are often unjustly blamed by the public for rate increases granted by the regulatory agencies. Such unions would probably find it helpful if hearings before the regulatory bodies afforded them an opportunity to develop for the information of the public the justification for their wage gains.

consumer interest.¹⁴ Such a Consumers' Counsel would not only have power to insure that all the pertinent facts are brought out, and to examine and cross-examine witnesses, but might also be empowered to initiate a demand for a hearing where a prima facie case could be made to justify a price decrease. Here again, if a firm had abused great economic power to maintain artificially high prices, it is probable that in many cases action to initiate a hearing would be sufficient to induce remedial action.

Let me emphasize that the proposal contemplates factfinding only. It does not involve price controls. The purpose would be exclusively to put the facts of each case on public view. In short, the pressures of the market place, which in the administered price industries have lost their effectiveness, would be replaced by the pressures of an informed public opinion, to which even the largest corporations are sensitive.

While no one can guarantee that these mechanisms would be fully effective in suppressing administered price inflation, the encouragement of self-restraint, which is their purpose, is certainly worth a trial in order to avoid the legislative compulsion that the public will inevitably demand if abuse of private pricing power continues to jeopardize the stability and growth of the economy.

The CHAIRMAN. Next we have Mr. Morris Livingston, consulting economist, Chicago, Ill.

We should be very glad to hear from you in your own way, Mr. Livingston.

STATEMENT OF S. MORRIS LIVINGSTON, CONSULTING ECONOMIST, CHICAGO, ILL.

Mr. LIVINGSTON. Mr. Chairman, my prepared comments were in two sections. The first used information about a particular market to illustrate the need for caution in drawing conclusions about the effectiveness of competition in American industry. The second urged a better understanding of the limitations of published prices and price indexes, particularly when these are used as measures of competitive behavior.

The various ideas as to what managements ought to do about prices presuppose that they can and should have any policy other than that of maximizing some combination of current profits and longer-term profit opportunities, within the limits imposed by actual or potential competition. One might infer from some of the papers presented by panelists before this committee last spring that our competitive market system is not working very well, and that we must rely on the industrial statesmanship of corporate managements.

Several influences have contributed to the widespread belief that markets are much less competitive than is frequently the case. One of these is the application of the textbook concept of an oligopoly without adequate knowledge or appreciation of all the ways in which actual market structure differs from the textbook concept.

Another is the use of such economic jargon as "monopolistic competition." Even the trained economist may at times forget that markets can depart from the textbook concept of "pure" or "perfect" competition and yet be workably or effectively competitive. Those not familiar with the precise meanings economists have given to such terms are understandably confused and misled.

¹⁴The creation of an independent Office of Consumers' Counsel has been urged repeatedly over the last 20 years. The proposal generally envisions that the Consumers' Counsel would be empowered to become a party in all proceedings before all Federal regulatory agencies whose activities affect consumer interests. Thus, intervention in the price hearings proposed above would be one of many activities to be carried on by such an office.

Another is the lack of data measuring actual transaction prices, and the uncritical acceptance of published price quotations as though they measured realized prices. The realized prices are likely to change much more frequently, and fluctuate over a wider range than the published prices.

Furthermore, managements' explanations of price policies are frequently misleading or subject to misinterpretation. As Professor Bailey put it, "they talk like oligopolists while they price like competitors."

But perhaps the basic difficulty is that economists rarely have either the time or the resources to acquire an adequate knowledge of the structure of particular markets, and all of the aspects of competitive behavior in those markets. I attempted to illustrate this point by providing a more adequate description of one segment of one market, the tank-wagon sales of gasoline to retailers. Because of the prescribed limitation on the length of the paper, however, I could do no more than mention some of the more important features.

In contrast with the textbook concept of an oligopoly, as a market dominated by a handful of sellers, the four largest refiners account for only 32 percent of the output. It takes 20 firms to account for 84 percent of the total. While these firms are superficially similar, there are also marked differences which have an important bearing on their competitive behavior. Their interests in particular markets are frequently conflicting.

Furthermore, their conduct is greatly influenced by the need to meet the competition of roughly 140 smaller refiners who supply the other 16 percent. The characteristics of these smaller firms are such that, in general, they can be expected to act as sellers and are presumed to act in fully competitive markets. Hence their competitive influence is much greater than their share of total gasoline sales.

Even more so than in most industries, the individual refiner finds it disadvantageous to curtail its output to preserve the general price level. For both large and small firms the high fixed costs of refineries and the low cost of the incremental barrel of output are strong inducements to operate refineries near capacity even if the output must be sold at far below total cost. This is the major influence toward effective competition. Industry spokesmen may talk about the need to curtail output in order to avoid ruinously low prices, but in actual practice each firm finds it advantageous to ignore this talk.

The effectiveness of this competitive pressure on prices is enhanced because no one firm, or small group of refiners, controls enough of the capacity so that a moderate curtailment of its output can have much effect on the price level. The smaller refiners could and would increase their output to make up the difference.

Another important characteristic of gasoline markets is that a substantial part of the output of both large and small refiners is sold through private brand, cut-price marketers. These marketers buy their gasoline in the highly competitive bulk or primary markets. If primary market prices decline, they tend to pass on the saving in terms of lower retail prices in order to enhance their volume, and vice versa. The refiner brands must meet this competition and hence their tank wagon prices also reflect changes in supply and demand conditions rather promptly.

I used the published tank wagon prices for the leading refiner brands in 55 cities over a 7-year period to show that these prices change frequently, even in response to comparatively minor changes in supply and demand conditions. In this instance the published data come reasonably close to measuring actual price realizations. These fluctuations are not what would occur if the large refiners had any significant control over tank wagon prices. On the contrary, they support the conclusion reached from the analysis of market structure that this market is highly competitive.

The second section of my paper illustrates the dangers of relying on published price data without a thorough understanding of the limitations and possible inadequacies of those data. For this purpose I used a detailed description of the reported primary market prices for gasoline. The specific difficulties encountered here are not the same as would be found in other areas. The net result, however, is that the data are misleading for the purposes to which they are frequently put.

The CHAIRMAN. Thank you very much, sir.

We have as our next witness Mr. William W. Tongue, economist, Jewel Tea Co., Inc., Melrose Park, Ill.

Mr. Tongue, we are glad to have you, and you may proceed in your own way.

STATEMENT OF WILLIAM W. TONGUE, ECONOMIST, JEWEL TEA CO., INC., MELROSE PARK, ILL.

Mr. TONGUE. Thank you, Mr. Chairman.

As Mr. Weinberg implied if we operated in a world of perfect competition there would be no conflict among the objectives of maintaining steady growth, full employment and a stable price level.

A monetary policy aimed at a continuing increase in the money supply at an appropriate rate would be sufficient. No producer would be in a position to affect the general price level by his actions. He would be so small, and his actions in pricing the products he sells or the labor he hires would have so negligible an effect on the corresponding prices charged or paid by others, that he would be effectively straitjacketed by general market conditions. He would be faced with a loss of sales if he raised his price and he would go out of business if he tried to pay more than the going wage. There would be no point in a labor union calling a strike, since under perfect competition it could not control a sufficiently large share of the labor supply to enforce its demands.

For the purpose of this inquiry, the important question is whether there are any areas in the economy that depart so much from the atomized conditions of perfect competition, areas where producers do have so large an influence on the prices charged by others for their products, or paid by others for their raw materials, labor, or other factors of production, that they destroy the workability of actual competition. The investigations of this committee have suggested that this may be the case in a few industries, labeled the "pace-setting industries" by Representative Reuss.

PATTERN-SPREADING THE PROBLEM

The question narrows down to a factual one of determining whether these industries, when they change prices, induce other industries to change their prices in the same direction and to the same degree. For if this is the case, a change in the price of automobiles or steel, for example, becomes the cause of a change in the general level of prices rather than a change in prices of steel and automobiles alone relative to prices of other commodities. In a sense, from the standpoint of the general price level, "administered" prices are dangerous to the extent that producers, in "administering" price changes in their own industry, are also "administering" similar price changes in all other industries at the same time, or with some slight lag.

I confess that after stating the problem in this fashion, I simply lack the factual knowledge to know whether this is the case or whether producers act on the assumption that others will follow product price changes initiated by them. I would suspect, however, that they do not act in this fashion as a general rule when cost and other conditions do not change. I can see that a price change by one steel producer, for example, might spread to other steel producers, but that it would spread to other industries, or that steel producers would act on the assumption that it would spread to other industries, seems very doubtful to me—again, with the qualification that cost or other conditions do not change. The spread to other producers of price changes initiated ad hoc in the automobile industry seems to me even less likely.

Supporting my doubts on this score is the fact that prior to World War II the United States did not suffer from a general upward creep of the price level such as we have experienced postwar. I see no evidence that there has been a sufficient increase in the degree of monopoly power in industry since before World War II to account for this difference in the behavior of the price level.

I have qualified the conclusion that price changes in the pattern-setting industries are not apt to spread, limiting it to price changes initiated solely by producers, unaccompanied by changes in cost or other conditions. For I think there is some evidence that producers in the pattern-setting industries do act as though a change in wage rates, for example, will establish a pattern and shortly spread to other industries. Under such circumstances they may feel more free to raise prices because they know that costs for other producers will also be raised and these other producers will likely raise their prices, too. Such a general increase in wage costs not only pushes up prices, but since wages and salaries represent some 70 percent of personal income, it provides the increased purchasing power to pay the higher prices, thereby exerting a demand pull.

Thus, the spread of a wage pattern set in the pace-setting industries appears to be the heart of the wage-price spiral.

WHO IS THE CULPRIT?

It is argued by some that labor is not responsible for this upward ratcheting of the wage-price level because wage rates have actually lagged slightly behind the change in the price level since a certain date. For example, real wages rose only by 35.2 percent from 1947

to 1957 compared with 37 percent for real product per man-hour. Actually, other figures compiled for this committee's staff show the opposite; for example, employee compensation per dollar of real product in the nonfarm private sector has increased by 33 percent between 1947 and 1957 compared with corresponding increases of 29.9 percent for nonlabor payments per dollar of real product and 31.6 percent for prices in the nonfarm section. But the differences are not great in any case, with the balance falling slightly one way or the other depending on the particular series or dates selected.

The really striking fact about these figures is that they are so close together, suggesting that the share of labor in the real national product has not changed significantly; and other statistics could be cited to show that this has been true for longer periods—for example, since 1919 in manufacturing. I believe this is what one would expect on theoretical grounds, also.

We can only prosper in real terms to the extent that productivity increases. An attempt by any large group to increase its share much more rapidly than this can only result in a rise in the price level; its share of the total pie will not change significantly. As the late Lord Keynes, the father of modern economics, stated in "The General Theory" some 22 years ago:

And the long-run stability or instability of prices will depend on the strength of the upward trend of the wage unit (or, more precisely of the cost-unit) compared with the rate of increase in the efficiency of the production system.

In theory, any element in the production process can initiate a price change and it will be unstabilizing to the general price level to the extent that it is followed by others. But I submit that prior to the advent of the large industrial unions in the pattern-setting industries, this problem did not arise. Today, these large industrywide unions are the only element in the production process powerful enough to impose price—or wage—changes which spread from industry to industry. To the extent that these become general, they do not benefit labor, but only raise the general price level.

Let us stop the witch hunt for culprits and agree on certain fundamentals. I submit that unless wage increases in general, and in the pattern-setting industries in particular, are held to the rate of growth in productivity, it will be impossible to stabilize the price level. On the other hand, if wage increases in general, and in the pattern-setting industries in particular, do not rise faster than general productivity, the general price level cannot have a sustained upward trend. Both propositions are consistent with Lord Keynes' appraisal cited above.

This brings us squarely up against the question of just how we should go about controlling the pattern-setting industries so that their actions will not have an unstabilizing effect on the general price level, leaving it to monetary and fiscal policy to control the general price level for the rest of the economy. This, in turn, narrows down to determining how to prevent wage settlements in the pattern-setting industries which exceed the growth of productivity. This is the nub of the policy question.

SELECTIVE PRICE CONTROLS OR NOTIFICATION BOARDS ARE NOT THE ANSWER

It has been suggested by some that control of prices in the pattern-setting industries—or requiring notification to some board before a

price increase can be made effective—would be sufficient to break up the wage-price spiral. I submit that such selective price control, leaving wages free to rise, would not be effective in holding down the general price level. For example, the price of steel might be held down, but if steel wages should rise substantially more than the increase in productivity in the economy generally, this would set a pattern which would spread to other industries. Not only would this push up costs, but general buying power would also rise, creating an upward pull on prices. The general rise in wages would result in a general rise in prices, except for steel. The general price level would thus not be controlled by this selective price control, but the price of steel would be lower and the prices of other commodities would be higher than would otherwise be the case, with unfortunate results on the allocation of resources, particularly of new investment.

There are other objections to this form of selective price control or prenotification. One is that there are no clear standards for determining what price a public body should recommend or condone in an administered price area. A second is that the difficulties of pattern setting, the tendency of patterns to spread to other industries, would be strengthened rather than weakened by giving price or wage settlements official sanction.

It is possible that the proponents of prenotification boards have in mind that if, for example, the steel industry knows that it must justify any price increase in advance, this will so stiffen their backs in labor contract negotiations that they will refuse to grant wage increases that cannot be paid for out of increased productivity. If the proposal would be successful in doing this, coupled with appropriate monetary-fiscal policies, it would, of course, go far toward halting the inflation spiral in its tracks. However, I doubt that this is what the proponents of prenotification boards have in mind and, in any case, I believe it would be undesirable for the reasons outlined previously.

THE NEED FOR PUBLIC UNDERSTANDING

Now, before we resort to such devices, which can have serious harmful effects, I believe we should first obtain some general agreement on the simple proposition that real wage increases can only come as productivity advances, and roughly in proportion to such advances. To obtain such agreement, we urgently need an educational program, particularly one which would reach union members, and one which would have bipartisan sponsorship. I should judge that the Joint Economic Committee is in an excellent position to conduct such an educational campaign, and I appeal to their sense of public service to do so.

If this is done, I have every confidence that responsible union leadership in the pattern-setting industries will exercise reasonable restraint in their demands in the best interest of their own members. For labor has nothing to gain from a continuous upward creep of the price level and is in a less favorable position than some other groups to protect itself against the loss of purchasing power in accumulated savings and pension rights that accompanies inflation.

Thank you, Mr. Chairman. That concludes my statement.

I have a supplementary table of data here that bears on some of Mr. Wishart's figures cited in his commentary; but I perhaps could pass on those at this time, pending Mr. Wishart's arrival.

The CHAIRMAN. If you would like to insert it in the record you may do so.

Mr. TONGUE. Yes, sir; thank you.

The CHAIRMAN. Without objection it is so ordered.

(The table referred to, "Retail Meat Prices and Retail Margins," is as follows:)

Retail meat prices and retail margins

[In cents]

| | Retail price per pound | | Retail gross margin per pound | |
|-------------------|------------------------|-------------------|-------------------------------|-------------------|
| | Per Wishart | Jewel Food Stores | Per Wishart | Jewel Food Stores |
| 1947 | 58.4 | 51.2 | 8.4 | 7.0 |
| 1948 | 65.6 | 57.9 | 11.6 | 8.4 |
| 1949 | 59.4 | 53.4 | 8.5 | 8.6 |
| 1950 | 62.4 | 55.4 | 10.7 | 8.9 |
| 1951 ¹ | 69.1 | 61.5 | 10.9 | 8.4 |
| 1952 ¹ | 68.0 | 61.1 | 13.9 | 8.2 |
| 1953 | 63.8 | 53.5 | 13.4 | 8.5 |
| 1954 | 64.1 | 51.7 | 14.3 | 8.5 |
| 1955 | 59.4 | 48.2 | 15.4 | 8.0 |
| 1956 | 57.6 | 46.0 | 15.4 | 7.8 |
| 1957 | 64.1 | 48.7 | 17.3 | 8.4 |

¹ Price control.

NOTE.—The Wishart figures are taken from his commentary (pp. 211 and 212 of "Commentaries Submitted by Economists From Labor and Industry Appearing Before the Joint Economic Committee, Congress of the United States, Oct. 31, 1953"). He states that they are derived from Bureau of Labor Statistics, Agricultural Marketing Service, and American Meat Institute data. The Jewel Food Stores figures are taken from the records of Jewel Tea Co., Inc.

The CHAIRMAN. Thank you, Mr. Tongue.

Our next witness is Mr. Martin J. Bailey, professor of economics, University of Chicago.

Mr. Bailey, we will be glad to hear from you.

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

Mr. BAILEY. Mr. Chairman and gentlemen, since the current series of hearings is for the purpose of obtaining an overall appraisal of a variety of views that have been submitted to you, I shall offer the most frank overall appraisal I can make, even at the risk of sounding intemperate.

The great diversity of opinion expressed in the papers and testimony submitted both to the current hearings and to those held in May reflect the almost universal tendency to try to fix blame on some group or other for the existence of the phenomenon of creeping inflation, which supposedly is a new phenomenon in the last few years.

We have, for example, heard labor economists and people sympathizing with them blame large corporations, administered prices, et cetera, et cetera, for the tendency of prices to rise and business groups retorting that labor unions are really the whole cause of the trouble.

Relatively detached and highly trained academic observers sometimes tend to blame both groups and point out that in the leapfrog-

ing process the year-to-year fluctuations in shares of national income would obscure any temporary success of one group or another in the process. Of course, if all groups together are doing it with more or less equal effectiveness this would be true. But if one particular group were initiating and leading the process while the others lagged behind this consistent success would show up in the aggregate statistics on factor earnings.

Since the data do not show anyone to be doing especially well at the expense of others, the results are inconclusive to say the least.

The idea that all groups could just happen to start simultaneously and with the same force to raise prices and wages merits special attention, however, because it is the only such idea that might possibly be reconciled with the facts. In my view it deserves exactly the same consideration as the idea that a man holding firmly to his shoestrings might go floating up into the air, or the idea that a body of water standing dead level might suddenly go rushing uphill. If one consults a natural scientist on such an idea he would assure us that it could in fact happen about once in every 10 billion years or so. He would not advise us to stand around waiting for it to happen.

The time was, however, when natural scientists were not so sure on this kind of idea and when many of them were busily trying to invent perpetual motion machines and other devices involving water running uphill on its own initiative.

Although this stage of theorizing has long been passed in the natural sciences, we are still busily at work in that sort of thing in the realm of economic policy discussion. The current fashion is to try to invent inflation machines which run on their own initiative without the steam of monetary expansion behind them. Of course, just as the sea water thrown up by a wave crashing into the beach may run uphill momentarily before hesitating and then lapsing back, so also it is possible to observe the momentum of an upward price movement continuing upward after the onset of recession.

This occurrence, drawing so much attention in the current recession, is an almost universal characteristic of recessions as far back as we have the data to observe them.

However, those periods in past history in which prices have tended to rise persistently or secularly have been without exception those periods in which the stock of money was rising secularly, either due to gold discoveries, Government creation of money for war or other purposes, or monetary discipline in the banking sector. Neither phenomenon—a secular rise in prices continuing for any substantial length of time or a secular rise in the quantity of money—has ever occurred without the other. That is, the actual machine of inflation has never operated without the steam of monetary expansion behind it.

In connection with all the above, it is pertinent to remark that, in my opinion at least, competition is still a powerful and pervasive force tending to keep in line those with overambitious designs on the division of the national income. Nothing cuts down a monopolist or other would-be local Caesar faster than an alternative supply of the thing that he controls. History is full of examples of attempts to monopolize and is strewn with the bones of their failures.

It is this rather than any good will, sense of responsibility, regulation, or what have you, that is the public's main protection against

exploitation. There is no evidence whatever to support the view that the invisible hand of competition is any less powerful or pervasive today than it was when Adam Smith remarked on it, except the evidence supplied by Mr. Weinberg that everybody knows that it doesn't exist any more.

I have to remark on this point that I used to think that I knew it too, but continued exposure to evidence on the question of what happens in particular industrial markets has convinced me that I did not know it quite as well as I thought I did.

Though pervasive as that hand is, it is still at least as invisible as it was in Smith's day, because hardly anyone will admit that it exists, except those most directly affected by it.

I would conclude from all this that the elegant contraptions of public policy now proposed from various sides to protect us from the dangers that supposedly threaten price stability and full employment are no more suitable for that purpose than they ever were. No new fact or no new danger has been demonstrated, and I doubt any will be for a while in this area. The most suitable subject for attention that I can think of from the public policy standpoint is that public policy should stop doing those things that stifle competition and deter growth. Such contribution as policy can make to price stability and full employment will be found primarily in the realm of sound monetary and budget management.

The CHAIRMAN. Thank you very much, Mr. Bailey.

Our next witness is Mr. Alfred R. Oxenfeldt, professor of economics, Graduate School of Business, Columbia University.

You may proceed in your own way, sir.

STATEMENT OF ALFRED R. OXFENFELDT, PROFESSOR OF MARKETING, GRADUATE SCHOOL OF BUSINESS, COLUMBIA UNIVERSITY

MR. OXFENFELDT. Thank you, Mr. Chairman.

It is difficult to summarize the statements before this committee concerning private pricing policies. For the most part, they talked about somewhat different subjects; even when they did discuss the same point, their frames of reference were so different as to frustrate direct comparison. These difficulties notwithstanding, a highly selective summary is attempted here.

Specifically, this paper presents the main areas of agreement and disagreement about the causes of and prescriptions against persistent inflation and the ratchetlike movement of prices—insofar as they relate to private pricing policies.

I apologize in advance for the violence done to participants' opinions when summarized so briefly. After this inventory is presented, I shall express a few conclusions of my own.

I. PARTICIPANTS' DIAGNOSES

A. AREAS OF GENERAL AGREEMENT

1. There is a downward rigidity of industrial prices during recession, and this condition is a relatively new development. Professor Bailey is a most notable and outspoken exception.

2. Prices advance rather promptly in many industries if increases occur in particular elements of cost—even though average or incremental costs may not have risen.

3. Labor and industry, through their wage demands and price demands have contributed to the persistent inflation, even though they are not necessarily equally responsible and other factors may have done far more to cause inflation.

4. There are pace setting industries from which wage and price changes spread to other parts of the economy.

5. This would seem to negate the other four points: Information available is too scanty and unreliable to support confident generalizations about the way that prices—and wages—are determined.

B. POINTS ON WHICH THERE WAS CONSIDERABLE DISAGREEMENT

1. The inflationary tendency is attributable to excessive demands of labor.

2. Inflation is due to the refusal of businessmen to reduce prices during recession and to inordinate price increases during prosperity.

3. The structure of industry, which generates only mild competitive pressures, explains the high and rising price level.

4. Governmental monetary and spending policies are responsible for the persistent inflation.

II. PARTICIPANTS' PRESCRIPTIONS FOR IMPROVEMENT

A. AREAS OF AGREEMENT

1. We do not know enough now to recommend a remedy for inflation resulting from private pricing policies.

2. Appeals by a public authority for self-restraint on the part of labor and industry cannot prevent inflation.

3. The antitrust laws cannot and should not be used to combat inflationary price increases or wage demands.

4. It would be impossible, and perhaps undesirable, to eliminate all power of labor and industry to influence wages and prices.

B. AREAS OF DISAGREEMENT

1. Criteria exist by which one might determine whether specific price increases are justified and inflationary.

2. It would be desirable to have a Federal authority call upon or require labor and/or industry in pace-setting industries to forgo wage and price demands that would be inflationary.

3. Businessmen and labor leaders should be required to base their wage and price demands on considerations of public welfare, at least in part.

This summary, which is highly sketchy and selective—and may simply represent what I regard to be important rather than what the discussants as a whole would have emphasized—implies several important conclusions. First, much more affirmative agreement was reached under the head of diagnosis than prescription. Second, the main points of agreement—whether regarding diagnosis or prescription—were essentially negative, such as we do not know enough yet to reach a conclusion on this or that point; or, this factor is not the main cause or that measure is not a suitable cure. Third, it is difficult

to escape the conclusion from the papers and discussion presented before this committee that inflation must be combated in some other way than by altering private pricing policies. This conclusion is profoundly important. We must seek relief where it may possibly be obtained.

I should like to turn now to a few personal observations, which I trust are no less frank and forthright than Professor Bailey's.

There is a strong feeling among many, which I share, that certain labor and industrial groups possess inordinate market power and are abusing it. Possibly, these abuses could be eliminated by Congress. However, I doubt that their elimination would end the ratchetlike movement of prices. The underlying tendency of the economy toward gradually rising prices reflects the total structure and "culture" of our economy. Anger and resentment, which underlies many of the attacks on labor unions and industrial leaders, leads some of the participants to seek an end for inflation by punishing a handful of wrongdoers. In my opinion, this view vastly oversimplifies the problem. Several related points bear on this conclusion.

First, no discussant, to my knowledge, said that he would outlaw all situations in which sellers possess any discretionary power over price or labor unions have any power to influence wage rates. Atomistic competition of the textbook variety is virtually nonexistent—as are examples of oversimplified models of monopoly and oligopoly—and is an unattainable goal. Moreover, it is far from clear that purely competitive markets would serve the Nation well if they were fit into the rest of our economic and social structure. That is a rather forthright difference of opinion with Mr. Tongue.

Second, no participants indicated how it would be possible to bring about more prompt and deep price reductions when recession occurs. Mr. Bailey believes this is not the problem, I might mention. Indeed, most of them expressed doubt that downward price flexibility would speed business revival and several thought it might delay revival seriously.

Third, there appears to be general agreement that price changes are desirable and that one must expect most of them to be increases during periods of prosperity. If price reductions are not desirable during recession and price increases are either useful, or at least inevitable, during prosperity, then the ratchetlike movement of prices is either desirable or inevitable.

These points lead directly to a basic question: How much of an evil is the type of mild inflation that has taken place over the last 7 years or so? Although all participants agreed that inflation is harmful on balance, there was no attempt to indicate how great a cost was warranted to eliminate it. We must not lose perspective; our inflation has been mild on the whole and probably has been stimulating to industrial effort, probably increasing the level of total output over the years. We must consider whether we might not resign ourselves to mild inflation and only attempt to erect measures that would protect those individuals who are most injured by it. I am driven to this suggestion because some of the measures that have been suggested to combat inflation may prove more obnoxious than mild inflation.

For example, if the desire to prevent mild inflation led to the adoption of the program recommended, albeit reluctantly, by Mr. Tongue,

I believe we would have chosen the worse of two evils. (Parenthetically, I would observe that Mr. Tongue's view has changed since he wrote his paper, included in the commentaries.) Any program that would limit labor to wage increases corresponding to the average increase in productivity—note that there is no suggestion that all increases in productivity must be reflected in higher wages—or that would limit industry to price increases that could be justified by changes in costs required to alter the product or provide added services—again, no assurance is offered that prices would reflect all cost increases—would change the rationale of our economic system. Also, if successful, this program would freeze the existing price-wage relationship which would have far-reaching and not necessarily desirable repercussions. Even if Mr. Tongue's program were politically feasible, which I doubt, and were administered with vigor and wisdom, it is far from clear that it would prevent inflation. And, most important, the change it would bring about in the form and strength of the incentives and the basis of economic rewards in our economy would be substantial and might well be adverse.

I would want to again inject disagreement with Mr. Tongue who thinks that if there were publicity boards that wage-setting pacesetters of industry would come to be even more widely accepted as pace setters. I think that once they were subjected to this kind of informal control they would lose the status of pattern-setting industries.

The many references to businessmen exercising self-restraint and assuming responsibility for the broad economic effects of their price decisions suggest that there is a tendency to underestimate the enormity of the burden involved. I submit that we lack adequate criteria to guide executives so that they would know what price would serve the public interest under many of the circumstances that arise in business. It is no small matter to make business executives into self-appointed public officials. We have every reason to doubt that many would want the job and would be particularly successful in fulfilling such responsibilities.

Self-restraint in the price- and wage-demand sector generally turns out to mean prices that run parallel to costs—though there is considerable latitude for argument and evasion in the selection of a cost concept—and wages that reflect changes in productivity. To my knowledge, no one has yet undertaken an exhaustive analysis of the implications of an economy that conformed to these basic principles. One might find that, in the end, most of the economy had come to resemble public utilities in their progressiveness and efficiency.

It emphatically is not my suggestion that Government wash its hands of the inflation problem. If it did so, inflation might prove to be far less mild than in recent years. Also, one would certainly want to prevent even mild inflation if it could be done without undue cost. I would venture the opinion that the prevention of price and wage increases will not come from reliance upon public appeals for self-restraint, publicity boards or any other form of conversation. That end will be attained only when the public, through Government action, both decides what the price and wage behavior is desired and is prepared to bear the cost of achieving them. This conclusion is offered both as a prediction of what would be needed to obtain the degree of control over prices and wages that would prove necessary to control inflation and as a recommendation of what would be equi-

table. It is not obvious that the public should be willing to bear the cost.

The CHAIRMAN. Thank you very much, sir.

Mr. Curtis, would you like to proceed at this time?

Representative CURTIS. Yes, Mr. Chairman.

I would like to pick up where Mr. Oxenfeldt was leaving off, and the thought that he expressed, which says that the basic question is how much of an evil is the type of mild inflation that has taken place over the last 7 years and to raise this question which I raised in several panels.

It seems to me we get into problems of what we mean by inflation. I wonder if this so-called mild inflation that you possibly are referring to might not be inflation, as many people look upon it, but possibly a price rise resulting from technological advancement which gives better qualities and new products and services to people. I have tried to illustrate that. I know that the cost of going from St. Louis to Washington by air is going to increase some when they put the jet in, and I will be able to do it in about an hour and a half instead of 3 hours. I don't regard that increased cost as inflation, and yet, as we advance in many, many areas in our society through technological advancements, with improved services and goods and new services and goods, it seems to be reflected in price increases. If that is creeping inflation, so-called, it seems to me that is an entirely different problem than what we tend to think about when we discuss inflation. Would you comment on that, or would anyone else care to?

Mr. OXENFELDT. I would suggest that the methods used to measure changes in cost of living, which I believe most of us have been implicitly referring to, are not likely to be much affected by what you are describing, sir. I think some element of this necessarily creeps in, though I would think it is not enough to account for what we have been referring to here.

Representative CURTIS. If I may, let me argue the point just a bit. One of the greatest increases in the cost of living index is cost of drugs and hospital and medical services. There is no question but that the cost of drugs has increased, because of new technological advancements. We have drugs today, and very costly ones, which can cure things which we did not have cures for before. So the cost of hospitalization to a large degree is a result of some of this expensive and new equipment. It seems to me an analysis would reveal that throughout our price index that we have advanced so rapidly in new products and in improved quality that you are bound to have an increased price to pay for the research and development and everything else that went to bring that about.

Mr. OXENFELDT. I don't want the last word by all means.

Representative CURTIS. No; I would like to have a discussion. I think you are right in essence. Then I tried to figure out whether that is not one of the primary causes for price increases, rather than what most people refer to as inflation.

Mr. OXENFELDT. If I were to try to get to the bottom of this and set a measure on pure inflation, I would deal with products so standard as to be completely free from this problem. If you think of the basic metals and some of the basic foodstuffs you don't bump into this problem to a significant degree, and you do find inflation.

Representative CURTIS. Has that been part of this so-called creeping inflation? Have you excluded the elements I am talking about?

Mr. OXENFELDT. Yes.

Representative CURTIS. You think there would still be increased prices?

Mr. OXENFELDT. The metals, fuels, power, such standard products as we have.

Representative CURTIS. Even with metals there has been a terrific technological advancement. There has been new kinds of steel and aluminum and so forth.

Mr. OXENFELDT. Yes; but I would like to look at the prices of the old kinds of steel.

Representative CURTIS. I just can't get away from the fact that when you put money into research and development that you are going to have to pay for it somewhere in the price of the product sold to the consumer. If you are putting it there, you are going to have a price increase. Does anyone else on the panel want to comment?

Mr. BAILEY. Mr. Curtis, I would be glad to add a comment to that. As a general statement, personally I have to agree that it is quite clear that some quality change—a significant amount of quality change is slipping through the BLS' fingers when they try to measure purchase price changes, and the rise in the index does in fact, as you suggest, consist in part, at least, of changes in quality. Unfortunately, not enough research has been done on this question for us to have much of an idea of how important this element is in the price index. Only some very sketchy research has been done on this. But such as has been done, e.g., the small study on furniture prices by Professor Rees, my colleague at the University of Chicago, suggests that it is indeed possible that the entire rise of the index in peacetime at least, or apart from immediate postwar inflations, could be attributable to quality change and that there has been no general rise in prices except in connection with war. But that is only a very rough statement because we don't really know.

Representative CURTIS. I would like to have all of you comment.

Mr. TONGUE. Shall we go in turn, sir?

Representative CURTIS. Yes.

Mr. TONGUE. I believe there is a great element of truth in what you say. It is almost impossible to allow statistically for such quality changes adequately, much as I know the agencies attempt to do so. However, technological developments do also result in declining prices.

Representative CURTIS. May I stop you there, because you mentioned the point I was going to come to. It may result in declining prices. But wouldn't you agree that is on the assumption you may have increased quantity because that is the way you make up the cost? That is the third element that comes into this picture. We have reached the point in some areas like agricultural products where we cannot pay for it through increased quantities because there are sufficient quantities.

Mr. TONGUE. Yes, sir. I think that is quite true. Advancing technology, increasing output per man-hour, in farming is very well known and is one part of the farm problem today. I would like, if I might, to refer to the table of statistics that I included at the conclusion of my opening statement because Mr. Wishart in his original com-

mentary talked about the very large increase in retail margins in recent years, for meat in particular. I do not know how he arrived at these figures. I am sorry he is not here to explain that. I just want to say that I don't believe them. I cite the experience of one firm, my own, with which I am familiar. There we have had in the last 10 years no change in our gross margin per pound of meat sold despite some 65 percent increase in average wage rates of our meatcutters. The journeyman butcher, for example, today makes \$2.825 an hour, or \$113 a week. The reason that our gross margin has not increased is a simple one of increased efficiency, largely the shift to self-service meat markets, which has made it possible to pass the saving along to customers. It has been done in our case. I cannot believe that the industry as a whole is charging 17 cents a pound, as alleged by Mr. Wishart, when the Jewel Tea Co. is charging 8 cents.

Representative CURTIS. Mr. Livingston.

Mr. LIVINGSTON. I would agree with you that if we could make allowance for improved quality, prices may have gone down rather than up since 1951. I question Professor Bailey's conclusion that this is a matter of not having done enough research. I think basically the measurement is an impossible problem. We know enough about improvements in quality in one line after another to make me reasonably sure that the improvement in quality has been greater than the mild inflation as measured by the "Consumer Price Index."

Representative CURTIS. The reason for the question, I hope, is clear. If that is what it is, applying these traditional remedies, particularly in the monetary field, is certainly not going to help. In fact, if that is what it is, I view with equanimity the increased cost if we are getting increased quality as a result. I do think we have created a real problem for many people on fixed incomes, regardless of why it is there. The older people on fixed incomes may not be able to buy these improved products.

Mr. LIVINGSTON. They won't be able to keep up with the general improvement in the standard of living.

Representative CURTIS. That is right. It is more a question of keeping up with your neighbor, rather than the standard of living. I guess what I am saying is that it is an increased standard of living that we are talking about in the cost increase, or might be. That is the thesis.

Mr. LIVINGSTON. May I offer one qualification. This inability to measure quality changes is not something that happened since World War II. It goes back over history. So when we apparently had a relatively stable price level in earlier periods, we probably were having an actual decline in prices, if you could have included quality.

Representative CURTIS. Did you want to comment?

Mr. WEINBERG. Yes, I did. I think it is correct that the Bureau of Labor Statistics "Consumer Price Index" does not reflect all quality improvements. On the other hand, I think you have to keep in mind that there have been persistent price increases for products that have not significantly improved in quality.

I might say parenthetically that the failure of price increases fully to reflect quality improvements also affects our measures of productivity to the extent that we use price indexes to determine physical

volume of output, and if the product is improved, that to some degree frequently represents improved productivity. As the automobile becomes more complicated, it nevertheless requires fewer man-hours to produce it. To merely divide the number of automobiles produced by the number of man-hours spent in producing them therefore understates productivity change as the autos become more complex products. Similarly, to determine the numerator of the productivity fraction through adjustment of dollar value by a price index that fails to reflect improved quality results in understatement of productivity change.

The main point I want to make is that the quality improvements are frequently accompanied by changes in productivity that should offset the tendency of prices to rise with better quality.

Representative CURTIS. Won't you agree that depends on whether you can market the increased quantity because to pay for it you have to have increased quantity.

Mr. WEINBERG. I agree. Let me take your jetplane example as a case in point. You will be able to travel from St. Louis, I believe you said, to Washington in an hour and a half instead of 3 hours. The jetplanes are going to be larger and because of their greater speed they are going to turn around faster, which means that per pilot-hour you are going to get a lot more passengers carried and per plane-hour you will get a lot more passengers carried. That should offset the tendency for the price to rise as the quality improves.

Similarly, sometimes the very thing that brings about an increase in productivity is the factor that accounts for the improved quality. The automobile engine produced in a modern automated engine plant is considerably improved in quality over the primitive auto engine of 40 or 50 years ago. The tolerances are much finer, and the quality is much more consistent. So that, on the one hand, you get better quality; on the other hand, you get that improved quality through devices that actually reduce the number of man-hours required to produce the product. That should bring about a price reduction.

You mentioned research and development.

Representative CURTIS. I notice my time is up and I will come back to it. When my time is available I would like for you to continue.

Mr. WEINBERG. Does your time limit limit my time to answer?

Representative CURTIS. Yes.

Mr. WEINBERG. I bow to the rules.

Representative CURTIS. I will come back to you when my time is available.

The CHAIRMAN. Thank you. Mr. Bolling.

Representative BOLLING. Go ahead, Mr. Weinberg.

Representative CURTIS. Thank you.

Mr. WEINBERG. I was going to say that your mention of research and development is very pertinent in this connection because a very great proportion of all research and development work conducted by industry is research and development work designed specifically for the purpose of improving productivity. As that materializes in improvements in production techniques, then prices should go down rather than up, although along with it as in the case of the automobile engine, you get an improvement in quality. I think you have to look at both sides of the thing. There have been improvements in the standard of living, both in terms of quantities of goods used

by people and in terms of quality of goods available to them. But at the same time there have been enormous increases in productivity, and our potential for increasing productivity has been tending to rise as the years go on.

Representative BOLLING. This is a very interesting discussion. I wonder if there are any comments on the comments?

Mr. OXENFELDT. I think, if you had not suspected this already, that you will not find many economists and marketing men who would agree that we have had a deflation rather than an inflation over the last several years. I don't think we should now talk about how we can prevent the deflation that has taken place. With due respect to Mr. Curtis and the difficulties of measuring just about anything in the economic field, or anything we are going to talk about this nihilistic view is not going to help us very much today. I think there has been a price rise. I think it can be demonstrated to the satisfaction of most people. I think one of the reasons there has been a price rise is the way we price our goods; also, the way wages are set, the kinds of people we have setting wages and prices, and the kind of consumers we have buying products, may result in persistent inflation. I trust it will be very mild. I am not so sure that it is a very, very serious problem. But I think it is the problem and not deflation.

Representative BOLLING. Any further comments?

Mr. LIVINGSTON. I don't think there is really any difference of opinion here. I think in the opinion of most people we have had an inflation and it may still be true that if you could adjust for quality changes, the price may not have gone up at all. Let me come back to gasoline again as an illustration. The average retail price of major brand regular grade gasoline in 55 cities, excluding tax, has been about 2 percent less in the last 5 months than 5 years ago. But the quality of regular gasoline today, in octane rating for example, is equivalent to that of the premium grade 5 years ago. If the price of the regular grade today is compared with that of the premium grade 5 years ago, the price reduction is not 2 percent but 11 percent.

Something was said here about the possibility of new technology permitting a decline in prices even though the quality is improved. I would like to come back to that illustration of the jetplane. One reason why the jetplane can carry more passengers faster than the propeller type plane is that the jetplane is terrifically more expensive. Somebody has got to pay for that additional capital outlay. You can't just say this is an economy that can get passed along in higher wage rates.

Representative BOLLING. Before we conclude on this, I think we have to point out that there are some areas in which, what I gather you as economists have been talking about as improvements in quality, the consumer would not agree. I would question very much whether the food, although no doubt good and pure that one eats, 6-day meat in a fancy package is as good quality as the 1-day meat that one perhaps got at an older time. This just represents an agrarian view. I am sure it is good and pure.

I also question the point on quality of the gasoline. What does the quality mean? You are looking at gasoline as an item that is pure and has more power but for what purpose? To be completely fair about this, one could raise the question about the quality of the

modern automobile. The modern automobile is designed as was the old one to get people from place to place. Is it quality that makes it possible to go 100 miles an hour with this higher quality gasoline necessarily an improvement in quality? This is, I think, making the silliness of the point clear.

Mr. TONGUE. I would like to speak to your point on meat, if I might, just briefly. Again I cannot cite specific numbers. I don't know whether you had authoritative information when you mentioned 6 days in the meat case.

Representative BOLLING. That was a mistake. I should not have said that. Older than 1 day.

Mr. TONGUE. That would surprise me, sir. But I am not certain about that. There is a very, very strict limitation on codes for the sale of meat, dairy products, etc., which are partly imposed by law, but some operators have stricter codes. I think the point that you make is probably not at all correct, especially as far as health and nutrition are concerned.

Representative BOLLING. You mean to tell me that I get fresher fruit in the store now than I did?

Mr. TONGUE. I would say very definitely fresher fruit today than would have been true even 10 years ago. It would be true also of most dairy products, I would say.

Representative BOLLING. This is why the Congress always has problems on preservatives.

Mr. TONGUE. On preservatives?

Representative BOLLING. Yes. We had a bill up this last session on the question of whether citrus fruit should or should not be allowed to use certain preservatives.

Mr. TONGUE. That is a technical question and I am not competent in that field. Getting back to meat again, you have quality improvement there in the form of much closer trim with self-service meat than used to be true with the service-type operation. You don't sell the head and feet and so on any more. So I think again that bears on Senator Curtis' comments. I think it is true that for food, even though they do try to bring new items into the "Consumers Price Index," the price index overstates the rise in prices since the base period for an equivalent service.

Representative BOLLING. I would persist in thinking that the cauliflower I used to eat in Long Island that just came out of the fields was slightly better quality from my point of view than the cauliflower from any chainstore.

Mr. TONGUE. Very definitely. I used to live on Long Island myself, and I would agree with you 100 percent as to cauliflower just from the fields. The thing is that now we can have cauliflower in Washington and Chicago and Detroit, all the way through the year which we could not have at all before.

Representative BOLLING. This is a question of the definition of quality.

Mr. TONGUE. This is like the jet airplane with respect to cauliflower.

Representative BOLLING. I don't care to pursue it any further.

Mr. BAILEY. Mr. Bolling, if there is time, I would like to comment on this point also.

In the first place, I think we should concede right away that there are some quality changes that are in a downward rather than an up-

ward direction. As quality changes ordinarily popularly are understood, that is. I think on this normal definition of "quality change," the balance is in an upward direction. You raise, however, another question, and that is more of a moral question of whether what we conventionally consider to be a quality change in the upward direction is always really beneficial, as in the case of faster, bigger cars, and so on. Certainly there are many people who believe that the very great rise in real standards of living or material comforts, as we conventionally understand this, has nothing desirable about it. They would argue that we are getting too soft and too civilized. But this is really quite a separate problem from the rather narrow technical economist's problem that we are discussing today in connection with the definition of the price index. Even if a rise in the real standard of living is not really needed, and I think we can make a good case for saying it is not—we don't need it, we can quite well get along without it—it is still true that it is useful to separate changes in prices as a pure concept applied to the very same identical product from 1 year to the next from changes in material standards or qualities of goods. On balance, if we did that I think that we would find that most of the quality change getting into the price index, from a purely technical standpoint, is in such direction as to bias the index upward, although there would be exceptions, of course.

Representative BOLLING. Now, back to the point that was made earlier, if I may intrude on somebody else's time. Aren't there certain commodities that have not changed in quality at all, and aren't the indications that there has been some inflation in their prices or some change in their prices upward? What is the simplest product that you could get?

Mr. TONGUE. A kilowatt of electricity.

Representative BOLLING. Yes; a pound of pig, and so on. I am not talking about the live pig. I am talking about pig iron.

Mr. TONGUE. The pig is not the same pig any more; at least the live one.

Mr. OXENFELDT. There are things that are the same. There is milk and butter.

Representative CURTIS. No.

Mr. OXENFELDT. You can measure milk by the butterfat content and standard of purity. I am sure the BLS would be able to put together for you, they would not for me, a list of 30 or 40 products that go into their index that have not changed over the last 7 years. And if you look into the factors of production used in their production, if anything, they have gone down due to increased productivity.

Representative CURTIS. I would say on milk, vitamin D homogenized, the health standards that have been imposed on the dairy industry, whether good or bad, are certainly added costs. Maybe the milk itself has not changed.

Mr. OXENFELDT. Would you say that these changes have taken place over the last 5 or 7 years?

Representative CURTIS. No. Maybe not the specifics, but there have been changes. I was giving examples of how milk had been changed.

Representative BOLLING. My time is up.

The CHAIRMAN. Mr. Reuss.

Representative REUSS. Mr. Chairman, I was very pleased to hear the labor economist cite approvingly Adam Smith, and the economist

from industry refer to Lord Keynes. Mr. Oxenfeldt, I would like to pursue the point you raised when you said at one point in your prepared statement that inflation must be combated in some other way than by altering private pricing policies, and then at the end of your paper, you made the point that we lack adequate criteria to guide executives in what should be public spirited pricemaking policies. You end up suggesting that only when the public, through Government action, decides what price and wage behavior is desired can there really be a coming to grips with the inflationary problem.

I certainly agree with your end conclusion, that it would be a useful thing to have a public body try to evolve some better criteria than those we now have on what constitutes desirable pricing and wage policies, but does not this point conflict a little with the observation you made earlier that you don't believe it is possible or desirable to alter private price or wage policies? If the result of the public action was to determine that in certain industries and under certain criteria, alterations from the present were in the public interest, wouldn't that constitute a suggestion at least that there be such alteration?

Mr. OXENFELDT. What I was implying, not clearly, was that once we formulate these criteria, we will find that they are incompatible with private ownership of property in the industries so regulated. We will end up with, if you like, a substitution of public prices for private prices.

Representative REUSS. I take it it involves a judgment on your part that the only criteria that would be evolved would be inelastic and unrealistic ones such as you condemned in detail. For example, restricting somewhat woodenly wage increases, to productivity increases, and equally woodenly restricting price increases to cost increases. I would certainly agree with you that those are not by themselves acceptable criteria. Is it your point that they could not be improved upon if the matter were studied?

Mr. OXENFELDT. I would not be able to rule out in advance the possibility that some very bright people would come up with criteria that helped combat inflation, promoted growth, and also were compatible with the reasonable demands you could make on private holders of shares of capital and labor. This is conceivable. My forecast is that this will not come about, and that we are going to have to rely on something else, or put up with the present situation. I am familiar with your bill, the purposes of which I applaud, but the effects of which, as I foresee them, I probably would deplore. I think it indicates that once you begin to control some industry by conversation, as I speak of it—not woodenly—that you wonder, what right do I have to ask this group to forgo what every other group has a right to? Then you feel obliged, if you like—and I think public policy will require you—to compensate them. Once you compensate them, why do it in this indirect way?

Representative REUSS. Of course, it was not suggested in my bill nor by me that in a given situation any governmental body would hand out advice to business or labor which it is not handing out to everybody else. In other words, it seems to me—and this is embodied in my bill—that the first effort must be an attempt to see if there are not criteria that are just and also widely applicable and that serve the inflation preventing purpose. If there are not, it seems to me then there

is nothing to be applied. However, I don't see how you can find out whether there are until a competent governmental body is set up to see whether such criteria are not within the grasp of mortal man. Would you agree with that?

Mr. OXENFELDT. Very strongly.

Representative REUSS. I was about to bring you in at this point, Mr. Weinberg. Let me ask you a question and it may be what you have on the tip of your tongue, anyway.

In your proposal for a price, and indirectly a wage advisory board, which you spell out in some detail, you talk about unjustifiable price increases, and I take it unjustifiable wage increases, too. How can you determine unjustifiability without first addressing yourself to the problem we have just been discussing of seeing whether there are criteria which make sense, without asking of the particular group to whom they are directed sacrifices that are not being asked quite generally?

Mr. WEINBERG. This is exactly the point to which I did want to speak. It seems to me that criteria have to evolve and the way to get the evolutionary process started is to get the facts out where people can start thinking about them, and thinking about their implications. We propose an agency that would be purely a fact-finding agency. Suppose we had a situation where a union had demanded a wage increase and the corporation involved, being one of those subject to the agency, notifies the agency of the proposed price increase based on the union's wage demands. The agency would then take a look at the corporation's profits, take a look at the justifications advanced by the union for its wage demands, measure the impact of those demands, if granted, upon the corporation's profits or upon its prices, and so on. These facts would be published before the price increase could be put into effect. Out of the publication of facts of this kind in one situation after another there would gradually be developed public criteria, accepted by a preponderant group in the population of acceptable conduct on the part of unions and on the part of management. As the standards of conduct evolved, unions and management would know what they would have to face from public opinion if they took a particular course of action.

Representative REUSS. You would favor a development along the lines of the British common law whereby you proceed case to case and, after some years or centuries, you find you have a body of the law, rather than the Napoleonic idea or the Roman law principle of stating everything at the start and then applying that to specific cases.

Mr. WEINBERG. Yes. Except the common law in this case would not be law in the sense of enforcement or penalties. The common law would be a question of moral pressure from the community.

Representative REUSS. Would you object to what I think is a relatively minor change in emphasis in your board along the following lines: That their first terms of reference ought to be an attempt to see, right at the start, whether certain tentative criteria could be evolved, not wholly in the abstract, of course, and with relation to actual industries, but not as specific semijudicial cases.

Mr. WEINBERG. I would let the criteria evolve from the case situations in terms of the contentions of the opposing parties and the findings of fact of the agency with respect to those contentions. For example, you frequently get the situation where a union claims that

a wage increase can be paid without a price increase, and the corporation claims exactly the reverse. This is a measurable proposition.

Representative REUSS. Haven't you just now stated, however, a general criterion, and wouldn't it be a good idea to think that out publicly pretty early in the exercise?

Mr. WEINBERG. I am suggesting that the parties involved in each case, those supporting the price increase and those opposing the price increase, would raise the considerations that they thought were pertinent. Out of discussion of those considerations, as the facts were made public, criteria would develop in the sense of generally accepted standards of conduct, as I said before.

Representative REUSS. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Douglas.

Representative REUSS. We will have a chance to return.

The CHAIRMAN. His time expired. We are operating under the rule of 10 minutes the first go-round.

Senator DOUGLAS. Mr. Chairman, I regret I was not here earlier for the oral presentation of the papers, but I have been reading them, and one or two questions have come into my mind. I would like to ask a question of Mr. Tongue, if I may, based on his statement:

Real wages rose only by 35.2 percent from 1947 to 1957 compared with 37 per real product per man-hour.

Was that based on Mr. Knowles' study for this committee?

Mr. TONGUE. I believe it is. It was brought up to date by one of the labor economists, by Mr. Ruttenberg, on page 240 of the Commentary.

Mr. KNOWLES. They look approximately right, Senator. I have not had a chance to check them.

Senator DOUGLAS. If they are correct, that would indicate that labor cost per unit of output did not rise during this decade.

Mr. TONGUE. No, sir, that is not the case. The 35.2 percent is real wages, with the dollar wage adjusted by the consumer price index, and not by the product price index.

Senator DOUGLAS. Yes. That is per unit of physical product.

Mr. TONGUE. Yes, sir; I believe that is correct.

Senator DOUGLAS. Real wages per unit of physical product did not rise. The next is employee compensation per dollar of real product. What is that unit?

Mr. TONGUE. That is nonfarm output, I believe, again Mr. Knowles' figures. There we are using essentially the share of the product produced.

Senator DOUGLAS. Is the second figure in terms of total value added by manufacturing?

Mr. TONGUE. No. It is a broader concept than that.

Senator DOUGLAS. I wonder if you would define it.

Mr. TONGUE. I believe it is the output of all nonfarm industry.

Senator DOUGLAS. In dollar terms?

Mr. TONGUE. In dollar terms deflated by a price index for all nonfarm output. The wages just take a percentage of that.

Senator DOUGLAS. You mean to say that the percentage which labor received per dollar rose?

Mr. TONGUE. Between those 2 years, apparently so, as can best be measured.

Senator DOUGLAS. Did the nonlabor payments increase, too?

Mr. TONGUE. They advanced slightly less than wages.

Senator DOUGLAS. You say corresponding increases of 29.9 percent for nonlabor payments per dollar of real product you have labor wages going up 33 percent, nonlabor payments going up 30 percent. In dollar terms that would be understandable. But it would hardly be understandable in real product terms.

Mr. TONGUE. I am sorry, sir. That is the rise in dollar terms.

Senator DOUGLAS. It is dollar product and not real product.

Mr. TONGUE. That is right.

Senator DOUGLAS. I think you should correct the paper on that point because you use the term "real product" and what you apparently mean is dollar product.

Mr. TONGUE. I am sorry I have not made it clear. Perhaps Mr. Knowles could explain it better.

Mr. KNOWLES. If I may, Senator, the confusion arises because he has in this calculation, as you do in most of these, two terms. The numerator of this fraction, which is the employee compensation, is the current dollars. The denominator of the ratio is real product. That is, it is output obtained from this labor and other factors of production, deflated to a constant price. So you get a rise in money cost per unit of real output. Therefore, all the unit costs can rise because they are all in current dollars, and the denominator is in real product.

Senator DOUGLAS. The comparison is between the rise of 33 percent and the rise of 31.6 percent.

Mr. TONGUE. That is right.

Senator DOUGLAS. Those are subsequently similar, isn't that true?

Mr. TONGUE. They are substantially?

Senator DOUGLAS. Similar.

Mr. TONGUE. Yes, that is my whole point. There is no use in arguing about this question of shares and about who is lagging behind whom. You can cite statistics either way, but the important point is that the figures are about the same any way you look at it.

Senator DOUGLAS. I wonder if you would turn to your summary statement, under the heading "Who Is the Culprit?" the next to the last paragraph and the last paragraph. Because you use the term "general productivity," are you saying that wages should not in any given industry, such as industry X, rise faster than the rise in the productivity of all industries? We will put it on a man-hour basis or man-year basis or what have you.

Mr. TONGUE. To the extent that we have to do that in the economy it is unfortunate. I believe that as much as possible we should allow price and wage changes in the economy to reflect the particular demand and supply conditions existing in that industry.

Senator DOUGLAS. That raises a very interesting question. Would you say that both prices and wages should be determined by the conditions in specific industries, or both determined by conditions in all industries, which I take it you reject, or that prices be determined by the conditions of demand and supply in respective industries, but wages be determined by the conditions in all industry? That is the inquiry.

Mr. TONGUE. I would stand by my statement that both wages and prices should be freely determined as much as possible, with one qualification. I do believe that in some areas of the economy, some industries as you say, a wage determination in particular, and to some extent a price determination, particularly if they are coincidental, tend to set a pattern for the rest of the economy and the rest of the economy tends to follow that. Then money and fiscal policy go along with it pretty much to maintain full employment. It is the pattern setting and pattern spreading that need to be broken up.

Senator DOUGLAS. Then you want neither a wage determination nor a price determination, is that right? Even with moral suasion?

Mr. TONGUE. Yes, that is right—at least until self-restraint has been given a chance. I would like to clear up a point there. Mr. Oxenfeldt referred to the fact that he disagreed with me on this particular point. I thought we were in agreement. I apologize that I did not make it clear that I do not approve of publicity boards or price-setting boards.

Senator DOUGLAS. Publicity boards on wages either?

Mr. TONGUE. No, sir, I do not. May I be allowed a moment to amplify my feelings on this. First let me say this. Mr. Weinberg advanced what is essentially the public utility concept. Having given my due to John Maynard Keynes, and I must confess it is my own economics, I would also like to pay my respects to Abba Lerner, who contributed to the compendium. He suggested that the way you should set prices in the pattern-setting industries is on the basis of supply. If there is a shortage of supply you raise the price, and if there is an excess supply you reduce it. This is quite different from the criteria suggested by Mr. Weinberg.

My argument is that in such industries as you would select it is their pattern-setting nature which is the problem; the fact that a wage-price change would spread to other industries. If it would not spread, you wouldn't have a general problem.

But I suggest that the really basic problem is that the public just does not know what is good or bad in this area, and I suggest that the reason the public does not know what is good or bad is that the experts have come to no agreement. I believe that this set of hearings is a very good example of that. Therefore, I argue that the really important thing that is needed is an understanding of the question, an understanding of the problem, an agreement as to what can or cannot be done. I would say that perhaps Mr. Reuss is starting off in the right direction with his proposal.

Senator DOUGLAS. Thank you very much. I wonder if I have time enough to address a brief question to Mr. Weinberg?

The CHAIRMAN. You have about 3 minutes, Senator.

Senator DOUGLAS. I notice you favor the public hearing on price. If there had been a previous wage negotiation and agreement, you would have to accept that as a fact. If you were for a prior determination of price, won't you really be compelled logically to be for a prior finding on the wage claim in the industry?

Mr. WEINBERG. I don't see why, Senator. If the corporation is convinced that the union's demands are totally improper and it files a notice with the agency that it will have to raise its price if the de-

mands are granted, the union then is up against the same kind of public restraint that the corporation is up against.

Senator DOUGLAS. But only indirectly. You would have the pressure of public opinion operate directly upon the company, but only indirectly on the labor with the company as a buffer between it and public opinion.

Mr. WEINBERG. I think we have to keep in mind that there is a very great distinction between the way wages are set and the way prices are set. Insofar as prices are concerned, a corporation like General Motors announces the price, and the dealer thereafter has to pay the price or go without the cars. In the case of wages, all the union can do is make a proposal. Thereafter it has to negotiate with the corporation. I can tell you from having sat through negotiations over a period of many years that it is not at all an easy process, even for a union that is supposed to hold as much power as our union is supposed to hold.

Senator DOUGLAS. I realize that. I wonder if you do not lay yourself open to the charge of inconsistency when you advocate hearings on prices but with wages excepted as an item in cost when the decision is over and done with, but don't accept hearings on wages and prices for a given industry.

Mr. WEINBERG. Our basic purpose is to bring information to the public and to bring the pressure of public opinion to bear on both sides.

Senator DOUGLAS. On both?

Mr. WEINBERG. Both sides.

Senator DOUGLAS. Then why not prior hearings on wages and prices in a given industry?

Mr. WEINBERG. Our objective in advocating this procedure is to impose what we consider to be the best kind of restraint, self-restraint on both sides. We hope that if such a mechanism were established a corporation would not announce a proposed price increase unless it were sure that it could justify that proposed price increase. In the same way a union would have to frame its demands knowing that if the corporation announced a price increase based on those demands, it would have to defend those demands before the same agency.

Senator DOUGLAS. You don't think it should have to defend its wage demands before the same agency?

Mr. WEINBERG. I have indicated that it might have to defend its demands before the agency. But the process of setting wages and prices is entirely different. We do give 60 days notice now under the Taft-Hartley Act before a wage increase can become effective, and we are thinking of a similar period with respect to corporations.

May I take just a moment on another matter since I was injected into this conversation by Mr. Tongue. He mentioned the public utility analogy. It is very pertinent to read a portion of the Anti-trust and Monopoly Subcommittee report on administered prices in the automobile industry:

The method employed by General Motors for setting its automobile prices is basically that of a public utility. Unit costs are projected on the basis of forecast volume by an elaborate statistical procedure; these become the instrument for the fixing of prices.

But a distinction should be noted. The public utility is a regulated monopoly; its cost formulations and pricing practices are subject to governmental supervision for the protection of the public. General Motors possesses much of the

economic power of a public utility but is free from governmental oversight. The utility is limited in its pricing policy to the recovery of its costs and a fair return on its capital. General Motors is free to secure the maximum attainable return.

Then the report proceeds to quote a statement from Mr. Donaldson Brown, who formulated General Motors' pricing policy, indicating that the project objective is the maximum attainable.

The CHAIRMAN. You may elaborate on your testimony and insert that if you desire. Senator O'Mahoney.

Senator O'MAHONEY. Mr. Chairman, I regret that I was unable to be present at the beginning of the session this morning so that I, like Senator Douglas, have not had the advantage of listening to the presentation of the various papers. There is, however, a basic question which I should like to address to all the panelists. It seems to me from what I have heard since I came into the hearing room and what I have been able to read from the papers that have been presented here, there is a general agreement that private pricing has an effect upon the prices that the public must pay. Am I right in that?

Mr. TONGUE. I disagree with that, sir.

Senator O'MAHONEY. Am I right? Those who think I am right, please raise their hands. [Two hands raised.]

The extremes are in agreement.

Mr. TONGUE. I think we are not quite sure exactly what you have in mind.

Senator O'MAHONEY. Judge what I say by what you have in mind, Mr. Tongue. My question is, Is there a general agreement that private pricing has an effect on the prices that the public must pay? The two gentlemen on the ends, Mr. Weinberg and Mr. Oxenfeldt, say yes. What do you say, Mr. Tongue?

Mr. TONGUE. I believe that there is not much that an individual business can do by and large. It is fairly effectively constrained by the general market condition in which it operates. For example, I already indicated that in retail meat pricing the advantages of extremely rapid increase in productivity in retailing of meat has been passed on to customers and to labor. However, my point is that in certain industries when price adjustments or wage adjustments are made, they do become a pattern for the rest of industry to follow.

Senator O'MAHONEY. I have no disagreement with that.

Mr. TONGUE. That is the nub of the difficulty. If, for example, wage increases in such industries exceed the growth in general productivity, with the qualification that general productivity is very difficult to define precisely—

Senator O'MAHONEY. What I am trying to do is to probe the area of agreement. I have no objection to your statement that an individual businessman or an individual corporation cannot exert very much influence on the whole price pattern.

Let me ask this question: Is it agreed among all of the panelists that where we have a condition which is frequently referred to by panelists as oligopoly, that in such cases the few corporations which carry on a large proportion of a particular industry can affect the price policy? I see two yeses.

Mr. LIVINGSTON. No, I want to disagree.

Mr. WEINBERG. I was agreeing.

Mr. BAILEY. I agree they can if they are willing to let themselves go out of business. But the actual influence, if they want to take a long-term position into account, that they have over the price is much smaller than one would imagine.

Mr. WEINBERG. I hope Mr. Bailey will take into account the fact that General Motors is not out of business.

Mr. BAILEY. One of the reasons they are not is that they price competitively, and what the market will bear in spite of what their projections may say. The last thing they do before they set the price is to go around to the dealers and find out what they can sell the cars at.

Senator O'MAHONEY. I am trying to get away from a confusion making detailed discussion. I am trying to get down to a simple pattern. Let me read from the opening statement by Mr. Livingston on page 2 of the closing paragraph:

In contrast with the textbook concept of an oligopoly, as a market dominated by a handful of sellers, the four largest refiners—oil refiners—account for only 32 percent of the output. It takes 20 firms to account for 84 percent of the total.

When one stops to consider for a moment that there are at least 134 or maybe 140 or 150 refiners in the United States, 20 firms are a very small proportion, and according to Mr. Livingston's testimony, 20 would control 84 percent of the total. In such a situation, assuming that there were one, is there any disagreement that such 20 firms could control and sometimes do control the prices?

Mr. LIVINGSTON. Yes, I disagree.

Senator O'MAHONEY. You disagree?

Mr. LIVINGSTON. Yes.

Mr. OXENFELDT. Would you mind changing the word "control." If you shifted the word "control" to "influence."

Senator O'MAHONEY. I should not use the word "control"; set a pattern, "influence" is really what I have in mind.

Mr. OXENFELDT. I think Mr. Bailey would have to go along with that, that it would have some influence. If he were hired as a price consultant with one of these companies, which might happen, he would be able to come in and influence what they did about price.

Senator O'MAHONEY. Let me give the panel an illustration of what is going on right now in the Government. Several years ago when the Reciprocal Trade Agreements Act was extended, a demand arose among oil producers in the United States for special legislation to prevent imported oil from decreasing the price of domestically produced oil and from probably driving domestic producers of oil out of business and thereby exposing the Government to the danger of a lack of supply of oil in the event that there should be a war. What was done was to give the President power to devise a voluntary restraint upon the importation of crude oil.

A plan was devised and put into effect. Capt. M. P. Parson of the Navy was transferred to the Department of Interior and made the head of the Oil and Gas Section of the Department of Interior and the administrator of the voluntary program. The domestic refiners in the United States who are not importers had no objections to this plan at that time.

There has been a great deal of disagreement, however, because the import restriction plan was defective in that it placed no quotas of any kind, no restraint of any kind, upon the importation of partially fin-

ished, partially refined oil products. So the complaint arose in many parts of the country, particularly in coal-producing States, that diesel fuel in an unfinished form was being brought in by the importers from their foreign refineries and placed in competition with coal in this country. There was some complaint that unfinished gasoline was being brought in. In other words, that the restraints upon the importation of crude oil were not sufficient. So it was decided by the President's Cabinet Committee to devise a new plan.

The Committee has been working on this matter for weeks, and as of yesterday I had not been informed that agreement had been reached. But this I do know: that the small refiners who are not importers are objecting to a plan which was drafted but which has not yet been submitted to the President, because they say it allows the big oil companies who are in the driver's seat so far as importation is concerned to establish a two-price system. It had been the practice of the importing companies to sell their crude oil produced at low wage standards abroad at the same price as though it had been produced by the wage standards of oil production in the United States. As long as that situation continued, and the importing companies sold their oil as though it had been produced in the United States, the small local refiners in the United States had no complaint. But the discovery of new sources of oil in Venezuela, the increase of oil production in the Middle East, Saudi Arabia and elsewhere, brought such a tremendous advance in the amount of oil that was seeking to enter the United States that a two-price system was developed. In other words, Venezuelan oil and some Middle Eastern oil was being offered at prices which could serve only the big refiners, who were also importers, and made it impossible for the small refiners to survive competitively.

I hope I have made this very complex situation fairly clear.

It is obvious that here is a situation where less than 32 percent, to use the figures used by one of our panelists here, Mr. Livingston, of the refiners have created a problem which the President's Cabinet Committee has not been able to solve as yet. It does have an effect upon pricing, does it not?

Mr. LIVINGSTON. If I may take a moment, I would like to explain what I mean here. I would agree with what Professor Bailey said. Within fairly narrow limits any company, small or large, if it is not too awfully small, has some choice as to its price policy. It can price a little too high and get a somewhat higher profit margin at the expense of losing business to competitors, or it can price somewhat too low and sacrifice current profit margins for the sake of increasing its market share. But the limits are pretty narrow and over any extended period of time, whether you want to talk about 4 companies or 20 companies, they can only influence the price at the expense of going out of business.

I have in mind the Frontier Refining Co. out in Cheyenne. It is a very successful outfit. It is one that does business pretty much on a price basis. The larger companies, if they attempted to get more than a competitive price out in Frontier's territory, with a dozen other companies like it operating in the same territory, could only get a more-than-competitive price at the expense of losing market share to outfits like Frontier that are perfectly willing to enhance their volume any time they can.

There are enough companies like Frontier in the country so that the market power of the large refiners is pretty well circumscribed. Furthermore, a number of the larger refiners sell a substantial part of their output to the private brand cut price marketers, and those marketers are operating entirely on a price basis. They are buying as cheaply as they can in the highly competitive open market, and when they sell at the retail level, they are interested in enhancing their volume and price as the means by which they enhance their volume. Any time they can buy cheaper in the highly competitive bulk market, they will reduce their prices and those are the prices that the large refiners have to meet. The 20 companies, even if they could agree among themselves, and even though they control 84 percent of the output, do not have the ability to control prices. You still have the 140 smaller firms that by all economic theory could be expected to act like competitors. Their competitive influence is far greater than their 16 percent of the total supply.

Senator O'MAHONEY. What I am pointing out is that the big importers were satisfied to handle their imported oil at the high production cost of domestic producers as long as they could until this voluntary plan was put into effect, and before the new discoveries of foreign oil made it possible for them to adopt a two-price system. That two-price system, according to the little refiners—125 or more of them are now protesting that they are being driven out of business.

My time is up and I will take only sufficient time to say that it seems to me we are confronted with trying to make a choice, assuming that it is a proper thing to have some restraint upon any possibility of raising prices in an inflationary manner. There are only three ways of doing this. One is by devising a formula to bring public opinion to bear upon the decision of the market leaders, the producers of any commodity at all. Another is to keep the hands of Government off altogether and allow management to do it. The third method, of course, is to establish a formula by which Government may regulate. I do not say control because I think Government control is as bad as monopolistic control. Unless we have Government regulation of pricing, we must either allow management to regulate it or we must find a way to enable public opinion to screen the facts and thereby make those who seek to advance prices justify their action before the public.

Mr. LIVINGSTON. May I add one sentence? It seems to me you have another alternative, which is really the desirable one, and that is to let the competition do the regulating.

Senator O'MAHONEY. I would agree with that if I could be convinced that competition exists.

Mr. LIVINGSTON. That was the purport of my paper, to indicate that it exists much more than some people think it does.

The CHAIRMAN. Mr. Curtis.

Representative CURTIS. To get back to the theme I was attempting to pursue, taking Mr. Oxenfeldt's statement that the basic question is how much evil the type of mild inflation is that has taken place over the last 7 years and attempting to analyze what this inflation is. I raise the question whether or not one big element of it might be actually increased quality of goods and services and of new kinds.

The second feature that I think is in that increased cost, because

that is what I would prefer to refer to it—price index—is the taxes that are being paid. I asked previous panels whether they felt that it was not true that when all was said and done taxes would be reflected in prices. It seems to me they will be. Therefore, whenever we go to Government for services or whatever, whether it is in fields like research and development, or in the support of the military or whatever it might be, that cost—whatever our tax bill is—is going to be spread over our prices.

I might say this, Mr. Oxenfeldt: I am not passing judgment on this thing. I am trying to find out whether it is animal, vegetable, or mineral, because if it is animal, I don't want to treat it like mineral. It seems to me if that is a feature of the increased prices, we can look immediately to see whether or not we are going to have increased prices by just taking a look at the total tax take.

Incidentally, I might say one other thing as far as taxes are concerned. The fact that we have imposed the burden of tax collection in a very direct way on business, and that comes back pretty quickly in increased prices; some of this may take several years because of the kind of taxes reflected in prices. Would there be any disagreement on the point that the tax bill will be reflected in prices?

Mr. BAILEY. On this point, Mr. Curtis, I think we have to proceed with some caution. It is possible to agree or disagree with the point that taxes will be passed along in higher prices. It is a subtle and very difficult question about which no agreement has been reached. Therefore, I would have to say "no," we could not agree for sure whether taxes will be passed along in higher prices or whether they will simply be reflected in lower incomes after taxes.

Representative CURTIS. I see what you mean.

Mr. WEINBERG. May I comment on that point?

Representative CURTIS. Yes.

Mr. WEINBERG. It seems to me we have to distinguish between types of taxes. There are certain taxes that are levied with the legislative body knowing that they will be passed on and not borne by the individual business or person or corporation that pays the tax—property taxes, excise taxes, and that sort of thing.

Representative CURTIS. Excise taxes would come pretty immediately to the prices.

Mr. WEINBERG. Yes. The legislature enacting such a tax expects it to be passed on. There are other types of taxes that it seems to me by their very nature are intended by the legislative body to be borne by the individual or organization upon whom they are imposed. This would be true of income taxes. For example, we don't under our escalator clauses in the automobile industry adjust wages up and down for increases or decreases in taxes. Our people expect to bear their share of the taxes. To the extent that the Government needs part of the resources of the economy, then obviously private individuals will have less and the living standard of the individual who pays such a tax will be lowered. However, we find that in administered price industries corporate income taxes, which are intended by Congress or State legislatures to be borne by the corporation, by the group on whom levied—corporation profit taxes are passed on by pricing formulas. For example, General Motors sets its prices to yield it a 20 percent return on net worth based on 180 days' utilization of

capacity per year. That 20 percent is after taxes. This means that it fixes its prices so as to yield a profit before taxes equivalent to 40 percent of its net worth, and on 180 days per year utilization of its capacity. So that General Motors' price policy is designed, it seems to me, directly to frustrate the judgment of the Congress that General Motors should share its profits with the Government for the purpose of providing government revenue, instead of General Motors extracting those taxes from the pockets of its customers.

Representative CURRIS. I don't know that Congress has any such theory. Having served on the Ways and Means Committee, our primary concern is where we can get the money. I regret we have not dealt too much in tax philosophy. The reason it seems to me that this is true is that taxes must come from the private sector of the economy, and unless it is a capital levy, it is going to come from the economic activity. The only way I can see that that finally would come out, and would have to come out, would be in prices.

I agree with you, real estate taxes would probably take the longest to be reflected in prices of the various kinds, but I think even there ultimately they would come into the price.

I will leave that there because we do dwell on it at some length. I do think it is important if that is true. When we could expect increase in prices as we increase the amount of activity that our Government indulges in.

The third point which has been somewhat anticipated, against these two features that bring cost rises, it has been suggested that the productivity increases might be a dampening effect. I agree. That is why I wanted to examine productivity and what it does. It seems to me that the only way productivity increase can economically justify this is through increased quantity. Yet in what some people are now calling an economy of plenty, we can reach a saturation point. The agricultural sector of our economy, as far as our own society is concerned, pretty well illustrates that can happen. If it can happen there, I suspect it can happen elsewhere; particularly as we get into this, it becomes a question of choice on the part of the consumer. That may even be the definition of an economy of plenty.

The second feature on productivity, which I think Mr. Livingston pointed out, I think is equally true. It does depend upon increased capital investment. We have to pay a lot of attention to that because that is a cost factor. Possibly if this syllogism is true at all, we can measure whether or not we have been properly paying for our increased quality and standard of living through wage increases, through an increased amount going to invested capital by whether or not the price index to the consumer has risen. If it has risen, probably the whole process has been ahead of our productivity increase. I don't know that is so but I would suspect it is so. Certainly if we were desirous of keeping stable prices, then it would seem to me that we need to analyze the syllogism that I have posed, and then be sure that we don't get ahead if our productivity increases. Would there be any comment on that?

Mr. WEINBERG. I think I can make a comment that is pertinent. It is demonstrable, as far as the relationship between productivity and wages in the automobile industry is concerned, that real wages have lagged very far behind productivity for a good many years. For

example, as of 1957 auto workers' real straight-time hourly earnings were 29.9 percent higher than in 1940, whereas output per man-hour in the private economy as a whole was 67.5 percent higher than in 1940. Historically it has been true that, as far as the automobile industry is concerned, it has advanced much more rapidly in productivity than has the economy as a whole.

Part of this difference between auto industry real wages and productivity in the economy as a whole has been made up by fringe benefits, but the gap is still a very enormous one even when that is taken into account. Fringe benefits can account for no more than half of the gap. This has been true in a good many industries. Yet despite the fact that real wages and total employee compensation, including fringes, have not kept pace with productivity, so that there is room for price decreases, there have been price increases in industries of this sort and labor has been blamed for them.

Representative CURTIS. I have noticed your figures in there. The thing that has been lacking in most of the figures I have seen in the auto unions is the reference to invested capital necessary to produce this increased productivity and the earnings that must be realized on the additional invested capital. Increased productivity comes—and I would say this is a pretty good general statement—from considerably increased invested capital. I notice the auto unions refer to the gross amount of money that goes to capital, but don't refer to the rate of return.

Mr. WEINBERG. May I give you the rate? General Motors rate for the postwar years, as reported by the Antitrust and Monopoly Subcommittee, has been 52 percent before taxes and 25 percent after taxes on its net worth.

Representative CURTIS. That has been over a period of how many years?

Mr. WEINBERG. That is an annual rate.

Representative CURTIS. I understand that.

Mr. WEINBERG. If I remember correctly, 1947 to 1957.

Representative CURTIS. I mean in comparison to the years in the industry. I am not alarmed at any figures unless I know its deviation over a long trend or its difference from another industry. Maybe that is the figure that is required in order to continue research and development and advancing in productivity. I don't know.

You think 25 percent is out of line historically and in relation to other industry. I don't know. I am just asking.

Mr. WEINBERG. In General Motors' case, not historically, because General Motors has always been one of the most profitable corporations in the United States. Historically the automobile industry has always been one of the most profitable industries in the United States. Compared to the average for all manufacturing industry General Motors does considerably better than double the average. I think this has to be borne in mind.

Representative CURTIS. In order to keep this thing in balance, General Motors does a lot of research and development. That is the point I am getting at.

Mr. WEINBERG. I want to get to that.

Representative CURTIS. How much of the 25 percent goes to the investor and how much goes into what we will say is future increased productivity which is research and development? I think those are the facts we need to get.

Mr. WEINBERG. The proportion going into research and development is an infinitesimal proportion of General Motors' total profits. May I point this out. Nobody can deny that investment has to be paid for. But it is equally undeniable that investment is not worth anything unless there are customers for the output of that investment.

Representative CURTIS. I think we all agree.

Mr. WEINBERG. I would like to remind you of a story that has gotten a lot of circulation about a trip that Walter Reuther took through a Ford automated engine plant. One of the company officials pointed out the machines to him and said, "Not one of those machines will ever pay dues to your union, Walter." They reply was, "Yes, and not one of them will ever buy a Ford car."

This is our problem. Our problem is to pay for the investment and yet to maintain a balance in the economy so that there will be customers for the output of that investment, and an expanding market so that there will be continuing investment. This is where we fall down. This is why we are in the situation we are in today. At the end of 1955 about 92 percent of our industrial capacity was in use, and earlier this year 70 percent of our industrial capacity was in use. It is not a shortage of investment that is our problem—it is a shortage of customers for the output of that investment.

Representative CURTIS. I see my time has run out. I don't agree with that. I think there is a way to solve the problems. I think you have stated the problem. I don't believe there is a disagreement on the problem. I don't think it is going to be solved with epithets. I think it is going to be solved by examining into these things. That is all I am trying to do. I have no answers. I wish I had the answers.

The CHAIRMAN. Mr. Bolling.

Representative BOLLING. I will pass.

The CHAIRMAN. Mr. Reuss.

Representative REUSS. I would like to pursue a little further with Mr. Oxenfeldt the discussion we were having about evolving criteria for wage and price increases and the difficulty of doing it. Would you agree—and I am sure you would—that before there are any public recommendations made by any public authority to business and labor about wage or price policies either in a specific case or in general, it would be well to see whether it is possible to evolve such criteria which accomplish the dual purpose of depressing inflationary price and wage rises somewhat, at least, and doing so without leading to socialistic orders which you fear in having too much infringement of the private pricemaking decisions? Would you agree that figuring that one out is a necessary first step?

Mr. OXENFELDT. Yes, sir.

Representative REUSS. Would you also agree that no agency in the Government is now engaged in a thoroughgoing and long-range study of what are sound pricing and wagemaking practices so as to achieve the goals of the Employment Act of 1946?

Mr. OXENFELDT. I would.

Representative REUSS. Would you also agree that Congress, in the nature of things, is not very well equipped to undertake the long range and probably continuing type of study which we are talking about?

Mr. OXENFELDT. I would only except members of the committee before me, but with that exception I would agree.

Representative REUSS. You are very kind. I did not mean, of course, in terms of competence, but in terms of the construction of Congress, the nature of committee staffs, and so on. Would you finally agree that we can't really tell whether these criteria exist, can be defined, and whether once defined their application does not present so many collateral problems that no one in his right mind would want to advocate them, that we can't really determine this until we do set up some machinery for coming to grips with this.

Mr. OXENFELDT. I agree completely with that conclusion. I think, however, that some of the comfort you get from this agreement might be withdrawn if you knew that I would approve of many other kinds of investigations to see whether they were possible, even though I thought they were unlikely. I would strongly endorse that kind of an investigation.

If there is any one lesson I learned today, and I have learned many, it is just how hopeless and how helpless we are in the face of conflicting information. When I have to sit alongside the distinguished representative of another university who is not quite sure that we have inflation, and hear the difficulties that arise in bringing the facts with respect to the oil industry into sharp focus—I become appalled by what is involved in getting agreement among reasonable men.

I am even more appalled at the amount of optimism that flourishes in some quarters. Here you have Mr. Weinberg who knows something about these factfinding boards and knows what kinds of facts get tossed around over a negotiating table, who would let the facts speak for themselves. What you are going to have to have is somebody in the middle voting what the facts should show. I hate to take this position. An educator believes in education—by the way, I would like to comment on the fact that Adam Smith and Keynes were cited here not by the academics, but the businessmen and the labor representative—really I am very upset by this situation. I have less optimism than I ever did about the possibility of making progress along the lines you described, though I am all for trying.

Representative REUSS. Would you agree that what is involved here is more than factfinding, that is to say, the facts of the most recent steel wage and price increases could, I am sure, be found, and indeed the Senate investigation came pretty close to finding those facts last summer. Would you agree that what is needed is the application of intellectual processes to those facts and an effort to determine whether there are morals to be derived from them, or criteria could be picked out?

Mr. OXENFELDT. I repeat, I agree with you completely. Our difference is that you are much more optimistic than I am.

Representative REUSS. Mr. Tongue, would you comment?

Mr. TONGUE. I would like to pick up from Mr. Curtis to some extent, if I might, that I believe such a thing could be very helpful if it would be confined as much as possible to the subject being investi-

gated; namely, general price inflation and the relationship of pricing practices in individual industries to that general question.

In this connection, I would like to mention that the real wage lag alleged by Mr. Weinberg is just a myth and is irrelevant anyway. The real question is not what has happened to real wages, but what has happened to money wages in relation to what has happened to general productivity. This is the matter of significance to the general price level and Mr. Weinberg passes that over completely. But let us get down to cases.

Let us take General Motors. I am not in a position to speak for General Motors, but that name has been brought up by others. Certainly General Motors is in a position to double its price if it wants. If it wants to earn 50 percent on its investment, I suppose it could raise the price indefinitely in an attempt to reach this goal. Yet, would the other auto manufacturers follow it? Would the producers of other commodities that compete with automobiles follow it, and so on? Only in this event would General Motors be in a position to start a general rise in prices by raising prices of its own products. If other manufacturers of autos or of other products do not follow, General Motors would be bound to lose sales.

Yes, General Motors does have some power to raise its prices—but it must be prepared to take the consequences of such action. For it is only half of the industry, or possibly less including imports. I would conclude that the danger of a rise in the price of automobiles, as such, starting a general price inflation is there, but I say it is small.

The real danger from the standpoint of the general price level comes from the fact that General Motors, when it settles with the UAW—let us come right down to it—knows that whatever settlement it makes will become the settlement by and large, with very minor differences, for the auto industry as a whole. If it were only for General Motors alone, we would not have the problem. But it is for the whole industry. And it is not only for the auto industry alone, for the UAW controls—I should say represents—its members in several other industries as well. We have had references to business people getting together in trade associations. But the AFL-CIO is not a small trade association. So, not only does the UAW control the entire auto industry, but it has a finger in many other industries, and what it does in those industries spreads to what labor leaders will demand and eventually get in other industries as well.

So, if General Motors were to double the price of its cars, and nothing else would change, this would be one thing. But possibly in the last 10 years the price of General Motors cars has doubled. If that were all that had happened, General Motors would probably be out of business. But that isn't all that has in fact happened. These price rises have been associated with wage settlements, and the wage settlements have spread from one industry to another, so that labor which buys most of the output anyway has received the income to pay the higher prices and has paid them. That is the nub of the problem, as I see it.

It seems to me that is the subject to which your factfinding board should be directed.

Representative REUSS. Our time is up, and I would just comment on that last point. You say labor has the income to bid up prices as

a result of this spread of the wage increase. Why? Doesn't labor simply have the income to buy more articles at the same price, or if it does result in bidding up prices, even in a period of less than full employment, doesn't that give your positions some concern? It seems to indicate to me that there is some price administration going on.

Mr. TONGUE. Representative Reuss, I would say that as far as the present price level is concerned, I am very encouraged as to the immediate outlook, partly because I feel that the wage settlement in the auto industry this year was with minor qualifications consistent with a stable price level. To the extent that pattern spreads, I believe it will be a constructive development. I believe we are now seeing an expansion in income and in output without a general rise in the price level. That is a very hopeful prospect to me for the time being. I am worried about what is farther along the road, specifically what will happen in steel this coming June.

Representative REUSS. Thank you very much.

The CHAIRMAN. Senator O'Mahoney.

Senator O'MAHONEY. Mr. Chairman, I have heard this talk about factfinding for as long as I have been a Member of the Senate, and I first became a Member of the Senate on the 1st of January 1934. We need something more than factfinding. We need action. The Congress represents the people of the country, not the profitmakers of the country. It represents the people in their several States and in their several districts within the States.

The business which is carried on through the United States now is constantly becoming international in its characteristics. Local business is losing strength as compared with interstate and international business. We talk about General Motors. In the hearings which the Senate Committee on Antitrust and Monopoly held on General Motors, just to try to assess the facts with respect to that corporation, it was clearly developed that it is an international corporation, with plants not only in almost every State in the Union, but in many foreign countries, where it is engaged in the production of automobiles of various kinds. Ford is engaged in the production of automobiles abroad. Mr. Curtice, in response to a question which was addressed to him as to what was the most important factor in the determination of prices, said that the most important factor was the profit on the stock. As I recall, his answer was 15 percent profit. It is impossible for the Congress of the United States to deal with legislation upon the basis of protracted factfinding devices. That leads to drift. While the agency which is set up to find the facts is studying the facts, the day-to-day events of life change the situation. We have got to get back to fundamentals, in my opinion.

So I want to ask each member of the panel this simple question: Do you believe that private pricing should be permitted to go its own way without any Government regulation? Mr. Oxenfeldt.

Mr. OXENFELDT. Must it be "yes" or "no"?

Senator O'MAHONEY. Yes, I think it will be a "yes" or "no" answer. Do you think we should do something immediately or should we let private pricing go its own way?

Mr. OXENFELDT. If they were my only choices, I would not let private pricing go its own way. I think there are relatively few areas in which I would really get upset about it, however. In these areas I would not rely upon—

Senator O'MAHONEY. Have you any recommendation to make to the Congress? What shall we do? This committee in a few weeks will receive from the President his "Economic Report." That will be a definite and specific recommendation by the President and those surrounding him. We will have to do something about it.

Mr. OXENFELDT. I think you have every right to ask that question. This is the most uncomfortable question to answer although in a sense I tried to answer it in my talk, and I said, given the present dimensions of inflation, I think that we better leave things pretty much as they are, because the only cures I know are worse than the mild inflation.

Senator O'MAHONEY. So you would have no recommendation for action now. You consider that a mild inflation will do less harm than anything we could possibly conceive to do.

Mr. OXENFELDT. I would want Mr. Reuss' kind of investigation and I would want to change the nature and maybe the personalities involved in our antitrust work. That is to say, the administrative agencies. I think some work can be done there and must be done there.

Senator O'MAHONEY. What is your answer, sir?

Mr. BAILEY. Senator, you earlier remarked that Government control is undesirable because it is as bad as monopoly, and therefore you thought that regulation was necessary.

Senator O'MAHONEY. I don't want any bureaucrat to be able to tell the people of the United States what they must do.

Mr. BAILEY. In my view, Senator, Government regulation is a form of Government control in practice, as it works out, and it too is just as bad as monopoly. Therefore, I would have to say no, I don't believe any action should be taken at this time along the lines you suggest.

Senator O'MAHONEY. Do you or do you not believe that the Founding Fathers were acting in good sense when they wrote the Constitution and provided in that Constitution that Congress shall have the power to regulate commerce among the States, with foreign nations and within Indian tribes? Those were the words that the framers of the Constitution wrote. Shall we neglect their advice?

Mr. BAILEY. I think they were quite right, but I think we should take their advice to the extent they took it themselves.

Senator O'MAHONEY. Let me point out to you that the very first Congress passed the Navigation Act. The immediate result was a protest by the operator of a ferryboat running across the Hudson River from the State of New York to the State of New Jersey. This operator said: "We want no Government interference in business. Leave us alone. We want no regulation." They took that case all the way up to the Supreme Court of the United States. The decision was finally rendered by a man named John Marshall. He was not a Red. He was no leftist. He was no Communist. He wasn't even called a Jacobin in those days, and that was the worst type of denunciation or epithet flinging that they could engage in. John Marshall said that Congress has the power to regulate all business, including intrastate business when it affects interstate or international business. His decision in *Gibbons versus Ogden* upheld the Navigation Act, and ruled against the plaintiff which held that the transportation of

passengers on a ferry both ways was not commerce. Marshall said it was commerce. Nobody has ever attempted to change that decision since.

I say from the very beginning Congress has been regulating business, and business is always resisting regulation. But it does not make any difference what administration is in power or what party is in power, we create board after board and commission after commission to regulate, and sometimes these boards, slip over into control. But the Interstate Commerce Commission was set up to regulate the railroads. Nobody has ever offered to repeal the law establishing the ICC.

The Harding administration passed the Meat Packers Control Act, which was the most stringent Government regulation ever passed. Nobody called Harding a leftist or a Communist or a Red or a Pink, but the record is clear that the regulation in that law was very, very rigid.

The CHAIRMAN. May I make this observation, Senator?

Senator O'MAHONEY. Yes.

The CHAIRMAN. On the problem of interstate commerce, wasn't that the principal reason that led to the Constitutional Convention, because under the Articles of Confederation, there was no power for the Congress to regulate interstate commerce? Wouldn't that be one of the reasons that brought about the first meeting over in Annapolis, and then finally the Constitutional Convention, because of that very question?

Senator O'MAHONEY. You are right. The students of the drafting of the Constitution are agreed that its ratification was brought about by the commercial classes of that time which felt that it was necessary to have a central government that would lay down the rules of the game.

The next panelist, Mr. Tongue, may I ask you, do you want to drift or do you want to recommend something for us to do?

Mr. TONGUE. Sir, I would like to make what I consider a strong recommendation.

Senator O'MAHONEY. Good, Mr. Tongue.

Mr. TONGUE. But you may not so consider it. I recommend that for the time being we rely on the free price system.

Senator O'MAHONEY. Do we have a free price system?

Mr. TONGUE. I have great faith in the free price system even where you might think there are monopolies. You cite the case of the meatpackers, for example. Even the labor people today would agree, I think, that if the packers ever had any monopoly power, it has certainly been dissipated. They complain that the packers have to sell on the basis of price, pure price alone. It is alleged by Mr. Wishart, who was unable to appear here today, that the retailers have taken their place. I submit that even the largest food chain today or the greatest supermarket today has far less monopoly power in any real sense than the corner grocer of 25 or 30 years ago. To the extent that monopoly power of the meatpackers has been reduced, the benefits have been passed on to consumers. I believe, as Mr. Bailey said, that time and not too long a time takes care of most monopolies.

At the same time, I believe it would be very desirable for a bipartisan group to come to some conclusion as to what is the nature of the

inflation problem insofar as it is related to "administered" prices in certain selected industries. I believe I have outlined how I feel on that subject and why I feel it is at the heart of the inflation problem.

Senator O'MAHONEY. May I ask your definition of "administered prices"?

Mr. TONGUE. I believe most businesses have some power to administer prices. They must decide on a price policy. Not that they can set prices without affecting their own volume of sales, but that they have some latitude in deciding on whether they shall have a high price policy or low price policy, and take the consequences; and the consequences are there, I feel certain.

The CHAIRMAN. Senator, your time expired, but I will take the liberty of yielding you so much of my time as is necessary. There are two more panelists to be interrogated, and I will ask them to be brief on this.

Mr. TONGUE. I will stop there. I would just urge that there be some agreement among the experts as to just what is the problem here and then publicize it. If we do publicize it enough, you will not need legal restraints on business or on labor, which happens to be where I believe the real problem lies.

Senator O'MAHONEY. Let me say this, since you brought that subject up. I shared that opinion some 10 years ago and I introduced a bill, the purpose of which was to require all corporations engaged in interstate and international commerce in which the commodity manufactured and distributed was the product of six or fewer corporations, to be required to submit to the Department of Commerce and to the Congress an advance notice of the intention to raise the price, so that they would be obliged to come before a public body and justify their action. I provided no penalty. I just sought to create a system by which publicity would be thrown upon the action of those who raise prices and let them justify it. Would you think that would be a fairly reasonable way of proceeding?

Mr. TONGUE. I would say, sir, that if Mr. Lerner would be the fellow who set the price, I would agree with that, because he would need no factfinding or anything else. All he would need to know is, Is the industry operating to capacity? If so, raise the price. Is the industry operating below capacity? If so, lower the price. That kind of a guide to pricing policy is to me a sensible one from the standpoint of resource allocation and efficiency of the price system generally. However, if the price board were to be guided by principles such as Mr. Weinberg has suggested, namely, "letting the facts speak for themselves," I am afraid that the present inflexibility in the pattern-setting industries would only become worse as one side hemmed and the other side hawed, and the board tried to interpret the message the facts were speaking.

Senator O'MAHONEY. The plan I suggested would not have given any board any power at all. I was just relying upon the force of public opinion and not upon any punitive action by Government or any control action by Government. Mr. Livingston, would you answer our question?

Mr. LIVINGSTON. Senator, I think I have much more faith in the competitive market economy than you have. I think anything we might do in the way of Government regulation of business pricing policy would do more harm than good.

Coming to your specific question of a board—again I think in terms of an industry with which I am familiar—any large oil company in this country is changing its prices at some point every day in the year. How do you possibly set up a body that could regulate or even hold hearings on that sort of thing?

Senator O'MAHONEY. I don't want to set up a body that could regulate.

Mr. LIVINGSTON. How could they even hold hearings? In order to be competitive, an oil company has got to be able to meet its competitor's prices day by day.

Senator O'MAHONEY. Your assumption, of course, is that we have competition.

Mr. LIVINGSTON. I can demonstrate, and I attempted to do so in a modest way in my full statement, that this is actually going on in the oil industry.

Senator O'MAHONEY. I have not a great deal of confidence in that faith that you have that there is competition. I am in close touch with the Department of Justice all the time, and I know the efforts that they are making through the antitrust laws to prevent exploitation. Mr. Weinberg?

Mr. WEINBERG. I hope I will be given an opportunity later on to get something into the record with respect to Mr. Livingston's comment on following "competitors' prices day by day."

With respect to your question, Senator, I would have first said I would have preferred to use some word other than "regulation." But now that you have defined regulation, I would favor such action by government. I think in a democracy we have to give the people the facts, and they can make their determinations and get action from private parties largely by moral suasion. But they have to have the facts on the basis of which to apply their influence intelligently. It seems to me that to require corporations that can have a major influence on the prices of important segments of the economy to set forth the facts and justification of proposed price increases, the specific facts of specific situations relating to specific price increases, that this procedure could be very helpful in inducing a measure of self-restraint. I think in the absence of the application of self-restraint, which might not be forthcoming unless we have such a mechanism for encouraging it, we will get to the place where the public in the face of continued abuse will demand regulation in the strict sense, and ultimately control.

Senator O'MAHONEY. Thank you, Mr. Chairman.

The CHAIRMAN. Each member of the panel will have the privilege of extending his remarks, if he desires, by elaborating on any question that has been brought up here today, or which he himself brought up. Mr. Wishart is the only absent member of the panel and I got word from him about the time we started that his wife gave him a very fine addition to his family late last night, and it was too late for him to get here. So I think he has a good reason.

I wonder if we should go on longer or should we try to work out an afternoon session, or what is the wish of the committee?

Senator O'MAHONEY. Mr. Chairman, I must go now. I cannot attend the afternoon session.

The CHAIRMAN. Can we say we have fairly covered it? Would either member of the panel like to make a brief statement of any kind, with the understanding that you have the privilege of extending your remarks for the record, as we have in the House and Senate.

Mr. WEINBERG. I would like to make one point, if I may. As I read Mr. Tongue's paper on the relationship of wages to productivity, I was not sure whether he meant real wages or money wages. He has now made that clear. I understand now why he is able to say in his paper that price increases by such industries as auto or steel would not spread throughout the entire economy. What he is saying in effect is that industries like auto and steel, by raising their prices, can transfer to themselves part of the incomes of consumers through a rise in the cost of living and then those consumers—those of them who are workers, for example—should have no means by which to maintain their living standards but should pay in declining living standards for the price increases imposed by corporations in a position to administer prices.

It seems to me that unless you look at the relationship between wages and productivity in terms of real wages, what you are calling for is a sacrifice on the part of the workers through constantly diminishing living standards to maintain a stable price level, and the ultimate result of that, as we saw in the 1920's when productivity increased and real wages did not, is the collapse of the economy from lack of customers.

The CHAIRMAN. Is there any comment?

Mr. LIVINGSTON. Coming back to the question Mr. Curtis raised, I think it is extremely difficult to measure precisely the changes in productivity and the changes in real output and changes in real wages. We are dealing with price measures that are just not that perfect. Obviously they are all going to go up more or less together. As Mr. Tongue suggested, one set of statistics may show one going up a little faster than the other and another set of statistics will show the reverse. It is a fruitful area for anyone who has something to prove. I object to Mr. Weinberg's notion that somehow or other corporations have been raising prices faster than costs and thereby gouging the public. I happen to have here in front of me the UAW brochure which is intended to prove this. They made the mistake of including in one of their tables the return on net worth of all manufacturing corporations. During this period when the corporate managements were gouging the public, their return on net worth went down from 16.1 percent in 1947 to 11.5 percent in 1957.

The CHAIRMAN. Does any other member of the panel wish to comment?

Mr. TONGUE. May I do so, sir? With all due respect to Mr. Weinberg, I would protest that I have no interest in beating down the real wages of labor outside of the pattern-setting industries, as might be alleged from what he said.

If I were to allege anything, it would be that he in ostensibly acting on behalf of the worker in pushing up wages—and money wages—more rapidly than the increase in real productivity, is doing a disservice to labor generally. He said what we must look at is real wages, namely, adjusted for price change. Any statistics I have ever looked at suggest that the share of labor in the product it produces,

leaving out farm, etc., has not changed appreciably over the period for which we have any reasonably satisfactory statistics. This would include manufacturing, for instance, where we have reasonably good statistics going back over a period of time, the share of labor has not changed significantly. This is what one would expect on theoretical grounds as well as practical grounds, and I cited the granddaddy of modern economics, John Maynard Keynes, on that side.

I should say, too, that Mr. Weinberg wildly throws in a lot of theories about the causes of past business cycles and unemployment that are very debatable. But I submit that the facts are that labor has gotten its share. The share has not changed. Thus, the only effect of the continuous round of wage-price increases of the past decade, with money wages increasing faster than productivity, has been to raise the price level. This has been a major factor; I won't say it has been the only factor. But until we, and particularly the labor economists, come to some willingness to admit that there is a relationship between money wages, productivity and the trend of the general price level, we will not get anywhere in our efforts to prevent the wage-price spiral.

The CHAIRMAN. Does any other member of the panel want to comment?

Mr. OXENFELDT. I do so only because these do not seem fitting remarks to introduce into the record.

First, I would heartily agree with Senator O'Mahoney's notion that under certain circumstances corporations should at least report planned price increases. Second, I would say that there have been some very unusual things said here today. Mr. Tongue, for example, endorsing Mr. Lerner's standard for allowing price increases when you are operating at capacity and beyond, and price reductions when you operate below, that this standard would be workable is a rather new idea to me.

Mr. TONGUE. I should say that Abba Lerner has been saying that for many years. He wants to set up the whole economy on that basis.¹

Mr. OXENFELDT. Yes. I don't know that many people have been listening to him. People can no more define capacity, than his marginal cost notion. It is a wholly unrealistic standard. This brings me to the major point I would like to submit to the committee.

The panelists here, who represent a high degree of theoretical training, plus the Members of Congress present, are using terms which were given us hundreds of years ago literally, and have relatively little application, it seems to me, to our present economy. "Monopoly," "competition," "oligopoly" are words which describe highly different kinds of situations with the same term.

I submit the differences in industries come from at least 25 different characteristics that would seem to influence the social effects of an industry's performance. I would hope that, in the study that Congressman Reuss will be able to get started, he will invite people to reject these terms, and these very limiting concepts which keep us from really seeing reality. I am thinking of how some members of the panel to my left would react to a situation in which I was involved some years ago. This was a firm, which was very close to being an

¹ I would add now that I agree that this suggestion of Lerner's is hopelessly impractical. Also, it does nothing to get at pattern setting and pattern spreading, which is the root of the problem.—W. W. T., December 23, 1958.

entire industry, that was charged by five agencies of Government with violations of the antitrust laws. Yet I was in constant contact with the sales manager and he was getting an ulcer because he had to meet price competition. Why? Because this firm, which was one of the most prominent duopolists of that period, priced its products so high that it wanted and invited competition. Anybody who sets a price so low that he is losing no business is wasting his oligopoly. Some people who find every little evidence of competition a sign of pure competition would be very encouraged by such situations. These people are so very anxious to believe that competition exists. I am encouraging you to start all over just because what the economics profession has produced offers you very little assistance with present-day problems.

Senator O'MAHONEY. Mr. Chairman, I want to express my appreciation to the members of the panel for their attendance at this meeting, and their preparation for it.

The CHAIRMAN. I want to join for all the members of the committee, Senator. We are indebted to these gentlemen for the fine contribution they have made to our study.

Senator O'MAHONEY. I think it is an indication of complete sincerity and it will be most valuable. I want to add, however, Senator, that at the first session of the committee on Monday I put into the record a table from an analysis of the census of manufactures of 1954 which shows some of the instances in which a large percentage of the total commodity output, in particular lines of business—lines of business that produce commodities most essential for the whole and for the individual—the record showing that four or six or eight companies produce by far the greatest percentage of the total output. In many instances this output amounts in each industry to considerably more than a billion dollars. I think it is an array of facts which must be taken into consideration by anybody who contributes to the discussion of this problem.

(The table referred to appears at p. 472.)

The CHAIRMAN. Thank you, sir.

Without objection, the committee will stand in recess until 10 o'clock in the morning in this room.

(Thereupon at 1:05 p.m., a recess was taken until Thursday, December 18, 1958, at 10 a.m.)

RELATIONSHIP OF PRICES TO ECONOMIC STABILITY AND GROWTH

THURSDAY, DECEMBER 18, 1958

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

The committee met at 10 a.m., pursuant to recess, in room 1301, New House Office Building, Hon. Wright Patman (chairman) presiding. Present: Representatives Patman, Bolling, Reuss, and Curtis; and Senators Douglas and O'Mahoney.

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

The CHAIRMAN. The committee will please come to order.

This is the fourth and last of these panel discussions in which we have been considering the relationship of prices to economic stability and growth. This morning we turn our attention to the merits and limitations of alternatives of economic policies in the light of the relationship between prices and the economic stability and growth which our economic policy should promote.

What criteria 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 a familiar question for our committee. We have discussed these same problems of economic policies in previous panels of experts, but today we concentrate attention upon the ways in which these policy decisions should be influenced by consideration of prices and the relationship which they bear to economic stability and growth.

We shall proceed as we have in previous panels, with each member being given 5 to 7 minutes for his opening statement. We will then encourage members of the panel to participate freely in informal discussion with members of the committee, commenting upon questions posed by the members of the committee and upon the papers in the Commentaries.

Our first witness is Mr. Stanley H. Ruttenberg, director of the department of research, AFL-CIO.

Mr. Ruttenberg, we are glad to have you, sir, and you may proceed in your own way.

STATEMENT OF STANLEY H. RUTTENBERG, DIRECTOR OF
RESEARCH, AFL-CIO

Mr. RUTTENBERG. Thank you very much. I am sorry that copies of my summary did not get up to the committee last night. They were sent up and evidently have not arrived, but they are on their way now, and I hope they will be here before very long.

The "new thesis" offered in explanation of the last few years' price changes illustrates, it seems to me, the economists' abdication of their responsibility to analyze general economic trends. The facile substitution of the new, so-called, cost-push concept for the former demand-pull theory is clearly inadequate to explain recent price developments. Yet economists have quickly subscribed to the cost-push notion and many have translated it into wage inflation or used the two terms as synonyms.

Problems underlying the past few years' price rises require a much more careful and studied analysis. I am disturbed that the economics profession has not performed this job. It seem to me that the series of papers presented to the Joint Economic Committee on the relationship of prices to economic stability and growth illustrates the economists' failure to fulfill their responsibility to analyze price trends adequately.

A careful examination of post-World War II price movements shows both some of the reasons for the development of the cost-push notion and its inadequacy as an explanation. In these postwar years, there have been five periods of varying price movements. Prices were rising during three of these time spans and were relatively stable during two of them. Most of the post-World War II price rises were war-related. About three-fourths of the total increase in the price level took place in two short periods between January 1946 and January 1948, and between June 1950 and June 1951. More than half of the entire upward change occurred in the 1946-48 period, on the release of pent-up demand after the end of price controls.

Of the three upward waves, therefore, two were closely associated with actual or anticipated shortages of goods and productive capacity. The causes of these changes fall neatly within the demand-pull thesis.

During another two of the five price periods—comprising more than half the years since World War II—there was relative price stability. Although they were not ideal, developments in these years indicate the possibility of economic growth along with increases in consumer incomes and productivity, and—most important of all—relative price stability. I point specifically to the period from June 1951 to June 1955 when these economic developments took place—growth, higher incomes, higher productivity, and relative price stability.

It is the last period—the most recent upward movement, the third upward wave of price rises—that presents analytical difficulties. Obviously, the demand-pull explanation so easily afforded the first two upward pushes could not explain a rising price level during a time when shortages of goods or productive capacity were not present and when unemployment was above 4 percent of the labor force.

Economists, therefore, needed a new explanation and chose the cost-push thesis. Quickly, this notion was translated into wage-push and wage-inflation. With minimal further mental effort these slogans led to decisions that unions were responsible for cost-push.

A lesson in logic seems to be in order. It does not follow automatically from the idea of a cost-push that wages must be the cost that is pushing. Or that wage inflation is a realistic conclusion to be drawn.

Obviously factors other than wages were pushing costs. Real hourly compensation of nonfarm employees, according to the Bureau of Labor Statistics, increased 35.2 percent between 1947 and 1957, lagging behind the 37 percent rise in productivity of the national economy's total private sector in the same period.

Factors other than wages, factors brought on by governmental and managerial decisions should be considered in analyzing the cost-push. Yet these factors seem to be sloughed off in many analyses: 1954 tax laws, altering depreciation accounting, led to a cost-push from increasing depreciation charges.

According to the "Survey of Current Business" of the Department of Commerce, "by 1956, corporate depreciation charges were \$3 or \$4 billion higher than they would have been," if these changes and the 5-year accelerated depreciation provisions had not been in effect.

As a result of the 1954 law, research and development costs also can be handled differently now. The "Harvard Business Review" states that, "the tax revision of 1954 added a new incentive (to business) by making research outlays deductible as current expenses." Prior to 1954, such expenditures were required to be capitalized over a period of years.

Internal corporate financing for large-scale expenditures for new plant and equipment throughout 1955, 1956, and into 1957, created other pressures from interest payments. Financing through retained earnings and bonded indebtedness instead of through the equity market has resulted in tremendous increases in interest payments. In addition, the administration's tight money policy's effect of increasing interest rates also meant higher interest rate payments by corporations.

Table 2 on page 257 of the Commentaries shows the percentage shifts and comparisons in these industrial cost factors that have been pushing the price structure. These factors were not caused by collective bargaining or wages, but by business and Government policies.

Another cost-push pressure came from administered prices in a few key industries, such as steel, auto, aluminum, rubber, et cetera. When the steel industry can make a handsome profit despite half-capacity operations, something is wrong within the price structure. But because it exists, it has contributed to the atmosphere of rising prices.

Since the "Consumer Price Index" has been used by the public as a quick, ready measure of inflation, changes in the index are currently treated almost as a definition of inflation. An analysis of the index from June 1955 through June 1958 shows that less than one-sixteenth of the total 8-percent rise during this time came from hard-goods price changes. Price rises in foods and services accounted for 60 percent or three-fifths of the total upward trend in these years. Yet public attention has been focused on a wage-push and big unions negotiating wage increases when "Consumer Price Index" rises are discussed.

As I have already indicated, real wages have stayed well within national productivity trends. While gross national product increased by 10 percent, payrolls of manufacturing production workers rose

7½ percent; research and development costs, 207 percent; depreciation costs, 53 percent; and interest costs, 45 percent.

Administered prices have also pushed break-even points to a very low level so that corporations can make profits while much of their capacity is idle. These administered price increases had a definite effect on the price level, but they have not been the sole or exclusive reason for the upward movement of the "Consumer Price Index." Industrial prices are merely one part of the general price structure; there are other important economic sectors that influence prices. As table 3, page 257, of the Commentaries shows, foods and services, housing, utility costs, Government taxes, have had important effects on the "Consumer Price Index."

Certainly, solutions to the problems of public policy for economic growth and price stability do not lie entirely in the area of cost—even of the costs emphasized in this paper. Yet this emphasis has seemed necessary because a condition precedent to any adequate solution to our current problems is a better understanding of the relationships of costs and price pressures. Until the current emphasis on wage costs and wage inflation is changed and attention is shifted to many complicated cost factors as well as the various structural sectors of the "Consumer Price Index," attempted solutions will be narrowly inappropriate and misdirected.

Of my eight suggestions concerning policy, therefore, only one is concerned exclusively with wages. Two deal with the overall price situation. The remainder are concerned with specific problems needing more careful study and attention because of their important effects on the price structure.

These suggestions which I make do not necessarily reflect the point of view of the AFL-CIO. They are advanced mainly to focus attention on the areas we believe economists have failed to analyze adequately.

We suggest the following items for serious consideration:

1. The establishment of a Government price commission to study and analyze the price structure and to develop information needed for sound economic decisions.

2. Comprehensive standby stabilization measures are needed to prevent the kind of price inflation which took place when controls were too quickly removed after World War II and were not imposed quickly enough after the start of the Korean conflict.

3. (a) The establishment of a Government price supervision agency with investigatory and subpoena power to examine proposed price increases of major manufacturing industries.

- (b) Government aid and assistance in the development of new products to stimulate competition.

- (c) Aid and assistance to small business through long-term low-interest-rate loans.

4. A reexamination of the Government agricultural programs and goals, with some consideration given during the examination to the possibility of a program of income instead of price supports for farmers.

5. Examination of price increases for all types of services to find possible avenues of stability in this area.

6. Examination of the cost of housing and construction with a view to creating stabilization through programs designed to improve efficiency of construction.

7. Improvement of the distribution system with its numerous inefficiencies—such as traffic bottlenecks, et cetera—to avoid the price increases now forced into the price structure by high distribution costs.

8. A consumer economics agency, largely educational, established by the Government within the Department of Labor.

Such an overall approach to functions within our economy is essential and necessary. Congressional and governmental policies cannot be determined on the basis of an analysis of price rises in only one sector of the economy.

The combined efforts of the Congress and the Government should be directed at promoting economic growth and expansion. Our policy, both public and private should not be stifled by the bogeyman of potential inflation. It is clear to us in the AFL-CIO, and we would hope to others, that private and public policy aimed at a combination of increasing productivity, expansion of the gross national product, increasing income levels and stability in prices, is not only possible, but essential, if America is to meet the great challenge which confronts it.

Thank you, Mr. Chairman, and I am sorry if I have gone beyond what I was supposed to say.

The CHAIRMAN. Thank you, sir.

Mr. Teper, director of the research department, International Ladies' Garment Workers' Union, AFL-CIO.

Mr. Teper, we are glad to have you, and you may proceed in your own way.

STATEMENT OF LAZARE TEPER, DIRECTOR OF RESEARCH, INTERNATIONAL LADIES' GARMENT WORKERS' UNION, AFL-CIO

Mr. TEPER. Thank you, Mr. Chairman.

In the past 12½ years, the wholesale price and the consumer price indexes went through periods of relative increase, decrease, and stability. While prices today are substantially higher than 12 years ago, the greatest part of the cumulative increase took place while the Nation was undergoing a readjustment after V-J Day and at the time of the Korean conflict. A review of the remaining period does not make it appear that the implementation of the Employment Act created of itself a condition for an uninterrupted inflation. We have thus witnessed comparative price stability during a 4-year period ending in 1955, a period during which the Nation went through one business contraction and two business expansions, a period of price declines during the 1948-49 recession, and a period of price rises in the more recent 1955-57 period.

It is this latter period that created concern in many minds. Prices as a whole began to rise about a year after the Federal Reserve initiated a program to cut down the supply of credit and while the Federal Government gave inflation its best and most morbid publicity. Continuation of price rises during the recession spurred on an idea that this was a novel development brought about by cost-push inflation for which, at least in part, labor was responsible.

There is, of course, nothing novel about an upward movement of prices during a recession. A review of price movements since 1836 suggests that prices fail to decline in roughly one recession out of every three. This phenomenon occurred even at a time when labor organizations were but a shadow of their present selves and before large-scale industrial enterprise began to play a major role in the economy.

A respectable body of academic opinion, as is evident from the papers in the compendium and the May hearings before this committee, properly alludes to the fact that no conclusive empirical evidence exists to support the thesis of a cost-push or sellers' inflation.

As noted by Professor Ackley, it is even impossible to differentiate, as a rule, between buyers' and sellers' inflations.

But to turn to the present.

At the moment, talk about an inflationary threat seems to be unjustified. Most of it emanates from the financial community. On the other hand, little inflationary sentiment is found either among businessmen or among consumers. Recent price behavior—outside the stock market—also does not seem to exhibit any pronounced inflationary tendencies. Even the price rises which occurred during the last recession do not portend any long-term trend. In the main, they were either brought about by the effects of inclement weather on farm production or by adjustments in the service sector of the economy. Despite recovery, no signs of dangerous upward pull on prices appeared, at least so far. On the other hand, sizable improvements in productivity did occur in 1958 and they seem to scotch whatever inflationary threat there might have been.

I would like to depart from my prepared remarks, and refer to the November issue of the *Monthly Review* issued by the New York Federal Reserve Bank. Commenting on the recent productivity developments, the review makes the following comment:

The other side of the coin to the rise of productivity is, of course, a sizable reduction in unit costs. In manufacturing as a whole, the direct wage costs of production workers per unit of output (excluding fringe benefits) were as low or lower during the third quarter than at any time since mid-1951, except for a 1-year period from mid-1954 to mid-1955.

This article, then, goes on to indicate that while similar data are not available for salary costs, because there was no increase in the employment of nonproduction personnel despite the recent growth in production, apparently nonproduction worker unit costs have also fallen recently. And yet, in the face of declining unit labor costs, we have not seen any effect on the price level. In the face of such a development, it is surprising to continue hearing allegations about wage-cost inflation.

To turn back to my discussion in the 12½ years under review, we have seen no sharp downswings in the general level of prices such as occurred, for example, during the great depression of the thirties. Unquestionably, such swings could only be concomitant to a major depression. In the absence of such a calamitous development, prices as a whole did edge upward. While such a creeping of the price level did erode the worth of monetary incomes, it is axiomatic, I believe, that an even greater erosion would have occurred were production and employment cut back by a major depression despite the paralleling price declines.

It is, of course, impossible to separate the discussion of price level stability from other objectives of national economic policy. This is recognized by the Employment Act, as presently written, when it refers to maximization of the purchasing power, i.e., to a composite of a flow of money incomes and the level of prices. Price stability is thus integrally tied up under the act with its policy objectives of employment and production maximization. This is sound because it is impossible to consider prices and ignore other policy objectives. The final criterion is one of overall welfare.

In reviewing the recent past, we thus cannot ignore the fact that despite price rises and the three intervening recessions, the Nation's economy and its people are much better off than they were 12 years ago. We must, therefore, not lose sight of the total picture lest our preoccupation with prices makes us myopic to policies which stifle economic growth and general economic instability.

Admittedly our present tools for combating price rises leave much to be desired. Restrictive monetary policies, which theoretically were supposed to bring about price stability, failed to do so in practice. At the same time, the implementation of these policies brought in their wake a number of undesirable side effects and probably even helped to generate the last recession. An overall review of our monetary policies is thus in order.

We must also consider the possibility of integrating the activities of the Federal Reserve and those of other top-level agencies of the Federal Government such as those which operate out of the office of the President. Better integration would lead to improved coordination of different policies and is also likely to obviate some errors of perception on the part of the Board and its staff such as those which were committed during the last recession and the present recovery.

Greater interdependence among Federal agencies is a step in the right direction. However, of itself it is not apt to lead to greater price stability. Because some upward price movements are centered in specific areas of the economy, the ability to act with regard to such key problem areas seems essential. Additional study is needed to determine the precise nature of such devices. These may include measures designed to spur investment where the existing production facilities are inadequate to provide needed goods and materials. They may seek to establish greater coordination between the Federal credit agencies and those concerned with monetary and fiscal management.

They may develop variable interest rates for different classes of borrowers depending on the needs of the economy. They may seek the regulation of consumer credit and of the charges made for these services.

Additional studies should also be made of the price setting mechanism in our economy. We actually know very little about it. For example, more has to be learned about price policies of large corporations, their influence on general price levels, and their effect on the economy. The creation of a proper public research body to study price setting would be a step in the right direction.

Fiscal instruments also require further exploration. Pay-as-you-go taxation could be strengthened by extension to incomes derived from dividends. The experience rating mechanisms, used in unemployment insurance, should be reviewed in view of its tendency to aggravate cyclical swings. Also, the unemployment insurance benefit structure

needs strengthening in the interest of general stabilization of the economy as well as on its own merit.

Another area for exploration is that of productivity. Experience of the past demonstrates that productivity gains are greater when the economy approaches full utilization of its resources than at a time when idle capacity abounds. Measures to spur on the rate of productivity development and to bolster steady economic growth thus offer an important key to continued price stability. This is one of the most important areas to which public thinking must turn.

Admittedly, I failed to cover all possible measures that could be encompassed in the arsenal of tools designed to combat price rises while maximizing employment, production, and purchasing power. I hope you will forgive me.

The CHAIRMAN. Thank you, sir.

Now, our next witness is Mr. Richard V. Gilbert, consulting economist, Westport, Conn.

Dr. Gilbert, we are glad to have you, and you may proceed in your own way.

STATEMENT OF RICHARD V. GILBERT, CONSULTING ECONOMIST, WESTPORT, CONN.

MR. GILBERT. Thank you, Mr. Chairman.

In the great debate on national economic policy, we have been guilty of a cardinal sin, a sin which may be fatal, the sin of irrelevance. The overriding fact of our time is the cold war. This is a struggle being conducted in economic terms. The first question we must ask ourselves is how we are doing in this struggle, are we advancing, holding our own, or slipping? Are we doing enough to win, or even to survive?

Nobody has raised these questions before this committee. Everybody has talked of acceptable rates of growth and employment. Nobody has asked, acceptable for what? I propose to discuss the harsh realities of our situation and the harsh choices our situation compels.

The Russians have made no mystery of their intentions. They have committed themselves, one way or another, to burying us. Nor is there any mystery about their performance. We know that Russian rates of overall economic growth and of industrial production are double our own, or more than double our own, and in the key areas on which warmaking depends are three or four times our own.

Russian education is both more massive and more productive than our own. They are graduating twice the number of scientists and technicians and, except for perhaps the highest levels, their education is more thorough and effective than ours. The Russians are outspending us in basic research and scientific development, and in scientific and technological equipment in all areas having military significance. We have the word of the highest scientific authorities in this land, that they have achieved a commanding lead over us in many of these directions.

What is more important, the Russians are allocating to the cold war much larger percentages of their total output than we are. With less than half of our gross national product they are putting into defense and defense supporting industries, manpower and materials approxi-

mately equal to our own. The percentage of their output devoted to these purposes is $2\frac{1}{2}$ times ours.

For years we have known that the Russians had an overwhelming superiority in military manpower and conventional armaments. For over a year we have known that they have also achieved a superiority in the new weapons systems and in the research and development which produces them. For the moment the preponderance of offense over defense provides us the dubious security of a stalemate of terror. But if the Russians were to achieve the same superiority in the field of antimissile missiles which they have won in the missile field, if they could in this way undermine our capacity for retaliation, there would be nothing left for us but to surrender. Can anyone doubt that the Russians are making an all-out effort in this direction? Does anyone think or suggest that we are?

The Russians are not committed to war if they can win by other means. Without lessening their military effort, they have embarked upon a program of economic penetration which has already produced startling results. It is clear that, in this area as in all others, they are prepared to devote, up to the limit of their capacity, whatever resources are necessary to attain their ends.

In a word, the Russians and their satellites are making what in the forties we used to call a total effort. They are driving their expansion of economic power at a terrific rate. They are allocating to the cold war, both on the military and economic fronts, resources at least equal to our own, resources which constitute $2\frac{1}{2}$ times the percentage of total output that we devote to these purposes.

The contrast between the Russian performance and our own is not lost on the uncommitted nations of the world. They can see the dedication, the dynamism, the massive expansion of power of the East, and they can see the soft, self-indulgent, confused, business-almost-as-usual policies and performance of the West. They can hear the hobnailed boots pounding up the stairs as the silken slippers come down. Nor are the lessons lost on our allies. Other people can surrender, as in the past they have, even if we indulge in the fantasy that we cannot. If we continue on our present course how many of our allies will remain on our side? How many will decide that "if you can't lick them, join them" is the better part of valor?

Some people say we are already spending enormous sums. But the grim arithmetic of war, hot or cold, requires that we ask, is it enough? The French, after World War I, spent what to them were huge sums on their Maginot line. While, after the event, we know they spent the money in the wrong directions, a fault from which we are not entirely free, the critical point is that they did not spend enough to meet every challenge, and learned in the end that if a nation is not prepared to spend enough on defense there is no point in spending anything at all.

Now is there anything in the objective situation, to borrow a term the Russians like to use, in the resources, the skills, and the manpower available to the two sides, which explains the difference in performance in the past 12 years, and which condemns us to surrender or defeat while it assures them of ultimate victory? The answer is obvious. In terms of presently accessible resources and skills the West is still more than twice as big as the East, and in terms of capacity it is still three times the size of the East. And

even in terms of manpower we could match them if we could win India to our side.

Our failures are not the result of basic weaknesses. They arise from our unwillingness to face up to the unpleasant realities and to accept the discipline and the sacrifice that is necessary to an all-out effort.

We can meet the threat presented by the Russians only by throwing our economy into high gear, by pushing our production to the limit of capacity and allocating to defense, to defense-supporting industry, to basic research, to scientific development, to education, to foreign aid, and to economic warfare, whatever is required by the grim arithmetic of cold war. Matching the Russians, area by area, can buy us security, but this is the slow and costly way to meet the problem. In the long run it would be quicker and cheaper, while matching them on the military front, to swamp them in science, technology, in education, in growth of productive capacity, and in economic assistance to the underdeveloped countries of the world and thus to make it clear that, whatever they do, they cannot win the hot, nor profit by the cold war.

These objectives lie within our grasp. We are operating our plant and equipment at approximately three-quarters of capacity—and that is probably an overstatement. The full utilization of this capacity would make possible an increase of one-third, approximately \$150 billion in our gross national product. And I don't mean 5 years from now at a rate of 5 percent per year, but right now, on the basis of present resources.

And we are not short of either raw materials or manpower. On the latter front, there is still substantial unemployment and part-time employment. Our standard work week is 40 hours, and the percentage of our adult population in the labor force is modest. In addition, there are several millions employed in the service industries at low productivity only because jobs are not available in manufacturing. If we were at war, nobody would doubt that we could, with our present resources, operate a \$600 billion instead of a \$450 billion economy. And I mean \$600 billion in real terms, not blown up by inflation.

It therefore lies within our power to quadruple the resources we are putting into the cold war, without reducing the real standard of living of the American people. However, nothing so radical is called for. A doubling of the resources we are putting into the cold war could put our programs beyond the reach of the Russians, while at the same time we could provide the resources for massive increase in productive capacity and substantial increase in the standard of living as well. Think of what the Russians would do with the same opportunities. Can we, should we, do less?

The imperative of our position, harshly stated, is immediate and sustained economic mobilization, with all that means in management and controls. To do less, to remain upon our present course, is to invite extinction. As long as we are not compelled to put major armies into the field, the full apparatus of wartime controls, with broad-scale use of allocations, rationing and general wage and price controls, is not called for.

But we do now need the full machinery for planning and for management which requires the use of selective controls. This follows inevitably from the magnitude of the effort required for survival. Anyone who accepts the necessity for the effort, must accept the necessity for the machinery without which it cannot be made.

There are those who say that there are things we, as a people, would find acceptable and would do in the case of actual war, which we cannot do short of war. This is a Maginot-line kind of thinking. That is the way we did it last time. Unfortunately, the next war, if it is a total war, will allow no opportunity for a long drawn-out mobilization effort. If we have not mobilized before that war, we will not have mobilized at all. And if we are thinking of a brush-fire war, it should be obvious that such wars can occur only if we are not prepared to wage them, as we were not before Korea, and as we are not today. Failure to mobilize before such wars invites their outbreak. And this is the critical point. Failure to mobilize our resources now, is to throw away the one hope we have of preventing the hot war and stopping the cold war. We must assume that the Russians' leadership is coldly rational. They will not give up the struggle as long as the growing preponderance of their power promises them the ultimate victory. But this promise depends on our failure to use our strength to the full. Once we have committed ourselves to a total effort, to repeat, an effort the Russians cannot match, they must recognize that victory is beyond their reach. This is the meaning of the proposition to which we have been committed, at least since 1947, that we can negotiate only from strength. The proposition is self-evident but is it not fair to ask, what strength?

Much of what I have said is common knowledge and, indeed, obvious. I have, however, drawn the grim conclusions and indicated the harsh choices. There are many who will shrink from the proposals, not because they do not recognize the dangers we face and not because they are unwilling to accept in the interest of national survival a temporary interference with the liberties they prize, but because they fear that the planning and controls represent a basic change in the nature of our system from which we can never recover. These fears are groundless. The controls of wartime were abandoned when the war was over. Not only was there no major effort to make them permanent, they were abandoned too soon, as the record shows.

Americans are dedicated to a free system, and the wartime experience shows that they can accept for long periods the management and restraints entailed in mobilization without impairing that basic dedication in the slightest degree. The threat to our freedoms comes from abroad and not from ourselves. It would be tragic indeed if we permitted our Nation to go under, not because of an inherent superiority of power on the part of our enemy, but because we did not have sufficient faith in our own people and in our own institutions to mobilize our full strength in their defense.

The CHAIRMAN. Thank you very much, sir.

Our next witness is Mr. David C. Melnicoff, manager, economic analysis, financial department, of the Pennsylvania Railroad.

Mr. Melnicoff, we are glad to have you, and you may proceed in your own way, sir.

STATEMENT OF DAVID C. MELNICOFF, MANAGER, ECONOMIC ANALYSIS, FINANCIAL DEPARTMENT, THE PENNSYLVANIA RAILROAD CO.

Mr. MELNICOFF. On my way to this office building this morning I passed temporary building D, on Independence Avenue. As I was passing it I saw, or thought I saw, emerging from the center doors, a ghost that looked something like Mr. Gilbert—but on second glance, it was not he. This was the building, of course, that housed OPA during the war, and in which I, along with Mr. Gilbert, spent a good bit of time. As I approached the corner, the ghost ran up to the door of the cab, or seemed to, popped his head in and said, "Remember, as you testify today, that inflation comes in 5 percent increases."

This was a rather cryptic remark, but as I reflected on it, it recalled to mind the scare slogan which I presume Leon Henderson originated during the early days of mobilization, intending to point out that inflation can come a little bit at a time. But the ghost, I took it, was warning me that this trouble came in 5-percent increases, and that the situation we face at the moment is something very different than that.

If we begin to think in terms of OPA, and a full-scale of price-wage allocation controls, in other words, we may be getting ourselves into a swamp from which it will be very difficult indeed to extricate ourselves.

The moral I draw from this little episode is that we have to be careful not to be caught up in the semantics of the situation, and not to be captivated by the scare words which we ourselves originate. We have got to be very careful that we define just what problems we are talking about and what our objectives are. I think, in fact, that one of the chief difficulties in formulating public policies for economic stability and growth arises because stability and growth mean very different things to different people; certainly economic growth means something different to Mr. Gilbert than it does to me, and to many others.

Policy adopted to achieve such growth depends on the nature of the objective. Moreover, there are other more limited goals designed to benefit specific groups or to serve special needs which may be incompatible with the main objective. I refer here, for instance, to objectives of job and income security, despite the desirability of labor mobility, to justice in taxation, and so on.

It is not strange that we have this multiplicity of goals in a complex and free society, where ways of doing things are always changing and people are free to change their minds about what they want. Indeed, the concept of economic growth itself as we now speak of it, is a recent one which has come to the fore as a result of the fact that we have less preoccupation with business cycles in the postwar period. We seem to have profited by the example of the efforts of the underdeveloped nations of the world and we have begun to construct some useful theories about the development of those economies.

I have little sympathy, therefore, with policies which attempt to place an automatic regulator on our economy or to make rigid rules in advance for any situation which may arise. The old laissez-faire principle was supposed to provide automatic regulators of this type,

and I believe the same principle is illustrated by those who want to impose a "stabilizing budget" on us or go back to the gold standard. Those responsible for helping to keep the economy healthy should be free to use a variety of policy instruments, to improvise and to develop new avenues of approach when this is called for in response to changing economic situations or to new objectives.

I have rejected automatic stabilizers, but to the extent it is possible, we should take full advantage of the possibilities inherent in the concept of built-in stability, and the bundle of fiscal policies associated with it should be fully developed. These are policies related to the idea that when we have a dip in economic activity we should allow a deficit on the Government accounts and when we have a boom, we should go to a surplus. It is not possible, of course, to rely on this alone. Our forecasting ability is not good enough to allow the creation of tax and Government expenditure patterns which will always call forth a nice balance at a full employment level. Some mechanism for making prompt changes, especially in tax levels, must be in hand. Instruments of debt management and monetary policy must be coordinated with fiscal plans and anticipations. Inappropriate use of monetary and debt management policies can, of course, frustrate the built-in stability features of our fiscal system.

I can refer to an episode which was unimportant in itself but which dramatically illustrates this difficulty. One day several months ago¹ on the front page of the New York Times, there were, side by side in adjacent columns, a story which described a decline in payrolls and a story next to it in which Secretary of the Treasury was urging people to combat inflation by buying savings bonds.

A wide range of combinations of fiscal and debt-management monetary policies is available and can be used effectively if there is adequate coordination and cooperation among the agencies involved, as well as a proper choice of policies. In recent years, coordination has been achieved with varying degrees of success, but sometimes at the expense of what appears by hindsight to have been too great a concession to expediency. I refer specifically to monetary policies before the "accord" with the Treasury in 1951 and more recently to some of the debt-management policies which the Treasury has been forced to undertake.

More recently, monetary policy has been attacked as either ineffectual or overpowering, depending upon the source of the criticism. These complaints are varied. Sometimes they refer to the growth of financial intermediaries as rendering powerless the work of the Federal Reserve, and sometimes they refer to monetary controls as discriminatory because they impinge too severely on certain segments of the economy. But all of these criticisms, it seems to me, arise out of the belief that the present structure of our economy and its institutions, particularly the modern giant corporation and the giant trade union, are such that an attempt to stifle an inflationary bias begets unemployment.

Now, there is considerable truth in this. However, the best environment in which to make corrections and adjustments is one in which monetary policy, as we now know it, can be operative.

¹ April 8, 1958.

The corrections and adjustments of which I speak are structural in nature. They refer to the pricing policy of large corporations, and from that lead to questions of the viability of small business and the ability of new firms to enter business areas. They deal also with union policy, although this is a much more subtle problem in which we must try to scramble eggs without breaking them. Corrections must also be made in this area, however.

There are two kinds of impediments to effective fiscal-monetary policy for economic stability and growth. The first concerns the goals themselves. The twin objectives of price and employment stability cannot be absolute. There must be some reasonable leeway. The attempt to achieve perfection in one or the other will be self-defeating. Moderate price increases and fluctuations, though troublesome, do not inevitably lead to runaway inflation. Moderate unemployment, although wasteful, need not be self-perpetuating or reinforcing, provided adequate remedial steps are taken promptly and individuals are protected. At times a clear demonstration that Government policy can be restrictive is apparently necessary, despite the danger, but not the certainty, that this may slow business recovery somewhat. Conversely, an inordinate fear of inflation should not prevent strong and prompt action to head off a recession.

The second type of impediment to effective monetary-fiscal policy is in the uncoordinated action of agencies and programs created for special purposes. The various financial aid programs in the field of housing and agriculture are examples of this. The National Bureau of Economic Research has just published a book,² one of whose authors is Dr. R. V. Saulnier, describing the lending and credit guarantee policies and practices of the Federal Government. It is a very thick book, but it is not complete. To the extent that such programs are necessary and desirable, they could be used to assist in creating a strong program for stable growth. The focus of these programs must be broadened, however, and they must be administered in a manner consistent with overall policy, if this is to be accomplished.

The desire for more rapid growth in our economy, whether for military or purely economic reasons, leads many to advocate the encouragement of forced-draft operation at all times. If this creates inflationary tendencies, then direct price and wage, and allocation controls are called for. This approach should not be rejected out of hand, though it would very likely change our economic and social system beyond recognition. I reject it because I do not believe it would be effective now in achieving the objectives we seek, ill-defined though some of those may be. I think there are overwhelming administrative objectives to this which would make such a program ineffective in the present situation. I think also it would create grave and unnecessary distortions in our economy, especially in the balance between investment and consumption.

The desire for more rapid growth can best be fulfilled by attention to long-range development factors and to revisions of programs which slow the pace of economic advance. Among policies which should be reexamined and revised in this connection are those in the field of agriculture and foreign trade. Transportation efficiency has been

² Saulnier, Halcrow & Jacoby: "Federal Lending and Loan Insurance," Princeton University Press, 1958.

reduced for many years by a combination of inappropriate tax, regulatory and public works policies.

The need for additional defense capabilities and for foreign aid, can best be fulfilled by a direct program of Government procurement and training for which we pay in accordance with the requirements of a sound fiscal policy. Unless it is clearly necessary that we go to a war footing, it would be folly to make a decision to move to a controlled economy—a decision which might be irrevocable.

It may well be that events will force us to move some part of the way down the scale from general to specific controls. Selective credit controls may be required at some time, for instance. This, however, should be done reluctantly and only after existing tools of fiscal monetary policy have been given the best chance of success. We have not yet done our best. Economic freedom is too precious to do less.

Thank you.

The CHAIRMAN. Thank you, sir.

Mr. Albert Rees, associate professor of economics, University of Chicago. We are glad to have you. You may proceed in your own way, sir.

STATEMENT OF ALBERT REES, ASSOCIATE PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. REES. Thank you, Mr. Chairman.

I should like to apologize first for not having provided the committee with an adequate number of copies of my statement, and I should like to make some very brief comments on growth.

These comments were inspired largely by Mr. Gilbert's paper in the Commentaries. Mr. Gilbert has changed his emphasis a little bit this morning from what it was in the published paper, so not all of what I have to say will be relevant to his remarks here this morning. I am, however, not quite fast enough on my feet to make all of the appropriate changes, so I will read the statement as I originally prepared it.

First of all, I think our production record since 1946 is better than it appears to be. We must recognize that our price indexes are biased upward and our production indexes are biased downward because neither can take full account of improvements in quality. During wartime, when quality deteriorated and products were standardized, these biases were reversed. Our wartime record thus looks better than it is, and our peace-time records looks worse than it is. Similarly, the Russian production indexes rise faster than ours in part because Russians produce standardized goods and the quality of Russian civilian goods improves very little. I do not mean to deny that the Russian economy is growing faster than ours. But I do think that we have to be cautious in taking production statistics at their face value.

Nevertheless, it is certainly desirable, and perhaps essential, that we grow faster. How do we do this? By creating massive inflationary pressures and smothering them under controls? This will produce a rapid rise in measured gross national product, but part of it will be fictitious and much of it will be waste. The way to get growth is to concentrate more effort on the key factors that produce growth. In my judgment, these are—

(1) Education, especially the quality of education rather than the quantity;

(2) Research, especially basic research as opposed to applied research and development; and

(3) Investment, especially the creation of adequate incentives for risky investment.

Would it help us get growth to avoid all recession, if this were possible? The answer is not clear. Deep recessions set back growth by curtailing output and investment. But in mild recessions, the effect on the quantity of output may be offset by the beneficial effect on the quality and composition of output that comes when producers are forced by the pressure of a buyers' market to take stock of their performance.

Finally, if it requires inflationary pressure to get adequate growth, should the resulting inflation be open or should it be suppressed by wage and price controls? In my opinion it should be open. Wartime price controls are reasonably workable because they are known to be temporary, because they are reinforced by strong patriotic motives, and because the lack of consumer durable goods creates abnormally high savings.

Permanent peacetime controls would cause widespread black markets and strong incentives to produce the wrong things—the things which controls accidentally made most profitable rather than the things people want or the economy needs. In this way, permanent controls would curtail the very growth they are supposed to promote.

Mr. Gilbert tells us that we can get rapid growth without inflation simply by going back to the good old days of OPA. This is dangerous nonsense, compounded of a misunderstanding of what things government does better than the private sector, and an incredibly naive attitude toward economic statistics. What we need of government is not massive interference with the economy, but small amounts of help at the critical points where the growth process begins.

The CHAIRMAN. Thank you, sir.

Mr. Robert C. Turner, professor of economics, School of Business Administration, Indiana University.

We are glad to have you, sir. You may proceed in your own way.

STATEMENT OF ROBERT C. TURNER, CHAIRMAN OF DEPARTMENT OF BUSINESS ECONOMICS AND PUBLIC POLICY, SCHOOL OF BUSINESS, INDIANA UNIVERSITY

Mr. TURNER. The compendium and panel discussion of last spring, and the more recent papers prepared by the labor and industry economists, lead clearly to two conclusions. The first is that much of the differences among the numerous able persons who have analyzed the problem of the relationship of prices to economic stability and growth can be traced to basic differences in their philosophical premises.

Each one of us, consciously or unconsciously, approaches a problem of this sort with a fairly firm set of value judgments which influences our selection of facts to analyze the conclusions we reach as to what these facts show, and the policy prescriptions we may propose. We may try as honestly and conscientiously as we can to be coldly and impartially analytical, yet we cannot avoid being influenced by our value systems.

I am not referring simply to the obvious fact that all of us tend to be influenced in our thinking by the source of our paycheck—although I seemed to detect a trace of such influence in the responses of the labor and industry economists. The real problem lies deeper than that. It lies in our moral, ethical, perhaps religious presuppositions as to what is really important in life. It lies in the relative priority which we attach to alternative objectives, both personal and social.

For example, if one is ideologically committed to laissez faire as the only means of achieving and maintaining a free society—if he has adopted laissez faire as a social objective rather than one means to an objective and finds repulsive any form of social control over individual behavior, he is likely to be uncomfortable, indeed repelled by a line of analysis which leads to the inevitable conclusion that a solution to the problem can be found only in further social control of individual behavior.

Conversely, one who attaches an overriding priority to those types of freedom which come only from personal economic well-being and security is much more likely to accept this line of analysis and its inevitable conclusions. The situation is seldom as extremely dichotomous as this because most of us have an elaborate assortment of objectives in our value systems, no one of which is, at all times at least, overriding. But we do have our priority systems, and in this lies the source of conflict.

One of the ideological conflicts which is particularly relevant to the subject of these hearings, as several of the authors have pointed out, has to do with our basic notions as to what constitutes equity in our society and as to the choice, where choice is necessary, between different kinds of inequity.

Involuntary unemployment, caused not by incompetence or laziness but by the simple fact that the current level of economic activity is not providing enough jobs to go around, treats inequitably those who bear the burden of this job deficiency. It is an inequity which not only deprives people of their means of livelihood but which robs them of their self-respect and their confidence in the social organization of which they are a part. Unemployment, as an older generation can testify, can be a devastating experience. It is a source of cruel inequity.

Inflation also creates serious inequity. It robs those on fixed income and gives to those with sensitive incomes. It robs those whose savings are in fixed-dollar obligations and gives to those who own land or commodities or common stocks. It robs creditors in favor of debtors. This is clearly a gross inequity.

If a study of the facts seems to lead to the conclusion that a choice between these two sources of inequity, unemployment and inflation, is inevitable, there are three possible sources of action. One is to give a higher priority to avoiding the inequity of unemployment. This calls for policy actions which, it is hoped, will generate and maintain a growth in economic activity fully commensurate with our growing labor force and rising productivity even though at the cost of a persistent upward drift in prices.

Or second, we may give higher priority to avoiding the inequity of inflation. This calls for public actions, such as restraints on demand through monetary and fiscal policy, of sufficient vigor to contain the rise in prices even at the expense of substantial unemployment. There

are many whose ideological predilections lead them openly to advocate such a course of action.

Still a third course of action is to deny that the choice must be made between these two sources of inequity. In some instances, such a denial is the product of an honest conviction based on careful reasoning that a solution to the dilemma can and will be found—that we can maintain full employment and have stable prices too. In other instances, such a denial reflects, I think, the unconscious effect of one's basic value system. Being unwilling ideologically to accept the unpleasant alternatives which are inherent in this inevitable choice, they find it easier—and much more satisfying—to adopt a line of reasoning which concludes that no choice must be made. The reasoning is competent, the purpose honest, but the entire thought process is subtly colored by the ideological base from which it is started.

Still a third group denies that a choice must be made, not because honest reasoning leads them to this conclusion, but because they are unwilling to confess publicly their preference for the inequity of unemployment—of someone else—over that of inflation.

These observations contain, I hasten to add, nothing that is new or profound. But I do think it is important for Members of the Congress and others who may be reading these papers and hearings constantly to remind themselves that ideological premises do influence economic reasoning. Economists are not as stupid or undisciplined as their conflicting testimony might suggest; they just start with different value systems.

The second conclusion which we may draw from these proceedings is that the subject with which we are dealing is a large and extremely complex one. Price and wage making is the very heart of a free enterprise system. If we are to understand price and wage making, we must perforce understand the entire functioning of contemporary American capitalism.

The point has been made by several of the authors in these symposiums that we really know very little about the price- and wage-making process. This is true, but it is not because economists have failed to study this process. On the contrary, over the years thousands of able minds have focused on one or another facet of price and wage making. The difficulty is rather the fact that our economy is so heterogeneous in its makeup.

Any theory of pricing in the contemporary economy must allow for a variety of forms of business organization, from the free-wheeling independent proprietorship to the huge, bureaucratic modern corporation. It must allow for a wide range of market structures, ranging from well-nigh perfect competition to massive aggregations of economic power in industry and in labor. It must account for the complex process of corporate decision making in which the key actors are professional managers who have been partially insulated from the coercive force of the market.

The important role played by these professional managers throws into our analysis the whole gamut of human emotions, not only the simple hedonistic calculus of the classical model, but a host of others ranging from lust for power, through socially oriented altruism, to synthetic wants created by the advertising profession. It must take into account the role of independent will. The factor of will can

be averaged out as long as we are dealing solely with large numbers, but when power is vested in a few—relatively speaking—and when those few have been significantly relieved of the coercion of the market, will become vitally important.

It must also take into account the law of economic indeterminacy which I somewhat brazenly propounded some 6 months ago, to wit: It is impossible to predict the exact behavior of large, quasi-public business units because consciously determined and inherently unpredictable public policy is one of the prime determinants of their actions. (See "The Apologetics of 'Managerialism': Comment," *Journal of Business*, July 1958.)

These proceedings have demonstrated that the inflationary process is not uniquely cost-push or demand-pull—indeed that cost-push and demand-pull are not necessarily separate and unrelated phenomena. You may recall that in my paper in the Compendium I tried to invent a new phrase: "push-pull inflation." Rather, the terms "demand-pull" and "cost-push" are dangerously simple, shorthand expressions for identifying the principal initiating influence which sets in motion, or perpetuates, the price-wage-income-demand spiral. In some time intervals one of these initiating influences is dominant; at other times the other predominates; at still other times neither or both are at work.

These proceedings should also have demonstrated that the solution to "creeping inflation"—if indeed there is a solution—will not be simple. The experience of the past year and a half have clearly established the principle that simple restraints on aggregate demand via monetary policy are not dependably effective nor always salubrious. At the other extreme, direct and comprehensive price and wage controls are probably unworkable in so-called peacetime and even if they were workable would be an unreasonably high price to pay for the difference in price behavior which would ensue from their application.

I suspect that the solution lies in the continued but very cautious use of monetary and fiscal policy to contain those occasional waves of inflation, or deflation, which clearly have their origin in monetary factors affecting demand, plus the gradual introduction, over a period of years, of a patchwork of miscellaneous policy actions centered around the twin theme of (1) bringing the price- and wage-making process out into the open where it is subject to public scrutiny before prices and wages are actually set; and (2) bringing pressure to bear on those individuals who exercise a significant degree of economic power to act in a socially responsible way.

I would not reject any proposed solution simply because it falls short of being an adequate answer to the problem. Rather I suggest that the Congress look for opportunities in many areas, including many which are seemingly remote from the subject of price stability itself, to make contributions toward this end—contributions which, one at a time seem minor, but which, in the aggregate, are significant. Mr. Rutenbergs's agenda is perhaps as good a starting point as any, except that in his points 1 and 3(a) I would substitute "price and wage" for the word "price."

The gradualistic approach which I am suggesting is, I believe, the commonsense approach. Creeping inflation is not about to explode in our faces. We do have time to forge sensible and workable, step-

by-step solutions to this problem. The social costs of creeping inflation, while not inconsiderable, are moderate compared with other possible consequences of unwise public policy.

The CHAIRMAN. Thank you, sir.

Mr. Douglas?

Senator DOUGLAS. Mr. Chairman, I appreciate your characteristic courtesy in calling on others first and putting yourself at the tail end for questioning, but I really think this is excessive and I would like to decline in your favor.

The CHAIRMAN. Very well, Senator.

The questions I would ask are usually asked better by others by the time it gets back to me. I am glad to yield to you, Senator. That is my preference. Thank you, sir.

Senator DOUGLAS. I would like to ask Mr. Gilbert a question or two, if I may.

I take it, Mr. Gilbert, you think that under forced draft the national gross product would be rated around \$450 to \$600 billion, or increased about a third.

Mr. GILBERT. That is right, Senator.

Senator DOUGLAS. And I take it also that you think this can be achieved by getting more man-hours of labor which at present are not utilized, and with either sufficient idle capital resources or capital resources which could be worked on a second shift so that the extra labor could be teamed up with adequate supplies of capital; is that right?

Mr. GILBERT. That is right, Senator. I think those figures are almost self-evidence. An increase to the 48-hour week is one measure, it seems to me a necessary measure, to produce approximately a 25-percent increase in man-hours.

Senator DOUGLAS. In other words, a decrease in unemployment, full-time unemployment and voluntary part-time unemployment, to around 9 or 10 percent to, say 3 percent, would add 6 percent to the national gross product.

Mr. GILBERT. No. I think the unemployment is more nearly 7 percent now.

Senator DOUGLAS. I mean involuntary part time.

Mr. GILBERT. Including part time, yes; I think the figure is perhaps 9 percent.

Senator DOUGLAS. So you would get 6 percent that way. Then you propose an increase in the working week from 40 to 48 hours, which would be 20 percent, and then an increased proportion of the population at work.

Mr. GILBERT. Approximately 3 percent.

Senator DOUGLAS. Young people and older people, married women, and then some curtailment of occupations which you regard as less necessary for social survival.

Mr. GILBERT. Well, really what Keynes used to call concealed unemployment, of which there is a very considerable amount right now, people who are eking out a living finding bits and pieces of useful work at low rates of productivity and at very low wages.

Senator DOUGLAS. May I ask how you would draw this added supply of man-hours into the productive processes? Would you draw it in through the payment of wages?

Mr. GILBERT. Well, I would like to take a few minutes to answer that question, Senator, because it is really crucial.

In this discussion up to this point, none of us have really got specific. But my views have been characterized in a way which seems to me to be absurd.

Senator DOUGLAS. Wait a moment. I don't ask you to defend yourself against your critics, but I would like to have you answer the question which I asked, namely, how are you going to get the additional purchasing power, assuming that you do not draft labor, which I assume you do not want to do, to call these extra man-hours into being?

Would you do it through taxation, or would you do it through Government borrowings?

Mr. GILBERT. You would do it in the first instance through the simple and obvious technique of increasing the defense budget, on the basis of which contracts would be placed with our major industries to produce missiles, tanks, or whatever it happens to be.

Senator DOUGLAS. How would you have the Government finance this increased expenditure on defense—by taxes or by deficit, and the creation of bank credit?

Mr. GILBERT. I will say this, first: Our present tax structure, if applied to an increase of \$150 billion in the gross national product, would throw off something of the order of \$40 to \$45 billion of additional Federal Government revenues.

Senator DOUGLAS. First you have to get the growth.

Mr. GILBERT. If you will just bear with me a moment, I am suggesting a \$50 billion increase in the Federal budget which would automatically produce, with our present tax structure, approximately \$40 to \$45 billion of additional revenue and, therefore, give us a \$5 to \$10 billion deficit on this program.

Senator Douglas. How would you finance the initial \$50 billion?

Mr. GILBERT. I would raise taxes, not only to balance the budget at that level but to throw off a surplus perhaps of \$10 billion, and that would still leave us with a substantial inflationary problem, as I will try to explain in due course.

This, therefore, would call for some use of price controls. I would like to get specific about that, too, if I may. But I do want to make this basic point first so that there will be no misunderstanding on anybody's part as to what I am really trying to get across to you.

We have to choose between alternatives within a real framework and not in a vacuum. If I have to choose between an increase, say, from \$3.3 billion in expenditures on missiles, which is our present pace this fiscal year, to \$10 billion, which I think we need, and this was to cost us a 10-percent increase in our price and wage level because we failed to do the things, either by fiscal policy or by direct controls to prevent it, I would say that was a very cheap price indeed to pay to get those missiles.

Senator DOUGLAS. Mr. Gilbert, may I say that I think you have done a very valuable service in emphasizing the fact that the Russians are gaining economically upon us, from a relative standpoint, and that they have superiority in many fields of military attack and possibly military defense.

This is what my colleague, Mr. Bolling, has been saying for some years, and I think you both are correct on this point. I was not questioning for a moment the need for added armaments. I was trying to go into the economic mechanism by which you would obtain them.

My questions are not meant to be unfriendly, but analytical. The question I have is how would you raise these moneys initially? Is this not a transfer of monetary purchasing power rather than the creation of additional monetary power? Namely, you are taking away an equal amount of purchasing power from those who pay the taxes to that which you grant to the other industries.

So it would depend upon the policy of taxation. I do not see where there is any net increase of productivity or in the national income, but merely a shifting of the components of the national income.

Mr. GILBERT. May I interrupt at this point?

Senator DOUGLAS. Surely.

Mr. GILBERT. What you have just said seems to me to be crucial. What I am saying is that there is \$150 billion of output which we are not producing because we are sitting on our hands—labor, management, and everybody else.

If we produced that \$150 billion, however it is distributed, between Government, business, and labor, everybody is still ahead of the game. I am willing to use any combination of fiscal, monetary, direct measures that anybody wants to mention. I will accept anything in sight so long as it guarantees us that increase of output which is the heart of the question.

I am persuaded that we can get it not merely with a balanced budget at a much higher budget level, but even with a substantial surplus at this higher level. But if it turned out, in fact, that that was an error in judgment and we had to run a large deficit or we had to do anything else in order to get the additional production, I say that that price would not be too great.

I will venture to say, Senator, that if my distinguished colleagues both around this table and throughout the United States could ever really bring themselves to think about what is the real problem, the technical differences between us on how to produce or finance the expansion would be of little consequence.

Senator DOUGLAS. I think the comments which have been made from those on your right made you feel that I am somehow associated with them, which is not necessarily the case. I am trying to probe the process by which you would get this increase.

I ask you if you would raise the additional sums for expanding the defense budget by taxation, whether that in itself really increases the national gross product, or whether it merely results in different components of it.

Mr. GILBERT. My answer to it, again, is if the Government of the United States will place orders for \$10 billion of missiles or missile work instead of \$3.3 billion, that the industries, the firms which get these orders, will hire the men, and if they can't get enough men on the 40-hour week basis they will pay overtime, and they will produce the goods.

The net result of this will be, No. 1, that our industries will be receiving enormous sums from the Government, and labor, in turn,

will be receiving very substantial increases in the total wage salary bill. The national income will rise, just as national production increases, and the Government revenues will increase.

Senator DOUGLAS. You are a trained economist, and I think quite a good one. You must certainly take into account the fact that the level of taxes will withdraw income from other sections of the population, and will cause their money to be used for products to shift, so that you will create unemployment in other industries, which possibly you should do, and you will get an increase of employment in the war industries through a transfer.

In practice, won't you be forced, as a matter of fact, in order to get the expansion you wish, to finance this by deficits and by borrowing from banks and the creation of additional monetary purchasing power in the form of bank credit?

Mr. GILBERT. No, Senator. Your description fits the Russian economy. They are already working at peak capacity. In order to increase the production of one type of armament, they have to decrease consumption on the part of the public—

Senator DOUGLAS. No; I am not really saying that.

Mr. GILBERT. In our situation, the point I am making is that we are not working to the peak of our capacity, and we can expand employment and production.

Senator DOUGLAS. I have not yet said that this necessarily brings inflation. I am merely trying to get the process. In order to get the addition of monetary purchasing power, wouldn't you have to have the Government float loans from the banks and they create the bank credit?

The question of whether you get inflation is whether or not the increase in productivity which you call forth by the additional monetary power would be sufficient to offset the added monetary purchasing power which is brought into being, and that may be.

I have always felt that if you had idle resources and could put them to work by the creation of monetary purchasing power, that the danger of inflation is certainly not as great as a great many people assume rather facily, and if you get a sufficient increase in production may be nonexistent.

I am not arguing against you at all. Don't feel that. But I am trying to examine the process, and I would like to have you think over for the record, if you want to amplify your reply when the text comes to you, as to whether this does not call for an initial increase in financing by bank credit.

An increase, by the monetary authorities, in bank credit, in the supply of money, is a necessary part of the process of expansion of output. Failure to increase the money supply could not only slow down the expansion, but, under some circumstances, frustrate it.

On the fiscal side, the expansion I propose, given the present tax structure, would produce a large deficit, a large excess of total demand over output and strong inflationary pressures. That is why I suggest an increase in taxes, sufficient to produce not only a balance in the budget, but a surplus, and to keep total demand within reasonable distance of our capacity to produce. But we must not lose sight of the fact that if we wish expansion, total demand must continuously exceed and tug at output.

Which brings us to the key question. Is there a combination of monetary and fiscal policies which can give us the expansion we need without producing a dangerous inflation? I think not. As I pointed out in the longer paper submitted to this committee, experience shows that a rapid increase of demand can produce strong inflation in the face of major underutilization of resources, as in 1937 and 1941-42; and that a slow increase, or even an actual decrease of demand, is consistent with some inflation in spite of large and growing excess of capacity, as in 1953-57 and 1957-58.

The reason is that under conditions of high production, employment and income, both labor and management are bargaining from strength. The risk of loss of jobs or loss of markets is minimal. And in their effort to improve or maintain their relative positions they simply push costs and prices up.

Furthermore, both groups are bargaining and pricing with an eye to the future as well as the past. And this is true not only of the so-called administered areas of the economy, but of the competitive, sensitive areas as well. For example, suppose the President were to send the Congress a message calling for mobilization and a major increase in the budget. Does anyone doubt that the mere announcement of such a program, and before a single dollar was appropriated, would touch off a rapid runup of prices and costs? Did not this happen after Korea? That is why, if we are serious about preventing inflation, we need the power to freeze prices and wages.

And even after the shock effect of such a declaration wore off and the economy settled down to the serious business of expansion, it would still be true that prices and wages are very volatile upward under such conditions. This does not mean that they must all be controlled. But it does mean that all of us need to know that they can be controlled if necessary.

The CHAIRMAN. Mr. Gilbert, each member of the panel may elaborate on his testimony or anything that comes up here when he receives his transcript. As Senator Douglas has indicated, his time has expired.

Mr. GILBERT. Thank you.

The CHAIRMAN. Mr. Curtis?

Representative CURTIS. I might just pursue one point.

Mr. Gilbert, have you read this committee's study on Russian economic development that was published in 1956?

Mr. GILBERT. I can't say I have studied it. I am familiar with it.

Representative CURTIS. The reason I asked is because I am a little disturbed at the conclusions you have presented as to economic achievements and the situation in relation to the United States in reference to the pamphlet you read on the part of the committee staff concerning the relationship.

I would think that it would be more helpful if we got into the economic evaluations and possibly use that study as a starting point instead of drawing conclusions throughout here that I cannot myself agree with nor follow. I just don't know where you obtained such information.

Mr. GILBERT. I would be very glad to tell you, and at the same time correct a misstatement embodied in both the long paper I submitted for the Commentaries and this short statement.

The basic source of this material is Mr. Allen Dulles, and this is based upon the work of the CIA. But I have checked it with many of the Russian economic experts. On the basic error in fact—

Representative CURTIS. I might say, Mr. Gilbert, so we do not get into a discussion here, that that was the point of the study. I was about to write the chairman a letter suggesting that we bring that study up to date. I think that is something that we always want to keep on top of so that our estimates of Russia would be as good as they can be on the basis of current studies.

Representative BOLLING. For the record, I think both of those studies, first the relationship of two blocs, and then of the Soviet and the United States, were made by the Legislative Reference Service for us.

Representative CURTIS. That is correct. I think our staff did a little more than just that. I think this is very important because throughout our panel discussions there has been constant reference by the economists, the panelists, to the Russian economy, and I think it is very important that we start discussing the specifics rather than general conclusions.

I would go on to say the same thing about your evaluation of Russian education. There was a definitive book written by, I think it was Mr. DeWitt, of the Harvard Russian Research Center, which certainly in my judgment does not bring about the conclusions you state here.

Thirdly, in regard to military prowess, there are no such, in my judgment, conclusions in the statements by our best experts. They do not support that. But as far as economics are concerned, I hope that our future discussions will try to relate to some definitive studies in the area so that at least I, as a member of the committee, can follow what is being discussed.

Now, if I may, I would like to point out one other thing.

Mr. GILBERT. May I say one thing, Mr. Curtis?

Representative CURTIS. Certainly. You can expand the record. But I wanted to make that point in the record at this time. I did not want to get into a long discussion about it.

Mr. GILBERT. I would like for you to think of this very short point I am going to make.

Mr. Dulles and the CIA, and this is supported, to my knowledge, by all of the Russian experts, have said that the manpower and resources being devoted by the Russians to their military and cold war effort are approximately the same as our own.

In other words, to make the translation from rubles to dollars, the net result is that we are really putting the same resources into the struggle. That flies directly in the face of what we know to be fact: No. 1, that the Russians have an overwhelming superiority in manpower under arms and in conventional armament, which is really where most of the dough goes.

No. 2, that they have an enormous superiority in manpower and equipment in the new weapons systems.

Representative CURTIS. That is what I want to avoid, our getting into a discussion there. I simply want to point out that there is an area for examining into that. The conclusions you have reached you are entitled to draw.

I have discussed this, as a matter of fact, with Mr. Dulles himself, and I think there is a lot of area which needs further exploration. I was just disturbed at the conclusions because I feel that what studies we do have do not bear that out.

You are entitled to your opinion. I think in the area of economics this committee can well help, and I know the committee, if it does make this study, will be glad to consider your materials.

Mr. GILBERT. Just to make the record clear, if such a study on your part were to support your conclusion, if it turns out that the Russians do not have what I think they have, then I withdraw my position in full. What I say policywise flows from an analysis of fact, I think an analysis of the facts of comparative strength, and rates of changes in that strength.

Representative CURTIS. That is why I think it so important that this be further analyzed, because I agree with you that if your conclusions were correct, then probably forced draft is necessary, but I would like to get on, if I may, to the subject of our panel.

I read in the Wall Street Journal this morning the following statement:

For all 1958, the Commerce Department predicted increased receipts of individuals are certain to hit a new high of \$253 billion, a \$5 billion gain over 1957. But because of the rise in consumer prices, the Department said, the purchasing power of the 1958 total wouldn't be as great as last year.

That gets down to one of the points I have been trying to discuss with the panel. Is that really true? In other words, what is the purchasing power?

I pose the question that maybe the purchasing power has not declined, but what we have looked upon as a decline in purchasing power is the fact that some of the products, goods and services are costing more, but in the cost is increased quality. Certainly there is a variety that wasn't there before.

In other words, there is an increased standard of living that comes along with this which could be costing more. I have just jotted a few things down. I know it takes me 10 minutes' less time to go from my home in Webster Grove down to my office in St. Louis because they have put in the superhighways. I think that is true for a lot of people. They are saving 10 minutes.

I don't know that we wanted to save it, but there it is. We are buying this stereo hi-fi for Christmas. That wasn't even on the market before. In another project I am interested in we are now offering completely air-conditioned homes in the \$14,000 to \$15,000 level. Such a thing was never available before.

We have a new hospital in the area. There is going to be more social security beginning in January, on January 1. The English Benedictines have come and put in a beautiful secondary school in the area.

But what I am getting at is that those things cost money, of course, and somewhere they are going to be reflected in our price index, I believe. That is, unless other economic factors, such as productivity, possibly, would enable us to get them for the same amount.

So the question is: Is it really true that the purchasing power has declined? I think possibly it might have, but maybe it is because we are trying to purchase goods and services, some even that we never had before, some of improved quality, which just cost more because

there has been more labor, material, research and development, which have gone into them.

Could that possibly be what we have been talking about as this creeping inflation, rather than the other?

Mr. MELNICOFF. I think, sir, that the question you raise specifically is a technical one concerning the way in which we measure price increases. I think that most experts in this field, of which I am not one, would agree that the indexes we now use to measure prices are biased in an upward direction because of this quality factor. During World War II they were probably biased in a downward direction for the same reason. They did not reflect adequately the deterioration of quality. However, I think that the problem of creeping inflation is one which concerns price levels overall and cannot be analyzed by reference to individual items and prices.

I do not think we can have inflation unless we have an expansion of demand and, usually, of the monetary sources for that demand. If we did not have an expansion of money demand for goods, the increase in quality of which you speak would merely make some prices go up at the expense of others. We do not necessarily have a rise in the general level of prices merely because of increased quality.

Representative CURTIS. In our price index has it been a general thing? Has it not actually been as in services, for example, which have constantly been rising, while certain things have seemed rather stable? I am wondering whether this upward bias that you refer to might not actually be, upon complete analysis, almost totally the result of new goods and improved quality?

I do not know, but I have been speculating on that for some time as to whether it might be. If that is so, then we have a lot different problem confronting us than what we have traditionally thought of as inflation. Certainly that is not a bad thing.

It creates problems for people on fixed incomes, whatever it is, but it is a different thing. To try to correct it through a monetary apparatus would be a mistake.

I see my time is up.

The CHAIRMAN. Mr. Bolling?

Representative BOLLING. In order to sort of clear the record, Mr. Curtis will remember that I had a good deal to do with both the studies that we have had on this question of the economic growth, first of the Soviet bloc versus the Western bloc, and then of the Soviet Union versus the United States.

Those studies were studies done by the Legislative Reference Service for the committee, with very constant and continuous staff and committee member supervision. The interesting fact is that the result of the first study so impressed me that I have had the feeling that Mr. Gilbert so ably expresses as the situation in the cold war ever since I completed my work on that one.

The second study reinforced this impression. At that time, as I remember, at the time of the first study, the subcommittee, the Subcommittee on Foreign Economic Policy, and I believe it was more or less concurred in by the full committee, recommended most of the proposals suggested by Professor Rees, that a tremendous emphasis would have to be placed on education, that a tremendous emphasis

would have to be placed on research and development, and a series of other recommendations. The same set of facts did not particularly impress Mr. Curtis.

Representative CURTIS. It was the other way.

Representative BOLLING. But they did impress me enormously that the Soviet Union was making incredible progress compared to ours in this economic field.

Representative CURTIS. Would the gentleman yield?

Representative BOLLING. Yes.

Representative CURTIS. I was thinking probably a good exercise might be to hold hearings on the staff study, particularly if we bring it up to date. We never did do that.

Representative BOLLING. We did have one set of hearings.

Representative CURTIS. Not on the second one.

Representative BOLLING. I believe it was on the the first one. I have forgotten the date.

Representative CURTIS. I would like to hear economists evaluate what these studies have brought out.

Representative BOLLING. At the time, and I do not remember in detail, we had a collection of the supposedly best experts in the field of the Russian economy. But the point I want to make, without getting into any argument, is that the same set of facts impresses two people entirely differently.

I heartily agree that this is something that must be pursued, because I heartily agree with you, Mr. Gilbert, that this is the only frame of reference that makes any sense at all. I am inclined to believe that perhaps some of the things that you recommend may prove to be necessary, but I am inclined to take Professor Rees' approach initially.

The point is that while we need this approach as a frame of reference, that what we are really talking about is a massive policy decision on the part, specifically, of the American people as represented in their Congress and by their executives, to change the level of activity in the cold war on the part of the United States.

There are, since I have been using this as, let's say, campaign material for several elections, at least the possibilities that this is particularly volatile. But at the level of policymaking it has received no significant acceptance. I don't mean to say by this that this does not make it all the more urgent that we direct attention to it, but we are a long, long way from getting anybody to look very hard at this on a realistic basis.

I have been working at it perhaps not as long as you have, but for at least 4 years, and it is really rather disturbing, the complacency that one runs into.

Mr. GILBERT. I have to apologize to my colleagues as well as the members of this committee for not having started on this line a long time ago. But it does seem to me that in facing up to the situation we should not delude ourselves that any of us know or can know with any degree of precision what the magnitudes of the efforts are on the two sides.

If what I was suggesting to you was a difference of 2, 5, or even 10 percent, I wouldn't be here wasting your time to make that point. The point I think you must recognize, and which the Nation has not

recognized, is that the Russians, starting at the end of the war, with something of the order of a quarter of our production, and a fifth or less of our capacity, have called the tune all the way through and we have danced to it.

They have had a series of smashing victories and we have had a series of disasters. And there are many more of them, I am sure you will agree, coming up within the next year or two. The point I am trying to make is that if anybody in Russia had or would today stand up and say they can't afford to spend this, that, or the other amount on defense, they would be shot as traitors; whereas, in this country if anybody says the same thing loud enough we make him Secretary of Defense or Secretary of the Treasury.

I wish we could trade this particular doctrine with the Russians. If we could, I would be reasonably sure that within 3 or 5 years the cold war would be over, our way.

I have had no access to confidential or secret material, but I am certain that we have not had a straight story from the military because they are under directions not to give us a straight story. If you would put the military people who knew the story on the stand under oath, and with a guaranty of protection against their civilian superiors, you would get the story in no time flat, and that story, it seems to me, compels us to try to do this time what we failed to do last time.

Twice in my lifetime we have been lucky enough to have had the time to mobilize. I think our luck has run out, and if we don't do something quickly and very quickly, if we stay on our present course and the Russians remain on theirs, the results are predictable. I haven't the slightest doubt that somewhere in the CIA these courses are being plotted, and they reach a point at which we have to throw in the sponge because there is nothing else for us to do.

But the study is sitting there in a cubby hole against the time when the President has to break the sad news to the Nation, at which time it will be possible for him to say, as he said after sputnik, that "Anyway, it didn't come as a surprise to us. In 1953," in such-and-such a journal, "the Russians said they were going to do this, and we knew all the time that that is exactly what was going to happen."

What I am asking is that we approach this problem with our eyes open. I don't know what the magnitudes are, but I know they have to be gigantically greater than they are. I know we can swamp the Russians on any front if we put our minds to it.

I say for God's sake let's get the scales off our eyes and really look at this menace.

Mr. TEPER. Mr. Chairman, I wonder if I can make a comment at this time? Because of my personal connection with an organization that fought communism, both in this country and abroad as far back as the 1920's, I feel that I can speak freely.

I am, of course, in sympathy with the general objectives of Mr. Gilbert when he refers to the Communist threat. Yet I do not share his alarmist approach. Despite all the gains made by the Soviet Union, their economy is still lagging behind ours. Admittedly, a number of Russian economic indexes available to us showed rapid gains in the recent period. But the rate of advance does not tell the whole story. What matters in the end is the absolute level of performance.

Even today, the performance of the Soviet state is far below that of the United States. It is apt to remain thus for a considerable period to come. It is this fact that underlines the alarmist character of Mr. Gilbert's observations.

To further the alarm, Mr. Gilbert tells the committee that anyone in the Soviet Union who might wish to seek limitation on armament production would be shot. Maybe so. But we know that the Soviets cannot devote all of their resources to the buildup of armaments. Lately, they were forced to give greater consideration to the production of consumer goods, unquestionably because their notorious insufficiency in the Soviet state is creating some form of a domestic crisis. The inadequate output of consumer goods is a major weakness to which even the Soviets must pay increasing attention. They cannot therefore continue a buildup of armaments without diversion of some of their facilities to the production of consumer goods.

The struggle against communism is an important one in our age. We cannot ignore it. But we must also remember that all this struggle does not solely lie in the economic or the military sphere. It is also ideological in character. Many of our failures in the struggle against communism can be found in the battles of ideas.

I do not propose to deal with the ideological struggle against communism. The present hearing is hardly the place for it. I do want to comment, however, on one aspect of the discussion of the Communist threat which we have heard so far.

While the Nation must be ready to meet the Communist menace in whatever form it may arise, we must not be stampeded by fear into the creation of a quasi-garrison state of affairs, such as Mr. Gilbert seems to envisage. Nor must we rely on the Communist bogey to whip us into a state for the development of sound economic policies. We must seek a better and fuller use for our human and material resources for their own sake. We must show by deed and example what a free society can offer to our people and to the world. For it is, ultimately, in our economic growth and our general wisdom that we must show our strength. That does not mean that we must relax our vigilance. Just let us not make the Nation a slave of its fears.

Representative BOLLING. It may be interesting to throw in here, since we have had so much discussion of these reports and their implications, that there was at least one so-called scholarly journal in the Soviet Union that took great exception to our last report in the section that dealt with how they had achieved this progress. It bears on your point.

We said in effect that they take it out of the hides of the Russian people. This caused considerable concern. We were attacked at very considerable length in these various journals for daring to say that the Russian people didn't have as high a standard of living as others.

I don't happen to agree, Mr. Teper, that Mr. Gilbert is an alarmist. The argument you make is an argument that we always hear, that they started from a much lower level, and that they obviously can't keep it up.

That isn't what you said. You said they started from a much lower level but you didn't say they obviously couldn't keep it up.

Mr. TEPPER. But I would like to add that our economy does have great potential, given sound economic policies, can also make great strides forward.

Representative BOLLING. This is not a safe assumption, based on the facts of the last 5 or 6 years. As you know, our rate of growth has been in the order of very substantially less than even our normal rate of growth. It seems to me that we are going in one direction and they are going in the other direction.

It is very important for us not to consider Mr. Gilbert an alarmist, but to recognize the basic validity of the fact.

Mr. GILBERT. I want to make a point. We have had in the postwar period not one demobilization, but two demobilizations. The second demobilization started in 1953, when we were spending approximately \$53 billion on the cold war. That went down to \$42 billion in the period of 1954 and 1955. It is now back up to \$46 billion, but there is at least 20 to 25 percent price inflation in those figures.

So there is not the slightest doubt that in real terms our cold-war effort is about one-third below what it was after Korea.

Representative BOLLING. My time is up, Mr. Gilbert, I am sorry.

The CHAIRMAN. Senator O'Mahoney?

Senator O'MAHONEY. Mr. Chairman, I have been very much interested in this discussion caused by Mr. Gilbert's paper.

Substantially, may I say that I agree with the tenor of your remarks.

Many of the questions that I had in mind have already been asked, except for one which is prompted by something that you said in your prepared statement. It reads:

If we were at war, nobody would doubt that we could, with our present resources, operate a \$600-billion instead of a \$450-billion economy, and I mean \$600 billion in real terms, not blown up by inflation.

I interpret that to mean that you believe, and I agree with this point, that if we were in a shooting war, the country would not hesitate to approve any expenditure that those who were directing the Government felt was necessary to make.

I say that out of experience. I have seen huge appropriation bills passed during World War II without even a request for a record vote in the Senate.

The next sentence, however, is the one to which I want to direct particular attention.

It therefore lies within our power to quadruple the resources we are putting into the cold war without reducing the real standard of living of the American people.

Are we to understand that you mean that the American people could continue to live in the lap of luxury, as they appear to be doing now, and wage successfully the cold economic war?

Mr. GILBERT. That is exactly what I mean.

Senator O'MAHONEY. Let me give you an example. The Antitrust and Monopoly Subcommittee of the Senate Committee on the Judiciary held a hearing on General Motors. The entire executive personnel on the highest level of General Motors appeared at that hearing and we had a rather searching inquiry into the operations and the management of the corporation.

It was clear that General Motors was committed to the building of luxury cars, and even after General Motors and Ford had constructed automobile plants in foreign countries in Western Europe, and were building smaller cars for their customers in those countries,

they still continued, until this year, to lay emphasis upon the big and the luxurious and the nonmanageable car.

Everybody in the city of Washington knows, for example, that it is impossible, almost, to find a parking space because of the size of some of the big cars. Everybody knows, for example, that in many cities garages have issued the rule that no Cadillacs will be accepted for parking in the garages because they take up so much room.

I remember one of my colleagues in the Senate telling me that his daughter had been driving with a young friend, and the young friend raised a question as to whether or not she should get a new, modern, up-to-date car. Her response was that she couldn't do it because her father said he was not going to increase the size of the garage any more to accommodate the car.

That is the sort of luxury that I am talking about. Do you think that we can continue the use of material by great managerial industrial organizations in the United States and successfully carry on the cold war against Soviet Russia? Can we build the antimissile missiles of which you have spoken, and at the same time use our natural resources for objectives like the big automobiles?

Mr. GILBERT. I think, Senator, what you said indicates what is probably our greatest obstacle. The trouble with us is that we are so big, we are so powerful in economic terms, that we can quadruple our cold war efforts without any sacrifice of any sort for anybody, and we can go on living the fat and sassy lives that we are living.

I wish that weren't true. I wish it were necessary to impose sacrifices because I don't know how to mobilize people to do something without saying, "You have to make sacrifices." I can only say that I have nothing but contempt for the way in which our American people live today with this sword that hangs over our heads.

I don't know how they can be awakened. I wish it were necessary to impose sacrifices on labor, on management, and all the rest of us. But I would at least dearly love to see somebody in authority ask the American people whether they are willing to make the effort.

Senator O'MAHONEY. But you say, "without reducing the real standard of living of the American people." My inquiry was designed to develop whether or not you believe that we could maintain this luxury standard of living. Now you say that isn't what you mean.

Mr. GILBERT. No; that is just what I mean. The fact is we don't have to reduce it, and we didn't reduce it in World War II. As a matter of fact, the real standard of living during World War II rose very appreciably. There was no sacrifice on the home front. The fact that we didn't have tires and gasoline—

Senator O'MAHONEY. We had allocation of materials, did we not?

Mr. GILBERT. Certainly we did.

Senator O'MAHONEY. We stopped the manufacture of automobiles, did we not?

Mr. GILBERT. That is right.

Senator O'MAHONEY. We put control upon the use of gasoline, and so forth. All I am trying to do, Mr. Gilbert, is to determine whether in your opinion we can maintain the high standard of living and the use of the products that are being turned out by our civilian industry, and still carry on the cold war by concentrating on the construction of antimissile missiles and other war materials.

Mr. GILBERT. I would say that normally I don't adhere to what can be called the hair-shirt philosophy. I don't like to see hardship or sacrifice imposed on people just for the sake of the sacrifice.

Senator O'MAHONEY. The reason I am asking these questions is that information comes to me that in Soviet Russia the manufacture of consumer goods is held down even now. The Russian automobile manufacturing plants have a limit beyond which they cannot go. The manufacture of automobiles in Soviet Russia, I understand, is held down to less than 150,000 units.

If we were to adopt such a standard there might be quite a lot of resistance to it. My only question is to determine whether, in your mind, we can continue to manufacture the high number of consumer goods for which there is a demand, and which we do manufacture, and at the same time raise our production of the materials to fight the cold war.

Mr. GILBERT. I cannot see any possibility short of our having to put, say, 12 million men into the field, and that is about as obsolete as a dinosaur's egg. We will never see that kind of war again. I mean that, and I know that "never" is a long time.

I can't see any possibility of this country being short of food, clothing, or practically any other consumer goods you care to mention. There is no possibility in sight of rationing or the kind of price controls we had during the OPA.

Senator O'MAHONEY. One of the panelists there is shaking his head.

Mr. GILBERT. I understand, and I am addressing these remarks to him.

What we need is a freeze technique to stop the kind of run-up in prices and costs that we had after Korea. And this is not because demand shouldn't be controlled by other and more basic techniques, like fiscal policy, but because we have arrived at a situation in which both labor and management behave more and more like sensitive commodity markets.

These prices and wages can run up very fast when there is expectation of a major expansion in real demand sometime in the future. The purpose of a freeze is not to suppress the effects of a large excess of demand. This excess should be sapped up by taxes. The purpose of the freeze is to cut through the cost-price spiral.

But to repeat, Senator, our basic question is not sacrifice; it is to stop sitting on our hands and go to work.

Senator O'MAHONEY. Professor Rees?

Mr. REES. Thank you, Senator. I am sorry to appear restive here, but it does seem to me that there is a material contradiction in what Mr. Gilbert has been saying. I am not competent to quarrel with him on how much we need to spend on missiles or antimissile missiles. That is way out of my area of competence.

I don't know if it should be \$3 billion or \$10 billion. I have heard Dr. von Braun say that in recent years there is as much money being put into the missile program as can be spent intelligently, although this was not true a few years ago. Perhaps that is wrong. But what is perfectly clear to me is this: If Mr. Gilbert is right, that we need to be spending much more money on defense, and he may be right, we cannot do this without making sacrifices.

Senator O'MAHONEY. But he actually agrees with that. He talks about sacrifices.

Mr. REES. He argues both sides of that question in successive sentences. His main device for getting this additional production is to go from the 40-hour week to the 48-hour week. The 40-hour week is part of the American standard of living. If you go from a 40-hour week to a 48-hour week you are restricting the American standard of living.

Maybe we should do that, but let's be frank about what we are doing, and honest about what we are doing, and not tell people that they can have their cake and eat it, too.

I have just one more comment along these lines. It is simply not true that during World War II we were able to get all this military output without any curtailment of civilian consumption. It is true that the index of real wages rises during a war, but that index of real wages rises only because people were saving one-fourth of their disposable income. They were saving it partly out of patriotic motives to buy war bonds. They were saving it partly because they wanted to be able to buy cars and refrigerators and houses when those came on the market again.

If those people had attempted to spend all that income currently, we would have seen prices break through the ceilings on a massive scale and your index of real wages would not have gone up. When you are talking about a long-term, permanent cold war effort, you don't have the kind of factors that are working for you in a short, temporary war.

It can't be done without some sacrifices. I might say one other thing.

Senator O'MAHONEY. Do you mean by that voluntary sacrifices or sacrifices imposed by law?

Mr. REES. They will in one sense or another be involuntary, that is, assuming that the defense expenditures for the most part are paid for by taxation. You get involuntary sacrifices when you devote your resources to military production and pay for them by taxation. But I would rather have them involuntary in that sense than have them involuntary in the sense of manpower mobilization, for example.

The CHAIRMAN. The Senator's time has expired. Mr. Reuss?

Representative REUSS. I would like to address a question to the critics of Mr. Gilbert's position.

Mr. Gilbert has said that he thinks we should spend right now or very soon an additional sum on the order of \$80 billion a year on cold war and allied subjects in order to make sure that we come out ahead of the Russians in the cold war.

I would like to put a much more modest proposition to Mr. Melnicoff and Mr. Rees to see what they think about that.

Would you agree, Mr. Melnicoff, that we should immediately in the next fiscal year spend on military defense, including missiles and antimissiles and on foreign aid of all kinds, not an additional \$80 billion or \$40 billion or \$20 billion or \$10 billion, but an additional \$5 billion?

Mr. MELNICOFF. My impression is that we should. However, I caution the committee that I am just not competent to answer such a question. This is a matter for many people to decide. My quarrel with Mr. Gilbert, if there is one, is not with his appraisal of the

situation which confronts us, but with the manner in which he proposes to meet it. As an economist, I am concerned with those technical matters, and I am troubled by some inconsistencies in his suggestions. I would say in response to your question that if the order of magnitude of increased expenditures for defense is \$5 billion, then we can certainly handle this within the present framework of existing monetary and fiscal policy instruments supplemented by the corrections and adjustments which I and others have suggested here.

Representative REUSS. What about you, Mr. Rees? Do you have a judgment on the amount, if any, that you feel is a necessary addition to our present defense expenditures?

Mr. REES. No, sir. I feel as Mr Melnicoff does, that I am not competent to make that judgment. I have not studied the defense budget in detail and if I were to study it in detail I still doubt whether I would be competent to set an exact figure.

I do agree that if the figure is of the order of \$5 billion it can be handled within the framework of the kind of economy we have.

Representative REUSS. Let me ask Mr. Gilbert some questions, then, which follow along the lines started by Senator Douglas.

One enormous problem you would be faced with, even after you had made the initial transfer of a lot of men and resources to, in your example, making missiles, you would be faced with this problem that the \$80 billion worth of cold war goods, military, defense and foreign aid, would be not available within the continental United States to meet the demands of consumers for objects to buy with income payments made as a result of producing the \$80 billion worth of goods.

Therefore, you have to handle that problem, as you suggest, by price controls, tax measures, and you also mentioned fiscal policies, if I understand you rightly. You could not have meant spending because you are already committed to spending very considerable sums, are you not?

Mr. GILBERT. I meant taxes. I meant increase revenues by taxes, and by the increased taxes sufficient not only to balance the much higher budget, but to produce a very substantial surplus.

I have no delusions on the question of the speed by which we could expand our program on the order which I have indicated. It would take time. I do believe that there are areas in which the military already know what they want and the issue is really a budgetary issue. Indeed, I think it is perfectly clear that all of the judgments made in this field since 1953 have been made not on a technical basis, but on a fiscal basis. That is one of the things that scares me today.

Representative REUSS. Wouldn't the real hardship and the real domestic dynamite in this whole proposal come in connection with the level of taxes on just about everybody to contain that \$80 billion worth of purchasing power not matched by civilian goods and services?

Wouldn't it, in short, have to be simply staggering by existing concepts of the ability to pay taxes, and would it not have to seize and immobilize, perhaps forever, a large portion of the monetary increments paid to people?

I don't say that this isn't necessary, but wouldn't this be the real basic soul-searching question?

Mr. GILBERT. I don't know how my colleagues would answer this, but I want to answer it unequivocally. What I have in mind is the handing out of orders to industry, new orders, of the order of \$50 billion, on which their profits would be astronomical. I have in mind time-and-a-half for overtime as in World War II, which means an increase in the level of take-home pay of the order of 30 percent.

It is a long time since I have done these calculations. But what I am saying is that however steep you want to make the taxes, whether it is an excess profits tax or a manufacturers' sales tax or a capital levy—however it is financed or out of whose hide it comes—you would have to work very, very hard indeed to reduce anybody's standard of living in the kind of program I am suggesting.

Representative REUSS. My point, however, was that you would have to change a lot of current folkways as to how much of your income you are allowed to keep.

Mr. GILBERT. Yes; I understand.

Representative REUSS. This would be a big domestic upheaval.

Mr. GILBERT. I would like to hear from my labor colleagues whether, if given overtime and a 48-hour week, and extra members of the family working, and in view of the fact that I should say that almost the entire labor force would prefer the opportunity for the increased income for the increased work, whether they feel that labor would resist the kind of taxes necessary to balance the budget or produce the surplus.

Mr. RUTTENBERG. I would like to comment, though not directly to the question he has raised.

I agree fully with the objective which Mr. Gilbert has laid on the table, that we are behind the Soviet Union and that we are losing the cold war and, as a result, may well lose the hot war unless we are awfully rapid and fast in doing something.

But I think the tone that this discussion is taking this morning has gotten us off onto the wrong tangent. I do not know, and I agree with the gentlemen at the other end of the table, how much money we have to spend on the military in order to catch up, or on education in order to catch up, or on science in order to catch up.

But I do know that if it is of the magnitude of \$10 billion, of \$15 billion, of \$20 billion it is highly possible and conceivable within the framework of our present economic system in America to accomplish this objective, I think, over a period of time, maybe not necessarily in the first year, but over a period of 2 or 3 years.

It is also possible to attain it with a balanced budget, both through higher taxes, properly levied, and through the process that Dick Gilbert described quite early in his remark to Senator Douglas, that with an expansion of \$100 billion or more in the gross national product, you will pick up additional revenue growing out of this. One billion dollars of revenue is collected for every \$5 billion of gross national product, so that the combination of the two can be obtained.

In terms of sacrifice, are we going to have to sacrifice? This should be the question that comes to us as we approach the magnitude of the problem. Dick Gilbert is talking about a magnitude that might go to \$150 billion. I don't think he is saying, or if he is I am misunderstanding him, that the \$150 billion is all exclusively in the area of military. He is talking about this \$150 billion being added

onto a gross national product of \$450 billion, making a total product of \$600 billion.

Obviously, how much of this is going to be related to military—a third, a fourth, a fifth? The rest will be distributed to the rest of the economy. What I am trying to get at is that it seems to me that we have spent the whole morning worrying about whether we are going to have to have direct controls or indirect controls, or selective controls when this is not the problem we are confronted with.

We are confronted with a job of meeting the Soviet challenge. What is the challenge? If we don't know what it is, let's find out. Let's find out fast and do something about it. But I don't think in doing something about this it is going to be necessary to reduce the standard of living of the American people.

Look at the Korean period. We almost doubled, if I remember correctly, the amount of military expenditures, but yet we increased the amount of civilian consumer goods on the market. So it is possible to do these things.

I would recommend that the committee look at the report of the National Planning Association, where I think they have set up three different levels of budgets as to how much we might spend for military, an increase of \$10 billion, an increase of \$20 billion, an increase of \$50 billion.

Under those conditions, what kind of tax measures do we need? This is the approach to the problem. It seems to me that we have been on the wrong binge all morning wondering about whether we should have direct controls or not. We will have to have direct controls if it gets to the point where direct sacrifices are necessary to obtain the objectives.

We don't know what the objective is. This administration has not told us. They are the only ones with the information and they are the only ones who can tell us.

The CHAIRMAN. Before starting around again, I wonder if any member of the panel would like to make a further comment? Mr. Turner?

Mr. TURNER. The statement was made that there was no sacrifice on the home front during World War II. This is correct if you measure standard of living or scale of living by total consumer expenditures corrected by a price index. They did not decline except, I believe, in one year of the war. Of course, there was a major shift in the pattern of consumer expenditures from hard goods to soft goods and amusements—services generally. Also, there was, as Mr. Rees points out, a very substantial increase in number of hours worked.

If we were to undertake a major expansion in our military effort now, I am convinced that we could expand our GNP by \$25 billion in relatively short time simply by putting to work those unemployed persons who already want to work and by putting those to work who are working part time and would like to work full time. That could be achieved in very short order. It would not require any sacrifice in our standard of living, even as defined by Mr. Rees.

Furthermore, productivity increases in the last several years have been substantially below what they should have been. We all know that productivity increases come best when the economy is operating under some pressure.

I am convinced that we could increase productivity by 5 or 6 percent a year for at least 2 or 3 years, which would add roughly another \$25 billion a year to our GNP. We could increase GNP by \$50 billion, I am convinced, within a relatively short time without anything approaching a real sacrifice to consumers in this country.

As with the others on this panel, I have no judgment as to what size military program is necessary, but I agree with Mr. Gilbert that we could add \$50 billion without much sacrifice.

The CHAIRMAN. Mr. Gilbert advocates, I believe, \$150 billion.

Mr. TURNER. In total GNP. Of course, if we increase military expenditures by \$50 billion, and GNP went up by the same amount and no more, that would mean that persons who are now unemployed and who become employed—who are not receiving incomes now and subsequently receive incomes—would be better off. The money which the Government spends for the defense program would have to come primarily from persons who are now employed and who are now receiving incomes. That is not a lowering of the standard of living of the people as a whole, but it does cost the particular people who are now employed and who would have to pay more in taxes.

The CHAIRMAN. You made one observation I would like to ask you about, Mr. Gilbert. I believe you said that if we were to increase our gross national product by \$150 billion, the Government would probably collect about \$40 billion in additional taxes.

Mr. GILBERT. Yes. Actually, the studies that have been made on the fraction of any increase in the gross product going to the Government come to about a quarter. But what I am thinking of is a very lush economy with time-and-a-half, and additional members of the family working, so that the Government's marginal rate of take in taxes would be substantially higher than it is in normal circumstances. I simply estimated that at \$40 to \$45 billion, and I could be dead wrong.

The CHAIRMAN. I want to ask you something that is not related to what I just asked you about, but I know you are an expert on this subject. There is a lot of talk about reimposing credit controls, installment-buying controls. It is my belief that if we were to consider imposing these wartime controls again, now, that we should keep in mind more the interest of the buyer than we have in the past.

I think it is a great advantage to the seller to have these controls in many instances because he is able to say, "Uncle Sam requires me to charge you one-fourth down," or one-third down. "I dislike to do it, but the great Government is compelling me to do it."

But by having that weapon to use, and actually being required to charge a substantial amount as a downpayment, that makes his security in the form of paper that he takes for the additional amount much better, and should, therefore, bear a smaller rate of interest, probably, than the rates of interest that are now charged on installment paper generally.

Don't you think we should give consideration, Dr. Gilbert, if we consider these controls, to also making requirements that would protect the buyer against extortionist rates of interest and against unreasonable, extortionist service charges; that if we are going to protect the sellers to the extent that we give them this measure of security which they do not now have, that at least some of that should be translated

into help to the buyer in the form of protection against extortionist charges?

Mr. GILBERT. I do indeed. Our entire monetary policy in recent years I can only describe as a piece of the most incredible stupidity.

The CHAIRMAN. I think it is terrible that we allow such awful charges to be made. There are not exceptional cases where the rates go up to 72 percent and even 100 percent interest. That is just horrible in a civilized country.

I think if we impose these controls again we should tie to them the benefits that the buyers will have, the obligation of translating part of it into help to the buyers. I am glad to have your opinion on that.

Mr. GILBERT. I couldn't agree with you more completely. I would just like to point out to you, for you to think about, that what has been happening in this country to the consumer in this business has been happening in Latin America to everybody as a result of this hard-money policy that we have been pursuing in these recent years.

If we continue on that course very much longer, I haven't any doubt at all that you will have to go a great distance to find a remaining friend of the United States.

The CHAIRMAN. I have one comment to make. I was shocked to learn right here in this committee room, the Banking and Currency Committee of the House, when we were going into the question of extending the power of the Export-Import Bank to extend them \$5 billion additionally, I believe was the question, when I received information at that time, shocking to me, to the effect that in these sales that are made in Latin America that you mention, about the Latin American economy, that in most of the sales the seller here in the United States and, of course, all lines of credit are predicated upon purchases being made in the United States, the sellers add 35 percent more than they would charge or be able to receive here in the United States.

That was shocking information to me. I received it from a source that I do not believe can be denied. I hope that the information was really wrong. But it seems to be correct in certain instances at least.

In other words, instead of the South American purchaser, and he is very much in the position of the tenant in the case of landlords and tenants, when the landlord was furnishing the tenant everything—the purchaser in South America first arranges for his credit and he is almost compelled to agree to any terms that are imposed upon him, and having to pay 35 percent more through some subsidiary of the selling group, or through some individual selected by the selling groups, seems to me to be terrible.

Do you know anything about that, Dr. Gilbert?

Mr. GILBERT. I don't know of that instance, Congressman, but I do know that all through Latin America the foreign aid program, the American credit program, isn't thought of in terms as we do, of aid to underdeveloped countries. They think of this as Uncle Shylock—a very dangerous viewpoint, which, unfortunately, has a real basis in fact.

The CHAIRMAN. You know, I am getting complaints from the people that I have the honor to represent about paying so much for these improvements, like water and conservation of water.

The nearby cities have to pay a certain amount for the water that is impounded in order to get the project built, which is a little different

from the way it used to be. These letters that I receive indicate that they know about these projects in other countries, 59 other countries of the world, where we are extending credit and furnishing them money, and in many instances to actually build, construct, these huge dams and huge reservoirs without any restrictions and impositions, such as we have here in the United States.

Mr. MELNICOFF. On consumer credit controls, Mr. Chairman, I have stated that this is one area in which we may find it necessary at some future time to impose regulations in order to supplement the monetary policy tools we have. I doubt the wisdom of combining that type of control with legislation setting a ceiling on interest rates, or prescribing certain interest rates. It is, of course, desirable to prevent usurious and fraudulent rates, and some States already have such laws. But this has no connection with monetary policy at all. I believe that we should educate consumers concerning what is available in terms of credit and concerning how they should use credit. But beyond this, if in addition to legislation to prevent fraud and usury we have to legislate to prevent poor judgment on the part of consumers, I think that the Congress would be in a hopeless situation. It is simply not possible, I believe, to legislate a rate or structure of rates, which is applicable in all times under all circumstances. I believe there is a great job of education to be done, but if we wish to take advantage of free markets, we have got to let the market operate.

The CHAIRMAN. On the poor judgment, isn't Congress saying, in effect, "Mr. Seller, you are using poor judgment taking a dollar down and a dollar a week. We are not going to permit you to use that poor judgment any more. We are going to require you to receive at least 25 percent down"?

On your argument about poor judgment, what is sauce for the goose is sauce for the gander. If we are willing to substitute our judgment for the seller in that instance, why shouldn't we be just as willing to substitute our judgment for the buyer's judgment in that instance and protect him?

Mr. MELNICOFF. I would say that we should be very reluctant to move into either end of the transaction to substitute legislative requirements for market decisions. In any case, the legislative requirements should be minimized.

The CHAIRMAN. My time has expired. If you will, please, when you get the transcript, elaborate on that question. I would appreciate it.

Mr. MELNICOFF. Yes, sir.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. I want to ask one question which is really not connected with the papers, but suggested by the questioning of our chairman. I wonder what the members of the panel would feel about a requirement that the interest rate should be stated in terms of the outstanding balance.

Sometimes the height of the interest rate is concealed by its being a percentage of the original loan, and if the loan is repaid in installments the actual interest rate is twice what the apparent interest rate is.

I will not go into the question of whether the interest rate itself should be regulated. I wonder what the panel thinks about the

desirability of the borrower or buyer knowing what the real rate of interest is that he is paying.

The CHAIRMAN. Do you mean an itemized statement being furnished?

Senator DOUGLAS. No; that the interest should be a percentage of the outstanding balance at any given time. Mr. Rees?

Mr. REES. Senator Douglas, I would be sympathetic with that kind of provision. I think it is in the tradition, say, of the Federal Pure Food and Drug Act or the Wool Labeling Act, which I think, on the whole, has been very good legislation.

However, I think you have one problem here. That is that the regulation of small loans and consumer credit, so far as interest rates are concerned, has thus far been in the hands of the States. I think that before any Federal legislation governing this of the type that Congressman Patman proposes is undertaken, you would have to have a very thorough inquiry into whether the States are doing an adequate job in this field and whether they might not be encouraged merely by the holding of such an inquiry to do a better job.

Senator DOUGLAS. What would you say about installment rates?

Mr. REES. I think several States do now regulate them.

Senator DOUGLAS. Are you saying that the Federal Government should not have the authority to regulate the types of installment selling and this should be turned over to the States?

Mr. REES. No. I am not talking about regulation W as it existed previously. I am talking about adding to that regulation over the interest rate to be charged to consumers.

Senator DOUGLAS. I was not proposing that the interest rate should be regulated. I was merely asking whether it would not be desirable to have the real interest rate stated.

Mr. REES. My reply is that I think it would be desirable, but that since that falls for the most part in an area where permanent legislation has been left to the States, that it is something that might better be done, perhaps, by State law than by Federal law.

Senator DOUGLAS. You would depend upon 48 State legislatures moving?

Mr. REES. We do in lots of things, and in some of them they do a good job.

Mr. TEFER. I would like to dissent from the position taken by Dr. Rees. Protection of consumers from excessive charges for credit, whether these are designated as interest charges or as finance charges, is a proper concern for the Federal Government. If the Federal Government has a right to promulgate regulations such as regulation W, then indeed it can also require that interest or finance charges be properly set forth as interest percentages due on the outstanding balances. In view of the inadequate protection now provided to the users of consumer credit or to small borrowers by the existing State legislation, a review of the subject by the Congress is also in place.

Senator O'MAHONEY. Mr. Chairman, before asking the question that I have in mind, I am prompted to make this statement.

On the 10th of November, the Department of State issued a press release announcing that the Development Loan Fund had made an arrangement to loan \$20,500,000 to the Government of Taiwan to help

build a multipurpose dam in Formosa. This dam is designed to conserve water, to produce electricity, to produce recreation.

In other words, it is the well known multipurpose dam which the Bureau of Reclamation and the Army engineers have, on one occasion or another, built in the United States. When the President submitted his budget to Congress last January 1958, for the fiscal year 1959, it contained an announcement that there would be no new starts for the conservation of water in the United States.

Yet in November we make a similar loan for a similar project in Taiwan, and the release concluded with this statement:

The loan is for a period of 35 years. Interest will be charged at the rate of 3½ percent. Payments on interest and on the liquidation of the loan will be made in Chinese currency.

Under the Development Loan Fund we appropriate annually in Congress some \$600 million a year of American dollars to make possible these loans, and the returns in the currency of foreign countries where the expenditures are made are received in the currency of those countries and they become part of a revolving fund.

So it results in a system that wastes money for the United States and piles up currency in the hands of the United States in the country which we are supposed to be aiding, money which might easily wreck that country if we spent it, and we do not spend it.

The CHAIRMAN. Would you pardon an interruption, Senator?

In Spain we have about 170,000,000-odd American dollars, valued at the American dollar currency, there now, and that money, of course, could not be pulled out very well. It would wreck the central banking system and the entire banking system of Spain.

There are things going on over there now where it is probable that some committee of the United States Congress should see whether or not our money is being protected. Part of it is counterpart funds, but I know it happens to be over \$150 million.

Senator O'MAHONEY. Professor Turner, I would like to ask you if you would care to be a little bit more specific about the following recommendation which you made in your prepared statement:

Bringing the price- and wage-making process out into the open where it is subject to public scrutiny before prices and wages are actually set.

Do you have a formula in mind to do that?

Mr. TURNER. No; I don't have a formula, Senator. My thought is that much of the difficulty with efforts which have been made in the past to influence the price- and wage-making process is traceable to the fact that actions have been taken only after the event when it is necessary to try to persuade or coerce someone to undo an action which has already been done.

Senator O'MAHONEY. Your second suggestion is, "Bringing pressure to bear on those individuals who exercise a significant degree of economic power to act in a socially responsible way."

Do you have any formula to suggest on that? Who is going to bring the pressure?

Mr. TURNER. This committee for one, or possibly an agency set up to make a continuing study of prices and wages and of the exercise of economic power. I don't have any pat formula, but I do believe that people who possess economic power, both on the management and labor side of the bargaining table, are responsive to public opinion.

They do have, in the main, high moral codes of their own. If they are placed in an exposed position where their actions are made known to the public, they are more likely to behave in a socially responsible way than now.

Senator O'MAHONEY. May I suggest to you, Professor, that I am sure the members of the committee would be benefited if you could give this matter more thought and perhaps amplify your idea in a paper to be submitted to us later?

Mr. TURNER. I will be happy to do so.

(Mr. Turner subsequently submitted the following for the record:)

DECEMBER 31, 1958.

HON. JOSEPH C. O'MAHONEY,
Senate Office Building, Washington, D. C.

DEAR SENATOR O'MAHONEY: This is in response to your request for elaboration of the statement in my testimony before the Joint Economic Committee on December 18, 1958, as follows:

"I suspect that the solution lies in the continued but very cautious use of monetary and fiscal policy to contain those occasional waves of inflation, or deflation, which clearly have their origin in monetary factors affecting demand, plus the gradual introduction, over a period of years, of a patchwork of miscellaneous policy actions centered around the twin theme of: (1) Bringing the price- and wage-making process out into the open where it is subject to public scrutiny before prices and wages are actually set, and (2) bringing pressure to bear on those individuals who exercise a significant degree of economic power to act in a socially responsible way."

I am convinced that the problem of cost-price escalation requires the continuing attention of a permanent administrative agency. The nature of the problem is such that any attempt to identify and proscribe specific price- and wage-making practices in a single piece of legislation would inevitably be inequitable and probably abortive. Rather, what is needed is continuous formal and informal communication between Government and individual business firms and labor organizations while specific prices and wages are being set such that the objectives of public policy can be made known to the parties currently involved and can be translated into figures relevant to the case in point.

In essence, this involves using the coercive power of Government only to the extent required to obtain all necessary information and to achieve such communication, but relying on voluntary cooperation beyond that point.

A fundamental and first step in this direction would be a law requiring Federal incorporation of all business corporations with assets above some minimum amount, perhaps \$1 million, coupled with a provision for financial reporting on a current basis along lines somewhat comparable to the reporting now required by the SEC of corporations issuing new securities. Provision should also be made for additional reports on such matters as wage rates and wage patterns, costs other than wages, pricing practices, etc., on request of an appropriate Government agency.

A second step would be to authorize and direct an agency of the Federal Government to make studies of labor productivity and to publish productivity estimates by industry on a current basis. (I understand that the Board of Governors of the Federal Reserve System now makes estimates for certain industries but does not publish, indeed treats as confidential, the results of these studies.) This activity will no doubt require collection of statistical data not currently available and funds for this purpose should be provided.

Third, an agency of the Federal Government should be authorized and directed to make general studies of costing and pricing practices in American industry and of their economic consequences. Again, collection of statistical information not now available from business firms will probably be required. The enabling legislation should authorize collection of such information and specifically should authorize the agency to send representatives to business firms with the status of observer but with authority to obtain all relevant and reasonably necessary information. These studies should: (1) Contribute to a better total understanding of the functioning of the American economy; (2) provide information needed

by the Congress for specific legislation to minimize a cost-price escalation; (3) provide essential background information for actions taken in response to my fourth recommendation.

Fourth, an agency of the Federal Government should be authorized and directed to undertake, on its own initiative, studies of labor productivity, wages, and prices in particular firms or trades when, in the judgment of the agency, wage and price changes may be in the making which would be contrary to the public interest. Such studies should be mandatory in the case of labor disputes brought under the national emergency provisions of the Labor-Management Relations Act of 1947. This agency should have the authority to make public the results of such studies, together with its own conclusions and recommendations. Prior to such public pronouncement, however, the agency, directly or through its representatives, should discuss with the competent jurisdictions within the firm or labor organization the public interest aspects of possible price and wage changes and should urge them to follow wage and price policies consistent with the public interest. The agency might also have authority to freeze price and wage changes for a, say, 60-day period, during which investigations are undertaken, but I doubt the advisability or necessity of such a provision.

Finally, this agency should advise the President, the Congress, and the public from time to time as to wage and price policies by private business and by labor organizations which will contribute to general economic stability and growth and as to further legislative actions which the Congress could take to encourage the following of such wage and price policies.

I would recommend that a single agency be charged with responsibility for carrying out all of the above functions, including administration of the Federal incorporation law. Inasmuch as the functions cut across both pricemaking and wagemaking, neither the Department of Commerce nor the Department of Labor would be the appropriate agency, although much of the data gathering could be assigned to these agencies. I would also question the desirability of putting such detailed, operating responsibilities in the Council of Economic Advisers, although there obviously should be close coordination between the activities of the Council and the agency chosen for the above duties. I would seriously question the wisdom of putting these responsibilities in the hands of such disciplinary agencies as the Federal Trade Commission or the Antitrust Division of the Department of Justice. I am led, therefore, to the somewhat unpleasant conclusion that the only satisfactory solution is creation of a new agency for this purpose.

Let me emphasize that these recommendations are not considered to be emergency measures. They will not solve the problem of cost-price escalation overnight. Rather, they are intended to provide the machinery for a flexible and continuing approach to a complex, long-run problem.

Sincerely,

ROBERT C. TURNER,
*Chairman, Department of Business Economics and Public Policy,
Indiana University.*

Mr. RUTTENBERG. In the paper which I presented I have made a specific suggestion and spelled it out just a little in terms of this problem: the creation of a Government agency to whom prenotification of price, and Mr. Turner adds wage, determinations would be made, public hearings would be held and the power of subpoena would be given to such an agency to get the necessary information.

Senator O'MAHONEY. That is in the paper that you presented this morning?

Mr. RUTTENBERG. Yes.

Senator O'MAHONEY. Unfortunately I was not able to be here at the beginning, so I did not hear it. I have not had the opportunity of reading it during the continuance of the hearing.

Mr. RUTTENBERG. But in a sense I agree with the idea that you first advocated, I think, and introduced into the Congress more than 10 years ago, was it not, for some such agency?

Senator O'MAHONEY. In 1948, I introduced a bill to that effect. It would require the corporation producing a certain percentage or participating in the production of more than 60 percent, say, or more

than 50 percent of the total commodity in any line to give prenotice of his intentions to raise prices to the Department of Commerce, and to both Houses of Congress, so that hearings could be held .

That is all I have.

The CHAIRMAN. I have a short statement to read in conclusion, but first, Mr. Herbert Stein, Director of Research, Committee for Economic Development, sent to the Congress, addressed to the chairman of the committee, a letter taking exceptions to certain statements made by Mr. Solomon Barkin in his testimony.

The letter was given to Mr. Barkin for reply. Mr. Barkin has replied to it. I ask consent to insert both letters in the record.

Without objection, they will be inserted.

(The letters to be furnished appear at the end of Mr. Barkin's testimony, pp. 433, 437.)

The CHAIRMAN. With today's discussion, the committee's study of the relationship of prices to economic stability and growth is brought to a close.

In announcing this study, the committee emphasized that its major goal was an objective and authoritative exploration of general economic processes which involve prices, price relationships, costs, and price policies in the expectation that this would reveal ways in which public and private policies can contribute to the Employment Act objectives of maximum employment, production, and purchasing power within the framework of free, private, competitive enterprise.

I am confident that the contributions and analyses presented during the four phases of the study this year will affect Government and private economic policies for many years to come. Certainly they will influence the committee's deliberations in the coming session as we study the President's forthcoming "Economic Report" and prepare our own annual report to the Congress for submission by March 1.

The committee deeply appreciates the cooperation given us in this study by the many experts who have participated. All of the contributions have given evidence of high professional competence and diligence. Thank you very much.

Without objection, the committee will stand adjourned.

(Whereupon, at 12:45 p.m., the committee adjourned, to reconvene at the call of the chairman.)

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