L64-19

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THE WAGE-PRICE RELATIONSHIP

Professor Jules Backman

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Reviewed by Col. R. W. Bergamyer, USAF on 17 October 1963

INDUSTRIAL COLLEGE OF THE ARMED FORCES

WASHINGTON, D. C.

1963 - 1964

The Wage-Price Relationship

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Reviewed by: Col. R. W. Bergamyer Date: 17 October 1963

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

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Captain Brady: We are indeed fortunate to have with us today as our initial speaker for the Economics Section of Unit I, a man who has been very popular with previous classes. He certainly has earned the reputation of being able to put rather complex subjects into meaningful and easily understandable terms.

It is my very great pleasure to present Professor Backman, who will discuss "The Wage-Price Relationship." Dr. Backman.

DR. BACKMAN: Good Morning:

My problem is to talk a little bit about wages and prices. And if I tell you that I once took a year to write a book on part of one part of the subject, and have spent many years on other parts of this subject, you'll realize how little I'm going to tell you this morning. In other words, we can only hit and run; we can't hope to do any more than cover some of the highlights. The real job is the one you will have to do afterward. And, of course, I hope that during the question period if there is anything on your minds that you will raise the question. I understand that I have free opportunity to speak on all subjects, and I'll take advantage of that.

When we talk about wages, I'm sometimes reminded of the familiar story about the blind men and the elephant. You recall one of them felt the leg and thought it was a tree trunk; another one felt the side of the elephant and he thought it was a fence; the third one felt the tusk and thought it was a spear, etc. Because, some people talk about wages in one sense, and others' in another. We want to talk about it in all senses. And what are these senses?

When a labor leader talks about it he emphasizes purchasing power. He says, "Wages represent the purchasing power of my workers".- note the possessive. "These workers will be able to buy the goods and services that are produced, only if they get enough money." Management answers, "That's all very interesting, but wages are costs. When we pay more wages our costs go up and we think something will happen to our prices!" this on the mistaken idea that costs determine prices, which, of course, I'm sure most of you believe, but it isn't true. But don't feel too badly about that; you're in the same boat with practically everybody, including many corporation executives.

I had one interesting experience about a year-and-a-half ago while making a study of prices for one of our larger companies. It had all been arranged by the top-side and I was now meeting the vice president in charge of pricing, for the first time. He looked at me a little dourly or sourly and said, "I hope you're not one of those economists who think that we set our prices by adding up our costs." I looked at him almost the same way and said, "I'm glad I've met a business man who doesn't think he does so," and we had a wonderful experience together from that time forward.

Now, when we talk of wages let's look at it as a cost first, and look at some of the elements that are involved. In the first place, the term "wages" does not cover the total labor cost. As you know, in recent years the so-called "fringes" - I like to call them "non-wage benefits," because they become so big they're no longer a fringe; when something gets to be 20% or 25% of the total bill it has gotten beyond the fringe stage; - and when we talk of pensions, welfare funds, paid holidays, paid vacations, sick leave, jury duty, and a hundred and one other types of special payments - and I'm not in featherbedding yet - when we talk about all of these things we're talking about a big part of the sales dollar and we're talking about a big part of the labor bill. And so, although I will use the term "wages," in many of the contexts in which I use the term I'll really be referring to total labor costs, as will be apparent from my comments.

Now, there's a second point that's very important, and particularly so today. Although the businessman stresses his labor costs, it isn't the total numbe of dollars he pays that's important, it's the dollar he pays per unit, which is important. Thus, for example, if, in a firm you increase your labor bill by 5%, but your workers turn out 5% more, your unit labor costs remain unchanged and the pressures which allegedly accompany higher wages are not taking place. And I shall have the occasion a little later to talk about wage inflation; what has happened to it and what is happening to it, because it's tied indirectly with this point.

And so, unit labor cost brings together two ideas; the number of dollars you spend, and a term we call "productivity;" output per man-hour, referring not to what labor creates - because what is turned out is the end-result of a team job - labor, management, use of capital. I like to point out that years ago we did work literally with our backs. And a time came when somebody discovered that if you pushed a lever you could push these things out without quite as much effort. We didn't work as hard and we turned out more. And then somebody discovered a machine to do the job. We are not at the stage of what all you do in terms of physical effort often, is push a button. You're not working harder; you're working much less than you did before. And the fact of the matter, gentlemen, is that we're getting to the point where all you're going to have to do is look at the button. And that may not be as silly as it sounds when you think of the electric eye and all the devices that are available to permit the breaking of that eye without any real physical effort.

What has happened? An enormous aggregation of capital has been made available to labor and to management; to say that labor is entitled to all of the benefits that result from this aggregation of capital, doesn't make any sense. Just as to say that you can ignore that labor is there and give it nothing, makes no sense. And yet at this point, in terms of our unit labor costs we have to keep in mind that regardless of who is responsible, the increase in output per man-hour, when it offsets, when it equals, when it is greater than, the increase in the total amount paid in wages and non-wage benefits will not be accompanied by pressures on prices, and will not be accompanied by pressures on the internal organization. And so, productivity - output per man-hour - is a key factor, and in that productivity a key factor is capital investment.

And this is what the new, proposed tax program is about, as you undoubtedly have heard, or will hear. From the labor point of view the emphasis is upon low-income brackets in order to release the purchasing power of those who have the lowest incomes. From the point of view of productivity, the emphasis must be upon reductions in the high-income brackets in order to increase the incentives to invest; to increase the capital. What do you think is the essential difference between countries like this and many of the backward countries of the world, in terms of our living standard? It's a fact that we produce enough so that we can save part of what we produce and we can turn that saving into capital goods, which capital goods - sort of a regular merry-go-round - we can then use to make more goods, which goods give us more savings, etc.

But, when you get over to Uganda and you get over to any of these newly emerging nations, they haven't got enough to stay in the same place; they haven't enough in the way of goods and services to do much more than subsist. And, because they don't, they can't create the capital. And they can't create the capital, so they can't make available this enormous amount of tool power which, when combined with labor, makes it possible to turn out enormous increases in the quantities of goods and services.

In Russia, for example, at the beginning of their noble experiment, we hear about how millions of people starved as they sent grain out of the country. But what did they send the grain out for? They sent it out for machines; for technical help. Now, we say this is not the sort of operation we would run, where we would let people die so that we could lift ourselves by our bootstraps. But, this was a recognition of the importance of capital. Capital is not confined to capitalism, as you undoubtedly know.

Well, let's turn to the other side of the coin - purchasing power. What are the facts? Total wages and salaries account for about 70% of our national income. And of that 70% about 3% or 4% is executive salaries. So, leaving that out, about 2/3 of the money that's available to buy goods and services comes through wages and salaries. That includes my salary; it includes yours. And it includes the salaries of everybody from the janitor right through to the top corporation executive; from the lowest worker in government right through to the President. But only a small part of that - that top 3% or 4% out of the 70% - represents the echelon that we call executives. And so, basically, about 2/3 of the income is generated through wages and salaries. And if we were to follow the procedure that some insist upon, namely, to describe farm income which is essentially a form of labor income, as part of this labor income, now a little broader than just wages and salaries, we'd get up to close to 85%. But since we're more concerned with wages and salaries, I'm not taking that position today.

Now, this total amount that is available to wage and salary workers, is not determined by a wage rate alone; it is determined by a combination of things, of which the wage rate is only one item. If we insist upon paying somebody $1.25 an hour - and in some sections of the country, particularly down South where wages have been lower than in the North and in the West - and the West is now higher than the Northeast, incidentally - we insist upon paying $1.25; and in some mom and pop store they decide that now they won't hire a clerk, it doesn't do the clerk who formerly had a job, any good, that he now gets a $1.25 an hour when he isn't there to get it. And so, instead of making $40 a week, or whatever he made, he makes nothing, while according to the book he should be making $50.

Wage rates play a role in determining jobs. I can give you any number of illustrations. The railroads which are very much in the news operate something along these lines. Let's say they get a 5% increase in wage rates. Late that afternoon or the following morning, the following conference takes place in the office of the president. The vice presidents are assembled in front; the president is sitting at his desk. "Gentlemen, there will be a 5% decrease in the labor force." And if any of the vice presidents say, "But," he's the first one off. They move from there. And so, you get the rather interesting picture that the railroads increase their wage rates and don't increase the amount of money they spend on wages.

In 1949, to give you one interesting historical illustration, when they were compelled by the pressure of fact-finding boards and public opinion, to reduce the work-week from 48 to 40 - and I don't want my friends on the railroads to be put in a bad light; this was a deal made with the unions back in the late '30s when the unions didn't want to go back to 40 hours; they wanted a 48-hour space; this wasn't a one-sided deal; when everyone else went under the Fair Labor Standards Act the railroads and the unions together decided that they'd rather have an exclusion. And so, they got stuck for 48 hours' pay for 40 hours' work, under the mistaken impression which the board had, that this was what happened in the '30s when we went to a 40-hour week. You couldn't get a worse reading of history. What happened in the 1930s was very simple; the work-week had fallen from about 48 hours down to 35. And then, in order to spread jobs we got time-and-a-half, first under the NRA and then under the Fair Labor Standards Act, for hours in excess of 40. And so, as people began to work more, up to 40 hours, they were getting hour for hour, not 48 for 40 at a 20% increase. They were very happy to get 40 hours' pay instead of 35 hours.'

And it was a misreading of what happened when we went from a 10-hour day to an 8-hour day, when the general rule was to pay 9-hours' pay for the 8-hours', not 10-hours'. But those are the little incidental sidelights which you at least ought to be aware of; most people aren't aware of.

But the fact is, when the railroads got done paying 48-hours' pay for 40-hours' of work, instead of 48-hours' of work - which theoretically meant they had to hire one more man for every five - the total wage bill was the same. And I remember hearings down here at the Interstate Commerce Commission, there was quite a bit of screaming over the fact that they said their costs had gone up when they hadn't gone up. And all sorts of tables were brought in to prove this. And the unions in their wage cases did the same thing; to prove that, "Look, it didn't even cost you anything to do that; it cost the unions something; it cost the workers something.

And so, the wage rate is important in any estimate of purchasing power. And I would be less than candid if I didn't tell you that today I believe our unemployment problem is not so much a question of a malfunctioning of the economy, although there are centers of unemployment which attend technological change; I think we've priced labor out of many markets. Interestingly enough, we have sped the introduction of automation because, as it has become more profitable to substitute, we have substituted. Now, from one point of view this is good. This is a better and a more efficient use of resources, for those who are working. But, from the point of view of those who lose their jobs this is an extremely unfortunate development. Any time that you get major changes in the economy, somebody gets hurt. And this is true whether you're talking about going into a war economy or coming out, or you're talking about major changes at any time.

And, the hope is, that in a normal peacetime economy, what you'll have will be rather small pockets of hurt which you can take care of - unlike the end of a war or going into a war when these pockets become rather widespread.

I have just one other illustration - I can give you many of them - this involved wage negotiations; a large chain of stores. I'll never forget the headman saying in connection with the demand for an increase of $10 a week for statisticians or some other clerks who were working in the offices. He said, "I don't give a damn how many dresses color blue, size 16 we sell; if my store managers can't estimate what they need - and they don't need all these darned statistics - I'll get new store managers. I won't pay $10 more to get that information; it isn't worth it; I'll throw them all out." And he meant it. Fortunately, they worked out a deal at somewhat less than $10, so they continued to work.

But, at some point you can price your way out of a market. And I think this unemployment today - which is really a question, you know, of only a million people - I know you read stories about four million unemployed, and there are four million unemployed. But, the fact of the matter is, an economy with 70 million jobs there is frictional unemployment and seasonal jobs. For example, those who have the summer jobs and don't have them; those who have jobs in winter in a retail store just before Christmas; the construction industry which, in certain parts of this country must grind to a standstill when we come into the bad weather; the garment industry which works on season, style, etc. These types of jobs have people who quit because they want to get a different type of job; the people who become ill. This type of employment called "frictional unemployment," concededly takes up to 4%. This is why the President, when he talks about objectives, has been able with a straight face to say that 4% is our immediate target for unemployment. Because, in a dynamic, expanding economy of this size it's impossible to provide jobs for everybody. And even today, with our four million unemployed, you can go into most communities and find columns of jobs listed in the newspapers, usually, of course, jobs that will involve skills of one kind or another. And so, you read a great deal about the unemployed who have left school early; who are untrained; who it is difficult to retrain.

For example, in this Armour Project they made a study to find out what they could do with the people who were laid off; they were going to provide for an offset to automation. They got the government employment service out in Kansas - I guess it was - somewhere out there - to survey and test these people. 60% of them didn't have any educational level that made it possible to retrain them for anything. They described them as common labor; casual common labor, which means only people who could shift from job to job and it was a waste of time trying to train them. This is another part of the unemployment problem. But as you push up these wage rates, this is the group which is hit. And it is hit because you cut off the level that you can replace with machines. And what is the level that you can replace with machines? Ordinarily it's common labor, or things that are done by rote.

Have you ever seen any of these assembly lines? I was in a pottery plant one day and it was quite interesting. They had two different operations going on; one was a machine operation in effect and the other was a hand operation. You saw a little conveyor-belt going along the table and these girls would take a plate off and do something to it, and back on, and the next one would take it off and do something to it; a machine could do that. All you need is capital. That is what we tend to get and others don't get.

And so, when we look at the purchasing power side, it must be not only the rate, but the number of hours. But there's another factor on purchasing power, and that is, what you can buy with your money. I was in Italy a couple of years ago and went into a hotel in January when the place was half empty; but the room wasn't ready. It was too busy. So, the maitre d' - or whoever he was - said, "We're so sorry, sir, it's not ready; why don't you go up the roof and have lunch; it's a beautiful view." We went up there and there was one person sitting on the roof, a friend of mine from New York. I'll never forget the first thing he said to me: "Jules," he said, "it's wallpaper." I said, "What are you talking about?" And he pulled out these lira - 650 to a dollar. He said, "It's wallpaper, that's all it is." Well, it wasn't quite that bad. The lira is still worth something, although there are countries where it is wallpaper.

But this is what we are talking about, and it's extreme when we talk about what happened to the cost of living. What can you buy with your money? And so, if, by any chance, we are increasing this purchasing power too rapidly, and it finds reflection ultimately in what happens to prices either because people have the money to bid up or because costs are effected, or because somebody thinks because these things are going on this is the environment within which to raise prices, the purchasing power of those dollars can't go up. And the fact of the matter is that your purchasing power can't go up any more than productivity can, anyway. You can't just manufacture money and buy goods with it; you clean your shelves and that's it. If this were the simple solution for all of our problems we could just have the Treasury work overtime. You notice out at the Mint in Denver they're having a little bit of a problem anyway, with the coins. So, we'd just build another Minut. It would be cheap, compared with the results you'd get. Everything that comes out is purchasing power. The trouble is, "What is that purchasing power worth?"

And so, when we talk about wages we must consider not only money wages; we must consider real wages as well. And real wages involves the relationship to what you can buy.

Now, what are some of the factors that determine wages? Well, in thetextbooks we talk about a few things. Way back we talked about the iron law of wages. There was a certain amount of money and you divided it around, and if you raised the wage all that would happen was you had fewer people who would share it. And we talked about a productivity theory of wages; that some way the businessman measured what the last worker contributed against what he had to pay him, and if he doesn't contribute enough he gets laid off. Well, this may happen in a two-man shop, but I have a sneaking suspicion that it doesn't happen on the Pennsylvania Railroad, or U. S. Steel, or General Electric, or Westinghouse, or some of the other places.

Yet, in a broad way it may describe what happens. More practically, what are the things that they look at; not what do we tell them in the textbooks? And here there are six criteria which have been developed - and I must say I had a little hand in developing them, because, the first time these six were used was in 1944 in the Steel Wage Case where we set them up. The six are, wage comparisons; what have other workers in other unions gotten. That's a powerful one when Dave MacDonald has to see what Walter Reuther is doing. And don't make any mistake about it; that can be more important in a steel wage negotiation than anything that Roger Blough says, or Mr. Kennedy says, or anybody else says, because Dave can't be behind Walter. And if you get him here, needle him a little bit about it; have a little fun. I don't think he'd deny it within the room. He'll tell you that he has to live with his own workers. And his workers are in the same community as automobile workers.

These things are not just power problems. You think of our industrial complex in the Middle-West, with steel mills and automobile factories, rubber plants, electrical equipment plants and aluminum plants, all within the same or adjacent communities, and you can see why, if your neighbor who works for ALCOA gets a raise, you in U. S. Steel want a raise, or vice versa. Otherwise, you've got to deal with your wife. And that's even worse than dealing with another labor union leader. Why can't you do as well? This is the hard, practical nature of collective bargaining in terms of what you can take and what you can't take.

On occasion when I've been here I've been able to talk about negotiations that were in progress, and to lay out some standards, as one or two of you may recall, as to what would limit what could be taken. There's no mystery as to what a settlement will be once the first ones have taken place. Wage comparisons are of vital importance because union leaders must live with it; the men must live with it; and they must live with their wives.

A second factor, the cost of living; consumer price index. If living costs are going on, discontent develops; pressures develop. Sure, you can get a country like Brazil where you get a rise in the cost of living, of 50% or 75% a year, and you read about the wage increases; all of a sudden you find they are doubling wages. They're not doubling wages. What they are doing is keeping their real wages pretty much where they were. They've got to be pretty careful. During the earlier post-war years increases in the cost of living were a vital factor. There wasn't a wage negotiation that took place - oh, there may have been a few unimportant ones someplace where you couldn't be sure that you'd get at least a cost of living, and now we'd keep you in the same place. Therefore, that wouldn't be enough, and usually wasn't. In the last few years this has become a relatively unimportant factor.

The consumer price index has risen an average of about 1% a year. And you ought to be aware of the fact that the price indeces are not so perfect that 1% really means 1%. You know from your own experience that there's an awful lot of juggling you can do within a household budget. So, instead of having canned peaches you have canned pears; instead of canned, you have frozen; instead of frozen you have fresh. And your wife becomes very expert at shopping, as most wives do. Of course, the modern wife unlike our mothers and grandmothers usually gets on the phone and orders the meat, and says, "Make sure it's a good cut." Of course, your mothers and grandmothers went down there, having come from a farm, and they look at it and know whether it's a good cut. The only way you know is by the eating test and that merely determines whether you go back. It doesn't determine whether that piece of meat is any good.

It sort of reminds me of an experience during the war. I had an occasion to write a long letter to the Times about some of the horrible things OPA was doing in its rationing. A friend of mine who was in the OPA wrote me a very nice note. He said, "You left out one very important thing. Do you realize that for 75 years the Department of Agriculture has been trying to improve the quality of meat in this country? And with one regulation OPA made all meat prime?" At least in terms of the price charged it was all prime.

But, this is part of the problem; that the indeces we use have a tolerance within them so that the 1%, or these 1/10ths, 2/10th, or 3/10ths of 1% changes really don't affect the average family. I was on a program one day up at the University of Buffalo, with a very smart gentleman from Canada. And I've never forgotten one of the things he said. He said, "One of the problems with our price index today is all the publicity it gets. In the old days when we published an index either sami-annually or annually, and prices went up a half of one percent, nobody knew about it, and nobody worried about it. Now the headlines come out, 'A new high, says the

Scripps-Howard Press.' Well, what does that mean? It went from 107 to 107.1. Now, let's face it, gentlemen, this is a crisis, particularly if the next month there's another new high - 107.2."

I've seen these headlines in the press when the index goes up 1/10th of a point. A new high flashes all across the country. You get 10 new highs like that and it's a point. It's all of 1%. You and I know that we can adjust to these things. And so, an interesting thing about wages is that we are now the victims of high-powered publicity. That also goes, incidentally, for unemployment. I remember when I got out of school - highschool - back in 1927; I know you thought I was older, but I'm not; I went out and got a job. I put together, radios. I didn't like it, so I quit. A week later I got a job listening to phonographs; we put those together. We played the same record over and over again; I couldn't stand it after three weeks, so I quit. I got another job with M. Lowenstein & Son. I was a wrapper; I was moving up. And after five weeks - the Easter Season - I was laid off; I was seasonally unemployed.

Well, you know, gentlemen? I didn't know until about ten years later that 1927 was a recession year. When I became an economist I knew it was a recession year. At that time it meant you had to wait a week or a week-and-a-half to find another job. But now I know it because I've seen that there are four million unemployed. I know there's a crisis, even though a relatively small part of this group, unfortunately, is unemployed for 15 weeks or more. Many of these people just move from job to job. But with our fine newspaper publicity we know there's a crisis.

Well, this happens with the cost of living. Because most of us don't buy everything in the cost of living every day or every week. I'm reminded of a cartoon the Canadian Government had during World War II. They showed a bar-chart, and a woman was standing behind the bars for clothing and food, and was complaining about how much prices were going up. And a man was standing behind the bars for electric power and rent. He said, "I don't know where you're spending all the money; nothing is going up." He was paying the rent and the electric power; she was paying the food and clothing. The food prices were moving up rather regularly. She was experiencing this and he didn't know what she was talking about. And, of course, this is what happens when you get these 1/2 and 2/10ths of 1%; it's small. So, the cost of living, while not ruled out completely, has become a less important factor.

There's a third factor which I won't spend any time on - consumers' budgets - closely related to the cost of living. This is tied in with minimum standards of living and basically is used for the minimum wage mainly. It plays very little role in major collective bargaining above the minimum.

The fourth factor is productivity. I've already mentioned it briefly. It refers to what is happening in our economy in terms of real goods and services; real output. Now, let's face it; a few rich college professors can't consume all of the beans and all of the automobiles and all of the suits and all of the other things that are produced. The fact of the matter is, unless there is mass-consumption of most of the products we produce they could not be consumed. And so, without, for the moment, being concerned about whether there is an equitable sharing in the mass, there must be the purchasing power there to buy it, or it will not be consumed. And this is why we often say that real wages go up about in line with output per man-hour. They go up in line with output per man-hour because there is no choice.

The people generally must be able to consume the large increase in goods and services or it will not be consumed. And I shall return to that in a moment.

A fifth factor very often mentioned is profits. This is a great target; let profits be big, and the unions are in there to share in them. Let profits be big and the public is ready to share them too in the form of lower prices. Because, the fact of the matter is that output per man-hour, and profits, are really tied together. If the output per man-hour goes way up it's going to increase your profitability. And you can share in this output per man-hour not only by wages and fringes, or non-wage benefits, but also by lower prices. One thing that is often overlooked - and Mr. Heller's group overlooked it a little bit - is that if you share by way of a price cut, this also involves an increase in real wages. You can't get it in higher money wages and lower prices at the same time, because, if our total output goes up 2% or 3% a year this is all there is to share or divide.

Sure, you can take a little bit away from the top, and when you've taken that away that's it. You can't do that forever. But having taken it away all that you can do is increase as rapidly as your goods and services increase, which, again is a problem of the underdeveloped countries. They can't increase their goods and services.

And finally, last but not least is the question of the economic environment. This includes not only what is happening to business, but the level of employment and unemployment. You know, we had increases in World War I before unions were powerful, because there were labor shortages. And without unions there would have been increases in World War II. When you get into years of recession, what happens? Well, this is where the unions play their positive role. Instead of no increase which would have been past experience, you get a modest increase. And when labor shortages prevail - and that's a by-product of a very active and over-active economy - wages go up because businessmen bid for these workers.

I remember around the time of the Korean War. Chrysler, you may remember, took a hundred-day strike and won it - in May of 1950. Then the Korean War broke. One guess: "Which was the first company voluntarily to raise wages after the Korean War broke?" Chrysler. Having just won the strike. But this was something different. Now they had a hard labor, you see; we're all familiar with that. Now they had to make sure that when the orders came in they had the workers. They rushed out with a 10¢ an hour increase. They were about the first important company. Having won a big strike that tied them up for about 100 days they were the first one to rush out because the economic environment had changed. Industry bids for labor; the armed forces bid for labor. You find it tough to recruit and what happens? Somebody gets the bright idea, "Why don't we pay them a little more? Why don't we give them some more benefits?" And sometimes it works.

The Council of Economic Advisors, about a year-and-three-quarters ago, came out with an important pronouncement on the subject of wages, the so-called "Guideposts." And this has been hailed as a major development. Well, it was. It's true that some of us hadn't been talking about this for more than 16 or 18 years, say, going back to the end of World War II. But it was a major discovery in the Council because they didn't have many people who knew much about wages or prices. The original Council included one man who was strong in monetary theory; one man who was strong in international trade; and one man who was a tax expert. There have been some questions raised about that after the events of last year. But, I guess he is still a tax expert, and you have heard from him recently.

But, none of the top people were in the wage-price field. So, they followed Molier's famous gentleman who discovered that he'd been talking prose all his life; you remember that one; and they decided that the economy can't have increases in real wages beyond the increases in productivity. That was a great discovery. In fact, you'd have to read any one of about 50 books I could mention, to make it. And so, they came out with the guideposts. Under the guideposts they said, "Well, now, since this great discovery has been made, and since nobody has really talked much about this since they started in about 1946, we think that wages shouldn't go up more than productivity - including fringes." Now, that was a contribution because while not a lot of people recognized it, at least now we had an authority recognize it; that a fringe benefit costs just as well as a wage. And this helped.

So, they came out and said, "Actually, you shouldn't increase your wages and fringes more than 2½ to 3%; and certainly not more than 3%. The fact that output per man-hour really had gone up over the years at about 2.1 was ignored in the shuffle.

It sort of reminds me of "Engine Charlie" - Charlie Wilson of General Motors - who made this discovery when he was sitting in a hospital bed in 1941; that's how new it is, you see. And this is how the annual improvement factor which is based on the same general principle was brought into operation in 1948. Well, Engine Charlie discovered that real wages are in line with money wages - I mean, with productivity. And he said, "After all, since they're in line with productivity why don't we just formally increase real wages each year by that amount?" And so, he said that the long-term increase in productivity is about 2%; if you make $1.50, we'll give you 3¢ an hour, and we'll adjust for the cost of living. Well, that's 2%. So, they got their 3¢ in '48.

In 1950 the union said, "We don't want 3¢, we want a nickel." And Engine Charlie said, "We'll give you 3¢." "We want a nickel." "3¢." "A nickel." Settled - 4¢. Whereupon, Engine Charlie who had been going up and down the countryside making speeches about how the annual improvement factor was based upon the long-term gain in productivity of 2%, merely changed it to 2½%. As far as I know, this is one of the only cases on record where the statistical record for the long-term gain in productivity was changed by collective bargaining. Because, everybody then began picking up the 2½%, you see, instead of the 2%.

Well, now, let me call your attention to one or two things about these wage guideposts, because it's important. In the first place, let me give you three sets of numbers. Suppose wages don't go up at all? Suppose the consumer price index goes down by 9%? You'll never see it in your entire lifetime go down by 9% from the present level. That's a forecast. I know it won't be violated before I leave today, so I can make it very safely. You see, basically I stick to economic tradition. But, it won't go down that much in your lifetime, so let's don't worry about it. But suppose it did - just for the purpose of illustration. I want to make sure that you understand I am not forecasting it because I wouldn't be found dead with that forecast. What would happen? Real wages would go up by 10%. Because, now you're paid 91¢ instead of a dollar, and that extra 9¢ is roughly 10%.

Let's take another illustration. Suppose the CPI went up by 20% and your wages went up by 32% How much have real wages gone up? 10%. Because, now you get 132 to buy 120, which is 10% more. Suppose your price level doubled - it's up to 200 - and your wages went up by 120%, to 220? You still have a 10% increase in real wages.

Now, I've given you these rather extreme figures for a reason. There are too many people who insist you must compare your real wages with the cost of living. This is a perfectly silly type of comparison, because the cost of living is one of the ingredients that determines what happens to your real wages. Now, what I'm trying to say is that if productivity goes up by 10% in a period of several years, whether you had a 9% cut in prices and no wage increase, or 100% increase in prices and 120% increase in wages, you couldn't get more than an increase of about 10% in your real wages. And you understand, I say "about;" it might work out 9, 8 3/4, 10½; these statistics are never as perfect as we can put them down on paper. Regardless of which of these alternatives develop, if the total supply of goods and services went up by 10% per man, woman and child, that's all that, per man, woman and child could be consumed - 10% more.

And so, the guidelines are designed to say in effect, "Look, it doesn't do you any good to get 10%, if all you can keep is 2% or 3%; let's keep it down to 3%." Now, actually, the labor bill has only gone up about this much during this period. But before we get overwhelmed in terms of thinking what was the cause and effect - I only have a minute or two - let me take you to wage inflation and show you what has been happening. When I used this for the first time here a couple of years ago some eyebrows were lifted. Today I think it will be taken as gospel. I think Professor Poppe will agree with me.

During the early war years - the post-war years - wages and fringes were increasing more than output per man-hour - much more. In fact, if we take the period, say, from '47 to'49 - and I'm ending each of these periods on a recession year so that I get the benefit of pluses and minuses; otherwise you get distorted figures. I was amused to see that the Council finally used the same analysis in its last annual report. The increase was 8.7% a year. Remember productivity going up 2.1; 2.5 - take any number you want, but not 8.7. For 1950 to '54 the average was 5.8. From '55 to '58 it was 4.6. In '59 and '60 it was down to 3.8. Notice this steadily declining level of increases in labor costs to a level which was closer to the increase in OPM - although it fluctuates from year to year - so that, the gap between them; the wage inflation - and that's what the term means - an increase in labor costs more than an increase in output per man-hour.

So that, the gap was narrowing. In the last three years it has been down to about 3 or 3.1%. And so, gentlemen, the amount of wage inflation in our economy has virtually disappeared on a current basis. Because, we can juggle and adjust to 1/2 of 1%, whereas you can't do it with 5%, 6% or 7%.

Well, one concluding note. We have cultural lags in economics as we do elsewhere. The cultural lag among economists usually runs four or five years; they're just catching up with this. It wasn't until about '57 or '58 that the economic fraternity was willing to use a word like "wage-inflation." Up until then it was considered anti-labor; now, everybody - respectable, unrespectable, disrespectable economists, all use the term as one that describes the situation. But unfortunately many of my colleagues still haven't learned what wage-inflation they mean, even though they now know what the term is.

Wage-inflation may be accompanied by one of three developments - alone or in combination. It may be accompanied by price rises. And those who insist that wage inflation means price inflation are taking this road. It may mean a cut in profit margins. We've experienced that. In fact, for the period of about 1950 to '58 part of the cut in profit margins was attributable to wage inflation which meant you were paying larger increases than the increase in OPM. But it may also mean a method to cut labor costs, and that means unemployment.

During periods of rising economic activity the tendency is for the prices to rise and for profit margins to hold. And during periods of climbing economic activity the tendency is for the burden to be felt in the form of lower profit margins and unemployment. And I think we must recognize that one of the penalties we were paying for wage inflation was a combination. Now, fortunately the magnitude of wage inflation has been dampened down to the point of almost non-existence. As I said, when I described that trend here several years ago there was quite a lifting of eyebrows. How could anybody say wage inflation was coming to an end? We know it's here forever. Didn't Sumner Slichter say that? And, of course, that proved it. But the fact of the matter is that there was already clear evidence that this was dampening down. And why is it dampening down? Because we have changed the pressures in our economy - I don't mean we have changed; I should say the pressures in our economy have changed from the early post-war years. What were they?

A shortage of goods to make up the World-War II accumulated demand; inflation, as we used the money that was created during World War II; tremendous demands from overseas as we attempted to rebuild both our former friends and enemies; foreign countries that couldn't enter into foreign markets with sales of goods because they had their own economies needing every unit that they turned out. As we got into the early 1950s and these foreign countries began to return to the level of living they had before the war - and that's where they were before their pre-war levels, while we kept creeping up - some of these pressures began to abate. By the time we got to the middle '50s all of the World War II and what little was built up during the Korean War - the accumulated demand - had been pretty well satisfied. The inflationary pressures had begun to spend themselves. We still had momentum on the wage inflation front and that carried along for a little while.

Surplus capacity began to take the place of shortages. Remember back at the end of World War II when you couldn't get a telephone because the telephone companies couldn't produce them fast enough? You waited in line for furniture and you waited in line for automobiles, houses and other hard goods. Surpluses began to take the place of shortages. The net result has been that today we have an economy with a capacity in excess of what is being bought in industry after industry, with few exceptions. We have foreign competition moving along in areas where they never knew about it before; steel is a good illustration; some in chemicals. You're all familiar with textiles, I know, glass, carpets and many other products.

Inflation has been dampened down - and my judgment is not eminent; and that I've said here for about three or four years. In other words, the economic climate has changed, and has changed very significantly. As a result, the ability of industry to recover its wage increase by raising prices, which they could raise not because costs went un but because the goods would be bought, has disappeared, and that stiffened the backbone of industry. Because, once you get it back, why fight?

Why be closed down? The result is that labor costs have been going up at a slower rate; in fact, in manufacturing industries in the last few years, total labor costs have gone up somewhat less than output per man-hour, so that, unit labor costs have actually gone down. And it is a fact that in American industry the Wholesale Industrial Price Index has fluctuated within a range of about one point. Since the spring of 1958, for more than five years, the Wholesale Price Index has remained about unchanged - literally unchanged as these economic statistics go.

And, most of the rise in the Consumer Price Index has been services, and you know what services are. That's wages. If you go to the barbershop, that's wages. If you call in the auto repair - I've got to tell you this story. How much time have I got? One minute?

I was having a debate with Leon "I'd like to be an economist Keyserling;" we've had a lot of debates all over the country, and Leon is a very rough debater, particularly if he thinks the other guy isn't, so, I never have any problems with him. We were having one of these wonderful debates where I talked first. He got up next and said, "I've had many debates with Jules and I always come, hoping we can agree. But today, again, I'm afraid that we can't agree. I can't understand this because I've changed my position many times and he never changes his." So, I was forced to say when it came time to rebut, that if you start with a sound base it isn't necessary to change your position so often." Well, that's another question.

The story I was going to tell you involved auto repairs. This was a mixed audience - labor-management. Incidentally, I was going to tell you the story of the two couples who had been going out for years and finally one of the fellows said to the other, "Don't you think we ought to change partners tonight?" The other fellow said, "That's a good idea." An hour later one of these fellows said to the other, "I wonder how the girls are doing?"

In order to make my point about this labor cost, I said, "You bring your car into an auto repair shop and you get a bill for $374; you look at it - $4 for material, $370 labor. Obviously,a little poetic license is involved in the way of exaggeration. A fellow gets up and says, "I'm a plumber and I object to what you've said about auto repair." So, I got up and apologized; I said I did exaggerate. Actually, the last time it was about $355 and the balance was materials. But, I said, "I've got to tell you something about plumbing. When I call in my plumber it costs me $12 an hour, of which $8 goes to the plumber and $4 goes to his assistant who carries his little wooden box." And if any of you gentlemen see Backman walking along the street with a little boy in a turban - like Rosenkavalier, you know - coming behind him carrying a briefcase, you'll know that I'm acting like a plumber.

Thank you, gentlemen.

QUESTION: I don't think you meant to leave the impression that it didn't make a great deal of difference whether or not increased productivity went into lower prices or into increased wages. There would be, I would think, a consideration of time-lag; differences in increase of productivity in different industries and according to who gets the benefit of these increases. Would that be right?

DR. BACKMAN: Yes. I think it does make a difference. I'm one of the smaller groups that think it should go into price cuts. I'm happy to say that while the group consisted of about three people up until about three years ago, we've now added some important allies. So that now, it is a little stronger group. Prior to about 25 years ago this was the dominant thinking in economics. I might tell you why.

Let's take a simple illustration. A plant has 100 people working for it. Let's use a round number; the 2% looks so small; and you'll realize what happens.

And one of the points you made is very important. These output per man-hour gains are highly uneven. There are some parts where there is no increase; in government, for example, where the increase is rather small. There will be a little increase, I suppose, when we get more of the office equipment. I'm sort of reminded of Senator O'Mahoney asking Al Reese a question at a committee hearing where we both were testifying. He said, "Isn't there any evidence of increase of productivity in government?" Al said, "I don't think so." So, the Senator said, "Well, what about measuring it by an increase in the number of Bills?" And we felt that that wasn't quite an increase in productivity; sometimes it's the reverse.

So that, when we say 2% for the economy, or 2 1/2%, we're really saying 4% to the electric power industry. And, we may be saying 10% or 15% for new electronics. And we're saying 1% for retailing. When we say 10% for electronics we're saying maybe 2% or 3% for Western Electric, and maybe 10% for Texas Instruments, if you know what I mean. In other words, this is a composite. And it's because it's a composite, for one fact, that it must take place at different rates and different parts of the economy.

Now, the suggestion was made that there's a lag. Behind that suggestion is the thought that if you increase the wages, the money goes out immediately. But if you wait for a price cut some of these companies won't cut prices, and by the time it drifts through the economy it won't have too much effect. Well, let me come back to the hundred men in the factory.

All of us know that while in theory we talk about economies going at full capacity, as a practical matter there are rarely times when any companies or industries couldn't sell more at the same price. We all know that as a fact. We have a hundred men. Let's say we increase the wages by 10% because productivity went up 10% in that company. So, now there is no increase in unit labor costs; no pressure on this company. What happens? The company is still only going to sell a hundred units because by the time that hundred peoples' purchasing power comes back to that company - which is also a lag - we can be sure that at least for the immediate future it will be 100 units. But how many people does it take to produce a hundred units now? It takes 90 or 91; it doesn't take 100.

The result is, the people who are in that plant get as much money, but there aren't as many people. Now, what happens if you cut price? Suppose the price were cut by 10%. And we all recognize that there are some products where a cut in price would have no effect, "inelastic demand," so-called. But there are the products where it would. Suppose that this price were cut by 10% and therefore more people could buy this product. So, instead of selling 100 units you sell somewhat more. If you sell 111 units you still keep your people working. If you sell more than 111 units you employ more people, and that, incidentally, has been the history of productivity gains and price cuts.

And so, there are lags whichever way you do it. The one way you take a price in unemployment. The other way you take a lag in how quickly the people on the job get the benefit. Well, let me get one thing clear. Merely because you are a steelworker working in a steel plant doesn't mean that you created that productivity. Professor Siebow (phonetic) and myself may have had some of you fellows in our class and because of the training we gave you you are able to do a better job. Shouldn't we share in it? Somebody in the aluminum industry or the copper industry may make an advance in metallurgy which may also come back to steel. Shouldn't aluminum and cooper workers share? Somebody working in a university laboratory may have made that advance.

Or, let me take a different point of view. No invention springs full-blown, or very few. Every one is built, one on top of the other. Now, what about the people who took care of the early stages and who are now retirned? Aren't they entitled to share a little bit as they could with a price cut? In other words, if you view our economy as a continuing operation, a highly-integrated inter-related economy, where it isn't Mr. Blough of U. S. Steel who is responsible, or Mr. MacDonald or any of their workers, but really the whole economy coming to bear on steel, which plays an important role, then I think we can see why this should be spread out.

And so, it does make a difference. As I say, my prejudice is in favor of the lower prices. Now, actually, I think as a political matter what you have to do is share some in the form of a wage increase and some in the form of a price cut. And let me warn you about one slogan often used by industry; "If you increase wages as much as productivity" - meaning 2% against 2% - "there is nothing left for a price cut." That's a lot of nonsense. In the average industrial firm the wage bill runs about 25%. Oh, it varies; petroleum and chemical under 10, coal up to 60, steel 40, railroads 55, cotton textiles 25; it varies; it runs 25% to 30%. Assuming it were 25%, if you have an increase of 2% in an item costing a dollar, that's 2¢. If you increase the wage part 25¢ by 2% that's a half a cent. There are 1½¢ left to buy materials, cut price and to take care of profits. If everyone shares equally there would be a little all along the line.

So, I don't mean to imply that as a practical matter you can put it all in one direction. I think what you do is, you have to share it. But, we have to give more weight to the price cut than has been the case up until very recently.

QUESTION: Professor Backman, what will be the effect on labor-management relations as a result of the mandatory arbitration resulting from the current rail dispute?

DR. BACKMAN: I don't think it will be good. This industry is the ideal illustration for my answer. Starting with about 1941 - there was one before - but basically starting with 1941, the railroads and the unions never agreed at a local level, never agreed at a regional level, they always came in for national bargaining. They always went before Presidential Fact-Finding Boards, with a handful of exceptions where some arbitration boards were set up. Almost without exception, up until a few years ago - and certainly, this was all true through the Truman Administration up to that point without exception - the unions never accepted a recommendation. They're not binding, you understand. These are merely recommendations which presumably with the power of the Presidency and public opinion behind would be something neither party could do much about.

They always went to the White House and always got a little more. Even when Mr. Truman, back in 1952, I guess it was - or '51 - denounced the railroad workers because the engineers and the firemen, I guess it was, were going out on strike, they had a 16¢ award. He denounced them; in fact, asked Congress to pass legislation, and then settled it for another 2½¢, in the White House. And so, you have this type of precedent in other industries as well.

Now, what does this come up to? I think you must understand a fundamental fact about collective bargaining. You have mice who are doing the negotiating. In many instances, behind the mice are the important people. And nobody wants responsibility. I don't have to tell you this type of situation; you've observed it someplace, I'm sure. It's sometimes called "passing-the-buck." And so, what happens? Both sides want to prove that they were forced to take what they had to take. Behind the No. 1 man in a union is a No. 2 man who wants to be No. 1 man.

I'll never forget, walking across Washington Square Park a friend of mine who was a labor executive of one of the companies, was walking with two of the union men he was bargaining with. He introduced me and I told the labor leaders, "You are the fellows who would rather take less in arbitration than more, privately, so that you can hang onto your jobs." So, one turns to the other and says, "It takes a professor to tell us what we do." He said, "Of course." And it's true. He was right. I know cases where they got less in arbitration than they could have gotten privately, because it's important to be forced. Now, what does this mean? Here we have a setup where Congress has indicated that in the event of a national situation it would act. There is no assurance that it will, but it might. If steel comes to an impasse, we'll let them take it off our hands.

Fortunately, there will not be too many of the national type of situation. But there are enough of them in key situations, to make it a problem. And so, this is opening a "Pandora's Box." Where it will end I don't know, but if the past is any test it will increase the resistance on both sides. In some key bargaining they already talk about other transportation industries, the longshoremen and others.

Now, it's unfortunate when you step into these things. This whole thing is a mess to start with. This is about as one-sided a story as you ever could get. But, the same game is being played.

QUESTION: Doctor, is it your opinion that the labor gains of the past 30 years would have occurred without the unions?

DR. BACKMAN: I think the answer to that is yes and no. I think the fringes moved ahead much more rapidly than they would have without the unions. I don't think we would have been as far advanced in any of these fringes and some of them we probably wouldn't have had, without the unions. I think this is the main area of gain by the unions.

I think the second area is the ability to wrest some increase during periods of recession when unemployment normally would have stopped it. I think the overall increases in wage rates would not have been too different; probably just a little less if there had been no unions. The overall increase in labor cost would have been less because it's the fringes where their major successes have been attained. In the other areas, in most cases you'll find that when times are good they get more; when times are not so good they get less. So, I'm inclined to feel that while the economic literature is almost split - some people say they got nothing and others say they got everything; others are willing to compromise - on fringes I don't think there is any question. On the wage rate I think it's a little; not as much as the overall increase.

QUESTION: You have commented on the advantages of viewing the economy as a whole, nationally. Would you also comment on the opportunities and problems of viewing the economy internationally as a whole, in the labor concept?

DR. BACKMAN: Well, the main area where this plays a role, of course, is in connection with foreign trade and its impact on the balance of payments. This is a very interesting area because here again the amount of confusion you run into and the misleading statements are enormous. Take, for example, the question of wage-rates here and abroad. Many of you know - or should know - that wages are lower abroad. I mean, let's not have any ifs, ands or buts about that. But what about the actual differences? How many of you realize, for example, that in practically all European countries production workers are treated the way white-collar workers are treated here. You don't lay them off when you haven't got work; they work by the year literally. Which means that if there isn't enough for them to do, the total cost will move up, or the amount that labor will receive in a year is different than you would get if you were in this country with the same wage rate.

Secondly, the fringe or non-wage benefits are very large. In Japan there is a big bonus system on top of everything else at certain times of the year. In other countries the fringes run up to 75%; sometimes even a little higher. With all of this, the actual wages are, at the best, no more than maybe a third of ours. But, this is only half the story. The other half has been, and still is, more important. What do you get for these wages? I remember an illustration several years ago in England. They were getting about 1/5 of the wage level that they were getting in the United States. But it turned out that our miners in those days were turning out seven tons a day against one ton over there. Who had the higher labor cost? The British did. And this is the area that is changing. Because, with what we used to call "the rationalization of industry" - and many of you may recall we had over 300 productivity teams here from other countries who would come over here and look at what we were doing during the earlier post-war years: I guess, until about 1955 or thereabouts, they were coming in; I had the privilege of addressing several of them; every country in the world came here. They looked and found whatever they could in the way of the best in our practice.

Their newer plants are as modern as ours, and, I'm sorry to say, sometimes reported to be more modern, because after all, this was a whole economy built up on ruins. So, they have the latest. And the result is, this difference in productivity which was the redeeming feature in terms of protecting us, is rapidly becoming narrower and narrower. Of course, the interpretations of these things sometimes vary.

I once heard this gem of a remark in one sentence. I was up in Toronto talking to the Canadian manufacturers and had to sit on the dais when the president was talking; you know, you get stuck with these things; it's not all pleasure all the time; and I heard him state this sentence. He said, "We have trouble competing with Europe because their wages are lower than ours; and with the United States because they are more efficient than we are." One sentence. The trouble with Europe, their wages are lower. We have trouble with the United States because they pay more wages but they're more efficient than we are. You can't have it both ways, unless you're being a little confused - and he was. But he was riding both horses as he had to ride them at that time.

And so, I think it's in this area that the relationships become important. But this is only part of the story. I had the occasion to make a comprehensive study of the electrical machinery industry recently. The one thing I quickly discovered was that while the wages were much lower the raw material costs were higher. And if you got into a place like Japan the transportation costs inbound and outbound also, of course, were considerably higher. And so, you've got to look at the whole picture.

One other thing of which Japan is an outstanding illustration, again I find, is not generally realized; the Japanese never produce across-the-board. They take one item - transistor radios - and they produce the hell out of it. Now they're in television. They're not producing large numbers of washing machines, dishwashers, etc.; maybe that comes next. They haven't got the resources to do the whole job. They take them one at a time. In that one they get all the economies of mass-production, low wages, modern plants, etc. which offset some of these other forces.

And so, in terms of our international picture we have a situation, as you know, and somebody undoubtedly will be discussing in detail, where our export surplus is about $5 billion. We're sort of like a family that's earning $105 and spending $100 on itself, and then having some relatives around who want to take away $8. And, for awhile they can do it. After awhile, if it continues long enough, you get into trouble yourself. And at some point you either have to say to these relatives, or would-be relatives - most of them are on your wife's side anyway - "look fellows, it's all very nice to give you the $8 and we know how important it is to you and how important it is to us, but if we get into trouble we're all in trouble. So, we're going to cut you back from $8 to $6, or $5, or $4, because you're better off getting a half-loaf all the time, than getting a full-loaf today and nothing tomorrow."

And I think that's the place where this wage thing can be important. But only in terms of building up the surplus still more. I think we've over-exaggerated that. I think we've got to look at the spending side a little more. Because, we're now up against a situation where we're not only in each other's market, but more important, in a third market where we both go in and compete; the new plants, the wage differential, etc. will all play a role. And this is what's affecting this balance of payments, not what we're doing. We're doing all right, strictly on the private end of it.

QUESTION: Doctor, do you think that our competitive international prices will in the future become a factor in wage negotiations?

DR. BACKMAN: I think it's a factor already. I think that in some industries this has been recognized. I think it's recognized in textiles; I think the steel union has been sort of keeping a weather eye on it; and a few others. It has become a fact, and will become a greater fact as time goes on.

QUESTION: Do you believe the proposed tax reduction would cause some inflation?

DR. BACKMAN: Well, my position on this proposed tax reduction is very simple. I think it's too large, I think it's in the wrong places; I think we need a very modest tax reduction on the incentive side. Our problem is to make jobs. I'm not convinced that we can make it through the spending route alone; I think it has to be some other route. I don't think we can afford to just build up large deficits. I'm one of those who think that we spend too damn much and that we ought to cut this spending. And I think that in terms of the kind of cuts we shouldn't go down - the latest, I think, is what 15%? I think that's cutting it too far; not that I wouldn't like it myself; I'm not talking about myself now. And I think the cuts at the top are too small.

I think incentives play a role. Now, this sounds like just a nice lot of talk and wouldn't it be nice to make some more money if you're rich, etc. I don't care about that, really. What I'm concerned about are the people whom I know who go into tax exempt; the people whom I know who look for capital gains; the people whom I know are very reluctant to go into risky situations because "heads I win; tails you lose" deal, but the other side is doing the calling. This is the part of the problem. Now, you may say, "But didn't you say there is some excess capacity? How can you use this stuff when there's excess capacity?" That would be a very important question. But the point is that we have two things going on at once in our economy, and we always have them going on. We have those industries with excess for a wide variety of reasons. There may be an excess like coal because technology has caught up with them. There may be an excess like the airline industry because they put in too many large jets at one time and are building up to it. There may be an excess like the steel industry which has had a combination of large capacity, plus some bad blows with small cars and things like that; a little bit on the export - that's only 4%. We make a big fuss, but in some items, wire etc. it runs to about a third.

Or, there may be an excess in industries like electric power where you only have a choice, in terms of efficiency, to put in a big unit of 500 or 1,000 kilowatts these days, and sometimes even higher. And you know you're going to grow up to where you're already planning the next one. So, you have all of these things. But against that you have electronics, office equipment; you have these other areas that are expanding, and these areas continue to expand. And what's more important is, you have all the guys who need a few dollars to get themselves started.

Any time anybody can make a buck, other people get jobs. I'm not talking about the racetrack sort of deal, I'm talking now about investment; putting money behind somebody. You'd be amazed at the number of things. I have some friends who are in one of these small SBICs. And I hear a great deal about the number of propositions and the types of propositions. You'd be amazed at how many of these things for $50,000 a fellow is going to start a little something for five people, six people, two people, ten people; he just needs that little bit of seed corn. I tell you, you look at those things with a real glint in your eye, because this is nice money to make, and when you begin checking them out you say, "Well, suppose it is successful; what do you get?" And if you don't see that you'll get enough you run. That's why, incidentally, we use incentives.

Under our Small Business Program, if you buy the stock of a small-business investment company and you lose money, no matter how long you hold it, it's just deductible from your income. You get a regular deduction; not a capital loss. Now, you fellows are Colonels. That means you're what? About the 70% or 80% bracket within the Armed Forces? This means when you make that investment it only costs you 20¢ if you're wrong. But if you're right you keep 75¢. Now, this begins to tilt the scale. That's why a lot of people have gone in for these risky deals. But, there are other problems there.

And so, I think we can stand a tax cut. I think the major reform needed is to cut these high brackets. It's much more important than these other forms we talk about. They're abusive. Anyone who has the slightest awareness; that means you wake up in the morning; that's all; can pinpoint the types of abuses going on in the economy - the expense account abuse which they're finally catching up with, and which, incidentally, is not a big business abuse because you can't get away with too much; a little bit. It's the guy who runs his own company, a half million to two million dollars, and his son is the accountant, or his nephew is the accountant; these are the places where they don't even pay for their own newspapers.

Anyone who has been around knows what goes on. The expense account; I can't tell you how many times - you know, you go out with people. This gets me sore;

you go out with a guy and after you reach - you know - a certain stage; you split checks; you know - I'll take it this time; you take it next time, and that sort of deal, as long as they're not too big - I don't know how many times a guy has said to me jokingly, "You know, you're Mr. Marino tonight." He writes down on his American Express or something else - the back of it - "Entertained Mr. and Mrs. Marino." Who the hell is Mr. Marino? Well, of course, one of his customers. In the meanwhile, I don't have any such deal. So, I have to say I just paid it and that's the end of it. But, there's an awful lot of this, and I think this type of reform is needed. Some of the other things that are called reforms, oh yes, there are glaring loopholes, but the basic reform needed is to get those top rates down to some sort of line. So, I think we need some tax reforms and I think we'll get some. But I think what's being asked for is too big.

CAPTAIN BRADY: Professor Backman will be visiting some of our seminars this morning, so we'll have an opportunity to ask him some more questions.

Professor, it was indeed a pleasure to have you here today, and thank you again for another sterling performance.