THE FOLKLORE OF INFLATION

by

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With Prices Rising . . .

We Americans are increasingly concerned about inflation. But do we truly recognize it as a clear and present danger?

How does it happen that in dealing with inflation, the right thing to do economically, is always regarded as the wrong thing politically?

Why is it that a long overdue revision of our national labor policy is politically unthinkable if not suicidal?

Are higher taxes the answer to inflation?

Mr. Blough discusses these thoughtful questions and their solutions; and in doing so he tenders a challenge to all Americans.

We believe you will find this talk of interest as it deals with a subject which is close to the pocketbooks of all of us.

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Winston Churchill is said to have observed that the three most difficult things for a man to do are these: To climb a wall which is leaning towards you; to kiss a lady who is leaning away from you, and to make an after-dinner speech.

Never having been a human fly, I obviously cannot comment on the first of these Herculean feats; and I know better than to comment on the second. But I am well acquainted with the formidable hazards inherent in the third. And never, perhaps, have they seemed more formidable than they do on this occasion. For when I think of the many great and famous people who have addressed this forum in the past, I am not only amazed to find myself here at all, but appalled by the thought that I am clearly expected to say something very profound.

Now it has been said that a profound speech is one which leaves both the speaker and his audience in utter confusion. And the state of the nation being what it is today, every topic of discussion I can think of is already so engulfed in confusion that nothing I could possibly say would add to it. So under these cir-

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cumstances, I submit, not even Casey Stengel could be profound.

Amid all this confusion, however, I note that there is one topic that has obfuscated economic man throughout five thousand years of recorded history — ever since the ancient Egyptians, in fact, devised a unit of value which was appropriately known as the Skat, and which depreciated slowly until it was worth nothing at all.

Here in our own country, the phenomenon of dollar decay has been a matter of continuous national concern now for more than a quarter century. Almost endlessly since 1940, economists, politicians, businessmen and others have discussed and debated the causes, effects and the cure of this pernicious monetary disease; but the only practical result, to all intents and purposes, has been that the 1940 dollar is now worth 42 cents. So there is little likelihood that any observations of mine in this field will greatly endanger our national solvency.

In recent days, of course, the discussion has been intensified by the devaluation of the pound sterling, by the possible resurrection of the Administration's tax proposals, and by what might be called a galling attack on our gold resources. And one disconcerting side effect of all this dialogue is that virtually everything that can be said about inflation has already been said—and better too. Yet, after reviewing our experience over the past few years, it occurs to me that there is one aspect of the matter that has not received the full measure of attention it deserves: and that is what I might term the "folklore of inflation."

Despite the advances of science, every generation has clung to certain favorite nostrums with a faith that surpasseth all reason. In my grandmother's day, for example, the homeopathic pioneers in the field of preventive medicine were wont to hang a small bag of asafetida around the neck of a child to ward off disease; and this may have done some good at that, since it emitted a strong odor like decaying garlic which tended to make the poor child a social outcast and thus diminished considerably the chances of contagion.

Again, an almost universal specific for colds and ague was a steaming cup of sassafras tea. This was calculated to induce perspiration in an age when the sauna bath had yet to be imported to these shores; and thus it also may have served a useful purpose.

Then in the spring, when you and I now think about draining the anti-freeze from the radiator and changing the oil, grandmother's idea of tuning up the human system was to concoct a generous dose of sulphur and molasses which she inflicted upon the entire family.

And you may recall from the pages of Mark Twain that there was a difference of opinion between Tom Sawyer and Huck Finn as to the best way to get rid of warts. Huck favored the dead cat method which was practiced in nocturnal mysticism at the graveside of a newly departed sinner whose soul was clearly ticketed to Gehenna. But Tom thought warts could be better exorcised by dipping them in a spunk-water stump at midnight and indulging in certain rituals and incantations. Both agreed, however, that when properly used in the dark of the moon, a blood-smeared bean was sure-fire.

Such superstitions, of course, have not been confined to the world of medicine. They have blossomed with equal profusion in the realm of economics, and the nostrums for dealing with inflation have been legion. It is true, to be sure, that we no longer seek to stop rising prices by beheading the neighborhood storekeeper; and Germany—after World War I—discovered that a whole Niagara of printing-press money was not the answer either.

But other myths have persisted; and among these, none has proved hardier, perhaps, than the notion that it is only necessary to prevent the price of steel from rising, and inflation will go away like Tom Sawyer's warts. Washington can inflate the money supply with impunity, labor can raise wages far beyond the gains in productivity, but hold steel prices down and everyone will be happy and rich—everyone, that is, except the steelmakers, of course.

Some credence has been lent to this theory at times by the tendency of some people to use steel as an excuse for their own price rises; and I recall that several years ago, a stockholder sent me a notice which he had just received from his bank, stating that because of a recent steel price increase, it would be necessary for the bank to raise the rent on his safe-deposit box.

Yet I had hoped that this particular bit of American folklore had been quietly interred last year along with the earthly remains of the wage-price guideposts. Unfortunately, however, there have been times this year when

it appeared that the Government was again being tempted to exert its awesome influence on steel and certain other highly visible industries; and with another Presidential campaign coming up at a time when the public is in revolt against higher taxes and rising prices, it seems inevitable that some candidates for elective office will be looking for a convenient scapegoat upon which to load the blame for inflation.

Now having once been cast in that sacrificial role, I am understandably reluctant to be tapped for it again. So with your indulgence, I would like to point out a few facts about steel prices, even though I realize that nobody loves a fact man. But the simple truth is this:

Since the end of 1958, the price of finished steel—according to the government's latest index—has gone up 4 per cent, while the overall cost of living—as measured by the Federal Consumer Price Index—has risen 16 per cent, or 4 times as much. So instead of leading the parade as many folks still seem to believe, steel prices have lagged far behind it.

It is enlightening too, to contrast the behavior of steel prices with that of the prices charged by the government itself in what is probably the largest single enterprise it operates—the Post Office.

Since the end of 1958, first class postage rates have risen from 4 cents to 5 cents—or 25 per cent; and under a bill recently passed by the House and Senate, they will soon go up to 6 cents . . . just half again what they were nine years ago. That means that the price of postage will have increased more than ten times as much as the price of steel during this period—and basically for the same reason: to meet rising operating costs.

It also means that the cost burden which this latest postal increase alone will impose upon the American people will be substantially greater than the total annual effect of all of the steel price increases that have occurred during all of the past nine years.

So from these simple facts, two things would seem to be evident: first that the comparatively slight—but widely publicized—rise in the price of steel has had little to do with the mounting cost of living; and second, that in any business, prices must rise to meet costs as inevitably as water must seek its own level.

Yet public opinion polls reveal that Americans—rebelling against the prospect of higher taxes — are looking with increasing acceptance upon price controls as the answer to the inflation threat we face. And this, of course, is a remanifestation of the oldest and most persistent myth in the entire realm of economic folklore—the notion that prices can be held down simply by making it illegal to raise them.

That cure has been tried for forty-six centuries, under every conceivable circumstance, by nations all over the world; and so far as I can discover there is not a single case on record where it has stopped—or even curbed for long—the forces of inflation. On the contrary, controls have infallibly discouraged production, created shortages, led to corruption, and aggravated all the evils they were intended to cure. And where they have not been abandoned in time, they have brought poverty,

want and disaster down upon the heads of the very people they were supposed to protect.

In our own country, under the stress of war, we have resorted to wage and price controls twice in this century; and we who recall those experiences have learned that it is one thing to impose controls and quite another thing to survive them. We recall the rationing and the shortage of goods, the black markets that sprang up in open defiance of law, the butter that was sold from under the counter to favored customers, and the shoddy merchandise that replaced the quality products we had bought before.

We also recall the enormous and wasteful costs involved in administering the unbelievably complex rules and regulations which governed prices. During the Korean conflict, for example, United States Steel's operations were under control by eight different Federal agencies, the two most important of which were the National Production Authority and the Office of Price Stabilization.

Regulations and directives of the Production Authority contained about 300,000 words and underwent approximately 400 amendments, supplements, revocations, and directives; while the Office of Price Stabilization issued 37 different regulations applying to our business. One of these alone consisted of almost 30,000 words and was amended 41 times with 20 supplemental regulations.

So estimate if you can the number of accountants, lawyers, engineers and others required to keep up with these regulations; multiply that number to cover all the businesses in the country, big and small; add the thousands of people employed by Government to administer these controls, and you will get some idea, at least, of how much this experiment escalated the costs of production and the Federal deficit.

One further lesson we learned from this experience was that while the lid could be held on prices for a limited period, trying to hold it down on wages was a different thing entirely. And so, by the end of World War II, steel prices had gone up only one per cent; but our hourly wage costs had risen 46 per cent, despite the controls.

This same lesson, of course, was repeated more recently under the guideposts which the government introduced in 1962 in an effort to control wages and prices by so-called "voluntary" means. The theory here was that if the national wage level were not permitted to rise more each year than the long-term annual 3.2 per cent gain in national output per man hour, the general level of prices could be prevented from rising at all.

And for the first three years, this experiment—for whatever cause—seemed to be working out fairly well as the Consumer Price Index climbed only moderately and wholesale prices rose hardly at all. But labor was growing more assertive and in 1965, settlements in major manufacturing industries substantially exceeded the guidepost proscriptions. Then, last year, the AFL-CIO openly defied the guideposts—both in words and in deeds—and when the White House undertook to settle the strike of the airline mechanics and was forced to accede to a 5 per cent increase, the 3.2 per cent limit had been hopelessly breached

and another noble experiment faded—like near beer—into oblivion.

Since then, of course, wages have gone up even faster, and the government has made no very audible protest against them. In fact, it has contributed to them in certain pattern-setting cases.

Earlier this year, the Special Presidential Board created to settle the railroad shopcrafts dispute granted the workers a wage increase of 5½ per cent annually for two years. And under the bill already passed by the House and Senate, postal workers will get a 6 per cent increase as the first of three pay boosts to cover a period of only 18 months.

In the field of construction, hourly wages have risen 8½ per cent so far this year without the assistance of Government, the United Auto Workers have won an estimated 6½ per cent package from Ford, and in New York City, the transit workers are modestly demanding a 30 per cent pay increase plus a multitude of fringe benefits.

All in all, then, wages have skyrocketed so far beyond any offsetting gains in productivity that unit labor costs in manufacturing—which had remained relatively stable in the earlier years of the guidepost formula—have risen sharply. According to William McChesney Martin, Chairman of the Federal Reserve Board, they were 5½ per cent higher in mid-1967 then they had been a year earlier; and since employment costs—direct and indirect—account for three-quarters of all costs in the economy as a whole, they have been a major force in pushing consumer prices up at an annual rate of 4 per cent since last spring.

Meanwhile profits declined 9 per cent in the past fiscal year.

So today we find ourselves caught in another serious round of wage-push inflation—a phenomenon that has been with us almost continually ever since the Wagner Act—passed more than 30 years ago—conferred upon labor what Arthur Krock has described as the "unique statutory power to raise the costs of production virtually at will."

On the other side of the coin, what economists call demand-pull inflation has also become an increasing threat to price stability as the spectacular rise in government spending and deficit financing has threatened to lead to another sharp increase in the money supply.

In the fiscal year 1965 cash expenditures of the Federal Government totalled about 122½ billion dollars, but in the current fiscal year it is now estimated that they will amount to about 181 billions—nearly half again as high as they were only three years ago. It is significant, moreover, that only half of this 58 billion-dollar increase has been for defense purposes. In other words, for every dollar of additional defense spending, non-defense expenditures have also gone up one dollar. And the largest part of this non-defense increase has come in the categories of housing; health, labor and welfare; education, and Social Security and Medicare.

To meet these ballooning expenditures—and to cope with the deficits that have apparently become an instrument of our national policy under the new economics—an inflationary expansion of the money supply has occurred. Thus far in the 1960's, the supply

of money, including time deposits, has been increasing at an average annual rate of 7½ per cent; but during the first half of this current year, that rate has jumped to about 12 per cent.

So today, according to some reports, we face the prospect of a staggering 30-billion-dollar budget deficit by the end of this fiscal year. And as new money is pumped into the economic stream to meet this deficit, the Administration and its economists are becoming more and more concerned lest an inflation of this magnitude set off another cycle of boom and bust and lead to a severe depression which —under the gospel according to Lord Keynes —would call for still more inflationary spending as the only effective counter-measure.

Now despite all the folklore that has surrounded this problem through the ages, there is no longer any mystery about the true causes of inflation. And if I were asked to define them, I would put it this way: When government spends more than it gets and when labor gets more than it gives, that empty feeling in your pocket is inflation.

Thus the remedy—like the cause—lies wholly within the domain of government. On the one hand, it is Federal law that confers upon labor the specialized power to impose uneconomic wage settlements at the bargaining table. And on the other hand, the Federal Government alone, under the Constitution, has the power to coin money and to "regulate the value thereof."

Washington can retard the expansion of the money supply to conform to the increase in the supply of goods and services. It can cut its expenditures to conform to its income, or—conversely—it can increase taxes to cover expenditures. Or it can employ a combination of all three. And conceivably, it could revise the laws to equalize the powers of management and labor at the bargaining table so that neither side would have an advantage over the other.

But government is a political agency—not an economic one and must, therefore, provide political solutions which affect basically our economic problems. And the trouble is that no one has yet discovered a solution which appears to be both economically sound and politically attractive. So throughout the course of history, governments have found it expedient to attack the symptoms of inflation rather than the causes. To change the loose fiscal and monetary policies that produce inflation may be politically perilous; but to inveigh against the high prices which result from these policies seems always to be politically popular.

To me, therefore, the most heartening sign on the whole economic horizon today is that neither in the Administration nor in Congress is there any apparent disposition to resort to the discredited and ruinous course of reviving price controls. And I believe the present government in Washington is to be congratulated on its efforts to come to grips with the hard economic facts of inflation even though the Administration and the two branches of Congress are still embroiled in controversy over them.

The Administration has chosen the currently unpopular course of seeking a 10 per cent increase in income taxes, in order to syphon off excess consumer purchasing power,

diminish the prospective deficit, and thus to curb the rapidly expanding increase in the money supply. And if a tax increase is a temporary one to meet our defense needs, and is accompanied by a meaningful reduction in Federal spending, it can, I believe, be beneficial. Without such a reduction in spending, however, there is no assurance that it would serve its intended purposes.

According to Parkinson's Law, expenditures rise to meet income; but where government is concerned, it would be more correct to say that expenditures rise to exceed income. For no matter how greatly the Treasury's receipts may increase, they seem never to be sufficient to catch up with the growth in spending; and thus the Federal Government has run deficits in 31 of the past 38 years.

So if, in accordance with this historic pattern, the prospective deficit were to remain substantially undiminished in spite of a tax increase, nothing would have been gained and, with the higher tax take, we might well be worse off than we were before, since taxes themselves constitute a significant part of both the cost of living and the cost of producing, and thus tend to exert upward pressures on wages and prices alike.

In Congress, therefore, the House leadership has taken the position that any tax increase must be accompanied by a curtailment in non-essential spending—a position that is highly popular politically . . . up to a point. The hazard lies in deciding what is "non-essential."

Some people would cut back on expenditures in Viet Nam or even abandon them entirely. Others feel that the War on Poverty is being escalated too rapidly. Some would curtail the space program or eliminate the development of the supersonic transport plane. Others would carve a slice out of farm subsidies or the foreign aid program. And so it goes. Everybody would cut government spending, but nobody has come forward with a list of priorities that would command a consensus.

So Congress and the Administration have been at odds over how to do the pruning, and by how much. Chairman Wilbur Mills of the House Ways and Means Committee reviewed this stalemate with great clarity in a speech he made two weeks ago tonight; and last week the Administration made an additional proposal.

Now no one would argue, I suppose, that any agency—governmental or private—can spend 181 billion dollars a year so efficiently that none of this money is wasted. Most of us would assume, moreover, that there must be a number of older agencies and functions which, over the years, have outlived much of their usefulness and might be cut back or phased out. And none of us, I feel sure, really believes that it is impossible to shave a few billion dollars from both the defense and non-defense sides of the budget without seriously impairing our national welfare at home or walking out on our military commitments abroad. Clearly it can be done. So it is natural perhaps that we should criticize government for failing to live up to its responsibilities.

But at this point one nagging question may arise to ruffle our self-complacency. Government *is* responsible for inflation. That is true. But who is responsible for government?

Well, we are, of course. And since our representative government is accountable to us and must do our bidding, how does it happen that—in dealing with inflation—the right thing to do, economically, is always regarded as the wrong thing to do politically?

Our elected officials may pass an unpopular tax bill. They may cut back on their spending, and tighten up on the money supply as necessary; but of what good is this to them, or to us, if they are then defeated at the polls by candidates who are pledged to take precisely the opposite course. And why is it, too, that a long-overdue revision of our national labor policy is politically unthinkable if not suicidal?

Mirror, mirror on the wall
Where does the blame for all this fall?

So I wonder if we Americans are really as concerned about inflation as we say we are. Do we truly recognize it as a clear and present danger?

Since the beginning of World War II, our dollar has shrunk to about two-fifths its former value; and some of our people have undoubtedly suffered severely—notably pensioners, widows, the unemployed and others who have had to live on fixed incomes. But most of us haven't been hurt much for the moment. Wages and salaries have consistently risen faster than the cost of living, so those with jobs still seem to be well ahead of the game. But they won't be if inflation ever gets out of hand as it has in so many other countries; or—as former Secretary of the Treasury Anderson once put it—". . . if we ever reach the point where people believe that to speculate is safe but to save is to gamble."

In the last analysis, then, the power to curb inflation rests primarily with us. We can support those elected officials who vote to cut government spending, even if this affects our own pet projects or communities. We can support those members of Congress who vote to increase our taxes after government spending is reduced. We can make it politically safe for them to do what has to be done. In fact, we can make it *unsafe* for them not to do so.

But all of this will take a good deal of missionary work on the part of those who fully appreciate the dangers of inflation and who understand the workings of this disease. And certainly, I think our schools should see that every high school graduate is as well instructed on this point as he is in reading, writing or arithmetic. For only when the voters in this country thoroughly understand the meaning and the causes of inflation can we reasonably expect our government to live within *our* income.

Too often, today, we hear it said that America is so rich and so "affluent" that it can afford to abolish poverty at home, establish freedom throughout the world, and finance the developing nations; all at once—in a hurry-scurry.

And to those who hold this view, let me offer—in closing—a thought-provoking little item which appeared in the news recently.

It seems that a bill introduced in the Illinois Legislature would require all credit cards issued in that state to carry this warning:

"Caution: Excessive use of credit may be hazardous to your economic health."

Perhaps these same words should be imprinted on all appropriation bills!

USS