PRICE-WAGE RELATIONSHIPS AS FACTORS IN ECONOMIC STABILIZATION

Mr. Stanley H. Ruttenberg

NOTICE

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Reviewed by: Colonel Tom W. Sills, USA

Date: 23 February 1960

INDUSTRIAL COLLEGE OF THE ARMED FORCES

WASHINGTON, D. C.

1959-1960

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Reporter: Grace R. O'Toole

Publication No. L60-118

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DR. KRESS: General Mundy, Gentlemen: There is an old adage that if you want something done you should go to a busy man to get it. That is true this morning.

Our speaker, Mr. Stanley Ruttenberg, returned just before the holidays from a research job in Europe, spent all day yesterday before the Joint Economic Committee, and leaves next Friday for the quarterly executive meetings of the AFofL-CIO in Miami.

I am sure the Director of Research will be very busy on that job and not sure that he is in Miami or some other place.

We asked him this morning to talk on the pros and cons of wage-price relationships, and he did not hesitate for a moment to accept that assignment. As you know, with the exception of three years in the Army, from 1943 to 1946, he has spent all his time since 1938 in research on labor problems.

Mr. Ruttenberg, it is a pleasure to introduce you to this audience.

MR. RUTTENBERG: Thank you very much. General, and Participants here in this Industrial College of the Armed Forces: I, as a former very junior-grade officer in the Quartermaster Corps, feel kind of out of place with all these generals and colonels here. If you will pardon that for a moment, I wish it were a week from Friday that I would be leaving for our executive

council meeting. It happens to be the first thing in the morning, which makes it even worse, because a great deal of the work that has to be done still is left to be done today.

I am going to talk today about the Price-Wage Relationships as Factors in Economic Stabilization. As a matter of fact, I have done something that I seldom really do, and that is, I have written this out, because I am going to use it, not here but at a few other places in the course of the next 2 or 3 weeks. I wanted to state the problem, so, if you will bear with me, I am going to read parts of this. But, because I am going to read parts of this, don't let it hinder you from asking me the most embarrassing questions that you can conceive of during the question and answer period, because, the more embarrassing and difficult they are, the better I will like them. I won't guarantee you that I'll answer them to your satisfaction, but I'll make a stab at trying to answer them.

Our economic challenge today is to keep a highly complex economy moving forward, picking up momentum as it goes. The goal for economic survival is a balanced growth rate of about 5 percent a year. I am sure Leon Keyserling yesterday talked to you at some length about that. We must have a maximum level of employment, production, and purchasing power in attaining that goal.

Prices and wages can be discussed intelligently only within the framework of this overall concept, for both price and wage movements respond to the direction of the total economy and are sensitive to its swift changes. The

relationships between prices and wages, between prices and the economy, and between wages and the economy are varied and complex. Distortions have made these relationships seem simple and automatic. In fact, the attempt for seven years to treat wages and prices as isolated factors, occasionally wreaking economic havoc, has hurt and harmed the American economy. The moment prices and wages are lifted out of context and made the goat for every economic imbalance, mistaken policies result.

These mistaken policies have led Americans to go off to war against inflation as their chief enemy for the last seven years. Yet the kind of inflation they fought did not occur in those seven years. Weapons to halt price rises therefore were ineffective because they bore no relationship to price changes. They were successful, however, in curbing economic growth. And that is the key question: A greater concentration upon fighting inflation than upon striving for the attainment of the economic goals that I am sure Leon Keyserling talked to you about yesterday.

Thus, mistaken notions about price-wage relationships have for seven years aided America's No. 1 economic enemy, stagnation, while the whole Nation has been distorted to fight an enemy which does not exist. Instead of a growth rate of 5 percent a year, we have had a total output increase of about 3 percent a year, and a per capita increase of .6 of 1 percent per year in the last seven years. And that is not enough. As I shall demonstrate a little later, it is in fact the failure to recognize the need for and to achieve balanced growth that has contributed to somewhat upward pressures

in the economy. The growth rate of .6 of 1 percent in the past seven years is just one-seventh the growth rate per-capita-wise of the Soviet Union.

Within this framework of a growing economy, two additional premises must be accepted before price and wage movements can be viewed intelligently. Like the overriding and overwhelming importance of economic growth, these ideas have been lost to the American people, despite many efforts to emphasize them.

The first is the need for balance between investment, production, and consumption. The other is the effect of the swift technological change on the problems of the American economy. First--on balanced growth--America's success in producing vast quantities of goods has been a source of pride to all of us. The necessity of building productive capacity to turn out even more goods and to install new innovations excites the imagination of the American people. Politicians constantly hail business investment and production and call for ways to get more of it. Lately, the President of the United States has advocated tax changes to spur even more investment in productive capacity. In fact, each tax-law change of the 1950's included an investment spur.

But consumption, the counterpart of investment in greater production, the real incentive for building new plant and equipment, for increasing productive capacity, for turning out more goods, receives less attention. Even worse, it excites suspicion. It is amazing, as someone remarked recently, how many people there are who do not understand that in order to sell something

you must have somebody who will buy. Increased buying power, growing markets, and the anticipation of sales are the best possible incentives for investment and greater production. Certainly there are more laudable incentives than the avoidance of taxation, yet tax sweeteners for business are part and parcel of every tax revision, while buying power boosts, such as increased exemptions or lower tax rates for the lower brackets, are regarded as inflationary suggestions, supported only by the devils who want to destroy America.

Consumption is, in my judgment, the key to the future balance of our economy. It is not enough to say that personal income has expanded to the highest levels in our history. The rate of per capita incomes rise has been less than 3 percent total since 1956, or about .6 of a percent a year. Yet every attempt to spur consumption is regarded as inflationary. Wages and salaries are the sources of the Nation's buying power. Since productive capacity has been used at the level of only about 80 percent of capacity on the average for the last seven years, it is clear that vast inflationary pressures have not—and I repeat have not--existed.

As a first step toward balance in the economy, the following consumption strengtheners should be regarded with as much favor as are business incentives:

1. Higher wages, which, in addition to their positive value for balancing the economy, can keep the economy from plummeting even lower in recession.

2. A minimum wage of at least $1.25 an hour, to establish a civilized,

decent minimum income for wage earners.

3. Social security improvements for old people to live decently and to have enough money to buy the necessities.

4. Unemployment compensation improvements for a system that would help shore up the economy in recession with a $300 billion boost in less than a year's time.

Constant exhortations about inflation, however, oppose each of these key consumer boosts. This anti-consumption war has helped to prevent balance in the economy and helped cause price and other distortions. Technological changes have shifted the pattern of American production, employment, and purchasing power. At the same time that the need for buying power has become increasingly important, the productive power of American industry has multiplied at an amazing rate in an amazing fashion. The first quarter of 1960 will see an automobile production greater than that of any quarter in the Nation's history, with over 130,000 fewer auto workers being employed in producing the greater auto output. We can develop more machines with fewer men. The meaning of this for prices is not that everything will be cheap because less labor is involved. As I shall discuss later, automation's impact on prices depends upon finding ways to absorb a much greater production.

Again, the balance wheel of production and consumption is called into play; only this time, with the advent of automation, there are fewer jobs in manufacturing, and potentially fewer jobs in relation to the population

in other sectors of American life. Who will have the money to buy the increased output of American industry? The displaced auto worker? The displaced steel worker? The insurance worker who is displaced by the automated machine? Jobs do not create themselves in an automated world, nor do incomes create themselves for the jobless.

The implication of technological change for balance in the economy, therefore, requires a readjustment of our thinking. The vast scope of productive ability must somehow receive an equally great increase in buying power. The new type of production must somehow be geared to the economic well-being of the Nation, and incomes to buy the new products of new machines must be available throughout an economy where more and more workers have been displaced by machines. Yet every attempt to raise wages, every attempt to achieve decent living standards for low-income workers, every attempt to provide employment through useful and necessary public projects, such as school buildings and public housing, all of these efforts to keep some balance in the economy, and have the balance adjust to the changing pressures of the new economy are viewed as inflationary.

Now, with this background of economic growth and the role of consumer income as I see it, let me turn to placing the problem of inflation in prices in what I consider to be its proper perspective. To view prices and wages in some realistic fashion, it is necessary to get an overall perspective of price movements since World War II. It is during this period that the inflation myth has spread through America. Prices have risen a certain percentage.

Wages have risen a certain percentage. A syllogism puts them together and says wages cause price rises, or, perhaps, higher prices cause wage rises—though the latter is seldom considered significant. But such syllogisms do not fit the facts. Viewed in historical perspective, price rises in recent years have not been astonishingly high. As Professor Alvin Hanson of Harvard explained in a letter to the New York Times about a year ago:

"When anyone suggests a possible increase in prices of around 2 to 2.5 percent per annum over the next 2 or 3 decades, alarmists are apt to cry, 'Ruin and disaster!' This rate of increase is, however, precisely what the United States in fact experienced during the last 60 years. Indeed, the record during the years 1948 to 1958, which, however, included a war of considerable dimensions, discloses a per annum price increase not much more than half as large as 1.25 percent for wholesale prices and 1.75 percent for consumer prices added in the entire 60-year period. This is by no means an irresponsible record."

I would like to just put these figures on the board for you to keep in mind as I go along. (Writes on the blackboard.) In the 60-year period from 1897 to 1958, the average price increase in the American economy has been 2.5 to 2.75 percent per year. This is true of the period if you take 1897 to 1913. If you take the period 1913 to 1948, or, if you take the entire period, 1897 to 1958, the same is true. But yet, from the years 1948 to 1958, those years which have recently been attacked as the great years of inflation, we find that whole/sale prices increased by 1.25 percent a year, and retail consumer

prices increased by 1.75 percent per year. If our country did not go to ruin in this period with this kind of price rise, why are we concentrating today more on fighting inflation than we are on the kind of economic growth which this American economy needs, and needs quite vitally?

Viewed in relation to changes elsewhere in the world, the United States price movements have gone in much the same direction as those of other nations. This has some relevancy to the problem of whether we are pricing ourselves out of the world market. If anything, the U. S. record appeared better than that of most other countries. Among 20 nations studied by the International Labor Organization, the United States was fifth best in terms of price stability between 1948 and 1957. Most recent studies show that U. S. price changes have been more moderate than those of most competing countries. An OEEC comparison of U. S. wholesale prices and those of five major European countries indicates the following trend: Taking the 1954-56 average wholesale prices and comparing them with 1958 prices, the change from 1954-56 through 1958, the U. S. shows a 6.6 percent rise; the United Kingdom 7.7 percent; France 21.1. West Germany's increase was similar to that in the United States, about 5.3 percent; and both Italy and Belgium showed a much lower price rise of less than 1 percent.

Viewed in relation to overall labor costs, price movements have obviously not been pushed forward by real wage cost pressures. In fact, the Labor Department studies have shown that, during the postwar period, price rises tended to move ahead of labor costs. The Bureau of Labor

Statistics said:

"The index for unit labor costs was lower than the price index for every year prior to 1956, although the difference was very slight and probably insignificant in 1953-54."

This is for the period 1947 to 1958.

Viewed in relation to productivity, it is clear that price pressures could not have come from labor's taking too great a share of the output. The rise in real wages and salaries between 1947 and 1957, according to the Bureau of Labor Statistics, did not even keep up with the productivity rise. Output per man hour was up 37 percent in the decade. Fringe, wage, and salaries rose 35.2 percent.

I think these figures are important to keep in mind. (Writes on blackboard.) From 1947 through 1958 the total productivity in the American economy rose 37 percent--productivity--while wages, including fringe benefits, including fringe benefits, rose by 35 percent. I am sure all of you are familiar with the exhortations in the newspapers, in the magazines, in the press conferences of the President of the United States, and in the economic report of the President to the Congress, that wages ought to move in relationship to productivity. There is little realization that these are the actual facts, as brought out by recent studies of the Department of Labor.

Viewed in their actual postwar patterns, overall price movements in the United States rose sharply only twice. Listen to this carefully if you will: two short-lived inflationary periods and then, after an interval of

price stability, they began to move forward more slowly again between 1956 and 1958. The two sharp waves of price rises occurred during 1946 to 1948, and from June 1950 to June 1951. Both of these upward movements were steep--a rise in the consumer price index of 23 points in the first wave and 9 points in the second wave. Both were related to wartime pressures. The first, 1946-48, followed the removal of price controls after World War II, before the economy had converted to enough civilian production to absorb the demand pressures. The second followed the scare buying in anticipation of shortages at the start of the Korean War.

Most economists contribute these price rises in these three years to actual demand inflation; that is, too much money chasing after too few goods. Most economists recognize that these price movements were caused by war-related demand pressures. Most economists recognize that about three-quarters of the upward price movement since World War II took place in just three years of actual inflation. From 1951 to 1955 prices were relatively stable; but, after the 1951-55 interval of relative price stability, prices began to inch forward. No swift wave of demand inflation occurred, yet, little by little, consumer prices showed an upward push, a push which has been variously attributed to demand pull, wage cost, cost push.

Actually, this latter period, the period of the last five years, particularly mid-1955 to mid-1958--for prices leveled after mid-1958--is the one which demands most careful attention, because it is the period which sets the stage for the 1960's. Problems in this most recent price trend are problems

for tomorrow. They point the way to the need for rapid, balanced growth and a better understanding of our economic system.

First of all, it has become clear that the consumer price index, the popular measure of price changes in our economy, is made up of a variety of different kinds of prices. Industrial prices, the resultant retail prices of manufactured goods, have moved differently, for example, than have food prices. Within the industrial sector, prices of some manufactured goods have moved differently from prices of other manufactured goods. Prices of services have moved still differently. Construction and other prices have had still other characteristic pressures.

It is important, in discussing the overall price pattern, that recognition is given to what kind of prices in the consumer price index are being discussed. The relationship between wages and prices in the industrial sector, for example, differs from the relationship between wages and prices in the services sector, where the influence may be more direct.

Price pressures between 1956 and 1958, for example, showed that two-thirds of the price rise in this period--1956 and 1958--came from the food and services sector. Two-thirds of the consumer price rise in the period 1956 to 1958 came from food and services, and less than one-third came from the industrial sector. Yet it is in the industrial sector that most concern has been raised in the American mind concerning price-wage relationships. It is in the industrial sector that inflationary wage settlements are held up with horror for the American people. The steel workers' wages and the auto

workers' wages are given credit for a consumer price rise, whether the consumer price index went up because of a drought or because of rising costs of doctors' bills. The facts are that manufacturing workers' wages have simply not produced price rises in the industrial sector. The facts are that price pressures in manufacturing have come in part from a failure to see the value of low unit profit margins and a high volume of sales. The basic industries of America--steel, auto, oil, et cetera--have made it a practice in the last seven years to administer their prices at high levels regardless of cost pressures. I'll have more to say about this in a little while.

Other price pressures have come from the changes in American industry--higher costs of overhead, fixed costs of giant machines, higher costs of more permanent technical personnel, the higher costs of interest and depreciation, and research and development. All of these latter cost pressures could have been alleviated if a sharp enough rise in consumption had warranted a sharp enough rise in production and still greater prospects of sales.

But the economy has not expanded fast enough to absorb the cost pressures in manufacturing; while the pressures have built up in these fixed overhead costs, the volume of sales of American industry has not been great enough to allow great enough production to spread the costs over enough items to produce low unit costs. When production levels are low and costs remain high, the relationship of high costs to low unit production is that costs per

unit of production are very high. But, if the fixed costs are here and production, instead of falling, rises, then the fixed costs are spread against a larger volume of product, and the unit costs per output are therefore lower. When we have a recession, as we had in 1957-58, and high fixed costs remain there--and wages are high fixed costs as well--then the costs per unit of production increase substantially.

Oddly enough, one exception to this development has been in unit wage costs for production and maintenance workers, the labor group which is charged with causing today's price rises. Let's look at these pressures as I mention them.

First, profit margins. Profits in giant industries in America are based on break-even points at as low as possible operating levels. For example, recent studies have shown that the relationship between prices and costs--that is, the setting of the profit margin--changed about 1955 in the giant steel industry. Up until that time prices were set in the United States Steel Company so that the rate of return on net worth would be about 8 or 9 percent when the industry was operating at 80 percent of capacity. But, beginning in 1955, as Professor Charles Schultz in a recent study for the Joint Economic Committee explained, United States Steel set its prices so that the rate of return on net worth would be 8 or 9 percent when the industry was operating at only 60 percent, instead of 80 percent, of capacity. By the time capacity operations reached 80 percent, the rate of return was at a 12 to 13 percent level. During the first half of 1959, steel companies reported

after-tax profits at 16.3 percent return on net worth.

Studies of the Senate Subcommittee on Antitrust and Monopoly--Senator Kefauver—show that both the steel and the auto industry have tried to set prices so they could reach a break-even point when operating at only 40 percent of capacity. I think this is something which ought to sink in and be understood. This adds up to an obvious conclusion: America's giant corporations have set their prices so that they can reap the highest possible return on the least volume of sales. This has affected the level of prices and, equally important, interferes with a healthy, balanced growth rate in the economy.

There are other cost pressures. Obviously, all of American manufacturing cannot set prices as easily as the steel, auto, oil, and other oligarchicalistic industries--that's a good word for economists. Excessive profit margins cannot be the only explanation for pressures on industrial prices. A consideration of how prices are determined and how manufacturing has been changing, however, can explain some of the pressures on prices in the 1955-58 period when the forward movement has been so disturbing to the American people.

Let's take depreciation first. Every item of cost to the manufacturer is considered in setting his price. Some of the costs are fairly theoretical. For example, the cost accountant figures in depreciation costs on the books for tax purposes at a very rapid rate, when the cost does not occur at that rate. Yet that depreciation cost is figured into the price. It is for this

reason that we insist that depreciation cost revisions in the tax-law changes of 1954 helped create the price pressures of 1955 to 1958. I wish I had time to spell that concept out.

It has been estimated by Professor Schultz of the University of Indiana, again, in his study for the Joint Economic Committee, that depreciation charges per unit of output of manufacturing rose 20 percent between 1955 and 1957 and 40 percent between 1953 and 1955, because of the accelerated depreciation laws of the Korean period.

Let's look at research and development. Another book cost is for research and development. In this area so great a rise has occurred that cost accountants are arguing in their journals about the proper way to identify it. I just spent an evening talking to the cost accountants of the State of Maryland in Baltimore, arguing about this point. Are these current expenses—research and development? Are they capital expenditures? In any event, research and development spending zoomed in the capital boom of 1955 to 1957. This is the age of automation. Technological change has been spreading and every industry is seeking new innovations. Obviously, research and development costs might not have any relationship at all to the current product's actual cost. It has a very real relationship to the price the manufacturer sets on the current product.

The system of accounting for research and development was altered in the 1954 tax laws that gave further advantage to using this as a cost factor in the pricing picture, by permitting them to write off in the year in which

they incurred the research and development expense the total cost, instead of capitalizing it as they had done previously. Obviously the cost in that year in the cost structure would be quite fantastic, particularly with the large increase--as all of you are familiar with—in the research and development field.

What about nonproduction personnel in this picture? With the expansion of research and development, management hired scientists, engineers, technicians, and supporting staffs in larger and larger numbers. Between 1955 and 1957 manufacturing employment of nonproduction workers rose by 369,000, while production and maintenance jobs dropped by 150,000. Furthermore, these additional 369,000 workers are largely salaried employees. Estimates put salary costs per unit of output in manufacturing up 22 percent between the years 1955 to 1957. Again these are Professor Schultz's figures.

Interest costs also rose during these years. Advertising costs went up also at a fairly good clip. During this time production and sales were not rising very rapidly. There was a boom in 1955-57, but it was a capital investment boom, unsupported by a sufficient rise in consumer income. There was not, therefore, enough production to spread the cost of investment in new plant and equipment and the new high overhead costs across enough products to get low enough unit costs, and as a result prices rose.

Unit wage costs and their differing trends also present an interesting question. Wage costs, however, in manufacturing, did not show this same

pattern. For one thing, the rapid changes in technology, the improvements of efficiency, both reduced the number of production and maintenance workers and spread the unit wage cost. Oddly enough, with all of the talk of high wages causing high prices in America, manufacturing unit wage costs are now lower than they were seven years ago. Here are the figures, based upon the latest revised Federal Reserve Board and Department of Labor statistics.

At no time in the past six years have unit labor costs been as high as they were in 1953. Even during 1956 and 1958, when creeping price rises put manufacturing prices away above those of 1953, when the amount of production was not great enough to keep unit wage costs at the low rate of last year, even at that time unit wage costs never reached the 1953 level. For example, if we take the years 1953 to 1959, unit labor costs in 1953 on an index basis, as measured by the Bureau of Labor Statistics of the Department of Labor, were 108 on an index of 100. By 1959 unit labor costs dropped to 105 on an index, while industrial prices at the wholesale level, again on an index, jumped from 114 to 128. At a time when unit wage costs were dropping, industrial prices on these same commodities were rising.

Let me give you some specific examples. The lack of causal relationship between wage increases and price increases becomes even more clear when specific industries or products are considered. For example, consider the most recent steel wage increase. The highest industry estimates of the

cost in wages are 41 cents an hour. Other calculations are as low as 32.8 percent, according to the Department of Labor. The conservative U. S. News and World Report estimates that the increase in labor costs in steel "after allowing for average increases in productivity will come gradually, as follows: 1.1 percent up to December 1960; 1.9 percent from then to October 1961; and 2.9 percent thereafter."

The price increase over 30 months, based on these calculations of U. S. News and World Report, will be $3.59. Again quoting from U. S. News and World Report: "A modern improvement in the industry's ability to raise productivity could enable the companies to avoid price increases altogether." Thus it seems that even U. S. News admits that this increase in wages can be completely absorbed without any price increase at all.

Now let me move to an example in the automobile industry. Two years ago--I'll be glad to talk more about the steel industry settlement if anybody cares to raise it in the question period--I am sure nobody is particularly interested in it, though—the Kefauver Committee started looking for answers to the mystery of higher car prices--automobile prices. The Wall Street Journal, December 10, 1959--over two years ago—talked to some car officials to find out what considerations went into car pricing. They picked a typical vehicle and broke down the costs that were considered in pricing. The four-door sedan which sells for $2600 was their model choice. Before any other considerations were made, a $180 profit base was figured. Direct labor costs amounted, according to the Wall Street Journal, to $75. There

were other labor costs included in various items, it is true, but the major direct auto union members' wages were only $75. But, even if the parts, materials, et cetera, of nonproductive indirect labor costs were added, the Wall Street Journal estimated that wages went up 18 cents an hour and that the wage increase would have boosted car prices by less than $25 per cost. Yet prices that year had gone up from $85 to $135 on the average on various models. Did wage increases cause that price rise?

Look at the appliance industry for another example. Here labor costs are even more remote from pricing. Nonetheless, I am perfectly certain that, if employees in the appliance industry got a 10 percent wage gain and prices went up 10 percent, the newspapers would report and the public would believe that there is a precise cause-and-effect relationship.

A book published by Brookings Institution a year or so ago, after several years of research, it seems to me, gives the lie to this sort of reasoning. On prices in big business, in this book the authors break down the price components of the deluxe automatic washer. Their investigation showed that the direct labor cost at the manufacturing level bore little relationship to the final price. The cost breakdown revealed that direct labor costs at the manufacturing level were only 2.8 percent of the price to the consumer. Advertising at that level was 3.3 percent of the price to the consumer. All the costs at the manufacturing level, including profits, were only 52 percent of the selling price. At the wholesale level, another 7 percent of costs were added, and the retail markup provided for 40 percent of the cost

to the consumer. Do wage increases which affect 2.8 percent of the price to the consumer cause price rises?

Finally, let us consider the example of the drug industry, which was recently under fire for alleged 100 percent markups over the production costs. Here even industry spokesmen did not try to place the blame for higher prices on wage gains, though they insisted that research, distribution, and advertising costs necessitated the price decisions. The wage factor was so slight in comparison to the price level that it was not a major consideration in the hearing.

Obviously, as these specific examples indicate, price-wage relationships have been less important in terms of setting of price levels in the industrial sectors of the economy than most of the American public would believe.

This brief explanation of some price-wage relationships suggests some clear implications about some complex patterns within our economic structure. First, it is necessary to look at price changes in relation to a variety of economic changes and to keep a sane view of price movements. While relative price stability is a laudable and necessary objective, an obsession with clamping down on price rises, as if they were an inflationary spiral, can be destructive in a situation when run-away inflation does not exist. In fact, the possibility of achieving relative price stability will in the long run depend upon the possibility of achieving long-run, rapid, and sustained economic growth.

That kind of growth can come only from an economy in balance. Stifling

of the consumption side of the economy by clamping down on wage increases will work against balance and therefore against the possibility of long-run relative price stability.

Second, it is important to notice the importance of standby legislation for economic controls in times of war-related emergency. Since almost three-quarters of the upward postwar price movement can be related to war-related pressures, it would be most reasonable to have available some effective control legislation to prevent a reoccurrence of the Korean and post-OPA price spurts.

Third, the word "stability" must replace the word "stabilization," in most other situations, since stabilization implies force or rigidity. A free economy cannot remain free if rigid controls and rigid standards are established in normal times. Therefore, attempts to freeze wages, or even to freeze prices, should be resisted, except in emergency situations.

Fourth, the way to overall price stability in manufacturing is high production and high profit levels based on a huge volume of sales, with a low profit per item. Pricing based on this type of profit margin works in favor of a smooth-running, steadily expanding economy.

Fifth, the most important lesson is that the country must learn to fight battles based on adequate intelligence. Wage increases have not caused price rises in the big industries of this Nation. The evidence is available to prove that. Wage increases in fact have not even caused higher unit labor costs in all manufacturing. The reverse has been true. Better

information is needed to get more data on the cost pressures which have led to price rises. Accurate data will be a good substitute for a wage inflation myth.

Sixth, the services sector and the food sector of the pricing structure have shown strong price pressures in recent years. Better information about these areas can lead to suggestions for reducing the cost-of-living pressure from them. Particularly, it is important to examine and get more information about the services sector, which has expanded and changed the most in recent years.

Last of all, in discussing the problem of economic stability, it is important to remember that price and wage factors will, in the nature of things, continue to change. It is the ability to recognize the need for change and to try to direct it constructively that is so necessary in our economy. The worst approach to economic stability in normal times is to seek only rigid price stability for each and every price item. A flexibility of prices is not unreasonable. Varying developments in specific industries can lead to a relatively stable overall price level. That is the best we can expect. That is what we should hope for. Any attempt to create another more rigid pattern will be growth-inhibiting and will therefore eventually lead to economic instability, a loss of production, and further pressures on prices.

Thank you.

DR. KRESS: Gentlemen, Mr. Ruttenberg says to put it on.

QUESTION: Mr. Ruttenberg, you stated that there had been a considerable increase in the numbers of overhead personnel--white collar workers, presumably--during the period 1948 to 1958. First I would like to find out who these people were, why the numbers were increased, and, since that is true, why then did the price increase amount to only 1.25 percent to 1.75 percent during the same period.

MR. RUTTENBERG: I think you have two questions here, of course. The people that had been hired in manufacturing industries at an increasingly large number were the white collar, semi-technicians, technical engineers, people at the drafting board, and other white collar people. This is more and more as you move into an automated age with technological advance and automation, the large increase in what is called a white collar worker who is on a salary basis--against being on a wage hourly basis. If you look at the figures you will see that the production and maintenance worker, who is the blue collar worker, the guy at the machine, the maintenance worker and the production worker, is being displaced. Those jobs have declined in any period you want to take--the last 2 years, the last 5 years, or the last 10 years. On the other hand, the number of white collar workers, the technicians and the semi-technicians, has increased. The numbers of white collar people have gone up. I think the figures I cited in manufacturing were a rise of 369,000 or 370,000, in total manufacturing, while in production and maintenance there was a drop of 150,000. So there has been this substantial

increase in white collar workers.

You asked what the relationship of this is to the price increase of 1.25 percent at the wholesale level and 1.75 percent at the retail price level. I don't know that you can relate these two problems. I don't know that we want to relate these two problems. What I am saying is that, when you combine the increased costs which are related to the increased number of white collar people on a salary basis with the increased costs relating to the depreciation charges and the research and development charges, these were important factors in the final determination of the reality of the increase in price of the product, and that the levels of the industrial worker , because of the unit labor costs which have dropped over this period, have not really been the factor. I am not saying, "Let's blame the other guy and let's not blame us." All I am saying is, as we look at the facts and the reality, let's not fall into the trap of blaming the unions and blaming the industrial workers for the price increase that does occur, even though it is small, per year in relation to the long 60-year trend. Let's realize all the factors that go into making the price structure.

I say this for this reason, that there are those who advocate that you ought to somehow restrict the activities of unions in their wage efforts, because the unions are the ones who are responsible for even this price increase that has occurred. All I am trying to show you is that, if you took that solution to the problem you were taking a false solution to it, because there are other areas that need to be examined. What should we do about

depreciation costs? What should we do about research and development costs? What should we do about these increased numbers of technicians that are on the job? This is the problem. This is the only direction in which I was making my comments.

Does that answer your question?

STUDENT: That answers my question, but it prompts another one. If this is a recognizable factor, and we are sold on the idea that these are facts, why, then, is it not proper to have an increase in the white collar salary group? Isn't this one of the elements of advance in technology which are essential to better products?

MR. RUTTENBERG: Absolutely. I couldn't agree with you more. One thousand percent, unequivocally, I agree with you. One of the big problems is that as we move this over into other areas, white collar workers generally are inadequately paid. We are not really attracting to the college levels sufficient engineers and scientists and technicians because we are not paying them sufficiently. Our rate of growth in providing people to the economy who are engineers and scientists is falling far behind the rate of the Soviet Union. One way to do this is through wage increases. I don't think this should result in a price rise. I think it can be absorbed out of profit margins and out of a productivity rise.

QUESTION: Sir, first a comment and then a question. It seems to me that when you are demonstrating something by statistics which you take out of a span of time, and inasmuch as prices, wages, costs, and so forth

fluctuate up and down, you can prove almost anything by depending on what time span you take out. For instance, over on the right you have shown some figures for 1947 to 1958 which indicate a productivity rise of 37 percent and a wage rise of 35 percent. You made a presumption, which we won't argue with, that labor is entitled to have an increase equal to the productivity rise. Now, also, you took a period of from 1956 to 1958 and you said that the increase during this period of your industrial prices was rather small as compared with the price increases in the services and the food sectors.

MR. RUTTENBERG: At the consumer level.

STUDENT: At the consumer level. Now, it occurs to me--and I am going to make a presumption here--that your organized unions, your industrial workers, are the greatest spearhead in any wage increase. So it would seem to me that, in comparing your industrial worker with your increased productivity, you have laid the ground work to show that the industrial worker has got a greater percentage of wage increase in the industrial productivity than this shows. Is this true or not?

MR. RUTTENBERG: I am not sure that I catch your point. Let me comment first briefly. Let me make just a general comment that I agree with your first comment. Statistics never lie, but statisticians do. I must say to you quite frankly and honestly, that I am what you would probably call a half-baked statistician, so that my lies would be half baked, I guess. I agree that if you pick the base periods you can show certain

things. There is some justification for this base period (1945-1958). It is immediately after the war and after the 1946 readjustment in the postwar situation. This is not the base period that I selected. This is the base period which the Department of Labor selected. I am using the Department of Labor figures in this analysis of wages and productivity.

I think you were saying--and if I am wrong, stop me--isn't it true that the industrial worker, through his union, is able to get a wage increase more effectively than can the nonindustrial, nonunionized worker, and, therefore, doesn't the industrial worker, as he gets his wage increase, really kind of force the pressure on the rest of the economy--he forces the nonunionized worker to force the barber to increase his price, or he forces the retail clerks to get a wage increase, even though they don't belong to a union--and that therefore, don't the unions really lead the way and cause other people to get increases. Isn't that what you are saying?

STUDENT: That is what I am saying. Also, in saying it, I am indicating that I believe from your figures that the industrial worker has gotten a greater than 37 percent of the productivity increase of the industrial sector. Inasmuch as these industries are key industries which have to pass the cost all the way down the line, this could very well be one of the reasons why we have price increases.

MR. RUTTENBERG: You raised another question by your comment, that I think I can't let go without a challenge. You just automatically say that this wage increase which is granted to the industrial workers obviously

has to be passed on through the structure forming any price rise. Is this really true? Do you really believe that? This is what happened, and I don't think it is what should happen. Let's take the steel case as an example. You had a 41 cent wage increase over a 30-month period, over a 3-year period. The steel industry immediately said to the public: "This will mean a $16 a ton increase price. Oh, but we are good boys. We are not going to raise the price. Maybe we made a deal with Mr. Nixon about not doing it until after November, or maybe we didn't. We are not going to raise prices now." I don't know whether they made a deal or not. It sounds like they did to me, though.

The thing that you've got to remember is that the cost of the wage increase is three years. The cost of the wage increase the first year is only 10 cents--and not a wage increase, because the workers don't get a wage increase this first year. Up to December 1960 the only thing that happens is that the companies are absorbing the employee contributions to health and welfare programs, contributions that have been made by the employees. That is 7 cents of this 10 cents. The other 3 cents has to do with other problems relating to insurance and benefits as against health and welfare. So the total cost to the employer is 10 cents, or one-fourth, which means one-fourth of this ($16) which is the price increase as far as the one year is concerned, $4.

Now we are talking about a 10-cent increase on what the industry claims

to be a $3.75 an hour wage and fringe benefit cost. Ten cents on that is about 3 percent. Three percent of $3.75 is about 10 cents. Maybe it is about 3.25 percent. This 3.25 percent cost increase on the wages is well within--and I repeat well within--the productivity advance of the steel industry which would enable it to quite successfully, without having a reduced profit margin, pay this 10 cents and not raise the $4 price rise and still continue to make the same profit they are making now because of the productivity rise.

This is why the steel industry--and not because of a Nixon deal or anything else--is not raising the price now, because they know that if there were a public hearing on this question these kinds of facts would come into the open. The thing that I feel quite strongly about is that if the industry could get away with it, if there weren't public discussion about the problem, they would have raised prices somewhere in the neighborhood of $8 or $9 and would have cried the blues by saying, "Oh, well, we just increased it half as much as we should have increased it."

You've got to remember that that 16 cents relates to the total 3-year cost and not to the one-year cost. So that they don't have to pass it on.

QUESTION: Sir, I would like to pick up the cudgel where the Captain left if off.

MR. RUTTENBERG: Go right ahead.

STUDENT: These steel workers don't operate in a vacuum, and it isn't as simple when you look at it in context as it is the way you have presented it

there. When he gets a 3 percent raise, all his buddies up and down the line--the fellow who hauls the steel, the fellow who runs the advertising program, the fellow who warehouses it, the landlord, and everybody who deals with this--and also when it becomes a refrigerator in someone's home—are also getting a steel rise. So that we are not just looking at one man in one industry. Everybody who handles that piece of iron ore until the time it becomes a watch spring—and there are a lot of little increments in there--is also getting a 3 percent price rise. That multiplies up as it gets processed further and further, including the guy who paints the warehouse. So that would appear to be more nearly in context than what you have on the board. Would you comment on that, please?

MR. RUTTENBERG: This is where I should have gone with the Captain's question until he got me aroused on the steel question. This is what I was assuming he would say. When you get pressures in the industrial sector for wage increases it causes wage increases to seep through the entire economy. This is true. There is no question about this. As a matter of fact, the unions do not hesitate one bit to point out to the nonunion worker : "One of the major reasons you have gotten a wage increase is because we have fought and striven on the picket line for 116 days in the steel industry to get a wage increase for steel workers." This permeates through the rest of the economy. Now you are saying, "Isn't this really inflationary when you do that?" I thought that was what the Captain was saying. Maybe they, the steel industry, can absorb it out of the productivity

rise, which I tried to indicate with the $16 figure and the $4 figure, but maybe the truck driver, the distributor, and the retail merchant can't absorb it; therefore maybe he, in granting the wage increase, has to pass it on in the form of some price change.

I think this is the interworking of the economy, which becomes a very complicated and difficult problem. I don't think anybody has a simple answer to it. I would say to you that, ideally speaking, what should happen--and I am sure it is not going to happen in the American scene until we do have public hearings, so that all the facts are thrown out onto the table, so that the public knows the facts and so that the facts are carried in the newspapers, magazines, radios, and televisions, so that people will know them--is that when we have the facts on the table the ideal situation will develop. If the ideal situation in the meantime doesn't develop, then I think we will get price increases; but I am not worried about those price increases, because they have been of the nature of substantially less than the historical pattern of the previous 60 years.

The ideal situation would be that in those industries where productivity is rising there should be price reductions. There is no question in my mind that, if you look at the pattern of the profits of the auto industries, the electrical manufacturing industries, and the steel industries, you could justify substantial price cuts. Let me just give you one example, quickly--I wish there were more time. Some of you probably are familiar with the electrical turbo generator problem, of TVA and other American companies buying electric

turbo generators from Parsons Electric of England or Brown Bouvirie of Switzerland, and with the great protest of the American electrical industry that they can't compete and that they are being driven out of business by these contracts that are being let overseas. But what happened when those contracts were successfully given to Parsons Electric in England? Do you know what General Electric and Westinghouse, the major producers of turbo electric generators, did in this country? They dropped their price a little. Then there was still the contract that went to Brown Bouvirie. So they dropped their price a little more. Did they lose money? Are they not making money on these items? They are making just as much as they made before, because productivity is advancing, and they can afford to drop the price if they are forced into it. And it took these contracts let overseas to force them into it. Thanks are due to the union, whose workers were being displaced in the United States because of the contracts being sent overseas. The unions did not protest the displacement of the workers; the unions protested the price structure of the electric turbo generator and got industry to reduce the price so that the American worker could get a job in competition with everybody else throughout the world, which I think is a very interesting point.

Let me get back, though, to this other point. They can cut prices. You can cut prices in those industries where productivity is rising. Certainly, even in retail establishments productivity is going up. Even in truck distribution productivity is increasing--when you think that, instead of driving a truck

over the road you take it and put it piggy-back on a railroad car, this is increasing productivity. When you think in terms of adding 10 extra cars to a railroad freight train, this is increasing productivity. So let us not get confused that in areas down the line, whether organized or unorganized, productivity is still rising, and it will continue to rise, even in the insurance companies, where they are moving to electric computers. I am now living in Virginia and I am getting my water bill punched out on a tabulating machine rather than done by hand as they formerly did it on the typewriter. This is productivity advance. Let's not get confused. Productivity is rising all the way through the economy, and, in those industries where it is rising, the prices ought to come down. In those industries, let's say, like textiles, or men's clothing, where there is not particularly any significant increase, or not too great an increase, in productivity, prices may well go up.

The effect on the total economy and on the overall price structure, if this ideal situation happens, is stability in the price structure, with the increases being offset by the economy. I say you won't get these declines in the economy until such time as you get the spotlight of public opinion thrown upon the way these price changes in this area, instead of coming down, are going up. That's what we need.

I see a lot of hands. Time is wasting, and I am taking too long in answering the questions. I don't mean to filibuster.

QUESTION: Previous distinguished speakers on this platform, from

industry, labor, colleges, and government have demonstrated general agreement that it is necessary for the United States, in order to compete with Russia, and to maintain and attain economic growth, to increase research. I am wondering, therefore, why you selected the change in the tax law on research as one which is contrary to your principles, since we have also been told that research is going to find new jobs and new productive operations which will employ the laborers displaced by automation. My question is: Why do you not select instead the nonproductive areas of our tax structure, such as depletion allowances, capital gains, liberal or extraordinarily liberal entertainment, and public relations expenses for your attack?

MR. RUTTENBERG: You happen to have raised a question which, if I had time, I would love to talk about. Taxation happens to be one of the major areas that I have spent a great deal of my adult economic life studying, advocating, and writing about. I am more convinced even than you, if that is possible, that we ought to do something about depletion allowances, we ought to do something about capital gains structure, we ought to do something about dividends exclusions and exemptions, and we ought to do something about family partnerships and stock options. If we did all these things we could raise close to $9 billion in revenue. I am convinced of this and I am glad to see that the Joint Economic Committee in its report just a few weeks ago came out and said they would go along with about $4 billion of this if we did certain things. That is aside from the point. I think we ought to and

can, and I have strongly advocated this kind of thing before the Congress of the United States and will continue to do it.

To get back to your question regarding research and development--I chose that for only one point. If you are looking at the cost accounting problem of a balance sheet, and if a company, because of the 1954 tax law, was able to write off in one year the total cost of its research and development program as against capitalizing it over a 5-year or a 10-year period, the cost factor in that one year is excessive in relation to what it would have been had they capitalized it.

With that situation the corporations then look at their profits for that year, their return on investment, and they conclude from this that the return on investment is going down, and that therefore they've got to increase prices in order to make more profits to offset this.

I am only pleading that in price determination they ought to account the way they normally do, because they are going to recapture this over a period of time anyway. I could describe the same thing in terms of some of the digits approached in depreciation as against a straight-line depreciation cost. The same thing results from that kind of a cost-accounting practice. They are trying to offset that big cost in the one year in which the return on investment is lost because they have written off the total cost instead of capitalizing it. That's my only point.

I agree just as strongly with you as anybody else does that we need more and more research and development, and unless we do more--and we could

mention a few things in the military that ought to be done a little more in this area of research and development, too--we are going to find ourselves some place where we don't want to be in relation to the rest of the world.

QUESTION: On this question of productivity, it seems to me that the ideal thing would be that for any given increase in productivity the benefits should be divided three ways--that part of it should go to increased wages, part to increased profits for the manufacturer, because, after all, our business is built on the profit motive, and a part of it should be passed on to the consumer in the form of decreased prices. But, against that, labor seems to have the position that if there is a 39 percent increase in productivity there should be a 39 percent increase in wages. I can't see where this leaves room for anybody else to get in the act, and I can't much blame the manufacturers for finding ways to disguise the profits.

MR. RUTTENBERG: Well, you have raised a very interesting question. I really wish that the public understood the economics of the situation. If the public, including yourself, understood the economics of this problem, I don't think you would make the comment you made. If productivity rises by—let's take an even figure--10 percent, and if wages rise by 10 percent, the conclusion the general public comes to is that therefore the total productivity rise has been wiped out by wage rise. I just refer you to any textbook on economics. This is not the case. You shake your head. Is that what you are saying--this isn't the case? Or are you saying it is the case?

STUDENT: I agree with you. It is not the case.

MR. RUTTENBERG: Wages reflect, depending on how you calculate, in the oil industry, about 6 percent of the cost of production, in meat packing, maybe about 8 percent of the cost of production, in steel about 25 to 30 percent of the cost of production. Let's assume it is 50 percent of the cost of production, which is very very generous, and I can't think of any industry except the hand industry in which this would be true. That means that in a 50 percent cost of production the wage increase is only 5 percent. This is important.

I agree with you fully that any productivity rise should be shared three ways. It should be shared with the workers in the form of higher wages. It should be shared with the consumer in the form of lower prices. And it obviously must be shared with the employer in the form of higher profit. All three of these can occur within the framework of a 10 percent price rise versus a 10 percent productivity rise.

You don't agree with this?

STUDENT: I am not convinced.

MR. RUTTENBERG: All right. Don't take my word for it. I refer you to a book on economics. This is what bothers me. I can remember back in 1947 and 1948 officials at General Motors and at U. S. Steel making public comments saying wages had gone up 10 percent, productivity had gone up 10 percent, and they had to raise the prices by 10 percent to offset this. This is just utter nonsense. And I think they ought to understand this. If, on the other hand, wages went up 20 percent and productivity went up

10 percent, and if wages reflected 50 percent of the cost of production, then you would be absorbing the total productivity rise with the wage increase, and then there wouldn't be anything left in profits and for consumer prices.

STUDENT: May I make this one comment? It seems to me that, if your wage increase keeps pace with your productivity increase, then the net cost of productivity in terms of labor alone is remaining constant. You get the same amount of productivity for the same labor cost. So that any savings have to come from somewhere else in the system. I think that the thing we all most readily think about is increased volume--sell more of the stuff--to make more profit. It seems to me that you sort of overworked that one a little bit. Our population is expanding only at the rate of 1.7 a year, and it seems that people can use up stuff only so fast.

MR. RUTTENBERG: You've got a lot of concepts mixed up in here. I don't want to be filibustering. If we take the total cost of production as 100 percent, the total cost, and productivity rises by 10 percent, costs are now on an index basis down to 90 percent--total cost. But wage costs over here at 100 are only 50 percent of the total cost. Therefore, as far as wage costs are concerned, they are down only to 95 percent. There is this remainder that is available. That is only one problem. I am back to repeating myself. I'm turning the figures around and using them on a total cost of 100 percent. If you move back to your other problem--and I don't mean to be political about this at all--in the years 1947 to 1953--maybe

Leon Keyserling used some of these figures yesterday--I don't know--the big problem in America was that the per capita increase in gross national product, the total goods and services of the American economy as it related to increased population, was 3 percent a year. During the period 1953 to 1959 the per capita rate of increase was .6 of 1 percent—less than 1 percent. Now, obviously, with a per capita increase in gross national product of .6 of a percent we will get into a problem, and we should get into a problem, of more production than the consumers can consume.

One thing that America is proud of in its history, I think, is that we have increased our living standards of the American people continually, year in and year out. We haven't increased them very much at the rate of .6 of 1 percent a year during that period (1953-59) as contrasted with 3 percent a year during the previous period.

If we would step up our rate of growth, as Keyserling was talking about yesterday, to 5 percent a year, then we could get a per capita increase of close to 3 or 4 percent a year. On that basis we can absorb the increased capacity.

To turn this problem around the other way, throw some more figures at you, and probably confuse you more, we now have 15 to 20 percent of our manufacturing productive capacity in the United States lying idle. Why? Because per capita income has not increased sufficiently to absorb the product. This is where I get back to my problem of consumption versus

investment.

I am slightly overtime, and I would love to go on answering these questions all day long. Maybe I haven't answered them well, but I at least like to comment on them.

DR. KRESS: Mr. Ruttenberg, you have demonstrated that these problems are very complicated. Yesterday we had a very interesting talk and today also. In the cloakroom a day or so ago I overheard that this was going to be a dull course. Thank you for making the opposite true.