FACTORS IN THE RISING COST OF LIVING

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So much has already been said this year on so many platforms on the subject of rising prices that I hardly know where to begin. Certainly, the data now available offer little opportunity to present ideas which are both novel and profound. However, as one who has had some responsibility for the establishment of some of these statistics and who knows something of their limitations and shortcomings, I may be able to call your attention to a few fundamental points which are often overlooked in general discussions and to point out a few pitfalls in analyzing trends for the use of the public and of those policy makers whose decisions can contribute to the amelioration of the problem of rising prices.

The most commonly used measure of domestic inflation is prices paid by consumers, for the standard of living of the entire population is affected by the rise or decline of prices paid at retail. Consumer prices are at the end of the whole economic chain. They embody the effects of many preceding costs, and many prices: the prices of raw materials, costs of fabricating and packaging, the using up of capital goods, charges for transportation, the cost of wholesale and retail distribution, excise taxes, and the like. Most economic forces sooner or later impinge upon consumer prices in some way, and analysis of the various waves of price increases in recent years will in itself provide part of the answer to the question assigned to me to answer--the factors affecting rising costs.

Consumer prices today are a little more than double what they were before the war broke out in Europe in 1939. The American consumer's dollar is worth about 48 cents in prewar terms. Interestingly--but not surprisingly--other prices and values have risen in much the same range. Wholesale prices are up by about 130 percent, with farm prices up about 150 percent and industrial goods up 115 percent from 1939. Real estate prices, to select only one more of a large variety of prices of equities, seem to have gone up even more--urban residential by about 200 percent, and farm land values by about 220 percent.

Let me remind you at this juncture that conclusions are too often affected by the time period selected; you get different results if you choose 1929, 1939, 1947, or 1956, as your starting point. Another common problem, which affects the conclusions arrived at in the vast amount of gratis literature now circulating on the subject of prices, is the use of rates of change which do not take account of the relative importance of the particular commodity or area of the economy rather than the use of aggregates, of percentage changes rather than of points in the increase in a total index. No matter how you look at it, however, and whatever time period you use, every kind of desirable goods or service has a much larger price tag today than most of us thought likely not too long ago. Thus it can be said that much of the adjustment to higher prices, induced by war and postwar inflation, is now thoroughly imbedded in the cost, value and price structure of the economy.

All of the countries of the free world have had to wrestle with the problem of inflation during and since the war. In Western European countries, retail prices have advanced more rapidly, both in the immediate postwar period and since 1953, than in the United States, notwithstanding their exercise of notable public and private restraints upon the factors affecting prices. The principal reason for this difference is that the United States, undamaged by the ravages of war, did not have to divert from consumption to reconstruction as large a proportion of its postwar industrial and agricultural output as did the European countries.

That the inflation both here and abroad is the offspring of war is now so commonly recognized that I need not labor the point. Prices have risen with virtually every major war in modern history. The shortages of supply and excess of demand created by the diversion and destruction of resources--natural, industrial and human--and by the pyramiding of government debt and the expansion of the money supply have inevitably affected prices and costs. The last two wars--World War II and the Korean episode--have been no exceptions. Increased prices have been attended by higher charges, higher wages, higher profits and higher money values for virtually all forms of equities.

In fact, it is surprising that we controlled prices in the United States as well as we did during World War II. About a third of the rise of 109 percent in consumer prices from 1939 to the present occurred before the end of the war. Of this a substantial part occurred before the United States actually declared war, and in the year before price controls were made effective, particularly controls of food prices. For a considerable period during the war, prices were held down with the aid of price controls, rationing, rent controls, and other forms of controls--at both the producers' goods and the consumers' goods levels.

In the immediate postwar years, however, we must admit that we made some mistakes as rationing controls were removed in 1945 and as price controls were removed in 1946, when supplies of goods were not yet adequate to meet the pent-up demands backed by the vast amounts of savings and the vast credit resources accumulated during the war. This proved to be the case. Prices spiraled upward and rose even more than they had done during the war years, to reach a peak in 1948. This second wave accounted for another third of the rise, so that by 1948 prices had risen two-thirds of the way to the height which they have now attained. Following this rapid spurt in prices, there was a mild

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decline in 1948-49, coincident with a recession in the level of business activity. Recovery, however, was already underway before Korea, and the new demands for goods and services for defense, coupled with sustained private demand, drove prices still higher. By 1951 this third wave pushed consumer prices up to 87 percent above 1939.

These first three waves of price increases since the outbreak of World War II are, thus, clearly attributable to classic fiscal and monetary factors--a combination of war inflation and postwar demands, with the absence of strong controls in the postwar period. But the worrisome point is not that prices went up in 1946-48 nor that they went up further in 1950-51, but that they have not returned at least part of the way to prewar levels, as was true in most earlier postwar periods. We count the number of years after the cessation of hostilities, and we ask, where is the typical postwar deflation?

An obvious explanation, so obvious that we sometimes take it for granted and leave it out of our considerations, is that today we do not have a typical postwar letdown in armament outlays. True, there is no active shooting; but there is a vast amount of international tension, and a large proportion of government expenditures in all countries is going toward armaments and various defense activities. These are inflationary, in a different push-pull sense than is commonly used for those two badly overworked verbs. They pull labor out of activities which produce goods and services for immediate civilian consumption; they push up the prices of many durable goods, from raw materials through to finished products; and they create government debt and civilian purchasing power without in themselves adding to the supply of goods and services available for distribution. Yet, while they may possibly account for the failure of prices to dip, neither defense outlays nor new warlike developments can explain our fourth wave of price increases, the one which began in 1956, the one I describe as a creeping inflation. In this most recent period there has been a rise of 8 percent, culminating in a peak in the summer of 1958. Since that time the overall consumer price index has remained comparatively stable.

Such a rise is not entirely unusual. There have been other non-war periods in the past when prices have risen. But coming after a four-year period when over-all values held virtually steady instead of suffering at least a moderate postwar decline, this rise has contributed to an economic climate in which many people--both in business and in labor circles--have been led to assume that prices will, if anything, go up and up rather than level off or go down. The new viewpoint on prices has brought into sharp focus a number of differences in the way in which our economy behaves today as compared to earlier years.

Let us examine some of these differences. One is that there has been a great burgeoning of demand, partly because of a rapid increase in the population, but partly also because of sharply advancing standards of living and a redefinition of what is a necessity and what a luxury, especially in the U.S. Adding to the demand has been a great social leveling process, designed to improve the position of the lower income groups, through tax policies, social security, and other Government devices. There has come to be a general recognition, in countries where men are considered as individuals, of the right to improve their levels of living. There has been the growth and acceptance of strong organizations in both business and in labor, and of new procedures by which both government and organized economic groups have combined to slow down what were formerly considered natural economic forces. There has been an acceptance of the idea of softening economic ups and downs. These procedures in the United States range from Government floors under wages and prices in order to assure incomes for certain groups in the population, to mass collective bargaining. Similar developments have gone on throughout the free world.

The emphasis on human values as the major criterion of economic policy has had an important manifestation in the "full-employment" orientation of this and other western countries, under which government buttresses a declining economy and thereby so modifies the relationships of supply and demand as to temper downtrends in prices.

Another institutional development, which was in evidence before World War I but which has been increasingly important, is the gradually increased control by a growing number of producers over the prices of their products. Farm products and other raw materials are steadily declining in importance in relation to fabricated goods. Their prices are normally more volatile because their supply often cannot be immediately adjusted to demand. But in our economy today other types of goods and services--produced by a much more complicated process, involving a higher proportion of labor cost and yet more easily controlled with reference to supply and therefore prices--have steadily increased.

Thus, for a variety of reasons, some old and many new, we now have an economic system in which price advances are relatively easily facilitated, but price declines are braked. I think we do not fully understand these forces, nor can we yet appraise their effects upon the economic "laws" on which we were all brought up.

I am not at all sure, however, that these basic factors have had as much influence upon the economic thinking of the man in the street--the businessman or the employee--as a more noticeable development, the apparent contradiction of prices continuing to rise even while business was shrinking. This is the kind of development every housewife is aware of. She doesn't need a statistician to tell her. Many good people have made the assumption that prices go down when business declines. Some do, of course, but even when they do decline, there is always a lag in prices of finished goods. Consumer prices are generally the slowest of all to reflect the turns of the business cycle, largely because there are so many built-in and virtually fixed costs. Increasingly, certain list prices do not change at all, although quality may improve, or sale prices may be "shaded".

It is worthwhile to compare the movement of prices in the four most recent recessions. From September 1937 to September 1938, the total consumer price index declined by 3.5 percent, entirely because of food prices; there were substantial increases in rents and new car prices and small increases in nondurable goods, public transportation and miscellaneous services, but these were offset by a good-sized drop in apparel and textile housefurnishings and small decline in fuels and miscellaneous durable goods.

Similarly, from September 1948 to September 1949, the consumer price index fell by 2.6 percent, with food alone accounting for a drop of 2.2 percent in the total index. As in the 1937-38 recession, there was a sizable drop in apparel and textile housefurnishings, together with small ups and downs in a variety of the other segments in the index, but a sizable rise in rent.

Coming to the 1953-54 downturn, we find a very small net drop in the consumer price index, only 0.4 percent, mainly because food prices also fell only very slightly; changes elsewhere all were small and offsetting. The last recession was the only one in which over-all consumer prices rose--by a substantial 2.1 percent from September 1957 to September 1958. It is also the only recent recession in which food prices rose. The food situation, you will remember, was affected by severe weather damage in southern growing areas and small marketings of cattle and hogs.

Food prices, thus, took up the slack in most earlier recessions. They did not this time, partly because of the accident of weather. But we must remember that agricultural prices--by action of the government as well as by long-run economic prices--are becoming not only less flexible but also less significant in the grand total. We cannot therefore look forward to agricultural prices providing the only flexible price element in every future business cycle. If this is our only source of price decline--it is not enough.

Another important note which emerges from the comparison of price trends during recessions is that in the most recent downturn there were no commodities which affected the total index on the downside by as much as one-tenth of one percent; in fact, only the apparel and textile housefurnishings dipped at all, and all other groups showed measurable increases. Thus, while the price rise of the 1957-58 recession is not as much cause for anxiety as has been commonly believed, it nevertheless does point to the conclusion that many prices are less flexible on the downside than they had been in earlier periods of declining demand. We must grant, of course, that consumer buying power was well sustained in this period.

As I said in the beginning, consumer prices are the most commonly used and most convenient statistical series for use in discussing inflation. Many economists have long been accustomed to say that they are a symptom rather than a cause. This is no longer entirely true, however, partly because of formal wage escalation through contracts, and informal escalation through common acceptance of the thesis that everyone--the barber, the nurse, and even the social security recipient--is entitled to the protection of his purchasing power against price changes, and to the maintenance of his relative standing in the income scale. All told, there are now subject to cost-of-living adjustments at least 4 million workers under union agreements and more than 300,000 unorganized workers. Actually, however, wage increases in various major industries have tended to keep pace with each other, whether or not there was a contractual escalation.

Services constitute another instance in which wage and price trends are closely linked. Prices of services have either held steady or risen since 1935, with the exception of only two brief periods. During the past recession, they accounted for an increase of nearly one percent in the consumer price index. The rising cost of services is often considered to be a direct reflection of labor costs or professional fees, on the assumption that there is little room for productivity improvement. This is not entirely true, however, as there do appear to have been substantial gains in some service areas, such as dry cleaning. Actually, the cost of services (less rent) has risen less in the past two decades than has the rest of the CPI; charges for certain services are still "catching up".

Many other types of costs have also increased--transportation for example, and mail, and all the regulated utilities; and many of these costs show up as services in the consumer index and do not appear at all in their own name in the wholesale indexes. Depreciation and other forms of capital consumption is one of these latter. These costs have gone up sharply because of higher original costs and because of more rapid write-offs.

Wages, which obviously are also a price, have also increased persistently and pervasively over the past two decades, and faster than commodity prices. Factory wage rates--adjusted as best we now can for overtime and changes in industrial composition--have gone up more than 200 percent since 1939, and this does not include the large variety of other labor costs which we characterize as fringe benefits. Some of the increase is associated with rising productivity, some of it with adjustments to rising costs of living. Much of it, unfortunately, has been only a paper raise, in view of the declining value of the dollar.

Actually, the upward course of wages has been so intertwined with changes in other prices and in demand that I do not think it is possible with our present data to get a general, economy-wide conclusion about the effect of wages on final prices. In some years, such as those immediately after the war when demand and productivity were rising strongly, prices rose more rapidly than wages, including fringe benefits. In more recent years, with productivity gains small and demand tapering off while employee compensation was rising, the reverse has been true. Demand, institutional forces, long-term contracts, assumptions about trends in productivity--all of these have played their role. However, since wages and salaries are relatively a larger share of the GNP than are other single factors in costs, employee compensation can rise by relatively small amounts and still add more in dollars to prices than a proportionately higher rise in other factors of less importance.

Whether the most recent development--for labor costs to rise more rapidly than productivity gains--constitutes a new trend or not, I have no way of knowing. But, in looking back over the span of years, I find a very interesting fact: Despite all the new institutions and the new rigidities, the share of national income going to labor has not changed significantly, either since the 'twenties or in the past decade. When business is relatively poor, the share going to employee compensation rises, mostly because profits drop sharply; when business is improving rapidly, the share to profits increases, and the share to labor correspondingly drops. But these are merely short-run developments. There is no evidence that either labor or capital, as a group, has lost or gained at the expense of the other for very long. Instead, the data on shares of the national pie suggest strongly that there is some sort of stability in the economy which we do not yet fully comprehend. It may well be that attempts of either labor or capital to get ahead of the other--i.e., to reduce the ratio of profits or to add to capital through increasing the selling price--may work (if at all) for only a short period of time. In any event, much of the past gains have turned out to be illusory; to the extent that dollar incomes have gone up faster than physical output--to that extent have dollars lost their value. Money gains which exceed the real gain in output are soon wiped out; that is a truism which too many people have forgotten for too long a time in what history may prove is a fool's paradise.

There are, however, groups of people within these broad categories who have by no means kept up with the procession and who are generally at a disadvantage. This includes some wage-earners and especially salaried workers, whose earnings always lag; those whose savings from an earlier day are in fixed dollar assets like bonds, life insurance policies, etc.; those living on relief or social security payments, which never keep pace with fast-moving prices; and, in general, the "little man" without capital. Thus the distribution of the gains in national product within big groups in the population needs to be taken into account.

Prices, wages, profits, and productivity are not all the facets of the inflation problem, however. There are also taxes--both income and excise--which have an important influence. There is monetary policy affecting the supply of money versus the supply of goods and property. We must consider foreign aid, the debt structure, and also the role of the huge unregulated non-banking institutions. And there is, finally, public psychology which now seems to be stampeding in one direction. There are thus many Hamlets in this play. There is no one devil in the piece.