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PHILOSOPHY OF PRICE CONTROLS IN A WARTIME ECONOMY

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Dr. Donald H. Wallace was born 29 June 1903 in West Chester, Pennsylvania. He received his A.B. degree from Harvard University in 1924, M.A. degree in 1928, and his Ph.D. in 1931. Dr. Wallace has held the following positions: Instructor Suffield, Connecticut School, 1924-25; instructor of economics, University of Vermont, 1925-26; assistant professor in economics, Harvard, 1926-27, instructor and tutor, 1927-36; study in Europe, Social Science Research Council, 1931-32; assistant professor of economics Harvard, 1937-39; associate professor of economics, Williams College, 1939-45; economist, U. S. Department of Labor (part time basis), 1939; National Defense Advisory Commission, price stabilization division, 1940; Office of Price Administration, 1941; director industrial manufacturing price division, 1942-43; acting deputy administrator for price, OPA, June-August 1943; economic adviser to deputy price administrator, 1943-46; member staff Council of Economic Advisers, 1946-47, consultant 1947; Director graduate program, and professor of economics, School of Public and International Affairs, Princeton University since 1947. Dr. Wallace is a member of the Board of Directors, National Bureau Economical Research, member American Economic Association. He is the author of the following: Market Control in the Aluminum Industry, 1937; International Control in Non-Ferrous Metals (with William Y. Elliott and others), 1937; Industrial Markets and Public Policy (with E. S. Mason and others), 1940; Economic Standards of Government Price Control (editor and with Ben W. Lewis and others), 1941. He has contributed articles to Quarterly Journal of Economics, and American Economic Review.

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DR. KRESS: General Holman, gentlemen: We have this morning a speaker whom I always think of as Mr. OPA himself. I have known of the work of Dr. Wallace for a longer period than he has known me, because I was interested in these things long before I was privileged to work in the field of price controls. Dr. Wallace was with the Price Stabilization Division of the Defense Advisory Commission from its very inception in 1940 and long before it evolved into the OPA.

Last year Dr. Wallace was forced to cancel his talk here because he had given of himself so unstintingly for the last ten years that his system required that he give it an opportunity to recover its balance, a period of several months being involved.

After leaving OPA, Dr. Wallace served for a while on the staff of the Council of Economic Advisers to the President. At the present time he is Professor of Economics and Director of the Graduate Program of the Woodrow Wilson School of Public and International Affairs in Princeton University. It is a real pleasure to welcome once more to a class in the Industrial College of the Armed Forces, Dr. Donald H. Wallace.

DR. WALLACE: Thank you Dr. Kress.

I shall follow in my talk this morning the excellent suggestion of General Vanaman and talk about the following things:

1. The general philosophy of war price control and the conditions in which price control is necessary.

2. Timing in the imposition of controls.

3. Techniques and principles of controls.

4. The relation between price control and military procurement.

5. Some major problems indicated by World War II experience.

6. Timing in the release of controls.

There may be other topics in this whole area which one could have thought of but there are not very many. I think you will see that in order to cover all these in the time allotted, I shall have to limit myself to a few basic things under each one, but I think perhaps that will be more interesting to you than taking one or two of these and going into them intensively.

First, <u>The general philosophy of war price control and the conditions in which price control is necessary</u>.--The extent of price control and other stabilization controls needed in wartime, if we need any--and conceivably there might be a kind of war situation in which we would not need any--depends basically on the extent of the military program in terms of the proportion of manpower devoted to military service and in terms of the proportion of manpower and other economic resources needed in the war production program.

In World War II, the objective was to divert the largest possible proportion of resources that could be effectively utilized without impairing the production effort itself. This was total economic mobilization. I do not know what drain might be made on the resources of the country by the kinds of warfare which are now possible and developing--atomic bombs, hydrogen bombs, guided missiles, and many other weapons of which I have not heard. Since I do not know what assumptions to make on this problem, I cannot, of course, deal with it today.

In passing I might, however, hazard one suggestion. Even if the impact of the military program itself, including the necessary war production did not apparently require price control, was not of sufficient extent in impact on the whole economic scene to require price control, nevertheless the destruction of facilities, of goods, and of life would probably be so great as to require price control and other sorts of control with respect to essential civilian goods. With total economic mobilization, price control and wage control will always be necessary.

It is worth noting also that even a relatively moderate increase in the military program at a given time will call for stabilization controls if it occurs when our labor force and our facilities are pretty fully utilized according to normal standards, for example, the present time. Hence, if we as a nation are successful in maintaining maximum employment and maximum production--to use the terms of the Employment Act of 1946--the advent of war, or more precisely, the beginning of a marked increase in the military program, will require stabilization controls immediately if serious inflation is to be prevented. If we have a situation in which unemployment is only somewhere between two and four million and most of our facilities are quite fully used according to normal standards, then any marked increase in the war production program, or in the size of the armed forces personnel, will make such a drain on the resources and will have such an impact on the economic structure that we would be plunged into severe inflation unless we could bring into existence within a relatively few weeks or months full-scale stabilization controls. In the absence of such controls, in this kind of situation, the Government, in order to get the necessary production on appropriate time schedules, would simply have to go in and bid goods, manpower, and the use of facilities away from private bidders who would not want to give up their claim on these resources. The result would be a whirlwind inflation.

One may ask, Why is it really necessary to prevent inflation in wartime? Most of the arguments about stabilization controls are arguments about this question of why it is necessary to prevent inflation or arguments about the question of how to do it, if it is agreed that inflation must be prevented. We don't need to linger much on the "why" because I think it is already clear, but I should like to make one or two points about it.

Many people would say that the basic reason for stabilization controls in wartime is to protect the civilian population from the ravages of inflation. That is, of course, a reason, but it is not the only reason. In my view, the chief reason is simply that inflation would play havoc with war production and with procurement programs themselves and would make impossible the maximum all-out war effort of which the economy is capable if effective stabilization controls are imposed and well operated.

There are several reasons for this conclusion. In the first place, with a gyrating inflation, prices here and there are rising all the time, wages are going up, and prices and wages are chasing each other in a spiral. Under such conditions there is a strong inducement to violate material controls, priorities and allocations, and let materials go to the highest bidders. In this situation, it would be very difficult, if not impossible, for the procurement officers themselves to refrain from competitive bidding, one branch against another branch, in order to try to meet the procurement schedules laid down for them.

Another point is that in the process of inflation there is inevitably a multiplication of middle men. Anybody who can get into the middle, buy something, and hold it for a week or a month can get a much better price for it and make a profit. This leads to speculation. It also induces the regular manufacturers and the regular middle men to hold on to goods for a while instead of distributing them as fast as possible. So there is a considerable tendency toward hoarding.

A third point is that a no-strike agreement is possible only if stabilization controls are in effect. With the cost of living rising all the time, the labor unions would probably not be willing to give up the one weapon which might be used to keep wages from falling behind.

Finally, a little thought will show clearly that continuous, spiraling price and wage increases here, there, and everywhere will seriously disturb the planning and scheduling of production by business enterprises, by war production authorities, civilian and military, and the planning and scheduling of procurement by the military. Effective planning and scheduling and operations in accordance therewith are possible only if businessmen, procurement officers, and production control authorities find that price and wage increases are the exception rather than the rule.

Stabilization controls during the war are also a great help when it comes to restoring a healthy peacetime economy in a democratic system after the war is over. Hence, both effective prosecution of the war and effective prosecution of the transition to peace require price controls which limit price increases very narrowly during the course of the war.

Second, Timing in the imposition of controls.--Here the basic principle is simple: A price ceiling must be imposed whenever the demand for a commodity markedly exceeds the supply, so the price would rise a great deal if it were left free. Of course we should make some qualification for prices that might be too low for adequate supply at the time the whole thing started. That was true of a number of commodities in 1940 when we were still in a semidepression condition. But beyond a moderate rise, the generalization would hold true even with this qualification.

In 1941, there was considerable argument about the relative merits of selective price control and universal price control. In retrospect, at least, much of this argument seems quite beside the point. As a matter of fact, the argument could occur only because there was at the time a large slack in our economy, and selective price controls could do the job for a little while. In 1940, if I remember correctly, there were still, on the average, eight million unemployed in the United States; in 1941, the average for the year was, I think, five million, although by the time of Pearl Harbor that had dropped to a much lower figure.

The truth on this matter is plain. Selective controls can be effective as long as there is considerable slack in the economy. In that situation selective controls will be necessary in order to prevent the start of an inflationary spiral in those parts of the economy which first feel the impact of war programs—sectors, such as the basic metals or lumber, where the big increase in demand first comes and eliminates slack. When, if, and as the war program grows, the slack will disappear everywhere and universal controls will then be necessary. In other words, whenever there is no substantial slack in the economy, whether this condition exists at the start of a war program or comes into being only as we go along, universal controls will be needed from then on.

Universal controls are necessary because leakage of resources into nonessential goods presents a very real problem unless the prices of those things are also held down. In World War II there was one school of thought which kept urging that so-called luxury goods be exempt from price control, that they were of no importance in the cost of living and hence had no relation to wage-price relationships and wage-price spiraling, and that it was a waste of time to control them. This argument overlooks the fact that if luxury goods are not controlled, their prices can run way up, profits to their sellers will become very high, these sellers can afford to pay higher wages than the wages paid elsewhere, and there will inevitably be a leakage of resources into nonessential civilian goods. Let us note that the same conditions that require universal stabilization controls will also require extensive controls on materials and on the use of facilities and manpower, if we are going to run a total war mobilization effort.

Third, Techniques and principles of controls.--With regard to techniques, I will start with a word or two about four principal types of price ceiling. One is the freeze ceiling. All the prices of a given commodity or set of commodities, or of a whole flock of commodities, are frozen as of a certain base data. This means that each seller is told that his ceiling price is the highest price he had on a certain date or between certain designated dates.

This provision is the quickest way to stop price increases on a broad front, or to stop price increases on a narrow front when the agency does not have the information to define any other type of ceiling. In any case, however, this is only a stopgap, because as time goes on the frozen prices may not accord very well with the developing economic situation; or, even worse from the standpoint of effective price control, a seller may be able to get out from under the freeze ceiling by varying his product enough so that it is no longer the product of which the price was frozen. It is a new product and has no ceiling price unless there is further action to establish one.

The second type of ceiling is the so-called dollar and cents ceiling. This is appropriate for standardized goods. A regulation establishing a ceiling of this sort states the maximum price for a commodity of a certain description in dollars and cents--for example, so much per pound for a copper wire bar at such and such a location. Obviously, this is the most easily enforceable type of ceiling since it is the one kind of ceiling about which there can be very little argument as to what the ceiling price really is. There can be a great deal of argument about what price was actually frozen by a freeze ceiling, and there can be a lot of argument about the application of a formula-type of ceiling which is the third type. A formula-type ceiling is a ceiling that is calculated, usually by the seller himself, by application of a formula specified in the regulation. In machinery industries it was typical business practice to calculate price by taking the direct labor and material cost and using a multiplier of several times that. OPA adopted the same general kind of formula for ceiling prices in these industries. In effect the regulation said to the individual management, "Your ceiling on a product is your direct labor and materials cost calculated in a certain way, multiplied by a certain factor." Other kinds of formula will easily occur to you.

The final type of ceiling, margin control, is in itself a kind of formula ceiling, used principally for wholesale and retail prices. Ceilings of this type allowed a specified margin over cost of the goods, stated either in terms of dollars and cents or as a percentage work-up.

In taking up principles of price control, I wish first to emphasize the most general principle or strategy of price control, without which, in my judgment, the thing will not work at all. There must be brought into existence a balance between the cost of living, wages, profits, and farm income, a balance which is understood and accepted, or at least tolerated, by the various major groups in the country. Unless there is such a balance, there will be a continuous jockeying for position, one group always trying to get ahead, or as it may very honestly say, just trying to catch up with the rest. Some sort of balance that is tolerable must be reached quite early in the game or else it will be impossible to make the stabilization effort work.

The principal reason for this is that it is not possible--at least with respect to the American people--simply to impose by authority or fiat a whole set of rules and regulations governing the heart of things, people's purses and incomes, and then police the regulators with satisfactory results no matter how much opposition to them there is. In large measure the policing has to be done by the people themselves, by voluntary compliance. The enforcement efforts of the agencies are, of course, important, particularly with respect to the recalcitrant minority; but unless 80 or 90 percent of the people affected by price control and wage control are willing to go along, with perhaps some grumbling, and tolerate the thing, it will not work.

My second principle is usually known as the principle of absorption: Wherever there is room for absorption of cost increases such absorption will be required before an increase in ceiling price is permitted. We have seen that an effective war program requires that the upward movement in prices and wages be effectively and narrowly limited. During the period of the war emergency there will be cost increases occurring here and there throughout the economy. For this there are several reasons. Some manufacturers will be forced to shift to higher-cost materials from lower-cost materials whose use is more important in other commodities. As the armed services build up to their maximum personnel requirements there will be a general decline in the efficiency of labor, since the labor force will be augmented by drawing in the aged, the young, the lame, the halt, and the blind. The consequent reduction in average labor efficiency will, unless otherwise offset, tend to raise labor cost. Another factor operating to raise cost is holdups of plant operations from time to time reflecting inability to maintain an even flow of all scarce materials into the plants. Again, some wage increases will have to occur in order to remedy inequities here and there, or to provide an incentive for labor to move into distasteful operations or into other regions. Some financial concessions may be necessary along with whatever manpower controls exist. Finally, some increases in material prices may be necessary because it is not possible to freeze the whole price-wage structure and keep it absolutely frozen for the duration. The objective is to limit the increases as much as possible consistent with fairness and adequate supply. But there will be some increases.

Hence, for many reasons, there will be a creep in costs as we go along. The only way to minimize the number and extent of price and wage increases is to adopt the principle that a cost increase is not in itself a justification for a price increase, that cost increases must be absorbed until a certain point is reached--for example, until profits have been reduced to a minimum reasonable level, or until there is a minimum reasonable relationship between price and cost on an individual item.

The opposite view, that whenever a cost increase occurs for any product, an increase in the ceiling price of that product should automatically result was, of course, very widespread among business men and others, too, during the war. For example, many people always felt that this should be the basic principle of war price control, that the profit margins existing on individual products in individual firms and industries in October 1942, when the Stabilization Act was passed, should have been maintained all the way through by matching every cost increase by an equivalent price increase. We did not know how to do it that way. We were convinced that this would not work. Let us see why.

If cost increases are being continually passed through into increases in ceiling prices, the result will be continuous increases in the cost of living which will in turn result in wage increases. These will again raise costs, and the familiar spiral will be in operation. I think it is too much to expect that any wage control authority, no matter how constituted, can stabilize wage rates in the face of continuous increases in the cost of living, even during an emergency. Hence the question would then be, how to control this spiral so as to keep it within "balance" or keep it somehow from getting out of hand.

We had some experience with that in 1942 before there was any real wage control and before universal price control was instituted and I, for one, would not like to try to do it. At that time the various groups in the country were jockeying to get the best position in the spiral of inflation. In 1943 subsidies to reduce the cost of living were necessary for achievement of a balance that could be stabilized. In 1946 and 1947 we all saw the inflation spiral in operation with controls off. It is obvious, I think, that it would be exceedingly difficult, even with controls on, to permit the spiral to go on and yet proportion the upward adjustments in everything in such a way that the all-important basic balance between profits, farm income, wages, and cost of living, was not disrupted. I think it is probably impossible to do that. Certainly it would be exceedingly difficult. So I conclude that the principle of absorption is a necessary part of effective price control.

In the case of a single-line industry or a single-line firm this principle is not hard to apply, apart from arguments, taking the heat, and so on. With only one product some kind of reasonable profit standard presents no great difficulties in application. The trouble comes in the much more numerous cases of multiproduct firms or industries where the over-all profits on all products as a whole are very good by all standards, but the ceiling on a particular product does not return its cost. What then? We shall return to this problem a little later.

Fourth, The relation between price control and military procurement.-- First, there can be no effective stabilization of the whole economy unless the prices on goods bought by the services are well controlled, the prices of goods on subcontracts are also well controlled, and wages are effectively controlled in firms and industries working on prime and subcontracts as well as in other areas.

Management workers, and stockholders in industries making essential civilian products, such as food, clothing, fuel, essential repair services, can scarcely be expected to do their part well--and that is an important part of the whole war effort too--if wages and profits are allowed to balloon in industries working on government contracts while theirs are held down. They will demand increases, too, and they will probably get them. Moreover, many firms will be doing both kinds of work. This is particularly the case in the food and clothing industries, but other examples are machinery, plant repair services, and tires. Civilian goods prices cannot be held down in these industries if wages and war goods prices there are not also held down.

The second point is that price control need not, of course, all be done by one agency. There can be a division of the field between civilian price control agencies and the military procurement agency or agencies, as the case may be. There is a problem of the line of demarcation, too complicated to go into details here. This was settled last time by improvisation as we went along. It worked pretty well in the end, but I think it could be improved on another time.

A few things can be said about the problem without trying to develop a complete answer. First, the closer the standards used by the procurement agencies to the standards of the price control agency and the tighter the pricing of the procurement agencies, the wider the field that can be covered alone by the procurement agencies without harm to inflation control.

Second, the smaller the field covered by the military, the better off is the military in one way. Sellers don't like price controllers; but the Army, the Navy, and the Air Force--doing the fighting--should be the country's heroes, not agencies which everybody is swearing at.

Third, it is self-evident that the armed services need not and should not enter the fields of pricing of basic materials--metals, lumber, and so on--or of civilian goods, and least of all the field of wages. Hence, in my view, this question line of demarcation is confined to the area of finished goods used by the military and the parts and subassemblies lying between these finished goods and the basic materials for them.

My next point is that the standards of military procurement pricing and the standards used by the pricing agency need not be exactly the same. Indeed the two operations are quite different in several ways and thus call for some differences in standards. The procurement agencies deal with individual firms on individual products or individual contracts. The pricing agency in doing its job must deal generally with commodities or industries as a whole using industry-wide regulations, even though adjustments for individual companies on individual products are also an important part of its work. But the general results--and here is my important conclusion--the general results in terms of profits and wages should not be greatly different in the fields covered by military procurement and fields covered by the pricing agency, or the whole stabilization effort will be jeopardized. You will notice that I said, "should not be greatly different." There needs to be some leeway for incentive prices and incentive wages in order to help divert the use of resources to a more essential program, but it should not be great.

The final point on this subject is that the attitudes of the civilian price control people and of the military procurement officers should be mutually helpful. I think that they can be in large measure, but this will take some working out before an emergency is upon us. We did work it out last time, but with a lot of sweat, blood, and tears. I think it can be done better beforehand, through meetings with the civilian agencies and the armed forces as we go along making plans.

Fifth, <u>Some major problems indicated by World War II experience.</u>-- I say some major problems. I shall take up one anyway, which is really a whole set of problems, and if there is time, I shall take up others.

The one I wish to emphasize is the problem of shifts in production by a multiproduct firm from loss items to profit items--by that I mean, a shift from items on which the firm is incurring a loss to an item where the ceiling gives it a profit--or shifts from lower-profit items to higher-profit items. With any frozen price structure profit margins will vary between items and some items will not bring any profit at all. The problem is especially difficult where the firm can shift into new goods by changing the style, by a new finish on a basic fabric, a new trimming on a shirt, or anything that makes it different enough so they can get a new ceiling price for it. Ceilings on new goods are usually computed by formulas and formula ceilings are looser than others.

In World War II, there were two areas in which this problem plagued everyone who had anything to do with prices. One was the area of textiles and clothing, both in the civilian and in the military field. This was the only broad area of essential civilian goods in the cost of living on which there never was any effective control. The reasons for that would be interesting if we had time to go into them, but I am very glad, since it is a sad story, to say that there is not time. I prefer to spend my time on the other area, that is goods purchased by the military.

The OPA tried in the last war to use nearly the same standards in military goods as were used on essential civilian goods. A lot of the finished military goods were, of course, exempt. I am speaking of those finished goods and parts and semifinished goods that were not exempt. In general we applied the absorption principle with pretty tight standards.

In applying the absorption principle where the over-all profits in a multiproduct firm were quite satisfactory, OPA limited upward price adjustments on particular, individual products by strict criteria: factory cost only, or total cost, or total cost plus a small profit, depending on the size of the over-all profits. Obviously those standards seemed unduly harsh to many procurement officers. Certainly they seemed unduly harsh to many of the companies, and the companies wanted to get out of the production of articles on which ceilings or strict adjustments gave them no profit or very little profit or a bookkeeping loss. Procurement officers dealing with particular products on particular contracts wanted, quite naturally, to use an each-product-on-its-own-profit-feet standard.

This problem was never entirely and satisfactorily solved. I do not know exactly what the answer is. I have a couple of suggestions to throw out in a moment; but, first, I want to convince you that it is a serious problem and not one that can be dismissed simply by saying that wherever the problem is encountered it can be solved by an increase in the ceiling price. That is the easy answer, but it won't stand up under examination.

In the first place, if the pricing agency should raise those ceiling prices on products of a multiproduct firm so as to equalize profit margins on all its products at the level of the highest margin, or even up near that, the situation would be very inflationary. Most prices would go up; profits would increase greatly; the balance between prices and profits, cost of living, farm income, and wages would be upset.

In the second place, theoretically the pricing agency could lick this problem by revising all the item ceiling prices, some up and some down, so as to equalize all profit margins but leave approximately the same composite average of prices and approximately the same level of profits as before. This is not practicable. It would take a great army of accountants and it would open up a vast arena for bickering and squabbling about what ceiling prices actually were on this, that, or the other item. It would involve a tremendous waste of manpower in the Government and in business enterprise. Moreover, business certainly would not like the idea. Companies would not like to have their peacetime price structures—which they have built up with this, that, and the other thing in mind—given wholesale revision during wartime. So I think the only practicable way to limit the number and extent of price increases is by fairly tough standards for increases on particular products.

Third, if producers of goods bought by the military get more favorable prices and larger profits than producers of basic materials going into these products or than producers of essential civilian goods, the latter groups consider it unfair discrimination, and compliance is weakened.

I would like to throw out a suggestion for your consideration. I do not know quite what I think of this myself. In a full industrial mobilization, a large proportion of the giant-, large-, and medium-sized corporations are working largely, and some entirely, on war production. The number of these would be even larger, of course, if we included those working largely on essential civilian products. May it not be possible to design a scheme to sign up these corporations for the duration of the war on terms whereby the Government would guarantee to these corporations returns sufficient to leave them in as good financial and physical shape, so far as that is possible, as they were at the beginning of the emergency period, and to enable them to pay reasonable dividends to stockholders during the period. Perhaps the terms might also include provision for normal capital growth, whether or not they needed during the war itself the type of facilities appropriate for that.

The companies would on their part agree to furnish whatever the Government procurement agencies wanted within the limits of their own ability to produce. Provision for this might possibly be included in a national service act. If there is no national service act, perhaps the Government could achieve the same result, in part at least, by requesting all corporations important in the war program to sign up on the same general terms. Such an agreement would take the profit out of war, not all profit, but extra war profit. It certainly would facilitate more rigorous price and wage controls than would otherwise be possible. It would have another advantage also. It would prevent the piling up of wartime profits in reserves of cash or liquid assets which may promote postwar inflation when spent, as was the case in 1946 and 1947.

The other major problem I was going to take up concerns the growth in the money supply. Since time is short I shall omit that and go to my final topic. If you want to raise any questions in the discussion period about that, I shall be glad to go into it then.

Sixth, Timing in the release of controls.--This really depends in considerable part on the degree of control of the money supply during the war. If we have held down the increase in the money supply, cash and bank deposits--and we can include government bonds because they are practically the equivalent of cash when individuals or businesses want to sell them to the banks--if the increase in the money supply has been held down enough so that the general price and income levels are well adjusted to the money supply at the end of the shooting war, then ceilings will be needed during the transition only on those things which are temporarily in short supply. This situation, however, is not a very likely one because of the political difficulties of raising taxes enough during the war and also because the necessary fiscal and credit policy might be too restrictive on the use of financial incentives to draw labor and other resources into the market and move them around. A more possible situation is that where the increase in the money supply and the idle liquid asset holdings of individuals or businesses have been moderate. In this situation there will probably be a small rise in the price level in the postwar period as these liquid balances become active and are spent. In these circumstances the timing of decontrol should be arranged so as to prevent (1) a general speculative inventory-building spree such as we had in 1920, and (2) a wage-price or price-wage spiral starting at key points in the economy before the goods can pour out at the end of the reconversion process.

If the increased money supply and liquid asset holdings have been very great, as they were during World War II, the problem is much more difficult. It is really the problem of controlling an upward adjustment of price and income levels to the new tremendously enlarged money supply. This was, in fact, the problem the last time. I think the decontrol policy which we adopted was, however, geared to the other situation, that in which the increase in the money supply had been only moderate and in which only a rather small increase in the price level was necessary in order to equate the two.

My last point is that the real trouble in planning a scientific decontrol program is the widespread fear that unless all emergency controls are removed almost immediately at the end of the shooting war, there will be great danger of their perpetuation.

Thank you.

DR. KRESS: We have a little time for questions. I am sure Dr. Wallace has given you several ideas which you would like to have him develop.

QUESTION: It would seem that plant allocation would have a considerable effect in setting the pattern of the problem the next time. Perhaps a better arrangement--where you are going to have trouble--would be that of allocating no more than 50 percent of a plant's capacity to defense production. Would you discuss the problems that would arise from that kind of allocation program?

DR. WALLACE: I am not familiar with the program to begin with, but I think the same kind of problems would arise that arise from other allocations. So far as the relationship to economic stabilization goes, it is a two-way relationship. Unless we have effective price ceilings--

and effective in some of the terms that I have been describing here this morning--it is often very difficult in the first place to make these allocation programs work. In other words, if the incentive is very great to get some other deal then the allocation program that you are supposed to accept, it may not be possible to make it work very effectively. On the other side, price ceilings sometimes might then help direct controls, allocation of facilities or of materials, and limitation orders would prevent the materials or the facilities being used in another way in order to avoid the price ceiling.

That certainly is true in the textile clothing field. All the experience during the last war indicated that you can't have an effective price control system without pretty rigorous plant allocation and materials allocation. I am not sure that answers the question you had in mind, but I think that is the best I can do on short notice.

QUESTION: I gathered the impression that you are recommending the decentralization of price control, to some extent, and I also am under the impression that some of our difficulties in the last war were the result of too many organizations--price control, wage control, and so forth--not properly administered from one head. What are your comments on that over-all economic organization?

DR. WALLACE: I am not sure. I changed my mind during the process several times last time. At present I would say that probably the best setup is to have a real division between military pricing and civilian pricing, including under the civilian pricing agency basic materials, even though they go in large part into the military requirements, the line of demarcation to be worked out. I am not sure just where it should fall as I said before. Now I would not favor any further decentralization of price control. I think it would be an intolerable situation and one which would jeopardize and probably ruin the whole program to have, say, price control for all farm and food products in one agency and price control on industrial products in another agency.

Coming to wages, it is a debatable question. My own view, however, is that the differences in the nature of the problems of wage control and price control are so great and the differences in the nature of the training needed by the people who do the jobs of control are so great that it probably is better to have them in separate agencies, but under pretty close control by a top coordinating agency. I think we could have more effective top coordination--perhaps more than we did in the past--that is, coordination in policy planning as well as simply umpiring disputes. A lot of the attention of the top people was given to umpiring disputes when they came up rather than to policy development.

I think if wage control and price control are in the same agency, you would actually get two separate divisions, one a wage division and one a price division, and you might as well have them in separate agencies. Moreover, it may be that the only possible pattern of organization for wage control is a tripartite board, broken down as in the last case into labor members, management members, and public members. I don't think you need that kind of organization for price control.

COLONEL McCULLOCH: With respect to timing, sir, I don't want to take advantage of you, but would you mind analyzing the situation existing as of today?

DR. WALLACE: I should think we could probably work our way along without bringing in price and wage controls, or rationing controls. Possibly a few allocations and priority controls of some sort are needed in the situation, and we haven't very much slack in the economy at present. I think the latest figure on unemployed is something like four million. That is some slack but not very much; particularly, if the armed services want to increase their personnel strength, they could wipe that out very quickly.

But, I think the only situation in which we would need to consider seriously full-scale, or relatively full-scale stabilization controls plus direct controls on use of plants and materials would be one where there was a very marked increase in the armed forces and/or the military program. I wouldn't dare say how many million men increase in the strength of the services or how many billion dollars added on to the present amount--what is it at present, fourteen billion dollars?--for war programs it would take to create a situation where stabilization controls would be needed. If the military program was doubled, say, the question would arise in the present situation. Certainly if the war program had to be stepped up in the course of a year to something like 50, 60, or 70 billion dollars, I think there would be no question about it, we would have to have controls and have them pretty fast. But probably not for an increase of only a few billion dollars.

QUESTION: That was an interesting proposal you made a while ago, to put on a control which guaranteed a level of profits and capital increase. I would like to ask if you have proposed that to industry, and, if so, what was its reaction?

DR. WALLACE: No, I haven't. I guess the first time I ever mentioned it out loud is today, as a matter of fact. It comes into my mind every time I think about this subject, but I don't know what it is worth. Today I thought I would give it to you people and maybe you could do something with it.

QUESTION: It seems, I believe, to a great many people--and it certainly does to me--that, regardless of how well controls work in another war, the minimum possible inflation is still going to be much more than it has ever been in the past. Would you comment on that, please?

DR. WALLACE: Well the only perfectly candid and straightforward comment is, I don't know, and I don't know how to work out the answer because I don't know what the economic situation will be in another war. In any war that requires total mobilization, there will be danger of very severe inflation unless there are adequate controls.

But I think it is possible to devise adequate controls and operate them. I think our experience the last time suggests this. Much of the price increase from 1939 up to the spring of 1943—when price levels were really held down--was the increase that would have occurred in any normal recovery from a depression level to a high-utilization level in the whole economy; I say much, not all. I think we could have probably stopped it short of where it got in 1943, and then flattened it out, if we had gone along a little faster with our controls in 1941 and 1942. But from 1943 until 1945 price indices were almost completely flat. There was some inflation that didn't show up in the indices, through deterioration of quality, particularly in clothing and things like that, and in other ways, but at the most the total of this unseen inflation wouldn't be equivalent to more than a few points in the indexes. So for all practical purposes, we may consider that prices and wages, too, were approximately stabilized during that two-year period.

The trouble came afterward because the money supply had been allowed to increase so greatly during the war. Although taxes were increased a great deal during the war, they did not come near paying for the whole war. Ninety billion dollars worth of bonds were sold to banks, and this was an increase in bank credit, spent by the Government, which got into people's incomes and into additional balances of business enterprises and individuals.

Now what it would be like next time, as I say, I don't know. I should think, however, that next time we could inprove on the situation because, as a result of what happened in 1946 and 1947, there should be a little more understanding among the general public of the importance of control of the money supply as well as the direct control of prices and wages. Perhaps with that we could have a higher taxing program next time, or forced savings, or something else.

QUESTION: It has been proposed that the principle of renegotiation could be applied generally to all business and thus equalize and stabilize both military and civilian production. Would you comment on the approach to renegotiation generally?

DR. WALLACE: Well, I had not thought of that. It certainly sounds like an idea that should be gone into very carefully. Maybe it would be the answer to keeping profits from getting out of line so much that they tend to impair the effectiveness of wage control or of price control in those parts of the economy where the profits aren't nearly so large as they are in other parts. I don't know. I see one big difference, however, between the military goods area, that is the munitions area, and civilian goods. I think the general experience during the last war, and it probably would be again, was that companies called upon to make for the first time any type of munition which they had never made before found at first that their costs were very high. Then, as they gained experience and the size of the runs got larger, they found that their costs dropped a great deal, even if wage rates had increased somewhat and material costs had gone up somewhat in the meantime. Hence, there was in the military goods area a special problem of reassessment or renegotiation of prices, either through the recapture of profits or through actual renegotiation of prices. I believe it was done both ways, wasn't it? These special features would not exist in ordinary civilian goods industries--food, clothing, house furnishings, and the like.

DR. KRESS: Thank you very kindly for coming here this morning, Dr. Wallace. You have made difficult things seem simple.

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