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RELATION OF MILITARY AND CIVILIAN PRICE POLICIES TO PROCUREMENT IN WARTIME

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CAPTAIN STOVER: Gentlemen, prices and that general area of economic phenomenon are discussed daily in the press and on the radio. There is probably more information, misinformation, good and bad principles expounded than in any other subject. Many of our current pricing headaches may be traced to our pricing policies in times of war.

Our speaker today has a distinguished career as a public servant in the capacity of economist and adviser in the National Defense Advisory Commission, Office of Price Administration, and, more recently, in the Council of Economic Advisers to the President of the United States. He is a distinguished economist, scholar, and author. His subject, "Relation of Military and Civilian Price Policies to Procurement in Wartime," aptly fits the unusual background experience of our speaker, Dr. Donald Wallace.

DR. WALLACE: Mr. Chairman and gentlemen. I must say at the outset that it has been some years since I have thought about the kind of problems we are going to be discussing here this morning. I assume that you are way ahead of me since you are studying these things currently and intensively. Hence I must apologize in advance if, at times, I repeat things that you have already been over.

I shall divide my talk into three parts: First, the system of controls which is necessary in a full-war economy with total, or nearly total, industrial mobilization and all that goes with it. Second, some particular things which seem to me, at least, essential if the economic stabilization controls, which are a part of the full set of controls, are to work effectively. The third part of my talk concerns the question of division of labor between civilian pricing authorities and the procurement authorities of the Armed Services and their relations to one another.

First, the system of controls.--The particular system of economic controls needed for a particular defense or war program depends on the size and nature of the program and on the existing economic situation. For example, a relatively small program with a planned, gradual increase which is put into effect at a time when there is a lot of slack in the economy--that is, when we have several million unemployed and many of our factories are not nearly fully utilized--is one kind of thing. That would require, for a time at least, only selective controls in the fields of prices, wages, materials flow, production, manpower, transportation, and so on. It would require controls only where there were bottleneck situations. That was about the situation we had in 1940 when the defense program was originally launched. That situation continued for at least a year. We could debate about the precise time at which it turned into the other situation I am going to describe in a moment. Certainly it would be some time in 1942; some would say some time late in 1941.

Going to the other extreme, there is the situation of launching a great-scale program of industrial mobilization, with a planned rapid increase to bring it up to a very high peak as soon as possible, in a situation in which we already have full, normal use of the economic resources of the country and hence little slack. That is an economic situation such as we have at present, when unemployment is about the bare minimum for normal peacetime conditions.

If we were to try to expand production greatly right at this point, for a war program, the addition to total production would have to come principally from drawing people who are not now a part of the labor force into the labor force and from extending hours of work. (Rapid expansion of military production would of course require drastic conversion and allocation controls).

What I have to say today relates to economic stabilization, military and civilian pricing policies, and procurement in a situation of full, normal use of manpower and equipment, and thereafter I shall not talk at all about the period when selective controls are sufficient to do the job. I am thinking of a situation in which the need for industrial mobilization is at least as great, in terms of proportions of the economy devoted to war uses, as it was in World War II; and a situation after we have passed the point of full, normal use of resources in the country.

A future war with atomic bombs, guided missiles, and many other things which I have not even heard of, might present a radically different kind of program in terms of the nature and degree of industrial mobilization that was necessary. If so, of course, the objectives and the programs of industrial mobilization and economic stabilization might be very different. Of such possibilities I know nothing and cannot speak. Presumably, another war will, in any event, present a substantially different set of conditions and problems from those that were faced in World War II. You are way ahead of me on this. I have done almost no thinking about it. Hence I must speak on something I perhaps know something about, that is, the situation of total mobilization such as we had in the late war.

In that kind of situation full controls are needed. The only primary objective is, of course, winning the war; maximizing industrial mobilization to that end. This plainly requires priority and allocation controls, production directives, the use (sometimes at least) of mandatory orders, manpower controls, transportation controls, export-import controls, and all the other direct controls over the use of the resources, physical and manpower, of the country, all geared to the achievement of the maximum possible amount of war goods that can be used effectively, or at least that can be produced after meeting the basic minimum essential living standards of the people; and also geared to getting the proper proportions of all of these various war goods.

Many persons would say that economic stabilization, on the other hand, is a secondary objective; that controls on prices, wages, profits, and so on, which are needed to achieve this, are of secondary importance. I would say, categorically, that this is not true. A maximum war effort is, I think, impossible without the effective stabilization of prices, wages, and profits, including farm income. In the kind of situation we are talking about, this means universal, or almost universal, price control, wage control, and limitations on profits. There are several reasons why this is so.

In the first place, a gyrating inflation--spiraling prices, wages, and profits--would obviously play havoc with the planning of production by the producing firms, by the civilian production authorities, and by the production and procurement authorities in the Services. A spiraling, gyrating inflation would also seriously impair the effectiveness of allocation and priority controls and procurement objectives.

The inducements to violate the direct controls on production and the flow of materials, and to avoid many of the procurement plans are just too strong when all prices and wages are rising rapidly, chasing each other, and rising very unevenly. No one knows what is going to happen to his costs next week, next month, or next quarter. No one knows whether he can be sure he can get certain kinds of materials when he needs them. Efficient planning and controlled production and procurement would be impossible.

Moreover, I think if we have a rapid, price inflation and inflation of the cost of living, we could not have a successful no-strike agreement on the part of labor. We would probably have a large number of strikes. Other disturbing features would be the multiplication of middlemen seeking to procure scarce materials for people who were desperate for them, or just taking advantage of the situation by buying goods, holding them while the price goes up, and then making a cleanup. Not only would such middlemen exist in much larger numbers than usual, but everybody who could get his hands on goods would have a strong incentive to hoard them as the prices rose rather than to direct them into the channels of production and distribution as rapidly as possible. In other words, it would be simply impossible to maximize the war effort, not because the

Government would be unable to get its hands on enough money to buy all the war goods it needed--that, of course, it would do, by one resort or another--but merely because a spiraling, gyrating inflation completely upsets morale, production, procurement, and everything else.

I think it is worth emphasizing specifically that such an inflation would seriously impair civilian morale because of the unequal distribution of the burdens of war. We never have an inflation that hits everybody evenly. We never have an inflation in which wages and the cost of living for everybody in the community move at just exactly the same pace. Many get left behind in the race and, obviously, they do not feel very good about it.

For high civilian morale in a war situation, the controls must operate in such a way that the various groups in the country feel, in general, that they are being fairly treated; that one group is not getting any worse treatment than another. I want to come back to that point a little later.

There are other reasons why economic stabilization is desirable. One is to minimize the dollar cost of the war and hence the increase in the public debt. Another is to keep the price structure and price level in what will be a tolerably good balance or adjustment for entering the postwar transition period. These two reasons, however, are not necessary in order to justify the use of effective, economic stabilization controls. My main point is that such controls and effective use of them are necessary simply in order to run the war as effectively as possible and to maximize the effort to win the war.

If I have labored the justification of economic stabilization here to this audience, it is not because I think you gentlemen need to be convinced of that. You have been studying these matters. But I do want to emphasize that you will need to convince your subordinate officers of this point. You will have a procurement operation in which many, probably most, of the members will be fresh out of business, recruited for the gigantic procurement activities which are necessary in the kind of total mobilization I am assuming here for our discussion this morning. A great many of these new officers just out of business probably won't understand the need for economic stabilization--except, perhaps, wage control. They will think, I am afraid, that the best way to get more production is to raise prices. And, even worse, they will think that an increase in prices will always result in an increase in production, even when all labor, all equipment, and all materials are being fully used; even if all production and procurement officers in a number of fields are raising prices at the same time in order to get, or to try to get, an increase in production out of the system--an increase which is not forthcoming because we are already in a full-use situation.

Now, of course, these views which I ascribe to some of your future subordinates are not true. I make the point because I speak from a long and rather frustrating experience with many of the production authorities in WPB, and, to be quite candid, I must say also with a number of procurement officers, although by no means all, who apparently held the views which I have just described. In other words, it is a hard point to get across to the average businessman who thinks unconsiously in terms of a normal business situation in which you can get an increase in the production and supply of a particular commodity if the price of that commodity moves up and most other prices remain fairly stable. That is the normal business situation to which he is accustomed.

I hasten to add that I am not saying that in a full-war economy, with full use of our resources, a price increase on a particular commodity will never stimulate production. Plainly, it will do so if most other prices are held stable. In other words, in order to use prices as an incentive, in order to use price increases as a means of supplementing and helping the direct controls, production directives, allocation and priorities systems, and the like, it is necessary to have prices in general held stable so that you can create the incentive you wish by moving a few prices up while the others are stable. If they are all going up at the same time, you do not get much, if any, incentive out of raising any particular one. You have to try to keep ahead of all the others and that is a fruitless race.

I wish to point out also that in the kind of situation we are speaking of there are many instances where a price increase on a particular commodity will have no appreciable effect on its production. The difficulty is not that the price is not high enough to give adequate returns; it is, rather that the producers simply cannot get additional labor supply or additional material supply. This illustrates the great importance, in order to make the whole system work satisfactorily, of close cooperation between those in charge of pricing and those in charge of production and controls on materials.

Now I turn to the second part of my talk--some principal things which are needed to make stabilization controls work effectively.

First, there are some who say that economic stabilization can be assured simply by having large enough taxation, in other words, a balanced budget and effective control of the money supply. According to this view the whole apparatus of price control and wage control is absolutely unnecessary. It is surprising to me what a large number of people there are who believe this, particularly among my economist brethren. There are several reasons why this is unworkable as a single stabilization scheme. In the first place, the way price and wage inflation occur as a war program sweeps ahead is by large price increases at particular points in the economy. It is the basic materials and semifinished products that are hit most and hit first by the large spending in a war program. You cannot control that sort of thing by an over-all control of fiscal and monetary policies.

Secondly, it is politically impossible, under present circumstances and any foreseeable circumstances, to secure an increase in taxes large enough to bring to the Government, out of taxation, enough money to balance the budget when the Government is spending at the rate of a hundred or a hundred and fifty or two hundred billion dollars a year on a war program. Neither the ordinary citizen nor the ordinary Congressman understands these things well enough to accept any such thing.

Finally, some excess of the total money demand for goods and services--the total of the Government demand for war goods and the demand of all civilians for civilian goods that are available--over the total available supply is, in fact, desirable, provided it is not so great that it threatens the breakdown of the direct controls. Mr. J. K. Galbraith, a Deputy Price Administrator, has pointed out in a brilliant article in the "American Economic Review" for June 1947 that some excess of total demand is desirable because it gives a strong incentive to produce more goods of any sort. Hence, there is a strong incentive to draw labor out of those portions of the population which formerly have not been in the labor force and to pay fairly high wages to do it--higher wages than they would get under normal circumstances. This draws in many women, the older men, the lame, the infirm, and so on, as long as they can add anything at all to production.

This excess of total demand over supply, with prices held down so that it cannot express itself by pushing all prices up and eliminating the excess of demand, acts as a forced draft to draw in as much of the resources of the country as we possibly can. If you can get them into production somewhere, you have a better chance to move them around in accordance with the needs of the war program.

A second thing I want to emphasize is that in many cases controls on the flow of materials and parts, production directives, limitation orders, and the like, are needed in order to make stabilization controls work. There is an interrelationship here--one is needed for the other, and the other is needed for the one. During the late war, in the case of basic materials for war goods, the direct controls were in general quite effective as we moved into the period of the maximum war effort. The difficulties on the side of price control, which showed up elsewhere, did not appear. In some fields of civilian goods, however, where the War Production Board was very loath to use allocations or production directives, price control was exceedingly difficult and, in fact, did not work very well because of the lack of direct controls on the use of materials. The most outstanding example of that semifailure was in the field of clothing.

A third point I want to make here is that in order to have effective, economic stabilization there must be worked out and put into effect some kind of balance of prices, wages, profits, and farm incomes, a balance that will be accepted by all of the groups involved as tolerable, at least, if not entirely satisfactory to any one group. This balance must, of course, be effective in terms of incomes over the whole field of operations in the economy, including the fields of war production and the resources devoted to war production.

Hence I say that procurement officers, if they are to do the maximum that they can for the war effort, must support the stabilization program, both where they have responsibility for pricing or placing limitations on profits--this should probably be a considerable area; I will come to that in a few minutes--and where central stabilization agencies are doing the job of setting prices and wages.

It is extremely difficult to control wages if the cost of living or profits are continuously increasing. It is highly difficult to control prices if you cannot control wages and hold them relatively stable. Farmers will not accept strict controls if wages and/or profits are continuously rising. Hence some sort of balance of returns, or at least standards for prices and incomes used by the government authorities, is imperative; a balance which is generally considered tolerable by the various groups so that they will, in general, accept the controls and not spend too much of their time trying to change them, either by forceful methods, such as strikes, or by the familiar technique of bringing pressure to bear on the agencies and on the Congress.

I think this balance is so important because the American people are accustomed to many individual liberties, a relatively free market, and democratic prodcedures in making and administering laws, particularly laws that affect such things as prices, wages, profits, and jobs. Broad and stringent economic controls won't work unless they have the general acceptance of the people.

Policing, of course, is important. But you cannot depend on the wholesale use of police methods with the American people even in a very great emergency. I stress this because I think business men and military men sometimes tend to forget it, or under-emphasize it, probably because they work in and are used to organizations which, for very good reasons, are organized on authoritarian principles rather than of principles of a democratic society.

Now I come to a point allied to the one just made. Nothing discredits a stabilization program so much as a feeling on the part of a lot of people that they are being unfairly discriminated against; that the other fellow is getting a better break on the price he receives from the price-control agency or from procurement officers.

Also, nothing discredits a stabilization program so much as several instances of bad failure, where the thing plainly is not working and the people who try to cooperate with the Government are getting hurt thereby. For this reason substantial uniformity of pricing standards and profit controls over the whole field of business, both the war-goods area and the civilian-goods area, is necessary so that, in general, people feel that whatever they are doing they are being treated according to the same standards and are not victims of unfair discrimination.

I would like to emphasize this whole point on human relations by quoting to you a remark once made by Leon Henderson. I went to see Mr. Henderson late one afternoon after he had had a very rugged day with a number of people from business, labor, and some Members of Congress. He was plainly worn out. He greeted me with a wry smile and said, "Don, this is the g---t, most complex economy ever invented, and then they have to go and put people in it." (Laughter)

The considerations I have mentioned make it plain that procurement authorities and production authorities need to support the stabilization program, even where they have no direct responsibility for it, in order to help make it work so that the war program itself can reach and maintain maximum effectiveness.

The considerations that I have noted above suggest that primary responsibility for most price control, although not necessarily all, should be lodged in one separate price-control agency. The same thing, I think, holds true for wage control. We do not need to go into the question of whether the same agency should control both prices and wages. If there are several different agencies controlling prices--and the same thing would hold true for wage control--the problem of overlapping would become exceedingly difficult. We had a chart once on the manifold uses of corn, which we presented on the Hill when the farm bloc was interested--as it always was--in trying to get price control on farm products given over entirely to the Secretary of Agriculture. You can't imagine the tremendous number of uses of corn. It is not just a food. It goes into innumerable industrial uses. A little imagination will show the difficulties that would exist if we had one price-control agency trying to control prices in the industrial area and another trying to control prices in the farm area.

Also, I have emphasized the importance of uniformity of standards and treatment. The only way to be sure to get that is to get as close as possible to one agency doing the job.

In introducing my third topic, the scope and relation of price control and procurement, let me make two general points about procurement agencies as instruments of price control.

Procurement authorities, in the job of procurement as such, touch only a part, even though a large part, of the whole economy. Hence it is obvious that in their procurement activities alone they cannot do the job of price control for the whole economy. They can, however, take primary responsibility for the control of prices and profits in particular areas, as we will see in a moment.

In general, I would think it unwise, however, for the Armed Services to take on the task of price control outside the area where, by virtue of their procurement activities, they have a close relation to problems of the production and supply of war goods and the companies producing them. For the best civilian morale in the country and for the maximization of the whole war effort, the Army, the Navy, and the Air Force ought to be the organizations for which everybody stands up and cheers. It is obvious that a group of men who are engaged in price control or wage control do not get many cheers.

On the topic of the scope and relation of price control and procurement, let us start with an old question: Shouldn't the procurement authorities be responsible for the stabilization of prices on everything they buy, at least, and perhaps for most or all of the parts, subassemblies, semifinished materials and basic materials? Let me take you back to June and July of 1942, when this question arose in acute form, and devote a few minutes to description of the problem as it then appeared and how it was settled.

In the middle of 1942 the economy was in process of rapid conversion to full mobilization for war. For several months prices and wages in nearly all fields had been rising at an alarming rate. In April, OPA issued General Maximum Price Regulation which froze at the March level nearly all prices that had not hitherto been controlled by the selective price-control schedules already issued.

The GMPR slowed up but did not stop price inflation. We in OPA were very much concerned about the situation, particularly in the wage field. There was, as yet, no effective wage control, no statute making direct provision for wage control. Also there was no control of a number of farm prices because the standards for ceilings on farm prices in the original statute were so liberal that many of them had not yet risen to the point where we could set ceilings.

In this situation, two things happened: One, a so-called Wage Stabilization Conference was called in Los Angeles with respect to aircraft wages; two, the Under Secretaries of War and Navy addressed to Mr. Henderson a very strong memorandum requesting complete exemption from control by OPA of all military goods, parts and subassemblies with minor exceptions. We had just issued a regulation (MPR136) covering a number of parts and subassemblies of military equipment. We had been working on a regulation for ceiling price control of airframes and another one for tanks. We believed that we could write the kind of regulation on these items which would not impede production. If I could show its terms to you I think you would agree that, in general, this type of regulation would not impede production because it was so loose that one could get almost any price that was needed. The principal restraining feature was a provision that cost calculations could not include increases in wage rates after a base date which, as I recall it, was some time in April. Thus whatever wage increase might come out of this Stabilization Conference was not to be included in costs.

Our major purpose in designing these two regulations was to use them as a lever to prevent the impending wage increase which otherwise would, I am sure, have gone through. They were successful in doing this, although we never actually put them into effect. The whole episode dramatized the great need for effective wage control and helped greatly in the drive during the summer for a Stabilization Act which was passed in October, giving effective control over farm prices and wages and setting up the War Labor Board.

As I have said the Services requested late in July 1942 that OPA refrain from any control in the area of strictly military goods, their parts, and subassemblies. We discussed it with the Services over a period of weeks, during the summer, while this whole business of wage stabilization was very hot. The outcome was a settlement in September by which OPA agreed to refrain from extending ceiling price control, beyond the coverage of regulations already effective, any further into the area of strictly military goods and those parts and subassemblies of military goods which were at a stage where they could be identified as plainly intended for the production of military goods rather than civilian goods. This went a long way toward meeting the request of the Services.

The Armed Services agreed on their part to undertake effective stabilization of prices and profits in the exempt area through their procurement methods and Price Adjustment Board operations. OPA signified its intention, because of its statutory obligation, of watching the results. As it turned out, we never felt thereafter that it was necessary for us to go into that exempt area to any considerable extent. In other words, we thought that the Services were doing, on the whole, a good job in improving the closeness of pricing and improving the operations of the Price Adjustment Boards.

Moreover, the imposition of wage control went far to remove any need for OPA control in the area of military goods, parts, and subassemblies in the absence of wage control ceiling price control seemed necessary in this area in order to damp down the wage increases there which would spread to the civilian-goods area and thus impair stabilization of the cost of living. The result would be a vicious spiral of prices and wages. That was what worried us.

We come now to the division of labor in stabilization between the price control agency and the Services. I think the solution worked out in 1942 was a good one and I think it points the way toward general principles for solution of the same problem if it should ever arise again. Plainly, the procurement authorities should be responsible for pricing military goods which are bought on prime contract, assuming that there is effective control of wages and prices of materials and supplies, and that there is efficient, noncompetitive procurement by the Services. This arrangement includes finished combat items and their parts and subassemblies in any form such that they are clearly destined for military use.

Notice that I mentioned prime contracts only. The question arises whether the Armed Services' procurement authorities can also control effectively the pricing on subcontracts in this same category of goods. I should think that they could. I should certainly think that it would be desirable for them to undertake that, if they can do it, rather than to have the price-control agency do it, for reasons which I think are obvious. The same types of product are often procured on both prime and subcontracts.

Coming down, however, to articles like food, clothing, drugs, and the like, these should be controlled by the price-control agency. I mean the whole array of them, including those bought by the Armed Services. I think the same conclusion holds with respect to basic materials, such as coal, metals, lumber, and heavy chemicals, which go, in substantial degree, into all kinds of civilian products as well as into war goods. In both cases we will get the best results with one control agency, one set of people to deal with the firms and industries, and one set of standards.

Moreover, the price-control agency can do industry wide pricing and make industry wide price adjustments. It can set up a price schedule and structure for the whole steel industry. In procurement activities, as such, the Armed Services can not do that because they never deal with all of the products made by all of the companies. Obviously, procurement methods are, in the main, methods suited for dealing with particular companies on particular products.

It might be decided during another war to have a central procurement agency procure all of the supplies of a basic material, perhaps several of them--steel, copper, or what not--on the best terms it could; that is, to buy from each company, not at a flat uniform price for all, but at a price worked out on the basis of that own company's cost-profit situation. That was done to a very limited degree during the war. It was done in the case of alcohol where a lot of the supply came from new plants. The RFC bought it up at many different prices and sold it out to further processors at one price. If such a scheme should be adopted, it seems to me that it should be operated by a civilian procurement agency rather than by the Armed Services.

I have just one or two remarks, if I may have a few minutes more, on pricing standards.

A price-control agency which is trying to do the enormously difficult task of really stabilizing prices, particularly the cost of living, and preventing a spiraling increase, must use standards which, to a reasonable degree, require absorption of cost increases in one way or another as long as there is any adequate margin in the existing prices for absorption.

That, also, is a hard point to get across to people who have not thought much about the job of price control and who take it for granted that the only fair way, in fact the only satisfactory and adequate way, of controlling prices would be to use a pure cost-plus formula--that is, to start with prices as they are at a given time, freeze them, and then increase the price of every product, for every firm, and every industry, whenever there is an increase in its cost. That will not work. There are always cost increases occurring here and there in the system. As we strain the resources of the country in trying to maximize the war effort, scraping the bottom of the barrel on manpower, and forcing materials substitutions, the creeping cost increases here and there tend to become greater.

If you have a price system which always adds on all cost increases, you will, in this situation, have a price system which is always in motion; the whole thing is moving up. I do not believe you can effectively operate a system in which your prices are always in upward movement, here and there, everywhere. So a reasonable amount of absorption, wherever cost increases can be absorbed without doing any harm to the financial and profit situation of the industry or firm in question, is a cardinal principle of effective price control.

When it comes to procurement authorities in the field where they have the responsibility for pricing, they need not, it seems to me, use exactly the same standards as the price-control agency. Indeed, their type of operation, dealing individually with individual firms as to particular products, is, of itself, a kind of operation which would make it difficult to apply exactly the same sort of pricing standards, particularly on an industrywide basis, that the price-control agency could and should use.

But the procurement authorities, where they have the responsibility for pricing, must, it seems to me, work out pricing standards and operate pricing standards which come to substantially the same results, in terms of effect on profits and other things, as the pricing standards used by the civilian authorities in the other fields. Otherwise, the claim of unfair discrimination between different parts of the system will arise. The man who is producing very essential civilian goods controlled by the civilian price-control agency will say, "Well, I'm producing something just as important as aircraft and yet I'm being treated much more harshly."

In fields where the price-control agency has responsibility, the procurement authorities, it seems to me, should accept the standards of the price-control agency and support that agency publicly. If they do not agree with the standards it is perfectly proper to argue their case in private with the price-control agency. But a public squabble in industry meetings, as occasionally happened, or in the press damages the stabilization effort and may impair procurement. And I would say that they should help to sell the price controls to their clients, as it were. They should also help to get the production authorities to use the amount of direct controls needed to assist in effective stabilization.

Finally, what should the price-control agency do to help procurement? First, it should tailor its ceiling price regulations on goods bought by the Armed Services to the particular circumstances, so as to be sure that there will be no impediment to production or procurement arising from any of the terms of the regulations.

The regulations should be flexible with respect to adjustments so that adjustments, either industrywide or individual company adjustments, will be provided wherever they are really needed in order not to hamper supply or procurement. The price agency should give the most prompt attention to industrywide or individual adjustment cases.

The price-control agency should, so far as it can in its contacts with producers and suppliers to the Armed Services, help to sell to them the procurement programs of the Armed Services.

My last point is that the price-control agency must maintain sufficient price control on nonessentials to help prevent any diversion of labor, or materials from the production of essentials for the war program, or for civilian consumption, into nonessential areas.

CAPTAIN STOVER: Any questions, gentlemen?

QUESTION: What effect or impact does foreign trade have on prices?

DR. WALLACE: Just in general, let us take the present situation. There is an abnormally large export surplus, as you know, going out of this country for very good reasons, with which you are familiar. In that situation, there must, of necessity, be some effect on prices. In other words, prices of some goods would be lower at the present time if it was not necessary to send such a sizeable amount of those goods abroad.

The extent to which foreign trade, in the particular circumstances we are considering here, affects prices depends on a whole lot of things. It depends on how large a part of the supply is going out. It depends on the "elasticity of demand," to use the economists' term, for the products in question, and a number of other things which make quite a long story.

The general answer is, of course, that foreign trade, like any other kind of trade affects prices to some extent. Foreign demand is a part of demand just the same as any segment of domestic demand is a part of demand.

In the present situation there has been a lot of wild talk about our large foreign export surplus being the principal factor for the continuing inflation. I do not think that is true at all. It tends to be a factor, but less important, I should think, than some others.

DR. HUNTER: Dr. Wallace, during the recent war there was a great deal of, one might almost say, continuous friction between the production agency, represented by the War Production Board, and the price-control agency, represented by O.P.A.

DR. WALLACE: Unfortunately, that is a correct statement.

DR. HUNTER: To what extent, in your opinion, did that interfere with the maximum production effort? And, second, do you see any way of handling that so as to eliminate substantially the impairment of war production effort?

DR. WALLACE: Well, of course, the field covered is so vast and the part of it that any one individual in the picture sees—not alone through his own eyes, but what he hears from other people who see other parts of it—is still such a small part of the total that I suppose any one person would really be incompetent to answer your question. I don't think I can.

My impression, however, is that the friction between the production and price authorities during the late war did not impair, in any substantial degree, the production of any of the essential goods--essential for war, that is. I think when we go to some essential civilian commodities, such as clothing, it is plain that the friction which existed, the inability to get together on a common program which would have real results, did result until relatively late in the game in an unsatisfactory situation.

Conceivably that could happen in the field of essential war goods. But it is not likely. The need is so obvious. The Army, the Navy, and the Air Force stand there in back of the production authorities to say, "We have got to have this stuff. If you fellows can't get together on it then we will have to have the President, or someone else, coordinate you or replace you."

I would not think that the chances of friction seriously interfering with war production would be very great. As to how to minimize that, it seems to me the best we can do is to get together continuously, to set up machinery forcing the opposite numbers in the price and production agencies to see each other frequently, to know each other's problems, then try to get together on them.

The other solution of having price control and production control in the same agency, under the same head, is not, I think, a good solution. That represents a change-over from my original position in 1940 when I first began to have something to do with these matters. At that time I took it for granted that we would get better results if the same group of men were controlling prices and production. But I think that is asking almost too much of any man because there is, to some extent, an element of conflicting objectives there. It is very difficult for a man, I think, to do a good job both with respect to production and pricing at the same time. If you try to do it in one agency, I am afraid one objective will be distorted out of all proportion and the other will be greatly sacrificed; and I have a hunch which one will be sacrificed.

COMMENT FROM THE FLOOR: I understood you to say, sir, that there was no reason for price-fixing and wage-fixing to be under the same head.

DR. WALLACE: I don't think I actually said that. I really ducked the question.

COMMENT FROM THE FLOOR: Well would you discuss it now, sir?

DR. WALLACE: I said there is no reason why we need to discuss it here this morning. Perhaps I was wrong on that.

COMMENT FROM THE FLOOR: Would you discuss the relationship that is necessary between those two so that when wages are lowered prices will be held down.

DR. WALLACE: I am not sure in my own mind whether one would get better results if wage control and price control were in the same agency. I am sure that they need to be coordinated by somebody who stands over both of them.

However, the two operations are basically quite different. One obvious difference is that in the case of wage control you are dealing in a very direct fashion with men, with personalities; much more so, I think, than in the case of fixing prices on commodities even though those commodities are produced and sold by men.

I think the kind of approach, the methods used, the standards used, all of that, are quite different in the two cases. Hence you need men with somewhat different sorts of training for each of the two jobs. In any case, what each of them is doing will be quite different from what the other is doing, so there is no particular advantage in having the same group of men right in one agency trying to do both of those things together, provided there is a good integrating officer over them.

As a practical matter, to get effective wage control, you may have to have the tripartite board arrangement which we had during the late war in the War Labor Board. If you have a board of that sort for wages you do not want that board fixing prices.

QUESTION: In a war economy, when there is an increased demand, you generally bring in marginal producers. Their costs are going to be higher; necessarily, prices have to be higher. The prices of the last producer would be excessive. How do you handle that situation?

DR. WALLACE: From the standpoint of an effective stabilization program, the best way of course to handle that situation is by special premium prices for the inefficient or abnormal part of the production as was done in the case of premium prices on marginal increments of copper, lead, and zinc during the war. Those premium prices were financed by a subsidy which paid for itself many times over, if you count the savings by measuring what the total supply of copper would have cost if you had a flat uniform price of 17 cents a pound as compared with what it cost when 17 cents was paid for only 25 percent of the total supply, the rest being obtained at 12 cents. Those figures as I recall, are not too far away from the actual situation as of 1945. We did that in a limited number of cases during the war and with very effective results in large savings and holding prices down.

It can also be done without subsidizing by buying up various parts of the supply at different prices, related to the differences in cost situation, and then selling all of that out at a uniform price which, as I mentioned in the course of my talk, was done in the case of alcohol.

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QUESTION: In a war economy why is it necessary to continue the operation of a commodity exchange with regard to the fixing of prices? What part did it play in the national economy that was so important?

DR. WALLACE: I do not believe it was necessary to continue the operation of commodity exchanges. My memory is a little vague on what happened last time. I think the metal exchanges, for example, simply closed down fairly early in the game. I do not remember whether the grain exchanges completely closed down or whether their operations were just very greatly limited. But, in any case, there isn't much reason for dealing in futures in a full war economy. There isn't much reason as compared to what there is in normal times.

QUESTION: I have heard it said that it is necessary, for prosperity in this country, to export ten percent of our maximum production every year. Could you comment on the veracity of that statement along with the effect that our expanding economy will have on that, if true.

DR. WALLACE: Well, that's a pretty large order.

I suppose you are talking about the present situation. Exports, I think, have been running roughly ten percent or a little less. I have not been intensively studying the present economic situation and the whole international situation in the last few months, so I am really not competent to answer your question.

The amount of our total production that we have to export in the present situation depends very largely on the whole situation, which is bound up with the Marshall Plan, of course. That is the basic factor in the situation. I am just not familiar enough with all of that to have an informed judgment to give here today.

I would say one thing, however: I do not believe anybody would say it is necessary to export, year after year, any particular proportion of the total supply of a country's output. The figure might vary quite a lot. Presumably, as Europe recovers and gets on its feet again, our exports to Europe may drop off very greatly and become a much smaller proportion of our total supply than at present or, apparently, in the next few years.

But if you are thinking of another angle of the thing, the contention that we will always have to export a considerable part, be it five, or ten, or whatever percent, of our total output in order to maintain maximum employment and production in this country, that is a somewhat debatable question. I should think probably we will have to export a considerable part. I would not dare guess what the figure would be. Conceivably it might be less than 10 percent. It certainly would be much less for us than for a country like Great Britain or many other countries of which the whole economy is geared to a large exportation of goods and services and a very large importation of many basic essentials, such as food.

COLONEL NEIS:: Do you think it is feasible to administer price control and rationing in two separate agencies?

DR. WALLACE: Yes, I think it is feasible. I think you would get better results, probably, if they are in the same agency. But I think if they are in the same agency you would probably get even better results if they were separated into different divisions or departments as was, in fact, the case with OPA.

There, again, my present position represents a change of mind from what it was way back in the beginning when I felt very strongly that price control and rationing should be in the same division inside OPA. That was simply because I really did not understand what was involved in rationing.

The whole rationing operation is a very different kind of operation, with much more of the purely mechanical arrangements for control of flow, from the control of prices. There is no particular advantage in having the two things done by the same group of men; say, having food rationed by the same group of men who are controlling the ceiling prices of food. If you had them in one division, I think that division would pretty soon be subdivided by its operating head into a rationing branch and a price-control branch.

However, I think it is much better to have them in the same agency under the same responsible head, because they supplement each other; they must do so in order to be effective.

DR. YOSHPE: Dr. Wallace, in your discussion you laid considerable emphasis on the intimate interrelationship between economic stabilization and production, material, transportation, and other vital controls in a war economy.

I would like to follow up one point which you raised in answer to Dr. Hunter's question. You brought out the fact that your preference might be for keeping price control in one agency and production control in another. Now it is obvious, of course, that somewhere in your mobilization program you must have some agency that sees to it that these two agencies get together and do exercise their responsibilities in the best interests of the war economy.

My question is, during World War II we did develop a certain amount of coordination which seemed to me to be rather improvised. The Office

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of Economic Stabilization and the Office of War Mobilization did not appear to me to be doing an effective job of coordinating these basic, interrelated programs in the war period.

I wonder if you would give us the benefit of your views as to the best kind of agency that might achieve such effective coordination.

DR. WALLACE: Well, I have not thought very much about that, actually. I think that the Office of War Mobilization and the Office of Economic Stabilization during most of the period in which they operated were not really planning agencies. They were mainly umpiring agencies, waiting for disputes, differences, or problems to come up to be resolved rather than looking at the development of the various programs and policies of the various agencies under them all the time and trying to plan ahead for a better integrated set of policies and programs. If that was what you meant, I think I would agree with you that those agencies did not live up to the maximum of what might have been possible, judging from the way they actually operated during the war.

Perhaps one, over-all agency instead of two, such as the Office of War Mobilization and OES, would work better. Perhaps a more effective use could have been made of a board or committee, composed of the heads of all of the agencies basically concerned with the major regulatory functions. The War Production Board was not a board that had to do with the whole field of war regulations. The Office of Price Administration was represented on it, to be sure, but the WPB paid rather little attention to the economic stabilization side of the thing.

Possibly you could get better results by a board composed of the agency heads that cover the whole waterfront on major controls--production, stabilization, and everything else; a board which, perhaps, had a functioning secretariat and which really was a top-policy committee in a real and effective sense. To be that, it would have to have a functioning secretariat which would work up material for decisions on particular cases, or changes in policy, or new programs, and so on. I do not know whether that would be better or not.

CAPTAIN STOVER: Dr. Wallace, in behalf of the students and faculty I wish to thank you for the very scholarly presentation on economic stabilization. Thank you, sir.

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