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JOINT ECONOMIC REPORT

REPORT

OF THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

ON THE

JANUARY 1948 ECONOMIC REPORT
OF THE PRESIDENT



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JOINT COMMITTEE ON THE ECONOMIC REPORT
(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

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JOINT ECONOMIC COMMITTEE REPORT ON THE ECONOMIC REPORT OF THE PRESIDENT, JANUARY 1948

MAY 18 (legislative day, MAY 10), 1948.—Ordered to be printed

Mr. TAFT, from the Joint Committee on the Economic Report, submitted the following

REPORT

[Pursuant to Public Law 304, 79th Cong.]

In accordance with the duties imposed upon us by the Employment Act of 1946, we have carefully examined and studied the Economic Report of the President of January 1947, and the Economic Report of the President of January 1948. We have further examined the reports made by the Council of Economic Advisers to the President of the United States.

The economic reports of the President give extremely valuable assistance to all those who are interested in solving the problems of continuous full employment. Necessarily, the President has to enter into more controversial fields than his advisers, and deal with policies which frequently have political implications. We feel, however, that the operations under the act have fully justified its passage and have given us a good start on the national economic policy guided by more information and study than we have ever had before. To the extent that we present any criticism of the reports, we do not intend to reflect in any way on the manner in which this work has been done.

We append hereto as part II the report of our staff on the President's Economic Report of January 1948. This is a detailed analysis of the various economic theories and recommendations contained in that report. The committee has gone over the report with the staff and made various suggestions and modifications. We feel that it is a useful commentary on the President's report, but we do not commit ourselves, either individually or as a committee, to all of the points made and arguments developed. We commend the report to those legislative committees which have to deal with specific recommendations.

The report of this committee, which follows as part I, will attempt to deal only with certain general observations and a few of the more important recommendations of the President.

Part III is a summary of the President's recommendations, and part IV is a statement of the views of the minority members of the committee.

PART I. COMMITTEE FINDINGS

We are somewhat concerned about the scope of the President's report, covering as it does nearly every domestic policy other than questions of national defense. In both reports the President has dealt with the "development of human resources and productivity." While the language used in the Employment Act of 1946 is very broad, we conceive that its principal purpose is to maintain full employment in the United States and to avoid the recurrent economic depressions which have brought unemployment, hardship, and suffering to its people. This task is sufficiently difficult, and we do not think that work under the act should be diverted from it by the study of all the important and complicated problems of social welfare, health, and education, nor should it be diverted to matters which cannot have an extensive effect on the over-all economy.

Of course there is no measure before Congress which does not to some extent affect the economic welfare of the people of the United States. But where the political or social aspects greatly outweigh the effect on the operation of the economic machine, we feel that the matter should be dealt with in the President's state of the Union message rather than in his economic report.

This does not mean we should concentrate attention exclusively on the short-run business outlook. We are generally concerned with long-range programs directed toward the gradual improvement of the standard of living of the entire country. Many such programs, such as those of reclamation, soil conservation, industrial research and the like, are of the greatest importance in improving the conditions of the people. They have both economic and political implications. It is true that we could proceed with such programs with the utmost rapidity without preventing the periodic recurrence of serious depressions with their attendant unemployment and suffering. But we must be interested in the general character of the public works program, and under what circumstances it should be planned, enlarged or retarded. There is a huge reserve of such public works to be carried out in the United States, and if properly handled it can be an important factor in alleviating unemployment.

At the present time the factors which seem to have the most bearing on the maintenance of full employment are the following:

1. Government fiscal policy, including the scale of Government expenditures and the scale and character of Government taxation.

2. Government controls of credit including bank credit to business, credit for consumption and durable consumers' goods, credit for all types of building construction, and the management of the Government debt.

3. The increase or decrease of Government controls over prices, wages, rents, and allocation and rationing.

4. Foreign trade and the extension of credit to finance exports.

We shall, therefore, deal specifically with the following recommendations of the President, contained in his report, at the pages indicated:

1. Fiscal policy to combat inflation, including expenditures and taxation (p. 47).
2. The regulation of credit (p. 48).
3. The need for selective controls (p. 50).
4. Housing and urban redevelopment (pp. 65-68).
5. Maintenance of competition (pp. 76-78).
6. Agriculture and food policies (pp. 56-57, 79-83).
7. International economic relations (p. 86).

1. EXPENDITURES AND TAXATION

It is generally agreed that we still face an inflationary condition, one in which demand, certainly in the world and probably in the United States, exceeds the available supply of goods. Since the issuance of the President's report, there has been a violent break in the prices of agricultural commodities. There are some other indications that the over-all forces of supply and demand are closer to a balance than was formerly supposed, but agricultural prices have recovered somewhat, and there may be some further increase in wage rates this spring.

The underlying inflationary condition has been produced by a variety of causes. As the President states at page 41: "The question has been raised as to whether we had inflationary pressure because of large exports, because of the very high rate of business investment, because of the large amount of residential and commercial construction, or because of the high level of consumer spending. The answer is that we had inflationary pressure because the sum total of these combined factors exerted too great a demand on available supplies. No one factor can be singled out as the principal cause."

It is interesting to us that both here and throughout the report the President wholly fails to give any weight to the tremendous impact of Government spending. On page 47 he says: "The Federal agencies will have to make cash payments to the public in calendar year 1948 of over \$40,000,000,000." No account is taken anywhere in the report of the inflationary aspect of such expenditures, for the most part made without any direct increase in the production of goods and services.

The substance of our conclusion is that the inflationary condition is due to our attempt to accomplish more than is possible at our present capacity for production. Just as England has been criticized for proceeding too rapidly with her housing program instead of devoting more time to production for export, so our people and our Government, both executive and legislative, may well be criticized for trying to carry on at the same time so many huge programs as those represented in our expansion of business transactions, our expansion of residential housing, our support of veterans' education and rehabilitation, our Government public-works program, our huge Military Establishment, and our economic support of free peoples throughout the entire world. Liberal credit policies on the part of private and public agencies alike, and the maintenance of low interest rates have encouraged the expansion of these programs. We do not intend to criticize these programs or question their desirability. We merely point out that the attempt to carry them all on at once, with very little restraint in the field of consumer spending and liberal credit

policies, is the basic reason for inflation, which otherwise could hardly coincide with a large Government surplus.

Our first recommendation is that Government expenditures be reduced. We quote Mr. Marriner Eccles of the Board of Governors of the Federal Reserve System, testifying on a program to prevent inflation:

It means rigid Government economy. It means deferment of all expenditures—Federal, State, or local, to the greatest extent consistent with public obligations at home and abroad. * * * This means the greatest possible economy in all Government expenditures.

We do not purport to determine the relative importance of different Government spending programs. That must be determined primarily by political judgments on the international situation and the urgency of domestic projects. We do insist, however, that every program for Government expenditure should be carefully screened and reduced to those items which are clearly essential and of real value. No matter how important may be national defense, there are certainly duplications which can be eliminated and economies effected without loss of efficiency. No matter how important the Marshall plan, it should be possible to eliminate projects of doubtful validity and concentrate on those which give a clear case for effective assistance against communistic infiltration. No matter how important an increased amount of housing, there is no reason to continue the more extreme forms of credit guarantee which ultimately will probably do the veteran more harm than good. No matter how important public works, this seems to be no time to increase the total public works program from \$2,000,000,000 in fiscal 1948 to \$2,800,000,000 in fiscal 1949 as proposed in the President's budget.

Taxes for the ensuing year are estimated at approximately \$45,000,000,000. Taken together with State and local taxes of approximately \$12,000,000,000, we find a tax burden of 57 billion, with a total national income estimated at 204 billion; approximately 28 percent of the national income, or 25 percent of the gross national product. Most of this expenditure does not contribute to the production of goods so that the Government activity constitutes a heavy burden on the economic machine to which we look for our standard of living. This burden is expressed at the present time to a large extent in the high price of commodities, because in a seller's market it is possible to pass on to the consumer a considerable part of the corporation net income tax and that part of the income tax which is withheld by employers; to which, of course, must be added the excise taxes which are frankly imposed upon the consumer directly. On a long range basis, a general reduction of expenditures and taxes would undoubtedly tend toward an increase in take-home pay or a reduction in prices or both.

This tremendous burden of taxation is also a deterrent to hard work and to increased investment in productive enterprise. It takes from individuals money which might be saved and provide for capital expansion. It decreases the incentive to the additional effort required to increase production, affecting particularly creative artists and corporation executives and experts subject to the high income tax rates after a certain income has been earned in any one year. The question of the necessity for stimulating the accumulation of capital is a question which we feel should be studied far more extensively and

to which we shall devote a good deal of the effort of this committee in the future.

With regard to immediate action relating to taxes, we disagree with the President's recommendation that a cost of living tax credit of \$40 be given for each taxpayer and each dependent, and to offset this decrease in Government revenues corporate taxes be increased sufficiently to yield an equivalent amount on the basis of present figures. Tax receipts in the fiscal year 1948 will be at least \$7,000,000,000 higher than estimated Government expenditures. The cash surplus, allowing for the payment to Government trust funds, will be at least \$10,000,000,000. This would be a huge sum to take annually out of the current earnings and the purchasing power of the American people, and could be an extremely deflationary factor. If prices should turn down, it might precipitate a substantial depression. The only doubt about the tax reduction voted by Congress is raised by the possible increase in budget expenditures for the armed forces. It is essential that we retain a balanced budget and make substantial payments on the national debt.

This appears to be no time, in any event, to adopt any increase in any form of taxation. Corporation taxes at best are only an indirect method of reaching the ultimate individuals who pay the tax, in part the stockholders and in part consumers. Many experts consider that all taxation should be imposed directly on individuals because they have to bear it anyway, and the corporation tax is a deterrent to the expansion of business activity. In any event, we do not feel that the corporation tax should be increased above the present rate of 38 percent of the net profits. It may be pointed out that if a tax reduction is immediately inflationary the President's plan is also inflationary as far as its immediate effect is concerned, because any personal income tax reduction takes effect at once, whereas the corporations' payments on 1948 profits are not made until 1949.

2. THE REGULATION OF CREDIT

This committee considers that the control of credit is a proper Government function and one of the most essential if we hope to exercise any control over the forces of expansion and depression. We have already recommended the extension of the power to control consumer credit.

We note that the President's report has treated very gingerly the question of credit for housing. It says: "Also dangerous is the mounting volume of mortgage debt, urban and rural. The longer-run interest of the people required careful consideration of the present financing policies of both private and Governmental agencies." Through the operations of FHA the Government has almost complete control over the expansion of credit for housing. Our committee feels that the provisions of title VI of the National Housing Act extend excessive credit to builders for the construction of houses with practically no capital investment whatever, and we can see no sound reason for continuing such credit beyond present authorization. In the long run, because it increases unduly the demand for building materials and the price thereof, we feel that it will not be for the ultimate benefit of those who buy the homes. From an economic standpoint, the policy of advancing 100 percent on GI loans is also unsound and can

only be justified by policies of the Government to give special consideration to veterans.

With regard to the extension of bank credit, our committee is not yet prepared to make a definite recommendation. Mr. Eccles in November submitted a plan for a special bank reserve of 25 percent to be held in short-term Government bonds. Violent opposition has been expressed to that plan by Mr. Eccles' own advisory committee and by many bankers throughout the country. Mr. Eccles has now proposed an increase of all reserve requirements by 10 percent of demand deposits.

There is a substantial question whether any increase in reserves can have any effect on bank credit so long as the banks hold such a large proportion of their assets in Government bonds, and so long as the Federal Reserve System maintains the policy of supporting the Government bond market at not less than par. Some bankers and economists feel that this policy, which uses Government power to hold down the interest rate, should be abandoned, and perhaps must be abandoned. The committee expresses no opinion at this time pending completion of hearings on the whole question which it is now holding.

It is true that the increase in bank credit during the past year has practically nullified the effect of the Government's budget surplus. Much of this expansion undoubtedly is necessary to provide for legitimate purposes of expanding production. We meet again, however, the question whether we can do everything we want to do in the way of current consumption and also expand our capital investments at so rapid a rate. The restraint of bank credit is undoubtedly one of the possible methods of reducing a dangerous inflation. If orthodox methods are no longer effective, we may have to devise some other means of bringing about an over-all control without attempting to have the Government pass on the wisdom of particular loans or types of loan.

3. THE NEED FOR SELECTIVE CONTROLS

Our committee is very much opposed to the establishment of over-all Government price controls, wage controls, or allocation controls in time of peace. The complete establishment of such controls would mean the substitution of a Government-directed economy for a free economy. We believe that the rapid expansion of the productive ability of this country in the last hundred years has been due largely to the existence of a free economy. We believe that a Government-directed economy would result in a lower standard of living for the people, even if it were effectively administered. We believe that Government is seldom able to impose an effective control of prices and wages. We believe, furthermore, that such controls are impossible to enforce in the United States in time of peace. We feel confident that stability in prices will be achieved without such over-all controls and that our efforts can be devoted then to adjusting inequalities by promoting the increase of income for those groups whose income is below a stabilized level.

The President lays great stress upon his desire to have power to impose selective controls. It is entirely possible that in a few isolated cases such controls may be successfully imposed to prevent distortions in the price and distribution situation. We doubt very

much, however, whether they can be imposed successfully on any important commodity unless we are willing to extend them gradually to the entire economy. Our experience with price control after the war leads us to believe that meat prices cannot be controlled without controlling the price of grain and the price of feed and finally the price of all other essential agricultural commodities related to the food supply.

Undoubtedly there are a good many industries in which even in the absence of monopoly control there is a degree of price management by custom or arrangement. We feel that this committee should undertake a study of this situation to determine whether additional legislation is required to maintain free competition. We believe very strongly that the proper solution of the price problems must depend upon the maintenance of such competition.

We have recommended a selective control over the distribution of grain for distilling, but only during the present crop year when crops have been short. We are maintaining an existing control on tin where the world supplies are limited and under strict government control outside of the United States. We have also recommended the continuation of rent control, because we feel that we are still in the midst of a shortage of housing. The total number of dwelling units in the United States, even at the greatest possible rate of construction, can only be increased by 800,000 to 1,000,000 a year, or about 3 percent. Rent control also is separable from the control of commodities. There may be other special fields in which control of prices and distribution can be effectively administered to meet special situations, without involving any control over large sections of the economy. Whether the selection of such controls should be made by the President under general authority, or by special action of Congress, is for the Congress to determine.

We recommend further study of the need for compulsory controls pending the outcome of actions taken under the so-called Anti-Inflation Act, Public Law 395, enacted by the Eightieth Congress. By this act the President is authorized to negotiate with industrial managements for the establishment of voluntary cooperative allocation of scarce materials, and to report to the Congress cases in which negotiations for the establishment of needed controls have been unsuccessful. Pending the receipt of information as to the status of efforts which may have been initiated to secure voluntary agreements for scarce materials, we do not believe Congress should change the allocation policy embodied in the Anti-Inflation Act.

We agree fully with the President that all groups in the population should cooperate to check the spiral of increasing wages and prices. We feel that businessmen making reasonable profits should refrain from and discourage price increases, that labor receiving reasonable wages should refrain from and discourage further demands for wage increases. Of course many prices are beyond the control of any private interest, particularly where large amounts of the commodity are bought by the Government for export or otherwise. Government policy should be directed to buying in such a manner as to check any price increase. This committee viewed with concern the recent increase in prices by many steel manufacturers and held hearings to determine the reasons for such increase. We consider that many of them were unnecessary in view of the profit position of the various

companies. We do not feel that the action taken was in accord with sound public policy or the policies generally agreed to by businessmen themselves.

4. HOUSING AND URBAN REDEVELOPMENT

We have already expressed our opinion that the social aspects of housing and urban redevelopment are somewhat outside the proper function of this committee if we do not intend to cover the whole field of domestic legislation. Unquestionably, the improvement of our cities through the elimination of slum areas and the development of the right type of housing is of vital concern to the welfare of the people. The ups and downs of the operation of the economic machine, however, are affected more by the total volume of housing construction than the exact character of the different conflicting programs of public and private housing.

The Federal Government is already committed to a policy of substantial credit aid in the construction of residences. We believe it should assist local governments by grants in urban redevelopment. If a policy of subsidized rents appears wise from a social standpoint, it will undoubtedly require Federal funds for financing. The rate at which such funds are advanced and the character of the lending has a material bearing on credit expansion. The policies of the FHA in insuring mortgages also have a substantial effect on inflation. We have already indicated that we think this policy has been too liberal, certainly under existing conditions and even under normal price stability.

The production of housing as an industry, however, must be of tremendous interest to anyone concerned with a stable economy. The industry of residential construction is one of the two or three largest industries in the United States. It is subject to almost more violent fluctuation than any other major industry, as pointed out in the President's report on page 65. The cost of decent housing is out of proportion to the average income of the American people, with the result that only a limited number are able to buy new houses, and the market for such houses is likely to disappear when demand for commodities and durable goods continues unimpaired. A rapid drop in residential construction in 1926 may have been one of the contributing factors to the depression of 1930.

We recommend that the Government do everything possible to stimulate research, to improve industry methods, to enact reasonable building codes, to eliminate monopoly controls in the material field, and to reduce labor union restrictions on housing. Furthermore, we recommend that Government credit policies be so varied from time to time as to maintain as level a rate of construction as possible.

5. MAINTENANCE OF COMPETITION

We agree with the President's report that the long-range increase of production in the United States requires the maintenance of free competitive enterprise and that "to operate effectively without a high degree of Government intervention, a free enterprise economy must adjust itself to changing conditions through appropriate moves of prices, costs, and production."

This ideal, of course, is seriously interfered with by the manner in which wage rates are practically frozen against reduction. They are not absolutely frozen, however, because in all well-organized industries, leeway to reduce wage costs is given through the possibility of increased productivity, and in some branches of the economy wage rates may be reduced when an adjustment is required in prices. We are also considering the maintenance of farm prices in some relation to industrial prices. Under that program some degree of elasticity will be lost.

Nevertheless, the ideal is properly stated and we should not permit it to be impaired by monopoly or private fixing of prices. In general, we believe that the proper enforcement of the Sherman Act and other Federal statutes will make prices properly responsive to competition. There are industries, however, where this appears not to be true. We note that the President has instructed his Council of Economic Advisers to make a special study of this problem, which we shall await with interest. Additional antimonopoly measures may be necessary.

6. AGRICULTURE AND FOOD POLICIES

We agree with practically all of the President's report on the subject of agriculture and food policies beginning at page 79. The war guaranty of a price equal to 90 percent of parity expires at the end of 1948, or at the end of the 1948 crop year. The President recommends no long-term farm policy, but we feel it is essential that Congress therefore assume the leadership in this field and enact such a policy before adjournment. While the present income of farmers is very satisfactory, we do not know what may occur in the field of agricultural prices before Congress meets again in 1949. Various programs have been recommended by farm organizations, by economists, and by congressional committees. We have not ourselves made a sufficiently complete study of the problem. We do feel that the farmer is in a special situation, because he must go on producing in order to live no matter what the price of his products may be. A prosperous economy requires that farm prices be not entirely out of line with other prices which respond more slowly to changing economic conditions. We believe Congress should consider a support price program at some relation to the general price level which will carry the farmer through bad times, and yet will not maintain a production for which there is no demand.

We feel that a complete collapse in agricultural products would have a very bad effect on the whole economy of the United States. It might well be the principal factor leading to a serious depression. We feel that Government action is justified, but that it should not be of a character to interfere with a reasonable elasticity in farm prices so that they may be rapidly adjusted to changes in supply and demand.

7. INTERNATIONAL ECONOMIC RELATIONS

The whole subject of foreign trade, the Reciprocal Trade Agreements and the International Trade Organization is dealt with rather sketchily on page 86 of the President's report. Our committee has not had an opportunity to make any extensive study of this subject, nor has the charter of the International Trade Organization been

completed. We therefore reserve our comments for some future report. With regard to foreign loans to pay for exports, we have expressed our general opinion that like all other Government spending programs, this program should be carefully screened, economically administered, and confined to those projects which are of clear value in the promotion of peace and the checking of communism. Without question, the export of a large volume of goods in excess of imports is a serious inflationary element. It cannot continue indefinitely. To the extent we finance it with Government funds, it should certainly be financed out of taxes, and it should be confined to those products in which an excessive draft on our resources will not start a rapid increase in price.

ROBERT A. TAFT, *Chairman.*
JOSEPH H. BALL.
RALPH E. FLANDERS.
ARTHUR V. WATKINS.
JESSE P. WOLCOTT, *Vice Chairman.*
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PART II. STAFF REPORT

It is not necessary to discuss separately section I of the President's report Foreword and Summary, since the issues which it raises are more fully discussed in later parts of the report. Section II, Levels of Economic Activity in 1947, is chiefly historical and descriptive; it forms a valuable background for the policy discussions which follow, but there is no need to analyze it in great detail. It shows that the record of economic activity during 1947 was in many respects highly satisfactory. During that year employment was higher than ever before, and production was higher than ever in peacetime; the number of housing units completed was nearly double that in 1946; and consumer expenditures broke all records, as did also private investment in plant, equipment, and inventories. Exports were at a maximum for all peacetime. Productivity was higher than in 1946, while Government expenditures were lower. The satisfactory elements in the situation, however, are overshadowed in the report, as they are in public attention, by the strong upward movement of prices, wages, and profits. The report indicates that this upward trend produced great inequities and created the danger of a serious set-back.

The remaining three sections of the report may conveniently be discussed under two headings: "Short-run issues" (Section III, "Price and income trends and the course of inflation," and Section IV "Levels of activity and adjustments needed in 1948") and "long-range objectives," which forms the subject of section V.

I. SHORT-RUN OBJECTIVES

The causes and effects of the inflation and the appropriate remedies constitute the principal topic of sections III and IV of the Report. We are interested in the answers which the report gives to three principal questions: first, the reasons for the inflation, especially its continuance through 1947; second, the appraisal of the results of the inflation; and third, the recommendations for action.

The report describes the inflationary pressure of 1947 as the combined effect of an unusually high level of four kinds of demand. These are:

1. The high rate of business investment.
2. The large amount of commercial and residential construction.
3. Large exports.
4. The high level of consumer spending.

To these we would add the high level of Government spending. The report summarizes the situation as follows:

* * * We had inflationary pressure because the sum total of these combined factors exerted too great a demand on available supplies. No one factor can be singled out as the principal cause (p. 41).

Like most statements about cause and effect relations, this is not an enumeration of final causes. It pushes the inquiry back to the causes of the high level of the four types of demand that are mentioned, and particularly, it raises the question why abnormally high levels of all four factors should come at the same time. If this is not just a coincidence, the condition that brings them all to high levels at the same time is a more basic explanation of the inflation than are the four categories of demand themselves.

It is obvious that the high level of all four types of demand in 1947 was an after-effect of the war, but the connection between war and these phenomena was not the same in each case. The major unifying cause is the monetary expansion which resulted from the financing of the war. Heavy deficit expenditures were financed by the expansion of bank credit. This resulted in a great increase of money incomes, which has not been matched by an equivalent increase of production. A similar condition prevailed in nearly all other countries. In addition, both exports and construction activities were stimulated by the destruction of property and the reduced production of civilian durable goods during the war years, both here and abroad. The high level of consumer spending was due to high incomes which resulted from the factors just mentioned. The high rate of business investment is partly due to the destruction and deterioration of business equipment and partly to the high level of profits resulting from the other factors. It is also materially affected by the provision of section 102 of the Internal Revenue Code, which puts a premium on the prompt reinvestment of earnings in tangible business assets as against the accumulation of reserves of cash and marketable securities.

The next step in the President's analysis relates to the role of the supply of funds in the price situation. Correctly, in our judgment, the report says that the prime demand factors enumerated "could not have become fully operative without funds to make them effective," and that the supply of funds was swollen by a large number of partly independent factors. Of these the major ones, as enumerated in the report (p. 41) were:

1. The liquidation of dollar balances and sales of gold by foreign countries and spending by foreign countries of loans and grants provided by the United States.
2. The spending of liquid funds accumulated by business firms during the war.
3. The liquidation of private savings.
4. The increase of bank credit to finance inventory accumulation, capital expansion, and construction.
5. The increase of consumer credit.
6. The cashing of veterans' terminal-leave bonds.

Of these factors, the most important were foreign liquidation of bank balances and sale of gold, and the expansion of bank credit. There was apparently no net liquidation of private savings—quite the contrary.

The factors enumerated make up an impressive total of additional buying power above what would have been disbursed as income in producing the output at the old price and income level. In fact, these sources of spending power were sufficient to have produced much more inflation than we got, if they had not been partially offset by other factors, of which the most important was the Federal cash surplus.

As it was, the combined effect of the forces of expansion was to step up the volume of spending a good deal more than the supply of consumer goods and investment goods was stepped up by the increase of productivity. In the absence of this new buying power, the general price level would presumably have come down slightly because of the increasing output of goods and because the backlog of shortage demand was gradually being cut down. This, however, is true of any year. Because of increasing population and increasing productivity, prices would always tend downward if no new buying power was added to that disbursed in the current process of production.

The factors of expansion are not all on the same footing, however. Some of them are net factors of increase; that is, they are ways in which individuals or organizations were enabled to spend more than their current incomes without a corresponding reduction of spending by someone else. Others resulted from the transfer of purchasing power away from taxpayers. For example, the liquidation of foreign dollar balances and the net sales of foreign gold were 100 percent additions to the volume of demand for the products of this country. The loans of the International Monetary Fund, insofar as they were financed by use of the old gold reserve of the stabilization fund, were also a net addition to current demand.

On the other hand, the expenditures by foreign countries from loans and grants provided by the United States were not 100 percent additions, since they were offset in part by the levy of taxes to provide the funds. If we assume that in the absence of the foreign aid program taxes would have been the same, these expenditures should be regarded as a source of inflation or as an offset to the deflationary effect of the taxes.

Likewise, the cashing of veterans' terminal leave bonds was a transfer of purchasing power from taxpayers to veterans. It may be assumed, however, that the taxes would have been the same anyway, so the transfer to veterans was from the cash surplus, which otherwise would have been used to pay off bonds of some other type. It probably increased the pressure on the cost of living by transferring a certain amount of demand from the capital market to the consumer goods markets, but since demand exceeded supply in both the consumer and capital goods markets, the net effect on total demand is obscure.

The increase of bank credit to finance inventory accumulation, capital expansion and construction was a very important addition to total demand in 1947, amounting to over \$5,000,000,000. The increase of consumer credit, which amounted to about \$3,000,000,000, was an addition to demand insofar as it was financed by the banks; some part of it, however, was financed from individual and business savings, and was simply a transfer of purchasing power from lenders to borrowers.

More important than reservations about individual items, however, is the offsetting pull of the budget surplus against the combined influence of the six factors that increase purchasing power. What the report says about the impossibility of separating the effect of one kind of demand from another kind is equally true of the effects of the inflow of funds from different sources. The combined total of the factors of increase and those of decrease is the significant thing, and the factors of increase were partly offset by the downward drag of the Treasury cash surplus, which amounted to 5½ billion dollars.

This brings up an important point with regard to the effects of the Treasury surplus. It is generally assumed that an excess of tax collections over expenditures of Government is deflationary, or anti-inflationary, and that a cash deficit is inflationary. But this principle is in fact subject to an important qualification. A public deficit does not increase total demand unless it is financed in such a way that it does not correspondingly decrease private spending. A deficit financed by selling bonds to investors who have to increase their savings or decrease other investments by a corresponding amount is not necessarily inflationary. That means in practice that the deficit to be seriously inflationary, must be financed by the expansion of bank credit or the issuance of paper money.¹ Likewise the significance of a Treasury surplus depends upon the concurrent actions of the banking authorities. To collect a cash surplus and lock it up in the Federal Reserve banks would indeed be highly deflationary, provided the withdrawal did not merely stimulate an offsetting expansion of bank loans or investments. If the money drawn out of private deposits as taxes goes right back to the commercial banks in redemption of short-term securities, or if the Federal Reserve banks buy an equivalent amount of securities from the commercial banks, the banks will have the same amount of reserves they had before. And since their deposits, and consequently their reserve requirements, will have been decreased by the payment of tax checks, the banks can make new loans to the full amount of the money withdrawn from the banks in payment of taxes. This is precisely what happened in 1947. It is just as though the banks had loaned new money to the taxpayers to pay the taxes in the first place. A possible deflationary influence may arise from the fact that people spend income money more freely than borrowed money. This may be the reason credit did not expand still more. But it did expand enough to offset fully the budget surplus.

We are saying that although it was inflationary to finance the war by selling securities to the banks, instead of by taxation, the repayment of these same securities out of taxes is not correspondingly deflationary.² This is not contradictory. The difference is that when the securities were offered for sale the banks were provided with additional reserves so that they could buy bonds without contracting credit somewhere else; but these added reserves are not being destroyed as the securities are paid off out of surplus. The reserves that were created in the process of war finance are still in the commercial banking system. The accumulation of the Federal cash surplus, if nothing else were done, would mop up a tremendous fraction of total bank reserves, but it has not been allowed to work out that way. In 1947 the Federal securities owned by banks decreased by 5.6 billion dollars, but their loans increased by 7 billion dollars. Reserves, in spite of the fiscal cash surplus, actually increased by 0.9 billion dollars. Thus the direct deflationary effect of the Treasury surplus was more than offset by expansion of business and consumer credit, listed as two of the six factors which the President's report

¹ Theoretically a deficit financed by sale of bonds to individuals or corporations who would otherwise hold the money idle would be just as inflationary as one financed by sale of securities to banks. But in practice the only important reservoirs of idle purchasing power to be tapped are the unused lending power of the banking system, and the capacity of the community to absorb additional cash.

² On this point the report repeats a common misstatement: "Retirement of securities owned by commercial banks, and especially Federal Reserve banks, has been emphasized in order to secure a maximum deflationary effect from the Federal program of debt reduction" (p. 30). Repayment of securities owned by commercial banks reduces the deflationary effect of the tax collections; repayment of those owned by Federal Reserve banks does not increase it.

identifies as sources of increased public buying power. Though the six sources of demand were subject to offset from the surplus, the surplus was not big enough to offset the forces of expansion in full. The excess was sufficient to finance an expansion of demand which raised prices all along the line. The effect was most conspicuous in the case of those commodities of which the supply was not expanded above the levels of 1946—notably food products.

This part of the report offers a clear and accurate description of the inflationary process. Some question may be raised, however, as to the second part of the analysis, according to which the inflation has been accentuated by actual and anticipated shortages of specific commodities which caused price rises at particular points and spiraled into higher costs and prices all through the economy (p. 42). No doubt this is true of steel, which is cited as an illustration. Our question relates to the statement that the most important of these specific shortages developed in the grains, leading to higher prices of many food products, which in turn led to new wage demands, these in turn leading through higher costs to higher prices. This is a statement of what may be anticipated in 1948 rather than what actually took place in 1947. The shortage in the corn crop has not yet decreased the flow of food to market; in fact it has made more meat available—at the expense of the supply which will be available in the future. Moreover, the major wage demands of 1947 did not follow the development of the grain shortage. Most of the demands were made in the first half of the year, while the rise in meat and grain prices occurred in the last half, and was not generally anticipated until July. The casual relations seem to run from increased income, through an increased demand for food, to increased prices. Aside from a small increase in bread prices, the fear of a shortage of grain influenced the situation only as it led to increased liquidation of livestock and perhaps to an earlier dating of the Government's purchases for foreign relief.

EFFECTS OF UNCONTROLLED INFLATION

The effects of inflation are of two general kinds, which may more conveniently be discussed separately, though they are intermingled in the Report. The first group comprises the immediate effects of inflation on the volume of production and on the distribution of income between different groups, which we may call the current effects. The second class of effects relates to the danger that the boom will cause a collapse of markets and bring on a period of stagnation.

Current effects

The current effects of inflation receive rather less attention than do the dangers it creates for the future. On pages 5 and 43 it is pointed out that price inflation produces great inequities, but the nature of the inequity is not analyzed, perhaps because it is deemed too obvious to require discussion. On page 6 it is stated that low-income groups are hit hardest by inflation. Specifically, this may appear to be contradicted by the data presented in table 2 on page 18 of the report. This table, which relates to income before taxes, shows that from 1941 to 1946 the largest percentage of increase in money income, before

taxes, was obtained by the lowest 20 percent of income receivers, and that each successive higher fifth fared worse. For the three lowest fifths the increase of money income from 1941 to 1946 was greater than the increase in the cost of living for the same period, and for the two lowest the increase of income to 1946 was greater than the increase in the cost of living, as measured to 1947. However, by 1947 allowance for taxes would wipe out the gain for most of the third fifth and some of the second fifth from the bottom; very few of the lowest fifth are affected by changes in taxes. The highest fifth of the population gained only 20 percent in dollar income from 1941 to 1946, and the increase in taxes in most cases was greater than this, to say nothing of the shrinkage in buying power of the dollar.

Nevertheless, the report may be correct in saying that the low-income groups are the hardest hit, meaning those who are now in the lowest group. For, although the lowest fifth are better off than was the lowest fifth in 1940, the people who now make up the lowest fifth may on the average be worse off than they were in 1940. If this is correct, those who were at the bottom in 1940 must, in general, have made greater gains in income than the table shows.

The lowest fifth appears to consist largely of persons on small fixed incomes who have lost in relative position because of the rise in the money incomes of most wage earners and farmers. Retired persons, pensioners, and recipients of relief and veterans' allowances have suffered real distress, and a minority of wage and salary workers have fallen behind. Their loss has been primarily the gain of farmers, and of those urban workers who have benefited from higher wages and fuller employment.

One point that seems to be overlooked in the discussion of real income in the report is that the sharp decline in the rate of accumulation of uninvested savings³ between the war years and 1947 necessarily produced a decline in the purchasing power of money as it is ordinarily measured. Statistically, the purchasing power of income is the amount which a recipient of income could buy with it if he spent it all. This is a significant measure for any one individual, but not for all income-receivers as a group, or any major fraction of them, because spending more money would not have enabled them to buy any more goods. If in a given year people should keep half their income in idle balances or in E bonds and the product of industry was sold for the other half, and if in the next year, with the same level of production and the same wage rates, they spent all their income, prices in the second year would have to average twice as high as in the first year. There would be a 50 percent decline in the nominal purchasing power of incomes, although the community would have the same consumption rate in the second year as in the first. If they had spent not only their current incomes but also liquid assets accumulated in the first year, prices would have had to be still higher. But the standard of living would have been the same. In other words, the more money people save out of their incomes the more they can buy with each dollar of their remaining income. It is impossible to expand the consumption of the population by liquidation of their savings, except in a period of unemployment when higher spending might lead to a higher

³ That is, savings held in cash or demand deposits or invested in savings bonds. This is what is meant by "savings" throughout this paragraph. What is said is not valid for savings invested directly or indirectly in productive assets or homes.

level of production. The total amount consumed is not affected by changes in the rate of saving unless the changes have some influence on the volume of production. Price control and rationing kept prices down by forcing people to save and by slowing down the rate of bank credit expansion; they did not give people as a whole any more current consumption.

Danger of bad effects in future

The main reason given in the report for immediate adoption of an anti-inflationary program is that price inflation is creating great danger of a future collapse of prices and production:

* * * what most fully justifies every effort to halt an inflation is the certainty that, if it runs its course unimpeded, it will spread in its wake the disaster of falling markets, unemployment, and business losses (pp. 43-44).

One can only be certain that, if permitted to run its own course, it [the inflation] will break with destructive force (p. 52).

This is one of the most popular current doctrines about the causes of panics and depressions. It is constantly brought forward as a reason for controlling prices or for other anti-inflationary programs. Only rarely, however, is anything said about the reasons why an inflationary boom should be expected to generate a depression. It is generally stated either as a logical truism or an historical observation. As a truism it has no more serious basis than an analogy with the laws of gravitation—the higher a rocket goes the farther it falls. Historical observation does not of itself tell us more than the obvious fact that downswings must come after upswings, just as upswings must come after downswings; it does not tell us whether upswings generate downswings, or downswings upswings, or whether both are the effects of other things. If the doctrine that inflation directly generates depression is to be taken seriously it must be for more cogent reasons than these.

The report does not offer a complete analysis of the causal relations underlying the sweeping statements quoted in the preceding paragraph, but it does contain two brief statements (pp. 9, 43-44) which suggest possible explanations of the connection between a price inflation dated today and a collapse of production dated tomorrow. One has to do with excessive investment, the other with adequacy of purchasing power. Immediately following the first passage quoted above, occurs the following statement:

A rapid general rise in prices has the effect of unduly bunching investment in inventories and equipment at early dates and according to distorted calculations of possible profit (p. 44).

This is, we believe, a correct statement of what has sometimes happened and may happen again. But the bunching of investment in inventories is quite a different thing from the bunching of equipment orders. With reference to inventories, accelerated buying may be stimulated either by the hope of making a speculative profit, or by fear that as demand increases it may become more difficult to get deliveries of inventory goods. With regard to speculation, the report goes on to say (p. 44):

Rising prices breed upon easy access to credit, which supports the trend. They introduce speculative activities which also support the trend. They produce a price structure which is increasingly sensitive and precarious and vulnerable to changes in business and consumer expectations, spending, and investment.

At whatever point these developments induce a reversal of business sentiment or a withholding of consumer demand, some markets weaken, with a spreading impact. Caution dictates the withholding of demand. Buying for inventory, capital expansion, and consumption declines. A decline of production necessarily follows, spreading unemployment and loss of income from point to point in a widening and deepening downward spiral.

We agree that a speculative price level is highly vulnerable to disturbing factors. In fact, it is not just advances in prices, but speculative booms, in which prices are made on the basis of expectations of further advance, that bring on disastrous liquidations of inventories. A recent Federal Reserve System study describes this type of inflation as follows:

The speculative type of inflation often occurs in an advanced stage of expansion when prices have risen long enough to create a general belief that they will keep on rising. The value of the total stock of money falls, while its nominal quantity remains inflammatory because the rise in prices, instead of curtailing the demand, stimulates it. This is the kind of inflation which has given rise to the false maxim that a boom is inevitably followed by a collapse. The maxim is true only if many prices have reached a level which people pay only because they think they can sell before the boom is over. When this stage is reached, it is only a question of time till prices collapse. The boom cannot level off, because too many holders are in the market only as in-and-out traders. Any price is too high from such a trader's standpoint unless he thinks it is going higher. The booms of early 1917 and early 1920 are familiar cases of this type of inflation.⁴

The Florida land boom of 1926 and the stock market boom of 1928-29 were of precisely this character. The same was true in a less extreme form of the commodity boom of 1920. We question, however, the statement on p. 42 of the report that in the last half of 1947 there was a great upsurge of speculative activity. We do not believe that speculation for a further rise was a major factor in recent price advances. However, this is not an easy matter to determine. Speculation is often more obvious in retrospect than at the time of its greatest price influence.

With respect to bunching of investment in equipment, the bad results attributed to rapidly rising prices seem to us more doubtful than in the case of inventory accumulation, though potentially much more important. Presumably the assumption underlying the report is that high or rising prices widen the profit margins of producers so much that considerable numbers of them simultaneously expand their productive investment until overcapacity develops, orders for new equipment fall off, and the equipment industries suffer depression.

It cannot be questioned that a burst of investment in equipment sometimes occurs, and that the ensuing deficiency of demand for equipment, because of the durability of equipment, may last for a long time. Such a deficiency of demand for equipment may appear even when the demand for consumer goods has not fallen off, but has stopped expanding at the rate which generated the equipment boom. The machine tool industry, for example, is notoriously a feast-or-famine industry; indeed it is now operating far below capacity in spite of a general boom.

The statements quoted from the report, however, seem to us to exaggerate the role played by price inflation in this process. The bunching of investment in equipment during a boom is not initiated primarily by the price rise as such, but by the high volume of sales, which taxes the capacity of existing equipment and would tax it even

⁴ Prospects of Inflation in the Transition Period (Charles O. Hardy), in *Postwar Economic Studies*, Board of Governors of the Federal Reserve System, No. 4, Prices, Wages, and Employment, 1946, p. 6.

more if prices were prevented from rising—because demand would be still greater. When orders are outrunning capacity, price control, at a level high enough to yield a profit, does not destroy the incentive to expansion. In fact, a general price rise usually does not of itself make investment more attractive, since the prices of equipment are apt to go up even more than the prices of the final goods which they help to produce. Aside from nominal profits of inventory appreciation, it is high volume rather than high profit margins that gives high total profit to manufacturers in boom times.

From a later statement we infer that the report does not intend to suggest that during the present boom purchases of equipment have been excessive.

* * * we are now in the stage where the improvement and modernization of our national productive plant has a high priority claim on our resources. Nonetheless, after the most urgent deficiencies in our national plant have been overcome, and the extraordinary export surplus has been reduced, a very substantial increase, both absolute and relative, in individual consumption will be possible and necessary (p. 79).

The doctrine that price booms generate excessive investment in equipment seems out of harmony with certain principles laid down in the 1947 Annual Report of the Council of Economic Advisers, which says:

Aside from certain temporary shortages of materials, the main obstacle (to adequate capital provision for sustaining maximum production) is the concern—well-founded or ill-founded—on the part of business managers that the maximum development of capacity and production will lead at some time in the foreseeable future to overexpansion or overproduction with consequent business losses of a serious or even catastrophic character.⁵

The President's report expresses concern lest the inflation lead to excessive bunching of investment, while the council fears that businessmen will check investment in anticipation of such an excess. The fact is that errors of both kinds are constantly being made. Some businessmen are induced to invest freely by a high volume of demand, accompanied by the low credit losses which characterize an inflationary boom. This tendency is accentuated when interest rates are prevented by credit policy from rising as the demand for credit rises. Other businessmen however, view the cost level of the boom with alarm and postpone the purchase of equipment. Neither attitude is reprehensible; and no trouble occurs if the expansion programs of some are balanced by the precautionary restrictions of others. Excessive booms and depressions occur when there is too much unanimity either of optimism or of pessimism.

Adequacy of purchasing power

The other possible reason suggested in the report for apprehension that the inflation may breed a deflation has to do with the maintenance of adequate consumer purchasing power to take off the whole product of industry. The doctrine that collapses result from a deficiency of purchasing power has a large popular following. It was the main basis of the forecasts of imminent depression made by economists in late 1945, late 1946, and the spring of 1947. It was expounded to this committee by representatives of Americans for Democratic Action

⁵ P. 11. Compare also pp. 17-18.

in July of last year. It was stressed in the first Economic Report of the President, if we interpret that report correctly:

Business should reduce prices wherever possible in order to bring about the necessary increase in consumer purchasing power to bolster their markets. * * * Beyond that, adequate social-security benefit payments provide a desirable support to mass purchasing power.⁶

It appears in less emphatic form in the Midyear Economic Report of July 1947.⁷

It appears to be endorsed on page 9 of the current report, as follows, but is not developed elsewhere:

* * * The distribution of purchasing power determines whether there will be enough funds available to provide investment for maximum production and enough buying power to absorb the output.

As generally stated, the purchasing power doctrine involves a fallacy, for any volume of production distributes enough purchasing power to buy that volume of production at a price level high enough to cover costs. What is meant by a deficiency of consumer purchasing power is simply that businessmen are setting their prices too high in relation to current incomes. Temporarily such prices can be paid since consumers as a group always have some reserves beyond current income.

In spite of the absence of reference to prices in isolated statement quoted above from page 9 of the 1948 report, comparison of the various references to "purchasing power" in the three reports indicates that the term is used in the sense that we have used it above; that is, that prices are too high to be paid continuously without an increase of income. When purchasing power is defined in the reports it is always related to prices. For example, the annual report for 1947 says:

The relation of wages, prices, and profits is the key to the maintenance of purchasing power. * * * If prices are too high in relation to wages, they restrict the market and reduce employment, as well as causing suffering to individual consumers.⁸

Our disagreement with the report, if there is any disagreement, relates to the implication that the volume of consumer buying is controlled by prices rather than prices by consumer buying. The report at times seems to treat prices as something determined independently of demand⁹ though elsewhere (as in the passages quoted above on pp. 1-2) demand is shown to control prices.

Disastrous deficiencies of purchasing power do not result from price increases; the effects run the other way. Price increases result from an excess of purchasing power, from people trying to buy more goods than have been produced, as measured in stable prices. This situation arises when people spend more than has been paid out in producing the goods currently available, whether by using up cash balances

⁶ Economic Report of the President, January 1947, pp. 20-21, see also pp. 2, 10, 19.

⁷ Pages 11, 16.

⁸ P. 2.

⁹ On page 33 the report states that price increases held the purchasing power of consumers down to a level which would have been insufficient to permit absorption of the full output had it not been for the export surplus, the use of savings and credit, and the backlog demands of business. (See also p. 3.) This is always true at every level of employment and prices. Total expenditures always balance with production multiplied by prices. Consequently every component of total demand is necessary to maintain a sales outlet for the total product at the prices at which it actually sells. If total demand had been smaller prices would not have been what they were: there is no reason to project them forward unchanged into a later period of lower total demand. (See below, p. 12.)

saved in the past, by expanding bank credit, or by any other device for enlarging the flow of funds.¹⁰

The opposite difficulty, a tendency of prices to fall faster than costs, arises not because industry distributes inadequate purchasing power but because too many people postpone using their purchasing power, or because purchasing power is destroyed by an excessive Government surplus.¹¹ When industry as a whole fails to get back for its product all it has disbursed, prices or physical volume of sales must go down, and so must wages or the volume of employment. The process starts with the rate of spending, not the volume of purchasing power.

REMEDIES

Several passages in the report deal casually with the question of remedies, and it is discussed explicitly on pages 47-52. On pages 3-4 and 52 it is indicated that voluntary action, both by businessmen and by labor, to hold prices and wages down will contribute to the restoration of economic stability. Reference is made to the first economic report in which businessmen were urged to bring prices into line and workers were urged to limit their demands for wage increases to situations where wages were substandard or where wage increases would not necessitate higher prices. Wage increases are treated as a cost factor which may or may not make specific price increases necessary; there is no reference to the broader effect of wage increases on the demand for cost-of-living goods.

Ever since the war, the discussion of business prospects has been dominated by apprehension that if prices were allowed to reach such a high level that supply would balance the current high level of demand, they would fail to come down promptly when demand fell off, with the consequence that full output could not be sold and full employment could not be maintained. (Compare p. 9 above.) This is the theoretical ground work of the recommendations, offered in all three of the President's economic reports, for voluntary lowering of industrial prices and abatement of wage demands.

The validity of the low-price policy hinges entirely on the extent to which prices may be expected to be "sticky" on the downswing; in other words, the extent to which producers and middlemen, having adjusted their thinking to a high level of prices, will refuse to accept lower prices when there is less demand—with the result that the physical volume of sales will fall off, production will be curtailed, and unemployment will mount.

No general statement about the downward flexibility of prices is valid for all kinds of prices. In general, the prices that go up most readily in a period of high demand are the ones that go down most readily when demand slackens. These include farm prices, farm wages, open market interest rates (both long-term and short-term),

¹⁰ On page 17 there is a careless statement that the cashing of veterans' terminal leave bonds halted the decline in real purchasing power. It did increase veterans' purchasing power, but only by taking purchasing power away from others. More money cannot give everybody more real purchasing power, (except as it may stimulate added productive activity; it cannot do that in any significant degree in a time of full employment like 1947.) If this were not true the problem of poverty could be solved with a printing press.

¹¹ Or conceivably because of bank credit contraction, though this factor is more likely to appear later and accelerate a downswing, when it is already under way for one of the other reasons stated.

soft coal, some forest products, and many clothing items. On the other hand, public utility rates, prices of many branded goods, urban wage rates, and some crude and half-finished products produced by quasi-monopolists (like steel and anthracite), respond less readily to downward pressures. Moreover, whenever inflexible prices of material and labor constitute the bulk of the cost of production of a commodity, as is the case with many miscellaneous manufactured goods, it may be impossible for producers to reduce prices in line with a shrinkage of demand, because the costs do not come down.

There is no question that the rigidity of certain costs and prices is a major part of the explanation of recurrent periods of unemployment. It does not account for the fluctuations of demand, but it does explain why shrinkage of demand results in a diminution of employment and output rather than an adjustment of prices with output unchanged. If all prices and wages were flexible, in the sense that employers and employees alike would accept any cut necessary to maintain a market for full production, the business cycle would become a mere price phenomenon instead of a cycle of production. That this is not mere empty theorizing is shown by the history of agriculture, in which prices and wages do adjust themselves downward to whatever extent is necessary to maintain substantially full-scale operation, so that price and not production moves up in booms and goes down in depressions.

The recommendations concerning low-price policy, both here and in the earlier reports, omit reference to the fact that prices can be too low for stability as well as too high. For example, it is obvious that in the middle of 1946 prices were much too low in proportion to money incomes and liquid savings. The inflation of the fall of 1946 brought prices more nearly into line with purchasing power. If we had the consumer prices of June 1947 with the present level of incomes, or even that of 1946, there would not be enough goods to go around. We should have to have either rationing or gray markets, or an upswing of legitimate prices.

If it were impracticable to lower a price once raised, a policy of holding prices so low as to create acute market shortages might conduce in the long run to orderly utilization of resources. But it seems obvious that producers who have enough control of the market to keep prices down in the face of acute shortages can also reduce prices when demand no longer justifies them. What is important is that they reduce them later when the market weakens rather than that they hold them down now so they won't have to reduce them later, merely for the benefit of middlemen and of buyers who are lucky enough to get part of a supply that will not go around.¹²

On page 46 the report shows that production cannot be increased fast enough within a few months to catch up with market demand or remove inflationary dangers. The production goals suggested are modest, and will presumably be attained, but it is emphasized that they will not stop inflation, because with employment already full

¹² Some manufacturers who are selling their products at prices materially lower than what they could get (with resulting market shortages and abnormal profits at the distribution level) claim that if they raised prices to absorb the gray-market differential their suppliers and employees would demand and obtain increases that could be paid only so long as the abnormal demand continued. Consequently, they would be caught a year or two hence in a squeeze between falling demand and rigid costs. There may be truth in this; if so, it means that the distributors' margins are more flexible downward than are production costs, and consequently, can more safely be allowed to go up in times of abnormally high demand.

the growth of productivity is far slower than the recent rate of expansion of demand.

REGULATION OF CREDIT

Under the heading "Regulation of credit" it is recommended, first, that Congress restore to the Federal Reserve System the power to regulate consumer credit. This committee has already endorsed this recommendation in its interim report of December 15, 1947, and the question is now pending before the appropriate legislative committees of Congress.

Next, the report states that the mounting volume of mortgage debt is dangerous, a conclusion with which, we believe, few people will disagree. It is dangerous, first, because the increase of the debt is supplementing the volume of spending power at a time when there is excessive demand without it; second, because in the event of a sharp recession of prices, even some years hence, debt incurred at the inflated price level may lead to financial distress and foreclosures; third, because the demand arising from mortgage finance is concentrated in a field where the backlog of consumer demand is excessive, and costs are being pushed up even out of line with prices in general. The report goes on to state that "the longer run interest of the people requires careful consideration of the present financing policies of both private and governmental agencies" (p. 48), and that "it is essential that the major Government credit agencies in making direct loans and in guaranteeing private loans shall pursue policies consistent with a national anti-inflationary policy" (p. 50).

This point has been stressed by Governor Eccles in his testimony before this committee. He pointed out that during the past 2 years the amount of housing-mortgage debt has increased by more than \$9,000,000,000 and the rate of current mortgage lending has risen to about \$1,000,000,000 a month. He pointed out also that more than half of the volume of mortgage lending is sponsored by the Federal Government under legislation enacted by Congress. His conclusions were stated as follows:

These two programs [operations under the National Housing Act and the GI bill of rights] sponsored by the Federal Government should be brought together so that appraisals are made by only one agency.

The "100 percent loans" under the program of the Veterans' Administration for both old and new houses and the nominal 90-percent loans on new houses under title VI of the National Housing Act should be revised so as to reduce the demand for housing and thus bring prices down. This means that both buyers and builders should have more equity in their properties than under the prevailing lending policies so long as present inflationary prices continue for housing.¹³

The over-rapid expansion of commercial loans by banks is appraised as being even more dangerous than the expansion of consumer credit. The increase for the year 1947 was 7 billion dollars, of which 4.5 billion occurred in the last half of the year. As is pointed out in the report, the expansion of bank loans is both a result and a cause of inflation. When prices rise, business firms need a larger volume of credit for working capital, and to maintain expenditures on plant and equipment. As the report notes elsewhere, employment and the use of capital goods are at such a level that an expansion of purchasing power cannot stimulate a material expansion in the rate of

¹³ Inflationary Aspects of Housing Finance, Federal Reserve Bulletin, December 1947, pp. 1463-1465. Reprint of memorandum submitted with testimony before the Joint Committee on the Economic Report, November 25, 1947.

production. Hence new loans do not correspondingly increase the volume of production, though they may enable the business firms that get them to bid materials and labor away from someone else. When the businessman must bid against the rest of the world for his share of a supply of labor and goods that is nearly fixed, it should likewise be necessary for him to bid for his share of a supply of credit that is also nearly fixed in total amount. Otherwise, as credit expands, total money value of resources and of product go up without an increase in resources used or volume of product—which is inflation. This is our understanding of what is implied in the President's conclusion that "among the strategic points at which to curb the inflation movement, none is potentially more powerful than the restriction of bank credit."¹⁴

The expansive interaction of prices and credit supply at the producer level has an exact parallel in what has been taking place in the consumer-goods market. As incomes rise, spending increases, but these increased expenditures do not correspondingly increase the supply of goods; they only aggravate the upward tendency of prices.

The parity principle in agricultural price policy involves a similar vicious spiral, as do also the currently popular assumptions that wage increases and tax reductions are appropriate adjustments to offset increases in the cost of living. A rise in the cost of living is evidence that consumer incomes are, or were, too high in proportion to consumer prices; raising money incomes can benefit one consumer only at the expense of another, except under conditions of less than full employment when it may stimulate added production.

The report points out, however, that two difficulties arise if credit restraint is used to curb the inflation. The first is the danger that the role may be overplayed, bringing about undue liquidation of credit and a lowering of economic activity. This is a real risk, and unfortunately is present in any effective method of checking inflation. Second, the problem is complicated by the relation of credit to the administration of the public debt. When commercial lending is restricted, interest rates rise, and prices of Government bonds will fall unless they are supported by Federal Reserve or Treasury buying. If bond prices are permitted to fall, bondholders will suffer capital losses and the Treasury will be confronted by an increase of the cost of servicing the debt.

The report is optimistic enough to say that "these difficulties can be surmounted through the wise exercise of restraints upon excessive bank credit," but it does not offer, nor are we able to offer, a satisfactory formula for getting the benefits of restriction of bank credit without the disadvantages of rising interest rates. We agree with the comment in the report that current proposals which have been presented by the Board of Governors of the Federal Reserve System for the increase of bank reserve requirements (special reserve plan) should be given close study, and we hope soon to be able to make such a study. But we are not optimistic that any formula can be found to reduce the amount of credit available for business use, without raising the rate of interest, unless in the meantime a decline of commercial borrowing demand has taken place for other reasons. We may have to choose between maintaining the price of Govern-

¹⁴ However, we believe that a considerable expansion of bank loans was necessary in 1947 to prevent undue deflation, given the size of the Government cash surplus.

ment bonds and maintaining the real value of those bonds. This requires further study, as competent observers are not all in agreement as to the importance of stability of bond prices. The real interest of the holders of the bonds may be served by measures which lead as a byproduct to a decline in the prices of bonds.

We do not believe that it was intended to say what seems to be suggested by a later passage in the report (pp. 85-86); namely, that there is no stopping place between the present policy of supporting the bond market slightly above par, and subjecting it "to the demoralization which swept over it in 1920 when the unsupported market for Government bonds fell about 20 percent below par." The collapse of 1920 came at a time when the Federal Reserve discount rate was 6 percent, when banks were under the strongest pressures to call in both agricultural and commercial loans, and when the country was heavily stocked with inventories financed by bank credit. Surely it is worth while to try to prevent a further material expansion of total volume of money and deposits, and at the same time give sufficient support to the market to prevent a disastrous collapse and accompanying contraction of the volume of money and deposits. Such a policy might at times involve considerable purchases of bonds, but it would also permit sales of bonds at other periods to check the continued growth of the volume of money. In fact, the experience of the past year indicates that the market can be supported in times of stress without any large net acquisitions of securities by the Reserve System.¹⁵

During 1947 total Reserve bank credit actually declined by about \$800,000,000, or 3½ percent, but since the gold stock was increased by \$3,000,000,000, the credit base expanded by over \$2,000,000,000.

With the exception of the recommendation for the control of consumer credit, the report does not spell out a program with respect to credit control. The only concrete suggestion which has come to Congress is the Eccles plan, which was opposed by the Secretary of the Treasury, and has received no support from the administration except certain very cautious references in the Economic Report.

If we interpret the report correctly, the Eccles suggestion is endorsed, providing Congress concludes (a) that existing controls are not adequate to make possible wise restraint upon excess bank credit, and (b) provided the use of a new system to restrain inflation would be compatible with the support of the bond market. There is little doubt that the Eccles proposal would strengthen the Federal Reserve System's control over the volume of bank credit. But whether the exercise of this power would involve less risk of precipitating a downswing, or would conflict any less with the support of the bond market, than would the freer use of existing powers, is a question which requires close study.

The Eccles plan has several merits. It meets in part the Treasury objection to measures of credit restriction which threaten to increase interest rates and therefore to increase the burden of interest on the public debt as outstanding securities mature and are refunded. It

¹⁵ During the 12 weeks ending February 25, 1948, the Reserve banks bought on balance over \$4,000,000,000 worth of long-term securities, but they were able to reduce their holdings of other securities so that the total holdings actually decreased by over \$1,000,000,000.

While we agree with the finding of the report that a stabilization of the total volume of bank credit, or a slowing down of its increase, would have been helpful in checking the inflationary developments of the last half of the year, we do not suggest that responsibilities of the Treasury and the Federal Reserve System were unskillfully discharged during this period, considering the magnitude of the debt and the rapid change from a problem of keeping the value of Government bonds from rising, to one of keeping them from falling.

would ease the financial burden on the banks resulting from a drastic increase of cash requirements. It would make it possible to increase reserve requirements much more drastically than would otherwise be possible, because in effect it would give the banks some interest on their reserve balances. By raising the reserve requirement, say to 45 percent, it would greatly reduce the amount of bank expansion made possible by the importation of gold, or a backflow of currency out of the circulation, either of which would increase bank reserves. Under the proposed system such an expansion of reserves (if not offset by contraction of Federal Reserve credit) will support an expansion of bank deposits of at least 6 to 1, whereas under the Eccles plan the potential expansion would be less than $2\frac{1}{2}$ to 1. It does not, so far as we can see, create serious administrative complications, though some arrangements would have to be worked out for enforcing it on the nonmember State banks. It is not clear, however, that it would bypass the difficulty in keeping the bond market pegged in the face of strong competition from the market for loan funds. Banks would still have an inducement to sell bonds yielding $2\frac{1}{2}$ percent in order to make loans at a higher rate, though any increase in deposits resulting from such operations would necessitate a much larger increase of reserves than is now involved.

Tax proposals

The only important short-run recommendations which have been added to the program outlined in the President's message of November 17, 1947, are the proposal to grant a credit of \$40 to each taxpayer and each dependent and the proposal of a compensating increase in corporation taxes. The latter takes the form of a revival of the excess-profits tax.

First, as to the mutually offsetting effects of the proposed increase of corporate taxes and the decrease of individual taxes: the report does not claim that the two measures taken together are antiinflationary and concedes that they may be somewhat inflationary.

We believe that this is an unnecessary concession, unless the excess-profits tax rates were fixed so high as to encourage unnecessary expenditures. Under some conditions such a transfer of purchasing power from corporations to individual consumers might lead to an increase of total spending, but at present, when the pressure on the markets for capital goods is just as great as that on the consumers' goods markets, there is no presumption that the transfer of purchasing power from one market to the other would be inflationary.

Our criticism of the proposed shift of tax liability from individuals to corporations is not that it would be inflationary but that it would actually increase the inequities which have resulted from the inflation. The stated purpose of the proposal is "to help those millions of families whose disposable incomes have lagged more and more behind the cost of living during the past year and a half" (p. 48). But giving the same amount of relief to those who have lagged and those who haven't will not help the one group at the expense of the other, nor provide more goods for both together.

The fatal flaw in the proposed plan ¹⁶ from the standpoint of those who have suffered losses from the inflation is not merely that it fails to give relief at the point where it is most needed; namely, to the bot-

¹⁶ And also in the bill which has recently passed both houses of Congress.

tom 20 percent of the population who already pay no taxes, but that it actually gives relief to taxpayers at the direct expense of those who are lower in the income scale. This follows from the fact that with full employment, an increase of money income does not stimulate much added production and consequently does not increase real purchasing power; it only changes the distribution of the product among claimants. A \$20 or \$40 per capita addition to the income of all tax-paying families will enable them to spend that much more money, and if prices do not rise proportionately they can buy more goods. But there is only one place those goods can come from, and that is from a shrinkage of the buying power of those who pay no income tax. This will be accomplished if taxpayers' added spending results in a price rise somewhat less than proportionate to their increased spending. But all those who do not save on their taxes will have their buying power reduced by the price increase.¹⁷

Ane, as is pointed out in the President's report (p. 19) the bottom fifth of the population who pay no income tax consists largely of those who have moved down in the income scale as a result of inflation—the group subsisting on life insurance, savings bonds and deposits, pensions, and other fixed incomes. The only tax relief which would not actually hurt this group would be the repeal or reduction of appropriate excise taxes.

As to the deflationary or inflationary effect of an excess-profits tax, little can be said without some specification of the form of the tax. The report assumes that this part of the recommendation, taken by itself, is anti-inflationary. Whether this is true depends on the level of the taxes levied in the top bracket. A 95-percent tax at margin of corporate income would be inflationary because it would encourage waste and extravagance, especially excessive advertising expenditures. The tax would almost certainly be deflationary if the top rate was, say, 50 percent or lower, as has been recommended by a subcommittee of this committee.

Finally, it is an error to assume, as the report apparently does assume, that because inflationary pressures are deemed to be serious any reduction in the Government surplus would tend to make the situation still more serious. It is true that in an inflation a budget surplus is desirable, but it does not follow that a surplus of the magnitude contemplated in the annual budget is necessary or desirable. In fact, the cash surplus of 1947 was, we believe, much larger than was necessary in order to check the inflation, if it had not been neutralized, and more than neutralized by bank credit expansion made possible by gold imports and the repayment of bonds held by banks. To protect the economy from a disastrous deflation, given a cash surplus of \$5,000,000,000, it was necessary that bank reserves be replenished to some extent. But a smaller budget surplus, if accompanied by a tighter credit policy, such as is recommended elsewhere in the report, would accomplish the same purpose.

¹⁷ In this connection the "price increase" means, of course, the amount by which prices go higher than they would have in the absence of the tax change, which may not be the same as the amount of change from the 1947 level. Other factors besides the tax change will presumably accentuate or dampen or offset its price effects. This does not affect the validity of our contention that the only gain which taxpayers would get from the proposed remission consists of a transfer of power to buy goods to taxpayers from those who do not now pay taxes.

Voluntary savings

The recommendations for encouragement of voluntary savings (pp. 51-52) are noncontroversial and seem entirely sound. The following points are perhaps worth noting with regard to a voluntary savings program:

1. As compared with a tax program that would reduce expenditures by an equal amount, a savings drive would have the advantage that it would not have repressive effects on individual incentive. It would not take income away from people but encourage them to reduce their expenditure out of a given income.

2. Under present conditions the purpose of the savings program should be to reduce total expenditures, not merely to divert them from consumption expenditures into investment expenditures that would not be made otherwise. Such a diversion would increase future production at the expense of current consumption, but it would not help to check the inflation.

3. To accomplish this purpose appropriate objectives of the program would include the sale of Government savings bonds, encouragement of deposit funds in the Postal Savings System, the liquidation of outstanding debts, and the reduction of the mortgage indebtedness on new homes.

4. It should be noticed that the accumulation of uninvested savings creates a backlog of purchasing power for an individual but that he can only realize on it on condition that most other people do not. Whenever a large block of people try to liquidate uninvested savings that are theoretically liquid they increase the demand for goods without increasing the supply, with inflationary consequences. If this happens in a time when there is a deficiency of buying it may be helpful by strengthening stagnant markets. Unless it does lead to an increase of production it cannot lead to an increase of consumption at the time the attempt is made to liquidate the savings.

5. Large liquid savings made in one year and expended in another year tend therefore to lower prices in the first year and raise them in the second. Obviously this is advantageous only if the prices tend to be abnormally high in the first year and abnormally low in the second year.

SELECTIVE CONTROLS

In addition to the two standard over-all measures for controlling the inflation (credit controls and budget policies), the report recommends a number of selective measures aimed at specific maladjustments. The most important of the areas singled out for specific treatment is the market for food, especially grain and meat. Meat rationing is recommended on the basis of the shortage which is expected to appear this spring. The position taken is that "it is not an acceptable alternative to let mounting prices ration a short supply at the expense of families of modest income." The report points out that the use of credit and fiscal controls to a point where they could halt the rise of meat prices would probably cause widespread unemployment.

The recommendation for the establishment of meat rationing has recently been investigated by a subcommittee of a standing committee of the Senate, which reported unfavorably. As the President's recommendation relates specifically to the immediate future, and

there is no prospect of congressional action at this time, it does not appear necessary for us to go into it here. The two members of this committee who served on the subcommittee which investigated the matter constituted a minority in favor of the proposal.

The report recommends selective controls of several other kinds, including control of specific prices, and of wages that threaten to make maintenance of a given price ceiling impracticable; allocation of basic industrial and agricultural products, rent control, export control, allocation of transportation facilities, and regulation of speculative trading on the commodity exchanges.

We do not believe that these recommendations conflict with the principles that were accepted by the President and by Congress in 1945-46, which led to the liquidation of the framework of wartime controls. But they do recognize the need for occasional exceptions to the general method by which the production and distribution of goods are organized in a free economy. Differences of opinion relate, not to the principle, but to what constitutes an emergency calling for action and to the extent of the deviation from free market control that is necessary in a given case. No one would dispute the necessity of rationing food in a starving beleaguered city, or the rationing of penicillin if a serious epidemic should make the supply inadequate for urgent needs. On the other hand, hardly any one wants to reestablish the full paraphernalia of wartime controls. We believe that the prompt restoration of a large degree of individual initiative and responsibility is a major reason why reconversion has proceeded more rapidly in the United States than in any other country, and why dollars are now in urgent demand throughout the world to buy goods which are being produced in abundance hardly anywhere else.

To repeat, differences of opinion arise, not with regard to the principle that freedom is to be the rule and control the exception; they arise over the selection of the area to which selective controls are to be applied and the specific criteria which should determine when to put controls on and when to take them off. Divergences of judgment are bound to arise because judgments differ as to the facts of the situation and especially the outlook, because judgment is sometimes colored by conflicts of special interests, and because people do not all weigh alike the relative importance of protecting the individual against an immediate hardship and protecting the community against the risks and costs of excessive Government control.

The report, following the line of the President's message of November 17, 1947, recommends the establishment of limited powers of price control to be used for combating (a) those rising prices which bear most disastrously on the cost of living; and (b) rising prices of a few vital industrial products that are in short supply, "since we have had ample demonstration that these areas of shortage are also a focal point of spreading inflation."

It is agreed that under present demand conditions the price fixed by competition may be, and undoubtedly is in some cases, considerably higher than is necessary in order to call out the maximum practicable use of existing capacity, considering the current scarcity of labor. The question is whether the competitive price or a lower price (fixed either by voluntary action of sellers or by public authority) would better serve the public interest.

Vital industrial products fall into two classes: (1) Those like steel, cement, petroleum, which are produced, or at least distributed in a given area, by a relatively small number of concerns and afford opportunity for a limited exercise of price policy; (2) those like soft coal, lumber, and in some areas brick, which are produced by a large number of competing concerns, no one of which controls enough of the supply to have an effective influence on the price. The price-making process in these areas is more like that in agriculture than it is like a typical case of large-scale manufacturing.

In the administered-price area, the range of the manager's discretion is limited at the bottom by his costs and at the top by competition, but within a significant range he can set prices at his discretion. In a situation like the present when demand from consumers, from industry, from Government, and from the export market are all strong, the price fixed by competition of buyers for a limited supply, rather than that fixed by competitors for a limited market, is the upper limit of the range of discretion. Prices may voluntarily be held much lower and still cover costs. But if this is done, some buyers who are willing to pay the price will be shut out by dealer allocation or by accident. The bidding of these disappointed buyers creates a legal gray market which bears the same relationship to the administered price that a black-market price bears to a price established by public authority.

For vital industrial products of the second type, this informal voluntary price control is impracticable, just as it is in agriculture, because the number of price makers is too large for any one producer to exercise an appreciable influence over the market. In general, prices are based on what the traffic will bear. Ordinarily, competition keeps the price in line with costs but under conditions of excessive demand and recurrent shortages prices are subject to abrupt fluctuation and there are frequent periods of abnormally high profit. Selective price control, however, with a free market at the later stages of production and distribution, probably would not, in general, reduce prices of end products to the consumer. Rather, it would introduce into these areas the same sort of two-price market as already prevails in the markets for administered products, such as steel, various building materials, and automobiles. Price control would have to be accompanied by allocation, and policing would be necessary to prevent some of those excluded from the market by allocation from bidding up prices in a secondary market. We assume that this is the intent of the recommendation of the report, though allocation is discussed only as a separate measure and not explicitly as a support for price control. Likewise in the administered areas where gray markets already flourish, to legalize price control at the primary market would not disturb the gray market or even change in into a black market, unless informal allocation by producers was replaced by public allocation.

Under these conditions it is not clear that price control limited to basic materials in short supply would make these shortages any less "focal points of spreading inflation" than they are without control. Since the demand for final products would not be decreased, nor their supply increased, there is no reason to expect prices at retail level to be lowered in line with prices of basic materials. Although effective control of consumer prices will work back automatically to the prices of raw materials (if they do not have alternative outlets in uncontrolled

areas), price control at the first stage will not automatically work forward. To hold down prices at the earlier stages of production without following through to the final stage tends strongly to increase the profits of fabricators and middlemen rather than to reduce final prices.¹⁸

The recommendation for wage controls limited to industries that may be subjected to price control (and perhaps their suppliers) seems less practicable under a system of selective price controls than it was when prices in general were controlled. If the inflation develops at a rate which would justify direct price and wage controls, it will be very difficult to justify denying wage increases for workers in controlled industries, while permitting them in uncontrolled industries.

LONG-RANGE OBJECTIVES

The discussion of long-range objectives for the American economy opens with an analysis of the amount of increase in production and income which can be expected in the next few years. It is pointed out that a continued growth of productivity at the rates that have been achieved in recent decades would yield at full employment by 1957, per capita disposable income about 27 percent above that of 1947, or 80 percent above that of 1937. As the report points out, this increase would be sufficient to provide adequate nourishment, medical care, social security, and education for the mass of the population—adequate, that is, by present standards, just as present output is sufficient to provide income that would be adequate by the standards of the nineteenth century. Whether the conventionally accepted standards of adequacy will continue to keep ahead of the means of satisfying them cannot, of course, be predicted.

We have some reservations as to this part of the report, relating to the extent to which the realization of such a rate of progress depends on the achievement of high-level stabilization, and, more important, as to the extent of responsibility of government in this connection. The report says (p. 56):

But these gains will not come by accident. They will not be registered in an economy characterized by a period of idle or wasted resources after any period when for a few years we attain full utilization of our plant and labor force, or in an economy running at only three-quarter capacity even in "fairly good times."

But the assumed rate of advance in productivity, and consequently in output at full employment, is an average based on gains realized in our economy over a period which included occasional depressions. In other words, if we can project forward the experience cited, the economy is capable of increasing man-hour productivity, and consequently per capita output at full employment, by 27 percent in 10 years, even if that period includes an average number of years of less than full employment.

We believe there is serious exaggeration in the statement that the economy has in the past run at only three-fourths capacity even in "fairly good times," though we all agree that the frequent intervals of depression have been costly. This committee and the Council of

¹⁸ Compare the testimony of Mr. Charles E. Wilson concerning gray-market conditions in the automobile market with that of Mr. Fowler McCormick concerning their relative infrequency in the distribution of farm machinery (80th Cong., 1st sess., Current Price Developments and the Problem of Economic Stabilization, hearings before the Joint Committee on the Economic Report, pp. 23-24, 149).

Economic Advisers were created in recognition of the need of a program for the elimination of depressions. But we see no reason to assume that if we have peace the same rate of progress which was achieved in the past in spite of recurrent depressions, cannot be maintained in the future unless we succeed in eliminating depressions.

On the same page the report says:

The attainment of our objectives will depend upon the best efforts of industry, agriculture, and labor, working with sympathetic understanding of one another's problems and of the common good. It will depend on a clear appreciation of maladjustments in the relationships among production, prices, and purchasing power; it will depend upon the willingness of all concerned to make necessary adjustments, and upon vigorous and forward-looking government.

We do not believe that maintenance in the future of a rate of progress comparable to that which was attained in the past really depends on "a clear appreciation of maladjustments in the relationships among production, prices, and purchasing power." If so, the outlook is very discouraging. We see no reason why the continuance of progress requires that industry, agriculture, and labor shall work with any more "sympathetic understanding of one another's problems and of the common good" than they have had in the past. If progress must wait upon "the willingness of all concerned to make necessary adjustments," it will be indefinitely delayed. Nor can we agree that the need for "vigorous and forward-looking" government is any greater than it was in the years when the 2-percent pattern of growth of productivity was established. Progress in productivity has always been primarily the result of the self-seeking efforts of individuals to advance their own economic welfare by invention, by investment, and by the development of new markets for the goods or services which they have to sell. With respect to this major part of the contribution it is more important that government shall avoid actions that retard progress than it is that it shall participate with "vigor." When we learn enough about the causes of economic instability to frame a program for abolishing depressions, active participation of government may be found to be necessary, but at this time the problem calls for study and for clarity of thinking and not for vigor of action.

The sections of the report (pp. 56-68) devoted to the development of natural resources and capital equipment deal broadly with desirable objectives rather than specific programs. Much of this analysis will be accepted by everyone as a statement of ideals; disagreement will develop when specific measures are brought forward to implement the program. We all believe in better plant breeding, increased use of fertilizers, progress in soil conservation, better management of forests and ranches, flood prevention, conservation of fish and wild-life, improved mining methods, and so on. But each specific program must at some stage be appraised by comparison of the prospective costs with the additions to national product to be anticipated from it. In their present form, the generalizations in the report do not lend themselves either to concurrence or to dissent, because they are not fitted into a framework of limitation of resources. The report lists a multiplicity of good things to do; it does not help us to decide to what extent, in an economy fully employed, resources could or should be diverted from present use to these uses, nor what is the priority between them. In the thirties social projects might be endorsed almost recklessly, on the theory that they were a net addition to

output in an economy filled with idle resources. But now, and in the full employment economy visualized in the report for the future, one project can be carried through only by crowding out another. Financial costs are once more real costs.

In other words, the report underemphasizes, if it does not overlook, the economic criterion of all developmental investments, public or private; namely, whether the resulting addition to output can be expected to exceed that from any other known use of the same resources, and in any case exceed the values used up in the project. This is especially important with regard to public investments, because it is easier for a government than for an individual or business concern to disregard the ratio of output to cost. For example, experience with the investment of public funds in waterways, river and harbor development, and soil conservation justifies the continuance of public planning and public investment in these fields, but the report underemphasizes the necessity of discrimination in the selection of projects, and ignores the colossal wastes that have accompanied such expenditures in the past and characterize some of those proposed for the future.

We do not mean by this that the report necessarily overstates public as against private participation in the development of resources and in the creation of capital goods. The relative emphasis shifts in the course of the discussion and it is sometimes difficult to tell whether the report is endorsing public or private planning. For instance, it is emphasized (p. 62) that the investment program is essentially the sum of a great many private programs privately planned, financed, and executed. It points out that the Government can help to develop a favorable climate which will encourage such business investment programs. But in the next paragraph we are told that "the policy of sustained maximum production requires that the actions of business, labor, and Government be based on broad agreement as to our overall economic goals, and on a reasonable degree of assurance that appropriate action will be taken to achieve them." This does not sound like a program which is the sum of "a great many private programs—privately planned, financed, and executed." It sounds like a long stride away from an economy controlled by free markets. No one except the Government is in a position to give the required assurance that "appropriate" action will be taken to achieve goals requiring broad agreement of business, labor, and Government. There is no such broad agreement, and if there were the essential character of the private competitive economy contemplated by the Employment Act of 1946 would be destroyed. A free-market economy cannot survive if its survival is dependent upon the exercise of a high degree of economic statesmanship in the direction of its affairs; it is precisely its advantage that it does not require individuals to plan their conduct on the basis of special wisdom or an unusual degree of patriotism.

With reference to housing, the report makes a strong plea for expansion of the level of residential construction, and for research in building techniques and modernization of building codes, in order to eliminate the shortage, to improve the quality of housing, and to stabilize the level of production. As to the last point, we question the implication which runs through the discussion that a high level of building activity is needed even in a period of high employment like

the late twenties and 1948 to stabilize productive activity. So far as stabilization is concerned, it would be better to concentrate publicly promoted housing construction in periods of low employment. Or, if we believe that we are not going to have any more periods of low employment, housing promotion must be appraised as a means of diverting resources into those parts of the field where it will provide more adequately for the needs of the population than does uncontrolled private enterprise. The report neglects the question whether we have the resources of labor and materials necessary to expand the scale of housing construction substantially without serious interference with other urgent needs. It also neglects the inflationary aspects of current and recommended methods of financing housing construction.

The report contains an unsupportable statement that "most of the housing is being built for families in the higher-income brackets." The Bureau of Labor Statistics has just released information concerning new nonfarm one-family homes for which construction was started during the second quarter of 1947. Half of these homes cost less than \$6,700 to build and 20 percent of them cost less than \$3,250. Only 10 percent cost \$9,250 or over. While these are building costs, not selling prices, it is clear that the situation they depict does not even remotely resemble that suggested by the report.

We believe that it is an exaggeration to say that "only a small minority of our families can afford to purchase new houses of satisfactory size and quality," though it is true that, as has always been the case, the majority of people find that old houses can be bought to meet their needs more economically than new houses. This is necessary, if the use of houses is to be economical. Since a house is expected to last from 40 to 80 years, at any given time new houses can be only a small percentage of the total number of available houses. If houses are to last an average of even 45 years, half the people will have to live in houses that are 20 or more years old. Also, because of mobility connected with employment, changes in size of family, and progress in income status, most families have occasion to change houses several times. Thus most houses in the course of their useful life change hands several times. Only confusion results from appraising the progress of the housing program on the assumption that it will be inadequate until everybody who wants a house can buy a new house.

We question the statements on page 68 that the restrictions which hamper the building industry have been developed primarily as protective devices because of the wide fluctuations in the activity of the industry, and that "the fluctuations have caused the restrictions far more than the restrictions have caused the fluctuations." Even if these things are true, the important effect of the restrictions is not the loss of stability in the industry. In fact, the restrictions probably have some slight tendency to stabilize the industry because they are less effective in depression times than boom times. The bad thing about the restrictions, both those originating with the building industry and those sponsored by building labor, is that they increase the cost and keep down the supply of housing both in good times and in bad times, thus imposing a cost on all the rest of the population. The restrictions are an exercise of monopoly power, which in general the report treats as an obstacle to maximum production. We see no justification for glossing it over by a purely hypothetical allegation

that people who have the power to impose such restrictions would not do it if they were not subjected to the hazards of a fluctuating industry. Both feather-bedding policies of labor and monopolistic price-raising activities of employers are in general correlated with power rather than with the need for protection against hazards that arise from instability.

STABILIZATION THROUGH MAINTENANCE OF BALANCE

From the standpoint of the objectives of the Employment Act, the section entitled "The Development of Institutions and Practices for a High-Production Economy" (pp. 75-89) is perhaps the most important section of the discussion of long-range objectives. This is the section which suggests the long-run policies, public and private, which are most likely to insure maximum productivity combined with economic stability and continuous growth.

The questions discussed are fundamental but, as would be expected from the incomplete state of knowledge of the causes of instability, there is no attempt to give final answers to all these questions in the report. With reference to one of the most important phases of the problem (price and wage policies), the report says:

I have instructed the Council of Economic Advisers to continue its work on this problem with the assistance of representatives of all groups concerned. The results of such a study should contribute to the development of sound legislative proposals. But its most important outcome should be a wider and deeper understanding on the part of the Government, business, labor, and consumer groups as to the price, wage, and production policies and practices which will contribute most fully to the maintenance of high levels of consumption and investment.

We wish to underscore this recognition of the undeveloped state of economic science, especially as to what policies will insure full productive activity in a free-enterprise system. We are not certain that there are any such policies, but we hope that the studies referred to will be carried forward diligently and persistently, and that they will yield progressively more satisfactory answers to the questions which crop up when we try to promote economic stabilization without sacrificing freedom.

The report (p. 75) summarizes the problem of long-run stability under four heads, each of which is stated in terms of "balanced growth." These areas are, first, the industrial area, in which the objective is stated to be "price-wage-profit policies which maintain balance between the output of industry and the ability of consumers to buy that output"; second, the agricultural area, in which we are said to need balance between city and farm income and between farm and industrial prices; third, the fiscal policies of Government, which need to be so contrived as to afford maximum incentives to production and to improve the "balance" within the economic system; fourth, to strike a "wise balance" between our internal economic activities and our international trade. Each of these objectives is discussed at considerable length. Since the term "balance" is used in all four items, an examination of its meaning under each head may well introduce our comments on that part of the discussion.

Agriculture.—The concept of balance is clearest with reference to agriculture. A perfect balance between city and farm income, or between farm prices and industrial prices would be a situation in

which additional investments of material and human resources would be just as profitable in one of these areas as in the other. If this is not the case, one of them is underdeveloped in comparison with the other. As to capital, this simple concept is satisfactory. But so far as manpower is concerned, the growth of technology for a century and a half has been increasing the proportion of the population who can find most profitable employment in industry and reducing the proportion needed in agriculture. Every census since 1800 has reported a lower percentage of the labor force as engaged in agriculture. So long as this pull is effective, "balance" between agriculture and industry has a rather special meaning. The proper balance between farm and industrial prices is not one that would make farming and industry equally attractive, on the average, to young men choosing a life career. Rather it is a relation such that the proportion of farm boys drawn off into the cities will enable agriculture and industry to produce foodstuffs and fibers and industrial products in a "balanced" relation.

The report emphasizes the importance for the entire economy of a high objective for agriculture and efficient use of resources. It suggests the desirability of increased capital investment to raise individual productivity 50 percent above the prewar level and "using two or three times as much fertilizer as before the war, about three times as many tractors on farms, and more of other types of machinery and equipment" (p. 81). There are also recommendations for improvements in marketing, especially of perishables, for commodity price supports under a modernized and improved parity formula, and for enlargement of the income of urban families as a means of stabilizing the markets for agriculture. Conversely, it is urged that improved income for agriculture is necessary to assure adequate markets for the products of industry.

The section on farm production embraces a variety of points which are worthy of careful study. We have some reservations as to the apparent use of prospective consumer demand as a measure of future needed levels of domestic farm production, without reference to the alternative of increasing the importation of food as demand increases. Thus the report says (p. 81):

In view of the growing population and expanding income, we should seek within a decade to raise agricultural production about 10 percent above present levels. This would mean that crop production would be about 25 percent, and livestock production nearly 50 percent, above prewar levels.

The goals stated seem very modest; and we have no doubt that they can be and will be realized. But this should not be understood as implying that a growing industrialized nation can anticipate or should aim for an indefinite increase of agricultural production keeping pace with the growth of its population and the rise of its standard of living. A leading industrial nation cannot expect to remain self-supporting in food for an indefinite period. The possibilities of the tropical and subtropical areas of the world as suppliers of food for the temperate zone have been exploited only to a slight degree. With the current rapid pace of improvement in refrigeration and packaging, the prospects for improving the standards of living of the countries of the temperate zone need not be restricted by their capacity to expand food production at home. But this is looking ahead; currently the productivity of agriculture is rising faster than population. It is only because of the

disruption of agriculture abroad and the extraordinary increase of employment at home, that the food supply has lagged behind the growth of markets.

International trade.—In ordinary times a “wise balance” between internal economic activities and international trade would mean practically the same thing that was suggested above about “balance” between agriculture and industry. That is, it would mean that as new resources, human or material, come into the market, employment openings would be about equally attractive in producing goods for export, in importing foreign products, and in producing goods for the domestic market. When this is not true, there is lack of balance, and it would pay to shift resources from one field to another (disregarding the costs and inconveniences of making the necessary adjustments). At the present time, however, our whole foreign trade policy is so tied up with considerations of international policy that the term “wise balance” can hardly be given any economic significance. Economic balance is secondary to considerations of national security.

Industrial prices.—The objective called “balance between the output of industry and the ability of consumers to buy the output” is really a matter of price policy. The industrial process always disburses income enough to buy its output at prices which change only as costs change. If producers should refuse to sell at prices which consumers’ income will cover, we could get unbalance in the sense of unsold goods; and vice versa, if prices are held by controls or by voluntary action below that which consumers’ incomes will cover, we get market shortages.

Markets and income distribution.—In this section (pp. 78–79), attention is given to the increase that has occurred since 1939 in the proportion of productive effort which goes to produce capital goods. Although the report appraises domestic capital formation in 1939 as insufficient, it states that the present ratio of capital formation to consumption is too high for permanence. It indicates that as a long-run matter a very substantial increase, both absolute and relative, in individual consumption will be necessary. The reasons for this conclusion are not stated, and we do not see how it could be substantiated. Certainly the fact cited, namely, that expenditures for producers’ equipment have increased 170 percent as compared with 48 percent for consumers’ expenditures, throws little light on the question. This comparison illustrates the well-known statistical principle that high percentages on very small bases are meaningless. The increase of 170 percent in expenditures for equipment is figured on a base which made up only 4 percent of total expenditures in 1939, whereas consumer expenditures made up more than 75 percent of total expenditures in that year. If all the increase of expenditures for producers’ durable equipment had been made available for consumer expenditures, their growth ratio would have been only 58 percent, as compared with the actual increase of 48 percent. In view of the role which capital formation plays in the year-to-year increase of productivity (compare above and report, p. 55), we are not convinced that we are confronted with any problem of a chronic excess in the proportion of total effort that goes into capital formation.

Fiscal policy.—In this area the suggestion is offered that fiscal policy should be such as to promote “balance” in the economy: “Balance” here seems to be only a rhetorical expression, with no definite content.

It may equally well mean "high income," or "full employment," or technological progress, or all three.

The discussion of taxation and debt management relates chiefly to the dilemma which arises from the established policy of supporting the market for Government securities, when it conflicts with the purpose of restricting the rate of growth of the money supply. The section offers no solution of the dilemma, but seems to make clear that stability of the bond market is to take precedence over the use of credit policy to restrain inflation.

We cannot, without more investigation and study, analyze the implications of the policy of permanent support of a long-term bond market at a 2½ percent yield level. There is competent opinion both in the Federal Reserve System and among bankers that support of the bond market at about the present level is essential in order to avoid wholesale dumping of securities and collapse of the bond market, with repercussions on all other financial markets that would be fatal to the maintenance of sustained prosperity. This view is not universally accepted, however, and we should not take a position on it without more study and more collection of views of competent people. It is hoped that hearings which this committee is now conducting may help to clear up the issue.

PART III. SUMMARY OF RECOMMENDATIONS OFFERED IN THE ECONOMIC REPORT OF THE PRESIDENT

1. FOREWORD

1. The objectives for 1948 are to halt the inflationary trend and at the same time to maintain maximum employment and achieve maximum production (pp. 5-6).

2. The Nation's long-range economic programs should be geared to three major purposes: Conserving and developing our natural resources and capital equipment, enabling our human resources to become fully productive and thus provide richer and more satisfying lives, and improving our economic institutions and practices so as to utilize free enterprise and representative government effectively toward maximum production and sustained general prosperity (p.7).

2. THE COURSE OF INFLATION AND ADJUSTMENTS NEEDED IN 1948

3. Increasingly through the second half of 1947 total demand for goods was in excess of the amount of goods and services available at current prices to satisfy the combined requirements for final consumption, private capital formation, Government services, and exports. We had inflationary pressure because the sum total of these combined factors exerted too great a demand on available supplies. No one factor can be singled out as the principal cause (p. 41).

Economic objectives

4. Further price inflation offers little prospect of stimulating a further expansion of production (p. 43).

5. Although there is a ready market, every one is employed, wages are good, and industrial capacity is being expanded, the accompanying price inflation has created inequitable shifts of purchasing power between different classes of consumers (p. 43).

6. What most fully justifies every effort to halt an inflation is the certainty that, if it runs its course unimpeded, it will spread in its wake the disaster of falling markets, unemployment, and business losses (pp. 43-44).

Employment and production

7. The present level of employment may be regarded as a practical maximum. To maintain this level and provide for the increase of the labor force would mean average civilian employment of almost 59,000,000 for 1948 (p. 45).

8. For the economy as a whole an increase of total output by about 3 percent above 1947 is a feasible objective for 1948. In the agricultural sector, however, it appears doubtful that total production can surpass that of 1947 (p. 46).

9. Our purchasing power objective for 1948 should be to effect the economic adjustments which are necessary to afford adequate protec-

tion against increasing inflation (p. 46). If employment and production goals were fully realized, this would not of itself meet our purchasing power objective nor dispel the need for other anti-inflationary measures (p. 47).

Fiscal policy

10. A substantial excess of Government receipts over expenditures is counterinflationary. With inflationary pressures a major threat to the stability of the American economy, no action should be taken now to reduce the excess of receipts over expenditures (p. 47). But to help the millions of families whose disposable incomes have lagged behind the increased cost of living during the past year and a half, Congress should enact legislation extending a cost-of-living tax credit of \$40 for each taxpayer and each dependent. The tax on corporate income should be increased to yield an equivalent amount (p. 48).

Credit controls

11. The power of the Board of Governors of the Federal Reserve System to regulate consumer credit should be restored (p. 48). (Recommended by this committee in its Interim Report of December 15, 1947.)

12. Both private and governmental agencies should give careful consideration to the dangers involved in the mounting volume of mortgage debt (p. 48).

13. Among the strategic points at which to curb the inflation movement, none is potentially more powerful than the restriction of bank credit. Proposals for credit control, especially those recently presented by the Board of Governors of the Federal Reserve System, should be given close study by the Congress, and legislation should be enacted to make available all the powers that may be needed (p. 49).

14. Credit control should be so exercised as not to interfere with the maintenance of the price of Government bonds (p. 86).

Selective controls

15. Consumer rationing of selected commodities (meat, for example) would relieve the demand pressure, and provide for a more equitable distribution of the available supply (p. 50).

16. There should exist limited powers of price control for combating rising prices (a) at points where they bear most disastrously on the cost of living, and (b) in the case of a few vital industrial products that are in short supply (p. 50).

17. There should be set up powers for dealing with the distribution of basic agricultural and industrial products where scarcity threatens to impede production or raise prices unduly (p. 50).

18. Authority should be granted to prevent wage increases where such action is necessary to maintain any price ceiling that may be established (p. 51).

19. Rent controls should be continued and strengthened (p. 51).

20. Provision for voluntary agreements relating to allocation of transportation facilities and scarce commodities, and to the regulation of speculative trading on commodity exchanges, should be strengthened by provision for governmental action along the lines previously recommended (p. 51).

21. The Federal Government is deferring many public works, and State and local governments are urged to do likewise. Businessmen

should defer expansion that does not immediately augment production (p. 52).

22. Voluntary savings of all types should be encouraged (p. 52).

23. Businessmen should hold the line against price increases, and should reduce prices wherever they can (p. 52).

24. Labor should be moderate in its wage demands (p. 52).

3. LONG-RANGE OBJECTIVES

25. Private groups and individuals, State and local governments, and the Federal Government should all cooperate in the development of natural resources, including agricultural and grazing land, water power, forests, and mineral resources. Programs for the development of underdeveloped regions in the West and in Alaska should be continued and expanded (pp. 56-58).

26. Continued high-level production will require large increases of capacity in many industries. The balancing of expansion in different industries calls for considerably more thorough study than has been given in the past (pp. 59-61).

27. Maintenance of a healthy shipbuilding industry, capable of rapid expansion, and the continued operation of an efficient and competitive merchant marine, are necessary to national security, and are essential elements in the achievement of a continued high level of employment in the United States (pp. 62-63).

28. The expansion of highways, air transport, and railroads is essential to economic growth and requires continued Government aid. Government aid is most effective when it stimulates the resourcefulness and inventiveness of private enterprise in developing and applying technological advances in aviation (pp. 63-64).

29. Improved planning and redevelopment of cities will enhance their usefulness as facilities for manufacturing and commerce, and increase workers' productivity. It has been estimated that over the next decade as much as \$75,000,000,000—mostly private investment—could profitably be employed in these redeveloped areas. The housing shortage requires a large amount of new construction in outlying areas before we can engage in slum clearance and urban redevelopment on the scale that will be needed. Local governments, State governments, and the Federal Government should all cooperate in urban redevelopment. Comprehensive long-range housing legislation should not be postponed. Postponement of this action represents postponement of attention to a problem of utmost economic importance (pp. 64-68).

30. One result of the war has been to increase the employment of teen-age workers, and of men and women in the older age groups. The exacting economic demands of modern employment, no less than social considerations, should impel us gradually to reverse this trend (p. 69).

31. Expansion of educational plant is urgently needed. Federal aid to elementary and secondary education should contribute to that equalization of opportunity in various parts of the country which will fit our youth for living and working in the kind of economy that we shall have when they are grown (p. 70).

32. There is need for enlarged research, both in basic principles of physical, biological, and social science and in their practical application (p. 72).

33. A comprehensive national health program along lines previously recommended should be enacted (p. 72).

34. Unemployment compensation should be increased in amount and duration and extended in coverage (p. 73).

35. The coverage of old-age and survivors insurance should be extended, and benefits should be adjusted upward with a higher limit upon earnings which may be received after retirement without loss of benefits (p. 73).

36. A lowering of the retirement age will be feasible in future years as we attain the levels of national output that sustained maximum employment and production will bring. At the same time, industry should provide opportunities for the efficient employment of those older people who are able and willing to work although they have earned the right to retire (p. 73).

37. The Federal Government should make grants to States to help them finance general-assistance payment, and all public-assistance grants should take account of variations in the ability of the States to finance adequate assistance programs (p. 74).

38. In the industrial area we need price-wage-profit policies which maintain balance between the output of industry and the ability of consumers to buy that output (p. 75).

39. In the agricultural area, we need balance between city and farm income and between farm and industrial prices (p. 75).

40. The fiscal policies of the Government, such as taxation and debt management, need to be so contrived as to afford maximum incentives to production and to improve the balance within the economic system generally (p. 75).

41. We must strike a wise balance between our internal economic activities and our international trade (p. 75).

42. There must be a strong and continuing pressure by the Government to keep alive the competitive characteristics of the business system (p. 76).

43. In the future amendment and enforcement of the antitrust laws, the principle should be followed of checking the further excessive concentration of industrial control and, by protecting the position of smaller competing enterprises, of reversing the past trend toward concentration (p. 76).

44. Pricing policies and practices which are designed to protect the individual company during future declines in business activity are not conducive to the continued health of the business community (p. 77).

45. Collective bargaining must be based upon a better understanding of the long-range interests of management and labor in the context of the interests of the whole economy (p. 78).

46. We should seek within a decade to raise agricultural production about 10 percent above present levels. More adequate educational and financial aids should be provided for this purpose. Orderly marketing and the widest possible distribution of bumper crops call for educational and service work with industry and consumers (pp. 81-82).

47. Commodity price-support levels should be kept flexible and the parity formula modernized (p. 82).

48. Except in years of depression, taxes should be maintained at a level which will balance the Federal budget and provide a substantial surplus (p. 84).

49. Our long-range tax policy must be such as to help sustain prosperity. Lowering particular taxes on business may at one time be needed as a means of stimulating business expenditures when they are inclined to lag, but maintaining or advancing taxes at another time may be needed as a means of checking overexpansion or overcapitalization (p. 84).

50. The program which Congress has been asked to authorize in order to assist European recovery may make the difference between success and failure of world reconstruction (p. 86).

51. It is natural and desirable that we maintain some surplus of exports in the years ahead by the steady investment abroad of private capital (p. 88).

52. The timing of the economic programs to promote stabilization is discussed as follows in the closing pages of the report (pp. 88-89):

While it is most urgent now that we combat inflationary dangers, we cannot wait until the tide turns before considering affirmative measures that will be needed in the future. Economic conditions may turn rapidly, but the formulation, enactment, and initiation of economic and fiscal programs require a considerable amount of time. Prudence demands that we look ahead and prepare for tomorrow while we act for today.

In timing the adoption of measures for long-run prosperity, we must give careful consideration to the following principles:

(1) Certain programs related to national security and foreign policy, to promotion of urgently needed production, and to protection of our natural and human resources against serious economic hazards must go ahead even though Government outlays for foreign or domestic programs contribute to the necessity of anti-inflationary measures.

(2) Certain adjustments, such as the increase in minimum wages and tax adjustments, are needed in order to mitigate the hardship imposed on those who are the hardest hit victims of the inflationary price rise.

(3) Major parts of the proposed expansion in the social security program will be deflationary in the first period after inauguration. Therefore, there is no reason to postpone the adoption of these urgently needed measures.

(4) Federal, State, and local public works in general should still be deferred wherever feasible. We need, however, certain initial steps immediately to prepare these measures for future years. For instance, the Federal Government and State and local governments should be preparing drawings and specifications for public works projects to be undertaken when needed. In my budget for the fiscal year 1949, I have included appropriation requests and estimated expenditures in amounts sufficient for the initial steps of new public works.

(5) When the inflationary pressure subsides, we should speed up the programs of resource development, transportation, and urban rehabilitation, and further expand the social security, health, and education programs.

Since our first experience with the Employment Act is occurring under conditions that give priority to measures needed to counteract inflation, we are given time to consider carefully the measures that will aid in meeting the threat of unemployment at some time in the future. But we must not fritter away the time thus granted us. We must not be complacent and believe that the job of employment stabilization has been solved. A boom carries in it the seeds of its own destruction. We must be prepared to act in time if we want to make good our promise and prove to the world as well as ourselves that an economic system of free institutions can be made to work steadily as well as efficiently.

PART IV. MINORITY VIEWS ON PRESIDENT'S REPORT

THE ECONOMIC PROBLEM ACTION VERSUS INACTION

Twice since the enactment of the Employment Act of 1946 President Truman, in compliance with that statute, has submitted to Congress a carefully documented economic report. Under the terms of the law, it is the duty of the President to submit such a report at the beginning of each calendar year. It is also the duty of the Congress under this law to review the proposals of the President in the Joint Committee on the Economic Report, and then to make its own recommendations for the use of the appropriate standing committees.

The theory of the Employment Act of 1946 was that it is the responsibility of the Federal Government to "coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power." It will be observed that the law envisages an all-out effort on the part of the Government to foster "free competitive enterprise" and to promote "employment, production, and purchasing power" to the maximum degree. This objective is not to be gained by half measures. It cannot be won by letting things drift. It calls for positive measures. It may be attained only, as the Employment Act contemplated, by the mobilization of all the plans, functions, and resources of the Government.

In order to enable the President to submit recommendations calculated to make such a program effective, the law equipped the executive branch of the Government with a Council of Economic Advisers, composed of high-grade professional economists, whose duty is to appraise economic conditions and to formulate and lay before the President its recommendations for a national economic policy.

MACHINERY FOR ECONOMIC MOBILIZATION

In order to enable the Congress to have the benefit of an independent review of the recommendations of the President and of the Council of Economic Advisers, a new congressional committee, the Joint Committee on the Economic Report was established. It is the duty and responsibility of this committee not only to review the President's report and the reports of the economic advisers, but to make independent studies of economic conditions so that the Congress as a whole and through its standing committees should have the benefit of the expert advice of the Council of Economic Advisers and the expert advice of a congressional staff and of the members of the Senate and House appointed to the Joint Committee.

The President and the Council of Economic Advisers have carried out their responsibility. The report of the Joint Committee which is now being presented to this, the second regular session of the Eightieth Congress, is long overdue. It is the first congressional report of the committee which makes any pretense of carrying out the original concept of the law.

The Presidential reports, both in 1947 and 1948, made two types of recommendations, the first being short-range measures to deal with the current situation, and the second being long-range measures to deal with the over-all problem. Both types of recommendation were intended by the President to utilize the plans and functions of the Government in accordance with the policy of the Employment Act of 1946 "to promote maximum employment, production, and purchasing power."

CONTRAST BETWEEN EXECUTIVE AND LEGISLATIVE POINT OF VIEW

The President's reports, as contrasted with the interim reports of the Joint Committee, the action of the standing committees of the Eightieth Congress, and the laws passed by the Congress itself, strikingly emphasize the conflicting points of view of the executive and of the legislative branches. President Truman has recommended affirmative action to hold inflation in check, to stabilize the economy, to preserve good business conditions, to stimulate production, and to provide for maximum employment and profitable private competitive enterprise.

The Congress, however, has preferred inaction. It has preferred to hold Government authority to a minimum. It has acted upon the theory that Government controls should be authorized only in extreme cases and even then it has been slow to act. It has chosen a negative rather than a positive approach.

Thus the clear issue is presented between action as recommended by President Truman, or inaction as exemplified in the policy of Republican congressional leadership. In other words, the question is whether the Federal Government shall act positively to check inflationary pressures occasioned by inescapable demands upon a supply which despite substantial increases in production is not sufficient to go around, or whether, in accordance with the congressional policy since the beginning of the Eightieth Congress, the Government shall do nothing and trust to luck that the public interest will not suffer.

The congressional policy of drift is illustrated by legislative history on the proposals which have been made. Most of the President's recommendations have been utterly disregarded. A few of them have been taken up in a half-hearted manner. The Senate, for example, has passed a bill providing for the control of consumer credit. Although this measure was passed on December 17, 1947, it is still awaiting final action in the House. Rent control extension though recommended by the President on November 17, 1947, was not passed by the Senate until February 25, 1948, and when finally approved in conference and sent to the President on March 26, it was in a denatured form. Rent control has been approved by the Congress although rents have risen less than any other group of prices, because there still is an acute lack of housing, and the costs of the housing that is being built have risen beyond the range of normal incomes. Congress has acted because people must have roofs over their heads.

THE CASE FOR ECONOMIC PREPAREDNESS

The case for positive, affirmative action by the Government as recommended in the two reports of the President is based upon the historic fact that inflation has always been followed by depression and that depression produces suffering and misery for all groups in the economy, for the producer, the worker, and the consumer, for organized and unorganized business, and for the individual.

It is also based upon the belief that inaction during a boom period produces the very conditions which themselves result in depression and which defeat the objectives of Government responsibility and action specifically set forth in the first section of the Employment Act of 1946. While the boom is on, all groups seek selfish advantage, hoping to gain the benefits of rising prices and rising wages and then somehow to avoid the inevitable penalties when the decline comes. If the brakes are not put on while inflation is ballooning skyward, there is no way, as experience teaches us, of avoiding the disastrous effects of the fall when the balloon is punctured.

The President's reports have been warnings and recommendations designed to prevent such results. The President has advocated a policy of economic preparedness. The Congress has been content to wait and see.

The hope of those who prefer the policy of inaction is that somehow, without Government guidance, things will take care of themselves, that somehow the law of supply and demand, instead of inevitably producing inflation due to competition among spenders for goods, will somehow equalize conflicting forces, that rising prices will induce production in sufficient volume to meet demand, and that in some vague and unpredictable way the economic system will adjust itself if only the Government follows a policy of keeping hands off. That this is an unsound concept is demonstrated by the fact that even its advocates, as indicated by the action of the Senate with respect to consumer credit and rent control, concede that there are circumstances in which the Government cannot afford to keep hands off.

The danger of spiraling prices became so great during the first session of the Eightieth Congress and the acuteness of the housing shortage became so evident that the Congress finally authorized the Joint Committee on the Economic Report, expanded by the appointment of other Senators and Congressmen from other committees, to conduct country-wide hearings on the cost of living and created another joint committee to investigate the shortage of housing. With respect to the cost of living, these hearings resulted in findings that prices had gone so high that millions of citizens in the low-income groups were no longer able to stretch their incomes to cover the cost of existence even though they were diminishing their purchases. With respect to the housing shortage, the findings of the Joint Committee on Housing were that Government action and Government expenditures are necessary because the hands-off policy has not been producing the desired results.

EVIL EFFECTS OF INACTION ALREADY BEGINNING TO APPEAR

Seven million American families at the bottom of the economic scale were obliged in 1946 to subsist on an average annual income of only \$835. It is true that this was larger than it was in the prewar days,

but in terms of purchasing power it means, and there is no dispute in the committee on this point, that these 7,000,000 families offer a much poorer market to industrial and agricultural producers and to those engaged in trade than would be the case if Congress had chosen to take positive steps to check inflation.

If the price spiral continues and the next group of 7,000,000 families, who in 1946 had an average income of \$2,023 for the year, are compelled, like the group on the bottom of the scale, to forego the purchase of necessities as well as of luxuries, then business will really begin to feel the disadvantages of shrinking markets. If finally the inflationary balloon is allowed to burst, then indeed business will come rushing to Congress for Government aid much as it did after the collapse of 1929. Effective action to halt deflation will require more stringent Government control over the economy than the preventive measures suggested in the messages and reports of President Truman. With a national debt of \$259,000,000,000 now as compared with a debt of only \$20,000,000,000 in 1930, the task of effecting recovery will be many times greater than it was when, under President Hoover, the Reconstruction Finance Corporation was established to do for business with Government credit what it could not do for itself. Both the leaders of Congress and the leaders of private business, if they are intent on preserving and strengthening a private competitive economy instead of sinking into a wholly Government economy, would be well advised to insist upon adopting the President's proposals immediately.

Business leaders, big and little, cannot afford to disregard the significance of the recently released study of the Bureau of Labor Statistics on the City Worker's Family Budget proving that millions of American working-class families are the immediate victims of the failure of the Congress to respond to the President's repeated recommendations for inflation control.

This study, based on June 1947 wages and prices, which has not been challenged since it was first presented to this committee, indicates that a city worker had to earn approximately \$3,000 to \$3,400 per year to provide a necessary minimum standard of living for his wife and two children. If he had a wife and three children, the city worker would have to receive almost \$4,000 per year. The city worker and his family constitute the best market that industry and agriculture can have. If, because of high prices and low income, he cannot properly feed, clothe, and house those dependent on him, the farmer and the industrialist will promptly learn about it in shrinking sales and vanishing profits.

How dangerously close to this point inflation has carried us is demonstrated by this fact: The average wage in manufacturing in June 1947, was \$1.18 per hour. If the average manufacturing worker worked 50 40-hour weeks a year, he would earn only \$2,360, or 41 percent below the necessary minimum for a family of three children; or 33 percent below the necessary minimum for a family of two children.

That these danger signals are visible not merely to those who support the recommendations of President Truman is proven by the comments on the current business scene even by the economists of business. Take, for example, the following quotation from the April

letter of the National City Bank of New York on economic conditions and Government finance:

There is no limit to the aggregate wants of people, but there are frequently limits to the amount of a given product that is wanted and can be paid for at a given time. As the boom runs on, these limits are bound to come into operation in certain lines. Evidence that they are appearing is not lacking. Buyers this Easter have not seemed willing to take all the apparel offered at the prices asked, and some manufacturers have found themselves overcommitted on fabrics. Prices of cotton print cloths and some rayon constructions have declined. Expensive services and luxuries have slumped. In many household appliances the testimony is that the well-known brands preferred by the public are becoming more generally available, and that the less-desired makes are feeling the pressure of competition.

These conditions apply in an increasing number of lines. They are certain to make things harder for the manufacturers who by reason of less experience, less efficiency, or less financial strength can be described as marginal. The same is true in the distributive trades. The result is bound to be an increase in business failures and rising pressure of competition on profit margins.

To date the Congress has done nothing about either the cost of living or the housing shortage. True the Senate has passed a bill to control consumer credit—but the House has taken no action. The Senate has passed a housing bill, but the outlook for it in the House is dark.

Thus the choice is presented between positive, affirmative action by the Government as recommended by President Truman in accordance with the intent and letter of the Employment Act, or inaction and delay as represented by the policy of the Eightieth Congress ever since it assembled on January 3, 1947.

NOW IS THE TIME FOR DECISION

It is clear now that it is too late to expect any change of policy by the leadership of this Congress. The choice, therefore, must be made by the people between the policy of action and the policy of drift. The facts before us, as well as the experience of the past, teaches us that the result of congressional inaction means only that the pattern of the past will be repeated even to the depths of disaster. This fact is clear, that when the purchasing power of the masses of the people is curtailed, the market for business is also curtailed, and both suffer.

Those who have urged the policy of inaction have contended that Government controls in time of peace are intolerable, but they overlook the fact that these are not times of peace. It is an utterly false assumption to contend that, with the turbulent world discharging economic and political lightning of an intensity scarcely ever seen before and with the peace treaties of World War II still unwritten, the people and the business leaders of the United States can safely close their eyes to realities and pretend that we are living in a normal world.

These are not normal times. They are abnormal times. They are times in which individual freedom, both political and economic, is threatened as it has never been threatened before. These are times in which totalitarianism is marching everywhere to overwhelm democracy. These are times in which freedom for the individual can be preserved only by wise Government action motivated by a desire to maintain that freedom against concentrated power of all types.

The President's reports have urged the Congress to combat inflation by constricting the supply of money and reducing inflationary

expenditures on the part of consumers, business, and government, and by stimulating the production of goods in short supply. He has recommended that the American economy be fostered and expanded by the conservation of our resources, human and material. He has particularly pointed out the necessity of strengthening the system of free competitive enterprise. He has specifically recommended, and this recommendation was contained in his first report, that Congress take positive affirmative action to prevent the progressive concentration of economic power through monopolistic mergers. This he did by recommending specific enactment of legislation now pending in both houses of Congress to amend the Clayton antitrust law. His appeals and recommendations have fallen on deaf ears and the economic situation continues to drift although Senators and Representatives of both parties have repeatedly urged a policy of affirmative action.

PROBLEM IS BOTH INTERNATIONAL AND DOMESTIC

In preparing his reports for the Congress, the President was aware that our economic problem is both international and domestic. He was cognizant of the burdens that were being thrown upon the American economy by unavoidable demands for assistance in the rehabilitation of war-devastated areas as well as the burdens occasioned at home arising from the shortage of materials to meet the demand. It was his recommendation to the Congress that, accepting realistically the conditions in which the United States found itself, it was essential for the Government to act.

That he had not overestimated the international demands and the gravity of the international crisis is now evident, and Congress has accepted his recommendations for expenditures to deal with the international problems, but to date Congress, so far as the domestic problem is concerned, has been content to hope that by voluntary action industry could allocate materials in short supply and hold prices in restraint while financial units likewise, by voluntary action, could restrain undue credit expansion.

These hopes were doomed to disappointment from the beginning. Now that the international crisis has mounted, it is even more evident than before that we cannot safely depend upon voluntary restraints or comfort ourselves with illusive hopes that somehow the situation will take care of itself. It is important, therefore, coldly to reappraise the President's reports, and weigh his recommendations in the light of the hard facts before us and the desire of the American people to achieve world peace and a stable economy in which freedom and opportunity for the individual may be maintained.

THE ECONOMIC REPORT OF THE PRESIDENT

In his Economic Report for 1948, the President urges upon the Congress two major types of action:

- I. Ten affirmative measures for combating inflation to be handled at this session of Congress.
- II. Twenty-two long-range measures designed to reinforce the American economy and strengthen the free, private enterprise system in a postwar world of rival economic ideologies.

Any program designed to combat inflation and create higher levels of employment and output is bound to be varied and complicated. There is no simple panacea for the economy just as there is no single simple way to win a war or even a battle.

1. COMBAT INFLATION

The basic dilemma of full-employment programs is, how can a nation maintain a relatively high level of employment without being subjected to constant inflationary pressures? Never has any nation done so during peacetime in the past. Even in war periods inflation is contained rather than prevented. Similarly, how can the cost of living be leveled off or brought down except by going through some measure of depression and mass unemployment? That, too, has never been done.

In 1948 more than ever, the United States needs a flexible double-acting price policy, one that will wisely put on brakes when needed, but which, at the same time, ever keeps the accelerator in readiness. Many of the things here and abroad which the United States wants to do in 1948 will remain partly or wholly undone if inflation continues. Thus, for example, rising prices will cut the heart out of any dollar-aid extended to Europe just the way the post-OPA inflation of 1946-47 cut the buying power of the dollars lent to Great Britain by nearly a third, thereby seriously curtailing the intended benefits of the loan.

On the other hand, a catastrophic fall in prices might again cause mass unemployment in the United States, seriously damage confidence in free private enterprise in Europe, and create rejoicing in the Kremlin. The Communists have been predicting such an event ever since VJ-day and planning to exploit it.

The price policies of American business in 1948 are thus of vital, strategic importance. They should not hamstring but should aid the United States to discharge its world obligations toward peace and prosperity with maximum efficiency and economy. They should not disrupt but should stabilize production and distribution at high employment levels. They should not diminish but should maximize the economic freedom of individual businessmen which necessarily implies that big corporate business must cease dictating the pricing policies of small individual business.

Despite recent readjustments of prices in the grain markets, the major problem in 1948 has been, and seems likely to be, curbing the excesses and alleviating the injuries of inflation.

The affirmative measures which the President recommended be handled by this session of Congress fall into three categories:

A. Measures that will restrict the total amount of money in circulation.

B. Measures that will divert purchasing power into noninflationary channels or otherwise decrease inflationary expenditures; and

C. Measures that will stimulate production of goods in short supply.

A. Constrict the supply of money

A sound policy of credit control is one that will curb reckless borrowing all around—by Government, by consumers, and by business.

The President accordingly urges: (1) Cut governmental expenses, (2) keep a substantial excess of Government receipts over expenditures, (3) reimpose controls over consumer credit such as those the Federal Reserve Board formerly exerted in Regulation W, and (4) "close study" of current Federal Reserve Board proposals including the increase of bank reserve requirements and legislation sufficiently comprehensive to give the powers needed.

(1) In order to insure an excess of Government receipts over expenditures, all governmental units, Federal, State, and local, should scrutinize meticulously every expenditure for public works and other purposes to determine which are postponable, which bid for scarce materials and labor, which fail to add in the immediate future to the total amount of available goods. Needless to say, all Government expenditures should, without impairment of vital programs, be cut to the bone, and every person possible released to private employment.

(2) From the standpoint of anti-inflationary effect, taxes are highly effective, especially those on individual and business net incomes. All leaks should be effectively plugged, every enterpriser, whether "gray market" operator or other citizen, required to pay his fair share. In 1948 more than ever the economy needs top operating efficiency by the Bureau of Internal Revenue. Its appropriations for enforcement should be increased. A larger personnel is not only needed to assist those citizens who for the first time are enjoying incomes high enough to be taxable, but it is necessary to insure a minimum of tax avoidance. Nickels spent for adequate enforcement will yield additional dollars of lawful revenue.

The time to tax heavily is when prices are getting out of hand. Any reduction in the total amount of taxes collected will but feed the forces of inflation. The people to tax are those who benefit most from higher prices. The burden should be eased on those whose incomes lag behind.

As compared with the preceding year, the primary beneficiaries of inflation in 1947 were those receiving net corporate profits after taxes, and those receiving incomes from unincorporated business and non-farm proprietorships. Those in 1947 showed larger percentage gains over 1939 than did farm incomes. On the other hand, interest and rental incomes percentage-wise were cut in two. Even the share of employee compensation in private national income, notwithstanding all wage increases, was not maintained. (See Appendix, table I.)

In comparing 1939 and 1947, pay rolls before taxes fell behind from 61.9 to 59.9 percent of total income, the corresponding share of corporate profits increased by more than one-half from 10.0 percent to 15.5 percent of total income.

Corporate profits after taxes of 5.005 billion dollars in 1939 amounted to 7.7 percent of the national income originating in the private sector of the economy (64.3 billions; i. e., national income, 72.532 billion dollars minus compensation of Government employees, 8.2 billion dollars). In 1947 that percentage had increased to 9.4 percent, a figure dangerously close to the excessive ratio of 10.2 percent in 1929. As need hardly be mentioned, 1929 was a year of such abnormality of economic relationships that it was followed by one of the worst depressions in recorded economic history.

Likewise closely resembling 1929 is the abnormally high ratio of profits to wages paid and the low ratio of compensation of employees to national income originating in the private sector of the economy. In 1939 private employers paid out \$7.50 in wages and salaries for every dollar of gross profits. In 1947 they helped themselves to a dollar of net profits after paying out only \$6.39 in wages and salaries and took out a dollar of gross profits after disbursing less than \$4 in wages and salaries. This is getting down to and going below in the latter case, the ratios of \$5.37 and \$4.60 respectively in 1929, which heralded the disaster of 1932.

Similarly the ratio of compensation of employees in the private sector to national income originating in the private sector has been steadily growing worse, and is again approaching the low levels of that most critical of all prosperity years in modern history, 1929. As the table shows it was 61.9 percent in 1939 and had gone down to 59.9 percent in 1947. It only has to go a little further down to get to the 54.9 percent level of 1929 which was so low and provided so inadequate a mass market for the goods then pouring out that more than three disastrous years of liquidation and bankruptcy followed.

Such trends are unhealthy and ought not to remain unchecked. An increase in taxes on profits will dampen both excessive business spending and inflation. A reduction in taxes, especially in the upper income brackets, doubly makes matters worse. Since such high incomes in large part come from dividends and other corporate disbursements, tax reduction in boom times only adds to conjunctural, fortuitous gains, and pours more fuel on the fires of inflation. The lesson of 1946 when the excess-profits tax was abolished should not be forgotten. Did prices go down? They most assuredly did not. As was authoritatively stated in Senate Document No. 21 published by the Committee on Labor and Public Welfare, of which Senator Taft is chairman:

*Undoubtedly the most important influence in sharply increasing the net profits of corporations and in reducing the losses of others was the elimination of the excess profits tax in 1946, along with the reduction in the corporate income tax from 40 percent to 38 percent and the tax credits resulting from the excess profits credit carry-back provisions of the Internal Revenue Code * * *. The sweeping tax reductions on corporate business were largely turned into net profits.¹*

The recent tax reduction law has paved the way for new upward pressures. This bill will add approximately 5 billion dollars in purchasing power (with 40 percent of it going to 5 percent of the taxpayers earning over \$5,000 a year), and take way a similar amount from our tax revenues. The international aid obligations which we have accepted will add more billions to Government expenditures. The rearmament expenditures will further increase the budget by additional billions.

As a result the Government's fiscal position for the balance of calendar 1948 is likely to be one of deficit—thus eliminating our only remaining important anti-inflationary weapon. During the last three quarters of 1948, according to the Board of Governors of the Federal Reserve System, the budget deficit may exceed 3 billion dollars. Sales of savings bonds and other public debt receipts are expected only to equal voluntary redemptions by holders of maturing bonds. The

¹ U. S. Senate Committee on Labor and Public Welfare, Data on Wages and Profits, 80th Cong., 1st sess., U. S. Government Printing Office, Washington, D. C., 1947, pp. 2, 3, and 5. [Italics in original.]

deficit will have to be financed by either drawing upon Treasury funds, or by borrowing in the market. Given these conditions it can be expected that no net retirement of the bank-held Government debt can be effected, there will probably be a further increase in bank reserves, and banks would thus be in a position to expand loans and investment for private purposes which would mean still more inflationary expansion of the money supply.

(a) Ease the burden on those crucified by inflation: But as Senator Flanders has recently pointed out, one must go back of these averages. He tells us:

Masses of figures, for the most part dealing with averages, conceal human problems which are most easily revealed by going direct to the people. To be specific, average wages may be better with relation to some average cost of living now than was the case in 1939, even though conditions have deteriorated somewhat from the peak of real wages in 1946. It became clear, however, that we could not indulge in complacency in spite of this generally favorable situation. Within those average incomes and average costs of living were to be found many millions of people who had been left behind in the war and postwar advances in incomes, and whose conditions were materially worse than they had been at any time, even worse for many of them than they had been during the depths of the depression.

Who were these people who had been left behind in spite of so great and general statistical advances? Among them, of course, were all of those who were trying to live in their older years on the savings of a lifetime. All who had been depending on pensions and retirement annuities were severely cramped. There are millions of wage earners, organized and unorganized, who have been left behind as the incomes of their more fortunate and aggressive fellow workmen had been increased. All of those who were connected with religious and charitable institutions were in serious straits * * *. Almost all employees of Federal, State and local governments have lagged behind * * * there is a human necessity, to recognize the difficulties in which these great groups, numbering in the aggregate many millions, find themselves.

They have been particularly hard hit by the increase in food prices. Food constitutes well over 50 percent of the total budget for these low-income groups and less than 7 percent for the top group. These low-income groups are hit much harder by the extraordinary increase in food prices than those at the top.

A comparison of changes in incomes, 1941-46, by families grouped according to income, with changes in the cost of a "market basket" indicates that the bottom 20 percent of our families have had almost 40 percent of their additional incomes absorbed by the increase in food prices. On the other hand, for the highest fifth of our families, increased food prices have only taken 5 percent of their additional incomes. (See Appendix Table II).

How then, ease the burden on those crucified by inflation? The President has indicated three ways. Those at the very bottom who pay no income taxes will be helped most readily first by an immediate upward adjustment of social security, old-age pension and minimum wage levels. They will also benefit greatly as will consumers generally by removal or reduction of various excise taxes such as those on freight traffic and passenger travel, entertainment, and oleomargarine. All governments—Federal, State, and local—should consider means for encouraging the repeal of excises, sales taxes and tariffs which bear most heavily upon low-income families.

(b) Make corporate profits bear their fair share of the total tax burden: Increasing by an equivalent total the taxes on profits and particularly on excess profits merely keeps the tax load from shifting

from those who benefit most by inflation to those who have been most seriously injured.

An analysis of the sources of Federal income 1939 and 1948 indicates the extent to which the incidence of taxation has been shifted to individuals—especially upon those earning under \$5,000, while the proportionate share of corporate income taxes has declined.

In 1939, individual income taxes provided 25 percent of Federal income and corporate income taxes—23 percent. By 1948, the estimated share of individual income taxes has increased to 50 percent while the corporate income tax share has declined to 21 percent.

With regard to individual income taxes, those earning under \$5,000 in 1939 contributed 9.8 percent of the total Federal income tax bill, and in 1948 (after the tax reduction law) will contribute an estimated 51 percent. On the other hand individuals earning over \$5,000 and who contributed 90 percent of the total tax bill in 1939 have had their share reduced to an estimated 49 percent in 1948.

(3) *Regulation of consumer credit.*—In its interim report of December 15, 1947, this committee endorsed the proposal that Congress restore to the Federal Reserve System the power to regulate consumer credit. Affirmative action has already been too long delayed.

(4) *Regulation of bank credit.*—“Among the strategic points at which to curb the inflation movement,” says the President, “none is potentially more powerful than the restriction of bank credit.” In 1947 all major types of borrowing (except security loans) increased at record or near record rates. In fact total loans of commercial banks expanded by 7 billion dollars or 23 percent over the year.

Due to the fact that the expansion of bank loans was only partly offset by the reduction in banking system holdings of Government securities, the privately held money supply rose 6 billion dollars in 1947 as compared with 13 billion dollars in 1946. Contributing to this expansion was the increase in gold certificates due to some 3 billion dollars worth of gold imports, and the further reduction in Treasury cash.

The ordinary way to reduce business borrowing is to raise the interest rate. However, if the Government debt is to be financed at 2½ percent, Government bonds of that tenor cannot be permitted to go below par. Thus the President recommends “close study” of proposals such as those of Mr. Eccles which purport to resolve this dilemma.

There are several lesser devices tantamount to voluntary rationing of credit. Government-lending agencies should continue with vigor the liquidation of their lending programs and apply more rigorous scrutiny than ever to new borrowing. Even in the case of veterans housing the underwriting or making of so-called “100 percent loans” should be tightened.

A period of inflation is not the time for Government ordinarily to be lending money. On the contrary, Government loans should be paid off as speedily as possible.

In addition, private bankers are commended by the President for their program of rigid scrutiny and voluntary rationing of bank credit. No loans should be made to finance purely speculative operations, nor other use of credit permitted which does not serve to increase the physical amount of goods available immediately or in the near future. Bank credit ought not to be used to finance more than minimum in-

ventories nor should it be used for withholding commodities from the market in anticipation of, or for the purpose of, increasing prices.

B. Policies reducing inflationary expenditures

The second general method of combating inflation is that of channeling incomes into bonds or other noninflationary outlets and reducing aggregate expenditure—by consumers, by business, and by Government.

(1) To reduce inflationary expenditures by consumers the President suggests five measures: Put on special drives to increase savings, and especially stimulate the purchase of Government savings bonds; continue and strengthen rent controls; authorize limited powers of price control; ration consumer purchases of selected commodities; and prevent wage increases where necessary to maintain a price ceiling.

(a) Spend less and save more: In 1947 although personal income increased from 177.2 billion dollars to 196.8 billion dollars or nearly 20 billion dollars, personal savings actually declined by 26.4 percent from 14.8 billion to 10.9 billion dollars. In the scramble for new cars, household appliances, furnishings and other consumer durables, consumer borrowings increased from 10.2 billion to 13.3 billion dollars. Moreover, the redemption of savings bonds in denominations of \$100 and less greatly exceeded sales. The table below gives the details:

Number redeemed as percent of number of bonds sold

Denomination	1945	1946	1947 ¹	Denomination	1945	1946	1947 ¹
10.....	15	77	177	100.....	23	87	136
25.....	53	130	194	500.....	17	51	67
50.....	37	108	163	1,000.....	15	39	40

¹ First 6 months. All figures from publications of the U. S. Treasury Department.

Clearly the low-income groups are spending more than current earnings. As they exhaust their savings and credit they are compelled to reduce their level of living. Their purchasing power is falling and thus the mass consumption market needed to support mass production is being eroded away. When the market disappears, then follow factory shut-downs and unemployment while the spectre of depression begins to rise.

To urge those to save more who now use every scrap of ingenuity and economy to preserve minimum standards of living is a sardonic and heartless counsel. The more so since by far the largest percentage of national disposable consumer income is enjoyed by those with incomes in excess of \$3,000. It is these families in the upper half of the income scale who have been primarily responsible for driving up consumer prices. It is these middle and upper bracket income groups who require education in thrift, who must be induced to put a larger proportion of their income in government savings bonds, in life insurance policies, in savings deposits, in paying off mortgage and other debt, etc. Nothing will encourage this more than stabilizing or gradually lowering prices. A governmental policy of drift discourage thrift. Consumers not only save less but do not see the sense of postponing buying if prices seem sure to rise. A firm and certain program of selective price control, limited to emergency use, will

unleash in millions of buyers that myriad of free, voluntary actions which will increase savings and take the steam out of inflation.

This is the time, likewise, to increase the savings of workers by making larger deductions for social security programs. Thus in good times reserve funds are built up which in periods of depression provide a floor to consumption.

(b) Control rents: In continuing rent control the Congress is keeping down the price precisely of that element in the cost of living which has increased least.

By the end of 1947, rents had increased on the average, 11 percent over 1939 levels, while food had risen 117 percent and housefurnishings and clothing had increased over 90 percent each. (See appendix, table III.)

(c) Control only the prices that get out of line: The willingness of Congress to keep down that cost-of-living element (rent) which has risen least, makes the argument the more forceful for specific measures to curb further increases in the prices of individual items that have risen most. Stand-by controls, sparingly used when absolutely necessary, will merely by being available, exert a restraining influence on short-sighted speculative and profiteering elements in business and labor that are now so enamored of immediate gains as to injure the long-run welfare and profits of everybody including themselves. These, among other considerations, have led the President to reject the revival of OPA or any other blanket form of control, but to suggest that there be granted limited powers of price control to be used for combating prices solely at those points where they bear most disastrously upon the cost of living.

(d) Ration if necessary: To this recommendation, he adds consumer rationing of selected commodities to provide a more equitable distribution of the existing supply.

On all fours with such limited price control and rationing of specific cost-of-living items, is the recommendation that authorization be set up for controlling, on a selective basis, when necessary, the prices of a handful of vital industrial products. In instances of extreme scarcity as evidenced by existing gray or black markets the availability of export controls and of limited powers to implement voluntary allocation and conservation plans would likewise curb inflationary activities.

Even if the traffic officer never makes an arrest, the certainty that, when necessary, he can and will, curbs the small number of reckless operators who endanger the lives and property of motorists all along the highway. In price control, a Gresham's law of human behavior makes the worse operator drive better out of circulation. If a few industries or unions get away scot free with excessive inflationary prices, profits or wages, the others who can do likewise are jeered as suckers for not following suit.

(e) Keep wage rates from endangering price ceilings: The most spectacular price increases both since 1939 and since December of 1945 have taken place, not in the industries affected by highly publicized strikes, but in those such as farm products where the influence of organized labor activity is moderate, if it exists at all. Prices of farm products at wholesale in December of 1947 had risen 201.2 percent above 1939 levels, and food, 153.4 percent. On the other hand, fuels, including coal, were but 70 percent above 1939 levels and metals

such as steel, and metal products such as automobiles, were up, on the average 61.1 percent. (See appendix, table IV.) It is self-evident, furthermore, that even the smaller price increases in the goods handled by corporations, and in manufactured products generally, more than compensated for increases in raw material and labor costs. The margin between prices and costs is profits. Corporate profits in the aggregate after taxes reached the completely unprecedented total of \$17,400,000,000 in 1947. The highest figure reached during World War II was \$10,363,000,000 in 1943 compared with \$6,447,000,000 in 1940 and \$8,420,000,000 in 1929.

Moreover, profits on the average in 1947 rose by nearly 50 percent above 1946, and more than that in industries commonly regarded as afflicted by strikes as, for example, automobiles, electrical equipment, mining and metals, pulp and paper, and steel.

In these industries 17 auto and auto parts companies reported an increase in 1947 profits as compared with 1946 of 224 percent; 16 electrical equipment companies reported 1947 profits 154 percent higher than in 1946; 17 mining and metals companies reported an increase in profits of 124 percent and so on down the line. Detailed reports for 332 reporting companies are shown in appendix, table V.

If, however, price ceilings were to be reimposed on items that got out of hand, upward adjustments in wage costs would have to be moderated. That is why the President repeats his recommendation that authority to prevent wage increases be granted where such action is found indispensable to the maintenance of a particular price ceiling.

(2) *Reduce inflationary expenditures by business.*—Fully as important as consumer expenditures in raising prices have been the unprecedented expenditures by business. However necessary to replace plant and equipment used up during the war and however indispensable to achieve those increases in capacity required for full-employment levels of output, the impact of spurts in business buying is inflationary.

Business expenditures for durable equipment were nearly 45 percent higher in 1947 than in 1946. They absorbed almost 8 percent of the total output, a figure far in excess of previous periods of prosperity for which information is available. Most of these expenditures were financed by equity capital, reinvested corporate earnings providing \$10,300,000,000 in 1947 as compared with \$6,900,000,000 in 1946. Undistributed corporate profits reached the unprecedented figure of \$10,600,000,000 in 1947 as compared with \$2,600,000,000 in 1929. Thus in 1947 five-eighths of the profits were plowed back into business. The amount paid for by sale of liquid assets was small.

As of the close of 1947 the book value of goods held in inventory by manufacturers, wholesalers, and retailers had increased by 20 percent over the December 1946 level. While the ratio of inventories to present sales is not high (it never is in years of active sales), their ratio to future sales may swiftly become burdensome. Inventories accumulate on the way down. The larger the volume the greater the losses in liquidation.

Most spectacular has been the increase in net foreign investment in 1947. Unless the amount of foreign aid is increased even beyond that embodied in the European Recovery Program, the amount of net foreign investment will fall to levels of five or six billion dollars in 1948 and thereafter. (See Appendix, table VI.)

In short, all types of business expenditures whether measured in absolute quantities or relative to gross national product were at very high levels. The sole exception is new construction and especially residential construction. Notwithstanding the fact that it increased in 1947 to absolute levels higher than 1946 it accounted for a substantially smaller proportion of national product than would be expected on the basis of past periods of comparable prosperity and housing shortages. In 1947 the current dollar value of new construction was 5.3 percent of total gross national product compared with more than 10 percent estimated for the 1926-29 period. The physical volume of housing built in 1947 was still roughly a third lower than in 1926-29 or 1942. There is still substantial need and justification for sound programs of Government aid to financing in this field.

Except for housing, the need for bankers and others to screen carefully business expenditures for capital goods is becoming more acute. Now is not the time for further diversion of labor and goods into plant or equipment that will take a prolonged period of time before it puts additional consumers' goods on the market. Such capital goods expenditures doubly increase prices—by adding to pay rolls and by diminishing the supply of consumer goods that could otherwise have been produced.

(3) *Reduce inflationary expenditures by Government.*—(a) Among the inflationary expenditures most difficult to defer are those on public works particularly at State and local levels. Local needs are visible and tangible. Bonds are easy to vote and float in boom times. Thus, new construction by public agencies rose 37 percent from \$2,151,000,000 in 1946 to \$2,954,000,000 in 1947, a dollar figure well above any peacetime level except that in 1930. Government, and especially State and local governments have thus competed with private industry for vital building materials such as steel in which gray markets exist, and helped to drive up the price of lumber and other items to fantastically high figures.

Bernard Baruch has suggested that a capital-issues committee be set up with advisory powers, under the Secretary of the Treasury, to review all capital issues, public and private, with a view to deferring less essential projects. He recommends priorities to projects immediately increasing production, housing, schools, and hospitals. Other civic and public improvements should be deferred but plans worked out so that contracts can be let as soon as mass unemployment begins to appear. Projects designed to save productive facilities and prevent loss of life may be recognized as nondeferable.

C. Stimulate the production of goods in short supply

The economy operated in 1947 at practically full capacity. There isn't much room for stretching output. The amount of frictional unemployment, that is, the number changing over from one industry or position to another due to seasonal variations or technological changes, is actually less than the number usually necessary to provide efficient elasticity and "give" to business operations. If the length of the workweek were increased beyond 40 hours, more output might be obtained in such industries as could acquire ample supplies of requisite raw materials or semifinished products. It would not increase output in continuous-process industries, agriculture, service enterprises, or those operating on a three-shift basis. Moreover, if the extra hours were paid for at overtime rates, the question would arise

whether the amount of inflationary buying power would be increased more than the amount of output.

The effective remedy is, consequently, one which with existing facilities, existing labor, and present pay rolls gets more physical output per man-hour or per dollar of cost. All the measured recommended by the President follow this principle.

(1) To complete large capital-investment programs that are near completion, whether of business or Government, provided they then produce goods in short supply, will aid in two ways. The laborers will be producing consumers' goods instead of plant equipment and inventories. Their wages instead of merely being added to the stream of buying power will be offset by the addition to consumers' goods they produced.

(2) Increasing the productivity per acre of land by more skillful use of fertilizers and other scientific know-how, by decreasing wastage of food and fiber on the farm and elsewhere in harvesting, storage and transit, by increasing yields, by minimizing the damage done by pests and rodents, by improving food processing, by eliminating spoilage—such practices, while always desirable, are imperative in periods of inflationary food prices.

(3) Housing is one of the items most in short supply. While rent controls may prevent widespread evictions and abrupt increases in rent, it does not add a single accommodation to the existing supply. That can only be done by breaking housing bottlenecks.

Vast improvements in the efficiency of the building industry are required, including the development of larger integrated home-building concerns and cooperatives, application of mass-production techniques, more efficient use of new materials, removal of monopolistic labor and business practices, modernization of building codes, local and regional planning and urban redevelopment, yield-insurance plans to attract direct institutional investment in large-scale rental projects, and public housing for the low-income brackets whom private enterprise is unable to serve. Imperative *sin qua non* for the realization of these goals is the enactment of the Taft-Ellender-Wagner housing bill.

(4) Labor productivity has not yet risen in 1946 and 1947 as it did after World War I. The veterans of World War II served several years instead of a few months, so that retraining and rehabilitation to industrial pursuits have been less rapid. World War II also caused larger shifts in population and more innovations in machine methods and production techniques. The possibilities of increasing per worker productivity through increased collective efficiency, better esprit de corps and greater mastery of tools and techniques are large.

(a) Consequently, the Federal Government should set up, not cut, its training programs. It should increase the facilities for management-labor cooperation not only in this program but throughout the whole of industry.

(b) In view of the fact that the reservoir of workers ordinarily facilitating seasonal variations and technological shifts in industry is small, less than half of the 3,000,000 figure normally considered a minimum, speedy placement in jobs of maximum marginal productivity will effect the largest possible alleviation of shortages. A national employment service is required to take care of Nation-wide needs.

2. REENFORCE THE AMERICAN ECONOMY

A free economy in the American tradition is one in which the individual is not regimented by either private or public power. The principal obstacle to the maintenance of such an economy arises from the failure to understand that when the government does not adopt a positive program but is content merely to drift, the inevitable result is, first, regimentation of the people by the concentration of economic power in private hands; and, second, the seizure by dictatorial government of the powers of regimentation thus built up in private hands.

The first step in the preservation of the traditional free, competitive American economy is to prevent depression, and the second step is to prevent the concentration of economic power in private hands. Neither of these objectives can be attained except by positive government action.

If the government is not granted the powers to solve these problems in the American tradition of opportunity and equality for all, then the unsolved problems will inevitably catch up with us and a crisis will ensue. In the throes of such a crisis we shall be obliged to go far beyond the comparatively minor steps required to do the job when the danger first shows itself.

In this respect the experience of the thirties provides a significant lesson. The failure of government to deal promptly and forthrightly to mitigate or resolve the crisis that evolved in 1929 or 1930 necessitated much more governmental intervention 3 years later.

The greatest danger that the country now confronts is that any Government action is mistaken to be, or misrepresented to be, a plan to establish arbitrary Government power. That is not the case. Communism in the area behind the iron curtain, socialism in Britain or in France, and fascism in Spain, Argentina, or elsewhere, are all the result of the failure of government to take in time the necessary steps to preserve a free, private-enterprise system against the destructive advance of private monopoly.

Unfortunately, many of those who desire to preserve what they conceive to be the vested interests of economic concentration already achieved, seek to prevent economic reform through the only agency by which it can be accomplished—namely, the Government of the United States—by misrepresenting it to be an attempt to set up totalitarianism. This attack has been made repeatedly upon the President's program set forth in his reports, with the result that nothing effective has been done (a) to control inflation, or (b) to prevent monopoly. Thus the stage is being set for the American economy to drift inevitably into the very condition which has resulted elsewhere in totalitarianism. The fight against totalitarianism must be made here in the United States by making the American democracy work.

Only in the measure in which our American democracy demonstrates that it can work to maintain a high and steady level of employment, to provide an increased standard of general welfare, will it be possible to preserve individual freedom; only in that measure will the tide of totalitarianism, communism, socialism, and fascism, subside. Only in that measure too will liberty, freedom of speech and press, free collective bargaining, and free competitive enterprise prosper and expand.

A. *Fundamental to such economic strength is the wise, efficient use and conservation of our natural and human resources*

1. Farmers are prosperous when workers' pay envelopes are full. Economic instability in the city makes the farmer alternately prince and pauper.

Until such time as the techniques of maintaining high and steady levels of employment have been demonstrated by successful experience, the insecurity of the family-owned farm must be reduced by a flexible program of placing a floor under farm income. As elements in such a flexible program many devices may be found useful as, for example, direct income and price payments, crop insurance, food stamp or allotment plans for orderly marketing of bumper crops, protection of diets of children and low-income families by the extension of such programs as the low-cost school luncheons, soil conservation, guided redistribution of farm population, rural electrification and Federal aid for improved rural medical, hospital, educational, and research facilities.

2. *Natural resources.*—Bold programs of long-range development of all natural resources are indispensable if firm foundations are to be constructed for enduring prosperity. Such programs should be discussed, planned, blue-printed, and organized during periods of prosperity. They should be taken off the shelf, contracted for, worked on and completed during periods of less than full employment.

The most useful in the near future, as the President states in the Economic Report, are those providing integrated development of areas in the West, Middle West, and Alaska, involving preservation and replenishment of vital water supplies, flood control, navigation, reforestation, irrigation, reclamation, drainage, soil as well as fish and wildlife conservation, generation by hydroelectric power and atomic energy.

The contribution of such programs to winning the war has just been emphatically demonstrated. It was TVA power at Oakridge and Bonneville power at Hanford that helped produce the atomic bomb. It was TVA, by and large, and other public-power facilities that provided enough energy for war production of aluminum, nitrates, and a number of other critical and strategic materials, not to mention vital contributions in transportation, in agriculture, and other areas. It is irresponsible folly to hamstring such vital programs in the face of present world difficulties.

Many of these programs, particularly those designed to curb soil erosion, are of such urgency that we can ill afford to delay in carrying out expanded conservation practices.

3. *Human resources.*—Most vital of all national capital is the "human stuff" which alone gives economic and political systems and activity their meaning. As Adam Smith pointed out in 1776 in his classic *Wealth of Nations*, labor constitutes not only the fundamental wealth, but the military strength of nations. Its skills, vitality, vocational aptitudes, civic spirit, political intelligence, and courage represent the one most important and indispensable element necessary for survival and prosperity.

Adequate medical care and hospitalization should be the birthright of every American family regardless of race or economic status. The inauguration of a national health program brooks no delay. The penalty for inadequate child care, malnutrition in low-income classes,

and lack of medical facilities is low productivity in peacetime and a high percentage unfit for military service in time of war.

In addition, all citizens should have equal opportunity to obtain that degree of training which their industry or capacity makes possible. In an atomic age even a wealthy country like the United States can no longer afford the luxury of class or race prejudices that deny or constrict both educational and employment opportunity and deprive the Nation of much needed economic and military strength. To permit needy teen-agers to succumb to the lure of present wages and deny society the enhanced productivity of their special abilities is a transaction of myopic improvidence. Such spendthrift wastage of our human capital ought no longer to be tolerated.

Last and most important—the flower of American manhood and womanhood cannot grow to full and effective productivity in an environment of overcrowded slums. Slums breed juvenile delinquency, crime, disease, social evils. Study after study has shown in city after city that such slums always fail to pay their way. The taxes collected fall far short of paying for the disproportionate expenditures the city has to make for are protection, relief, jails, police surveillance, and crime losses. Why continue to subsidize the slum? Since private enterprise always has been, and seems likely to be, unable to provide other housing than such disease- and crime-breeding slums, why continue to pour public treasure down such rat holes when it would make available good housing with adequate play space in redeveloped areas? With respect to housing this Congress has flagrantly and cynically defaulted in a sacred responsibility.

B. The second important economic foundation of a strong America is efficient, free, private, competitive enterprise

1. Monopolistic restrictions and the concentration of unbridled economic power in private hands are not only major enemies of economic productivity, but have destroyed, and will continue to destroy, human freedom and democracy.

Central economic power as exercised by those who control the modern instruments of commerce has been the cause of the development of arbitrary central political power in the modern world. Mussolini, Hitler, and Stalin, all three, have been the direct product of the concentration of economic power. The modern monopolies become the collectivist pattern for a collectivist state. The fight for freedom begins with the fight against monopoly.

Recently less than a half-dozen big steel companies decreed for the second time in less than 6 months an increase in the price of steel. Their profits after taxes were greater than at any time during or before the war with the single exception of 1916, 1917, and 1929.

Their action may later turn out to be a major move against their nonintegrated competitors within the industry, for the price increases of February 1948 were only on semifinished steel products, increases which were explicitly excluded from the price decreases announced in April. They put the independent fabricators of finished steel at a disadvantage with themselves by raising the price on their rivals' raw materials. It is now far easier for the large producers to take all the markets for finished steel.

At a time when a reduction in grain prices gave hope to the inflation-burdened low-income families that the cost of living would decline,

big steel decided to collect extra tribute from customers and citizens of every economic and political hue.

In this action as in previous ones they draw no party line. Without being responsible to the millions whose lives and welfare they affect, they regulate commerce in steel and by arbitrary private decision fix costs for all industry. They make rules for all to obey and that in a democracy holding sacred the principle that rule-makers can only "derive their just powers from the consent of the governed." A handful of big companies, behind closed doors, set the pattern for 145,000,000 people.

Yet beyond making polite inquiry the Government sits idly by. Reactionary leadership by refusing to exercise age-old constitutional powers to abate the spiraling of prices and by surrendering under post-OPA pressure to concentrated economic power the control of industry and commerce is false to the hallowed traditions of Americanism.

How are the people of the United States to be freed from the dangers of economic concentration? This concentration of power is not fore-ordained nor inevitable. The Government, acting for the people, can do much to prevent the destruction of their economic and political freedom which is jeopardized by these economic giants. Antitrust enforcement should be strengthened. Antitrust cases suspended during the war should be prosecuted with renewed vigor.

Appropriations for both the antitrust division of the Department of Justice and for the Federal Trade Commission should be increased.

Furthermore, section 7 of the Clayton Act should be amended to prohibit mergers by the acquisition of assets as well as by the acquisition of stock control. The recent war brought about a tremendous upsurge in the number of mergers and acquisitions, particularly of small companies by large corporations. As concluded by the Federal Trade Commission last year (March 10, 1947), "the figures indicate, conclusively, that the major impetus behind the current merger movement has been the desire of giant corporations to consolidate their wartime gains and to expand the scope of their domination through acquisition of smaller, independent enterprises."

For corporations whose sales and other operations are Nation-wide, national incorporation and registration by means of national charters should be required. These charters would clearly define their powers, duties, and responsibilities, and would be of immediate benefit to such corporations themselves, by then freeing them from discretionary regimentation by the Government.

In addition, a maximum of incentive needs to be given to new entrants into business and to small independent business. The more ready accessibility of both short-term and long-term credit has long been desired by small businessmen to put them on a somewhat more comparable competitive position with large business on this score. Tax inequities should also be removed, by granting, for example, higher exemptions on corporate incomes during the first few years of a business than later. The Government must also give much more aid in the way of market counseling, product research, and other advice which now are excessively costly to new and small businesses.

These are but a few of the many practical measures for the preservation, of free, private, independent enterprise which have been carefully studied and recommended by a variety of committees of the

Congress on which no significant action has been taken. The Temporary National Economic Committee, the Senate Committee on Small Business in the Seventy-eighth and Seventy-ninth Congresses under the able chairmanship of Senator Murray, of Montana, the House Committee on Small Business in the Seventy-ninth Congress, and a variety of other groups inside and outside Government have emphatically warned this Nation about the danger of monopoly—yet the Congress continues by a policy of inaction and drift to let concentration of economic power go unchecked.

2. *Develop a favorable climate for private investment.*—The problem of keeping business investment from fluctuating wildly has thus far not been solved. In 1947 gross private domestic investment reached the astounding total of \$30.5 billion as compared with \$15.8 billion in 1929. Only time will tell whether or not such a rate can or will be maintained.

In the past there have been a number of times when over-investment in inventories and in plant occurred as, for example, after the Civil War in railroads which later became streaks of rust in the wilderness. In the twenties there were over-optimistic real-estate development programs, and excessive construction of manufacturing capacity in a variety of industries from cement to shoes. Without fail such periods at the time have not been recognized, but were followed by drastic liquidation of inventories and dwindling of new investment in plant and equipment to a trickle. In less than 3 years gross private domestic investment went down from \$15.8 billion in 1929 to only \$886 million in 1932. It is the most unpredictable and unstable of all employment-sustaining and income-creating expenditures, so much so that many experts explain business cycles primarily in terms of fluctuations in business investment induced by changes in business anticipations, variations in the marginal efficiency of capital and in real or money rates of interest.

The period 1947-48 is without a doubt one of high prosperity. Moreover, all the evidence indicates that the relationship which not exists between wages and consuming power on the one hand, and prices and profits on the other, is definitely inimical to any indefinite continuance of such prosperity.

But the readjustment to come does not have to be a major collapse. Deep depression is not a foreordained necessity. Comfortable accommodation can be readily achieved by prudence and foresight.

To provide a cushion against a major decline, measures should be taken at once to restore balance. These, let it be repeated here, are of three kinds. Prices should not be permitted to get more top-heavy. Excessive profits, leading to the inflationary levels of business inventory buying and spending should be reduced by immediate reenactment of an appropriate excess-profits tax. Provision should also be made for adequate expansion of our basic raw materials industries which otherwise are likely to continue to be a drag upon the economy.

3. Most important to the reinvigoration of free private enterprise is the vigorous support of the United Nations and such economic agencies as the International Monetary Fund, the World Bank, the Food and Agriculture Organization, and the International Trade Organization.

No one can draw a line between foreign and domestic policy. Satisfactory solutions at home must fit those abroad. Unemployment is a world problem. Booms and busts in recent decades are worldwide. Prosperity like peace is indivisible. Not only is the maintenance of full employment in the United States essential to world prosperity and peace, but a steady and balanced world trade is essential to a steady and high level of exports, employment, and national income in the United States. Rising living standards abroad will create new opportunities for producers here.

Programs of economic aid to Europe and other areas thus form our first line of defense for they will increase employment, production and purchasing power that will be reflected here at home. Removal of cartel practices abroad is a corollary to destruction of monopolies at home the elimination of artificial and arbitrary restraints will open new doors to progress.

This is no time of pusillanimous penny-counting, astigmatic nationalism and selfish profiteering. This is no time for a policy of do-nothing and drift. It is a time for faith in our democratic way of life, for courageous pioneering, blazing new trails into new areas of international cooperation. There is a new world to be built, one of full employment and world prosperity. It will be lost by default to totalitarianism unless here and now this Congress backs its protestations of faith in American free enterprise by a vigorous program of action implementing the famous economic bill of rights laid down by Franklin Delano Roosevelt in 1944, carried forward in the Employment Act of 1946 and further developed in the Economic Reports of President Truman in 1947 and again in 1948.

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APPENDIX TO PART IV

TABLE I.—*Incomes 1939, 1946, 1947*¹

Item	Billions of dollars			Percent change, 1946-1947	Percent of total	
	1939	1946	1947		1939	1947
Corporate profits before taxes.....	6.5	21.1	28.7	+36.0	10.1	15.5
Inventory valuation adjustment.....	-0.7	-4.7	-5.7	-----	-1.1	-3.1
Corporation profits and inventory valuation adjustment.....	5.8	16.5	23.0	-----	9.0	12.4
Corporation profits after taxes.....	5.0	12.5	17.5	+39.2	7.8	9.4
Unincorporated business and professional income.....	6.8	19.7	23.5	+19.3	10.6	12.7
Compensation of employees in private industry.....	39.6	95.6	111.2	+16.3	61.6	69.9
Net interest ²	4.2	3.2	3.6	+12.5	6.5	1.9
Farm income.....	4.5	15.2	17.0	+11.8	7.0	9.2
Rental income of persons.....	3.5	6.9	7.3	+5.8	5.4	3.9
National income originating in private sector.....	64.3	157.0	185.7	+18.3	100.0	100.0

¹ Source: Survey of Current Business, July 1947, table 40, p. 48; Feb. 1948, table 1, p. 5, and table 3, p. 7.

² Net interest is exclusive of interest on Government debt.

TABLE II

Families grouped according to income	Average money income before taxes		Increases	Increase in cost of a market basket as a percent of extra dollars of income
	1941	1946		
Lowest fifth.....	\$366	\$335	\$469	39
Second fifth.....	936	2,023	1,087	17
Third fifth.....	1,646	3,050	1,494	12
Fourth fifth.....	2,367	4,201	1,834	10
Highest fifth.....	5,445	8,921	3,476	5
Cost of market basket of foods in dollars ¹	347	528	181	-----

¹ Market basket consists of the retail cost of 1935-39 average annual purchases of farm food products by a family of 3 average consumers.

Sources: Economic Report of the President, January 1948, pp. 18, 104-106; Marketing and Transportation Situation, October-December 1947, p. 20.

TABLE III.—*Rise in cost of living items, 1939-47 (1935-39=100)*

	1939 Average	December 1945	December 1946	December 1947
Food.....	95.2	141.4	185.9	206.9
Housefurnishings.....	101.3	148.3	177.1	191.4
Clothing.....	100.5	149.4	176.5	191.2
All items.....	99.4	129.0	153.3	167.0
Miscellaneous.....	100.7	124.8	136.1	144.4
Fuel, electricity and ice.....	99.0	110.3	115.5	127.8
Rent.....	104.3	108.3	108.8	115.4

TABLE IV.—Changes in wholesale price indexes, 1939-57

	1939 average to December 1947	December 1945-December 1947	December 1946-December 1947
All commodities.....	111.5	31.6	15.8
Farm products.....	201.2	27.8	17.0
Food.....	163.4	47.4	11.4
All commodities other than farm and food.....	78.7	24.1	16.5
Hides and leather products.....	112.4	48.6	14.9
Textile products.....	111.8	32.8	9.6
Fuel and lighting materials.....	70.0	13.3	28.3
Metals and metal products.....	61.1	27.6	12.9
Building materials.....	111.0	32.1	21.0
Chemicals and allied products.....	77.6	30.8	7.4
Housefurnishing goods.....	56.2	14.8	12.1
Miscellaneous.....	62.4	14.9	11.6

Source: U. S. Department of Commerce, Survey of Current Business, February 1948, p. 12.

TABLE V.—Net income of leading corporations for the years 1946 and 1947

[NOTE.—Net income is shown as reported—after depreciation, interest, taxes and other charges and reserves, but before dividends. Net worth includes book value of outstanding preferred and common stock and surplus account at beginning of each year]

[In thousands of dollars]

Number of companies	Industrial groups	Net income after taxes		Percent change	Net worth, Jan. 1 ^a		Percent return	
		1946	1947		1946	1947	1946	1947
21	Baking.....	\$56,975	\$57,523	+1.0	\$274,948	\$284,576	20.7	20.2
14	Dairy products.....	64,736	60,364	-6.8	344,280	392,467	18.8	15.4
20	Meat packing.....	69,368	83,928	+21.0	662,051	697,450	10.5	12.0
24	Sugar.....	37,753	79,952	-----	395,662	429,035	9.5	18.6
66	Other food products.....	187,566	245,477	+30.9	1,052,214	1,173,576	17.8	20.9
15	Soft drinks.....	39,405	49,066	+24.5	196,894	217,338	20.0	22.6
10	Brewing.....	20,861	20,683	-27.9	89,956	104,148	23.2	25.6
32	Distilling.....	161,635	159,065	-14.0	388,424	522,484	41.6	26.6
22	Tobacco products.....	98,458	115,035	+16.8	863,858	897,217	11.4	12.8
42	Cotton goods.....	101,717	162,190	+59.5	351,607	448,804	26.7	36.1
18	Silk and rayon.....	59,579	90,326	+51.6	251,995	346,320	21.1	26.1
16	Woolen goods.....	34,131	31,282	-8.3	137,763	147,242	24.3	21.2
3	Hosiery, knitted goods.....	22,626	22,556	-3	77,084	96,213	29.4	23.4
43	Other textile products.....	92,263	137,092	+48.6	462,004	527,766	20.0	26.0
30	Clothing and apparel.....	34,739	34,768	+1	146,074	173,295	23.8	20.1
10	Leather tanning.....	5,519	11,290	-----	50,205	63,282	11.0	21.2
23	Shoes, leather products.....	27,071	37,534	+38.7	211,452	232,017	12.8	16.2
26	Tires, rubber products.....	135,727	122,154	-10.0	662,784	760,470	20.5	16.1
21	Lumber.....	23,066	42,458	+84.1	109,128	132,925	21.1	31.9
15	Furniture, wood products.....	10,412	18,958	+82.1	106,745	115,114	9.8	16.5
74	Pulp and paper products.....	144,282	267,176	+85.2	1,010,471	1,179,824	14.3	22.6
28	Printing and publishing.....	35,606	42,548	+19.5	187,160	199,767	19.0	21.3
60	Chemical products.....	320,672	398,813	+24.4	2,160,524	2,321,855	14.8	17.2
29	Drugs, soap, etc.....	126,139	126,460	+0.3	520,744	614,783	24.2	20.5
17	Paint and varnish.....	36,842	54,856	+48.9	269,714	288,241	13.7	19.0
40	Petroleum products.....	769,556	1,215,947	+58.0	7,174,266	7,712,538	10.7	15.8
25	Cement.....	19,539	24,193	+23.8	191,827	198,469	10.2	12.2
12	Glass products.....	53,719	68,046	+26.7	362,208	390,331	14.8	17.4
41	Other stone, clay products.....	63,622	92,790	+45.8	465,222	524,652	13.7	17.7
50	Iron and steel.....	271,008	425,552	+57.0	3,659,481	3,780,331	7.4	11.3
13	Agricultural implements.....	45,695	96,249	-----	797,152	866,294	5.7	11.1
67	Building, heating, plumbing equipment.....	58,398	108,109	+85.1	508,038	570,388	11.5	19.0
74	Electrical equipment and radio.....	113,861	272,222	-----	1,270,385	1,412,386	9.0	19.3
50	Hardware and tools.....	36,101	55,025	+52.4	272,967	291,326	13.2	18.9
39	Household equipment.....	45,354	83,650	+84.4	210,177	243,617	21.6	34.3
151	Machinery.....	63,655	150,331	+81.0	980,721	1,075,775	10.2	16.8
21	Office equipment.....	56,426	91,783	+62.6	328,525	338,083	19.2	27.1
30	Nonferrous metals.....	\$133,158	\$283,341	+73.8	1,963,856	2,018,206	6.8	14.0
83	Other metal products.....	77,783	135,155	-----	822,007	877,075	9.5	15.4
28	Autos and trucks.....	121,307	450,942	-----	1,983,117	2,172,379	6.1	20.8
63	Automobile parts.....	40,691	125,722	-----	442,305	534,474	9.2	23.5
25	Railway equipment.....	47,260	61,821	+30.8	561,659	588,944	8.4	10.5

See footnotes at end of table, p. 68.

TABLE V.—*Net income of leading corporations for the years 1946 and 1947—Con.*

Number of companies	Industrial groups	Net income after taxes		Percent change ¹	Net worth, Jan. 1 ²		Percent return	
		1946	1947		1946	1947	1946	1947
24	Aircraft and parts.....	\$19,566	⁴ \$16,625	-----	\$406,539	\$452,134	4.8	-----
5	Shipbuilding.....	10,220	9,876	-3.4	66,894	74,103	15.3	13.8
45	Miscellaneous manufacturing.....	81,778	95,352	+16.6	529,324	584,602	15.4	16.3
1,571	Total manufacturing.....	4,111,875	6,316,975	+53.6	34,005,411	37,062,316	12.1	17.0
24	Coal mining.....	37,316	³ 62,424	+67.3	494,109	506,929	7.6	12.3
26	Metal mining.....	² 25,029	³ 46,227	+84.7	389,894	402,345	6.4	11.5
41	Oil and gas.....	³ 35,316	³ 69,983	+98.2	292,947	351,980	12.1	19.9
12	Other mining, quarrying.....	³ 23,870	³ 30,344	+27.1	118,165	123,759	20.2	24.5
103	Total mining, quarrying.....	³ 121,531	³ 208,978	+72.0	1,295,115	1,385,013	9.4	15.1
16	Chain stores—food.....	46,643	47,501	+1.8	239,386	269,422	19.5	17.6
58	Chain stores—other.....	213,030	201,030	-5.6	927,012	1,069,901	23.0	18.8
44	Department stores.....	133,325	116,649	-12.5	669,551	785,766	19.9	14.7
5	Mail order.....	148,494	165,169	+11.2	621,297	752,985	23.9	21.1
54	Misc. and wholesale.....	82,964	85,483	+3.0	392,925	450,351	21.1	19.0
177	Total trade.....	624,456	615,832	-1.4	2,850,171	3,368,425	21.9	18.3
183	Class 1 railroads.....	287,139	460,200	+60.3	12,665,923	12,715,977	2.3	3.6
26	Traction and bus.....	13,253	3,000	-77.4	281,602	287,902	4.7	1.0
13	Shipping.....	28,211	32,213	+14.2	234,584	250,517	12.0	12.9
12	Air transport.....	⁴ 2,694	⁴ 11,835	-----	70,377	70,123	-----	-----
47	Misc. transportation.....	15,849	20,251	+27.8	207,217	214,204	7.6	9.5
231	Total transportation.....	341,758	503,829	+47.4	13,459,703	13,538,723	2.5	3.7
186	Electric power, gas, etc. ⁵	565,150	586,466	+3.8	6,418,734	6,504,968	8.8	9.0
54	Telephone and telegraph ⁵	217,310	185,590	-14.6	3,132,321	3,205,333	6.9	5.8
240	Total public utilities.....	782,460	772,056	-1.3	9,551,055	9,710,301	8.2	8.0
17	Amusements.....	134,166	109,494	-18.4	600,209	686,880	22.4	15.9
43	Restaurant and hotel.....	22,604	24,600	+8.8	144,901	158,254	15.6	15.5
29	Other business services.....	18,062	21,715	+20.2	128,988	137,650	14.0	15.8
17	Construction.....	9,432	12,623	+33.8	77,711	85,960	12.1	14.7
106	Total amusements, services, etc.....	184,264	168,432	-8.6	951,809	1,068,744	19.4	15
274	Commercial banks ⁶	385,974	378,132	-2.0	4,536,040	4,816,632	8.6	7.9
83	Fire and casualty insurance ⁶	20,701	44,626	-----	1,608,120	1,452,401	1.3	3.1
154	Investment companies ⁶	135,638	147,741	+8.9	2,397,883	2,447,223	5.7	6.0
58	Sales finance companies.....	29,140	56,232	+93.0	508,793	534,124	5.7	10.5
105	Real estate companies.....	11,903	15,205	+27.7	135,188	143,273	8.8	10.6
674	Total finance.....	583,356	641,936	+10.0	9,186,024	9,393,653	6.4	6.8
3,102	Grand total.....	6,749,700	9,228,088	+36.7	71,299,288	75,527,175	9.5	12.2

¹ Increases or decreases of over 100 percent not computed.² Net worth is based upon balance sheet book values of assets, which may differ widely from actual present-day values.³ Before depletion charges in some cases.⁴ Deficit.⁵ Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net worth only.⁶ Figures represent in most cases operating earnings only, and do not include profits or losses on investments.

Source: National City Bank Letter, April 1948, p. 45.

TABLE VI—*Spending by business, 1946-47*

[Billions of dollars]

Item	1946	1947	Percent change	Item	1946	1947	Percent change
New construction:.....	\$8.5	\$10.7	+25.9	Producers' durable equipment.....	\$12.4	\$17.9	+44.4
Residential non-farm.....	3.3	4.9	+48.5	Net foreign investment.....	4.8	8.7	+81.0
Other.....	5.2	5.7	+9.6	Inventories as of December.....	34.9	41.3	+18.3

Source: Department of Commerce.

