about by an excessively large increase in the money supply—7.2 percent in 1967, compared to the normal 4-percent growth figure. The second explanation, termed "cost-push," attributes rising prices to "administered" costs and prices set by powerful groups in the economy—the Government (through minimum wage laws, farm price supports, and the like), labor unions (negotiated wage increases greater than productivity gains), and some business firms ("administered pricing").

The stepped-up rate of price increase in late 1965 undoubtedly resulted from acceleration of Government spending for Vietnam in a fully employed economy without the slack to accommodate a comparable step-up in production. The result was that the Government bid away manpower and capital from the private sector and, in the process, boosted prices. This was the pull of demand at work. So rapid was the escalation of demand in the capital market—much of it speculative and anticipatory—that a "credit crunch" developed in mid-1966, especially in that part of the market devoted to mortgage financing.

This demand-pull inflation set the stage for a wage-price spiral that developed in 1966 as representatives of organized labor sought and obtained wage increases that built in the earlier price rise. These higher than productivity wage gains caused employer companies to raise product prices in an attempt to preserve the profit margins necessary to generate internal funds for investment in plants, machinery, and equipment. This investment is necessary not only to replace wornout and obsolete capacity, but also to expand that capacity. Profits are also necessary to provide investors with a return on their investment.

Once inflation gets underway it tends to be self-perpetuating. This is especially true of "cost-push" inflation typified by the current wage-price spiral, as is emphasized by the Council of Economic Advisers in chapter 3 of its report. Just so long as the greater than productivity annual increase in wage rates is "validated" by further injections of Federal deficit spending, the upward spiral of costs and prices will continue.

THE DANGERS OF INFLATION

But isn't a little inflation good for the economy—or at least not harmful? Why is a wage-price spiral so bad?

The answer to the first question is a flat "No." Inflation hurts the economy. It retards the real growth of output partly through a reduction in efficiency; it redistributes incomes away from the great majority who work for relatively fixed incomes in favor of the few who engage in speculative activities; it harms our international competitiveness; and if not checked it can bring on a recession if costs rise faster than prices. In fact, the whole international monetary system suffers because of inflation in this country, due to the dollar's role as the key international currency.

The cost-push pressures of the wage-price spiral accelerate and magnify inflationary pressures generated elsewhere. When we had high unemployment and a gradually rising level of total spending in the economy between 1961 and 1964 average union contract settlements were no higher than the productivity gain of 3 to 3½ percent. But