INFLATION CONTROL

EXTRACT FROM

HEARINGS

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
UNITED STATES SENATE

EIGHTIETH CONGRESS

SECOND SESSION

ON

CONTROL OF INFLATION

INFLATION: DANGERS AND REMEDIES

By LEON H. KEYSERLING
Vice Chairman, Council of Economic Advisers

(Statement before Senate Committee on Banking and Currency
August 4, 1948)

UNITED STATES
GOVERNMENT PRINTING OFFICE
79768 WASHINGTON : 1948

INFLATION CONTROL

Mr. Chairman and members of the committee, I am particularly appreciative of the opportunity to discuss with this committee some current facts about our economy and some of the economic analyses which may be applied to these facts, because this committee had initial legislative responsibility for the Employment Act of 1946 under which I serve as Vice Chairman of the Council of Economic Advisers. The high purpose of this act was that, while no men are infallible and economics is not an exact science, men of good will could be aided by the known and tested tools of economics in evaluating and deciding upon national policies in the national interest.

I am deeply conscious that my only function here is to lay before you some of the facts and some of the methods of economic analysis which may help you in evaluating proposed public policies. This task of ultimate evaluation is yours, not mine, and if I should overstep this boundary it will not be intentional.

For almost 2 years, the members and staff of the Council of Economic Advisers have been devoting constant study to the tasks and trials of our complex and tremendous economy during a period of postwar transition characterized for the most part by the central problem of inflation.

In the course of our studies, we have received additional evidence that no economist will ever have a perfect answer to practical problems. But because we have assumed a public responsibility, these imperfections have not turned us from seeking clearer understandings, more workable answers, and a wider range of common agreement.

Considering the difficulty of our work, and the imponderables involved, we have arrived at a surprising degree of agreement as to what the facts say, what they mean, and what should be done about them. That appears clearly from various publications issued by the Council as a whole, such as its recent report on The Economic Situation at Midyear 1948. However, I ought to say that my statement here today is my own in the sense that no two individuals in a field such as economics ever use exactly the same process of reasoning or stress exactly the same points in reaching results.

In the current economic situation, as I see it, there are compelling reasons why inaction is fraught with danger, and why men must act even if they cannot be absolutely certain of every step they take.

The material that I should like to bring before you classifies easily into four main parts:

First, as an aid in the interpretation of specific data and problems, I shall attempt to state a few general principles and uncover a few current fallacies. Without this as a foundation, we all seem to be confronted with a hopelessly baffling welter of facts, contentions, and conflicting viewpoints;

Second, upon this foundation, I shall attempt to build a fair portrayal of some of the most serious maladjustments and disparities which our economy is generating in the process of inflation, and to indicate how these maladjustments and disparities are now imposing genuine hardships upon millions of our people and how they threaten all of our people if they are not corrected;

Third, I shall endeavor to show why the prospects for continuing inflation are so substantial as not to justify the belief that relief will come quickly, or come at all without involving even more serious dangers, if this inflation is left to follow what might be called its "normal" course;

Fourth, I shall try to apply some economic analysis toward an evaluation of various proposals now before the committee for consideration, in terms of their relevance to the current and immediately prospective economic situation.

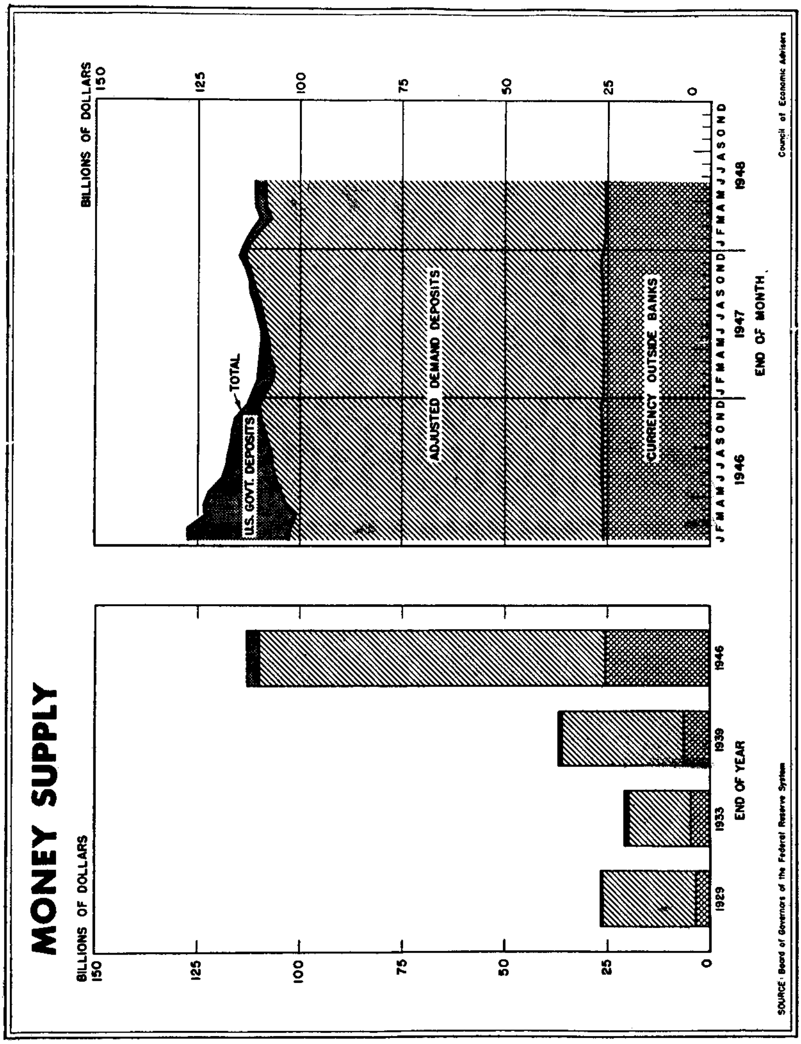
BASIC PRINCIPLES AND CURRENT FALLACIES

Generally speaking, we are now and for some time have been in an era of rising prices, wages, and other incomes, accompanied by rising costs. In popular terms, this situation and the processes by which it is unfolding are called inflation. It is frequently stated that this inflation is taking place because demand for goods is being exerted in the market in excess of the supply of goods flowing into the market. This demand for goods is made manifest by money exerted as spending power; and consequently it is said that inflation is taking place because the money supply is unusually high in relation to the volume of available goods.

The total money supply, which was 26.5 billion dollars in 1929, rose to 37 billion in 1939, and to 115.1 billion in 1947. In June 1948, it stood at 110.4 billion dollars. (See chart 1, p. 310.) Manifestly, the money supply has increased much more than the volume of available goods.

The proposition that the relationship between the money supply and the available supply of goods has a basic influence upon the level of prices and incomes of all kinds is obviously correct as a statement of fact. But it does not in itself tell us much about causes and effects. More important, it does not in itself tell us why the current inflation is dangerous, or where the particular dangers lie, or why we need to worry if nothing is done about these dangers, or what ought to be done about them. Until this is firmly recognized, we are likely to be misled by oversimplified or distorted solutions focusing attention upon the

CHART 1


MONEY SUPPLY
BILLIONS OF DOLLARS
150
125
100
75
50
25
0
1929
1933
1939
1946
END OF YEAR
SOURCE: Board of Governors of the Federal Reserve System
BILLIONS OF DOLLARS
TOTAL
U.S. GOVT. DEPOSITS
ADJUSTED DEMAND DEPOSITS
CURRENCY OUTSIDE BANKS
J F M A M J J A S O N D
1946
1947
1948
END OF MONTH
Council of Economic Advisers

money supply alone. This is true because it is not demonstrable that a generally rising price level interacting with a generally rising money supply is bad per se. We had a falling price level after 1929, and the country was certainly not on the way to prosperity. We had a rising price level after 1932, and yet the country was on the way to increasing employment and production. We had a fairly stable price level in the later twenties, and yet obviously something must have been wrong with the economy in view of what ensued although everyone will not agree as to just what was wrong. In short, there is no arbitrarily sound or even preferable price level or course of price movements—such as those of 1926 or 1939 or 1946—as distinguished from some other price level or course of price movements; and, therefore, there is no arbitrarily sound or ideal relationship between the size of the money supply and the available supply of goods.

To detect whether our economy is in a state of danger or safety, we must concentrate foremost attention upon other things besides the over-all levels or movements of prices and the money supply. In a period such as the present, when prices, wages and other incomes are far above prewar levels, and when employment and production and other indexes of useful business activity are also far above prewar levels, the most important thing to be considered is the relationship among these various factors in the economy rather than the absolute magnitude or course of each factor viewed separately. This is particularly true when the relationships among these separate factors, as well as the absolute magnitudes of each of them, have been changing substantially for some time and are changing rapidly now.

Since 1939 (see chart 2, p. 312) these relationships have changed enormously, and they have been changing greatly during the accelerated inflationary process since the middle of 1946. To select a few items, employment since 1939 to the middle of 1948 has increased about 28 percent; consumers prices about 70 percent; wholesale prices about 112 percent; weekly earnings in manufacturing about 118 percent; gross national product in current dollars about 173 percent; manufacturing sales about 231 percent; and corporate profits after taxes about 272 percent. The base year that I have chosen, 1939, is used only to illustrate the point generally that relationships have changed greatly. The use of this base year should not be taken as an assertion that it is the best base year for all purposes of comparison or analysis.

The Chairman. Where is your cost of living there?

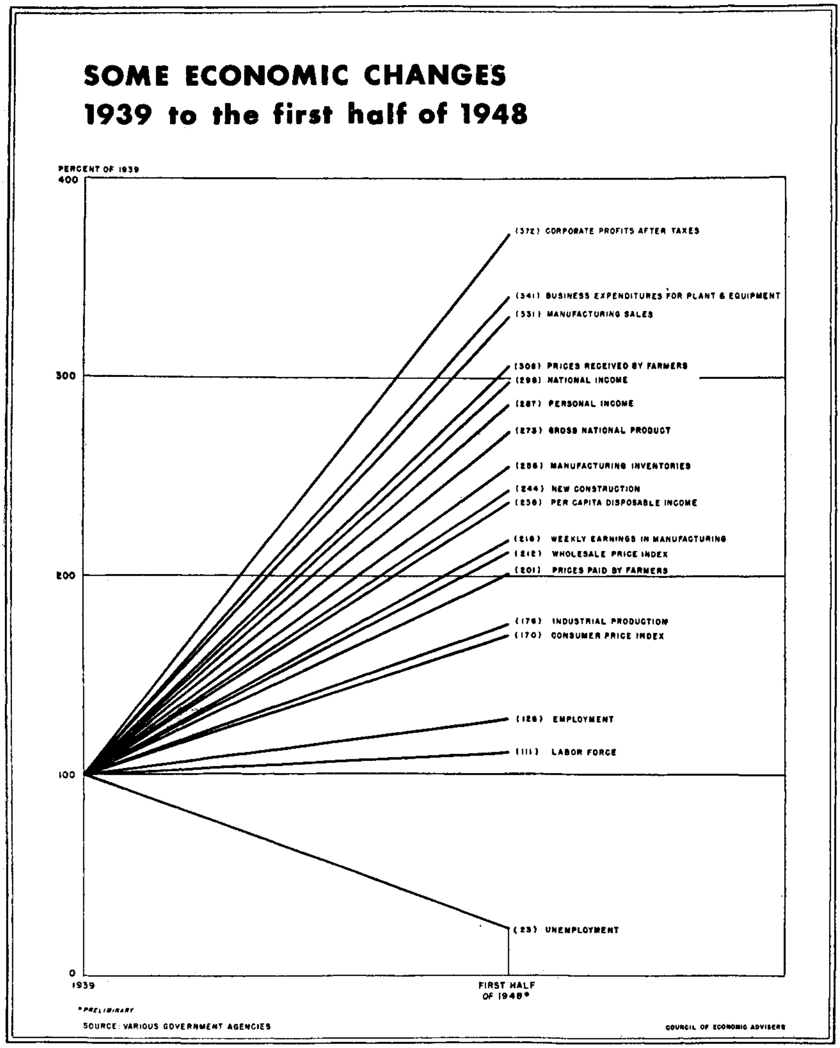
Mr. Keyserling. The cost of living is represented by the consumer price index; that has gone up 70 percent.

The Chairman. May I interrupt you? I am puzzled. Hold that a second.

Kindly show me the relative difference between the cost of living and the wage income.

Mr. Keyserling. I will show that in much greater detail, Mr. Chairman, in the further charts.

CHART 2


SOME ECONOMIC CHANGES
1939 to the first half of 1948
PERCENT OF 1939
400
300
200
100
0
1939
FIRST HALF OF 1948*
(372) CORPORATE PROFITS AFTER TAXES
(341) BUSINESS EXPENDITURES FOR PLANT & EQUIPMENT
(331) MANUFACTURING SALES
(308) PRICES RECEIVED BY FARMERS
(298) NATIONAL INCOME
(287) PERSONAL INCOME
(273) GROSS NATIONAL PRODUCT
(256) MANUFACTURING INVENTORIES
(244) NEW CONSTRUCTION
(236) PER CAPITA DISPOSABLE INCOME
(218) WEEKLY EARNINGS IN MANUFACTURING
(212) WHOLESALE PRICE INDEX
(201) PRICES PAID BY FARMERS
(176) INDUSTRIAL PRODUCTION
(170) CONSUMER PRICE INDEX
(126) EMPLOYMENT
(111) LABOR FORCE
(23) UNEMPLOYMENT
*PRELIMINARY
SOURCE: VARIOUS GOVERNMENT AGENCIES
COUNCIL OF ECONOMIC ADVISERS

The CHAIRMAN. Thank you.

Mr. KEYSERLING. In probing the significance of these changes in relationships, there are two current fallacies to be avoided. First, it is fallacious to assume that dangers or maladjustments have been created in our economy simply because the indexes of various items have moved upward, or that the cure lies simply in moving them downward. For example, it is certainly desirable that employment and production are much higher now than in 1939. Likewise, it is to be expected that both wages and profits should be higher now than in 1939. The second fallacy to be avoided is the idea that there is any danger or maladjustment in the current situation simply because some of these items have moved upward faster than others. In a changing and growing economy, some items must move upward faster than others. For example, wages should be expected to move upward faster than consumer prices during a period when there have been vast increases in production for civilian use. Profits should be expected to move upward faster than prices during a period which has carried us from large-scale unemployment to full employment. Thus, persons who attempt to prove that dangers or maladjustments exist solely because some items have moved upward faster or more slowly than others are simply misjudging the nature of our economy in action.

The real problem we face now, in order to detect dangers and maladjustments, is to examine carefully and objectfully whether the relationships among various factors in the economy have changed and are changing soundly or unsoundly by reasonably derived objective tests; whether these changes are bringing us into a state of better balance or worse balance throughout the economy; whether they are curing discernible maladjustments or causing further discernible maladjustments; in short, whether they are moving us nearer to a zone of safety or further and further into a zone of danger.

On the basis of these principles, we may turn to a more specific examination of the relationships that are developing in our current economy during the continuing process of inflation. The evidence, as I shall try fairly to present it, is that the changes that have occurred and are still occurring in the process of inflation are progressively creating dangerous maladjustments which now inflict hardship upon millions of individuals; and also maladjustments among price relationships, wage relationships, and price-wage relationships which are now interfering with essential national objectives, and which are also distorting the pattern of production, consumption, and national income in ways that will eventuate in a general economic decline of employment and production if they are not corrected promptly.

CURRENT MALADJUSTMENTS AND THE DANGERS THEY PRESENT

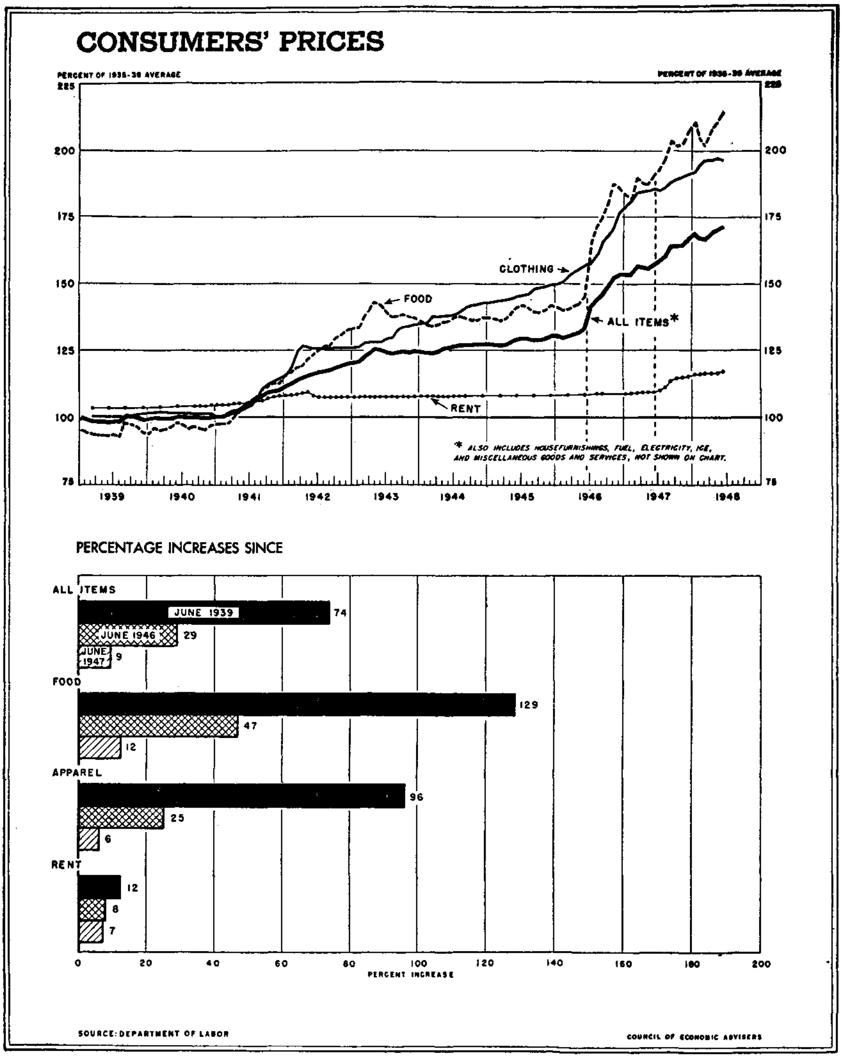
The first serious maladjustment to which attention should be turned involves the effect of the continuing rise in consumers' prices upon family standards of living.

The CHAIRMAN. I think it is the most important.

Mr. KEYSERLING. It is extremely important, perhaps the most important.

Since June 1939 (see chart 3, p. 314), the consumers' price index for all items has risen 74 percent; for food it has risen 129 percent. By

CHART 3


CONSUMERS' PRICES
PERCENT OF 1935-39 AVERAGE
225
200
175
150
125
100
75
CLOTHING
FOOD
ALL ITEMS*
RENT
* ALSO INCLUDES HOUSEFURNISHINGS, FUEL, ELECTRICITY, ICE, AND MISCELLANEOUS GOODS AND SERVICES, NOT SHOWN ON CHART.
1939
1940
1941
1942
1943
1944
1945
1946
1947
1948
PERCENTAGE INCREASES SINCE
ALL ITEMS
JUNE 1939
74
JUNE 1946
29
JUNE 1947
9
FOOD
129
47
12
APPAREL
96
25
6
RENT
12
8
7
0
20
40
60
80
100
120
140
160
180
200
PERCENT INCREASE
SOURCE: DEPARTMENT OF LABOR
COUNCIL OF ECONOMIC ADVISERS

far the most rapid increases took place immediately after June 1946; since then, the increase has been 29 percent for all items and 47 percent for food. The increases since June 1947 have been 9 percent for all items and 12 percent for food. While the net increases during the past year have not been as rapid as in the preceding year, they have, of course, come on top of earlier increases. Furthermore (see chart 4, p. 317), the net increases during 1948 have been reduced by the downswing which followed the commodity break near the beginning of the year; but since the middle of March the index for all cost-of-living items, and particularly for food, has been rising very sharply. In the second quarter of 1948, the food index rose at the rate of about 2 percent a month. In recent months, the cost-of-living index has been reaching new peaks.

The CHAIRMAN. Before you take that chart away, the lower strata there gives some evidence that rent control, although it is much maligned and created some injustice, has been effective in keeping costs down?

Mr. KEYSERLING. There is no doubt about that. You will notice in this connection, Mr. Chairman, the beginning of the rise in rent after the mid-1947 period.

The impact of the rising cost of living, in terms of hardship, is necessarily associated with the distribution of family income. According to the most recent comprehensive studies covering 1947 (see chart 5, p. 318), about 50 percent of all families had incomes below the $3,200 a year estimated by the Bureau of Labor Statistics to be necessary to maintain an urban family of four at a reasonably satisfactory standard of living. Between a quarter and a third of all families had incomes of less than $2,000 a year, and more than 10 percent had incomes of less than $1,000 a year. Even allowing for the fact that many of the families included in these statistics were of smaller size than four, and that many of them were rural families where the cost of living is somewhat less, it is nonetheless a palpable fact that a large proportion of our population is being literally submerged by the high cost of living.

It may be said, of course, that "the poor are always with us"; that millions of families were submerged even before the war and before inflation; and that, relatively speaking, low-income families are better off now than they were during prewar periods. If we take the whole span of years since 1939 into account, these assertions are undoubtedly true, because our total national output has gone up so much since 1939 that practically everyone has benefited to a degree. But this would not be true since 1946, when postwar inflation got started in earnest; since then, families of low income and moderately low income have undoubtedly lost ground in the race with living costs. And 1946 if a fairer base of comparison than 1939 for this purpose, because our national output now is quite similar to 1946 but far and away above 1939.

The CHAIRMAN. In view of that situation shown by the crossed lines under $3,200, in view of the price level and cost of living, it might not be an overstatement to say that within the scope of those crossed lines is a very definite, concentrated section of human beings in misery.

Mr. KEYSERLING. There is no question about that.

Moreover, as a study of developments in 1946 and 1947 indicates (chart 6, p. 319), while a majority of the families in the middle income and upper income brackets have received increases in income as the cost of living has advanced, a majority of those in the lowest income brackets have either received no increases in income or have actually suffered decreases in income. Among families with incomes under $2,000, a full quarter suffered actual decreases of income during this period, and an additional 40 percent of these families received no increases in income. Thus, the families who have been the worst victims of the advancing cost of living because their incomes are low are also the families who have been least able even to hold their ground during the process of inflation.

The sheer physical problem of being unable to maintain a satisfactory standard of living has been compounded by the psychological problem of going deeper into debt. In 1947 (see chart 7, p. 320), about 57 percent of the families with incomes below $1,000 and about 41 percent of the families with incomes between $1,000 and $2,000 either spent more than they earned or barely broke even. By early 1948 (see chart 8, p. 321), about 27 percent of all spending units had no liquid assets, while another 15 percent had liquid assets of less than $200, and still another 13 percent had liquid assets between $200 and $500. Cumulative, about 55 percent of all spending units had liquid assets of less than $500.

These hard facts illustrate one of the clearest and most undebatable evils of spiraling inflation. There can be no disputing the truth that inflation is imposing an intolerable and ever-increasing burden upon millions of families. While it is hard to draw the line between matters of social and economic significance, it is obvious that a social maladjustment so extensive in its range must have great economic significance in a nation of people who believe rightly that the ultimate objective of their economic system is to promote the welfare and security of its citizens as a whole.

The CHAIRMAN. We will recess at this point. I do not think we will be gone more than 10 or 15 minutes, and we will extend your time.

(Brief recess.)

The CHAIRMAN. Come to order, please.

You may proceed, Mr. Keyserling.

Mr. KEYSERLING. Mr. Chairman, the main concern I have is that these factual matters which I am presenting to you are the basis for a brief discussion of how the various measures now before your committee tie into this analysis.

I don't want——

The CHAIRMAN. That brings us nearer and nearer to the $64 question of what we are going to do with it.

Mr. KEYSERLING. I don't want to burden you with the facts to the extent of not getting to the very point and purpose of how I think I can be helpful in the evaluation of measures, but I do think that the facts are important.

Having covered the question of the effect of the price structure upon people as individuals and families, I now turn to the wholesale price situation, and will use this as a basis for what might be called the economic as distinguished from the predominantly social question.

A second area in which the inflationary and uneven march of prices is aggravating present maladjustments and storing up dangers for the future is revealed by an analysis of wholesale price trends and relationships.

CHART 4

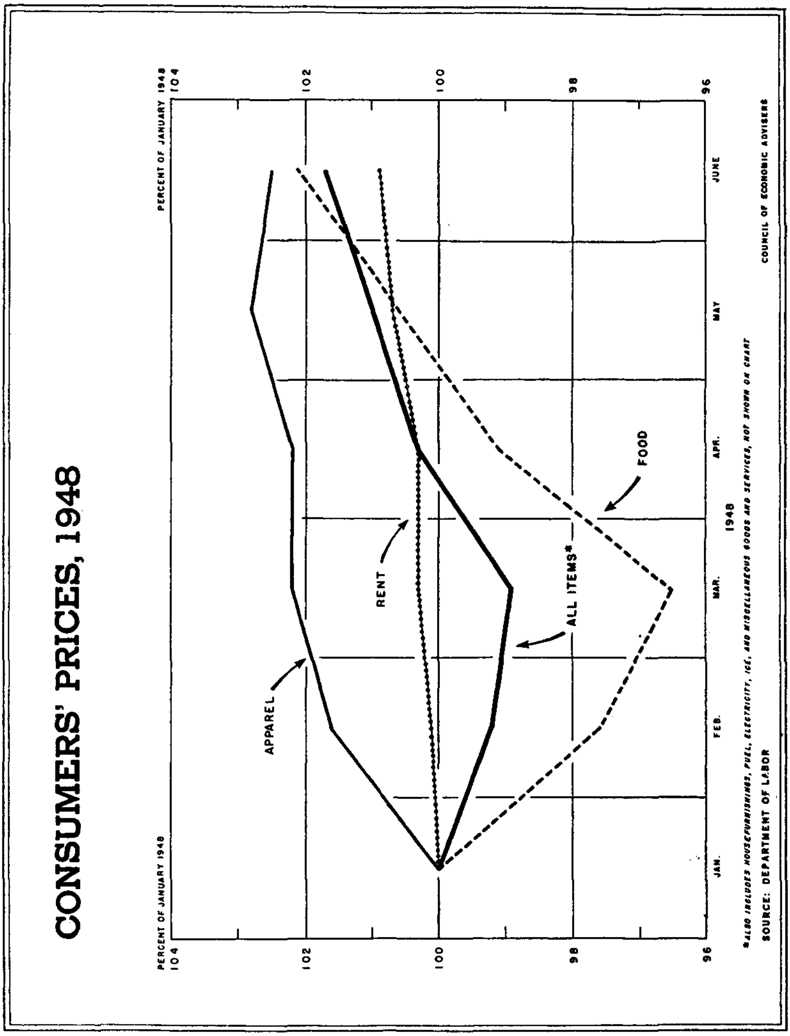

CONSUMERS' PRICES, 1948
PERCENT OF JANUARY 1948
104
102
100
98
96
JAN.
FEB.
MAR.
APR.
MAY
JUNE
1948
APPAREL
RENT
ALL ITEMS*
FOOD
*ALSO INCLUDES HOUSEFURNISHINGS, FUEL, ELECTRICITY, ICE, AND MISCELLANEOUS GOODS AND SERVICES, NOT SHOWN ON CHART
SOURCE: DEPARTMENT OF LABOR
COUNCIL OF ECONOMIC ADVISERS

CHART 5

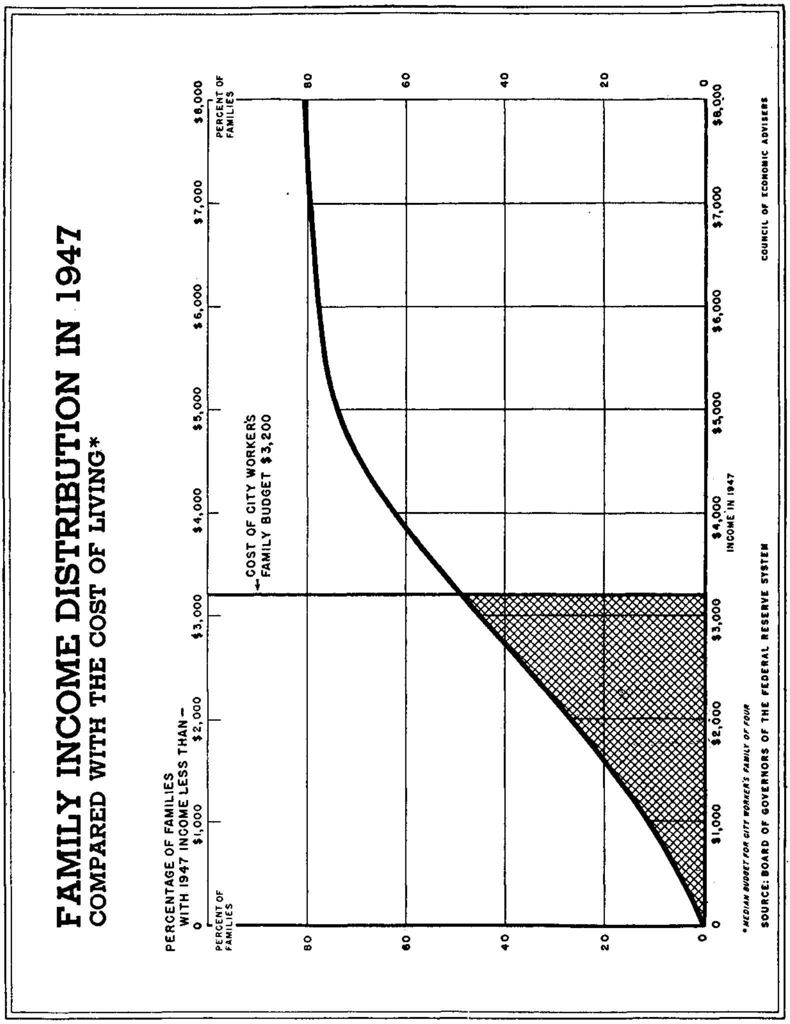

FAMILY INCOME DISTRIBUTION IN 1947
COMPARED WITH THE COST OF LIVING*
PERCENTAGE OF FAMILIES WITH 1947 INCOME LESS THAN—
0
$1,000
$2,000
$3,000
$4,000
$5,000
$6,000
$7,000
$8,000
PERCENT OF FAMILIES
80
60
40
20
0
COST OF CITY WORKER'S FAMILY BUDGET $3,200
INCOME IN 1947
*MEDIAN BUDGET FOR CITY WORKER'S FAMILY OF FOUR
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
COUNCIL OF ECONOMIC ADVISERS

CHART 6

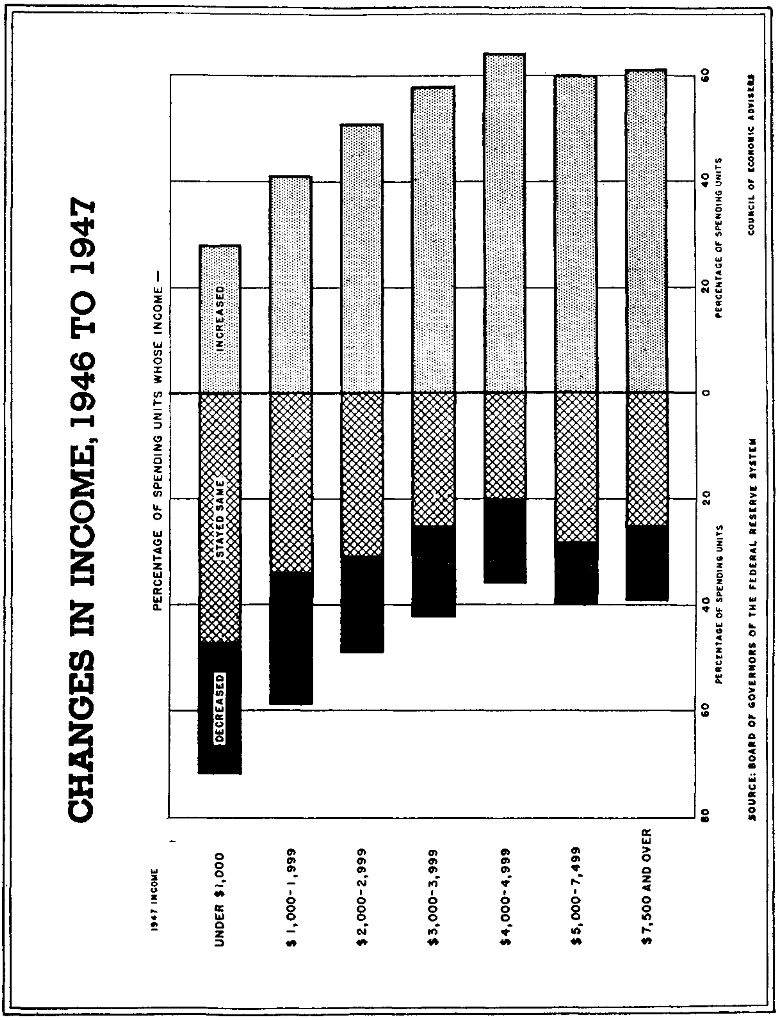

CHANGES IN INCOME, 1946 TO 1947
PERCENTAGE OF SPENDING UNITS WHOSE INCOME –
1947 INCOME
UNDER $1,000
$ 1,000-1,999
$ 2,000-2,999
$ 3,000-3,999
$ 4,000-4,999
$ 5,000-7,499
$ 7,500 AND OVER
DECREASED
STAYED SAME
INCREASED
80
60
40
20
0
20
40
60
PERCENTAGE OF SPENDING UNITS
PERCENTAGE OF SPENDING UNITS
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
COUNCIL OF ECONOMIC ADVISERS

CHART 7

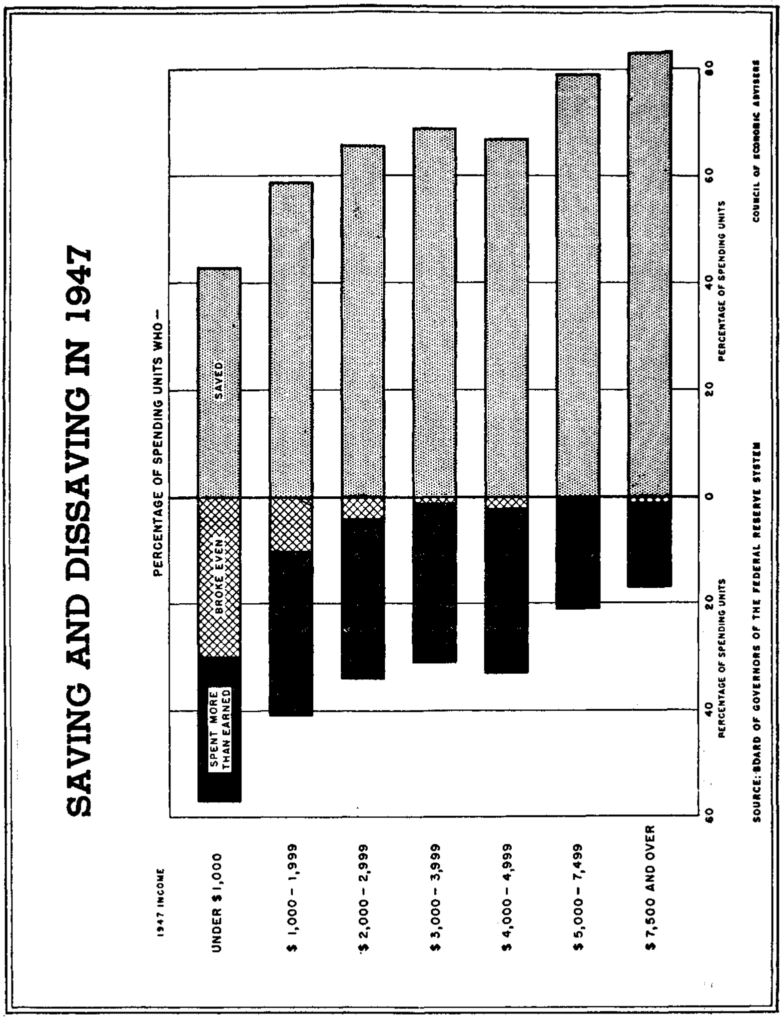
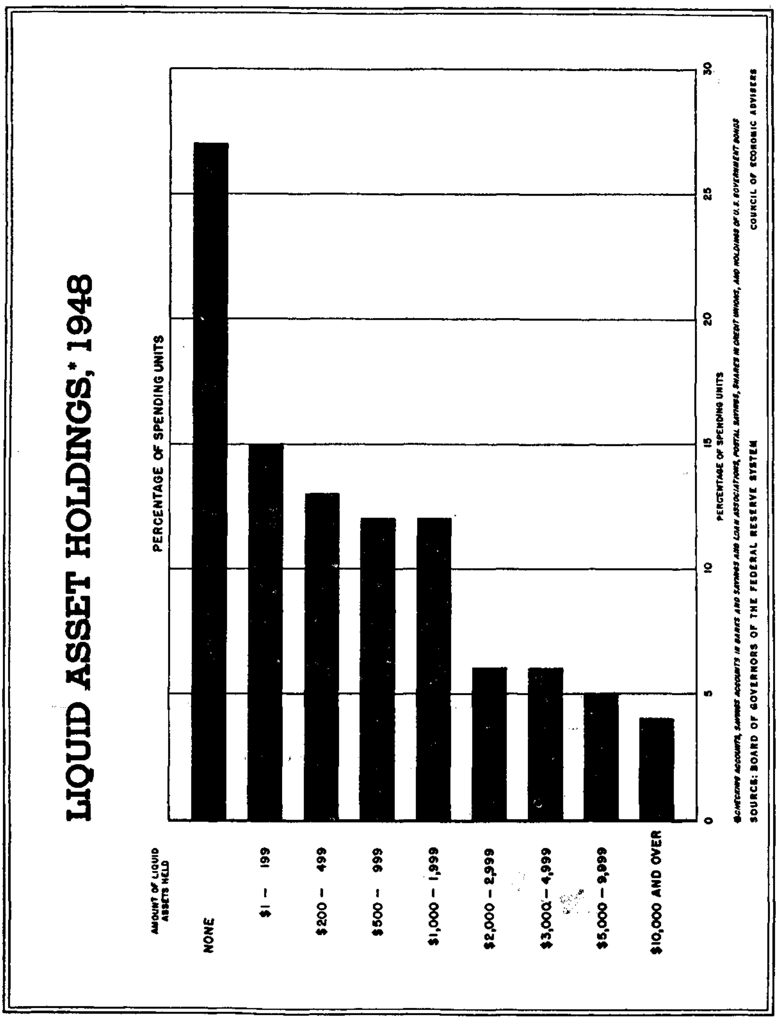
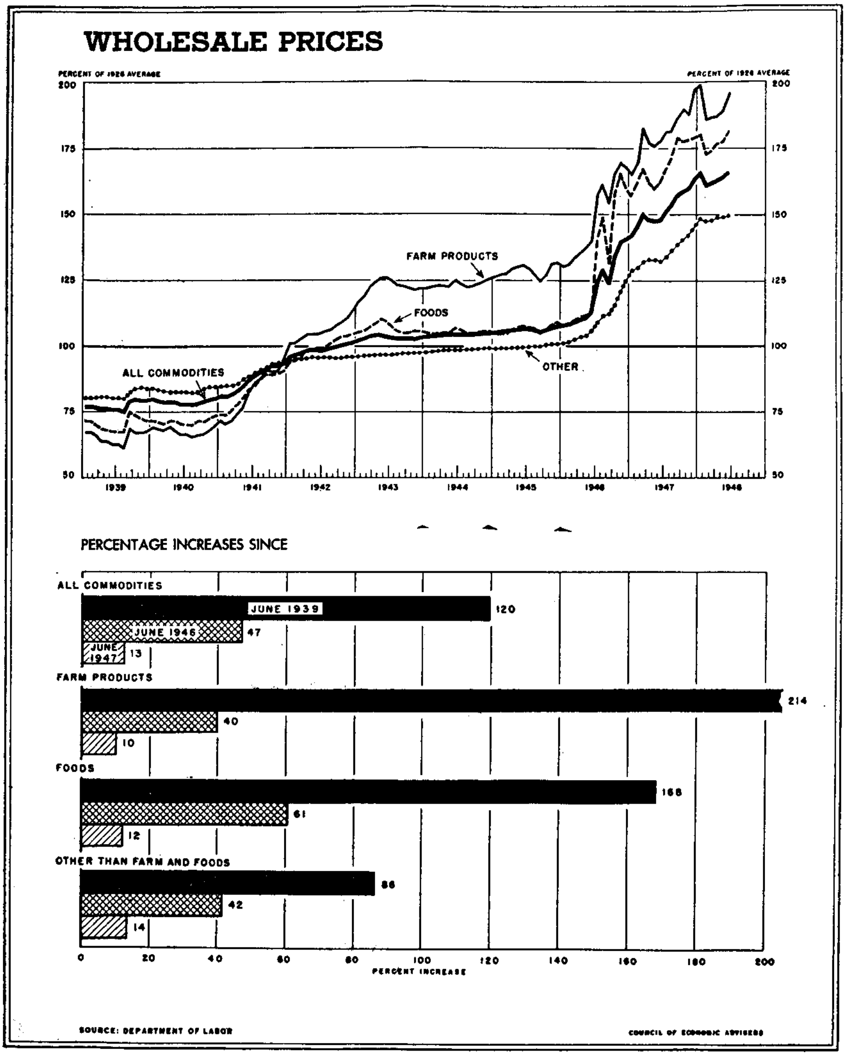

SAVING AND DISSAVING IN 1947
PERCENTAGE OF SPENDING UNITS WHO—
SPENT MORE THAN EARNED
BROKE EVEN
SAVED
1947 INCOME
UNDER $ 1,000
$ 1,000 - 1,999
$ 2,000 - 2,999
$ 3,000 - 3,999
$ 4,000 - 4,999
$ 5,000 - 7,499
$ 7,500 AND OVER
60
40
20
0
20
40
60
80
PERCENTAGE OF SPENDING UNITS
PERCENTAGE OF SPENDING UNITS
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
COUNCIL OF ECONOMIC ADVISERS

CHART 8


LIQUID ASSET HOLDINGS,* 1948
PERCENTAGE OF SPENDING UNITS
AMOUNT OF LIQUID ASSETS HELD
NONE
$1 - 199
$200 - 499
$500 - 999
$1,000 - 1,999
$2,000 - 2,999
$3,000 - 4,999
$5,000 - 9,999
$10,000 AND OVER
0
5
10
15
20
25
30
PERCENTAGE OF SPENDING UNITS
*CHECKING ACCOUNTS, SAVINGS ACCOUNTS IN BANKS AND SAVINGS AND LOAN ASSOCIATIONS, POSTAL SAVINGS, SHARES IN CREDIT UNIONS, AND HOLDINGS OF U.S. GOVERNMENT BONDS
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
COUNCIL OF ECONOMIC ADVISERS

Since June 1939 (see chart 9 below), the wholesale price index for all commodities has increased 120 percent; for farm products, the increase has been 214 percent; for foods, 168 percent; and for products other than farm and foods, 86 percent. As in the case of retail prices,

CHART 9



the sharpest increases have come since the middle of 1946. The significance of these trends in wholesale prices may be appraised by examining (*a*) the relative trends of agricultural and industrial prices, (*b*) the trends of a few specific industrial prices with particular stress upon events of this year, and (*c*) the more general trends of prices as they affect the relationship between funds available for business investment and funds available for consumer use.

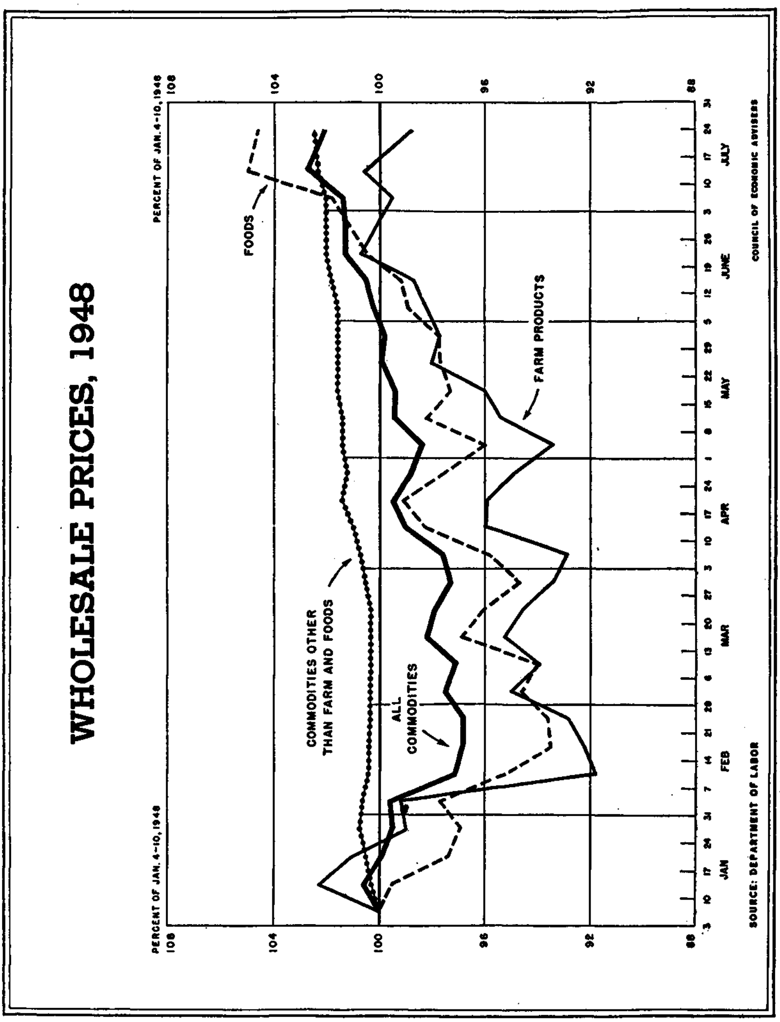
The relative trends of agricultural and industrial prices may be evaluated by the test of equity, and also by the test of their implications for the maintenance of economic stability at maximum levels of employment and production. By the test of equity, I do not share the viewpoint of those who have belabored the proposition that agricultural prices have increased more than industrial prices since 1939 or since some other base period. In the main, I think it can be demonstrated that the relatively greater gains in agricultural prices and incomes have tended to redress the unfairly disparate position in which farmers and farm families found themselves before the war in a predominantly industrial economy.

While farm prices may well have climbed a bit too high at their postwar peaks, in broader perspective the changes that have taken place since 1939 for the most part not only represent an equitable gain, but also represent a relationship between farm income and other incomes that will maintain our whole economy in better balance if it can be substantially retained. Moreover, by this vital test of effect upon general economic stability, the quick adaptability of farm prices to changes in the supply-and-demand situation gives reasonable assurance that a substantial break in general levels of employment and production will not be engendered by inflexibility or stickiness on the part of farm prices. In fact, experience thus far in 1948 (see chart 10, p. 324) illustrates quite clearly the almost unique sensitivity and responsiveness of agricultural prices to the market situation and outlook, compared with the fairly sustained pulse of rising industrial prices. Thus the most recent experience tends to corroborate the comments that I have just made with respect to the problems of agricultural prices and industrial prices over the longer period since 1939. I venture the prediction, and it is one of the very few that I shall make, that in the ensuing months and years the problem of preventing agricultural prices and incomes from getting too high will be less pertinent and less difficult than the problem of preventing agricultural prices and incomes from falling so low in relation to other prices and incomes as to jeopardize balanced national growth. This balanced growth, as we have learned from experience, depends in large measure upon such parity between agriculture and industry as assures a high demand on the part of our farm population for the products of our factories and city workers.

On the other hand, the fairly steady upward march of industrial prices since 1939, which has been maintained thus far in this year 1948 (see again chart 10), is a cause of genuine concern. The reason for this is that these prices are in large part administered or at least partially administered prices, which we know from repeated experience do not respond so rapidly or so sensitively as farm prices to changes in the composition of demand. If industrial prices go beyond levels at which they can be permanently maintained, and this they would seem already to have done, the necessary reductions in such prices particularly if they are allowed to advance still further along lines indicated by current trends will not be accomplished quickly enough without being preceded by wide-scale unemployment and large cut-backs in production. It follows that, although farm prices happen now to have reached higher levels in relation to a prewar base, there is a large margin of error in the oft-repeated proposition that the problem of restraining industrial prices is less serious than the

802626—48——3

CHART 10


WHOLESALE PRICES, 1948
PERCENT OF JAN. 4-10, 1948
FOODS
FARM PRODUCTS
COMMODITIES OTHER THAN FARM AND FOODS
ALL COMMODITIES
108
104
100
96
92
88
JAN
FEB
MAR
APR
MAY
JUNE
JULY
SOURCE: DEPARTMENT OF LABOR
COUNCIL OF ECONOMIC ADVISERS

problem of restraining farm prices. There will be something further to say about the trends in industrial prices, in connection with further analysis of current dangers and maladjustments from the more general perspective of price-income relationships throughout the economy.

The CHAIRMAN. What is that line, may I ask? Farm products? That sharp digression downward back in July 1948. What are those products that went down like that?

Mr. KEYERSLING. I would have to furnish you with a break-down of that.

The CHAIRMAN. I think that is interesting.

Mr. KEYSERLING. It is partly grains, but I would have to give you a break-down.

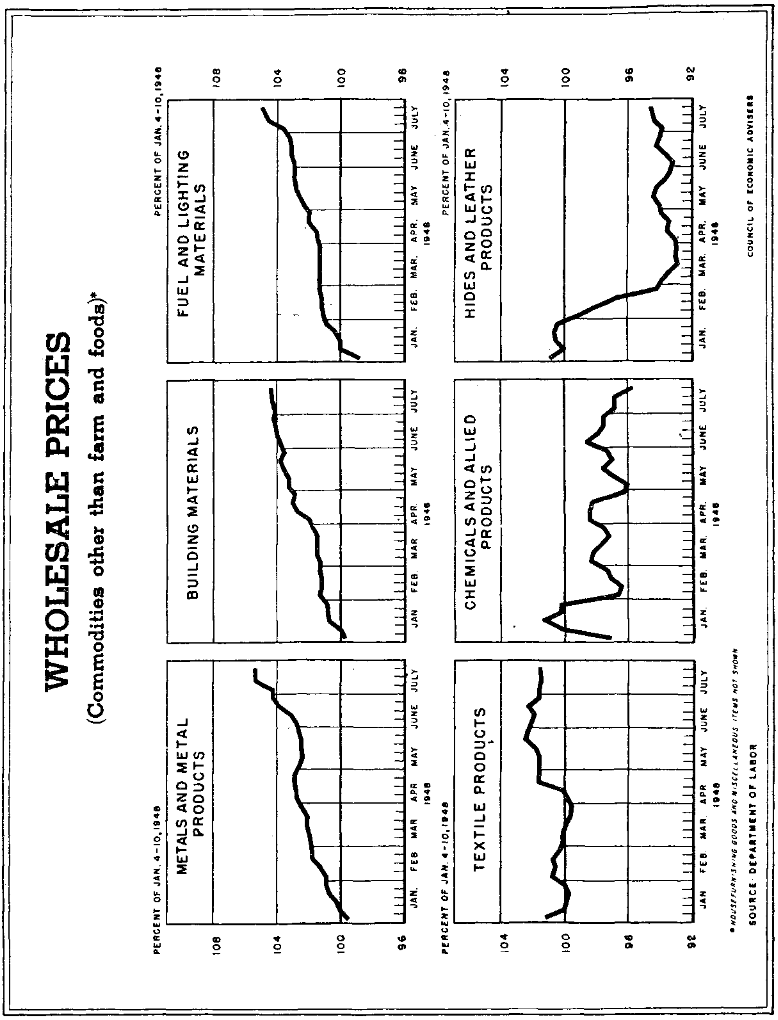
The dangers in advancing industrial prices are further revealed by examining some specific price trends in the industrial field (see chart 11, p. 326). During 1948 sustained and substantial industrial price advances in highly significant areas have been occurring for metals and metal products and for building materials, as well as for fuels and lighting products. This continued upswing is taking place in fields where the postwar demand thus far is extraordinarily high, in view of the business reconversion and equipment boom, the cumulative shortage of housing, and the special demands of the preparedness program and the foreign aid program. True, if our economy is maintained at full employment, it may continue to need an output of metals and building materials as large or even larger than the present output. But it is extremely doubtful whether a demand sufficient to absorb an output of this size can be maintained at current price levels when the special temporary factors in demand just cited have spent their main force.

For example, the country needs for at least 10 years an annual volume of housing output as large, or even considerably larger, than the current high level of house construction. But when the relatively thin market of those who can buy high-priced or luxury housing is saturated, and when the residential construction industry is faced with the task of supplying the mass market of those who need far more moderately priced housing, there is certain to be a collapse in the postwar building boom, analogous to that which took place after 1925, unless prices are drastically lowered. My personal belief is that the postwar building boom at current prices cannot be sustained for as many years as it was after the First World War. This forces upon us the unpalatable conclusion that the rigidity and stickiness of industrial prices in crucial fields will lead to serious unemployment and cut-backs in production if the price level is permitted to move further and further above levels that can be permanently maintained.

The continued upward surge of these industrial prices is also of great significance in its effect upon the foreign-aid and preparedness programs. This upsurge of prices confronts us with the unhappy choice either of carrying these programs forward at a slower pace than our national interests require, or of serving these interests fully at the cost of greater damage to the civilian distribution of the commodities involved than would result if a more restrained price policy were pursued.

In connection with this phase of the industrial price situation, there is to be considered the price-wage spiral. The movement for higher wages through collective bargaining is not responsive solely to changes

CHART 11


WHOLESALE PRICES
(Commodities other than farm and foods)*
PERCENT OF JAN. 4-10, 1946
METALS AND METAL PRODUCTS
BUILDING MATERIALS
FUEL AND LIGHTING MATERIALS
108
104
100
96
JAN. FEB. MAR. APR. MAY JUNE JULY
1946
PERCENT OF JAN. 4-10, 1946
TEXTILE PRODUCTS
CHEMICALS AND ALLIED PRODUCTS
HIDES AND LEATHER PRODUCTS
104
100
96
92
*HOUSEFURNISHING GOODS AND MISCELLANEOUS ITEMS NOT SHOWN
SOURCE: DEPARTMENT OF LABOR
COUNCIL OF ECONOMIC ADVISERS

in the cost of living, although most of the attention has focused upon this aspect since the war. The demand for higher wages rests also in large degree upon the price-profit picture in the industries that pay the wages. Even if the cost of living should be leveled off or reduced, no one familiar with the realities would predict that the price-wage spiral can be stopped so long as industrial prices are moving upward and resulting in such large net returns as now seem both present and prospective.

This brings us to an examination of price trends in terms of their effect upon the flow and use of national income. Particular emphasis should be placed upon the key problem of maintaining a workable balance between productive capacity and consumer buying power. There is a general tendency to overlook this venerable problem in the midst of inflation, although one of the main dangers of inflation is that it stealthily creates conditions which will ultimately throw this problem at us with stunning impact.

The CHAIRMAN. Which is coincident with deflation.

Mr. KEYSERLING. Which is coincident with deflation, and this is the real central danger of inflation, from the economic point of view. The paradoxical thing about it is that inflation masks this danger to the point that it is hard to see it while the inflationary period lasts, but it is there, nonetheless.

The growing maladjustments taking place, during the process of inflation, in the relationship between income available to stimulate and finance production and income available for consumer use, may best be revealed by examining trends in the gross national product and in its composition.

Since 1929, there have been enormous changes in the gross national product measured by current dollars, and very great changes in real output are evidenced when the current dollar figures are deflated to take account of price changes. (See chart 12, p. 329.) Our real national output is about 72 percent higher now than in 1929, reflecting a profound and presumably permanent change in the national economy. The gross national product in real terms was only very slightly lower in 1947 than it was in 1946, when it still reflected conditions carried over from the war. During the first half of 1948, the product has been running at about the same annual rate as during 1947 as a whole. The slight variations since 1946 are not very significant, because of changes in the composition of the product which makes available measurements inexact. It is significant, however, that total output since 1946 has not increased as might have been expected in view of the volume of employment and the improved quality of plant and equipment.

The gross national product may be translated into receipts and expenditures by consumers, Government, business, and in the form of net foreign investment. (See chart 13, p. 330.) For the purpose of appraising trends in the composition of demand, the expenditures figures are relevant. The expenditures of consumers, which may be taken to represent the pull of consumers upon the total supply of goods and services, dropped from 71.1 percent of the total gross national product figure in 1939 to 65.2 percent in the first half of 1948. Contrasting the same two periods, the expenditures of Government rose from 18.5 percent of the total to 19.4 percent; net foreign investment rose from 1 percent to 1.5 percent; and business investment rose from 9.5 percent to 13.9 percent. Thus, the most significant changes in the composition of demand since the last prewar year have been the sharp downturn in the relative size of consumer expenditures, compensated for mainly by the sharp upturn in the relative size of business investment. This reflects industry's postwar reconversion boom and does not in itself reveal anything undesirable.

However, the present composition of expenditures or demand cannot be expected to maintain as we move to a more characteristically peacetime economy. To preserve a workable balance between productive capacity and ultimate consumption, consumer expenditures or demand will need to assume a relatively larger role, not only because business will be through the reconversion and reequipment period but also because the relative role exerted by Government expenditures and net foreign investment must be expected to decline with the advent of a more normal international situation. Yet, when we examine the income relationships being developed in the current inflationary process and remember that income is the foundation for expenditures or demand, we find that these developing income relationships threaten to militate against, rather than to facilitate, the necessary adjustments.

This conclusion rests on national-income analysis. The total of national income, rising with the total gross national product, has increased in real terms by about 80 percent since 1929 and has not changed significantly since 1946. (See chart 14, p. 331.) Upon examining the composition of national income (see chart 15, p. 332), it appears that the following developments have taken place: Compensation of employees has dropped from 65.9 percent of the national income total in 1929 to 63 percent in 1947 and to 62 percent in the first half of 1948. During the same three respective periods, business and professional income has increased from 9.4 percent to 11.5 percent to 11.8 percent. Farm income has increased from 6.5 percent to 7.8 percent to 8.4 percent. Corporate profits and inventory valuation adjustments have increased from 8 percent to 12.2 percent to 12.3 percent. Interest and rents dropped from 10.6 percent in 1939 to 5.6 percent in 1947 and remained at the latter level during the first half of 1948. The most important changes have been the increase in the farmers' share, the significance of which I have already discussed; the decrease in the share represented by compensation of employees; and the very substantial increase in the share represented by corporate profits and inventory valuation adjustments, accompanied by a lesser increase in the share represented by business and professional income.

The CHAIRMAN. Is it correct, sir—do I interpret that chart aright—that compensation to employees has been practically at parity from '47 to '48?

Mr. KEYSERLING. That is substantially correct, as a percentage of the total national income, contrasting 1947 as a whole with the annual rate during the first half of 1948. There has been a slight downward movement of compensation to employees, from 63 to 62 percent.

The CHAIRMAN. How about corporate profit?

Mr. KEYSERLING. There was a slight change upward, hardly discernible on the chart, from 12.2 percent to 12.3 percent, between 1947 and the first half of 1948. The great change in the corporate profits percentage of total national income was from 8 percent in 1939 to more than 12 percent in 1947 and in the first half of 1948.

CHART 12

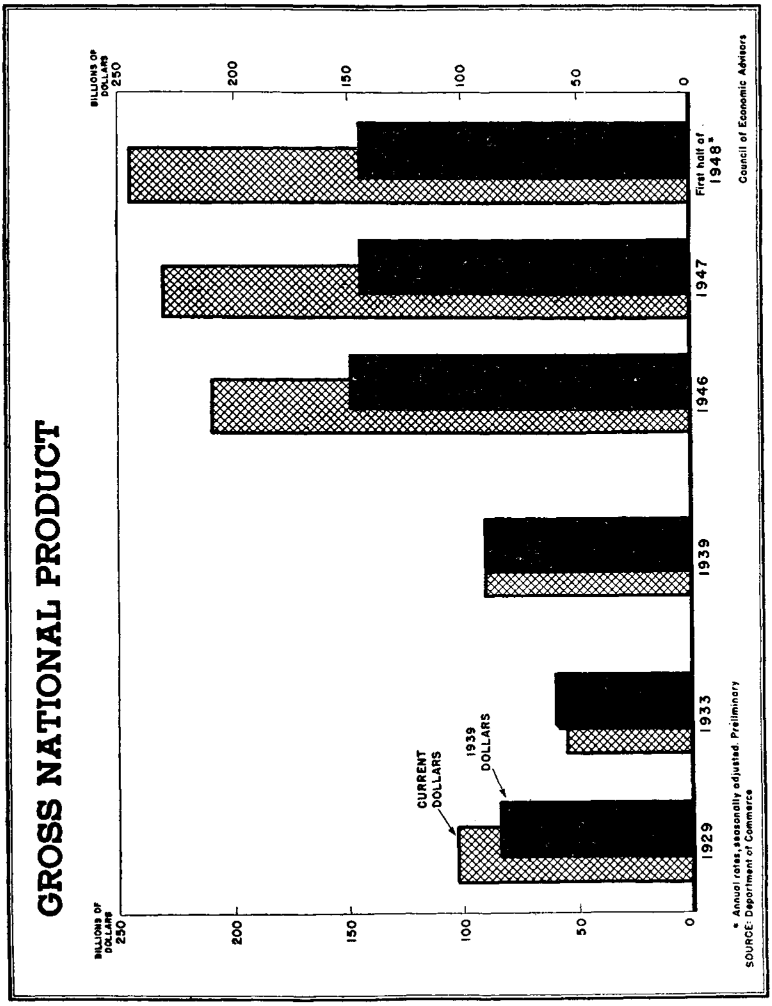

GROSS NATIONAL PRODUCT
BILLIONS OF DOLLARS
250
200
150
100
50
0
CURRENT DOLLARS
1939 DOLLARS
1929
1933
1939
1946
1947
First half of 1948*
* Annual rates, seasonally adjusted. Preliminary
SOURCE: Department of Commerce
Council of Economic Advisors

CHART 13

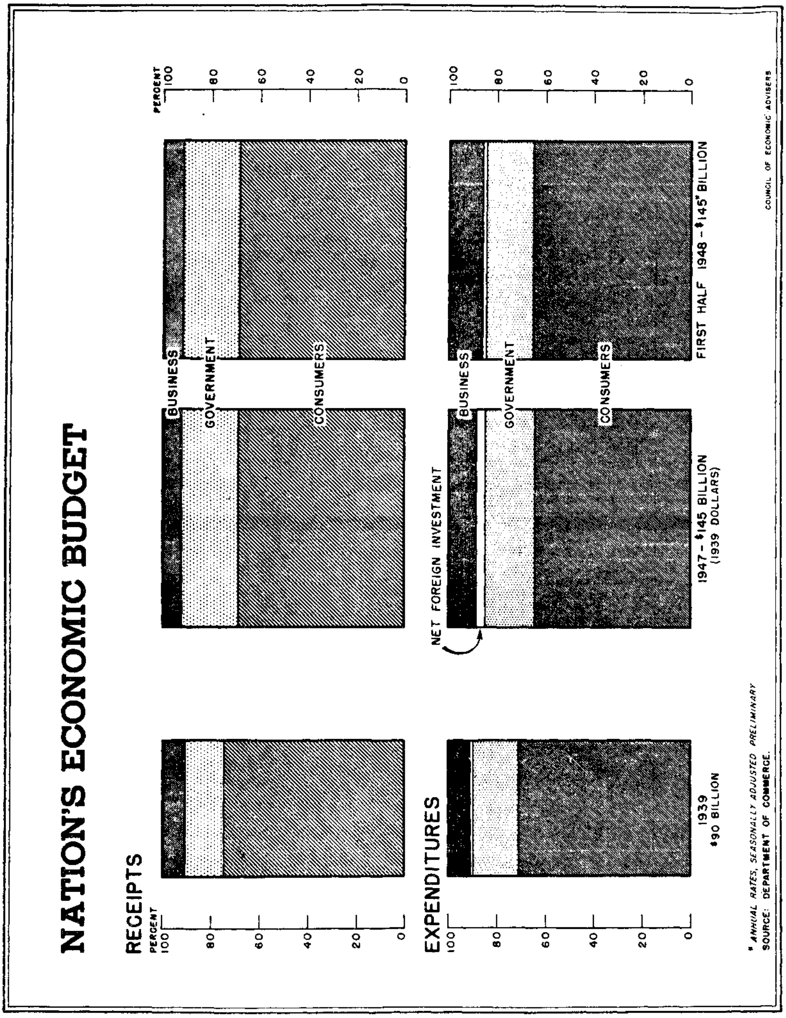
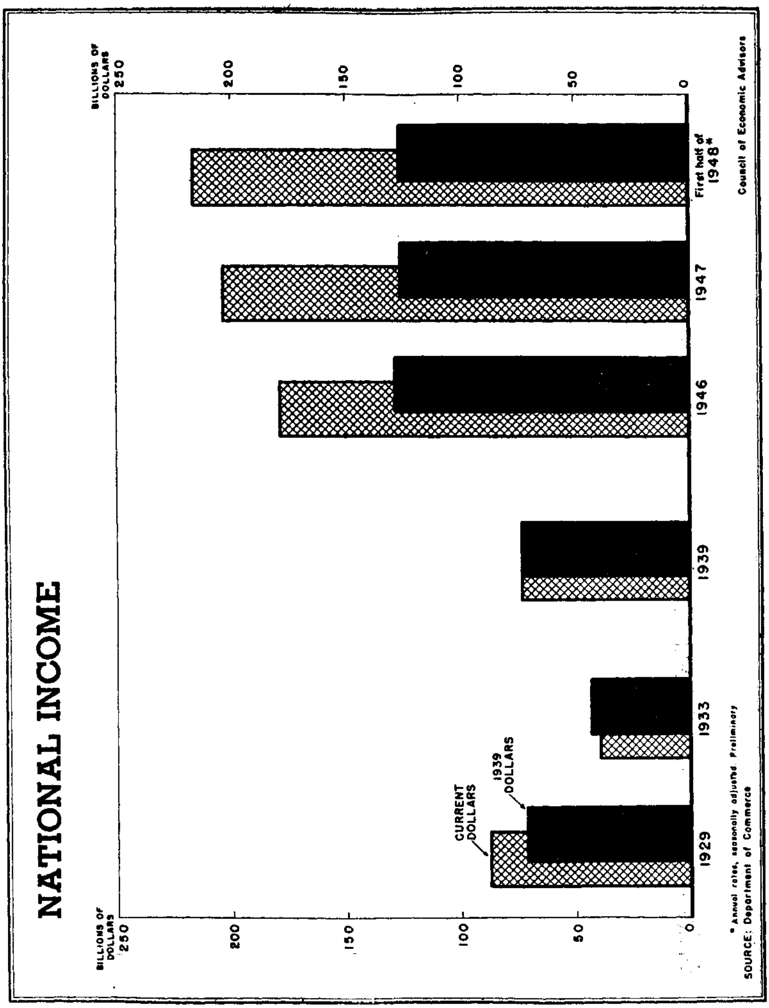
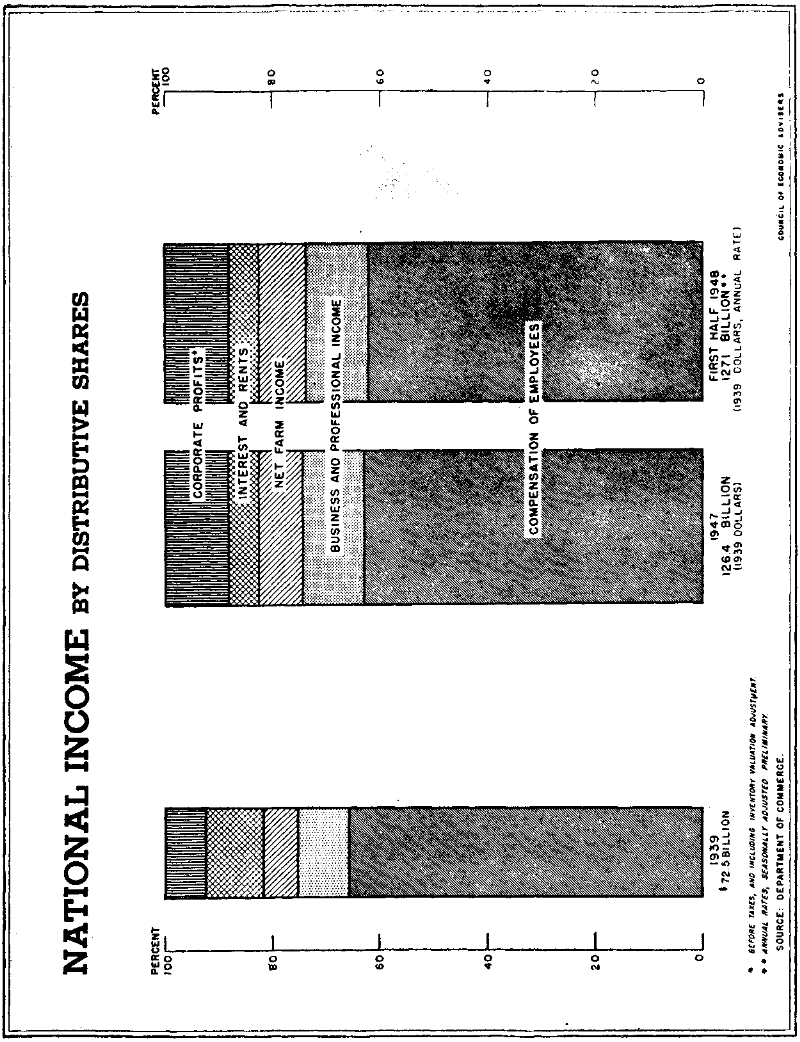

NATION'S ECONOMIC BUDGET
RECEIPTS
PERCENT
100
80
60
40
20
0
BUSINESS
GOVERNMENT
CONSUMERS
1939
$90 BILLION
1947 - $145 BILLION
(1939 DOLLARS)
FIRST HALF 1948 - $145* BILLION
EXPENDITURES
NET FOREIGN INVESTMENT
* ANNUAL RATES, SEASONALLY ADJUSTED PRELIMINARY
SOURCE: DEPARTMENT OF COMMERCE.
COUNCIL OF ECONOMIC ADVISERS

CHART 14



802626—48——4

CHART 15


NATIONAL INCOME BY DISTRIBUTIVE SHARES
PERCENT
100
80
60
40
20
0
1939
$72.5 BILLION
1947
126.4 BILLION
(1939 DOLLARS)
FIRST HALF 1948
127.1 BILLION**
(1939 DOLLARS, ANNUAL RATE)
CORPORATE PROFITS*
INTEREST AND RENTS
NET FARM INCOME
BUSINESS AND PROFESSIONAL INCOME
COMPENSATION OF EMPLOYEES
* BEFORE TAXES, AND INCLUDING INVENTORY VALUATION ADJUSTMENT.
** ANNUAL RATES, SEASONALLY ADJUSTED. PRELIMINARY.
SOURCE: DEPARTMENT OF COMMERCE.
COUNCIL OF ECONOMIC ADVISERS

The CHAIRMAN. That cannot be right; compensation to employees in 1939 is 72 billion.

Mr. KEYSERLING. No; that is the total figure for the whole bar, representing total national income.

Senator SPARKMAN. You seem to have one element in the 1939 column that is not in the column to the right. I guess it is. Is that business and professional income?

Mr. KEYSERLING. Yes; they are all in.

Senator SPARKMAN. It seems a little lighter on this side.

Mr. KEYSERLING. It is the same. The width of the bars, rather than the height of the bars, indicates the change in the total size of the national income (deflated), which was 72.5 billion in 1939, rising to 126.4 in 1947, and to an annual rate of 127.1 for the first half of 1948.

The CHAIRMAN. For the sake of ordinary minds like ours, you could elucidate that a little better in your chart to make that distinction.

Mr. KEYSERLING. I would like to try to do that.

Senator SPARKMAN. Let me see if I understand. You have a percentage bar running up and down on both sides.

Mr. KEYSERLING. The percentage bar indicates the percent of the total that is taken by these various factors.

Senator SPARKMAN. The percentage of the total which the compensation of employees bears in 1939 is not greatly out of line with 1947 and 1948, the percentage, not the quantity.

Mr. KEYSERLING. It depends on what you mean by greatly. The change has been from 65.9 percent, Senator, to 62 percent. When you are dealing with large compounds, that is quite a substantial change.

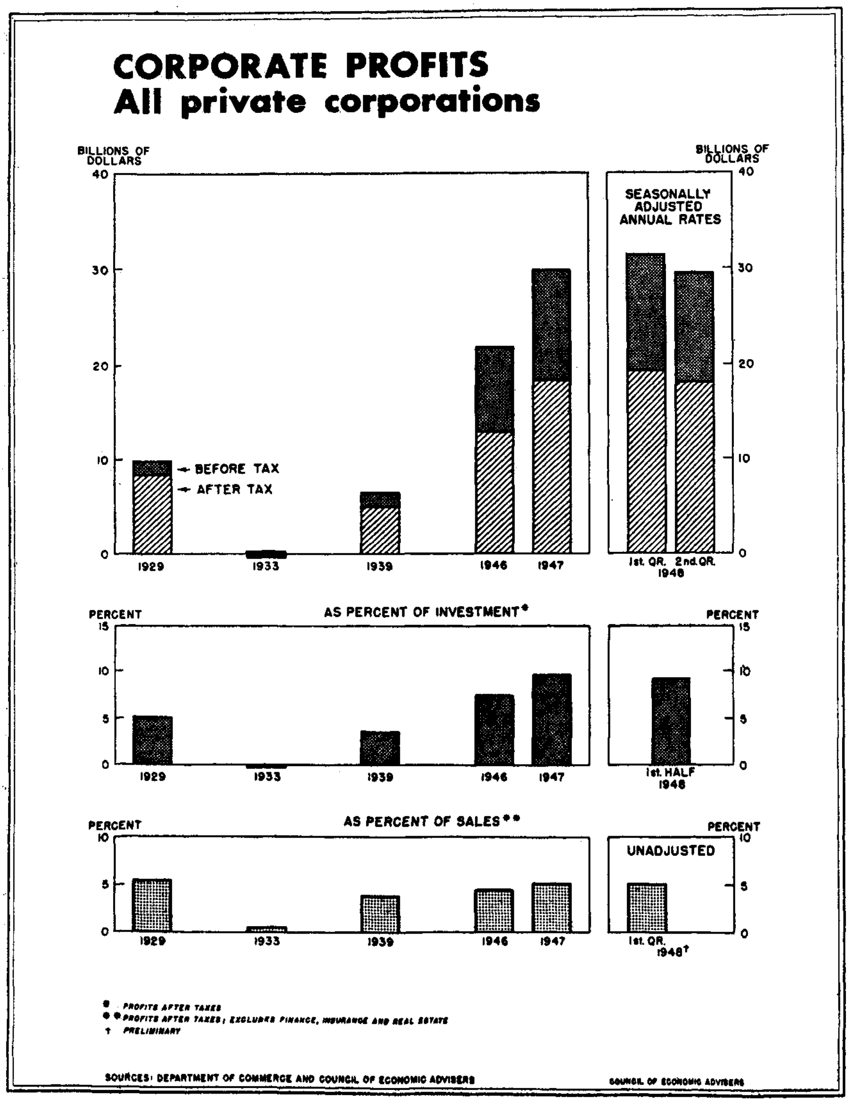
Senator SPARKMAN. It looks slight there.

Mr. KEYSERLING. It is a substantial change.

These relative trends in the main types of income would not seem to correlate at all well with the composition of expenditure or demand that will be needed in a balanced economy at maximum employment and production as we move toward workable peacetime relationships. But before embracing this conclusion, it is necessary to examine the trends in corporate profits and in consumer incomes a bit more specifically. Looking first at the corporate profits picture (see chart 16, p. 334), these profits when measured as a percentage of sales were 5.4 percent in 1929; 3.9 percent in 1939; 4.6 percent in 1946; 5.2 percent in 1947; and 5.2 percent in the first quarter of 1948 according to the best available estimates. Measured as a percentage of investment, these corporate profits were 5.1 percent in 1929; 3.5 percent in 1939; 7.4 percent in 1946; and 9.6 percent in 1947. Details for 1948 are not yet available. Together with these figures, it is noteworthy that, during the first half of 1948, retained net earnings and depreciation reserves continued to supply the major part of corporate financial requirements (see chart 17, p. 335). It appears from the available data that business income is on the high side in relation to the amounts required to sustain the volume of business investment compatible with peacetime economic balance. At the same time, consumer incomes, of which the compensation of employees forms the major part, have been reflecting a decreasing share of national income. Furthermore, total real per capita personal income after taxes is now lower than during 1946, although it has been fairly constant since the second half of 1947 (see chart 18, p. 336).

The foregoing analyses strongly presage the emergence of an inadequacy of consumer income when production mounts, when reservoirs of wartime savings have been further depleted, when those expenditures of Government which reflect the tense international situation

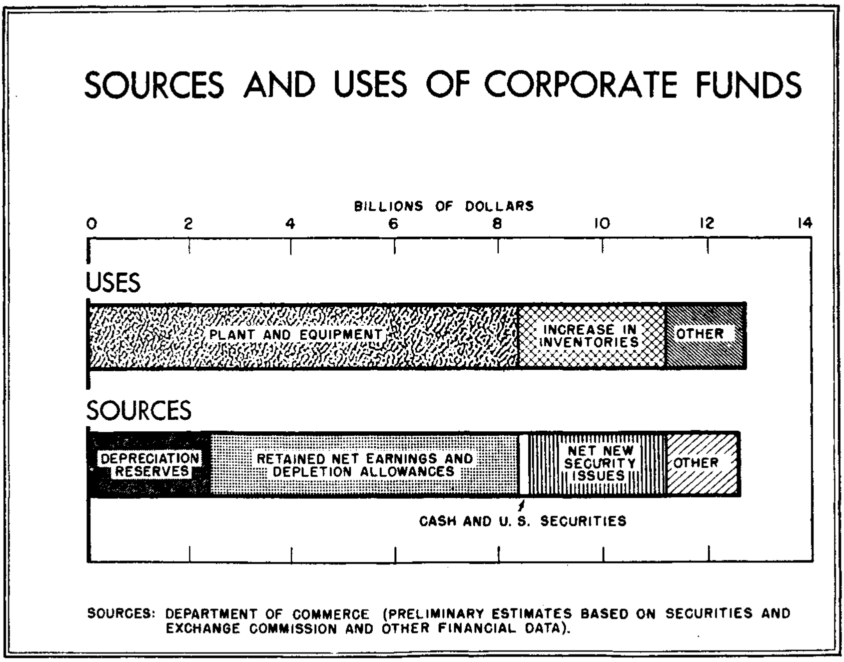
Chart 16



decrease, and when business investment comes to assume a relationship to total economic activity more nearly in line with peacetime experience. It may be said, in dissent from this conclusion, that total consumer income is now adequate, or more than adequate, to take the supply of goods now available for consumer use, as evidenced by the fact that prices are still being pushed upward. This would be a comforting conclusion if we could but ignore the lesson of experience. For experience during past periods of adjustment leaves little room for belief that wages would be increased voluntarily or prices decreased systematically at the very time when the business outlook might be dampened by a decline in Government-created demand for foreign aid and preparedness. Experience indicates, rather, that the delay of adjustment until that time would result in curtailment of employment and production, followed by disorderly price breaks and a general economic decline—the spiral of depression.

It would be far safer if real consumer incomes were now kept more nearly abreast of increases in domestic output. If compelling reasons of national policy require for a time that an extraordinary part of this output be diverted away from domestic consumers, the worst

CHART 17

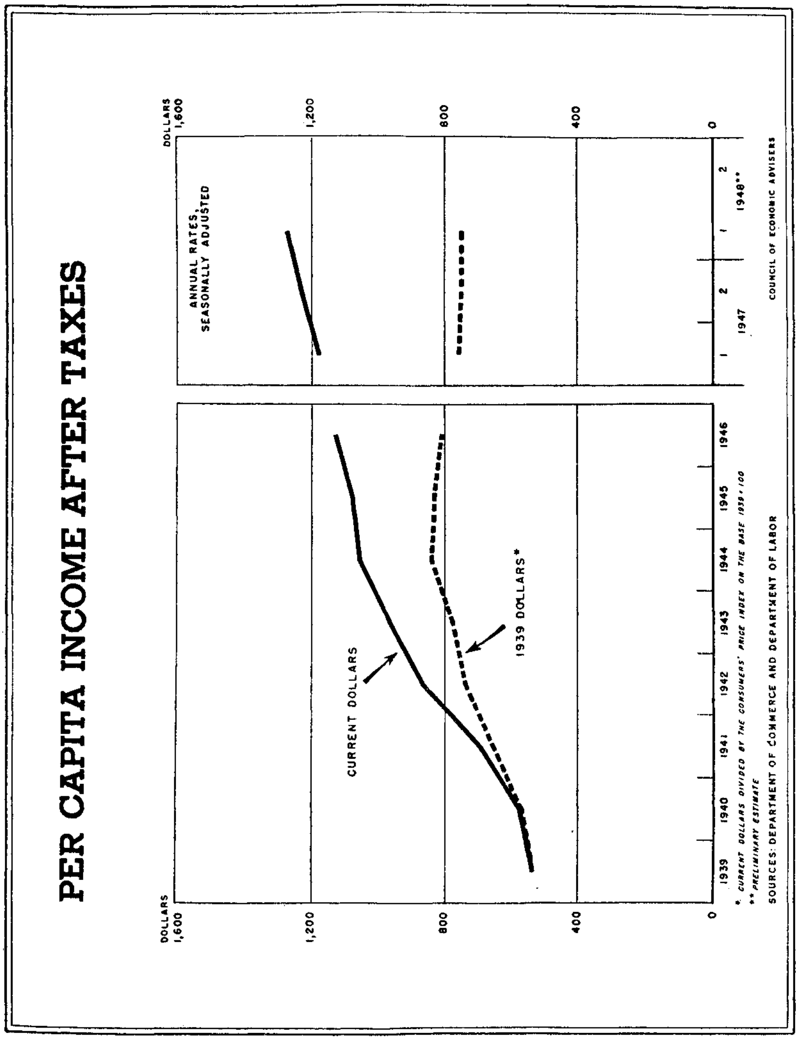


way to deal with the situation is by price increases that ration goods unfairly and enormously magnify the coming problem of peacetime adjustment. A more prudent approach, for the time being, would be to keep income relationships in sounder balance by a restrained price policy, and to cut consumer spending rather than consumer incomes by voluntary savings and high taxes. We should then have a better chance to maintain a full economy by not cumulating maladjustments against the day of reckoning.

The CHAIRMAN. Are all those charts in this booklet?

Mr. KEYSERLING. Yes.

CHART 18


PER CAPITA INCOME AFTER TAXES
DOLLARS
1,600
1,200
800
400
0
CURRENT DOLLARS
1939 DOLLARS*
1939
1940
1941
1942
1943
1944
1945
1946
ANNUAL RATES, SEASONALLY ADJUSTED
1
2
1947
1
2
1948**
* CURRENT DOLLARS DIVIDED BY THE CONSUMERS' PRICE INDEX ON THE BASE 1939=100
** PRELIMINARY ESTIMATE
SOURCES: DEPARTMENT OF COMMERCE AND DEPARTMENT OF LABOR
COUNCIL OF ECONOMIC ADVISERS

Senator SPARKMAN. What number will be the one that you are about to put up?

Mr. KEYSERLING. Chart 19 is coming up. This chart shows the final type of maladjustment which I shall discuss, now appearing in the process of inflation, which is a consequence of unequal trends in the real earnings of individuals. For all wage earners (see chart 19, p. 338), the index of real earnings has declined about 10 percent since June 1946, and this is to be regarded as an unfavorable development for reasons already stated. But more significant than this, in some ways, is the much greater decline in real earnings suffered by such groups as clerical and professional workers. This group has been thrown for a loss of about 15 percent during the same period. Meanwhile, a few groups have fared much better than the average.

The CHAIRMAN. I confess I am surprised at that, sir. I had supposed that the wage scale was fully as high today as it was then.

Mr. KEYSERLING. Not in relation to the price level.

Senator SPARKMAN. This is the real wage?

Mr. KEYSERLING. The real wage, in relation to the price level. This is made more realistic by adjusting it to the price level.

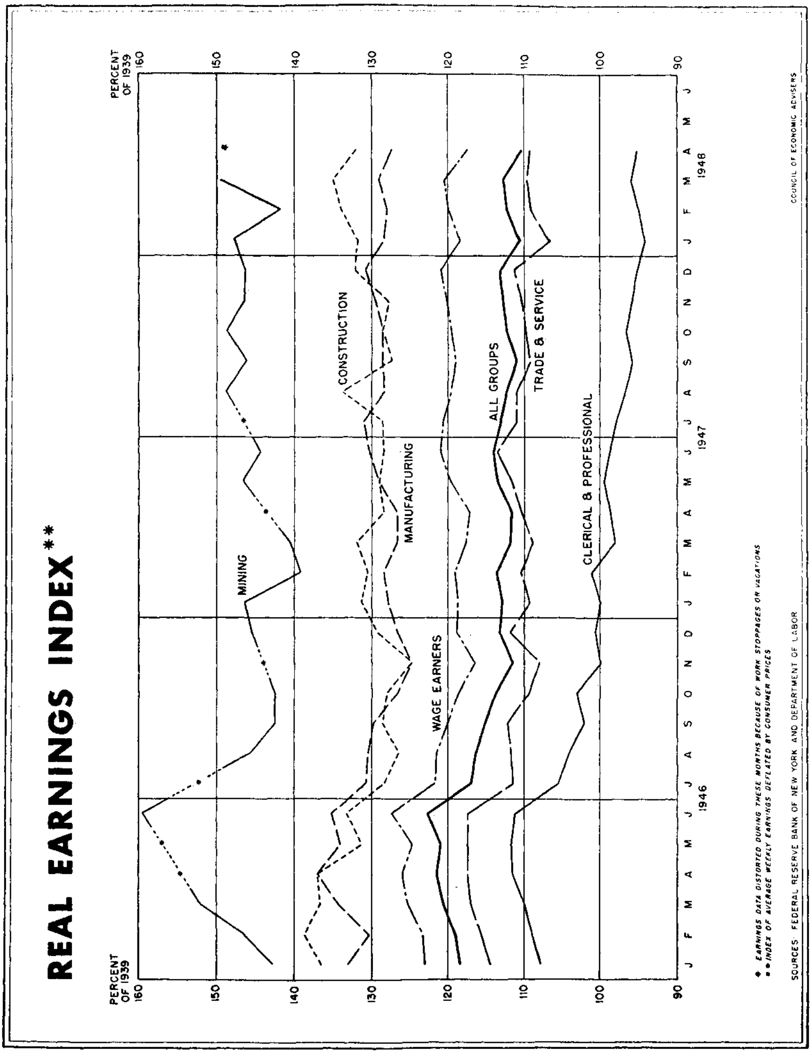
Quite aside from the inequities involved, these widely disparate changes in the wage and salary structure are not a basis either for social contentment or for uniformly calm industrial relations. Moreover, in the extremely tight labor market of full employment, these disparities do not result in the distribution of required manpower along lines consistent with the best national interest by any reasonable test. An outstanding example of this, of course, is the situation of the teaching profession, where the shortage of teachers is growing while the number of school-age children is increasing rapidly.

Due to historic and other reasons, disparities in wages and salaries among groups where most people would not say that the differentials in training or skill justified the differentials in pay, is to a degree normal even if not entirely fortunate in a complex economy. But disparities as great as those that have been developing in the process of inflation are neither normal nor desirable. They constitute some of the worst manifestations of the inflationary process. These disparities also indicate the superficiality of the argument that an effective anti-inflationary program must "hurt everybody a little bit," when in fact the essence of an effective anti-inflationary program is that it be selective enough to help those who have already been hurt too much, while it restrains those who have been going too far.

We may now summarize briefly the dangers and maladjustments which have been and still are being generated in the inflationary process.

First, the inflationary process is working untold hardships upon millions of families. Not only have these families failed to participate in the rising standards of living that have been made available to others as the end of the war has released more goods for civilian use. More than that, these millions of families are now losing ground in absolute as well as relative terms. Their money incomes are going down; their real incomes are going down; their accumulated savings are disappearing or have already disappeared; they are spending more than they earn; their debts are increasing. Whether one calls this a social or an economic problem—and it is certainly a mixture of both—it is a problem that no great nation can discount or ignore without

CHART 19


REAL EARNINGS INDEX**
PERCENT OF 1939
160
150
140
130
120
110
100
90
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J
1946
1947
1948
MINING
CONSTRUCTION
MANUFACTURING
WAGE EARNERS
ALL GROUPS
TRADE & SERVICE
CLERICAL & PROFESSIONAL
* EARNINGS DATA DISTORTED DURING THESE MONTHS BECAUSE OF WORK STOPPAGES OR VACATIONS
** INDEX OF AVERAGE WEEKLY EARNINGS DEFLATED BY CONSUMER PRICES
SOURCES: FEDERAL RESERVE BANK OF NEW YORK AND DEPARTMENT OF LABOR
COUNCIL OF ECONOMIC ADVISERS

facing the prospect of mounting discontent, friction, envy, and suspicion, at a time when there is desperate need for unity of endeavor. Under such circumstances, wily or misguided agents can more easily show the seeds of trouble in the field of discontent.

The CHAIRMAN. It has some religious aspects, too.

Mr. KEYSERLING. I think it is fundamentally a moral question.

The CHAIRMAN. I think so.

Mr. KEYSERLING. As many economic questions are ultimately.

Second, the inflationary process is creating price and income and production maladjustments of increasing size throughout the economy. It is threatening, though few as yet perceive it, to revive the post-World War I problem of disparity between agricultural income and industrial income and thus to complicate the problem of price supports. It is pushing specific industrial prices, such as those in metals and building materials, to the point where output cannot permanently be disposed of at these price levels, while if the threatened further rise of these prices occurs it will make readjustment of these prices to maintainable levels almost impossible without being preceded by large cutbacks in employment and production. The inflation is creating enormous disparities in the wage structure which are indefensible on equitable grounds, and which are inconsistent with the availability of an adequate supply of workers for some of our most vital national needs such as primary and secondary education. The inflation is so distorting the composition of national income that the old danger of inadequate consumer buying power to provide a market for the maximum output of industry and agriculture at full employment is threatening to reappear; and this danger should not be overlooked because inflation by its very nature tends to conceal the danger until it suddenly descends upon the economy in full force. There is stewing in the boiler of inflation the main ingredients for an economic explosion, and we cannot afford to wait until these ingredients fuse themselves into the combination that will touch off that explosion.

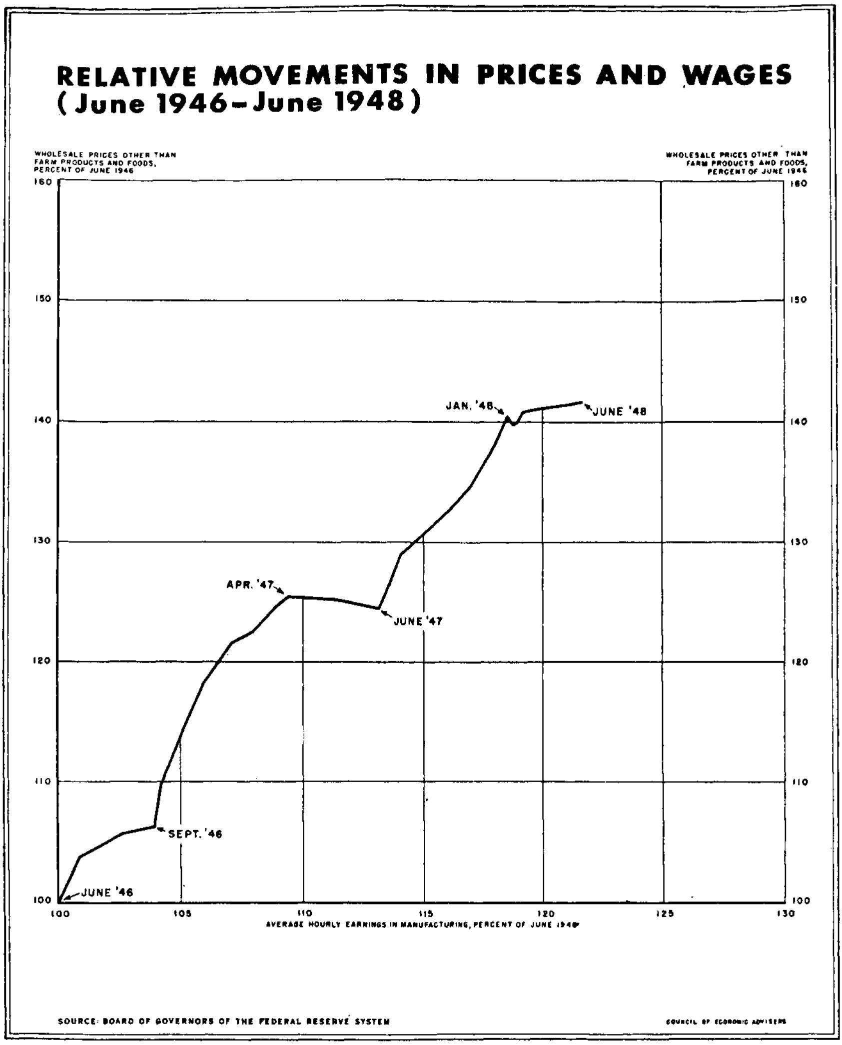
Third, even if in the process of inflation many of the changes in the price-income-production structure were not moving in the direction of further maladjustment, which in fact they are, we could still be certain that the speed with which these changes are taking place prevents any responsible factor in the economy from getting its true bearings. By keeping everyone off balance, inflation is profoundly unsettling everyone. This is best illustrated by the price-wage spiral (see chart 20, p. 340). Quite independently of whether prices are outrunning wages or wages are outrunning prices, quite independently of who is blameworthy or blameless in this process, the very fact that prices and wages are chasing each other at such a mad speed around so many dark corners means that serious collisions are bound to take place unless both management and labor can slow down for a while and get their bearings.

The CHAIRMAN. When Mr. Ben Fairless came before the Joint Economic Committee last spring, I happened to be present, and in the course of his prepared statement he made this statement; I think I report it verbatim:

"Under no circumstances should demands for increased wages follow increased profits."

I wrote it down. When he got through I asked him the question and he said he did say that.

Chart 20



My question was, Suppose he wasn't Ben Fairless, president of the steel corporation, but Ben Fairless, one of the open-hearth operators in Pittsburgh, and he is intelligent as most men are who are in labor today, and he thought the steel corporation was making large earnings of $11.70 on a share after taxes and reserves and $120,000,000 net profit, when would Ben Fairless, now John Smith, hearth worker, feel that he was entitled to increased wages when the concern he represented was making the largest earnings in the history of the country?

He didn't like the question. I was thinking in terms of when the reverse happens. Then they close the plants and John Smith goes out on his ear, and his income is lost, and his family is in distress.

I am asking you on this theory about labor and the demand for wages and all, when would they expect to get increased wages if it wasn't at a time when profits were being paid and made from products which they produced.

Mr. KEYSERLING. I think what you say, broadly speaking, is correct, Mr. Chairman. I would say that I have tried to approach this subject objectively, and as I said near the beginning of my statement it doesn't always follow that wages and profits should increase at the same rate.

There are periods when profits should increase faster than wages, because the profit structure is more volatile. When the economy is going downhill, when it is running into a period of large-scale unemployment, profits sometimes fall below the zero point, and manifestly we couldn't allow wages to fall below the zero point. And likewise, profits have to increase faster than wages at times to make up for the times when they have decreased faster.

At other times, wages should increase faster than profits. I think this second formula is closer to the correct formula for a well-balanced, healthy, maximum employment and maximum production economy.

What has been happening at the present time is partly illustrated by this chart 20 showing the relative movements in prices and wages from June 1946 to June 1948. The line moving upward is the price line. The line moving sideward is the wage line. The dates on the lines indicate the points at which particular spurts occurred, and they are important for the purpose of showing you how you have had a sequence of a price jump and a wage jump and a price jump and a wage jump. That is the spiral. The line, of course, does show that the prices have moved forward more rapidly than the wages.

The CHAIRMAN. Is it possible in your judgment as an economist for the mind of man to devise some scheme whereby the dollar may be tied into the values and factors that make up the cost of living something along the line of a commodity dollar, whereby that dollar would reflect in the exchanges which a man receives for his wages and go along in juxtaposition with changing conditions?

Mr. KEYSERLING. Irving Fisher had an idea something like that and worked for many years on it. It wasn't very widely accepted for a variety of reasons. It may have some merit, but it still would leave you with the real problem, Senator Tobey, which is the fundamental problem of the distribution of the product, because you cannot simply say that the wage at all periods should change simply comparably to the cost of living. If it did that, you would have a constant standard of living although production might be increasing. If you are in a period when production increasing, you should have an increase in the real wage. This is a generally accepted proposition. The real question is how much of an increase? The real question is how much of that increased production should take the form of further capital expansion financed or stimulated in part by profits, and how much should go immediately to increased consumption. This is the problem at its core.

As an economist, I would say that in one form or another we are always going to have this problem with us in the free society we want to maintain. But we can, I believe, reduce this problem by developing some economic judgments to promote a better balance in the economy than is generated by the unrestrained price-wage spiral during inflation.

Senator SPARKMAN. Before you get away from that, may I ask you this question?

I think the whole country has been interested in the recent price and wage increase in steel. I am just wondering if you and your group of analyists have analyzed that situation. I don't vouch for the accuracy of these figures, but I have heard something like this:

The increase in the wage amounted to somewhere—nearly $5 a ton—$4.70 or something like that; but United States Steel almost immediately announced an increase in its product of nearly $10 a ton; $9.94, I believe.

I also saw somewhere that the profit they were already making after taxes was something over $12 a ton. As I said, I don't vouch for the accuracy of those figures; I wonder if you have analyzed that situation so as to be able to say whether or not there was any justification of this in such a price increase, on steel, following that wage increase, and particularly in view of the already existing high corporate earnings?

Mr. KEYSERLING. Senator Sparkman, I don't have the detailed figures before me now, and a generalization in a matter of this kind is always difficult. I am prepared to say, however, directly in answer to your question, that it has seemed that the price advances which have taken place in certain key industries, steel being one, have been more than were desirable or necessary in view of the whole economic situation. In other words, in such cases the level of profits after taxes has afforded a higher rate of return than has been necessary amply to stimulate and support the level of investment and production required to keep a fully employed labor force and plant at work and to use the resources that should at this time or shortly be turned to production purposes. This conclusion is generally implicit in my analysis of the production picture, and it was developed a little more specifically in the charts and figures which I have submitted on the profit picture in general.

Senator SPARKMAN. Are they in the report?

Mr. KEYSERLING. Yes.

Senator SPARKMAN. I do not recall whether or not in this midyear economic report to the President, which the President in turn transmitted to Congress, you and your associated economists called attention to the effectiveness of an excess-profits tax in drying up those high-level corporate earnings.

Mr. KEYSERLING. I shall touch on that question as I come to an evaluation of specific proposals.

Mr. Chairman, I have cited three of the dangers and maladjustments occurring in the current inflation. I should now like to cite two others.

Fourth, the pace of the inflationary process is breeding a psychological uneasiness throughout the economy. This psychology is based upon the observation that booms in the past have ended up in busts; and the question of whether history must repeat itself becomes irrelevant in view of the fact that history will repeat itself if enough people think that it is going to.

Fifth, the inflationary process is jeopardizing our whole program of aid to the free countries of western Europe, along with all of our objectives for the restoration of better international economic relations as a foundation for permanent world peace. The inflation is confusing many of our own people into the mistaken belief that the foreign-aid program is primarily responsible for the hardships they are suffering under inflation, and thus is tempting them toward the relinquishment or abatement of an imperative undertaking of policy. The inflation is reducing the value of the financial aid that we are extending to other countries, planting in their minds legitimate concern that America may be heading for another depression, and therefore militating against their cooperation with us on the full and trustful basis which the world situation demands. The inflation is affording a talking point for such enemies of our foreign policy within our own gates as look elsewhere than to America's best interests for their guidance or command.

THE OUTLOOK FOR INFLATION IF LEFT UNCHECKED

If these be the dangers of inflation, what are the prospects that these dangers will disappear of their own accord, except through a process of deflation and depression which would mean infinitely larger dangers?

There is little need at this point to enter into an extended demonstration of the fact that inflation is still on the march. Prices are still going up, and reaching new peaks. The price-wage spiral is augmenting. The suffering of the primary victims of inflation is increasing. While a year ago, or 6 months ago, there was division of opinion as to whether the forces of inflation were nearly spent, there is little division now. Business journals and business economists join with others in appraising the current situation as highly inflationary. The proponents and opponents of the anti-inflationary program now before the Congress are not divided in this appraisal. The overwhelming majority of them seem to agree that inflation is still very much with us; their division of opinion is limited to what are the main causes of inflation and what are the main remedies to be applied. Some favor the proposals that have been advanced on the ground that they will help remedy the inflation, while others oppose the very same proposals on the ground that they would aggravate the inflation; but almost all agree that the inflationary problem has become more acute. Under such circumstances, to bring before this informed committee the accumulated evidence that the danger of inflation is still here, beyond the evidence contained in the various charts and figures already referred to, would be carrying coals to Newcastle. The question is no longer what the factual situation is, but rather what to do about it.

The only prospect now being held out for relief from the dangers of inflation in our strained economy, without benefit of an affirmative program, is that there will be a general softening of demand which will reduce prices. This is nothing more than a sugar coating of the bitter pill that inflation of course will be over when unemployment mounts and when the economy passes from a sellers' to a buyers' market. There is nothing new about that kind of relief for inflation, and by the same token there is nothing desirable about it. There is no assurance that an adjustment along such lines would afford succor to the millions of families who are the primary victims of inflation; on the contrary, we know full well that rising unemployment and a slackening of industrial activity would put these families in an even worse position than they are now. Nor is there any assurance that such an adjustment, even if tolerable, would stop at some nice and convenient point between what is called inflation and what is called deflation. The prospect is all too real to be overlooked that our highly sensitive economy cannot start rolling down this kind of hill without rolling into the valley.

In essence, the bad thing about inflation is not the high price level in itself, but rather that the maladjustments and disparities which are occurring in the process of inflation victimize countless individuals and threaten the maintenance of maximum employment and the achievement of maximum production. The main reason for wanting to combat inflation is that it jeopardizes prosperity. We cannot wait for or solicit the kind of cure that kills the patient.

The CHAIRMAN. You are pretty nearly through; are you?

Mr. KEYSERLING. Yes.

The CHAIRMAN. May I ask you a question? Here is a committee, sitting here. We are charged with the responsibility of doing something. You, I assume, can testify you were consulted in drawing up the administration bill; is that correct?

Mr. KEYSERLING. In drawing up the administration bill?

The CHAIRMAN. Yes.

Mr. KEYSERLING. Not as a technician on the details.

The CHAIRMAN. You are familiar with the bill?

Mr. KEYSERLING. Yes.

The CHAIRMAN. You know how important price control is to most of us?

Mr. KEYSERLING. Yes.

The CHAIRMAN. Here we are in a tropical sea in here, and this inflation is going on. We have Mr. Eccles' thesis that we are going to have a bust. When, as, and if is the question.

Forgetting the political side of this entirely, what do you think we ought to do?

Mr. KEYSERLING. That is what I want to come to now. My statement thus far has attempted to provide the factual and analytic foundation for evaluating proposed measures. I want to take these few remaining minutes that you may give me—and I am terribly sorry if I am delaying the Secretary of Commerce, but I got started about an hour after I was scheduled.

The CHAIRMAN. He is getting an education, too.

Mr. KEYSERLING. On this foundation, we may make a general appraisal of the relative weight and significance of some of the explanations advanced as to the causes of inflation and some of the economic proposals made to combat the dangers and maladjustments of inflation.

THE ECONOMIC SIGNIFICANCE OF PROPOSED REMEDIES FOR INFLATION

INFLATION AND FOREIGN AID

The very first point to be made involves firm, unalterable recognition that we must conquer inflation while meeting our essential obligations as a nation, and not by avoiding these obligations. Sufficient examples of this are the foreign-aid and preparedness programs. Even if these programs were complicating the inflation problem far more than they in fact are, we would have to carry these programs forward nonetheless. To be sure, if we abandoned foreign aid, and preparedness, and agricultural price supports, and the good living standards that come with good wages, and the goal of maintaining maximum employment and production, and many other things that make our Nation what it is, we would then have no problem of inflation. But we would lose infinitely more shan we would gain.

It is true that if we decide to divert more of our resources to a particular purpose, such as foreign aid or preparedness, we will for the time being not have those same resources available for other purposes. But there is no good reason why a decision on grounds of national policy to divert manpower and other productive resources to one purpose rather than to another should present us from dealing more equitably with our people at home or from checking the economic maladjustments which are now under way. During the war, we diverted about half of our output to noncivilian use, and yet through affirmative economic policies we actually raised civilian standards of living and ended the war on a fairly promising footing for lasting economic prosperity. Growing maladjustments have developed since then, not because we have undertaken certain essential programs, such as foreign aid and preparedness, but because we have done so little to deal with the disruptive forces which have been released by the actions of men and can likewise be contained by the actions of men.

INFLATION AND INCREASING PRODUCTION

The second point in evaluating measures to combat inflation is that increased production alone is not a feasible solution. In the first place, with full employment (see chart 21, p. 346), shortages of materials, and almost full utilization of our resources, we cannot increase production very much in the short run and must live with that fact. Certainly, price inflation is not driving production upward (see chart 22, p. 347). In the second place, mere increase in production will not by itself correct the maladjustments already indicated in the price-income structure; taken alone, it might even accentuate some of these maladjustments, particularly the general balance between production and consumption. If this were not true, no one would be able to understand how a business upswing ever turns into a business downswing. The truth is that our immediately soluble problem is less one of total production than of the composition of production and the distribution of the product. Prices under unrestrained inflation are operating to induce the production of too much of some things and not enough of others at a rather fixed level of total production. Some lines are expanding relatively too fast, and others relatively not fast enough, to serve national needs or to avoid eventual disruption of production generally. In short, while the problem is partly to relieve inflation by more production as fast as we can, the bigger problem is that inflation is impairing production in detail and in the long run will impair it in general. If we can deal vigorously with inflation, production for the most part will take care of itself.

CHART 21

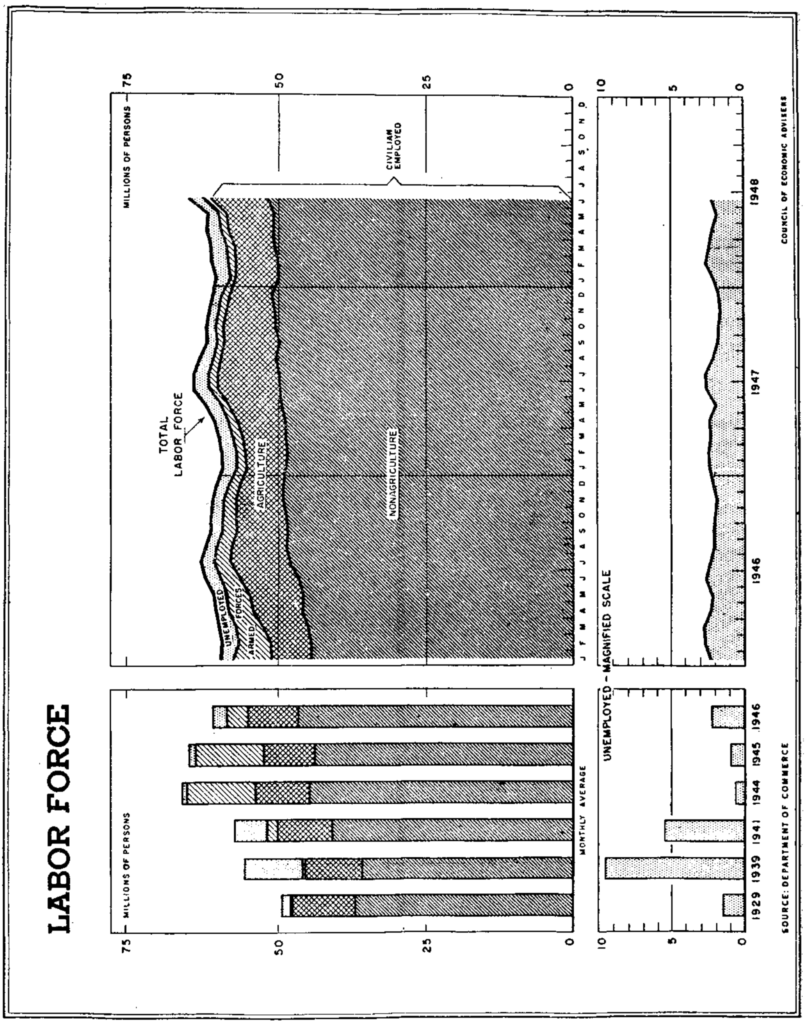
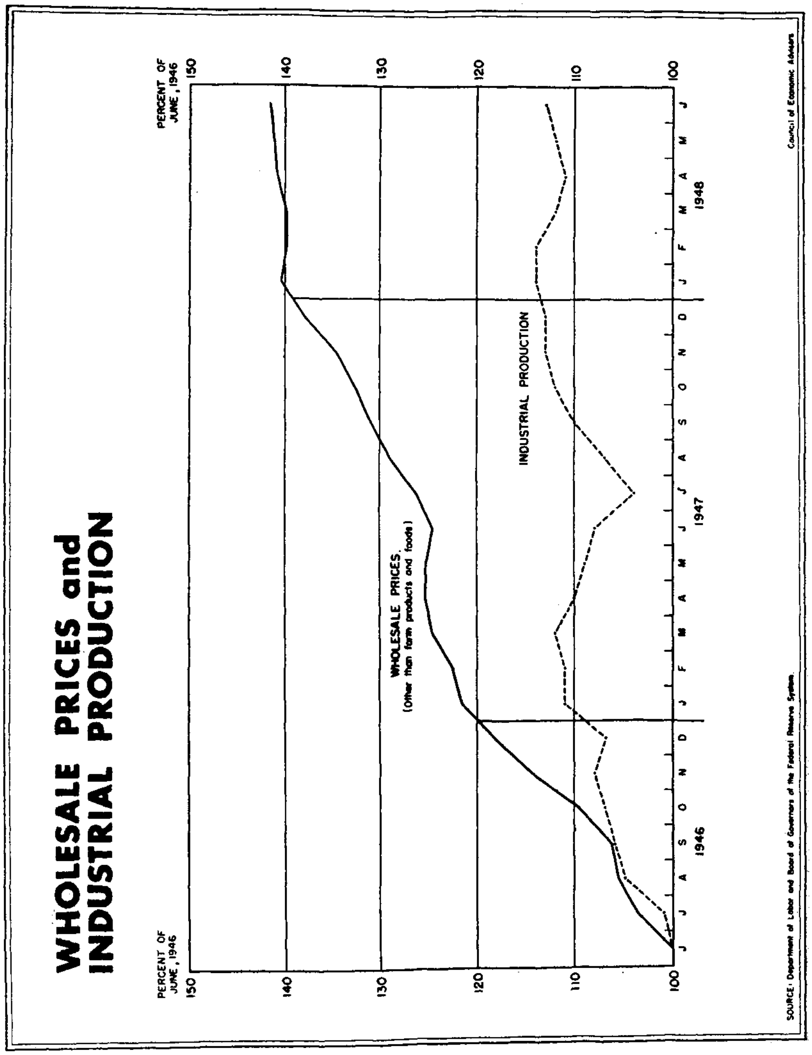

LABOR FORCE
MILLIONS OF PERSONS
75
50
25
0
MONTHLY AVERAGE
1929 1939 1941 1944 1945 1946
UNEMPLOYED - MAGNIFIED SCALE
10
5
0
TOTAL LABOR FORCE
UNEMPLOYED
ARMED FORCES
AGRICULTURE
NONAGRICULTURE
CIVILIAN EMPLOYED
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D
1946
1947
1948
SOURCE: DEPARTMENT OF COMMERCE
COUNCIL OF ECONOMIC ADVISERS

CHART 22


WHOLESALE PRICES and INDUSTRIAL PRODUCTION
PERCENT OF JUNE, 1946
150
140
130
120
110
100
WHOLESALE PRICES (Other than farm products and foods)
INDUSTRIAL PRODUCTION
J J A S O N D J F M A M J J A S O N D J F M A M J
1946
1947
1948
SOURCE: Department of Labor and Board of Governors of the Federal Reserve System.
Council of Economic Advisers

INFLATION AND DECREASING DEMAND

The third point in evaluating anti-inflation measures is that reducing total demand is by no means a full solution, although it is frequently hailed as such. Demand means spending power in the market. If all demand throughout the economy were reduced pro tanto, we would indeed have a lower price level, but price-income relationships and the distribution of goods and services would remain approximately the same as they are now. The submerged families who are not now getting enough goods would still not be getting enough goods; and some others who are getting relatively too much would still be getting relatively too much. On the demand side, as on the supply side, the immediate problem is mainly one of relationships rather than of totals. Some types of demand need to be curbed, while other types need to be made more effective. Effective demand in the market determines the kind of work that people do, the kinds of goods that are produced, and how these goods are distributed. When we are faced with trouble on the demand side in a full employment economy, the real task is not to reduce all demand but rather to readjust relative demands either for reasons of equity or national policy or in the interests of general economic stability. We need to do this now for all three reasons.

INFLATION AND HOUSING

A good example of the demand problem is in the field of housing. The point has been made that the Taft-Ellender-Wagner housing bill is inconsistent with an anti-inflation program because it would add to demand.

This point is not well-founded. If there is a shortage of housing, and if this is contributing to excessive housing costs in the same way that a shortage of food would contribute to excessive food costs, then the production of more housing is anti-inflationary in the same sense that the production of more food would be anti-inflationary. It may well be that, for a time, we cannot divert much more labor and materials to the total production of housing in view of other competing national needs. But let us make sure that they are competing national needs, and not competing nonessentials. And even then, there would still remain the question of the composition of the housing that is being produced. It would still be sound and desirable to produce relatively more low-rent housing for veterans and others of modest means, and relatively less high-priced housing for families who can get along very nicely for a while with what they already have. The Taft-Ellender-Wagner bill is designed basically for this purpose, although this is not true of the "title VI" provisions contained in the bill. Thus, under present circumstances, talk about damping down the demand for housing is undiscriminating and mistaken until one breaks the demand down into various types. Some types of housing should be expanded, other types should be contracted.

INFLATION AND GOVERNMENT PROGRAMS

What is true of housing is equally true of other expenditures, including expenditures under Government programs. Some types of expenditures, of course, should be held low or reduced. Those types of expenditures which represent essential national purposes, or serve essential individual needs, cannot be reduced below the point of safety or basic welfare. Some of them, for example educational outlays, need to be increased. The problem is to translate the more necessary expenditures into effective goods and services, and this can be done only by reducing, on a selective basis, other types of expenditures which are drawing goods and services away for less-essential purposes. The problem here again is one of the composition of expenditures and their relationships one to another.

INFLATION AND PRICE-WAGE-PROFIT POLICIES

The price-wage-profit problem in the current stage of inflation cannot be met by deciding arbitrarily that all prices should be held where they are now, or that all wages should be held where they are now, or that all profits should be held where they are now. Some items are relatively too high, and others are relatively too low, both on grounds of equity and on grounds of economic stability. A program which sought to hold everything just as it is now, even if it could be successful, would merely freeze current maladjustments where these exist; and if current maladjustments did not exist there would be no crying need for the program at all. The fact is that some items need to be raised, and others need to be lowered, in relation to the general structure of prices, wages, and profits.

INFLATION AND PRICE OR WAGE SUPPORTS

As a further example of this point, there is nothing intrinsically inconsistent between proposals on the one hand to maintain agricultural price supports, and proposals on the other hand to check such prices as are found to be rising too fast. Preventing some prices from falling to levels that are relatively too low is just as much a part of a sound economic program as preventing other prices from reaching levels that are relatively too high. Likewise, there is no inconsistency between raising minimum wages, or seeking to improve the real earnings of those who are discriminated against in the current price-income structure, while at the same time seeking to restrain such wage increases as would break through necessary price ceilings.

TREATMENT OF INFLATION SHOULD BE SELECTIVE AND NOT INDISCRIMINATE

For these reasons, there is little merit in the high-sounding notion that a genuine anti-inflationary program should get equally tough on everybody, and that a program which gets tough at some points and not at others is unsound or disingenuous. For example, inflation cannot be remedied by getting tough on those who are already its chief victims. The very essence of a corrective program is that it increases pressure at some points and relieves pressure at other points so as to get things into better balance. The only kind of economic development that gets tough on everybody is a depression.

An effective anti-inflationary program must be both comprehensive and selective. It must embrace a variety of measures because the problem is complex, and it must treat each of these problems carefully and not with a meat ax. Maladjustments can be cured only by treating everybody fairly, not by treating everybody the same.

In the light of these standards, it becomes easier to evaluate the main proposals now before the committee, relating to credit controls, materials allocations, and selective price control.

CONSUMER CREDIT CONTROL

The control of consumer credit has an appropriate place in a rounded anti-inflation program, because it can be used to curb the effective demand for goods on the part of those who are now securing too many goods in relation to what the economy at current levels of production can make available. But manifestly, consumer credit controls cannot and should not be used to decrease the amount of goods made available to those who are already receiving relatively too little. In short, consumer credit controls by themselves cannot do much for the primary victims of inflation, and for this reason, as well as others, they need to be combined with other measures.

Let me illustrate that a bit more specifically, Mr. Chairman. If consumer credit controls were to be directed primarily against those whom I call the primary victims of inflation, in other words, those at the bottom of the structure, isn't the manifest truth that it would operate to lower their living standards much more rapidly than it would operate to lower the whole price-wage structure to the point where they might be among the beneficiaries of that general lowering?

The CHAIRMAN. Of course, because they haven't the fat.

Mr. KEYSERLING. Certainly. In other words, consumer credit control is a selective device that can be used effectively in connection with other measures; taken alone, it would be a puny device indeed.

The CHAIRMAN. You understand what the committee is charged with in the next few minutes, is to put you on the spot in view of your background. Tell us what you, Leon Keyserling, would do if you were charged with full authority—carte blanche—to go ahead and remove the danger of inflation.

Mr. KEYSERLING. I am certainly relieved not to have that responsibility. It is my responsibility to put before you, as the makers of policy, as objectively as I can, the facts and some of the results of analysis. It is up to you to decide basic policy.

I think I have sufficiently discussed consumer credit controls. The next proposal relates to bank credit.

RESTRAINT ON INFLATIONARY BANK CREDIT

This proposal has great merit as a part of a rounded program, but I don't think that it should be ridden to the point where anyone would regard it as a sufficient remedy by itself.

The CHAIRMAN. Would you also agree with me in a remark made last night in the committee that by no circumstances would the common people be justified in feeling that relief from this burden of high prices would accrue to them from regulation of bank credit?

Mr. KEYSERLING. Taken alone, it is not nearly enough, in my judgment.

The control of inflationary bank credit, by whatever devices may be used, has fruitful usages and is subject to obvious limitations in the kind of inflation we now have. If such controls are used selectively to abate the types of business enterprises which should not be undertaken at this time, they can be useful. But if they were to be used in a blunderbuss fashion to contract the total volume of business activity, they would be utterly inconsistent with the sound idea of striving to increase total production, and would be consistent only with the fallacious and dangerous notion that inflation can be cured by bringing on a "mild" recession in the general level of employment and business activity. Such controls, moreover, have other inherent shortcomings which prevent them from being the whole answer or even enough of a answer to the current inflationary problem. Some of the lines of enterprise and expansion which ought to be relatively reduced under present circumstances are not dependent upon outside credit to an extent that they would be affected perceptibility of these controls. Conversely, some of the types of production that should be relatively stimulated under present conditions would not be helped by such controls and might be impaired by them. And, manifestly, these controls would not reach into the crucial problem of the price-wage spiral generally unless they were applied so extremely and so unwisely that they brought about a serious contraction in Nation-wide levels of business activity—which is just the reverse of what we should want to do. Therefore, neither by the test of relieving the primary victims of inflation, nor by the test of curing the maladjustments in the economic structure which are the central danger of inflation, do credit controls afford more than a part, albeit a necessary and essential part, of a workable program for checking inflation.

So, without laboring the point too much, and I will carry it further if you have any additional questions, it seems clear that consumer credit controls and bank reserve controls taken together are highly selective measures to be judicially employed for limited purposes, but they hardly touch some of the most strategic elements of danger in the current inflationary situation.

The CHAIRMAN. What are they?

Mr. KEYSERLING. First, the hardships inflicted on the primary victims of inflation. Second, the question of the allocation of materials and productive effort to necessary uses in the short run, and to uses that will build up the most favorable conditions for sustained maximum employment and production.

The CHAIRMAN. And the lever there would be to have some power of allocation over these things.

Mr. KEYSERLING. That is right. This brings me to the subject of allocations.

ALLOCATIONS

Because it is neither desirable to contract the total level of economic activity nor feasible in the short run to expand it very much, the real problem is to weigh the composition of this activity in favor of our most urgent national needs. This means that a vigorous and fully implemented program of allocation of basic commodities in relatively short supply ranks high on the list of effective measures from the viewpoint of general economic analysis. So long as there is not enough steel for everyone to get as much as he wants or has the money to try to buy, it is imperative that a program such as the preparedness program not be jeopardized because too much steel is being drained off in other directions. It is likewise important, even to the extent that effective measures exist for getting steel for the preparedness program, that the amount of steel which this program leaves available for general civilian use is wisely directed and sanely used. The same principle applies to other basic commodities in relatively short supply, whether because of domestic conditions or because of a combination of domestic conditions and the foreign aid or preparedness program. We should not want to reduce the total production or the total use of these basic commodities through general contracting measures which would both impoverish the country and create unemployment; the problem is rather to channel them to the most effective use. And in appraising what is the most effective use, we need to take into account not only short-run urgency but also the longer-range problem of the balanced development of interrelated facilities. The worst danger of relative shortages is the distortions which they create.

Senator SPARKMAN. I suppose every Member of the Senate received just a few days ago from Mr. R. R. Young, president of the Chesapeake & Ohio Railroad, a letter and an article that had been published in some railway publication dealing with the unavailability of steel with which to build needed railroad cars, whereas trucks and automobiles apparently were getting all they needed.

I don't recall the figure, definitely. I believe he said they were having a shortage this year of 28,000 railroad cars.

He pointed to the fact that when the time comes for transporting the great fruit crops of this year, the grain crops, we were going to feel that. Is that when you mean by taking care of the more essential needs?

Mr. KEYSERLING. Very definitely.

Senator SPARKMAN. At the expense of the less essential.

Mr. KEYSERLING. Very definitely. There are illustrations of this problem at numerous key points in the economy. Some of the specialized agencies working in the various commodity fields would be able to illustrate this better than I.

This brings us to what the chairman calls the $64 question—price control.

SELECTIVE PRICE CONTROL

I very genuinely feel, as I know every member of the committee does, that there is involved here a question of balance. On the one hand, there is to be weighed the inconveniences, the black market possibilities, and the administrative difficulties, of imposing this kind of restraint. On the other hand, there is the fact that unrestrained prices have become immensely dangerous.

In weighing this issue, we cannot say that price control is basically inconsistent with our form of government or our basic freedoms, because we have used it before without endangering these precious values. Nor can we set the proposal for price control aside on the ground that it won't work at all, because we know that despite the black markets and inconveniences and aberrations it did work to hold a fairly stable level of prices and that it did bring us out of the war on a much sounder economic footing for postwar prosperity than we now have, because of the maladjustments which have crept up particularly since mid-1946.

If price control is going to be excluded from the tools made available to fight inflation, this can reasonably be done only on the ground that its inconveniences outweigh the need for meeting the great dangers and hardships in the existing economic situation, or on the ground that other proposals than price control are in themselves sufficient without price control.

I have indicated my reasons for believing—and I most reluctantly reach this conclusion—that the other proposals taken alone would be insufficient; that the other proposals taken alone would seem even to be inequitable; that the other proposals taken alone would seem to have an even greater shortcoming—they would seem to impose upon our people the belief that their Government had taken adequate steps to cure the situation when in fact it hadn't, which I think as an economist should be a cause for great concern.

Senator HAWKES. Might I ask a question there? I am not on your committee.

The CHAIRMAN. Do you want to wait until he gets through? We will question him when he gets through.

Mr. KEYSERLING. You are the chairman. It is up to you.

The CHAIRMAN. We will wait until you get through.

Go ahead.

Mr. KEYSERLING. Then we come to another question which has been raised, and this is whether selective controls can be effective. The argument has been made that selective controls must necessarily move to all-pervasive controls.

Purely as an economist, I think that this argument proves too much. It proves too much because it seems to run to the conclusion that a nation cannot take moderate measures to deal with—I won't say a moderate situation, but a developing situation—but must wait until you have a total situation and then take all-out measures.

It seems to me that such an approach is inconsistent with prudence, and inconsistent certainly with the "stitch in time saves nine" idea that this committee and the Congress approved by a great majority in the Employment Act of 1946 under which I serve.

The reason that we moved from selective controls to all-pervasive controls earlier in this decade was not by any inexorable law of logic that if you do something you have to do everything. It was rather because of the fact that we moved from a defense period which presented a relatively lesser strain to a war period which had a terriffic impact on our economy.

During the war, we were devoting about 50 percent of our total resources to noncivilian use, and at the same time, because we were financing the war mainly through borrowing rather than by taxation—and I am not criticizing that policy—the volume of purchasing power in the economy went up as fast or faster than production went up, but the production was not going to civilians although civilians were getting the income. Thus there was a perfectly terrific spread between purchasing power and goods. In that situation, of course, we needed all-out measures. We needed all-out rationing, we needed all-out price control, we needed all-out compulsory savings, and other extraordinary things besides.

We haven't that kind of all-out situation now. A comparable emergency in peacetime would be a large-scale depression, which would be as great a danger to our economy as a war, or nearly as great. If we now waited until we arrived at such a critical situation, we would need all-out measures, though different from wartime measures. But there is no reason, as I have said, why the application of certain limited measures to the limited dangers of today should lead to all-pervasive measures unless we neglect the situation until a crisis is at hand. I don't want to burden the committee with detail, but I think the Canadian experience with selective controls has worked fairly well, if you measure it by the test of holding down the cost of living. I think it can be done.

The point I want to stress again is that this is not the kind of situation where it would be safe to compound a series of remedies which fairly clearly cannot do the job. Anyone would be pretentious who said—and I am not prepared to say—that any series of remedies offer sure-fire 100-percent proof, in advance, of their perfection. The real test before us is to select those proposals which, looking at the situation as a whole, we think are most likely to do the job with reasonable safety and dispatch.

If this covers the questions raised sufficiently, I can turn to the excess-profits tax matter.

The CHAIRMAN. Go ahead.

THE EXCESS-PROFITS TAX

Mr. KEYSERLING. You asked me to discuss the excess-profits tax proposal. That is not before this committee. Nonetheless, this committeee has to consider that the whole range of anti-inflation proposals are interrelated.

I think that, in the present economic situation, there is merit in the proposal for the excess-profits tax.

First, by definition the tax does not apply to restrain either normal or legitimate levels of profits. I am not using the word "legitimate" in the legal sense. I am using it in the popular sense.

Second, in the current economy, as was indicated by my general analysis and further brought out by one of Senator Sparkman's questions, there clearly are important instances where the level of profits after taxes is higher than needed to provide adequate incentives and funds for the highest rate of present and prospective investment that our resources can sustain.

Third, I think that the excess-profits tax would help to moderate the price-wage spiral for this reason: Although wage negotiations recently have concentrated largely upon the question of the cost of living, it is only realistic to recognize that the cost of living is not the only question or rationale underlying collective bargaining. Even if the cost of living should be held at its present levels, there is a general philosophy which we cannot set aside that there should be some relationship between the earnings of a business and what those who work therein receive. There is a philosophy which we cannot set aside that, at a stable cost of living or a stable price index, wages should go up as productivity increases to reflect increasing standards of living. Because these issues enter into collective bargaining, I think that a restraint upon excess profits would relieve tension and help to moderate the rate of wage increases. This does not claim that it would be a panacea, but it would help.

The fourth point I would make relates to the argument that an excess-profits tax would operate actually to raise prices because, since the return after taxes would be lower with the excess-profits tax than without it, even higher prices would be charged in order to keep the return stable. Putting aside entirely the fact that this argument is directly contrary to accepted principles of economics, there still remains the fact that the repeal of the excess-profits tax when it was repealed had no restraining effect upon prices. The price-wage spiral continued.

In the present inflationary situation, in those administered price areas where businessmen make conscious judgments as to prices, the price does not necessarily represent the highest price that can be charged at any given moment. I think that there has been some restraint in this respect. But it does represent what some businessmen regard as the highest price that it is wise to charge, and their judgment may sometimes be wrong, although the principle of seeking the optimum price is right and proper in the profit system which we all want to retain and support. I think that, where there are excess profits, the judgment is wrong from the point of view of the interests of the whole economy. For these reasons, in an inflationary economy operating at full employment and very high demand, I do not believe that an excess-profits tax would operate to drive administered prices higher, because in any event they tend during inflation to come near to the highest level that those who administer prices think they can safely charge. I think that the spiral of inflation will take prices still higher, if firm measures are not applied.

The CHAIRMAN. You do not contend that you can increase production by price-control measures?

Mr. KEYSERLING. I would make two points. I would say, first, that it has been clearly demonstrated from chart 22 which I have already discussed, that spiraling prices do not increase production. Second, while I would admit that price control in itself does not directly and immediately increase production, we have learned from experience that production can be increased greatly while price control is in effect, if the manpower and resources are available to increase it. Moreover, by helping to check inflation, price control would help to remove one of the main dangers to both employment and production. The maladjustments that are developing in the course of inflation will turn us down hill if they are neglected. If we can stop inflation, without a recession or depression, production will be quite satisfactory.

The CHAIRMAN. If wage controls are necessary, in your judgement, is not the pending legislation deficient in that respect?

Mr. KEYSERLING. I think that the formula in the pending legislation relating to the relationship between price control and wage control is a sound formula. I think that if we look at the situation in the main, Senator Tobey, on the factual side, economic analysis will not support the proposition that the total level of wages has risen relatively too fast in the relation to the whole complex of the national economy. Wages, since inflation got started in earnest, have been trying—and not with complete success—to keep up with the cost of living. Nor has the total of compensation to employees been too high in relation to other distributive shares of national income, as my earlier remarks have indicated in more detail. The outrunning has been mostly in parts of the price structure and in certain levels of profits. For these reasons, I do not think that there would be an acute problem on the wage side if the cost of living could be held measurably in line, and if the exacerbating factor of some excessive profits could be dealt with.

The formula in the bill, however, does not sidestep the wage problem. It says simply and directly that in those cases where it is necessary to impose a price ceiling because of the price structure, the Government should have authority to prevent those types of wage increases which would break through the price ceiling, except where necessary to relieve hardship or maintain living standards or correct inequities or maladjustments. Wage increases based on productivity or payable out of margins without breaking through a price ceiling should not be interfered with.

The CHAIRMAN. There are those who do not think that strong enough.

Mr. KEYSERLING. There are those who don't think it strong enough, and there are those who think it too strong. I disagree with both. It is a middle approach.

The CHAIRMAN. I want to give my colleagues the privilege of asking questions. Senator Buck?

Senator BUCK. I have no questions.

The CHAIRMAN. Senator Cain?

Senator CAIN. No questions.

The CHAIRMAN. Senator Fulbright?

Senator FULBRIGHT. Mr. Keyserling, would you say the imposition of credit controls alone would be worth while if the whole program is not undertaken.

Mr. KEYSERLING. I find it hard to answer that question, Senator, although I don't want to duck it.

Mr. Chairman, the question asked me was whether I would say that the imposition of credit controls alone would be undesirable if the whole program were not undertaken. I did not intend to say that, and I do not think that I said it.

Senator FULBRIGHT. You didn't put it that way.

Mr. KEYSERLING. I said that I did not think that credit controls alone would be nearly adequate to deal with the current inflation.

Senator FULBRIGHT. I was trying to clarify what you meant. I realize you did not use the words I used, but I was trying to get at your meaning, because all of your remarks were in the background of an over-all program, including several things. I don't think as a practical matter the whole program is going to be given serious consideration. It is generally thought in the Senate that this credit control, particularly bank credit and consumer credit, is the only feature of this program that may be given consideration. As a Member of the Senate, I am intensely interested in whether or not that alone is worth while.

Mr. KEYSERLING. Senator Fulbright, I think we are talking in an area where it is important for me to distinguish between the functions of the economist and the functions of the legislator. I don't want to step over the line. I understand your question, and it is reasonable, but it is a very hard question for me to answer. About as far as I can go is to say that it seems clear to me that a rounded and sufficient program to deal with the inflationary situation requires the range of measures that I have discussed, and that anything short of this range of measures would be insufficient. That much I can say as an economist. When you go beyond that and ask me to advise whether or not, if I were a Member of the Senate, I would vote for a partial program, being unable to get a whole program, I think that this is a practical question of legislation beyond my appropriate province. Frankly, I don't know what I would do if I were in your place, but I don't have to make that decision.

Senator FULBRIGHT. Do you think the repeal of the excess-profits tax in 1945 was a proper-measured move to take at that time?

Mr. KEYSERLING. I think it was well-intentioned at the time, but in view of subsequent events I think it would have been better not to have taken such action.

Senator FULBRIGHT. Do you think the decrease in income tax this spring was a proper measure from the inflationary point of view?

Mr. KEYSERLING. I think that from the inflationary point of view it was a mistake to do this at that particular time.

Senator FULBRIGHT. We will assume for purposes of this question that we do impose some credit controls, the ones proposed. Do you think at the same time that we increase the availability of money for the housing program that that would not have the effect of offsetting——

Mr. KEYSERLING. I am glad you asked that question, Senator Fulbright. It raises the whole point which I have labored throughout my statement to develop, namely, that in a situation like the present it is impossible to get a formula which says: We are going to fight inflation by clamping down on everything. Every expenditure is in a sense inflationary. Expenditures for production are in that sense inflationary. Raising the wage of the fellow who is getting $14 a week and who can't live under inflation is inflationary, in a sense.

The CHAIRMAN. It is a question of objectives, is it not, and of human needs?

Mr. KEYSERLING. It is a question of balance. On the housing program I would say this: If you look at it solely from the demand side, obviously when you create more demand for housing it is inflationary. If you look at it on the production side, then a proposal to increase the volume of housing because the inflationary situation in that area is caused partly by a shortage is no more illogical than if we were proposing to increase the production of steel or to increase the production of food because there were shortages in such areas. As I understand it, the proposed housing program is primarily designed to increase the production of housing. It is quite different from something like consumer credit, which does not increase the production of anything.

Further, even if we have reached the point where for a while we cannot increase the total volume of housing because of shortages of manpower or resources or materials, we still have to be concerned tremendously about the composition of the housing product. We should have a combined program, which on the one hand cuts down the amount of certain types of housing which are being built, like luxury housing, high-priced housing, 12- to 15-thousand-dollar-a-unit housing, while at the same time filling in the gap with a relatively greater diversion of the product into low-rent housing which now represents a much greater need on the part of veterans' families and others with low and moderate income. I think that the Taft-

Ellender-Wagner bill, which has been before this committee, is sound at this time because its main immediate purpose is to deal with the composition of the housing product. We are in a situation where at any given level of housing production we should have relatively more low-rent housing available at moderate charges for the kinds of families who now are suffering most from the housing shortage.

Senator FULBRIGHT. As I understand it, as a practical matter, title VI is about the only feature that is receiving serious consideration.

Mr. KEYSERLING. I think that would be a most serious mistake, to act on that feature alone.

Senator FULBRIGHT. That is really what I meant by housing. I am not sure about that because the agenda of the Congress is still uncertain.

It seemed to me that that alone would do the very thing which you say should not be done.

Mr. KEYSERLING. Exactly, Senator Fulbright. Housing is the best example of the point that what is needed is a well-rounded, selective anti-inflation program. We can't just take an oversimplified solution and say that we want to cut down on everything, because that would cut down on employment and production. We can't say we want an over-all solution that will cut everybody's income, because that would cut the income of the people at the bottom faster than the income of anybody else. We can't say we want a program that is just going to contract credit, for that would restrict necessary production as well as unnecessary production. We need a selective program in this kind of situation, and that is why I think a balanced program of credit controls, allocations, selective price controls with its attendant features, and fiscal measures, is the kind of program adjusted to the kind of situation we are in.

Senator FULBRIGHT. Just one other question. Why is it that the control of bank credit by the increase of reserves is more appropriate now than it was last January, when it was first proposed and apparently was not supported?

Mr. KEYSERLING. I think that this would have been a desirable measure last January, and I recall that it was proposed.

Senator FULBRIGHT. What?

Mr. KEYSERLING. I think that this would have been a desirable measure last January, and I recall that it was proposed.

Senator FULBRIGHT. Well, I understand the administration didn't approve of it last January. I understood that; I thought there was some change in the economic situation that might very well have justified that difference of view.

Mr. KEYSERLING. I have tried throughout my statement here to give you my objective views as I hold them, and not to defend——

Senator FULBRIGHT. I understand that.

Mr. KEYSERLING. Not to defend or disclaim.

Senator FULBRIGHT. Unfortunately, we have to make that decision.

Mr. KEYSERLING. I have answered your question in the one way that I can. You asked me about the control of bank credit last January, and my answer is that I think it would have been a good thing if it had been done then.

Senator FULBRIGHT. That was a mistake, then, not to have done it then——

Mr. KEYSERLING. I do not know who made the mistake.

Senator FULBRIGHT. But it is proper to do it now.

Mr. KEYSERLING. Whoever may have been responsible for the mistake, I think it was a mistake. As to who was responsible, that is not within my province.

The CHAIRMAN. Carrying that out further, we are 8 months further down the river, nearer the breakers.

Senator MYERS. I surmise that just the restriction of bank credit last January would have been just as inadequate as the restriction of bank credit alone today might be.

Mr. KEYSERLING. I think that is correct, Senator Myers.

Senator MYERS. And you needed a balanced program last January in 1948 just as much as you need a balanced program today.

Mr. KEYSERLING. I think that is correct, except possibly that it is even more clearly needed today.

Senator HAWKES. I was going to ask the gentleman, at the time he said he didn't think we ought to hold out a plan that you know will not work, did he say that? Did I understand that correctly?

Mr. KEYSERLING. I said that I, as an economist, had concern about that.

Senator HAWKES. I thought you said that you didn't think we should hold out a plan that we know will not work. I want to ask you whether you know that this plan you are suggesting will work?

Mr. KEYSERLING. Well, no; I cannot be certain of the future. I have said that very frankly. I said that——

The CHAIRMAN. You made a qualifying statement.

Senator HAWKES. I was not here at the beginning.

Mr. KEYSERLING. I said that in the kind of world we live in, we cannot get universal agreements, or absolute surety, even among technicians.

Senator HAWKES. That is correct; or legislators.

Mr. KEYSERLING. Also, we cannot be absolutely certain of every step we take. However, that is generally true in dealing with practical problems. But this does not mean that, where a situation is sufficiently critical and the pressure sufficiently acute, no steps should be taken until they are as certain as a mathematical demonstration. It is necessary to make the best possible judgment as to whether, on the basis of experience and analysis, the steps proposed seem like wise or foolish steps.

I have tried to indicate, in response to questioning, what seemed to me to be wise or foolish steps by the test of economic analysis. I didn't intend in any way, Senator Hawkes, to have that carry over into an expression of what I felt members of the committee or of the Congress ought to do as they weigh from a somewhat different perspective the whole range of competing considerations.

Senator HAWKES. The point I had in mind was to ask you this question: if you can tell us a single nation that has gone to and stayed with controls, price controls and allocations, the things that are being asked, that has been successful in doing the thing we want to do in the United States.

Mr. KEYSERLING. I don't think, Senator Hawkes, that I suggested in any way that we should stay with price controls permanently. They should be employed temporarily and selectively, and such is the proposal before you.

Senator HAWKES. That is all right. We don't need to have so much conversation. What I wanted to do is to get right down to the point that if you get them on, these other countries, their leaders, promised that they would not stay on, but they did stay on, and habit is very strong, and when you get it going, it is very hard to get it off.

We who got OPA off the backs of the American people happen to know how hard it was to get it off. It was a very difficult thing. The countries who have adopted the plan that the President is recommending to us now, and that you are talking about, are all socialistic today, and they are all in the junk pile, and we are sending millions of tons of foodstuffs and things of that kind over to keep them from starving to death.

I am not saying I am right, and you are wrong. I am saying that this is a very debatable thing, and I think every serious-minded man in the Congress and in the Senate realizes it is a debatable thing, and we are trying to find out if there isn't some way to do this thing without fastening controls again upon the American people and destroying voluntary cooperation and incentive.

Mr. KEYSERLING. In conclusion, I want to say just a word about timing.

THE PROBLEM OF TIMING

Nobody can foretell just when the dangers and maladjustments of inflation will culminate in a crash. But is it not a strange paradox that those who believe that this ultimate calamity is some time off should on that ground be skeptical of prompt remedial action? Is it not more prudent to take remedial action while the common judgment is that there is still time for it to be effective? I think that these questions pose one of the supreme issues of our generation, which is a moral issue as well as an economic issue. Will our democracy make manifest its innate sense of justice, which rebels against hardship for so many people even in the presence of prosperity? Will our democracy make manifest the strength and the unity to act before the ultimate crisis appears, just as we have made manifest the strength and the unity to act upon the event of crises—especially when we know that some of these crises would never have appeared if we had acted in time?

The CHAIRMAN. I would like to say, now that you have come to the conclusion of your talk, and I sat all through it; that you have in a more comprehensive way than any witness that has come before us in my memory met this situation that you came to talk to us about.

Speaking from this chair and for myself only, and I do not doubt very much reflecting the minds of some others here, you have shown a grasp of the situation, you have shown a manifest fairness, you had a lucidness of utterance of expression, you have not been dogmatic, and you have impressed me with the fact that you realize how delicate the situation is; all of these things, after all, are experimentations, but you have a reason for the faith that is within you.

I want to pay you a compliment, if I may, and say that as far as this fellow is concerned, and I invite the committee to join me, I envy the mental equipment that God has given you and that you use so well. I thank you for being present.

Mr. KEYSERLING. Thank you very much.

O