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ECONOMIC STABILIZATION

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MR. MUNCY: General Holman and gentlemen: This morning, as we start the economic mobilization phase of the Procurement Course, I am sure it would be very comforting to you if I could honestly say that you are going to have smooth sailing through this course. I would like to do it. But I think all of you have read the papers recently and know that, were anyone to make a statement of that sort, it would not be in accordance with the facts.

There are many serious-minded people, men in responsible positions in connection with our mobilization program, who have honest differences as to how we should mobilize and, in the process of mobilizing, how we should operate to maintain our economic stability. I need not call your attention to the very frank statement of Bernard Baruch some months ago when he was testifying in connection with the passage of the National Production Act of 1950. That was an honest and a very fine statement from a great American. I commend it to you for your reading if you have not had the opportunity of seeing it as yet.

If I cannot offer you smooth sailing, at least I shall try to offer you, through our speakers and through the seminars we shall have, certain anchors or posts to which you can tie; certain facts which will help you in thinking through the problem. That may not be the most satisfying thing, but it is a realistic statement.

Our speaker this morning, who is the first one to appear in the Economic Stabilization Course, will give us some of the foundation information with which you can begin to evaluate what you read and observe as we proceed with economic mobilization.

Dr. Miller, I think, has the unique distinction of combining in one man the practical operating experience that he had in a top procurement position in the Navy Department in World War II with an opportunity for serious and scholarly study of the problem both before and during the intervening years as a professor of economics at Yale University.

I understand at the present time he is in the process of writing a book dealing with the very problem of economic stabilization. Perhaps in your questions this morning you can bring out certain points that may clarify or at least get out on the table certain points that may well find their way into that book. So, possibly you will have a chance to help write a book.

Dr. Miller, I welcome you back to the Industrial College. It is a pleasure to have you here. I now present you to the staff, faculty members, and students.

DR. MILLER: Mr. Muncy, General Holman, and Gentlemen: It is a pleasure to be here this morning and to have an opportunity to talk with you.

My task, which has been set, is that of discussing the general objectives of "Economic Stabilization." I am not here to tell you what is being done. I confess that from my ivory tower I do not know too much about what is being done today. Nor is it my task to tell you what should be done. This morning I would rather devote myself to discussing the general purposes of economic stabilization and to raising some of the questions with which I am sure you will want to deal in your seminars and in the study which you will undertake subsequently.

The first question I might raise concerns what economic stabilization is or what it is about. Briefly, I think we can say that economic stabilization is a program or a set of policies designed to permit the fulfillment of our economic objectives while avoiding the twin problems of economic depression with its unemployment and inflation which is associated with a period of high or overemployment.

Stated in these terms, economic stabilization is not solely a problem of a wartime or militarily mobilized economy. Anyone who has reflected on what has happened in this country since the last war will recognize that economic stabilization is a problem which is always with us. It was a problem that was with us in the thirties in terms of the unemployment situation. It was likewise a problem in 1946, 1947, and 1948 in terms of a potential, if not actual, inflationary situation which called for public policies to mitigate the threatened situation.

Of concern to you, however, is stabilization in a society which is at war or mobilizing for defense. I think it is particularly significant that in contemporary United States military budgets of 10 billion, 25 billion or 50 billion dollars--I know not what--seem to be with us for many years, even if we can avoid a major war. And since it is the military part of the budget which creates a good deal of the potential trouble, it is essential that our military officers should think broadly not only about stabilization in so far as it impinges upon their own particular problems, but also about how their functions impinge upon the stabilization of the economy as a whole. Never before, I take it, has the American society depended so much upon its military organization for the state of health or illness of its economy.

One thing I think we should remember is that stabilization in a mobilized society is not an end in itself. It is simply an instrument, an adjunct to the general mobilization plan. Stabilization of prices and wages in and of themselves are of little significance.

This suggests that in designing a program of economic stabilization we should give considerable attention to two things: First, facilitating mobilization, which is after all the predominant and immediate concern in times of war or crises; and, second, aiding in strengthening and preserving our democratic institutions, which is what we are fighting for.

In order to discuss the objectives of a stabilization program in more detail, I would like to point out a few factors about economic mobilization in general.

This problem of mobilization is primarily a problem of social organization. It is a problem of organizing our scarce resources to meet our needs. In this sense, it is the same as the economic problem of any society at any time. It differs only in terms of the techniques to be used, the ends to be served, the needs with which we are faced.

Now, if I were lecturing to my boys at Yale, I would devote considerable time to discussing the nature of an economic system. However, I do not want to bother you with such simple and elementary analysis. But I would like to point out that any society has some six types of economic decisions to make. These decisions are critical in terms of the type of institutions and laws which are devised.

Any society has to determine, first, how much or how many goods shall be produced. This is a function of its resources, its technological knowledge, the effort it is willing to exert and the efficiency with which it applies its effort.

Second, it has to determine what shall be produced, that is, in what direction the effort is to go. This depends upon its needs and wants. In a free, peaceful society, as we know it in this country, we depend primarily upon the consumer casting his ballot in the market place. In wartime or in time of mobilization this involves a choice between guns and butter. It involves also a choice between immediate production of end products vs. investment in capital and equipment which holds forth the prospects of more products in the future; a choice between the present and the future.

A third decision which any society has to make is where and how the goods shall be produced. We have choices as to the location of our steel plants. My associates in New England, for instance, are trying very hard to get a steel plant located there. We have choices in the techniques of production open to us. We must make a choice as between these alternatives.

There are several other decisions to be made. We have to determine who shall get the claims to share in the wealth and development of our society; who gets how much in terms of money (the financial aspect of distribution); and who shall get the immediately available goods (the rationing or "real goods" aspect of distribution) in our society.

And finally, since all economic societies have losses due to technological change or due to shifting from civilian to mobilization production, and since all societies are open to error, we have to decide who is to bear the burden of the financial losses and gains incident to changes and errors, for many of which they themselves are not responsible.

Those are the functions of an economic society. In peacetime, in this country, we depend primarily upon a highly decentralized decision-making process, popularly called the free private-enterprise system, working through free markets, the price system, and the profit system--all within a general framework of laws concerning fair dealing, contractual relationships, and so forth.

Quite an important part of this institutional framework which we depend upon in our free peacetime society is our institutions of money and credit, which are very important from the point of view of stabilization. If run according to certain rules, they put an upper limit on the inflationary side of our economy. One of the great virtues claimed for the Gold Standard, which bound together the world's money and credit systems during much of the nineteenth century, was that it tied us to an upper limit and kept us from facing the problems of hyperinflation.

In the last two decades government fiscal policy has played an increasingly important role in the general environment within which our markets were working. This was true for at least two reasons. The first is that government expenditures--Federal, state and local--are becoming increasingly important. No longer can we look upon the question of government expenditures as simply a small and insignificant part of what is happening in the total environment.

The second reason why government fiscal policy has become more and more important and must be taken into account in any one of our stabilization programs is the fact that many people believe a positive government fiscal program, by which the Government takes the initiative in spending and calling a halt to spending, is a desirable--in fact, necessary--instrument for maintaining stability in modern society. Whether their claim is right or wrong, it is fairly clear that in our own society government expenditure programs are being so used.

These are the problems and functions which a society has to face. They are the problems and functions which we normally face through the market institutions, the price system, the profit motive, acting in the general environment of our institutions of money and credit, our fiscal policy, and our laws of free and fair trade.

In wartime or times of mobilization we face the same problems, though we solve them, if we can, in somewhat different ways. The economic problem of mobilization, if it is a clear-cut mobilization where we know the direction we are going or have a rough idea, is in some way a little easier than in peacetime. The needs for which a mobilized society must organize production are somewhat clearer. Now, I do not want to underestimate the problems that arise in determining our military needs--a problem to which many of you have devoted a good deal of thought and attention--but at least we can start with something similar to a strategic plan and work back. True, the technical problems are difficult to solve, but we do know toward what we are driving. In a peacetime economy we are driving at the uncoordinated and disorganized wants of a population of large size and of varied tastes.

Moreover, mobilization in time of emergency is a little more easily done than in peacetime because we will tolerate a wider range of solutions to our problems. We will tolerate direct, even arbitrary, action somewhat more than in peacetime. However, a mobilization program is a very difficult thing. It requires, generally, a large reorganization and redirection of resources, and it requires that this redirection be made swiftly. In addition, we are inclined to be intolerant of delays in making these readjustments. As the prospects of war or mobilization change, the mobilization plan itself, or the strategic plan and the needs which are based thereon, are subject to very rapid and, sometimes it appears, illogical change. Consequently, great pressure is put upon the economic system to make large, swift and often frequent redirections of its energies. This is a type of strain we normally do not face in a peacetime economic system.

Another reason why a mobilization program and, consequently, the economic stabilization program, become more difficult is that in the process of mobilization, unless you have large unused and untapped resources, sacrifice is demanded of some, if not all. In the process of determining who is going to bear the sacrifice and in what proportion, there tends to be a good deal of pulling and hauling, unfortunate though it be and inevitable as it seems. Many groups are desirous not only of avoiding immediate sacrifices, but they resent and try to resist interruptions to programs which have represented their long-run aspirations. For example, agriculture may have been trying for parity. It resents any program that prevents it from moving on towards parity, particularly in an environment when parity seems attainable. Or labor has been trying to organize. It resents an economic stabilization program which stands in the way of furthering its aspirations in an environment which seems to be favorable from its own point of view. These very real conflicts within a society make the problem of mobilization in war or for defense extremely difficult. The net result is that a mobilization program of any large magnitude threatens the economic stability of the society.

Historically, experience has shown that in all the major wars in which we have been involved there has been a substantial inflation in the price and wage levels, with all the attendant difficulties. Why this is so is indicated by a careful analysis of the effects of a military expenditure program on incomes and prices. Although this may seem a little dull, not to say abstruse, I should like to pursue it a bit because I think a study of the process by which inflation takes place may make somewhat clearer the alternatives open to us in trying to avoid or mitigate inflation and destabilization.

Let us start with what I call an autonomous change, which comes from a decision of the military or the administration for an increase in military expenditures. Military budgets go up, contracts go out, and people are put to work. What happens? Unless there is a large volume of unemployed resources (labor, plant and equipment) we shall experience in the absence of other offsetting actions a very substantial increase in the price level--the extent depending upon how substantial the initial expenditures were.

There is involved a cumulative process. Why? Well, I think we can see why if we look at the six facets of spending, the six important types of spending which determine the level of employment and the level of prices and incomes in our society, to see what the effect of the original expenditure for military purposes is upon spending in these other sectors. This is my primer in income determination in society. I will run through them hastily and then go back to see what kind of results are induced by a military expenditure program.

The six sectors to which I refer are: (1) other government expenditures, (2) consumers' expenditures, (3) business expenditures for investment purposes, (4) business expenditures for dividends, (5) the net expenditures of foreigners in this country, and (6) the tax receipts of government, which are a special form of consumer or business expenditures.

Other government expenditures.--An original increase in expenditures by the Government for military purposes can hardly be expected to induce any decrease in most other government expenditures. Anyone who analyzes the current budget will soon see that the area of the budget subject to any decrease is relatively small. Of a total budget of 40 billion dollars, by the time we take care of the veterans, service on the debt, expenditures on the foreign-aid programs, and so forth, there is not much left from which savings can be made. But the chances of making savings are not very great. For one thing, I suspect the Budget Bureau is so busy taking care of the military budget it would not have time to exercise increased vigilance in these other sectors. So that other government expenditures, while they may be cut some, are not likely to be cut much unless we have a rigorous program of cutting out public works, and so forth--and the difficulties of cutting them are even greater in a period of mobilization.

Consumers' expenditures.--What happens to consumers' expenditures? The immediate impact of a mobilization program is to increase consumer incomes. At least in my household--and statistics indicate the same is true in many other households--the bulk of current income is respent. So, the immediate impact of a defense program which puts more people to work for more hours, with more pay, is to increase consumers' expenditures for food, clothing, automobiles, television sets, and so forth.

Moreover, if we are faced with a really serious mobilization, there may be a good deal of anticipatory purchasing, of which it is rumored quite a bit was done this summer. All this simply adds fuel to the fire.

Business expenditures for investment purposes.--What happens to these in a mobilization? These divide themselves into two parts: (1) expenditures for inventory and (2) expenditures for plant and equipment. An increased volume of goods produced for the military, unless there is a decline in goods produced for others, means more business. More business generally calls for an increase in the level of inventory. An increase in inventory means an increase in immediate expenditures for inventory purposes over and above replacement needs.

When a serious mobilization is faced, many business firms, in the absence of inventory controls, are led to purchase ahead in anticipation of shortages in order to assure more capacity to supply military or civilian needs.

So far as plant and equipment are concerned, investments which did not look too good before the mobilization seem more promising in the face of a mobilization. So that, if unlimited, many business firms would be led to accelerate their investment programs. Moreover, even if a firm does not anticipate immediate needs, the very fact that a mobilization is assumed to lead to an inflation--and in these days we no longer believe inflation is followed by deflation as we did in 1941--causes him to decide that if he has to make an investment in the next decade, he had better make it now before the cost of construction gets any higher. I would say, then, the incentive for investment by business is to spend more when a major mobilization has been announced.

Business expenditures for dividends.--There is some possibility that business firms facing mobilization, facing the need for liquid reserves for expansion purposes, will be led to curtail their dividends somewhat. But dividends are such a small part of the total business expenditures and of the total expenditures of the country that even this prospect is not likely to be very significant as an offsetting force. As a matter of fact, we have seen that when business anticipates a mobilization and an increase in tax rates, it hurries to declare dividends before the higher taxes become effective. This is a very fine for those who are fortunate enough to have a security or two. Although we may have more current income to spend as a consumer, it is nevertheless simply adding fuel to the fire.

The net expenditures of foreigners in this country.--Foreigners' net expenditures, that is, the excess of their purchases from us over their sales to us, is another factor which in a mobilization might work to alleviate the problem. However, it is a relatively small factor compared to the forces which work in the other direction.

The tax receipts of government.--With an increase in individual and business incomes, the tax receipts of government go up. But unless the tax laws are changed they do not go up as much as the autonomous increase in military expenditures. I do not know what the recent figures would be, but we might expect that something like 25 percent of the increased expenditures would come back to the Government in the form of increased taxes on incomes, property, sales, and so on.

Here we have a series of forces which, in the absence of other action, are on the whole acting in the direction of reenforcing the inflationary trends, and we would expect to get a net increase of expenditures in the country for goods and services in an amount substantially greater than the expenditures of the military itself.

If you have unemployed resources, there may be more output, though generally this greater output can be had only at a somewhat greater price. In the case of food, the immediate impact is usually pretty serious because food supplies are not immediately responsive to increases in consumers' income. It takes a crop year or, in the case of some food items, more than a year to increase substantially the flow of goods to the market.

In the case of many industrial raw materials there is also often an immediate impact upon prices. And quite apart from these increases, if they reach capacity production, the normal laws of supply and demand will raise the prices of many industrial commodities. The net effect of this on wages is perfectly clear. As we approach full employment of our labor force, we get pressures upon wage rates, which increases costs and lead to further increases in prices. In modern societies we have developed mechanisms by which the spendable funds of the military and the Government in general seem unlimited; it must be unlimited. We must get the goods. We have an inexhaustible capacity to pump more money into the economy and to continue the process over and over again. This is the classical traditional process of inflation at work.

But inflation may be initiated in modern societies from a second direction, not simply from an increase in the expenditures (in this case expenditures on military goods) but from another direction. In contemporary society some prices, including wages, and some raw material prices are administratively determined, or at least they are determined by the process of collective bargaining in contrast to an open-market determination. In these circumstances the power resides in certain groups to take the initiative in raising their prices or wages in anticipation, and even in the absence, of an increase in demand for their products. It is perfectly possible in a modern society to start an inflation not simply by increasing government expenditures or even private expenditures, but to start it by increasing cost prices. In the old-fashioned society the old-fashioned economists used to say that if we tried to raise wages above the market level we would get unemployment.

However, one thing is clear about a mobilization program--we are not going to allow the threat of unemployment and a rise in the cost of military goods to curtail the procurement program. We have a monetary system which is responsive. Woe be unto the man who tried to veto the increase in price and costs and the increase in expenditures which the military have to meet in order to get the goods in a mobilization program! We may be sure of one thing--if increased prices come about from cost increases, our monetary authorities are going to be responsive.

So we have two processes at work in contemporary society which may be making for inflation. Even a few years before the current mobilization came about there was some question as to whether these cost-induced rises in prices and consequent inflation were not threatening to become an important new phenomena in peacetime American society.

Well, these are the two directions in which we may find the inflationary process at work. One might elaborate and embroider, or one might try to make statistical estimates of the various forces, but that is not necessary at this point. I need not tell you why this inflationary process is bad. Most of you, I judge, are men with wives. You have budgets. You try to make them balance. You have insurance policies designed to take care of your wives and your children. You can see the effects of this inflationary process upon the value of the currency, upon debtor-creditor relationships, and upon the Federal budget in the future when it is necessary to increase old-age pensions because the cost of living has gone up. The potential effects may change radically and fast the whole class structure of society, as was true in Germany following the First World War. While we do not have to worry about a slow change in class structure, there is a rate of change which may be disruptive.

But there are certain other things which are more directly related to the mobilization program. Perhaps we can let our society in the future be forgotten about, though I doubt it. There is still the effect of inflation upon the flow of production for mobilization purposes. A highly inflationary economy is one in which it is difficult for military procurement officers and business alike to make any realistic estimates of cost. It is a difficult environment in which to encourage businessmen to be efficient in their production. And even if you do not like efficiency for its sake, efficiency is necessary to make sure that we get all the goods that are necessary when we want them for our military program. An inflationary economy increases incentives to inventory accumulation with all the difficulties this raises. It encourages strikes for higher wages, with the interruptions resulting therefrom. Also, an inflationary process creates a great deal of social and political disunity which may easily threaten the whole mobilization program and the progress of society in time of war. These are the sacrifices that are made by those who have been drafted into the military organizations, on the one hand, and we have the distrust of so-called "war profiteers" on the other hand. Anyone who remembers the last mobilization period will recall only too well the pulling and hauling, resulting from the social disunity which came out of the threatened situation.

What are the objectives of this stabilization program? How can we go about it? There is a naive view that the objective of the stabilization program is simply to keep prices from going up. As I have said, we must recognize that stabilization is an adjunct to a mobilization program. A mobilization program is designed to win the war in order to save our society. The end objective, after all, is to save our society. So we do not want to become too much imbued--although as an ex-OPA'er I may say it is very easy to become so imbued--with a subsidiary objective, namely, preventing prices from going up. Although someone has to represent that side rather vigorously, it is important that it be kept in perspective.

I would say the first thing we have to do is to devise a stabilization program which will help divert resources from civilian uses, or from idleness, into the production of military goods or goods essential to the mobilization program. This is a problem of diversion, of allocating resources. And even though the stabilization program may not be designed as the primary program for accomplishing this, the stabilization plan had better not interfere with it.

Now this can be done, on the one hand, by creating incentives for people. We can make it profitable to produce goods that the military want. We can do this in one of two ways: (1) We can give the military enough dollars to outbid the others or (2) we can take the dollars away from the others so the military representatives do not have to bid so high. These are alternative techniques for diverting resources.

This second alternative is being discussed currently under the heading of "indirect controls," which refers to policies of curtailing individual and business expenditures by such devices as cutting down consumer credit, increasing business, and increasing individual taxes. These are the mechanisms by which resources are shaken loose and made available to the military sectors without too large a bribe. This method for diverting resources creates an incentive by making the civilian lines less profitable. The other alternative is simply to give the military sufficient money so that military goods can be made more profitable.

There are other ways of diverting resources, of course. We may use direct action. This direct action may limit the use of certain materials to a list of designated purposes. We may even go so far as to direct a firm to close down its production, for example, of automobiles. We may go further. We may direct a firm to produce designated military items. For example, we may direct the textile or clothing industries to supply a certain proportion of their capacity to the military; or we may direct the slaughter houses to provide a certain proportion of their meat to the quartermaster.

But even when using direct action to effect production, can we afford to have negative price incentives? In other words, can we afford to direct a man to do something under conditions where he makes less than he would have made elsewhere? This is a very serious problem because if we use direct production controls, we almost certainly will be compelled to establish direct price controls.

There are those--and I have a lot of sympathy with this view--who say that in the transitional period, when we need a rapid and large diversion of resources from civilian to military goods, there is something to be said for a slow inflation partly because that "sweetens things up" a bit and helps to avoid pools of unemployment. It encourages voluntary diversion of resources. Incidentally, it also enables us to build up a staff in terms of, administrators, procurement officers, and so on; to train them in the required skills; to acquire their office space, telephones, and so forth--all of which is a time-consuming process.

A second objective, besides the diversion of resources from civilian to military use, is to provide for the maximum output from those resources. This is a question of using all available resources and using them efficiently. Using all resources is not likely to be serious except as a transitional problem. Pools of unemployment may develop, as I am sure you have learned in an earlier section of your course, if certain industries are shut down too rapidly. This is a temporary problem. But it is a very serious one, politically and socially.

The really difficult problem is to try to keep people efficient under conditions of war. One of my friends, who runs a scrap-metal business, the other day told me that not until the threat of the current excess-profits tax arose was he led to reconsider the operation of his business and to decide to discontinue the use of a very expensive grade of paper. He has cut his paper costs, five years after the last war, to about one-half and has reduced himself down to a quality of paper that he thinks is quite adequate for his business.

War is the greatest breeder of inefficiency in industrial management that we have. It is hard to tell whether a person is efficient or inefficient. So, in order to be certain, some business firms tend to hire more employees than are necessary so that they will not be caught short. Business becomes callous in its purchasing policies, its inventory policies, and its production policies. I daresay there are few businessmen who will not quietly admit this to you. And yet, although each business-man, by making sure he has all that is necessary to fill his contract--and a little bit more--seems to be serving our military objectives; he may in fact be limiting the total military program.

Efficiency in the use of labor and materials is a primary objective, it seems to me, of any mobilization program. If I knew how to develop a mobilization program and keep it efficient, I would tell you, but I do not. It is partly a matter of direct action. The worst sorts of waste can be pounced down on by limitation orders in the use of materials, by limiting employment through labor-manpower programs. But it is in part a problem of providing some incentives to efficiency. This problem is one I am sure you will give a good deal of attention to in your discussion of procurement techniques. This is peculiarly a problem which the military alone can solve. The excess-profits tax, renegotiation groups and, I daresay, a good many more in our society are all working against you. Many techniques which are important in stabilization most certainly are not helping to create incentives to efficiency. The job is one resting very heavily upon the military procurement organizations.

Another problem, of course, in a mobilization program is to keep some unity of purpose. The conflicts between various groups, of which I have spoken before, have to be mediated. The fear of the "profiteer" which followed the Nye investigations of the thirties dominated so much of our thinking in the early part of World War II that it created some serious mobilization problems. Unfortunately, the steps usually taken to make sure there is justice between groups, that there is no scandal on the part of business management at home, often turn out to be techniques which interfere with efficiency, like excess-profits taxes, renegotiation, and so on. I am not prejudging these in their entirety, but I do have some feelings on the matter.

Programs of rigorous price control which are also designed to create unity--over-all direct controls--may also result in degrees of inflexibility which create very serious problems.

There are two more purposes. We want to minimize the cost of the war. I have little more to say about this. We want to do this partly because we want to keep the deficit down and partly because the financing of war, if it leads to inflation, is going to create those postwar problems of debtors and creditors, to which I referred.

This problem of postwar debtor-creditor relations is a very interesting one. During the last war we started with the belief of most people that direct price controls would not work over the long run and that increased taxes and other monetary mechanisms were necessary. This, I think, was OPA's attitude, in general. They were simply to be the stopgap. They put their thumb in the dike for a little while and waited for Secretary Morgenthau to catch up. But Secretary Morgenthau never caught up and they were still holding the dike in 1945.

OPA controlled prices reasonably well, I would say. I sat on both sides of this fence, so I think I can consider myself a bit impartial to both.

But when the war was over, the long-run effects of four wartime policies became clear; and here is a very important problem because we have to make some very serious choices as between the short run and the long run. Direct controls were not backed up by fairly rigorous tax and related fiscal policies. This gave us a "suppressed inflation" which Henderson, Bowles, and their cohorts were able to keep under relatively good control until such time as the people would no longer have any more of it and then we got the inflation in the postwar period.

Modern society seems to have found more and more ways in the economic sphere of postponing the solving of its problems. The inflation did not become terribly serious during the war; it came afterward. We have found ways and means of avoiding the immediate impacts, but can we find ways and means of avoiding the long-run impacts?

This leads to the last objective which I would put in the forefront of any stabilization program; namely, we should be trying to preserve and strengthen the institutions for which we are fighting. The methods we use for stabilizing our society if the war or mobilization period is short may not be too important. We may be able to undo some of our practices and attitudes. If, however, we face a period of mobilization for decades, the question of the techniques we use for mobilization and the kind of society we want to live in become the same since we will be living in a mobilized society. If that is the type of society we are going to live in, we need to give more consideration than we have in the past to the question of whether or not we can rid ourselves of our controls afterward.

If we believe that democratic institutions are what we want to preserve and that decentralized decision-making through the market is what we like rather than centrally controlled and directed economic institutions, then we must face quite soon the issue as to whether we can run a mobilization program with a minimum of direct controls and a maximum of indirect controls.

I might make more comments about the problems immediately ahead, but I think I will leave them for the discussion period which is to follow. The problems will be serious; they are in any mobilization period. There are conflicts between interest groups. There is the problem of the long-run vs. short-run objectives. There is a large kit of tools available to do the job and, I daresay, our ingenuity is such that we can devise some new ones, all of which may lead, under favorable circumstances, to the same end.

In this whole problem I am reminded very much of that story of the croquet game in "Alice in Wonderland," which I was reading to my son yesterday afternoon, where they were playing croquet with hedgehogs for balls, flamingos for mallets, and little soldiers who bend over and put their hands on the ground to form the wickets.

Now, Alice found that "it is a very difficult game indeed." The hedgehogs were running off for a fight; the flamingos, when the players got in their position to hit the hedgehogs, twisted their necks around and looked up with a puzzled expression; the little men were playing leapfrog; and the Red Queen off in the distance was yelling, "Off with the players' heads!" I hope the mobilization period will not be so serious as that game.

Thank you.

QUESTION: I wonder if you would care to discuss the alternatives to an excess-profits tax. There was quite a bit of discussion in the newspapers yesterday.

DR. MILLER: I might make a few comments about that. It seems to me the first question is this: Why do we want the excess-profits tax? And second, what is the matter with it?

I suppose we want the excess-profits tax because we are afraid some business firms will make too much money--and I think they will, for pretty good reasons.

The trouble with the excess-profits tax, at least as it has been administered in the past, as I understand it, is that it puts a great damper upon the small expanding firms. On the other hand, as a matter of national policy we are trying to help small people grow bigger and to prevent big people from growing still bigger. I take it this is an important policy consideration in the back of many people's minds.

Here we have a conflict between our antitrust laws and our fear of war profiteering. It is in those terms that I think if we could convince the public on a program of increasing the basic corporate tax to whatever level is necessary, we could collect as much money and we would not have the resulting disadvantageous effects on incentives to expansion.

I am sorry to say I do not know what the percentages would be, but I would not see any reason why we could not work in terms of an increased general corporate tax. I suppose there is only one reservation I have on this and that is connected with the fact that large increases in profits for firms arise in wartime from one of two principal sources: First, a firm may do more business. We certainly should not discourage industry for this, particularly small business. Second, in so far as firms do military business, they may have taken advantage of the contracting officer. My solution for this situation is to improve our procurement. I think it can be done.

But I think the big loophole which makes many people have reservations about giving up an excess-profits tax is this fear that some fellow will take advantage of the war situation and get more than others. If that is because he has expanded his business, why not? If it is because he took advantage of the prime contractor or of the contracting officer, then I take it that is a problem of putting our contracting and purchasing procedures in order.

QUESTION: In connection with the excess-profits tax, what will its effect be on management efficiency? Will it induce or decrease efficiency?

DR. MILLER: You are reducing the financial incentive with the excess-profits tax. And, by and large, it seems to me you are reducing one particularly desirable incentive--the incentive to expand. It is in that direction that I think its greatest disadvantage lies. The increment of expansion is made less profitable. I do not think it helps incentives; yet, it can hurt them.

I don't think the excess-profits tax is the greatest offender so far as efficiency is concerned; on the other hand, it certainly does not help efficiency.

QUESTION: You have given us a very interesting thought there about decentralizing our organization, and so forth, in order to maintain and preserve our free institutions in a prolonged period of semimobilization.

Now, it seems to me we have to avoid kidding ourselves on this. Everything we did in the way of mobilization in World War II, or are planning to do now, seems to be in the direction of more and more complete centralization of our wartime economy. Have you anything specific in mind that would reverse that trend, any alternative process that would meet those objectives without centralization?

DR. MILLER: You have to make choices on this. If I were reasonably certain of a major war by next summer, I would say, "Put in the direct controls because we are going to need them."

If you told me we are going to have a military budget of--I'll pick a figure out of the air--around 50 billion dollars for the next 10 years--it may be 70 billion or it may be 30 billion--I would say, "Let's put on consumer and other credit controls. Let's have higher taxes. Let's curtail unnecessary government expenditures. We're going to have to make sacrifices."

Consumer-credit controls will not solve the whole problem. If we raise taxes--I am not talking of 5 billion; I am talking of 15, 20, or 30 billion dollars in taxes, individual, corporate, or wherever you can get them--that at least would help. But it takes time to pull these up. These are the principal indirect controls, which are becoming quite unfashionable, I confess, but they are most compatible with maintaining decentralized decisions.

I would certainly hate to face the problems that a good friend of mine faced during the last war. It was her job to calculate the margins for canned fruits, vegetables, and so forth. She calculated the differential between pears and peaches. Then there was the problem of mixed fruit, which is made by cutting up pears and peaches with machinery that is quite scarce. Well, she made an error; there wasn't time in which to correct it. So it turned out that it was more profitable to dice the fruit and have mixed fruit. It was more profitable to cart this slicing machine from coast to coast, dicing up the fruit. True, we had few cans of pears or peaches, but we had plenty of mixed fruit.

Now, when we have to make these decisions, we will always make serious errors; that is inevitable. I would like to minimize them if we are going to have a long-drawn-out mobilization crisis in our society. If we use taxes as a principal line of defense, there is a certain amount of choice as to how much we shall put on corporate enterprises and how much on individuals. A 50-billion-dollar military budget is going to hit them all. It is going to hit them hard and continuously.

It may be we should think of our tax system in terms of Lord Keynes' proposals during the recent war and have part of the taxes remitted in the form of bonds negotiable at the discretion of a local rationing board for hardship cases or when at the discretion of the Government the situation warrants. This would provide a cushion of liquidity for the postwar depression, greater liquid assets when the war is over, and take some of the sting out of personal taxes. That is one way of doing it.

QUESTION: In regard to the excess-profits tax, what is the logic of applying it only to corporate increases and not applying the same tax also to individual labor increases since they are the ones who normally gain the most?

DR. MILLER: Well, I suppose that the logic--at least the reasoning; let us not talk about the logic--is that wages go to people; profits go to either things or to people who have too much anyway. Corporate income taxes of any sort eventually come out of certain groups of people. It so happens that people seem to create much less difficulty if we tax their corporations than if we tax them individually. I think a good case could be made for limiting all corporate income taxes of any sort, taking it from the people who earn the income.

That is perhaps no answer to your question, but I think you have to see it is a politically determined factor. Corporations are much more vulnerable. Moreover, I should point out that we do have graduated income taxes on individuals.

QUESTION: In all this talk about excess-profits taxes I understand that only a very small percentage of the number of corporations engaged in war production actually paid excess-profits taxes during the last war. Do you have any figures on how extensively the tax was applied?

DR. MILLER: I confess that I do not. I have heard the figure, but I have not looked at those figures recently enough to know; I'm sorry.

QUESTION: You recommended that in order to keep profits down we should use an excess-profits tax; also that the military procurement people should assume more discretion.

Now it seems to me we have several safeguards backing up the military procurement officer's decision--renegotiation, redetermination, and so on. However, we have no control over the nonmilitary items which tend to spiral completely out of proportion during a period of mobilization. Do you favor price control, for instance, for those sorts of items?

DR. MILLER: There are two things you can say about that. So far as military goods and their subcontracted components are concerned, that is a difficult problem of procurement. But so far as you are talking about goods in the purely civilian sector of the economy, we can do one of two things: Try to cut down the demand for them by the indirect methods, that is, take enough money away from each of us through taxes, voluntary savings programs, and so forth. It may be necessary, during the transition in order to keep things from getting out of control before the indirect controls became effective, to use some direct controls. But, essentially, if we want to preserve decentralized decision-making, then we must depend upon the indirect methods. During the last war, we left everybody sitting around with so much money that it was always threatening to come forward into the markets and raise prices. Letting people sit around with some extra money in their pockets may be a good thing--there are certainly some advantages to that--but you have to be sure they don't use it.

The other alternative is price control. If we have comprehensive rationing too, they cannot use their extra funds unless they violate the law. But then we must have an enforcement system to make sure that there are no violations. How long could we run a rationing system in our society in this country--where our wives have to go down to the store with tickets and stand in long lines, and so on, and where they have more money burning holes in their pockets than there are goods to be bought--without the existence of a major shooting war, before the system itself broke down, is hard to say.

QUESTION: Would you give us a few words on the use of the incentive type of contract to increase business efficiency?

DR. MILLER: In theory it ought to be pretty good. I think the Navy officers among you ought to know more about it than I do if you have been connected with procurement recently.

If you can make a reasonably good estimate of costs, if you have a reasonably good cost accounting system in the firm, if the contracting officer and the contractor trust each other, and, finally, if the contract is a reasonably large one, then some sort of incentive type contract, which provides a target cost and profit and also provides that if costs go below that target level the dollar profits will be increased and if costs go above it they will be less, should provide some sort of incentive to management. But let us be clear about one thing: That incentive contracts may break down also if there are redetermination clauses in the incentive contract. If redetermination comes too close to the end of the life of the contract, then the incentive feature may be taken out of the contract.

But certainly I think there is a place in some of our procurement, where we have a relatively large contract, where the cost of a particular contract can be segregated on the company's books, especially where the Government trusts the contractor and he in turn, trusts the contracting officer. I think you can essentially say to such a contractor, "We'll pay you so many dollars if the cost is so much. We'll pay you more if the cost is less." You really have a sliding-fee system for corporate management. I think we ought to be able to make that work.

QUESTION: Do you think the public would support a policy of taxing for the purpose of reducing purchasing power?

DR. MILLER: I do not know. I take it that the public is subject to being led; however, it may not be.

During the last war the Congress continuously objected to increasing taxes adequately. Not only the Congress but also the Secretary of the Treasury and his advisers evidently took so much pride in their voluntary savings program--for which they are to be commended--that they were afraid taxes would cut down the ability of the people to buy bonds voluntarily.

I would hope we could be more effective--let me put it that way--if we really explained the problem. I have a great deal of faith in the American people if we tell the story to them. I think the greatest danger is that Leon Henderson and Chester Bowles and their staffs did such a splendid and successful job during the last war that we are apt to depend too much on their techniques again. The other story has not been told enough. Of course, the only way to find out is to try.

QUESTION: I have a question which relates to maintaining incentives for production efficiency. It is more or less a question of this nature: There are certain large determinations and decisions that have to be made to show us how we will do things. For instance, in the last war mobilization, in construction work, I saw the comparison between fixed-fee construction as opposed to the lump-sum type. I even saw instances during that period where we cut the price to less than one-half. One particular item I am thinking of in general went from about $5,000 per unit prewar to around $20,000 or $22,000 during the war. What I have heard about the shipyards indicates the same surplus of people working on the job, the same lack of management efficiency, which ultimately increases the cost. Of course, the question there was whether to use the lump-sum type of contract, take time to do the job, or else get the job started without much preplanning.

There ought to be a decision made, it seems to me, by some rather high-level government agency. What I know of it, which is not too much, it would seem to me it should be made by the Secretary of Defense. Could you tell us from your experience, at least in your opinion, who should make that type of decision?

DR. MILLER: I would suppose that is a decision which rests with the Munitions Board, although I certainly do not want to create a problem in this august body which knows more than I about current divisions of responsibility and the lines of authority.

Obviously, each contracting officer has to be given some flexibility. (I assume you refer to cost-plus-fixed-fee contracts, not the cost-plus-percentage-of-cost contracts which have been outlawed since World War I.) The cost-plus-fixed-fee contract is a device which, I suppose, we are going to have to use. I see certain reasons for using it. I know there was a tendency in the last war to use the CPFF contract too much for production purposes.

I would suppose the place to make the decision in a possible future war is in the Munitions Board where the three services presumably get together on broad policy problems with respect to procurement. It is conceivable, of course, that pressure would be brought from the National Security Resources Board and the Economic Stabilization Agency, which also have an interest in this whole question. How the lines of authority between these civilian control agencies and the military establishment will be drawn on another occasion, I am not too certain. In the last war, the Office of Production Management or WPB tried to discourage the Services from using CPFF contracts and then, having put their men into the services, tried, through them, to minimize the use of the CPFF contracts.

Assuming it is agreed that there are appropriate conditions for its use, I would not see why its use could not be wisely left to the discretion of the contracting officer, within broad limits determined by the Munitions Board.

The next thing is to make sure your contracting officer and his assistants are aware of potential abuses. I might say in that connection that some of my contracting officer friends in the last war will testify--and I take their judgment seriously--that in certain cases they have seen cost-plus-fixed-fee contracts which they were convinced were administered much more efficiently than fixed-price contracts. This may reflect differences in the wisdom of the persons handling the various contract. It depends a great deal on the contractor's incentive to keep things efficient. Or it may be a reflection of the fact that even a fixed-price contract, if you redetermine it late and loose enough, may be only a highly disguised CPFF contract.

QUESTION: Sir, what are your thoughts on how we should handle the inflationary effect of the tremendous quantity of war bonds that will be maturing in the next two or three years?

DR. MILLER: Well, that is part of the general inflationary problem--more liquid assets going into people's hands.

You might make it advantageous for them to reinvest. You might make a special reconversion bond with very special incentives to a person so he would commit himself for another 10 years. In our present system you can have all sorts of specially tailored bonds. You might do something of that sort. Otherwise, that simply represents part of the liquid assets which, if the inflation is serious, people will most certainly want to get rid of as soon as they get those dollars. Then, if you get the inflation under control, whether by direct or indirect means, it may be that you can get them to convert their "E" bonds into other bonds at maturity. They may be willing to reinvest their bonds in new government bonds unless they have lost confidence in the willingness and ability of the stabilization authorities.

MR. MUNCY: We will adjourn now. But before we do, I thank you most sincerely, on behalf of the faculty and class, for your very excellent opening of our Economic Stabilization Course.

Thank you.

(18 Jan 1951--650)S.