

security taxes were increased in January 1969 by \$3 billion with no corresponding increase in benefits; (b) final payments required by April 15 to cover retroactivity of the surtax will take \$1.5 billion more from taxpayers; and (c) increases in expenditures will be less than the \$13 billion increase in tax revenues which is the trend figure at high employment growth rates. In consequence, by the spring of 1969 the Federal budget is expected to show a surplus, so that Federal Government operations will be taking purchasing power out of the economy rather than putting it in. Arthur Okun, Chairman of the Council of Economic Advisers under President Johnson, has said of this change: "Involved is a \$20 billion swing in the budget [since the spring of 1968]—the biggest swing toward restraint we will have had in any year in the past 20." And he adds, "Nobody can be sure that the economy can take it."

We believe Mr. Okun has good reason to be apprehensive. The last time a comparable fiscal swing occurred was in the 15-month period between the fourth quarter of 1958 and the first quarter of 1960. During that period the budget situation changed from a \$10 billion deficit to a more than \$7 billion surplus on a national income and products account basis. This sharp swing to restraint was followed only a few months later by the recession of 1960-61, in which the unemployment rate rose to more than 7 percent. While attempting to balance the budget, the administration unbalanced the economy.

STATE AND LOCAL GOVERNMENT SPENDING

Looking at other sectors of the economy, demand for the services of State and local governments is perpetually on the increase, with the result that State and local government expenditures have been rising steadily at a rate of more than 10 percent per year in recent years. This pressure will continue as respects current expenditures, but, on the other hand, State and local capital expenditures are sensitive to the level of interest rates. If these remain at the current exorbitant level, or rise even higher, it is quite likely that some public fixed investment projects now planned for will have to be postponed.

CONSUMER SPENDING

As previously noted, real consumption expenditures increased by more than the normal rate in third quarter 1968, in spite of the income surtax, doing so at the cost of a sharp reduction in the savings rate. In the fourth quarter this trend was reversed and consumption expenditures, after adjustment for price changes, actually declined. It is expected that real consumption expenditures will continue to be weak in the first half of 1969 because of the factors already noted—the increase in social security contributions, payment of the retroactive portion of the surtax, and the relative inflexibility of contractual savings.

BUSINESS INVESTMENT

In the fourth quarter of 1968 private fixed investment expenditures for plant and equipment increased substantially over the previous quarter, and both the McGraw-Hill survey and the FTC-SEC survey predict further substantial increases in the first half of 1969. But these

predictions must be evaluated with some skepticism. The surveys can be taken to reflect correctly the mood of the business community at the time they were taken. But they probably reflected a reaction to the sharp increase in real consumption expenditures, which between the fourth quarter of 1967 and the third quarter of 1968 had been rising at an annual rate close to 7 percent. Assuming that the slowdown in consumer expenditures in the fourth quarter of 1968 carries forward into 1969—and no other assumption seems valid—businessmen will tend to revise their investment plans. If they did not they would merely be creating the basis for a later slump because the margin of unused capacity was undesirably large even at the peak of demand, and if it is substantially added to while demand slows down, will rapidly become intolerable.

RESIDENTIAL CONSTRUCTION

In terms of social need there is a serious housing shortage. Vacancy rates are abnormally low, and there is a backlog of overcrowded housing, and of actually substandard housing which ought to be replaced. But effective demand is another matter. It is doubtful that residential construction can expand significantly as long as that demand is held back by exorbitant interest rates, as well as the excessive cost of speculatively held land and the high-cost, obsolescent nontechnology which burdens the residential construction industry.

High interest rates hit residential construction from the supply side as well as from the demand side. On the one hand, they impose heavy financial burdens on buyers, which many would-be buyers cannot meet. On the supply side, builders experience increasing difficulties in obtaining mortgage money. At times of rapidly rising interest rates, the savings and loan associations, which account for a substantial proportion of all mortgage loans, find it difficult to compete for deposits because they suffer from the disability that the bulk of their funds are invested in long-term loans granted at a time when interest rates were much lower. Consequently, savings which would normally go to these associations are diverted to other institutions which can pay higher interest rates, and are then used for purposes other than mortgage loans.

For these reasons it is likely that residential construction will tend to stagnate at current levels, or even to decline in the coming months. Any sustained upswing will depend on a reversal of the present monetary policy.

In summary, these are the factors which will tend to slow down the economy in the first half of 1969:

- The deflationary fiscal policy which tends to reduce the purchasing power originating in the private sector;
- The exorbitant interest rates which tend to depress private residential construction and public investment of State and local governments;
- A further slowdown of real consumption expenditures resulting from a larger tax bite which cannot continue to be offset by lower savings;
- Eventually a downward adjustment of real inventory spending and real fixed investment spending in response to the slowdown of the activities in other sectors.

POLICIES OF THE NIXON ADMINISTRATION

The prospective developments considered so far are those which may be expected to flow from a continuation of policies adopted by the previous administration, or imposed on it by Congress. As this is written no really clear picture has yet emerged of the economic policies to be followed by the Nixon administration. (One exception is the firm statement by Labor Secretary George P. Schultz that there will be no increase in the minimum wage in the immediate future. This will continue to condemn some millions of workers and their families to live in poverty, even though they work steadily at full-time jobs.) The general impression, however, is that there will be no abrupt change in policy and, if any change is made, it will probably be in the direction of further restraints on economic growth—slowing down the economy as a means, hopefully, of slowing down inflation. The consequence, of course, must be a rising level of unemployment, and this is recognized by President Nixon's economic advisers.

Thus, for example, Paul McCracken, the new Chairman of the Council of Economic Advisers, said at a meeting of the National Industrial Conference Board, last September:

"We must recognize that there is no steady state trade off between the rate of price increase and the unemployment rate that will be acceptable or even viable on a continuing basis. At some times the reduction of unemployment is the prime problem. At other times minimizing the present value of future economic distress will require a disinflationary policy even if it means some short-term rise in unemployment. And clearly now is one of those times."

David Kennedy, Secretary of the Treasury, under questioning by Senator Vance Hartke, said, according to the *Congressional Quarterly*:

"The effort would be to take the inflationary steam out of the economy with a minimum of increase in unemployment.' He agreed that some increase in the jobless rate was inevitable and said an increase of one-tenth of 1 percent 'would sound better at the moment but 1 percent would be more likely.'"

We have already referred to the disastrous consequences of a 1 percentage point rise in the unemployment rate, which would mean that an additional three-quarters of a million men and women would join the ranks of the unemployed. But an even more serious danger is that the slowdown will not stop there. We can expect Mr. McCracken to agree with Mr. Ira T. Ellis, chief economist of the Du Pont Corporation, who said in *U.S. News & World Report* for February 17, 1969:

"The critical problem is to adjust slower growth and not scream for the Government to do something about it. If we rush in with big spending programs, we're going to keep prices continuing to rise too rapidly.'"

Mr. McCracken can be relied upon not to rush in with big spending programs. He has already said that he feels the big mistake of the previous administration was that they were "economic hypochondriacs who were excessively worried over every wiggle in the business statistics." McCracken instead is worried about the perverse effect economic policy can have if it tries to follow the economic indicators too closely, and about the danger of overreacting. For these reasons he will insist on fixed policy rules. One of these rules is the concept of full

employment budget surplus. A supplementary concept is the concept of full employment money supply.

But there is also the danger of underreacting and the perverse effects of fixed policy rules. In an interview with the *New York Times* McCracken explained that for domestic policy purposes he would define the full employment surplus as a condition under which at full employment the net budget balance fluctuates between a deficit of \$2 billion and a surplus of \$2 billion. But because of our international payments situation, he prefers a concept under which the net balance fluctuates between 0 and +\$2 billion. And he adds: "I think there would be a great therapy to be had from our running a surplus for a while. It doesn't have to be a large one." (*New York Times*, January 24, 1969.)

McCracken does not define full employment but presumably he means 4-percent unemployment since he considers that the present unemployment level represents over-full employment, and that unemployment has to be raised. Since he is anxious to maintain a surplus, he will be likely to estimate the surplus at the 4-percent level conservatively, which would mean that the budget would be balanced at an unemployment level in excess of 4 percent. Given our lack of precise knowledge and McCracken's tendency to be conservative, the unemployment level at which the budget will be balanced might very well be 5 percent or more.

Since he is afraid of overreacting, and does not believe in responding to every wiggle of the statistics, then if he does make a mistake, and allows unemployment to go higher than he had planned, there will be a lag before he will be sufficiently convinced of his mistake to recommend a change in economic policy. Then there will be a further lag, probably one of several months, before Congress can be relied on to approve the necessary changes in fiscal policy, either by increased spending appropriations or by reducing taxation. And finally, there will be a still further lag before such changes can have an impact on the economy. By that time, what was originally intended to be a mere slowing down of the economy may very well have developed into a full-scale recession.

THE EXPERIENCE OF OTHERS

Restricting economic growth is not necessarily an effective method and is certainly not a necessary method of preventing or controlling inflation. This is borne out by the recent experience of two other free world countries, Canada and West Germany.

THE CANADIAN EXPERIENCE

Early in 1966 the Government of Canada began to fear the onset of inflationary pressures, and undertook to counter them by the process of economic restraint. A number of measures were taken in the budget produced in March 1966, for the fiscal year beginning May 1, 1966, which were aimed directly at slowing the rate of public and private spending and investment. Income tax rates, which had been cut in 1964, were restored to close to the previous level. A special refundable tax was imposed on corporation profits and depreciation and depletion allowances which in effect constitute a forced loan from business. Special tax provisions for accelerated depreciation on a wide variety of

capital investments were ended. Exemption in two stages of production machinery and equipment from the 11-percent general sales tax was announced, but the first reduction did not take place until April 1967, in the hope that this would encourage firms to postpone for a year or longer plans to buy such equipment. The construction programs of all Government departments and crown corporations for the 1966-67 fiscal year were cut by 10 percent.

In addition to these fiscal measures, a very tight money situation was permitted to develop by the summer of 1966. And on January 1, 1967, the general sales tax was increased by 1 percentage point to a total of 12 percent. Finance Minister Mitchell Sharp predicted that the effect of these various measures would be to restrain price increases while probably reducing the rate of growth in gross national product by about 5 percent in real terms.

The effect on economic growth was far more drastic than that. The former vigorous expansion was slowed to a crawl.

The accompanying table shows what happened. For each quarter it gives the volume of GNP, seasonally adjusted and expressed at annual rates in dollars of constant buying power, and also the amount by which it exceeded GNP for the same quarter of the previous year.

Before the applications of restraints, real GNP had been growing at a rate of about 5 to 8 percent per year. For the previous 5 years, it had averaged 6.4 percent per year. But in the second half of 1966 it fell to about 5 percent, in the first three quarters of 1967 to about 3 percent and in the fourth quarter 1967 to 2 percent.

This sharp decline in the growth rate was particularly serious because of the rapid rate of increase in the country's labor force. Between 1961 and 1967 the Canadian labor force grew at an average annual rate of 2.6 percent, compared with 1.7 percent in the United States. Between 1966 and 1967 it increased by 3.7 percent.

ECONOMIC GROWTH, UNEMPLOYMENT AND CONSUMER PRICES IN CANADA, 1964-68

Year and quarter	Gross national product ¹		Unemployment		Consumer Price Index	
	Amount (millions)	Growth over same quarter of previous year (percent)	Number ² (thousands)	Rate ² (percent)	1949=100	Change from same quarter of previous year (percent)
1964—I	\$41,252	7.0	335	4.9	134.4	1.7
II	41,872	7.4	328	4.7	135.1	2.0
III	42,004	6.3	317	4.6	136.0	1.8
IV	42,440	5.2	314	4.5	136.1	1.6
1965—I	43,648	5.8	290	4.1	137.1	2.0
II	44,180	5.5	296	4.1	138.2	2.3
III	45,364	8.0	269	3.8	139.3	2.4
IV	45,832	8.0	251	3.5	140.1	2.9
1966—I	47,188	8.1	259	3.5	141.9	3.5
II	47,728	8.0	257	3.5	143.5	3.8
III	47,520	4.8	289	3.9	144.8	3.9
IV	48,244	5.3	276	3.7	145.6	3.9
1967—I	48,552	2.9	289	3.8	146.2	3.0
II	49,252	3.2	317	4.1	148.2	3.3
III	49,012	3.1	317	4.1	150.6	4.0
IV	49,212	2.0	355	4.6	151.1	3.8
1968—I	50,392	3.8	353	4.5	152.8	4.5
II	50,796	3.1	397	5.0	154.3	4.1
III	51,380	4.8	401	5.1	156.0	3.6

¹ Seasonally adjusted at annual rates and in constant (1957) dollars.

² Quarterly averages of seasonally adjusted monthly data.

Source: Dominion Bureau of Statistics.

An immediate result of the lag in economic growth, therefore, was an increase in unemployment. From a peak of 7.6 percent at the beginning of 1961 it had been reduced to 4.5 percent at the end of 1964, based on quarterly averages of seasonally adjusted monthly figures. As the table shows, the decline continued at a slower pace through the end of 1965, and then held steady at 3.5 percent through the first half of 1966. This compares with an average of 3.8 percent in the United States.

Commencing with the third quarter of 1966, however, both the number of unemployed and the unemployment rate began to rise. By the third quarter of 1968 there were 140,000 more unemployed than at the beginning of 1966, and the unemployment rate had risen to 5.1 percent.

The Canadian economy had been "cooled down" with a vengeance. But what was the effect on prices? It was minimal and short term. The Consumer Price Index, which had risen by 3.5 percent between the first quarter of 1965 and the first quarter of 1966, rose by another 3 percent between the first quarter of 1966 and the first quarter of 1967, and then shot up still more rapidly than before restraints were imposed. By the first quarter of 1968 it had risen by a further 4.5 percent.

Altogether, between the first quarter of 1966 and the third quarter of 1968, a rise in the unemployment rate from 3.5 to 5.1 percent was accompanied by an increase in the price index of 9.9 percent. During the same period, in the United States, a drop in the unemployment rate from 3.8 to 3.6 percent was accompanied by a price rise of only 9.3 percent. The restraints in Canada succeeded in slowing down the growth rate and forcing up the unemployment rate, but they had no appreciable effect on the rate of price increases.

THE GERMAN EXPERIENCE

The performance of the West German economy in recent years shows a startling contrast. Unfortunately there is a certain lag in the availability of German data to us, so that complete data are not available beyond 1967. In the comparisons that follow, the United States and German data cover the same period, 1962 to 1967.

5-YEAR ECONOMIC PERFORMANCE, UNITED STATES AND GERMANY, 1962-67

[In percent]

	Total change		Annual rate	
	United States	West Germany	United States	West Germany
GNP at constant purchasing power.....	27.0	19.1	4.9	3.6
Real ¹ GNP per person employed.....	13.9	21.4	2.6	4.0
Gross hourly earnings in manufacturing.....	18.4	41.9	3.4	7.2
Cost of living.....	10.3	14.4	2.0	2.7
Real hourly earnings.....	7.3	24.0	1.4	4.4
Average ² unemployment rate ¹			4.6	2.5

¹ Absolute level.

² Adjusted to U.S. definition.

Source: OECD "Germany," I.G. Metall; "1969 Economic Report of the President."

Between 1962 and 1967, GNP expressed in dollars of constant buying power grew in the United States at an average rate of 4.9 percent per year, and in Germany at an average annual rate of 3.6 percent.

This difference is more than accounted for, however, by the fact that over this period the U.S. civilian labor force grew at an average annual rate of 1.8 percent, while in Germany the labor force actually declined in size. Thus, real GNP per person employed—a rough measure of the productivity performance of the economy—grew at an annual rate of 2.6 percent in the United States but at a rate of 4 percent in Germany.

During the same period, the U.S. unemployment rate averaged about 4.6 percent and the German rate, adjusted to U.S. definitions, averaged 0.5 percent.

Yet during this same period, under conditions of what American economic managers would consider a gross overheating of the German economy, the German cost of living rose at an annual average rate of 2.7 percent, only somewhat higher than the annual U.S. rate of 2 percent.

Nor was this price stability attained at the expense of German workers' wages. On the contrary, they did much better than their counterparts in the United States. During the period, gross hourly earnings in manufacturing increased at an average annual rate of 3.4 percent in the United States and 7.2 percent in Germany. After adjustment for changes in the cost of living, real hourly earnings rose at an average annual rate of 1.4 percent in the United States and 4.4 percent in Germany. It is interesting to note that in Germany the buying power of an hour's work increased at a slightly faster rate than the physical volume of production per person employed, while in the United States it lagged far behind.

The rate of increase in money wages was more than 50 percent higher in Germany than in the United States. This faster increase in wages is partly the cause and partly the effect of the better productivity performance. On the one hand, the rapid expansion of domestic demand due to the rapid increase in wages enabled overhead labor to be spread over a larger volume of production and consequently helped speed up productivity. On the other hand, the rapid expansion of output made it easier to raise wages and consequently demand without increasing inflationary pressure.

Although there was a lag in German expansion in 1967, such data as are available for 1968 indicate that the former strong performance has been resumed. In the first half of 1968 real GNP rose at an annual rate of 6 percent over the last half of 1967. Consumer prices in October 1968 were only 2 percent higher than in October 1967, and the unemployment rate in November 1968 was 1 percent.

The Government is planning for a continuation of this state of affairs, for we find the same combination of low unemployment, high price stability, and high growth rate in the German medium-term economic plan, which covers the years 1969–72. In this plan the Government has set itself the following targets:

(a) Full employment, defined as an unemployment rate of 0.8 percent.

(b) Price stability, i.e., a rise in the GNP deflator not exceeding 1 percent per year.

(c) External equilibrium, defined as a surplus on the balance of trade in goods and services on a national accounts basis of 1.5 percent of GNP.

(d) A reasonable economic growth corresponding to a trend rate of 4 percent of real GNP.

At time of writing we do not have information as to the institutional means by which the Germans have achieved this amazingly good economic performance. Unudoubtedly the much better productivity performance than in the United States, contributed to price stability, and it is very likely that the competition forced on German industry through its participation in the Common Market contributed to the superiority of both the productivity and the price performance.

ECONOMY MUST CONTINUE TO EXPAND

Because there is still a slack in our economy—idle capacity in our factories, and a level of unemployment that most other industrialized countries would consider intolerable—we must again resume expansionary economic policies in place of the restrictive policies now in effect, and avoid any more restrictive policies that might be contemplated.

One of the changes which could be made fairly quickly would be to let the 10-percent income tax surcharge die a natural death on June 30 next. That would immediately put about \$10 billion per year back into the taxpayers' pockets, and while not all of it would be in the form of consumer buying power, a great deal of it would.

There is a compelling reason, however, for preferring another course. For many years now, while the majority of consumers have become relatively affluent, the public programs required to meet the social needs of our Nation have been virtually starved. In some of our larger cities important sectors of the educational machine are grinding to a halt, with teachers being laid off and classes discontinued because of lack of funds. As regards other problems of the inner cities, urban blight, slum conditions, air pollution, delinquency, and just plain poverty, we have barely begun to scratch the surface. Our entire apparatus for health care for the citizen is woefully inadequate and disorganized. As a result, for example, our life expectancy is lower than that of many other countries whom we surpass in most material ways. There are at least 10 and probably 11 other countries where a girl baby, when she is born, can expect to live longer than one born in the United States. There are at least 17 and probably 20 other countries where a male can anticipate a longer life expectancy than in the United States. And these include such countries as East Germany, Bulgaria, Japan, Greece, and Italy, whose per capita wealth is far below ours.

One of the best measures of a nation's standard of health care is the relative proportion of children who survive or die in their first year of life, as measured by the infant mortality rate. Here the record of the United States is not only poor in comparison with many other countries, but is getting relatively worse. In 1953, there were only seven countries which had an infant mortality rate below the U.S. rate of 27.8 per 1,000. By 1963, 12 had lower rates than ours, and by 1965, 15 were ahead of us. As of 1966, the United States was tied in 17th place with Czechoslovakia. True, we had reduced our rate from 27.8 in 1953 to 23.7 in 1966. But that was far less progress than many other countries had made. Sweden, for example, had only 12.6 deaths per 1,000

infants under 1 year in 1966. In that year, some 40,000 babies died in the United States who would have lived had our infant death rate been as low as that of Sweden.

Countless other unmet social needs abound on every hand. President Johnson's Cabinet Coordinating Committee on Economic Planning for the End of Vietnam Hostilities has listed new programs which should be adopted and existing programs which should be expanded to a total amount of \$39.7 billion per year when funds and resources become available.

Obviously, not all of these programs can be undertaken while a large part of our discretionary resources are going into the Vietnam war. But a considerable part of them can, to the extent that additional spending stimulates the economy and leads to fuller employment and higher production.

We, therefore, propose that the 10-percent income tax surcharge be continued for 1 year, but that the revenues from it be devoted to meeting social needs, in particular, our needs in education and in the cities. (The 1-year limit is proposed in the hope that peace can return to Vietnam and the money now spent on war can be diverted to these needs.) Education and the cities are two major fields where performance has fallen short of public policy pronouncements and where recent legislative enactments fail to overcome huge deficits.

EDUCATIONAL NEEDS

The quality of education in urban public schools and its close tie to the economic and social development of our urban communities ranks high among our major domestic problems. The enormity of the needs will require massive injections of Federal moneys, as well as creative innovations, to deal with the special problems of the disadvantaged child in our urban areas.

Just what are the dimensions of the shortages of our school system that demand action? Fully one-third of the present stock of 1.7 million classrooms are more than 35 years old—a figure which coldly describes a large supply of antiquated equipment and inadequate facilities in our Nation's schools. One-half of the classrooms in slum areas are over 50 years old.

According to the Department of Labor, about one-third of the young people currently in the Nation's schools will drop out before getting their diplomas. In some of our cities' slums, this percentage runs much higher. Those who drop out have an unemployment rate two-thirds greater than others in the same age group who complete their education.

How does current performance measure up against these visible needs? The simple answer is that these needs are not being met. In the words of the authoritative study of HEW's Office of Education, *Projections of Public School Facilities Needs*, "Public elementary and secondary school construction in recent years has done little more than keep pace with the urgent demand for facilities created by enrollment increases." In short, the backlog of inadequate educational facilities persists at a disgracefully high level—over 500,000 classrooms, according to the Office of Education study.

This backlog has several components. To reduce classroom overcrowding and achieve the median size of 27.4 students per elementary class and 27.5 students per secondary class would require the construction of about 100,000 new classrooms. Using average cost of \$50,000 per new classroom in 1968, the construction bill to achieve median classroom size for overcrowded units would come to \$5 billion.

To eliminate makeshift classrooms, which over 1 million students now attend, would require the construction of 40,000 new classrooms at an estimated cost of \$2 billion. To replace classrooms with four or more defects¹ would require the construction of 194,000 new rooms at an estimated cost of \$9.7 billion.

Education professionals have argued that for far more effective school experiences, the median class size should be 25 students per elementary school class and 20 students per secondary school class. An additional 187,000 new classrooms would be needed to achieve this goal—at an estimated cost of \$9.4 billion.

In sum, construction costs to eliminate these various school shortages would require \$26 billion—over a \$5 billion outlay per year for the next 5 years or over \$2½ billion a year for 10 years. (It should be noted that these projections and estimates are conservative ones. They do not take into account the likelihood of appreciably higher construction costs in the coming years.)

Far from catching up on this backlog, we are adding to it. For the period of 1967–68, the projected classroom need to take care of growth and to improve some of the unsatisfactory facilities amounted to 77,000 classrooms. However, estimated construction for the calendar year 1968 is only 66,700 (*School Management*, July 1968).

Adjustments in teachers' salaries must also be added to any cost projections for improvements in urban education. Recently released statistics show that teachers' salaries in all public elementary and secondary schools average slightly above \$7,000 per year. Salaries in the teaching profession must be made more competitive with salaries in other occupations to encourage recruitment of new teachers. Aggregate compensation for teachers will continue to rise as more teachers are hired to staff newly constructed classrooms.

The magnitude of our financial needs in education underlines the necessity for the Federal Government to allocate billions of dollars so that we can provide quality education for the pupils in our public elementary and secondary schools. State and local governments cannot support the necessary school expenditures without such aid.

Schools in States with low per capita income and schools in our city slums and impoverished rural areas are already hard pressed to acquire enough funds to maintain the present educational system. Nationally, nearly 34 percent of the 1,600 school bond issues proposed in 1967 were defeated, totaling more than \$945 million. And, the record for the first 3 months in 1968 indicates that more than four out of every 10 bond issues proposed were turned down. It is obvious that homeowners are reacting to the fact that they are carrying a disproportionate share of the increasing tax burden.

In addition to the difficulties in obtaining necessary financial support locally, school districts in low-income urban centers receive a

¹ "School defects" include such conditions as building partially or totally nonfire resistant, inadequate plumbing, nonpermanent facilities (e.g., quonset huts), and insufficient acreage for playing area, etc.

disproportionately low share of what State aid is available because of the traditional political domination of State legislatures by the rural and suburban districts in the State.

The gap in per pupil expenditures between the wealthiest and the poorest States has been widening. On a per pupil basis, major cities generally spend only about two-thirds of the amount spent by the suburban communities which surround them. This despite the fact that it is the poor children living in urban centers who are most desperately in need of the highest quality of education.

In addition, this projection of needs and costs of quality education in elementary and secondary schools throughout the Nation avoids, but should not obscure, the equally pressing problems in the field of higher education.

URBAN DEVELOPMENT

Turning to the problems of our urban centers, we find the list of needs and the amount of funds necessary to meet them are even more overwhelming and staggering than for education. Here, with little difficulty, the full \$10 billion of surtax revenue could be allocated to vital facilities and services necessary to make our major cities livable. The \$10 billion, even when added to our current outlays, would only begin the mammoth task of transforming our blighted, decaying urban centers into communities with healthy physical environments, decent housing accommodations, and with the amenities of life which the average American has the right to expect.

Our cities reflect the myriad sociological and economic problems which have engulfed our Nation. The extensive migration of Negroes from essentially rural, southern communities to northern urban areas has worsened the already intolerable slum conditions in those areas. Racial discrimination in housing has prevented many Negroes and other minorities who have improved their economic status from leaving the ghetto or other substandard environments.

The interrelationships of the problems of our deteriorating cities can be seen from the programs listed by the Cabinet Committee referred to above, and outlined in the latest report of the Council of Economic Advisers.

As the Committee points out, in many cases the hypothetical expenditure figures contained in the table were "*considerably below the recommendations*," (emphasis added).

Omitting the education expenditures which, to a major extent, were discussed earlier in this statement, here are the key programs relating to urban life and their costs.

Program	Expenditure (billions)
Community Service Programs—for expanded day care centers for children of needy working mothers, etc.-----	\$0.8
Public Jobs—500,000 jobs for public service employment for the chronically disadvantaged -----	1.8
Crime, Delinquency, and Riots—of this amount, some \$600 million is for rehabilitation and prevention of delinquency-----	1.0
Quality of the Environment—primarily for prevention and control of air and water pollution, and sewerage treatment-----	1.7
Economic Aid in Rural Areas—this program is included because it can help stem part of the migration trend to the cities-----	1.0
Total -----	6.3

As for urban development itself, the task forces and study groups came up with a series of programs with a price tag of \$5.5 billion (one-half billion dollars of which was for land acquisition and financial planning in suburban areas).

Major expenditures for health and such income supports as public assistance have not been made part of the above calculations, although; indeed, such expenditures are inextricably involved in the living standards of urban dwellers. However, even without these, the expenditures total over \$11 billion *on an annual basis*.

HOUSING

Nor does this immense sum provide for allocation of funds to meet the vital housing needs facing this country. Currently there are from 7 to 9 million housing units which are substandard because they lack decent plumbing facilities or otherwise fail to meet minimum standards of adequate accommodation. In addition, of the present housing stock, there are some 15 million units which are in various stages of deterioration, and they too must be considered in any planning for new construction and rehabilitation. Experts who have been working on the statistics of housing, and special groups, like the Kaiser Commission and the National Commission on Urban Problems, agree that from 26-28 million housing units must either be constructed or renovated within the next 10 years. (The overwhelming proportion represents new construction.)

During the past several years we have been adding an annual average of 1.3 million housing units; the projections call for a doubling of that rate.

Those in the most dire need of improved housing are the families with income below the poverty line and those who, while above the line, pay more than 20-25 percent of their income for housing. An estimated 6 million units of the total must be provided for these two disadvantaged groups. For poor families with a head who can work, public service employment is a vital part of the strategy which will enable them to improve their living conditions.

Illustrative of those who pay a disproportionate share of their income for housing was the finding by the Kerner Commission that in Detroit "over 40 percent of the nonwhite occupied units in 1960 required rent of over 35 percent of tenant's income."

In dollar terms, the Kaiser Commission data indicate that over the 10-year period, to meet the goal of 6 million units will require the expenditure of \$1.4 billion per year on the average. By 1978, the yearly total will be roughly twice as high as the number of those benefiting from the several programs rises. Unless the Nixon administration requests and the present Congress fully funds what the 1968 Housing Act authorized, the Nation will fall further behind in meeting its 10-year housing goal. However, even that is not enough, for our neglect of housing needs has been so prolonged and severe that an acceleration of meeting those needs would be sound social policy. A portion of the \$10 billion surtax revenue should be used for this purpose through appropriate adjustment in the expenditures allocated to other vital urban needs.

While on the housing issue, let me make clear that a whole range of institutional changes are necessary to bring new technologies and

economics of scale to housing production, consumption, and marketing. Assembling housing markets in order to obtain the volume necessary to assure the use of advanced technology, is one such change. This will require updating obsolete building codes and zoning regulations.

In turn, these methods would create pressures to obtain land for housing and other public purposes through advanced land acquisition and land banking.

A rational land policy should empower the Federal Government to:

- Preempt local zoning and building codes for federally subsidized housing;
- Assist local governments to acquire land for housing and related facilities;
- Pay costs of relocation, demolition, and acquisition;
- Aggregate large parcels of land through direct acquisition of land for subsidized housing and related facilities.

Obviously, all the programs discussed here cannot be financed even with the \$10 billion of surtax revenues. (A considerably larger amount could be made available through appropriate measures of tax reform, but that is a subject more appropriate for discussion before another committee.)

Nor is it our purpose to indicate priorities. Those will have to be allocated on the basis of many considerations which only the appropriate governmental bodies can fully weigh. We do urge, however, that the principle of using at least the surtax revenues to meet pressing social needs be endorsed—and implemented.

THE PROBLEM OF INFLATION

As indicated at the beginning of this statement, we in the UAW are deeply concerned about the problem of inflation. We do not agree, however, that a program of overall restraints on economic growth is the proper method or necessarily an effective method of controlling inflation in an economy which still retains substantial slack in its productive machinery and sizable levels of unemployment. In this connection, it is worth noting that Prof. Daniel B. Suits, of the University of Michigan's Research Seminar in Quantitative Economics (who has been a close student of the relationship between the level of economic activity and the price level) predicts that in spite of a sharp economic slowdown and an unemployment level close to 5 percent by the end of this year, prices will rise even faster in 1969 than in 1968.

He estimates that in order to slow down price increases by this route, we would have to hold back economic growth for several years, with an implied unemployment rate of 5 to 6 percent.

The theory that restraints on economic growth will control inflation contains a major premise that unemployment and inflation are bound together in a simple inverse relationship—the less unemployment, the more inflation; the more unemployment, the less inflation.

The concept was much more crudely stated a few months ago by an anonymous economist quoted by *Business Week*. He said: "You have to keep unemployment high enough so that workers don't get too greedy."

Interestingly enough, *Business Week* also revealed in the same article that it is no longer "greedy unions" but greedy unorganized and low-paid workers who are now the villains in the piece. It reported:

"The current wage spiral has been led not by members of strongly entrenched unions but by the loosely organized workers in poorly paid industries such as textiles, furniture, and retailing. Apparently, a tight labor market creates upgrading opportunities for unskilled workers and, to hold on to experienced help, employers must pay premium wages.

"Against this type of wage inflation, guideline policies are ineffective. The only way to keep labor costs to a level in line with productivity is to reduce the bargaining power that comes with relative prosperity."

In other words, we should renounce forever the goals of full employment, full production, and full prosperity for this country, because by achieving them we would give too much bargaining power to the workers—especially the poorly paid ones who need it most.

The brutal irresponsibility of such a doctrine is exceeded only by its economic absurdity.

The concept of a simple inverse relationship between unemployment and inflation is based on the belief that changes in labor costs are the major factor in determining whether prices rise, fall, or remain stable.

This simply is not so.

PRICE INCREASES PRECEDED LABOR COST RISE

In 1967 and again in 1968, in appearances before this committee, we of the UAW produced detailed facts and figures, for example, to show that labor costs had nothing whatever to do with the initiation of the present round of inflation. We showed that prices of manufactured goods began to rise while unit labor costs were stable or even falling, and that it was profits, not labor costs, that responded initially to those price increases. Labor costs remained stable or even fell a little for over a year after prices had begun to rise. Eventually, of course, rising living costs forced workers to demand compensating wage increases, but that came much later on in the spiral.

It is some satisfaction that these facts were subsequently recognized by as business oriented a publication as the *Wall Street Journal*. The *Journal*, in fact, did a little more digging and discovered that the phenomenon of prices and profits rising first, and unit labor costs only some time later, was not confined to the present round of inflation. On August 5, 1968, the *Journal* reported:

"In the past 20 years, there have been three distinct periods in which factory prices climbed substantially over a prolonged interval.

"In each instance, labor costs per unit of factory output were *declining* when the price climb began—and these costs continued to decline for a considerable period after the price rise was underway.

"In each case, corporate profits began to increase sharply well *before* the price climb started.

"Such facts, at least to some economists, bear an obvious message. 'The pattern is clear enough,' says Peter L. Bernstein, president of Bernstein-Macaulay Inc., a New York investment counseling service. 'Instead of labor costs pushing prices up, what we see instead is a sort of profit-push. Profits are already well on their way up before prices begin to rise, and prices are well on

their way up before wages begin to rise faster than output.'"
[Emphasis in original.]

This idea of "a sort of profit-push" is supported by Prof. George L. Perry of the Massachusetts Institute of Technology, and a former member of the Council of Economic Advisers. In his book, *Unemployment, Money Wage Rates, and Inflation*, he says:

"Profits enter the inflation problem at two distinct points. First in the product market, profits are the goal of pricing policies. Price increases may be initiated to restore profit margins (or maximize profits) in the face of cost increases; or may be initiated to augment (or maximize) profits independently of cost changes. Second, in the labor market, profit rates have been identified as a major determinant of wage changes.

"This interrelationship in which profits both affect and are affected by wage changes gives rise to a range of possible explanations of inflationary phenomena. Wage increases that raise unit costs will initially reduce profit margins which may be restored, at least in part, through price increases. This is a standard wage-push argument. Alternatively, an initial attempt to raise profit rates through higher prices will lead to accelerated wage increases which then in turn may be passed forward into still higher prices if the higher profit rates are to be maintained. Or the same sequence can arise through an initial rise in profit rates stemming from exceptional productivity gains with no reduction in prices. In some circumstances, these could properly be labeled instances of profit-push inflation."

Professor Perry's findings, based on a mathematical analysis of actual wage-price-profit relationships between 1948 and 1960, is that there is not only a possible "tradeoff" between unemployment and inflation, but there is also a tradeoff between profits and unemployment. Specifically, he finds that with an after-tax manufacturing profit rate of 5.7 percent return on investment, and an unemployment rate of 3 percent, an inflation rate of zero (overall price stability) may be expected. If the profit rate goes up to 11.5 percent, however, it requires an unemployment rate of 6 percent to keep prices stable.

In the same way, if the profit rate is 11.7 percent and the unemployment rate 3 percent, prices may be expected to rise at a rate of 3 percent per year. If the profit rate goes up to 17.4 percent, however, it will require an unemployment rate of 6 percent to keep the inflation rate at 3 percent per year. (See table below from Professor Perry's book.)

MANUFACTURING PROFIT RATES ASSOCIATED WITH VARIOUS UNEMPLOYMENT RATES AND RATES OF INFLATION
[3 percent rate of productivity growth assumed]¹

Inflation rate (percent per year)	Unemployment rate (percent)			
	3.0	4.0	5.0	6.0
0.....	5.7	8.6	10.3	11.5
1.....	7.2	10.1	11.8	13.0
2.....	8.7	11.6	13.3	14.4
3.....	11.7	14.6	16.3	17.4

¹ Calculations are based on equation 3.15, the central case which assumes unchanging income distribution, labor force distribution, and appropriate relative price shifts, with wages in all sectors of the economy changing at the same rate as those in manufacturing. The kinds of changes introduced by relaxing some of these assumptions were discussed at the end of ch. 3.

² Associated manufacturing profit rates.

Source: George L. Perry, "Unemployment, Money Wage Rates, and Inflation" (table 6.1).

In this connection it is worth noting that many major corporations, such as General Motors, which have and use discretionary pricing power, set themselves and regularly achieve profit targets well in excess of 17.4 percent on investment.

Incidentally, another of Professor Perry's findings is of significance to anti-inflation policy. He finds that the elasticity of wages to living costs, and the elasticity of living costs to wages, are both less than unity. That is to say, a given percentage rise in living costs will generate a smaller percentage rise in wages, which in turn will generate a still smaller percentage rise again in living costs. As a result, the price-wage spiral is not endless, but tends rather to damp itself out. As Professor Perry puts it:

The circular process whereby prices affect wages which in turn affect prices and profits (negatively) gives some appearance of a wage-price spiral, but one that disappears rather than becoming explosive or indefinitely self-perpetuating.

This is important because it effectively answers the often-heard argument that even though wages may not have been responsible for initiating an inflationary spiral, wage restraint—whereby workers accept increases in real wages substantially below the rate of productivity advance—is essential to bring the spiral to an end.

THE SOURCE OF PROFIT PUSH

What is the source of the profit push which was certainly responsible for the current round of inflation, and according to the *Wall Street Journal* has been responsible for the last three such rounds? It is the lack of effective competition in too large a sector of the economy. This results in some corporations, which hold controlling positions in particular industries—frequently in more than one industry—being able to exercise a discretionary pricing power. That is, within certain limits, they are freed from the normal restraints of the competitive marketplace, and within those limits are able to set the prices of their products at their own discretion.

The existence of such discretionary power is now taken for granted by nearly all economists—though too few of them have taken this factor sufficiently into account in formulating their theories as to how the economy operates—and by at least those businessmen who exercise it. Executives of General Motors Corp. have more than once admitted to congressional committees that their corporation does determine prices on the basis of a profit target. Many other large corporations are well known to follow the same practice. This would be impossible to them if they did not have at least limited freedom to determine a selling price for their products and to make that price stick.

A very illuminating analysis of the role of discretionary power in promoting inflation is to be found in the recently released studies by the staff of President Johnson's Cabinet Committee on Price Stability.

The major source of such discretionary pricing power lies in the domination of particular industries by a relatively small number of companies. When there are many sellers, no one of which enjoys a very large percentage of total market sales, the activities of all of them are constrained by market forces. If such a force—an increase in costs, say, or a sharp increase in demand—comes into play, it affects all

sellers and they will all respond in the same way. But lacking such a force, if any one seller tries to raise his price merely to increase his profits, he will quickly lose sales to his competitors and be unable to maintain the increase.

In the same way, when market forces permit or require a reduction in prices, if some sellers try to maintain prices there will always be others who will find it more profitable to reduce prices and increase their sales, and the holdouts will be forced to follow the market trend.

It is very different when the number of sellers is few. The simplest example is an industry with only two firms in it, A and B. Let us suppose that A makes a discretionary decision to raise his price because he wants a larger profit. B then has two choices. He can maintain the lower price, and this will soon force A to roll back his price especially if B is operating below optimum capacity. Or B can raise his price to A's level, *in which case both firms will enjoy higher profits* as long as the higher price was set in such a way that the drop in demand is more than offset by the rise in profit per unit. B's decision is virtually automatic. The situation is essentially the same when there are any small number of sellers dominating the market. It is particularly so when one seller enjoys a particularly high percentage of the total market. He then tends to become the recognized price leader, and the others follow his lead.

Concentration alone is not the only factor affecting price discretion. Ease of entry is another. If it is relatively easy for newcomers to start up in business, high profits will quickly attract them. But if that is a very expensive undertaking, as it is, for example, in the automobile industry, such newcomers will be very few. Product differentiation is still another factor. Heavy advertising of a company's brands or models tends to develop consumer loyalties and to reduce the competition they face from others. This is inflationary in two ways. It adds to the cost of selling, which is passed on to the consumer, and at the same time it permits such higher price level. It also increases the difficulty of entry for newcomers.

The study points out the relationship between these factors and the pricing and profit policies of the corporations possessing them. It says:

Recent empirical studies demonstrate that each of these market characteristics—market concentration, entry barriers facing potential entrants, and the degree of product differentiation—has a bearing on the market power and pricing behavior of sellers. A growing number of studies confirms that there is a significant positive relationship between the level of industry concentration and reported industry profits. The studies show that profit rates tend to be 50 percent (or more) higher in highly concentrated industries than in moderately concentrated ones. Other studies demonstrate that the entry barriers protecting an industry from potential competitors also affects the level of profits. That is, the more difficult it is to enter an industry, the higher the prices at which firms may sell without inducing new competitors. Research studies also support the hypothesis that the degree of advertising-created product differentiation has a direct effect on industry profits. According to a recent study, consumer industries with high advertising outlays enjoy profit rates about 50 percent above those with low advertising outlays. The costs of advertising and of maintaining other barriers to entry will raise prices without appearing in reported profits.

There are other factors also which can enhance discretionary pricing power. One is the development of "conglomerate" corporations—the merger into one of various enterprises with a wide variety of totally disparate products. This alone does not give them market power, but it gives them economic power which may be used to obtain market power. For example, a large conglomerate may be able to mount for one of its divisions a massive advertising campaign directed at product differentiation, which the division alone, if operated as a separate enterprise, could not afford.

Other factors that may tend at least to blunt competitive rivalry are those which produce a community of interests among competitors—such as joint ventures and interlocking directorates. As the study says:

If such ties became extensive enough, they would create a cartel-like atmosphere that would replace independent behavior with cooperation leading to a live-and-let-live attitude.

AGGREGATE CONCENTRATION

The study goes on to discuss the actual incidence of these various factors. It says:

Aggregate concentration of control exists in many forms. We have evidence of increasing control of manufacturing by the 200 largest firms. We also are witnessing increasing numbers of joint ventures among large manufacturers, interlocking officers and directors, interconnections among banks and firms in other sectors, and growing concentration of financial control outside manufacturing.

Between 1948 and 1967, there was a persistent and substantial upward movement in the share of assets controlled by the 200 largest U.S. manufacturing corporations. The sharpest rise occurred in the last 2 years, when merger activity reached an all-time high. By 1967, the 100 largest corporations held 47.6 percent, and the 200 largest corporations held 58.7 percent of the assets of all manufacturing corporations. By 1967 the 100 largest manufacturing corporations held about the same share of assets held by the 200 largest in 1948.

An even more startling figure is that only 78 corporations, those with assets of \$1 billion or more, held 43 percent of total manufacturing assets.

The study continues:

Concentration of profits within the largest manufacturing corporations is even higher than assets. In 1968 the 78 largest manufacturing corporations received 49 percent of all manufacturing corporation profits. Thus these companies enjoy not only large earnings, but also access to a reserve of uncommitted funds sufficient to afford them substantial independence from capital markets.

This latter point is of particular importance with regard to an anti-inflationary money policy, since it means that the investment plans of these corporations are virtually free of the restraints intended by such a policy.

The largest corporations are also especially prominent in those industries where discretionary power is most common—consumer goods

as against producer goods, and especially those industries producing highly differentiated consumer goods, where the 200 largest manufacturing companies were responsible for 73 percent of value added.

The largest corporations are steadily entrenching their leadership positions, frequently in several industries. Thus, in 1958, of the 100 largest manufacturing corporations, 29 were each among the four leaders in four or more industries; by 1963, that figure had grown to 48 companies.

Joint ventures are particularly common among the largest corporations. The staff study declares:

One study reported that the 100 largest manufacturing corporations appear as parents of joint ventures 210 times.

Another source of close relationships between corporations is through interlocking directorates. The study cites a report to the Senate Antitrust Subcommittee which shows that in 1962 the 29 largest industrial and commercial corporations had officers and directors who were also on the boards of 745 other industrial and commercial corporations, 330 banks and 51 other corporations.

MARKET CONCENTRATION

The above facts indicate that the *aggregate concentration* of economic power in industry is growing, and that some of the developments will tend to reduce competitive rivalries. The figures themselves do not show that *market concentration*—the concentration of economic power among a few firms in single industries—has also increased. And at first sight it would appear that it has not.

The degree of concentration is expressed by a "concentration ratio." This is a figure representing the proportion of industry shipments by a specified number of the top firms in the industry. Thus, a "four-firm concentration ratio of 60 percent" means that the top four firms control 60 percent of the shipments in that industry.

The average of four-firm concentration ratios for all manufacturing industries rose from 41.2 percent in 1947 to 41.9 percent in 1966—a negligible increase. But this picture changes when the industries are broken down by type of industry (see accompanying table). Thus, the concentration ratio in producer goods industries fell by 1.7 percentage points, while the concentration ratio in consumer goods industries rose by 4.8 percent. What is more significant, the concentration ratio in 17 highly differentiated consumer goods industries rose by 12 percentage points, from 48.2 in 1947 to 60.2 in 1966. Since total shipments of these industries in 1966 amounted to more than \$40 billion, or more than 45 percent of all consumer goods industries, the impact of this increase of market power on pricing policies and thus on prices is substantial.

4 FIRM CONCENTRATION RATIOS IN MANUFACTURING, 1947 AND 1966

	1947 (percent)	1966 (percent)	Change (percentage points)
213 manufacturing industries.....	41.2	41.9	0.7
132 producer goods industries.....	45.1	43.4	-1.7
81 consumer goods industries.....	34.8	39.6	4.8
17 highly differentiated consumer goods industries.....	48.2	60.2	12.0

Source: Studies by the staff of the Cabinet Committee on Price Stability.

Competition is further weakened by the fact that the largest corporations dominate not just one product line, but frequently dominate the market of many related lines. This means that frequently the monopoly price for a specific product line is bolstered by the monopoly price of the substitute product which is set in such a way that the combined profit of both lines is maximized.

The prevalence of this sort of situation is illustrated by the example of the food industry. In 1963, the food industry covered 116 product classes. In only 2 percent of these product classes the 100 largest food producers occupied none of the eight top ranks. In 70 percent of all product classes, the 100 largest food producers occupied at least four of the eight top ranks. This type of concentration has increased substantially in recent years. The percentage of product classes in which the 100 largest food producers occupied at least four of the eight top ranks increased from 50 to 70 percent in less than 10 years.

An interesting feature of the staff study is its finding that this increase in concentration in consumer goods industries is not due to technological requirements, "but rather to product differentiation created by advertising." It continues:

Empirical studies demonstrate that product differentiation and the requirements of large-scale advertising are the major barriers to entry and causes of high market concentration in many consumer goods industries.

WHAT IS TO BE DONE?

We have seen thus far that the current round and probably also previous rounds of inflation have not been caused by the "cost push" pressures of rising labor costs, but by the "profit push" demands of large corporations with increasing economic power in the whole of industry and increasing market power in key consumer goods industries. How is that power to be curbed in the public interest?

The staff study makes a number of useful suggestions. These include:

- Vigorous enforcement of the antitrust laws.
- More exercise by the Federal Trade Commission of its powers to investigate the organization, business conduct, practices, and management of corporations, with particular reference to industries that pose special competitive problems.
- A thorough and expeditious study of the whole problem of conglomerate mergers by the antitrust agencies, with a view to seeking legislative remedies.
- Careful study of the impact on the economy of the trust activities of commercial banks, whose trust departments control a large and growing proportion of the stock of American corporations.
- Tightening up of the rules governing reporting by conglomerate corporations to the SEC so as to require them to report separately their sales and revenues with respect to each product class representing the lesser of 5 percent of sales volume or sales of \$25 million, and requiring them to report separately for a period of years the finances of acquired companies.
- Careful study of the special problems in competition raised by multinational corporations, and of the general problem of policing international competition.
- Elimination of resale price maintenance.
- Better consumer information about products.

All of these are useful suggestions, and we endorse them all. But none of them really gets right down to the point of stopping inflation where much of it begins—at the point price decisions, and sometimes possibly wage decisions, are actually made.

PUBLIC INFORMATION NEEDED

We believe that one of the reasons large corporations are able to get away with some of the price decisions they make is because the public generally is uninformed about the economic issues involved. The decisions are made in the privacy of a corporate board room. The public may not even be informed of it until the housewife notices a higher price tag on the package in the supermarket. If the public is informed, it is through an unctuous statement prepared in the corporation's public relations office, attributing the increase to some cause beyond the corporation's control—usually a vaguely worded reference to "higher costs of labor and materials." But the public is rarely, if ever—and certainly never voluntarily by the corporation—given the answer to such vital questions as:

What are the facts regarding unit labor costs?

What has been the rate of productivity advance in this firm?

How big are the firm's profits, and how do they compare with those of other firms or of industry generally?

How much of the "cost" of the product is really the cost of advertising or other methods of product differentiation?

These questions, and many more like them which could be asked, are matters of public interest and concern when the answers to them affect the prices consumers will have to pay for a large proportion of their daily needs. What is even more important, if the corporations with discretionary pricing power knew that they would be required to answer such questions before a public forum as a condition of raising prices, we believe that they would be much more reluctant than they are now to initiate an increase which could not be justified.

PRICE-WAGE REVIEW BOARD

As a means of providing such a forum, the UAW has long advocated the establishment of a Price-Wage Review Board and a Consumer Counsel.

Under legislation establishing the Board, any corporation holding a dominant position in a key industry—for example, controlling 25 percent or more of the industry's sales—would have to give at least 60 days' notice to the Price-Wage Review Board of any intended price increase. The board would have authority to call the company before it for a public hearing.

As a matter of fact, new legislation might not even be required. The FTC already seems to possess the necessary powers under the Federal Trade Commission Act. This act states:

The Commission shall also have power—

(a) To gather and compile information concerning, and to investigate from time to time the organization, business, conduct, practices, and management of any corporation engaged in commerce, excepting banks and common carriers subject to the act

to regulate commerce, and its relation to other corporations and to individuals, associations, and partnerships.

(b) To require, by general or special orders, corporations engaged in commerce, excepting banks and common carriers subject to the act to regulate commerce, or any class of them, or any of them, respectively, to file with the Commission in such form as the Commission may prescribe annual or special, or both annual and special, reports or answers in writing to specific questions, furnishing to the Commission such information as it may require as to the organization, business, conduct, practices, management, and relation to other corporations, partnerships, and individuals of the respective corporations filing such reports or answers in writing. Such reports and answers shall be made under oath, or otherwise, as the Commission may prescribe, and shall be filed with the Commission within such reasonable period as the Commission may prescribe, unless additional time be granted in any case by the Commission.)

Because the Commission has not always been as zealous as it might have been in carrying out the functions now entrusted to it, there is room for doubt as to whether it would be the most suitable body to direct the operation of a Price-Wage Review Board. However, the powers are there, and could be given to an autonomous board.

Certainly it is essential that the Board should have the power to subpoena and examine witnesses under oath, and to demand the presentation of all pertinent books, papers, and other sources of information. Following its hearing the Board would publish its findings and recommendations and the facts supporting such recommendations.

The recommendations would be based upon a set of standards carefully designed to assure equity to all affected parties on a basis compatible with reasonable stability of the general price level.

The Board's recommendations would not take the form of binding determinations, however, and once the Board's report was published, the corporation would be free to act as it saw fit. But if the public were informed with facts and figures which made it clear that the price increase was not justified, it is highly doubtful that the corporation would attempt to effectuate such a price increase in the face of enlightened public opinion. Indeed, as we have said, just the knowledge that such an investigation was probable would deter most large corporations from even proposing price increases unless they could in fact be fully justified.

The number of corporations that would be subject to such hearings procedures is relatively small, for it would need to apply only to the one dominant company in each major administered price industry. If that company were restrained from raising its prices, the smaller ones would have to follow suit.

OFFICE OF CONSUMER COUNSEL

It has been suggested, as an argument against the Price-Wage Review Board proposal, that under such a system corporations would never reduce a price because of the difficulties in the way of restoring the price cut if it should become necessary. And in any case, a procedure that could be triggered only by a threatened price increase would fail

to meet the problem posed by high-productivity industries which refuse to grant the price cuts they could well afford.

Both of these objections can be met by the establishment also of an Office of Consumer Counsel. The Consumer Counsel would have two main functions. He would represent the interest of consumers in all hearings before the Price-Wage Review Board. And he would be authorized to initiate hearings when sufficient evidence was available to suggest that prices of any corporation subject to the procedure were already too high.

UNIONS ALSO COVERED

Unions would also be subject to the hearings procedure when appropriate. Whenever a corporation subject to the procedure claimed that it would have to raise prices if it gave in to union demands, it could so notify the Board, and both the union and the corporation would then be summoned to a hearing and required to produce the relevant facts.

The Council of Economic Advisers has pointed out in previous years that there are circumstances in which a wage increase is justified even if it does require a price increase. If this were the situation in a given industry, the hearing would reveal it. But if the union's demands were exorbitant, that would be revealed. If, on the other hand, the company could well afford to grant them without raising prices, that fact would be made apparent.

As in the case of a hearing involving a corporation alone, the Board would publish a report containing its findings and recommendations and the supporting facts. Both sides would then go back to the bargaining table free to act as they saw fit, but with the knowledge that the public had the facts, and was equipped to pass an informed judgment on the result of their negotiations. The union and the corporation alike would be subject to the same discipline—the need to accept full public responsibility for private, voluntary decisions which affect the public interest.

We believe that unions generally would welcome the opportunity, in a collective-bargaining situation, to have a public forum before which they could explain the economics of their demands. One of the difficulties perpetually faced by unions in such situations is not only the simplistic and misleading propaganda too frequently put forward by employers, but the fact that the greater part of the public have an extremely rudimentary and simplistic understanding of economic processes. The difference between hourly wage rates and unit labor costs, for example, is a closed book to most people, and the concept of financing wage increases out of the fruits of productivity advance has never entered the minds of many, so that the union in its public relations is faced at every turn with dogmatic attitudes such as that "every wage increase causes a price increase."

If both sides were free to state the issues as they see them in a public hearing, and if an impartial tribunal then issued its findings on the basis of the objective facts, we believe that the economic understanding of the public would be advanced and public confidence in the democratic process of collective bargaining would be strengthened.

A further advantage of this procedure is that it can restrain inflationary decisions without the necessity of any form of governmental

price or wage control. Price and wage actions would still flow from the voluntary decisions of free men in a free society. But just as the freedom to make such decisions is limited in a completely competitive economy by the restraints of the competitive marketplace, so under this proposal the freedom to make such decisions would be limited by the restraints imposed by an informed public opinion, which should be mobilized to discipline voluntary actions and make them responsible. Thus the democratic concept of ultimate public authority over decisions which vitally affect the public interest would be extended from the political sphere, where it is recognized as the cornerstone of a free society, to the economic sphere where it is equally important that the concepts and the processes of democracy should prevail.

CONCLUSION

Our economy today faces three vital domestic problems:

With industry still operating at far less than capacity, and unemployment still much higher than it should be or need be, our economy is slowing down.

We have vast areas of social needs unmet, especially those which affect our ability to solve the problems of our cities, of our minorities and of the poor, which increasingly threaten the stability of our whole society.

We are undergoing a round of inflation which causes hardship to millions of families and also threatens to disturb our economic stability.

We in the UAW believe that for the first two problems there is only one answer—we must adopt programs to meet our social needs, and do so in such a manner as will stimulate the economy to produce the necessary goods and services and so reduce unemployment.

To solve the third problem, we must stop relying on processes of economic restraint which increase unemployment and reduce our ability to meet social needs, without effectively checking inflation. Instead, we must examine carefully the real sources of inflation and the institutional forms and structures which foster it. Having done that, we can then develop new approaches, based on the economic realities of the situation, to restrain the inflationary forces. In particular, we must find means to insure that those who make private decisions vitally affecting the economic welfare of all the people are subjected to the democratic pressures of an informed and enlightened public opinion.

We hope that this statement has contributed to the achievement of these goals.

UNITED MINE WORKERS OF AMERICA

By W. A. BOYLE, PRESIDENT

We appreciate the opportunity to present the views of the United Mine Workers of America on the state of the U.S. economy.

We believe that the objective of governmental policy in the economic sector should be the fullest development of the human and material resources of the United States. This development should be carried on within the framework of our social and political institutions and should reflect the dedication of our Nation to the cause of human dignity and justice.

President Johnson, in his economic message this year, stated the objective of governmental policy very well when he said:

"I regard achievement of the full potential of our resources—physical, human, and otherwise—to be the highest purpose of governmental policies next to the protection of those rights we regard as inalienable."

We share these views. Our remarks are aimed at helping to create policies which will further their implementation.

We would like to comment in this paper upon three areas which are in need of governmental action in order to insure the fullest development of our human and material resources. There areas are:

- (a) Research and development.
- (b) Import programs.
- (c) A national energy policy.

Research and development is perhaps the single most effective means to achieve national economic growth. Unfortunately, in our view the current status of research and development is such that it does not contribute all that it could to such progress.

When considering the efforts made by the Government in the field of research, we should not confine ourselves only to dollars. It may be argued that we have an almost unlimited fund of dollars. But, it is obvious to even the most uninformed that we do not have an unlimited number of men of science. Thus, when we commit a part of that human resources to one project, we forgo its application in other areas where such talent might be used to better advantage.

As it now stands, the bulk of the money for energy research is being spent in the atomic energy field. For the fiscal year 1970 the Atomic Energy Commission has budgeted more than \$700 million to this area. This compares with the total request for the Office of Coal Research of \$13,300,000.

The discrepancy is obvious. It is all the more apparent when we consider that the Atomic Energy Commission has spent more than \$3 billion to develop the civilian atom since 1946 and that the Federal Government has granted to the atom privileges accorded to no other agency of government in our history.

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There are many arguments that can be made against the disproportionate share of research resources going to atomic power. There are many arguments that can be advanced that coal is being short-changed. In the final analysis, however, coal research should be expanded because coal research holds the brightest promise of future benefits to the American people, benefits that can be measured in terms of economic progress and human welfare. Consider some of the following facts:

(a) Coal is the most abundant energy resource available within the continental United States. It is estimated that coal reserves form more than 80 percent of our total energy resources.

(b) Coal is well situated geographically with reserves located throughout most of the United States. Coal is mined in 26 of our States.

(c) Coal mining is a well-known and highly efficient technology.

(d) Coal miners are the most productive workers in the world.

(e) Coal is the mainstay of the American industrial economy, fueling more than 50 percent of the electric generation in the United States. It is also vital to the manufacture of steel and is an important contributor to the making of cement and many other industrial products.

(f) Coal is the "mother" fuel and as such is capable of producing most of the hydrocarbons upon which America depends.

(g) Coal, in its production, transportation and consumption, is one of the major American industries and contributes directly and indirectly several billion dollars to the U.S. economy each year.

To say that coal is important is to state the obvious. It is apparent that coal will be needed for many decades and even centuries to come. From this it is easy to reach the conclusion that the Federal Government would be wise to provide for an adequate coal research program. With coal research the following results can be accomplished:

(a) The efficiency of electric generation can be increased to a significant degree, with the resultant economy in fuel utilization, a lowering of thermal pollution and a wiser utilization of our national energy resources.

(b) Many of the problems of environmental pollution incident to the burning of coal would be reduced and eventually eliminated.

(c) The conversion of coal to liquid and gaseous fuel would be made a reality with a fuller development of our coal resources and an increase in industrial activity in coal mining areas.

(d) America could once again become self-sufficient in energy. In short, we are suggesting that the application of research dollars to coal would be beneficial to the economy and would foster economic progress out of all proportion to the actual money expended.

Finally, research in the fields of coal mine health and safety is vital to the national effort to reduce death and disease among our Nation's miners. For too long research in this area has been given short shrift by the Government. But, it is now obvious that unless new methods are developed to permit a safe and healthy environment in our Nation's coal mines, America will refuse to accept the cost in human lives that is now a tragic part of coal mining.

Over the past several years the American coal industry and many others have staggered under the burden of unfair foreign competition. At the same time, American industry has been prevented from enter-

ing foreign markets by a variety of controls imposed by foreign governments to protect their own industries. This situation has reached a point of crisis.

Last year, approximately 93 million tons of residual oil in coal equivalent entered the United States. This total represents a 12.1-percent increase from 1967 and a 125-percent increase from 1959 when import controls were first introduced.

Because of the policies surrounding the administration of the residual oil import program, there is in fact no program. The result has been the accelerating loss of markets for coal along the east coast of the United States. Each day we hear of other consumers who have switched from coal to imported residual and each day the danger of even more conversions becomes more and more acute. The result of this invasion has been twofold:

(a) It has reduced the ability of coal to compete along the east coast.

(b) The east coast is fast becoming a captive of foreign nations for its fuel supply.

But, there is another and perhaps more dangerous implication behind the increase in foreign oil imports. That is the effect which such imports have on the over-all oil import program and thus the fullest development of our own national resources, especially our coal resources.

It is well known that coal is the basic energy reserve in the United States. It is also well known that coal can be made into oil and other hydrocarbon products.

However, we are at the moment of decision in this area. We can proceed to develop our coal resources for such uses and reap all of the advantages of such development. Or, we can kill the fledgling coal-to-oil industry by overdependence upon cheap foreign oil.

America in her infancy faced a similar dilemma. At that time she chose to develop her own industries rather than to rely solely upon the good will of foreign nations. Such a choice must be made today and the same decision should also be made.

Other nations have learned this lesson well. In nation after nation restrictions have been raised against the import of American goods in favor of domestic industries. To prove our point, we have only to look to the experience of coal which is barred from at least one major industrial nation and restricted in many others. The moral is obvious. We must protect ourselves as other nations are doing, or we will soon lose that strength which flows from our industrial economy.

Finally, there is the question of energy policy.

America is both a major producer and a major consumer of energy. Coal, oil, natural gas and electric energy constitute four of the major industries in our Nation. Each are expected to continue to grow as the energy demand of the nation expands.

America consumes tremendous amounts of energy. The United States consumed in 1967 (the latest year for which figures are available) 2.2 billion tons of energy in coal equivalent. Of that total, 21.9 percent was in the form of coal. The bulk of the energy consumed in this country is produced within our borders. But, in recent years an ever-increasing amount has come from abroad.

The atom is now a force in the American industrial scene, due largely to Federal subsidies and a favorable climate created by the Federal Government.

Laws covering the energy industry are a crazy patchwork which are often in conflict and which rarely complement each other. Government agencies view a sector of energy from a particular standpoint, but no single agency has the authority or the mandate to view the subject of energy in a rational, overall sense.

For example, the Atomic Energy Commission promotes the development of atomic energy as a competitor of coal. The Interstate Commerce Commission makes freight rates which have a direct impact upon the competitive ability of coal but that Commission has no responsibility for the health of the coal industry. Policies bearing on energy are made by several committees of Congress. Yet, no one committee looks at the question from the overall national view.

There are serious questions concerning the national welfare which can be answered only from this standpoint. There are questions relating to research and development. There are questions on imports and questions on the phasing in of the very large quantities of oil currently being discovered in Alaska and elsewhere. There are questions relating to the impact on the environment and the quality of life caused by the large-scale production of energy. Finally, there are questions regarding the competition between different segments of the energy complex and, indeed, between the parts of any single segment.

There is the question of the desirability of mergers in the energy industry. We have seen this trend with the coal industry and, more recently, we have witnessed the gradual takeover of coal by major petroleum interests. There is a similar development in the atomic field, with the emergence of a virtual duopoly in that area. There is the beginning of a similar trend in the electric utility field where co-operation can easily generate an atmosphere conducive to corporate concentration. The outcome is not yet clear, but the course of the events is ominous indeed.

Such disarray is not conducive to the national welfare, nor to the long-term value of our energy resources. We have suggested for many years that a national energy policy is required in the interest of the people of the United States. We suggest that such a policy is more important now than it has ever been before. We hope that the Congress will begin the task of developing a national energy policy without further delay.

We view the future of the U.S. economy with confidence. It is within our power to continue the long record of our Nation for economic progress within the context of social justice. With wisdom and a rededication of ourselves to this end, we will continue to forge ahead.

JERRY VOORHIS, PAST EXECUTIVE DIRECTOR, COOPERATIVE LEAGUE OF THE U.S.A.

ECONOMIC PROBLEMS FACING THE UNITED STATES

These comments will be limited to one problem area: that of the extortionate interest rates now prevailing in our economy with particular reference to the effect of those rates upon the shelter of the American people.

Prevailing high interest rates are economically indefensible, dangerously inflationary, and destructive to the supply of homes for the American people.

A few facts about past experience will be helpful. In May 1920 the Federal Reserve Board increased its rediscount rate substantially and advised banks to raise their prime rate to 7 percent, which the banks promptly did. The result was a decline in the total cash income from all farm products from \$14,600 million in 1919 to \$8,150 million in 1921. American agriculture was plunged into a state of depression from which it did not recover until the middle of World War II.

During the years 1941-46—war years, it will be remembered—the U.S. Treasury was paying as little as three-eighths of 1 percent interest on short-term borrowings. In 1967 the Treasury was paying more than 5 percent on similar borrowings. What these figures mean is that it cost American taxpayers \$3,750 a year to borrow \$1 million in the 1940's, whereas in 1967 it was costing them more than \$50,000.

Each one-fourth percent increase in the interest rate adds about \$1 billion to the annual interest which the American people must pay on the national public debt.

During the years of the Roosevelt and Truman administrations average interest rates on Government securities were held at about 2½ percent. If this could be done against the tremendous pressures of the most terrible and costly war in history it is obvious that the same policy could be followed under any conceivable circumstances—given the *will* and the policy on the part of the Government and the Federal Reserve to do so.

But this has *not* been done. Today the U.S. Government is paying more than twice the rate of interest on its borrowings that it paid during the 1940's and very early 1950's.

The result is that interest on the national debt is, next to military expenditures, the largest burden the taxpayers must meet in the entire national budget—amounting at present to about \$15 billion a year. At the rates prevailing in 1951 that figure would be less than half what it is today.

In August 1967 Chairman Patman reported to the Congress that the American people had paid \$43 billion in excess interest charges on the national debt alone since 1951.

Out of a tax payment of \$1,000 paid by a married man with two children and a \$10,000 income, no less than \$120 goes to pay needlessly high interest on the public debt.

The Federal Reserve banks can exercise an almost limitless money-creating power—a power which should be a function of national sovereignty. Therefore, *if* the Federal Reserve Board wishes to—or if the Government of the people is able to persuade it to—it can support Government securities at a decently low and economically justified rate of interest. This is substantially what was done during the Roosevelt and Truman administrations.

The reason it is so important for the rate on Government securities to be kept low is not far to seek. For the rate of interest on Government notes and bonds is the bellwether of all other rates. Investors generally will not buy other bond issues unless their rate of return is somewhat higher than that on Governments, since Government securities are generally regarded as the most secure investments of all. And if the rate of return on bonds goes up, then companies seeking to sell common stocks must try to show a rate of return on those stocks which is higher than the rate on bonds. For, again common stock equity investments are in general more risky than investments in preferred indebtedness like bonds. Hence there exists an insistent pressure upon every corporation which is interested in the market for its securities to increase the prices of its products in order, in turn, to increase its profit margins and thus make possible the payment of higher and higher dividends.

And yet the excuse that is constantly given for a high interest policy is that it is "necessary to curb inflation." We pay further respects to this deceptive myth later on.

The problem is not that interest rates *could* not be lowered if those who control our monetary policies wanted to do so. The problem is that the Federal Reserve Board, which is able to dictate monetary policy, deliberately decided—albeit by a 4-to-3 vote—in December 1965 to embark on a high interest policy. That policy has been in effect ever since and in increasing tempo. And the Government of the people of the United States has not acted to reverse that policy. Indeed, since the power to create the money of this Nation has been permitted by Congress to be taken over by the banking system generally and by the Federal Reserve specifically it is questionable whether under present circumstances the Government could, even if it were to decide to do so, compel the money powers against their will to reverse their escalating interest policy.

Congressman Patman's bill, H.R. 11, would go a long way toward correcting this situation and certainly, at the very least, that piece of legislation should be enacted by the Congress.

For the extortionate interest rates now afflicting our country are endangering the economic health of our Nation and preventing constructive progress in many important directions.

WE LIVE IN A CREDIT ECONOMY

We are living, as everyone knows, in a credit economy. Almost every State, city, town and school district in the Nation, most American families, practically all American farmers and the great majority of American business enterprises are in debt up to their ears. The rate

of interest therefore may well be the most critical factor in our entire economic life.

It is probable that a majority of American families are living beyond their present means. And no wonder! For they are bombarded by every advertising medium there is with the most clever blandishments to buy now, fly now, do everything else now—and pay later.

In 1966, the first full year after the Federal Reserve Board raised its rediscount rate by 12½ percent, \$125 billion was paid in interest on debts, public and private. Today that figure would be much higher.

In the 20-year period, 1946–65, consumer debt rose tenfold, from \$8 billion to \$80 billion. And farmers' debt trebled in the 15 years from 1950 to 1965.

It is reliably estimated that between 15 percent and 20 percent of all the disposable income of American families is today obligated for payments on installment and mortgage debt.

And probably 30 percent to 40 percent of the total incomes of the poorer families are so encumbered. It takes no great intelligence to see that the higher the interest rate, the less the likelihood that these families will be able to pay off their debts.

Under such circumstances the suggestion that unemployment be deliberately increased in order to control inflation is not only unbelievably cruel, but economically extremely dangerous. For with the mountain of indebtedness that now hangs over most families even a minor downturn in the economy could trigger such a succession of defaults as would plunge the Nation into a major depression.

The Government therefore cannot conceivably allow this to happen. Therefore the mounting burden of debt being imposed upon the people, aggravated by the spiraling of interest rates, becomes a powerful, if not an imperative influence necessitating ever broader governmental action to forestall the possibly disastrous results of its misguided high-interest policy. Some of the very people who decry governmental interference in the economy are the ones who are making such interference necessary by their extortionate inflation of the interest rates.

And what a job has been done. Beginning with the action of four-sevenths of the Federal Reserve Board in December 1965 we have witnessed—and been victims of—an almost continuous rise in the rate of interest. The rediscount rate of the Federal Reserve now stands at an unprecedented 5½ percent, the prime rate for bank loans is 7 percent and above—again almost unprecedented—and the rate on FHA-insured mortgages and veterans home loan mortgages has just been increased to an effective 8 percent, made up of a basic 7½-percent rate plus one-half-percent insurance fee. To the devastating effects of 8-percent interest on the hopes of the American people to have decent homes and decent shelter over their heads we shall return later on.

In State after State moneylenders are bringing pressure to lift the ceiling in the anti-usury laws. In Illinois legislation is pending at this moment which would raise that ceiling to an extortionate 9 percent. And this is the proposed rate not for consumer loans, short-term credit or revolving credit, but for prime lending by banks.

And the end is not in sight. Increasing interest rates is an unjust method of trying to curb inflation.

It is unjust because the burdens of the higher rates fall in exactly the wrong places. First, they fall most heavily upon the poor who are the most defenseless against them. Second, they fall most heavily upon the homebuilders and the home buyers, whereas America's one greatest unmet economic and social need is for more good homes in good neighborhoods at costs they can afford. Third, high interest falls especially heavily on farmers, the very producers of whose production we need vastly more, if world hunger is to be prevented. And, fourth, small competitive businesses are severely penalized by high-interest rates in their struggle to stay alive in competition with giant conglomerate corporations.

Now what we don't need more of are big, fancy automobiles, a fifth color television set in every bathroom, or several billion more cigarettes. Yet the huge corporations that control these manufacturing segments of our economy are, generally speaking, not affected by the high-interest rates for the reason that their profit margins are generally so high that they can get all the financing they need from internal financing and without borrowing a cent.

At this point I cannot refrain from further discussion of the relation between the growing and almost all powerful monopolistic segment of our economy as contrasted with the struggling and disadvantaged sector which remains competitive. Economists frequently discuss our Nation's problems with a complete disregard of the effects of monopoly, oligopoly, and the artificially controlled production and administered pricing which result therefrom. Erroneously it is assumed that the three or four corporations which in each case effectively control such industries as food processing, automobile manufacturing, containers, chemicals, farm machinery, electrical equipment, steel, and many other key industries are subject to general economic influences.

Such, however, is not the case.

On the contrary, and in striking contrast, to small businesses in the competitive sector, these giants are able to do practically all of their financing by the simple process of overcharging the consumer for their products. They thus derive sufficient profit margins to buy out competitors, to expand plants, and to do anything else they decide to do without the necessity of either borrowing any money or selling any stock. They are literally, therefore, private sovereign "nations" responsible to absolutely no one except their own managements and boards of directors.

Raising interest rates has absolutely no effect in "cooling off" these giants.

The prices of their goods are fixed by decision of management and their boards of directors at the point of highest practical and defensible return. The so-called "law" of supply and demand has no effect. The prices of these commodities may actually rise, even in the face of economic conditions which would compel declines in price for competitive industries. Price competition is a thing of the past. It is no great oversimplification to say that the reason farmers receive only about two-thirds on the average in income as do the rest of the population is because the people are compelled to pay monopolistically fixed prices for automobiles.

All this is another and very powerful reason why raising interest rates adds materially to the disadvantage of all competitive and smaller businesses and encourage on the other hand, the monopolistic tendencies already strong in our economy.

Why then, would any nation in its right mind pursue such a mad high and escalating interest rate policy as our Nation is now doing?

Certainly not because there is the slightest economic justification for it. The banks, the money lending institutions generally, are making such large profits—and have been doing so for many years—that their stock is so valuable that it is seldom sold and almost never on the open market. Indeed it has been repeatedly found that many businesses make more money out of their “financing” of sales than they do out of the sale of the merchandise itself. A basic reason why Congress finally passed, after 8 years of struggle, the “truth-in-lending” law was because it has become common knowledge that the extension of credit and the so-called “financing” of sales is the most oppressive, extortionate, racket ridden but fabulously profitable business in our entire economy.

Nor can it be honestly argued that high interest rates are the natural result of the tired old law of supply and demand—a so-called law now observed far more in the breach than in the observance. In the case of money such an argument is almost ridiculous. For under our fractional reserve system the supply of money is virtually a function of the demand for it. The banking system creates the money of our Nation by the costless method of writing up demand deposits on its banks and loaning them into circulation to borrowers. Can anyone find a banker or moneylender who is today refusing to make a 7- or 8-percent loan to a reasonably good risk borrower? Probably not. But when those loans are made—as a result of the demand for money—the supply of money automatically is increased to meet the demand.

So we come back to the threadbare and by now abundantly discredited excuse that high interest rates are necessary in order to curb inflation.

It is frequently lamented that in the past 25 years the dollar has lost 50 percent of its buying power, because of what is called inflation. Well, in that same period, interest rates have more than doubled. In fact they have more than doubled in just the last 16 years. If raising interest rates were an effective method of curbing inflation these two events could not possibly have happened simultaneously.

When the Federal Reserve Board raised its rediscount rate in December 1965 I wrote in my biweekly column “The People’s Business” the prediction that it would not be long before we would be paying 10 percent more for houses, and 10 percent more for almost everything else we, the people had to buy. I received some criticism for that statement, including that of one of the Federal Reserve banks.

But my statement was the soul of conservatism. For the fact is that prices have risen considerably more than 10 percent since the high interest policy was launched in December 1965.

My argument then was—and it is today—that the cost of money is, in our present credit economy, a factor in the cost of production of every commodity or service in the market, except those produced by the internally financed giants who need not borrow. Therefore, the

greater the cost of money, the higher will be the price consumers must pay for their necessities and amenities of life.

History has certainly proved this to have been the case. The higher interest rates have risen, the worse the price inflation has become.

Even were the facts of history not convincing a bit of widely accepted economic theory can be cited. That theory is that the way to bring less of something onto the market is to reduce the price received by producers. Especially is this argument used against farm price supports.

How then can it be contended with a straight face that the way to reduce the amount of money and credit being created is to *increase* the return to the creators and lenders of that money and credit? Yet that is precisely the position in which the high-interest advocates place themselves.

There is one circumstance in which, it must be admitted, high-interest rates can curb inflation. If these are raised *high enough* to cause widespread unemployment and to bring about a wave of bankruptcies, foreclosures, and defaults, then indeed inflation will be stopped. For we will then be in a downward spiral of deflation, depression, and economic collapse.

But I am confident that no one—not even the most ardent of the high-interest advocates—is willing to pay that high a price to validate the otherwise discredited myth that raising interest rates is a counter-inflationary measure.

In fact, the price we are now paying is indeed far too high.

For the high-interest rates operate as a heavy tax on everyone, not only at the Federal level, as was explained earlier, but at the local level as well. Higher interest rates mean that every school bond issue, every bond issue for urban improvement, or pollution control, or any other good purpose costs the taxpayers just that much more. This was no doubt a major reason why the schoolchildren of a large Ohio city had to forgo their education completely for a 6-week period because the voters turned down an essential bond issue for school financing. Shortly before the Newark, N.J., riots, that city had been forced to cancel a \$15 million bond issue, the proceeds of which were to be used for improvements of life in the ghetto. And the finance director of Newark stated at the time that: "The prime factor in our decision was the increasing interest costs municipalities have to pay in recent weeks."

As interest rates rise the cost of government and hence the burden of taxation goes up almost in geometric proportion to the rate increases.

HIGH-INTEREST RATES ARE DEPRIVING THE PEOPLE OF HOMES

With all the talk about the values of homeownership and despite all the constructive legislation that has been passed by Congress to try to encourage homeownership the fact is that more than half of all American families are priced clear out of the market for homes today.

The one reason for that fact is the extortionate rate of interest. Other cost factors are of comparatively little consequence.

The average cost of homes built in 1968 was more than \$30,000. But it takes an annual family income of close to \$9,000 for people to be able prudently to afford even a \$20,000 home; \$9,000 is far above the median income of the American people.

Here are the facts.

In the case of cooperative-owned housing which is built not for profit but solely because people need housing at costs they can afford, the monthly charges to the cooperative homeowners must go up by between \$3 and \$4 per room per month forever; 1-percent rise in the rate of interest.

Even at 6¾ percent—the rate only a short time ago on FHA-guaranteed loans—a family attempting to buy a \$25,000 home on a 25-year mortgage had to pay almost \$27,000 in interest alone—\$25,000 for the home; \$27,000 to the moneylender.

But at the present 7½-percent rate—disregarding the ½-percent additional insurance fee—a \$20,000 home bought on a 35-year FHA-guaranteed mortgage obligates a family to pay more than \$60,000. Twenty thousand dollars for the home—all the brick, wood, plumbing, fixtures, labor, every other cost—but \$40,000-plus just for interest on the money.

Such a situation is manifestly unjust to every American family except the richest ones. It is indefensible from any decent economic point of view. It means in simple terms that well over half the American people are priced clear out of the market for homes. *And it is utterly unnecessary.*

The first reason why it is unnecessary is because Congress could correct it by implementing with adequate appropriations its own Housing Act of 1968.

Under that act provision is made for Government subsidies to home buyers such as would reduce their effective interest payments to 3 percent, or even 1 percent. And it is a fact that for moderate-income families a 3-percent rate is all that can be afforded, and for low-income families even 1 percent may be hard to meet. But very substantial appropriations will be required if this implementation is to be at all meaningful or to have any real impact on the need for homes of the entire lower income half of our population.

And, obviously, the higher the interest rate, the greater the cost of such a subsidy program.

Again, if it is desired to bring more private funds into participation in the housing program, the Congress could provide funds to subsidize the difference between a lending rate that average families could afford to meet and the going rates of interest. Here again the cost to the Government—and hence to the taxpayers—will be multiplied by every ½-percent increase in the going interest rate.

A third method that has been used in other very worthwhile programs of our Government and which is indeed appropriate in the present situation is direct lending by a Government agency.

Such direct lending could have the competitive result of bringing down the usurious rates now in effect in the private money markets. Furthermore, if the funds to be lent were not borrowed by the Government lending agency but were derived from tax revenues, as they should be, then it would be entirely sound economically to make the loans at a rate simply sufficient to cover administrative costs and to provide a reserve against possible losses. Experience with other similar direct lending programs clearly indicates that the Government could "make money" at a 3-percent or even perhaps a 2-percent lending rate through such a direct lending program.

In these comments considerable has been said about the ineffectiveness and the moral wrong of trying to curb inflation by raising interest rates.

Therefore it is necessary to suggest how inflation can be kept within bounds by other, better, more effective, more direct, and more morally defensible means.

A number of such means are available.

First is the rather obvious step of reducing the money-creating power of the banking system. This the Federal Reserve Board can do at any moment by increasing the reserve requirements for demand deposits. In somewhat oversimplified terms here is what such an increased reserve requirement would mean. Whereas before the increase in required reserves the banks could create new money in the form of demand deposits at a ratio of 7 to 1 to their reserves, after the new ruling they would be able to do so only in the ratio of 4 or 5 to 1. Here is the most direct method in all our presently existing monetary system of dampening monetary inflation. Why the Federal Reserve Board has not used it, if it was so alarmed about inflation, would be hard to understand were it not for the fact that all the voting stock in the Federal Reserve System is owned by the very same banks whose money-creating power would be curtailed by such a move.

Nonetheless, an increase in reserve requirements would be a far more direct, immediately effective, logical, and economically defensible counterinflationary move than is raising interest rates.

Second, if anyone—repeat anyone—is really concerned about price inflation, overextension of credit, families living beyond their means, “heating up the economy” or any such matters, a quick look should be taken at the nauseating saturnalia of credit card promotion which is now being foisted on an all-too-gullible public. If anything on earth is inflationary it is to urge people to buy and buy and buy whether they have any money with which to pay for it or not. Once the Truth-in-Lending Act becomes effective on July 1 and credit card promoters have to advise their cardholders of the rate of interest they must pay on their outstanding balances, some of the enthusiasm may be cooled. But meanwhile it is hard to understand why a nation worried about rising prices and increasing cost of living takes no action to regulate this credit card craze.

There have been times when the Federal Reserve Board by regulation has restricted the extension of credit in the economy. Wisely used, this method could act as a controller on the use of “buy now—pay later” inducements to consumers to acquire gadgets they may not need at “financing charges” nobody ought to afford.

Here again such action would be straightforward, could be aimed at the exact place where credit is being overextended, and could have a much earlier effect on any inflationary trends than raising interest rates.

At least two States—Texas and Pennsylvania—have completely abolished the garnishment of wages as a means of collecting debts. Such action by the Federal Congress would end, once and for all, the harassment to which wage earners and their employers are so often subjected. It would also have the effect of cooling the present

avidity of unsolicited salesmen in trying to induce families to buy things they cannot wisely afford.

Finally there is the basic method of taxation.

The fundamental way to stimulate an economy which is sluggish is to put more money in circulation. And if it is felt necessary to slow down economic activity the classic and fundamental way to do so is to produce a governmental surplus by means of taxation. Furthermore, it is the honest way to do it—provided always that the incidence of the taxation falls upon those best able to pay, who are also in practically all cases the ones who receive the greatest benefits from Government services and protection. At present it is highly questionable whether our tax system is just from this point of view. The need for tax reform is quite evident. But with that subject these comments do not attempt to deal.

The only humane, economically sound, or growth-inducing policy that makes sense in this debt-burdened world is a low-interest policy.

And to the extent that taxation—in accordance always with ability to pay—is actually necessary to prevent precipitous increases in the price level, we the citizens of our country should be willing to pay.

Especially should we be willing to pay enough taxes to pay currently the cost of every war in which we may, tragically, become involved.

The 19-year-old youngsters whom we compel to fight in Vietnam didn't cause that war. We did, by our failure to create peacekeeping machinery in the United Nations strong enough to stop and settle it, with justice and in orderly fashion.

Therefore, at the very least—if the older generation of Americans had the decency we should have—if our love for our children were as sincere as we like to claim it is—we should be demanding that taxes be increased at least enough to pay the cost of that war.

Unless the older generation does this, we of that older generation are in the position of not only compelling our children to fight and die and learn to kill in a war they did not make, but also of forcing them to pay our bill for it at some future date, when the bonds come due.



