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1273

ECONOMIC DEMOBILIZATION

23 January 1951

CONTENTS

Page

INTRODUCTION---Colonel R. I. Williams, USAF, Member of the Faculty, ICAF.....1

SPEAKER--Dr. Howard B. Myers, Director of Research, Committee for Economic Development.....2

GENERAL DISCUSSION.....9

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ECONOMIC DEMOBILIZATION

23 January 1951

COLONEL WILLIAMS: As you have seen in the weekly schedule, the last lecture of the procurement and economic stabilization program today is on economic demobilization. I hardly think to as erudite a crowd as this I need explain why that is a timely and necessary subject not only for us to consider, but for organizations such as the one represented here today to be concerned with, even when economic mobilization is, as you and I feel, at least somewhat obscure in its past and present.

You also know, from having read his biographical sketch, that we have with us the Director of Research of the Committee for Economic Development. As much as I dislike long introductions, I think it is probably a necessity that I explain somewhat to you what the Committee for Economic Development is.

The Committee for Economic Development is a nonprofit organization created in 1942 by businessmen to accomplish the following stated purposes: In order to develop policies of government, business, labor, and agriculture which will most effectively contribute to an expanding economy, the CED Research Division was organized. Under the CED bylaws all research is to be thoroughly objective in character, and the approach in each instance is to be made from the standpoint of the general welfare and not from that of any special political or economic group. But it is purely an organization of businessmen, and they publish from time to time expressions on national policy.

I thought we might go one step further. The subject, as it is and as it was experienced after World War II, might bring to your mind: "Well, what is the record of the CED on price control?" So I got a pamphlet that the CED printed in April 1946 entitled "End of Price Control--How and When." I don't know what Dr. Myers is going to say today, but I do know that then the record was an enviable one. When most of us, I believe, thought that business as a whole was going to say, in early 1946, "Take off all controls. Let business and prices seek their own level," CED said the earliest that price control should come off was July 1947. It said rent controls should probably go somewhat longer. CED didn't set a date. As you know, due to the hue and cry of others than this research organization, price controls came off at the end of 1946, before they thought they should come off.

I would like to mention also that after the war CED had over 3,000 task forces in industry throughout the country, which enabled no doubt our national gross product to increase considerably, as they were encouraging business to build in reconversion and not to curtail.

It gives me great pleasure to present Dr. Howard B. Myers, Research Director of the Committee for Economic Development.

DR. MYERS: It is very nice to be here and have a chance to talk to you this morning. I would like to talk quite informally. I want you to feel very free to ask questions during the question period.

I feel a good deal of responsibility being here in the windup position. I hope I can keep up with the average of the preceding speakers.

As has been just indicated, the CED started out with problems of demobilization. So all of this seems in general somewhat familiar. It will be different this time, but we can learn from the experience at the end of World War II. Of course, some of what I shall say this morning will be drawn from our experience in that war.

When the subject was first mentioned, it seemed odd to me that just at a time when we were entering the mobilization phase anyone should be asked to talk about demobilization. At the present time that seems so far away that one thinks: Why should anybody talk about it now? Actually, however, the two subjects are rather closely related. How we can demobilize and the success of the demobilization effort depend in considerable part on the mobilization work that has preceded it. I want to talk this morning a little about both, because I think I have to talk some about mobilization in order to present suggestions for demobilization policies.

More specifically, I think the demobilization policy depends on five factors. The first is the extent of the mobilization effort. Are we going into a war, or is it a limited defense effort? Are we going to have a total conversion to war, or is it going to be just a partial conversion?

Second, our demobilization policy depends on how well we mobilize. Is it an orderly or a disorderly process? Do we have a stabilized economy during the mobilization period or do we have inflation? Do we have control over the volume of money and liquid assets held by the people, or is there a great increase in money volume during the war or defense period?

The third factor is, How long have we been mobilized? Has it been a short effort, with the economy still capable of shifting back to peacetime production; or will it be a long-continued effort during the course of which we become fully adjusted to war and in which our peacetime skills and abilities and equipment become rusty or obsolescent from disuse?

Fourth, How rapid is the reconversion? Is it a gradual decline from a plateau period to a continued fairly high and fairly stable level of armament production? Or is it a very rapid and abrupt cessation of war orders and a quick shift over to peace?

The fifth factor which I will comment on is the question, What do we demobilize to? That is, do we go back to a free economy, or do we go back to something else? Do we still continue rigid controls, or do we free the economy and put it back in as nearly as we can the situation which has existed in the last few years?

Now, we have two possible mobilization patterns. Actually, of course, there are dozens, but I shall suggest two types. One is a rapid mobilization ending in war, with an all-out conversion and military expenditures of 150 billion dollars a year or more. A much happier assumption, and one on which I gather the planning is now taking place is that military expenditures will be about 40 to 45 billion dollars a year for fiscal 1952, rising above the level in fiscal 1953 to a level of perhaps 60 billion dollars plus, and after 1953-1954 some decline, perhaps to a level of something of the order of 35 to 40 billion dollars annually; in other words, a substantial but nevertheless a clearly limited rearmament defense effort.

In terms of our gross national product that would mean a diversion of around 13 to 15 percent of our total production to war purposes in fiscal 1952. That is roughly the average for the year as given in the President's budget message of a few days ago. It would be that portion of the total production, rising to, say, 20 percent or more in fiscal 1953, and thereafter declining to perhaps 10 to 12 percent. That is against the about 5 or 6 percent, I think, in fiscal 1950 or in the first half of fiscal 1951.

How shall we mobilize in these situations? Well, again we have a variety of alternatives; but I shall select two as typical cases. Under my first alternative, that is, rapid mobilization leading to war, what we would need is very stiff taxes, drastic limitations on credit, direct controls across the board, maximum diversion from civilian production, a high degree of government direction of all aspects of our economy--manpower, productive effort, and so on--in other words, more or less the pattern of the last war. That, I am sure, is familiar to everyone here; so I shan't develop it.

The other alternative, the limited war effort, is more pleasant to contemplate, but probably on the whole more difficult to do. Her we need to increase production as rapidly as possible, particularly military production at the present time, but nonmilitary production as well. We need to take various actions to speed the change-over t defense production. Finally, we need to prevent inflation and to stabilize the economy at approximately the present price level or something in the neighborhood of that.

Now, on increasing production—I shan't go into that in detail, but only rapidly and very briefly—we need, of course, to lengthen the hours of work. We need to bring new workers into the labor forc We need to use our facilities on a more-than-one-shift basis. We ne to improve and build up skills. We need to channel our investment f into needed lines so as to increase the equipment and plant inventor We need to maintian incentive, that is, we need to encourage managem and labor to take action which is in the public interest.

To speed the change-over to defense production we need, first, speed up military contracts. They are not coming out fast enough. need to use limitation orders, conservation and conversion orders, set-asides—a variety of production controls with which I assume you are familiar—which can both make it possible and encourage business to shift over to war orders. We need to use various tax devices to encourage the shift-over.

One of those is accelerated amortization, to encourage the incr of capacity in lines where increase is needed. You are all familiar with that, I take it. We need to use government credit where necess to encourage investment in increased capacity; and maybe government guarantees, government insurance, or direct government loans if priv funds cannot be made available.

We need to use the price system as a devise to stimulate people do the things we want them to do—workers to shift over to the plant making war goods, manufacturers to shift from civilian to military production, and so on. The most persuasive and efficient device for that purpose is still the price system. We can't allow it to work uncontrolled; but neither can we afford to abandon it. I think it i extremely important to remember that fact.

Finally, to prevent inflation, my third objective, I agree with my friend, Professor Burns, who spoke to you a month ago, that the problem is to restrain total demand. For that purpose we rely, and should rely, primarily on indirect controls. That means stiff tax increases. You are familiar with the general outline of the Preside budget message. You realize that in general what I mean by "stiff"

this situation is roughly something on the order of 10 to 15 billion dollars of additional taxes this year. We ought to in this limited effort, in the situation with which we are now faced, at least pay as we go.

We need strict controls on credit. We need to use selective controls, and we have been doing it with a good deal of effectiveness, I think, that is, the controls on housing finance, the consumption of durable goods, automobiles, and what not.

We also need to use general credit controls and there our record has not been good. The total volume of loans has increased by more than 5 billion dollars in the last six months, which is one of the major factors giving rise to the present inflationary pressure.

We need also to take action to increase savings—voluntary or conceivably forced savings. There again our record has not been good. No effective action has been taken thus far to increase the volume of personal income which is not spent.

It might be useful to go at this matter another way and talk a little about how not to control inflation. A friend of mine once wrote a book on the subject of how to make a hole of golf in 19. Similarly, we might consider the things that we ought not to do in this situation.

Primarily, I think, the things we ought not to do are to rely mostly on price and wage controls to control inflation, and to finance the war by borrowing. If we do that, the results will be precisely what Professor Burns told you a month ago that they would be. We will have reduced production rather than increased production. We will have distortion of production patterns. We will have shortages of goods most in demand. We can buy sport shirts, if we want to, but not white shirts. We will have supressed inflation. Eventually we will have open inflation when controls are removed or when they break down. These are hard facts, and they are controversial facts in many circles; but I don't think there is much disagreement in the economic profession about them, or much disagreement, in government or out, on the part of those who study the problem intensively.

It is clear that we are going to have price and wage controls. It is announced every day in the papers. The danger in the situation is that with price controls we shall consider that we have done something and will relax our efforts to take fundamental action to control inflation. Tax and credit policies of the sort I have just sketched will be as important with price and wage controls as without them. Our objective should be to first supplement and then replace the price and wage controls with indirect controls and, as rapidly as possible, to remove the price and wage controls which we are now about to impose. The form

that price controls should take depends a good deal on two major propositions or major questions. Should we attempt to stop inflation, to prevent further price advances? Or should we attempt to slow inflation and gradually bring it to a halt.

I think it is very important that we not attempt to just cut off and hold a given line. The "hold the line" technique is, particularly in the present state of our administrative efficiency in the ESA, the surest way to get the system to break down. We should try to restrain but not to stop price advances. That is my first principle.

My second priciple is this: We should leave as many decisions as possible to business, to the individual producing units. That is a very simple administrative precept. It applies in most administrative operations and it obviously applies here.

Now, in general these two principles point to a system of margin controls rather than specific price ceilings; in other words a system in which you control the margin or the markup on price, except at the raw material level. It means the sort of price control we moved toward in World War II—a percentage markup at retail and wholesale, with either a percentage or a dollars and cents markup over direct costs at the manufacturing level. I shan't go into this here, but I will be glad to talk about it further if you have any questions later. At the raw materials level I think you need specific price controls. The margin technique will not work at that point in the production process.

To get back to my five points: I have talked a little about two, that is, the size of the mobilization effort and how and what our mobiliz tion effort consists of. My third question is, How long have we been mobilized? I won't try to go into that in detail. I think the consequen for demobilization here are rather obvious. The problem is clearly more difficult if we have become rusty, if our machinery and our skills are obsolescent, if we have habituated ourselves to the new form of life, in which the military takes a large share of the national production. It is much more difficult then than if it is a quick process of shift-ove and then reversal.

My fourth point is, How rapid is the demobilization? Obviously, here also there are important differences. The problem of a slow demobilization is quite different and probably a good deal more difficult than is a rapid demobilization. The problems of maintaining equity and maintaining efficiency become much more complicated. For example, take the question of the gradual reduction of military orders from competing plants. Take the automobile industry as a single illustration. If we can cancel our war orders overnight, as we did the last time, and give everybody an even break, a chance to start to produce civilian goods—let the various producers race for competitive advantages—the job is clearly

much simpler than it is if we have to do it gradually, to slow down on the orders we give to Chrysler, Ford, GM, and Studebaker and try to maintain a balance and treat each one fairly relative to the other. That is both very difficult to do and obviously plays hob with the efficiency of civilian as well as military production.

My last point is, What kind of economy shall we demobilize to? I shan't say much about that. It is my hope and my assumption that we will try to demobilize back to the kind of economy we have had in recent years—one in which there is a large area of freedom of enterprise with only very general and very broad types of controls. I believe that practically the entire population agrees on this assumption; so we don't need to talk about it.

Now to get more directly to the demobilization process. Our major objectives in demobilization, I think, are three. First, we want to facilitate the change-over process. We want to shift, as we now are anxious to shift, over as rapidly as possible to war production. We shall then want to shift back, as rapidly as possible in terms of continuing military needs, to civilian production. Second, we want to increase civilian production as rapidly as possible; to increase the total volume of goods produced. Third, we shall want to stabilize the economy at high levels of employment.

Those were our objectives the last time. By and large it was a pretty good job. It seems to me in retrospect better than we perhaps had a right to expect. But how shall we apply our general principles when the time comes again? How shall we work toward these objectives in what we hope is the forthcoming situation?

So far as the first two objectives are concerned—facilitating the change-over and increasing civilian production—we want to do several things. We want a prompt cancellation of government contracts, government orders. We were discussing just before we came into the room the procedure of last time, in which thousands of telegrams were sent out on the very day of the Japanese surrender, canceling war contracts. If it can be a rapid demobilization, we want to do that again. We don't want to "make work" on war production.

We want also prompt settlement of terminated war contracts. Again I think the record of World War II was quite good.

We want to release funds rapidly for civilian production. We can and should devise methods such as those used the last time, by which the bulk of the funds which were to be paid by the Government could be paid quickly on certification, with the balance withheld for audit and more careful examination and with stiff penalties for fraud.

1282

We want to take certain other steps to free funds for business, because business is going to be faced with an immediate and urgent need for more money--money to put into plants, money to put into equipment, money to rebuild inventories, money for other types of working capital. We will want in that situation a flexible credit policy. We may need to turn to government loans, government guarantees, or government insurance devices in some situations. If we need to, we should do it promptly.

We need next the prompt disposal of government war plants and war equipment and supplies where those can be used for civilian production. We may, particularly if the mobilization period has been long, need some retraining of workers. And we should remove controls as rapidly as is consistent with reasonable stabilization.

My third objective--stabilization at high levels--presents a number of difficulties. Particularly it will be difficult if there are large accumulations of cash and liquid assets in the hands of individuals and businesses, as there were during World War II; particularly, in other words, if we do not restrict credit expansion during the war.

We need to protect against the dangers of both inflation and deflation. The last time we were primarily concerned with the danger of deflation. I think now, as we get into new demobilization, we will take the position, which I think is the correct one, that the greater danger is that of inflation. We have seen it work out recently. We no longer have our thinking quite so much controlled by the experience of the thirties, and our governmental and private action is apt to be wiser in consequence.

Deflation is, I think, the less likely development. It is, obviously, one we should guard against. Our policy, I think, should include the extension of unemployment insurance for unemployed workers, beyond the present period if necessary. It should include an expansion of public works, a device thought of in the thirties as a panacea, pretty much discredited in the forties, but probably one which has considerable merit, not as the program against deflation, but as one eleme in a rounded program to deal with inflation.

We shall want to make tax reductions. That is one of the happiest recommendations that anybody could ever make.

We may need to run deficits. If we do, we should run them without fear.

We should adopt an easy money policy. That may involve reducing reserve requirements. It will probably involve open market operations on the part of the Federal Reserve System designed to encourage expansi

That is, the Fed will probably want to buy governments, and it should probably do its financing largely through sales to the banks. Both devices have a tendency to encourage the expansion of credit and thus to maintain demand.

Again, we may need to use government loans, guarantees, and so on; and the case of housing is a case in point.

In a deflationary situation we shall want to have a rapid elimination of direct controls over prices, wages, and production. That is a situation in which we can decontrol rapidly without harm.

What should we do in the event of inflation? Largely we do the reverse of the above. We maintain high taxes. We run a substantial surplus. We adopt a restrictive monetary policy; that is, we tighten reserve requirements or keep them at high levels. The Government may wish to sell securities in order to tighten the market. We try as much as we can to keep government financing in nonbanking hands, since that money cannot serve as a basis for an expansion of credit, as bank purchases of governments can do.

We want to encourage saving. That would be a good time to have a further savings bond campaign at attractive rates.

We want to take off controls gradually as our tax and credit policies become effective.

That is a very difficult operation, but I think the proper strategy is essentially the one which was referred to a few moments ago, which we proposed in 1946—that use of fiscal and monetary policies, so-called indirect controls, gradually to control demand and thereby stabilize the price level. We follow a policy of relaxing direct controls as rapidly as we can consistent with stabilization, gradually removing the direct control structure which we have built up.

That is a brief sketch of some of the more important actions to be taken, as I see them. The problems are obviously very complex. At the same time, I suspect that we all would be delighted to face those problems if we felt we could do so with safety.

QUESTION: Mr. Myers, I think you have introduced something that we haven't heard before in this body. Would you go a little further with your idea of margin controls?

DR. MYERS: Yes. It is really a part of the decentralization process I was talking about. It is not new. It was used during World War II in the case of retailers. The general order controlling

retailers gave them essentially a percentage markup on costs. That is, in determining the prices of the goods, they would put in the goods at cost and then put a conventional and controlled percentage markup on top of that; this would give the final price.

QUESTION: But you are talking only about retailing.

DR. MYERS: At the moment I think this is the simplest place to see the device in operation, because retailers always operate on a percentage basis. Anyway, everyone is familiar with the way they price.

This proposal involves just an extension of that principle. As it works in the case of retailers, it can work in the case of wholesalers, because they operate in the same way. Substantially all pricing, except for certain price-fixed goods, is cost-plus-a-given percentage markup.

Let us discuss retailing and wholesaling for a moment. What I would do in that area is to take a prewar base period--the first half of 1950 average, the first quarter of 1950--whatever seems a suitable prewar period. I would select that as a base. Then the markup which was prevalent at that period would be the markup which is accepted for control purposes. Then the retailer's price is determined by his cost plus this markup. You see, it is administratively very simple. The same thing is true with the wholesaler.

Now, at the manufacturer's level the principle would be applied a little differently. The manufacturer typically does not work on a percentage markup basis. At the manufacturer's level what we would do in general is to take direct costs, not including overhead, for labor and materials. We would add to that a markup. In the manufacturer's case I think it would be best to use a dollars and cents markup.

Again we would take a historical base. Let us say that manufacturer A, making nidgets, has direct costs in the base period of so much for labor and so much for material, and 5 cents per item which covers his overhead, cost and profit and so on. I would let him determine his price by that. I would allow first the increases in direct labor costs, the increases in direct material costs per unit, and make him keep to the 5 cents per item for overhead and determine his price in that way.

At the raw material level we can't do that. What we have to do is go back essentially to direct price ceilings for individual items. But that is the point at which the imposition of price ceilings is simplest. We don't have a very wide variety of items. There are differences in items, but they are much less complicated than the differences which arise as we get further into the manufacturing process. So we can and should in that situation set direct price ceilings.

The system I am describing will give an elastic system of controls. This system does not prevent price increases; it limits them, tends to restrain them. There is no way under God's heaven in which we can prevent some price increases from this point on out. We didn't during World War II and we won't now. What we want to do is limit them as much as possible, while we take away the excess demand that is forcing them up.

This process, then, puts a sort of elastic control on prices. At the same time it simplifies tremendously the administrative problem. Instead of Mr. DiSalle having to determine the end product price in the case of each of the hundreds of thousands of commodities that come on the market, he controls margins. It is a relatively simple operation. It is one figure per product item.

The system has to operate on a historical basis. If the manufacturer or retailer has increased his markup, there can and should be adequate penalties provided for punishing him. So long as he retains the margins that are set, all the job of pricing individual units and all the job of developing historical records and everything are avoided by Mr. DiSalle, and he isn't worried. His concern is to see that the control margin is being observed, which is a relatively simple operation.

Does that answer your question? Does that give you the kind of information you wanted?

QUESTION: Yes, except that it throws up one red flag immediately. We have a law that prohibits figuring government contracts on a cost-plus-a-percentage-of-cost basis. I am wondering how you propose to hold down the increase of cost in order to provide the increased margin. I think you have answered it so long as you use price controls coincidentally with it.

DR. MYERS: I am thinking primarily of civilian goods sold on the civilian market. I assume that goods sold to the military would be priced on a basis of whatever contract standards the military planners adopt as to specifications, including price specifications. They would be subject to renegotiation. So the question of whether the price is closely controlled in the original instance really doesn't matter very much. If we make a bad guess, we renegotiate it out. The renegotiation process is essential in this type of situation, I think, and should be followed vigorously. But it largely removes the control problem so far as military orders are concerned. It takes most of the steam out of it. You get it back one way or the other.

COLONEL WILLIAMS: Although putting that on is much simpler, how about detection and policing it when there are four or five persons handling it and you have to get the percentage of profit they made and you have no end price to judge it by?

DR. MYERS: They submit their historical records and their increases in direct costs to the ESA. A good accountant can tell ninety-nine times out of a hundred if there is any serious juggling going on. It will show up.

COLONEL WILLIAMS: In addition to that, you would spot check, of course.

DR. MYERS: There should be a spot check.

The problem there is much simpler than the problem of shopping around to see whether the individual item ceilings are being followed. You still have an administrative problem. This simplifies it, but still leaves you with some part of the problem.

QUESTION: I wonder if you could explain more how you would control the pressures for wage increases under the elastic price controls. The prices are going to go up. Then there is going to be increased pressure from the unions to increase wages to meet these prices. How are you going to control that?

DR. MYERS: I shall get rapidly into controversial territory here, but it is useful to remember in starting that wages are prices. The price of labor determines in part the prices of goods. So we have a control problem there. Its implementation has to be different, but I think the principle is about the same.

If we are adopting the first principle, that is, if we are adopting an elastic control of commodity prices, then it is appropriate and proper to adopt an elastic control of wage prices. The proposal I would make is, I gather, more or less along the line of Wage Stabilization Board thinking, according to the papers. I would allow cost of living increases, partly on practical grounds. I don't think we can do anything else politically. But I would do it also partly because I think the thing that is needed here is an elastic control and not a flat, rigid ceiling, not a "hold the line at all costs" position. I would allow cost of living increases to be passed on in wages, much along the lines of the GM formula.

By the way, I should have said earlier, and I should say now, that the ideas I am presenting here are my own and not necessarily those of the CED. The CED has not yet taken a position on these matters, so I don't know where it would stand.

I would allow the cost of living adjustment to be passed through. I would start first with a base period, say, January 1950. Then I would allow an increase in wages between January 1950 and the present, if the control is imposed now, which would include the cost of living increases for that period, plus any further increase in rates during the year. In other words, I don't think a rollback is practicable in the wage case; and I don't suppose anybody argues that it is, really. So what I would do is to let the past take care of itself. I would set a pattern for the present which would include the cost of living increases over the year, plus, let us say, an average increase in hourly rates; permit any wages that have not increased by that percentage to rise to that point; prevent wages which have risen by that much or more from rising further, except in accordance with the formula, which would apply from now on out.

That formula would be, first, to allow the cost of living adjustment; second, to allow an improvement factor. You are all familiar with the terms of the GM contract, I take it. I would allow the improvement factor, but pay it in noncash form, in terms of, say, a bond which can't be cashed except in hardship cases. We could have industry funds. I don't care about the form. I would allow the improvement factor, but in noncash form, so it wouldn't add to current demand.

What I would do on the penalty payment for overtime would depend on what I thought I could get away with, frankly, because it is essentially a political decision anyway. I would like to see the penalty clause for overtime retained; but the penalty--the 50 percent, not the 150 percent--to be paid in noncash form. In other words, I am suggesting a sort of forced savings device. It gives headaches later, because after the war, when we demobilize, we find that people's liquid assets have increased. But it seems a practicable arrangement. It adds to costs currently, and thus has some inflationary consequences on the costs side. But it does not add to demand, since it is in a noncash form and cannot be spent.

QUESTION: I wonder if you would comment on one other alternative which you suggested but didn't really develop. There is the possibility that after two or three years of buildup in military readiness we then can slump off a little bit, though it will still be necessary to maintain a high degree relatively, in terms of the past, of readiness over a period of perhaps 10 or 15 years. So we won't really have a demobilization at that period. We will still have a continuing partial mobilization. What kind of effects is that going to have?

DR. MYERS: It makes a lot of difference, of course. It makes some of these problems easier and it adds a host of new problems. I have touched on one or two of them, but I didn't develop them at all fully.

The principles applied in getting rid of controls and freeing the economy would be essentially the same. That problem by and large is easier, because the amount of shift-over from our plateau to our continuing level, from a higher to a lower level of military procurement, is less great. Suppose we are adjusted to a 60 billion dollar military expenditure and then you cut back to 40 or 35, if you are really adjusted to 60, the cutback to 35 is not so very difficult in terms of the problem of controlling inflation and removing direct controls. It is a good deal less of a problem than of going from 60 to zero.

The other kinds of problems that come up are illustrated by the automobile case I gave you. How do we handle it? We have substantial military orders, with rather tight renegotiation, concurrently with civilian orders without controls, with some inflationary pressures and large opportunities for profits. It is very difficult.

There isn't really proper time to go very far into this problem, but it is primarily one of sharing the burden equitably. If we want to preserve the equities of the situation, we try to distribute the military orders so that everybody takes his share of the burden. The assumption I am making is that the profit on military orders is substantially less than the profit that can be obtained in supplying civilian demand. There is a problem of sharing the burden.

We could do it by dropping renegotiation and letting the military compete for civilian orders. Most people, I think, would oppose that. So there is some inequity involved in the military orders. What we would do is distribute it. What we do in the automobile case is to load most of it on the three big producers and let the little ones get along as best they can. If that gives them a relative advantage in the market, well, they can do with it anyway. We devise all kinds of expedients of that sort to try to distribute the burden, but the way we would apply it would differ markedly in different situations.

That is not an answer really to your question. It is an approach to an answer. The question itself is one that I don't think anybody has really thought through. It would be very complex to answer. I haven't thought it through.

QUESTION: Can we apply this matter of equity to a preceding question? You just elaborated on the matter of equity in decontrols, but you referred to a previous question by saying that we would have a flexible increase in inflation; that we can't control inflation completely; that it would be tied to an increase in labor costs or the price of labor. Suppose that as a matter of equity we agree that organized labor constitutes quite a strong political force, but that

there is a large element in the country that lives on a relatively fixed income. What would we do with that group if we permit the price of labor to go up according to the cost of living?

DR. MYERS: There isn't much of anything we can do directly. There are going to be inequities in any situation. Most of you men are in this situation that you speak of and so am I. And, of course, the people who are hit hardest even worse than those of us who are on fixed salaries, are the dividend recipients and the rent recipients and the interest recipients, because they lose two ways. At least in the case of the interest recipients, their interest returns decline absolutely—they did during the last war at any rate—and the amount they can buy with the return declines.

There isn't any satisfactory way to handle that problem. The best we can do is to control the inflation. If we control the inflation, the question of escalator clauses in labor contracts makes no difference. If the cost of living doesn't change, there is no adjustment.

Now, practically, we have to expect a certain amount of inflation from here on out. It is possible, I think, to keep that down to a relatively small amount. One element that we can't get out of the system is that price increases in the early stages of production have to work on through to the later stages. Raw material prices have gone up a good deal more than finished goods prices, and a certain amount of the increased cost has to work through the system.

If, however, indirect controls are really used vigorously, if the taxes are put on, if credit is controlled, if people get in the habit of saving, then it is possible to control inflation, so that the price rise still ahead will be relatively small. If we do that, the inequity of which you speak largely disappears. If we do not do that, there is no way by which the inequities can be avoided.

QUESTION: How can we prevent John L. Lewis from breaking the elastic on this?

DR. MYERS: I do not propose to answer that question here, because I do not know the answer to it. A lot of better people than I have spent a lot of time on that problem and nobody has figured out a way to do it as yet. We must have coal and apparently we have to pay for it.

Theoretically, or in terms of the equity of which we were just speaking, John L. Lewis and the miners' union ought to be held to the same formula that applies to everybody else. Realistically, that is likely not to happen. It may or may not. If we use the same kind

of instruments that we tried before, we will have the same degree of success that we had before. That is as far as I can go in answer to that one. If that seems inadequate, I can only point out that nobody seems to have done any better with the problem.

QUESTION: I would like to know how you reconcile the approach of holding down profit margins with the requirement for an expanded production capacity, which is based on profit.

DR. MYERS: That, I think, is fairly easy to do. I am glad you raised that question, because it makes a point that I didn't cover.

One of the big advantages of the margin control approach is that it does preserve incentives to expand and produce. It is the margin that is controlled, not the price. We don't get the situation in which a producer is asked to produce a good at a loss or at no profit. He gets a standard dollars and cents markup.

That may affect his overhead a little, but I think it should. After all, his volume, unless he is in a line where volume is cut way down, is not reduced. If it is, he can put in an inequity complaint to the administrator and try to get an adjustment. But in the ordinary case his sales will be increased. He can sell all he can make; so his volume will probably increase. His margin will not increase, but his total amount of profits should increase unless he is in an industry where overhead costs mount very rapidly.

So he has incentive under this device to keep on producing. The more he produces, the more he makes. It is one of the great advantages of the elastic control I am speaking of, as against these flat ceilings, where the producer works around and tries to figure out what it pays him more to produce; then he produces that whether it is what the people want or not, on the theory that somebody will buy it.

That is one of the big advantages, and that is one of the reasons I am anxious to have elasticity in the system--so there will be an opportunity to produce, an encouragement to produce, and an encouragement to produce things that people want.

Incidentally, this device takes care of the low-end problem, that is, the problem we had during World War II, of everybody making the luxury item in the line and dropping out the low ones. If you hold the producer to his prewar average markup, it doesn't make any great difference to him. He makes the same rate of profit on the high end, the low end, or the intermediate. So presumptively he makes a distribution in accordance with people's wants. What I say may not be strictly true, but it is so close that it makes no great difference. What he will do is keep more or less his earlier distribution of goods across the production range.

QUESTION: You proposed two systems for employment during a demobilization period. One was to counteract deflation and the other was to counteract inflation. Is it not true that if during a demobilization period we assume that we are faced with a recession and take the steps that you proposed, and then it turns out that it is an inflationary period, as it was following World War II, it would be almost impossible to reimpose controls to hold down the inflation, due to public opinion and congressional opinion?

DR. MYERS: That is a very good point. Yes, it would be very difficult. World War II was a beautiful illustration.

It was interesting to watch the turn-around in government policy. It took six months or more to get it around. During the course of that period a lot of damage was done.

The problem of determining when to take action is a very difficult one. But I think the answer is that we cannot forecast accurately and it is not safe to rely on a forecast of what the developments are going to be. What we do is keep on the balls of our feet and take action as the events develop. If we find that unemployment is increasing, we can take action of an antideflationary nature to offset that. We opiate not a forecast, but an observed decline. If we see that prices are tending to rise and employment is high, then we can take action to meet that observed, not anticipated, inflationary pressure. Do you see?

QUESTION: Yes. But wouldn't the most satisfactory answer to it be to take this whole question of controls out of the political field? After the last war one of the most serious things that happened was that the subject of price controls came up during a year in which we were voting in a new Congress.

DR. MYERS: I think there are two lines of answer to that. One, how would you take controls out of the political field? Then, more seriously, I don't think it would be a good idea if we could. I don't like the alternative, because it assumes some economic body or somebody above the control of the people to decide these matters. I don't like that kind of setup.

Surely, the political pressures give us a lot of difficulty, and we do a lot of things that the theoreticians say are far short of perfect. But we are all free to criticize and we all do it vigorously. And I suspect that the mistakes that some presumptively all-wise body, which is removed from political control, would make would do more serious and be less likely to be corrected, because nothing could be done about such mistakes.

The difference is very roughly the kind of difference given as between the Russian setup and ours. Or, to take a less controversial example, take the Spanish and ourselves, or any country that is operated by a dictatorial government, where the public cannot make its wishes and reactions felt. Such a government doesn't make so many little mistakes, I suppose; but the mistakes it does make are big ones and far more serious. I want to see this right in the middle of politics. I want to have everybody yelling about it all the time.

QUESTION: You indicated that one of the prospects we may face is an expansion of military expenditures to the point of about 20 percent of our gross national product and a maintenance of military expenditures on that level for several years; and then, possibly, if there is no war, a falling back to about 10 percent of our gross national product for military expenditures.

DR. MYERS: Roughly that.

QUESTION: I understand that we are undertaking a steel expansion program of roughly the magnitude of 15 percent of our current steel production and comparable expansions in the aluminum industry and copper and other parts of the economy. Aren't we then facing the prospect that if we fall back to 10 percent of our gross national product for military expenditures at the same time that we have expanded our productive capacity by, if steel sets the level, about 15 percent, we may be facing a situation where we have more production than can be absorbed by our civilian economy?

DR. MYERS: In the first place, I would be inclined to say that if that is all we had to pay for protection, it is well worth it. I don't think the figures that you suggest are anything to get very much frightened at.

I don't recall the figures, but, obviously, steel production ought to increase in proportion to population increase. In the case of steel production, I think it ought to increase by more than the rate of population increase. Historically, it has grown more rapidly.

Suppose it should increase at the rate of increase of total production. If we say that is 3 percent per year in five years it would be 15 percent, even without compounding it. So, if we increase steel production 15 percent, and if it is right--and that is just a guess--that steel production ought to increase approximately in proportion to the production increase, then in five years we would have caught up.

Moreover, in the period between the end of World War II and now there has been very little time in which we wouldn't have been able to sell a good deal more steel if it had been available. So if the steel capacity had been 110 million tons, say, between 1945 and 1950, instead of 90 to 100 million, I suspect that we would have been able to sell all that steel or substantially all of it. It would have meant that certain things would have gone ahead a little faster.

I am not worried about a 15 percent capacity increase. If it were 50 percent, it would be another matter. But that is not suggested. Neither is the industry worried, by the way, about this 15 percent.

Some government quarters have argued for about a 20 percent increase--to about 120 million tons. The industry itself, on its own initiative more or less, has made plans to increase to 115 million tons. So, if they aren't afraid of it, I don't see why we should be.

QUESTION: My question goes directly to the subject of demobilization planning, but also has its effect on mobilization. What steps are being taken, if any, to give contractors assurance that on termination of their contracts for one reason or another, the settlement of their claims will be final? I understand that the Contract Settlement Act of 1944 was an unusual piece of legislation in many ways. One was that it gave finality of settlement to the contractors. That was very pleasing to many of the military and war contractors and highly offensive to Mr. Lindsey Warren, as prejudicing his jurisdiction. I understand that the act is still in force but is not being used, by virtue of an interpretation that he has given. It would seem to me that many contractors would hesitate to embark upon a war contract program where they felt that they were not going to get finality of termination. What steps have been taken in that regard?

DR. MYERS: I don't know the facts, but I agree with you that the subject is important.

I think the World War II piece of legislation was excellent. Again I speak not as a technician in that field, because I am not. But in its general objectives and in the way it worked I thought it was very good. We ought to have something like that now.

I don't know to what extent the original act has been impaired or limited by the Comptroller General's rulings. But, if it has been seriously limited, I think the limitation ought to be removed or corrected in some way. But as to the facts, I don't know whether there has been any action taken or precisely what the situation is.

QUESTION: In your discussion of margin controls I think you said that the sport shirt wouldn't come back at the expense of the two-dollar white shirt. I can't quite follow that. It seems to me that a 20-percent markup on a five-dollar item would be much more interesting to the retail store than a 20-percent markup on a one-dollar item. And, further, while Mr. DiSalle may not have to go out and do the shopping and check in this matter, he would have some 3 million establishments to check on paper, and he gets no help from the housewife, who remembers that you could buy a shirt for $1.20 for a small boy last year, but can't today.

DR. MYERS: There are several angles to that one. First, I don't think this problem of the low-end item is a problem of retailing. It is a manufacturing problem primarily, as it was during World War II.

That was one of the reasons I suggested dollars and cents markups on manufacturing. I don't think the problem would then be serious at the manufacturing end. I don't argue that there is absolutely no problem. It might be of some advantage to the manufacturer to concentrate on the higher-end items. But the pressure would be much less than it was during World War II.

So, while I wouldn't argue that the problem is theoretically solved, I would argue that the pressure to shift away from low-end items is much less under this proposal than under a rigid price and end-item ceiling control.

I would argue further that I think with reasonable adroitness, with reasonable care in drawing the regulations, the problem could be reduced to a size where it is relatively unimportant, because, after all, to most manufacturers, maximizing profits is not their only objective. They are also interested, for example, in maintaining their full production line.

I don't think the problem is very important at the retail end. I would expect the retailer to push the high-end item, but I don't think very many stores will refuse to carry the low-end item if it is available.

As to the enforcement, that is more difficult. I think that is true. When we have dollars and cents prices, we can advertise all across the country: "Nylon hose" of a certain grade at $1.98, or whatever it is. The housewife can see more easily that there is a violation and can report it. That is one objection to my proposal that is frequently advanced.

I would point out there two things: First, the number of items on which we can set a flat dollar and cent rate is sharply limited. It is all right on a standard white shirt or nylon hose and things of that sort, but we can't do it on a wide variety of items. Second, the difficulties of flat-rate pricing in World War II led the OPA to shift to the margin markup for retailing on most items before the end of the war.

In spite of this one disadvantage, the experience in World War II indicates that the percentage markup was a more effective kind of control than were dollars and cents ceilings on most goods. There can be exceptions.

Incidentally, this thing doesn't have to be applied in pure form. When we get a standardized item which is nationally advertised, there is no reason why we can't do precisely what you suggested. If that means that there is a violation of the strict margin procedure, as you say, it would mean not a standard markup, but in the case of an individual store it might be somewhat less or somewhat more. Where it can be used I would use it, but I wouldn't rely on it very extensively, because I don't think it would apply to a very large number of items.

COLONEL WILLIAMS: Dr. Myers, we sincerely thank you for your splendid discussion of economic demobilization and its necessary tie-in with mobilization itself. Thank you very much.

(15 Feb 1951--350)S.