THE IMPORTANCE OF PRIORITIES AND ALLOCATIONS IN A WAR ECONOMY

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COLONEL NEIS: Gentlemen, one of the main problems or main tasks of he agencies or individuals engaged in economic mobilization planning is he conversion of the existing economy into a wartime economy or the construction of an entirely new economy. I think we have all been in this ourse for a sufficient length of time to realize that we do have to perate under a different system in a war emergency from that in normal eacetime.

There are three basic tools by which this conversion or new construcion can be accomplished. We like to think of those three tools as riorities and allocations, public opinion, and price control. When we peak of price control, we think of the entire field of economic stabiliation--price control, profit control, wage control, rationing, and war inancing. I hope that we can get you to think of this tool chest. You ust have tools in order to accomplish this reconversion or the construcion of a new economy.

The materials that you will use for either the alteration or the new onstruction are, of course, the essential factors of production, that is, ower, fuel, transportation, facilities, manpower, and materials. But ou must have tools, and in this vertical phase of the course conducted y the Mobilization Branch we attempt to bring to you an understanding of he potency of these three tools. This morning we are extremely forunate in having Colonel Scharff here with us to discuss the priorities nd allocations aspect of mobilization, and the importance of these paricular tools to economic mobilization.

I might tell you that Colonel Scharff has had a very wide and profiable experience in the field of priorities and allocations administration. hen we found during World War II that we could no longer control the size f programs or adequately control the flow of materials by the use of riorities, he had a very active part in the development of the allocations ystem, the so-called "CMP system". I think we are extremely fortunate n being able to have with us here this morning a man who has had so ital a part in the development of these basic tools. It is with great leasure that I present Colonel Scharff.

COLONEL SCHARFF: Gentlemen, I would like to say first that I appreiate very greatly this opportunity to continue my discussion of the various phases of priorities and allocations with the members of the Industrial College of the Armed Forces for the fourth successive year. I understand that my discussions of last year and the year before were mimeographed

and have been made available to the members of the class as texts. Therefore I do not wish to take any time for repetition of any of the discussions of details that I had the opportunity to present at the time of these previous visits. I would like, however, to introduce my remarks today be recalling very briefly in summary form the ground that I covered in these previous discussions.

Three years ago, and again two years ago, I had the opportunity to review here the historical background of our priorities and allocations systems and the history of the development of our priority system, the Production Requirements Plan, and the Controlled Materials Plan, with their related control measures, during World War II. I pointed out at that time that our experience had demonstrated, effectively I thought, tha no single system of control can suffice to effectuate maximum production for national purposes in time of emergency; that priorities play a useful, and indeed an essential, role in the early stages of an expanding emergency economy when capacity still exceeds demand, and when all that is required is to secure delivery of emergency needs on time; that even in the later stages of the development of an emergency economy, when demand is in excess of capacity and when allocations become necessary, priorities are an indispensable part of every complete system of controls, since they provide a means of solving, in accordance with relative urgency and the maximum over-all advantage, the conflicts which inevitably arise even under the most complete control system.

I pointed out that the Controlled Materials Plan, operating through allotments of a selected limited number of materials, provides an effective means of gross adjustment of programs to capacity, and of production to requirements; but that it is necessary to provide for fine adjustment by supplemental controls, including scheduling of critical components, allocation of critical materials, conservation, standardization, limitation or prohibition of production, and so forth.

I called attention then to the degree of success which we accomplished by the combined system of controls which we developed during World War II. But I pointed out also that we had fallen short of success in avoiding inflation in statements of requirements, in establishing effective inventory control, and in adjusting B product production under the Controlled Materials Plan to the requirements of the A product programs.

I therefore suggested at that time further study of the possibility of solving these unsolved problems by additional development of standard bills of materials and standard lead times for products and components; and by extension of the A product procedure under the Controlled Materials Plan to cover a larger proportion of the entire production field in conjunction with some form of simplification of procedure for allotment extension.

Last year I continued my discussion of the subject by calling attention to the fact that the necessity for controls in a war economy arises, ot from the existence of war or combat as such, but rather from the inbility of our free-enterprise system to adjust itself to the requirements f the emergency by the operation of the normal controls and corrective actors of price, wage, and capital competition; and I suggested that it ould be helpful if this fact could be more generally recognized in times f unbalance due to national emergencies of other types than war, as a uestion of practical statecraft rather than as one of partisan or religious faith.

I also discussed last year the relation of material controls to the omplete program of social and economic controls, including universal ational service, which will be required in any future emergency. And suggested that they be considered, not as separate, isolated problems, ut rather as part of the general problem of national mobilization in uch a way as to maintain our national unity, and to develop when necesary our maximum national military potential through complete utilizaion of our material, manpower, and spiritual resources. And may I reind you in this connection that the concept, the philosophy, of priorities and allocations is applicable not only to the control of programs nd the resolution of conflicts in the use of materials and industrial roducts, but also throughout the complete system of social and economic ontrols, including controls of manpower, power, fuel, transportation, ommunications, credit, etc.

This year I have been asked to discuss the importance of priorities nd allocations in a war economy. I suppose I could dispose of the subect in a single phrase by pointing out, as I have done previously, that uch material controls are an absolutely essential part of the combined ystem of controls that is necessary in time of war. And certainly no uestion can be raised as to the importance of that which is absolutely ssential.

However, rather than leave the matter there, I would like to call our attention to some of the demonstrations of the importance of maerial controls we have been having during the years since the end of orld War II. I have in mind particularly the difficulties and repeated hut-downs that some industrial establishments have experienced due to hortages of steel; the growth and development of gray markets; the efforts hat have been made to alleviate these difficulties by voluntary allocaion systems; the occasional use of priorities or set-aside orders to ssure deliveries for foreign-aid programs; and the provisions of the elective Service Act of 1948, authorizing priorities for defense orders, nd allocations or set-aside orders when necessary to assure delivery of teel to manufacturers of products required by the Armed Forces. Also I ave in mind the reported inability of the Munitions Board to proceed more apidly with the strategic materials stockpiling program, and the reported

consideration that has been given to possible voluntary or compulsory allocations as a means of assuring more rapid progress.

Incidentally, within the last few days I have noted striking evidences in the newspapers of the limitations that are applicable to attempts to solve these problems by so-called "voluntary" action. I refer particularly to statements by industrial leaders and by the Chairman of the Munitions Board and the Secretary of Commerce that the steel industry was already taking care of as many programs of public interest by voluntary allocation as possible, and that no additional burden could be put upon the voluntary steel allocation system. I refer, also, to the report that an effort had been made to induce the copper industry to make voluntary allocations for stockpile purchase, and that the proposal had been rejected by the industry on the ground that the Government had not yet exhausted the possibilities of normal purchasing procedure.

These experiences seem to me to illustrate effectively how impossible it is to carry out programs of vital public interest requiring materials, for which the demands of private industry are already absorbing substantially the entire supply, without the use of priorities and allocations. And they afford a demonstration on a small scale of the vastly greater importance of these controls to the supreme public need for the development of maximum national military potential in time of war.

I would also like to enlarge briefly upon two paragraphs of my discussion of last year, which I am taking the liberty of recalling to your attention by quotation, as follows:

> "* * * in what we like to think of as 'normal times,' our competitive economy is a very delicately balanced system. Facility capacity, the distribution of materials and labor, and production are quite precisely adjusted to the requirements of demand. Within certain definite limits, variations of demand and supply result in the maintenance of that adjustment by additional investment or by capital withdrawal; by facility construction or shutdown; by increases or decreases in prices and wages; by redistribution of materials and labor; by financial reorganization; and by the other factors that work under the influence of competition. The accomplishments of this system, which we have come to call 'free enterprise,' have been one of the marvels of our age."
>
> "But we tend to forget that these more or less automatic control mechanisms, like the servo-mechanisms that engineers use to control mechanical, electrical, chemical, and physical processes and systems, can operate successfully only between the limits of variation for which they are designed. Beyond those limits the system simply cannot satisfy the requirements of a modern democratic society sufficiently, and in time, to maintain that general support which is the indispensable basis of social stability in such a society."

My reason for recalling these two paragraphs to your attention at ıis time is that they seem to me to emphasize that the importance of ·iorities and allocations extends far beyond the limits of their appli- ıtion in time of war. Indeed, consideration of these matters calls atten- ion strikingly to some of the basic characteristics of our competitive ıpitalist economy, of which I believe we must have a better understand- ıg if we are going to have it operate successfully in the great competi- ion that is now under way with other forms of social organization in ;her parts of the world.

Secretary of Defense Forrestal was quoted in the newspapers recently ; having pointed out that the 15 billion dollars a year or so that we ·e planning to expend on national defense, together with other govern- ıntal programs, are already assigning to national aims a proportion of ıe national income and production which is imposing a severe strain upon ır domestic economy and which he suggested may well require some form of ;onomic control in order to permit it to continue. He went on to say, ıd here I quote: "that any level substantially beyond that figure would ıevitably demand the creation of controls, priorities, and allocations."

Everybody recognizes that there is a limit beyond which the competi- .ve price and profit system cannot operate to meet the requirements of ıch national programs without the creation of intolerable social strains. ; have seen the process carried to the point of disaster in some other ;untries; and we are today witnessing with anxious concern the struggle ;r the restoration of economic and political stability that is being ırried on by some of our closest friends and allies. Nor can any of us ; sure that similar disaster will not overwhelm us if we do not have ıe intelligence and the strength of character to take the necessary steps ı time.

But what are the limits within which our normal corrective mechanisms ın operate successfully? And what and where are the danger signals that ; must learn to recognize in order to take the necessary action in time ; avoid social disintegration?

It seems to me that the Council of Economic Advisers, established by ıe Employment Act of 1946, could perform no more vital function in its ;ntributions to the Economic Report of the President than to carry for- ırd studies designed to develop standards and yardsticks for measurement ' the answers to these urgent questions. And the National Security Re- ;urces Board, as the civilian component of our defense organization ıarged with planning the effective application of our national resources ; meeting civilian and military requirements in times of national emer- ;ncy, might well consider this problem of timing the initiation of con- ·ols at the proper point in the expansion of a war economy as one of the ·gent aspects of the broad problem of national mobilization. Let us not ı this, or in any other part of this program, so vital to our national ;ecurity, be "too little or too late."

Priorities and allocations are by no means the only forms of controls that will be required whenever the accomplishment of national aims becomes impossible through the normal operation of the free-competitive system, whether in times of war or in times of other types of national emergency. But in every such case I am confident that priorities and allocations will be among the earliest types of supplemental controls that will be required; and as the emergency develops, their importance will inevitably be recognized to such an extent that they will surely become an essential part of every comprehensive system of social and economic controls.

Thank you very much.

COLONEL NEIS: I would like to lead off the discussion with one question. You made reference to A and B products. I believe that most of the students have not had an opportunity to hear of them before. Would you elaborate on them for a moment, please?

COLONEL SCHARFF: I shall be glad to try to do so, and then I shall refer the students to the mineographed copy of my remarks of two years ago, in which I endeavored to explain the system, perhaps with greater success.

The Controlled Materials Plan, as those of you who have studied it know, was based upon the allocation of a selected list of materials of general application--steel, copper, copper alloys, aluminum, and so forth--to manufacturers, who were prohibited from accepting delivery of or from utilizing any of these materials without the possession of valid allotments. Under the Controlled Materials Plan, allotments were made in two ways: to A products, by what may be described briefly as a vertical procedure; and to B products, by what may be described briefly as a horizontal procedure.

Under the plan, B products were selected as products of general use in a wide variety of programs by different claimants under the Controlled Materials Plan. The best example of B products is the classical one of nuts and bolts. A list of some 450, as I recall it, products of this general character that went into a wide variety of end product programs was made up, and they were designated as B products. The Operations Vice-Chairman of the War Production Board, under whom the industry divisions of that organization operated, acted as the claimant for all manufacturers of B products. He submitted their applications for controlled materials to their appropriate industry divisions in the War Production Board, which in turn made allotments to these manufacturers out of the B product allocation made by the Requirements Committee at its quarterly allocation meetings.

Under the plan all products that were not on the list of B products ere defined as A products. All allotments to A product manufacturers ere made, as I said, by a vertical system. That meant that the claimnts--the Army, the Navy, the Air Force, the transportation system, the ommunications system, agriculture, civilian requirements, and so forth-- ade up their programs and estimates of requirements for these controlled aterials. When modified and finally adjusted by the Requirements Comittee of the War Production Board, those requirements became the basis f allocation of controlled materials to the claimant agencies themselves, ather than to the industry divisions of the War Production Board, to be pplied to their programs.

These claimant agencies then, in the case of those which were pruring agencies, like the Armed Services, made allocations to their prime ontractors for the materials required for the manufacture of A products hat they had undertaken to produce. In the case of claimants who were ot procuring agencies, such as the Director of Transportation and the ffice of Civilian Requirements, allocations were made to appropriate rograms and through corresponding divisions of the War Production Board o the manufacturers themselves.

The prime contractors of procurement agencies and the manufacturers eceiving allocations; that is, the manufacturers of A products receivng allocations from nonprocurement agencies, used those allocations-- irst, to procure controlled materials that they used in their own lants, and, secondly, to pass on allotments to their subcontractors; hey in turn used as much of the allotment as was needed for their own perations and passed on their remaining allotments to their sub-subontractors; they in turn passed a portion on to their own sub-sub-subontractors; and so on down the line as far as the production process involved the purchase by a higher level contractor of an A product comonent from a lower level contractor. No passing of allotments in the ertical chain was required for B products, because at any stage of the rocess a manufacturer got his B products direct from the manufacturer, ho in turn got his allotment direct from the industry division of the ar Production Board.

We found in some studies made of the extent to which this vertical assage of allotments was carried on, that, in some instances, it went o a considerable extreme. My recollection is that we found one instance n which an A product allotment had been passed down through a chain to he eighteenth subcontractor in the production chain.

That, I think, should give you at least a general description of the istinction between B products and A products. And I think it also carries ith it necessarily an implication of the difficulty to which I preiously referred; that is, of having the B products production, based pon allotments received from the industry divisions of the War Production

Board, correspond with the B product requirements of the A product program manufacturers, who secured their controlled materials through the vertical allotment procedure.

As I suggested earlier, that was a problem that we never solved satisfactorily. We were constantly bothered by lack of correspondence between the B product production resulting from the B product allotments that had been made, with the requirements of the A product manufacturers for B product components. We never solved the problem satisfactorily. I came to believe that it could never be solved except by a considerable extension of the scope of the A product procedure and by as great a compression and limitation as is practically possible of the application of the B product procedure.

QUESTION: Would it not have been a solution to give the B product manufacturers an original allotment and then pass allotments to the A product system and let him keep his B product manufacturer's allotment banked up?

COLONEL SCHARFF: That is an interesting suggestion, which might permit the B product manufacturer's allotment then to be retired and cancelled when replaced. The difficulty of it is, of course, the same as that which led to the adoption of the B product procedure--the difficulty of subdividing the A product allotment ad infinitum and providing, for example, as an extreme example, a nut and bolt manufacturer the thousands or millions of fractional allotments that he would have to get to replace his B product allotment. In other words, that would be more or less the equivalent of using the A product procedure on everything; and nobody, not even an enthusiast like myself, who thought that it should be considerably extended, ever believed that it could be made universal. So that suggestion might be adopted perhaps within some limited extension of the A product procedure, but it could not practically be applied to entirely eliminate the difficulty.

COLONEL NEIS: Would you comment on the inflationary evolution of the priority system, just a word or two, that led to the ultimate adoption of CMP?

COLONEL SCHARFF: I don't know whether any of those who were responsible for the development of our original priority system ever had any idea that it could be used as a sole measure of control and as a means of successfully limiting the size of programs within our productive capacity, or whether it could not. Certainly our experience indicated that it could not possibly be used in that way.

Our first priority system, as I recall it, started in about 1940 and was practically limited to something like the procedure that is in the present Selective Service Act, that is, the authorization and priorities

:o manufacturers of military products. But as production expanded, even)efore we entered the war, that was found to be inadequate to take care)f the widely varying urgencies for types of products that commenced to :ompete with that single class of priorities.

We had at the beginning of the war a relatively simple system which, :s I recall it, attempted to classify products by relative urgencies in :bout ten or a dozen classes, which were designated as priorities A to ', inclusive. Immediately, the pressure of the lower-urgency group to ;et into the A priority group or the B priority group commenced to mount; .t continued to mount and became so overwhelming shortly after we en- ;ered the war that that system was wrecked, so that it was not possible :o give effective meaning to the higher priorities. There was therefore :ubstituted a new classification of priorities that ran from A-1 to A-5)r something of the kind--about five classes of priorities, with the ıilitary programs largely in A-1 and A-2 and then the other types of)rograms spread through the rest of the bands.

The same process was immediately repeated, and each agency that had uthority to assign priorities attempted at once to get its products, hose that it was interested in, into higher and higher priority bands. he pressures again became so great that they had to be met by conces- ions at various points until the A-1 band became so inflated that it be- ame necessary to have an AA-1 band, which was supposed to be limited nly to the most urgent programs, and, I think, an AA-2 between that and -1.

Then the same thing was repeated all over again. The AA-1 band be- ame loaded to a point where it was necessary to set up an AAA system or programs of such urgency that an AA-1 priority would not produce hem in time. Finally even the triple A began to get crowded to a oint where a WPB special directive procedure was authorized. That was ven more effective than the triple A and was guaranteed to wreck any- hing in order to get results.

I think that that experience demonstrates two things: first, the otal inability of a priority system to do anything except act as a easure of relative urgencies and to solve conflicts in accordance with he greater need; and secondly the total inability of such a system to imit the size of programs and to do the job that an allocation system s needed to do. It also provided a striking demonstration of the fact hat the pressures put upon a priority system from the very beginning f its initiation are enormous; and that careful and intelligent plan- ing in advance, a clear understanding of the purpose and nature of the riority system when it is put into effect, and great determination and trength of character after it is put into effect are necessary in order o make it accomplish the results that it is capable of accomplishing as art of a control system.

QUESTION: Colonel, what types of inspection, if any, did you have to determine whether or not manufacturers were playing ball with us with these two systems?

COLONEL SCHARFF: The War Production Board had a division set up for the purpose of enforcing compliance, called the Compliance Division. That division operated through the regional offices of the War Production Board in making actual physical inspections of some plants and actual accounting inspections of the CMP allotment records which were prescribed, which manufacturers and recipients of the allotments were required by the regulations to maintain.

Those inspections were, however, extremely limited in scope. The personnel assigned to them was never large enough to do more than spot check a limited portion of the field. They did, however, uncover occasionally some striking cases of violations, and by giving publicity to those violations--such as violations of inventory regulations through the maintenance of inventories several times what was prescribed, violations of the application of priorities, violations of the CMP regulations with respect to procuring controlled materials without the possession of valid allotments, the application of controlled materials secured by allotment to purposes that were not authorized by the allotment--enough violations of those characters were obtained to make it possible in some cases to institute effective legal compliance action. By giving publicity to those successful cases I think a great deal of good, that was entirely out of proportion to the amount of inspection that was done, was accomplished.

I personally think that, while undoubtedly there were large numbers of violations, the general compliance record of American industry with these regulations during the war was admirable. I think, too, that this compliance procedure, through the intelligent use of publicity in connection with a limited number of violations, was relatively effective.

COLONEL NEIS: General Holman, have you a comment?

GENERAL HOLMAN: I was interested to note that one of the important factors that you introduced here is the so-called tool of public opinion.

COLONEL SCHARFF: That certainly is directly applicable to this question.

QUESTION: Could you tell us what was the reaction of industry to these various plans--the one by which the A products were released and the one by which the B products were released? Did industry favor one over the other?

COLONEL SCHARFF: The whole development of the allocation procedure started even prior to the development of the Controlled Materials Plan, with the Production Requirements Plan, and with the experimental allocation plan that was tried before that. All those developments were carried out in the closest cooperation with the industry divisions and the advisory committees that were established in the War Production Board in planning and developing this system. There was the fullest opportunity to criticize and to discuss and to debate. When the decisions were made to try out these successive plans, my own impression is that they were generally accepted by industry as sincere efforts to solve a difficult problem. They gave them cooperation and every opportunity to succeed.

In the case of the first two allocation plans that were tried, experience demonstrated that they were unsatisfactory and could not be made to work. The Controlled Materials Plan, when it was put into effect, received general approval as a major improvement over what had been tried before. Details of it were subjected to continuous criticism by industry, and many changes in details were made during the progress of the plan, by modification of regulations.

This difficulty about the inability to get B product components necessary to carry out A product programs was naturally one of the subjects of difficulty and criticism. But I think that the plan in general, as it was developed, received the fullest possible acceptance and cooperation from industry. The plan received the benefit of criticism from industry. I think it was generally recognized that, while undoubtedly there were cases of particular firms that had unhappy experiences and never felt fully reconciled, as a whole, it was felt that the plan as it developed was a reasonably satisfactory solution of the program and one that justified the full support of industry.

COLONEL NEIS: We are certainly deeply indepted to Colonel Scharff for taking the time from his many duties to prepare this lecture and come down here from New York. I cannot help but feel that each of us realizes after hearing Colonel Scharff that the subject of priorities and allocations will have increasingly broad interest with respect to practically everything that we expect to be currently studying. We have placed this lecture in the program at this time because of its broad application, just as we have placed in the curriculum the public opinion studies at this time because of their broad application. There is hardly a study that you will pursue from now on where the subject of priorities and allocations will not have broad implications. It is the feeling of the faculty that it was very desirable that we have Colonel Scharff here at this time to give us a basic understanding of this important control tool.

Colonel Scharff, on behalf of the Commandant I wish to thank you again for your fine contribution to our course this year.