

# RESTRICTED

ADJUSTING BUSINESS TO WAR

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15 December 1950

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Mr. Leo Cherne, Executive Secretary of the Research Institute of America, was born on 8 September 1912 in New York City. He is a graduate of New York University and the New York Law School. Before he reached the age of 21 he was both newspaperman and member of the bar. For several years he was economic analyst and commentator for the Mutual Broadcasting System. From 1940-1943 he was a member of the faculty of the Georgetown University School of Foreign Service. During the period 1939-1943 he lectured at the Army Industrial College. Since 1945 he has been a faculty member of the New School for Social Research in New York; his current course at the school is called the Anatomy of Authority. In 1941 he wrote a study for the War Department on English and German economic mobilization; he has also written a study on the economic problems to be involved in the reoccupation in the Pacific Islands. In 1943 he was a member of the Board of Economic Warfare. At the joint request of General MacArthur and the War Department, he went to Tokyo in April 1946 to prepare a program for the revision of the Japanese tax and fiscal structure. His writings include: "Adjusting Your Business to War," 1939; "M-day and What It Means To You," 1940; "Your Business Goes to War," 1943; and "The Rest of Your Life," 1945. His articles have appeared in the "Saturday Evening Post," "Colliers," "Look," "Coronet," "This Week," "Liberty," "Harpers," and the "Atlantic Monthly."

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GENERAL HOLMAN: What happens when, in a national crisis, business and industry must go all out to support the military effort? What adjustments must be made at the market place and in the factory? How can the hard-boiled, highly competitive American businessman best serve his country and operate his business in a war economy?

Questions like these are not easy to answer, but nevertheless the right answers must be found. And they are just as important to the man in uniform as they are to the businessman.

We turn today to Mr. Leo M. Cherne to help us in our research. We are in good hands because that is his profession—economic research and adviser to business and industry. As Executive Secretary of the Research Institute of America, with offices in New York, Chicago, San Francisco, and Washington, Mr. Cherne and his research staff read the signs of the times and publish their findings and advice to thousands of business subscribers.

Mr. Cherne has a special interest in the problems of economic mobilization which dates back as early as 1938. With the signs of World War II clearly visible to him, he felt it his duty to do all in his power to alert businessmen to changing conditions. The result has been a keen and active interest in conversion and reconversion problems ever since. In this work Mr. Cherne has become well acquainted with the Industrial College and has rendered valuable assistance to our efforts. He has served the Government on many occasions as a consultant to the various departments and war agencies and through their publication of special reports.

I take great pleasure in presenting Mr. Leo M. Cherne.

MR. CHERNE: Gentlemen, it is a privilege to lecture before the Industrial College again. In a very real sense this is a homecoming for me. As with all homecomings, a mixture of pleasantness and of nostalgia makes this an occasion of more than usual significance for me. The events of recent weeks unhappily make so many of our problems reminiscent of those which were previously approached—some were solved; many were confronted with the belief during previous days that we might never confront them again.

Though we are here concerned with the problem of economic mobilization, I would like the privilege of first stating several general principles concerning the international danger in which we find ourselves, because I believe a solution of the economic problems, particularly those which confront business, may be assisted by the articulation of the basic challenges we face.

One problem which concerns the business community, for example, flows from the fact that free men find it difficult to believe that other men want war. As a consequence, in a free society, businessmen are no more ready than any other individuals within the community to assume that the threat of war is real—until the very last moment. Yet we must face the threat of war now; and I doubt that there are many in the United States who question the very real existence of that possibility. In time of crisis free men are stirred to action; and we will in the days to come—very brief days now—see many aspects of that action, some intelligent, some not quite so intelligent; some helpful, and some harmful.

When Stalin said, "What else is our country, if not the base of world revolution?" he was describing the intentions of his state as graphically as did Hitler in "Mein Kampf." The Stalinist conspiracy tolerates only those who accept the complete discipline of the Soviet Union. From the days in 1929, when the American Communist Party pleaded with the Politburo to be permitted a measure of "exceptionalism," to the days in 1949 when Tito asserted Yugoslavia's right to a limited amount of national aspiration, the Soviet Union has moved relentlessly against its most fervent adherents at the first suspicion of the heresy of independence.

We now know that the Soviets want to dominate the world militarily as well as politically. This imperialism will use every means to enlarge the territory over which it asserts its iron discipline. The world's most powerful police state has now added war, waged by its satellites, to its crimes of terrorism, exile, forced confession, character assassination, the great lie, slave labor camps, blackmail, political murder, international assassination, and induced starvation.

Now we know that Stalin has taken another weapon from the arsenal of all power-intoxicated dictators—flagrant and open war waged with the blood of his satellites. In language too clear to be misunderstood, Soviet diplomacy rests on the tactics of intervention through civil war, conquest under the pretense of liberation, and aggression in the name of peace.

The danger of war has simplified many of the decisions we must make. We must bind together the nations which oppose Soviet aggression. Any criticism of a friendly state or its criticism of us, whatever differences of policy may exist between us, must not obscure the need for our cooperation. Anyone in our own country or abroad who acts to divide us from our allies, whatever his motive, however persuasive his argumentation, aids only the Soviet Union. To destroy unity is to divide the world into morsels for the hungry aggressor.

We must aid all who will help us. Aid to a threatened victim of Soviet aggression can no longer be contingent upon our approval of his habits. When the police in our society defend us against the gangster's attack, we are not first asked to prove our own impeccability. The world

is no longer a debating society; nor is it, unhappily, a court of equity in which all must enter with clean hands.

Quite obviously, we must immediately construct a military apparatus such as we do not have today and a civilian defense such as we do not have today to meet the possibility of the most devastating war our world has ever suffered.

We must now, and without a moment's further delay, strengthen every aspect of America's economic life. We see no prospect for peace with the Soviet Union in the years ahead. We see merely the possibility of avoiding war. Therefore, our industrial apparatus must be so expanded and strengthened that it can provide the weapons to build military might while satisfying the basic needs of a civilian community.

In my judgment the following five principles must govern the economic action enjoined upon us by events:

1. Convert whatever industry is required to make arms, regardless of difficulty and dislocation.
2. Expand our inadequate resources, whatever the temporary deprivation.
3. Control the inflation that is here, with whatever restraint of our enjoyment and our consumption is entailed by courageous, adequate action.
4. Pay the giant cost of these urgent undertakings, whatever the sacrifice to our own standard of living.
5. Expand our available military manpower, whatever the wrench to the heart of America.

No concern about transition unemployment, of injured business, disrupted homes, a diminished standard of living, curtailed profits, or inhibited labor—no concern must stop our march toward strength so long as the alternative is a war that destroys all values.

In a civilian community it is normal for us to seek painless ways toward any responsibility. That is the normal response of a free man. It is not always pleasant. It is not always dignified or responsible behavior; it is the normal behavior. But there is no painless way toward peace today, no comfortable way toward military and diplomatic strength. No convenient scapegoat can shorten the road. No impatience with an ally alters the need for his support. No one group can remain immune from the difficulties we confront at home.

A number of economic difficulties follow from these general principles—two stand out most prominently. They exist because we have never had parallels for them before. I must confess that in the days

when I previously preoccupied myself with the problems of industrial mobilization, prior to Pearl Harbor, it was inconceivable that anyone would even give thought to the existence of these problems. Yet, in my judgment they are the two pivotal problems today, and no answers previously reached in our earlier planning suffice, in my judgment, to cope with these new central difficulties.

The first is the national uncertainty as to the nature of the period we are entering. In our past experience, industrial mobilization planning and all the actions designed to make maximum use of our economic resources were conditioned upon the existence of war. Now, though war may indeed occur in the spring of 1951, we cannot be sure but that it will not come until 1961 or perhaps later—or even never. In a real sense, the more successful we are in our military and diplomatic policy, the longer we shall stave off that war. The first problem therefore is the determination and the articulation of policies designed for a question mark. The question mark is, "What kind of a period are we entering?"

The second problem flows from the first one. If we do stave off direct war between the United States and the Soviet Union for any period of years, we face substantial intervals of time in which there will be no foreign battlefields to discipline us, no daily urgent headlines to stimulate our industrial mobilization, no casualties to compel the sacrifice required by an extended interval of rearmament.

As an illustration: In the week prior to the Chinese intervention in the Korean War the great bulk of the American community was already, though the war was only five months old, in a mood to return to the accustomed ways of business. Any possibility of imposing price and wage controls the week prior to the Chinese intervention was just out of the question politically and psychologically within this community. Indeed, Congress seemed well on its way to forgetting its specific promise to hammer out an excess profits tax.

It boils down to one question that dominates business response today: "What is it we are planning for?"

So long as there remains any real possibility that active war between the United States and the Soviet Union may occur within the next 24 months, it seems urgent that we develop the maximum firepower to meet any sudden contingency. Thus, where a month ago there was hesitation to induce priorities unemployment as a result of too drastic a change-over from peace to war production, there can be no restraint now on the ground of injury to our civilian community. It was less than a month ago that Walter Reuther made quite an eloquent case against the credit restraints on the automobile industry and voiced fears of priorities unemployment. That language of a month ago has no place now—and the full power of leadership must be applied to make this crystal clear to the entire community. The change-over to defense must be accomplished, and accomplished in minimal time, whatever pain to the community is involved.

In the stockpiling of strategic materials, in the rapid production of armament, and in the stepping up of the draft, I believe that we must act as though war will occur—not may occur, but will occur—within an arbitrarily short period. If we faced solely the short-term problem, or if there were the certainty of war within the months immediately ahead, this would suffice. Unfortunately, however, the very measures which serve quick rearmament and the rapid growth of military strength can debilitate us in the long run.

We have the choice, for example, of using our limited quantity of steel for tanks or of using a certain portion for expansion of steel- and aluminum-making capacities. It is true that we will require this larger capacity if war is avoided for a period of years. Yet, it is also true that we cannot sacrifice immediate rearmament in order to secure it.

This leaves us with the unhappy alternative—which few in business and almost none in government are ready to accept today—of quickly cutting into our civilian consumption deeply enough to free enough of the metals both to build rapidly military strength and to expand capacity. In the face of this twofold need, we seem called upon to almost double the civilian slash that would be necessary if war were to begin within the next 12 months.

Now, there are obvious difficulties inherent in this task. It involves a degree of governmental restraint on the consumption and normal habits of the community probably greater than required at the peak of our effort during World War II. It would require the use of direct and indirect controls so drastic that compliance with them in the absence of actual war would be difficult to achieve for any extended period. This very difficulty is one of the reasons I emphasize this problem—because we are beginning to face up to it partially if not fully; and a sharp increase in all inflationary pressures will appear and grow more critical.

The indirect methods of combatting inflation which we have already employed, and some that are projected ahead—such as increased taxation—will prove inadequate to restrain a further rise in prices and wages. This means that, even without the further diversion of materials for expansion of basic industry, we cannot long avoid general wage and price controls in addition to sharply increased taxation and credit controls.

Unfortunately, however, these direct controls are difficult in wartime and will deteriorate rapidly in the absence of the discipline of the battlefield. Unfortunately, too, these direct restraints apply only to symptoms; they are not cures. The only cure to inflation is to expand production or reduce consumption to bring supply and demand into approximate harmony.

Here, then, is one of the major objectives of a program of ambitious expansion of basic industry. If, because of the urge of immediate rearmament we sacrifice the enlargement of our capacity for steel, aluminum, and

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the other metals and materials, we will find ourselves two or three years hence with no greater capacity to meet civilian needs than we have now. The bigger the snake, the more tail he can swallow.

There is one point I would impress on the businessman and the community at large: That wage and price controls will deteriorate almost from the moment of imposition in the absence of war, and even in the presence of war. The only difference war makes is that the controls last longer, but they diminish in any case. The only means of keeping a balance is to follow a course of rearmament coupled with expansion, so that the total of our capacity in 24 or 36 months is capable of meeting both the armament needs of our military and the repressed consumption needs of our civilian community.

In oversimplified terms, this policy contemplates guns with a very sharp reduction of butter for a number of months in order to meet the need for both more guns and more butter subsequently. The nature of the external danger is such that we cannot and must not diminish any portion of the military program to satisfy either the desire for expansion or the appetites of the peacetime community.

I am urging, therefore, the following priority in the consumption of scarce materials and scarce labor: first, military needs; second, the requirements for large expansion of basic industry; and third, civilian needs. In giving second priority to expansion it is important not to minimize the military role of expanded industry. If war is delayed for several years, we will face a Soviet Union and a total satellite economy stronger than it is today. And bear in mind that neither the Soviet Union nor its satellites face difficulties comparable to ours in the inhibiting of civilian consumption for the purposes of armament and expansion.

It is important, too, for any ultimate contest with the Soviet Union, that we do not settle on the degree of military effectiveness of those weapons ready to be produced today. Only expanded capacities can in the future enable us to meet the then current military needs while leaving a measure of industry free to experiment, improve, invent, and retain the American eminence in the technology of war. This, incidentally, is one of the problems that businessmen anticipate with greater clarity than is true of any in the military or civilian agencies of government.

The businessman understands the needs involved in improving the technology of his production. He understands, too, how easily the initiative can be destroyed by ineffective or undesirable government policy.

When war occurs, all nations are then ready to sacrifice any further dramatic advances in the technology of weapons. But until war occurs, we must take no step which diminishes our capacity to improve.

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In every phase of technology, science, and production our preparation must enable us to meet techniques, experiences, weapons, and disaster such as we did not experience in World War II. May I inject at this point another reason for expanded capacity, which I emphasize but do not place prior to the satisfaction of military needs. In the past almost all our planning has been in terms of our industry pretty much "as is." I forget who it was who said that "The victorious nation prepares in terms of the war it has won; the defeated nation prepares in terms of the war it wishes to win." It is quite understandable that so much of our preparation contemplates that we shall remain as immune from destruction of industry as we have been in the past. Yet, this is a fantastic assumption. If our industry is just adequate to meet military needs in terms of past experience, it is completely inadequate to meet the military needs of the war we face. As a consequence, every aspect of industrial mobilization, all the restraints applied by government, all the habits of industry and labor, must be re-examined in the framework of continuing improvement, technology, and expansion.

In this same direction, I think it is also inescapable that a far greater emphasis on subcontracting must take place than has thus far characterized mobilization. In an extended contact with businessmen of all types within the last 60 days, I have heard one most serious criticism of the degree of rearmament we have already projected.

The conviction is uniform throughout the entire country that there is no business except for the prime contractor. The conviction is uniform throughout the country that this time, unlike the somewhat meager efforts last time, there is no room for the small manufacturer; that there are no contracts for him and no subcontracts he can secure. It is urgent that the smaller industrial establishments remain healthy and able to make a dynamic contribution to the Nation's production and ingenuity. The normal tendency of any armament program is to extend the concentration of industry. That is the normal tendency and, I am afraid, an inescapable one. The nature of any armament economy is to speed up the degree of concentration of the industry in that economy. It takes aggressive action to even retard that trend. Thus far there is not only no retarding action to retard that trend, but the nature of the rearmament program hastens it.

As a matter of fact, if business had an awareness of the degree to which this is true, there would really be h--- raised in Washington.

A key deficiency here is that the defense agencies have very little notion of how much capacity exists. There is even less idea of how much capacity we need. I should have imagined that a board concerned with the security resources of the country would have had as its primary responsibility the determination of the resources which exist. I know of no such determination.

An understanding of our future needs and capacity will yield a more precise way of translating the projected arms requirements into the necessary bills of materials. Five hundred Sherman tanks remain a meaningless obligation upon the Nation (and even more meaningless, incidentally, to businessmen) until translated into x tons of steel, y pounds of copper, z hours of skilled labor. Those z hours of skilled labor may ultimately prove the most troublesome. New steel facilities can be built. New sources of manganese may be explored. Additional aluminum may be processed. But labor may prove the most inflexible of our shortages.

The answers must be found not only in the hours worked and in the degree of output within those hours. We must actively explore the means of employing all available unused manpower both within this country and in our more immediate neighboring countries.

All this will require a degree of planning, clarity, and consistency such as has, unhappily, not been evident here in Washington.

May I make it clear that I do not like to criticize the Government; quite the contrary. I have over the period of the last 15 years developed very considerable impatience with the easy abuse that we heap upon the underpaid servant of society. I would hesitate publicly to state some of the criticisms which I extend to you; and I wouldn't extend them readily if I knew any other way of approaching the problems which confront the businessman and the problems which confront the national security.

For example, Red Chinese military units had been fighting in Korea for four weeks and the rout of our troops under the overwhelming onslaught was 10 days old when one of the agencies in Washington took the following action: It delayed by a full two months the effectiveness of the 35 percent reduction in civilian use of aluminum, and it extended to as much as 120 days the lead time which steel companies are entitled to before accepting defense orders for certain types of products. I emphasize, this action was not taken prior to the Chinese intervention; it was taken after the defeat at the hands of the Chinese. In other words, at the very time when military events seemed to scream for hurried mobilization, there were those in this community who were still moving in the accustomed groove and pussyfooting to delay the unpleasant effects on the domestic economy. And I sympathize with the pressures they faced, because I know that when the original order was issued an avalanche of protests descended on the particular agency; and I know how easy it is to accede to such protest.

On the very same day—this was within the last two weeks—three of Washington's top officials testified before the same committee on price and wage controls. These three are in the same agency. They represent a chain of command. These three men are expected to work in close unison in implementing defense measures at home. Yet, one took a very firm stand in favor of exhausting all voluntary restraints before imposing

any mandatory curbs on prices. The second insisted with equal emphasis that voluntary control simply would not work and that we had better get in line for compulsory measures. The third, finally, took a firm stand in favor of "a rigid system of voluntary restraints"—whatever that may be.

Now, material shortages of one kind or another have been haunting us for almost six months. The blunt truth is that the medicine administered by Washington to date has been both too weak and of the wrong kind to cure or permanently relieve our materials headache.

Early in October a one-band priority system—DO ratings—was inaugurated with a great deal of fanfare. There were to be none of the complications attendant upon World War II priorities and allocations. The only ones entitled to priority assistance were to be the military and the Atomic Energy Commission; all their orders were to enjoy equally preferred status on suppliers' books. This ideal system lasted something less than three weeks. By that time the National Production Authority found it necessary to break through with so-called special directives in order to assist one civilian program (steel for railroad freight cars). Since then, Great Lakes cargo vessels have been added as a preferred civilian activity, and there are several more waiting in line for compulsory government allotments of steel. In addition, spot or emergency directives are beginning to come into use, such as an order issued very recently requiring the immediate shipment of a substantial number of electronic tubes for civilian aviation. This is the beginning of the breakdown of the one-band priority system and of the extension of preference ratings to civilian activities.

Now, one of the unhappy things about being a human being is that all humans insist on making their own mistakes. But must we insist upon making every mistake that has been made before when the problems and solutions are not really novel?

The truth, evident even at the time when the one-band priority was instituted, is, of course, that such a system can work only so long as the military bite of civilian supplies is very modest and so long as the urgency of military orders isn't particularly great. Neither of those assumptions is true.

Nor will there be much choice of instruments to replace the present priority system. Temporarily, the agencies may continue to improvise with special directives and authorizations to recognize the varying urgency of civilian needs. Before many months, however, there will be the imperative necessity to dole out at least key materials like steel, aluminum, copper, and so on, according to an over-all plan. Such a plan would have to be based on detailed figures of supply, civilian as well as military—requirements pretty much along the lines of the Controlled Materials Plan of World War II.

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It will be interesting to see how many separate experiments or how many separate approaches will be taken before the Controlled Materials Plan is used once again, as it will be.

Along with stricter priorities and allocations must come tighter inventory controls. When NPA Regulation No. 1 was issued, with its vague standard of "minimum practicable working inventory," it was easy to foresee that it couldn't last. Actually, even within these first few weeks, a number of tight materials have been put under stricter inventory restrictions; for example, rubber and cobalt 20 days, nickel 30 days, zinc 45 days, aluminum and copper 60 days. Correspondence and frantic phone calls which we receive at the Research Institute from our member companies indicate that these tighter inventory limits are already imposing hardships in some cases, particularly where firms traditionally had to maintain a wide selection of stock to fill fast-changing consumer requirements.

Now, a full week or more after the Chinese all-out intervention in Korea had revealed the true character of the present conflict, the NPA reversed its previous decision on aluminum and delayed the impact of even the limited restrictions by a full 60 days. At the same time, NPA also came out with its copper cutbacks at 15 percent—just about one-third of the 45 percent cut originally suggested.

Military events have far outdistanced this type of thinking. Washington as well as industry and labor will have to fall in step. The first move in this direction must be abolition or drastic shortening of the transition period now allowed in all limitation orders. The aluminum people, for example, were given almost a full two months before cutting back to 80 percent of their base period use, and another 60 days before settling down to the now contemplated maximum cut of 35 percent of their original use. This is a luxury which we can no longer permit ourselves. Please by management and labor that these controls will cause priority unemployment will just have to be shrugged off. There is no alternative. Incidentally, to those of you who find yourselves in any of the defense agencies and receive the urgent pleas of businessmen or labor leaders that the particular action destroys the enterprise or the labor union—may I suggest that they weather a refusal of relief quite remarkably. The only question is whether you will weather it quite as well.

Future limitation orders will have to go beyond anything that has thus far been contemplated despite the secrecy surrounding our stockpiling program. One of the reasons for secrecy is that some of the stockpiles are not stockpiles. It is pretty generally known that our inventories of many strategic materials are far short of stated needs. Certainly they are totally inadequate to meet the contingency of a world war. Military orders for which money has already been appropriated, plus the request currently pending before Congress, guarantee that some time next year the military will be taking a substantial share of these strategic materials for its current needs. The logical conclusion, therefore,

is that the next few months may be the only interval in which to set aside substantial quantities of critical materials for the national stockpile. My rough guess is that, if we wait six months more, there will be no opportunity to stockpile; that all available supplies and the maximum tightening of civilian consumption will be required then solely to meet current military needs, with no possibility of stockpiling.

Civilian cutbacks will also have to be modified in another important respect. For the sake of simplicity--which in the early stages of mobilization has been something of an idol here in Washington--limitations on the use of critical materials have been imposed straight across the board. Every manufacturer using aluminum is cut by 35 percent, whatever he makes. In other words, the manufacturer of vital machinery for the Army or for our power plants is compelled to cut his copper use back by precisely the same percentage as the firm which manufactures juke boxes or electrical toys. As a matter of fact, in the absence of price controls, the juke box manufacturer is left free to outbid the machinery maker for the available short supply of copper. Clearly this condition cannot be permitted to continue when mobilization really takes hold. Well before 1951 is over, probably during the first half of this coming year, civilian cutbacks will have to be differentiated by the essentiality of the end product. That is when the outcry will be sharp, because such measures do indeed affect the continuation of the particular enterprise. When you say "No metal toys" you affect a whole ramification of industry, not only the manufacturer of the toy, but the department stores that sell them, the jobbers who distribute them, and even the children who enjoy them. All are similarly hit by the same governmental action. Availability of materials and essentiality of end products must thus be among the chief factors determining each industry's economic outlook in 1951.

The next few weeks will, unfortunately, in no way be representative of what mobilization will look like once it hits its stride. Civilian cutbacks will compel some layoffs; the resultant unemployment will serve at least as a partial offset to the tightening of labor markets in key centers of heavy industry, such as Detroit and some west coast cities. Beyond this transition interval, however, I have already referred to the fact that there will be a period of long and acute manpower shortage. Particularly in skilled categories which require a considerable period of training, there won't be enough applicants to fill the openings in defense production.

The only feasible solution, no matter how unpalatable it may be, is to use every means at our disposal to accomplish the transfer of scarce workers into defense jobs. Short of all-out war, we will try to avoid compulsory labor draft and government assignment to specific jobs. Still, just about every other means must be used. Government employment offices must exert strong pressure on both employer and employee to induce less essential civilian industries to give up some of their skilled manpower to defense plants.

An effective instrument here is the limitation of the use of scarce materials by nonessential industry--which otherwise will continue to find the manpower it requires. Regular civilian shops must be left to shift for themselves and must increasingly depend on green crews, a substantial portion of which will be composed of women, older workers, and newcomers to the labor force. The effects of this in terms of efficiency, cost of training and retraining, high turnover, and general employee attitude can only be guessed at. Eventually there may have to be outright curtailment of certain elements of nonessential activity.

America faces a test it has never before experienced. The degree of rearmament to which we have committed ourselves makes it impossible that we shall enjoy a peacetime economy as long as armament remains the only hope for peace in the world, and in my judgment this means for the balance of our lives.

We face a difficult problem of national psychology precisely because this road seems to have no turning. If we were in a shooting war, we would know that it must come to an end--victory or defeat, but an end. Every individual engaged in war, every businessman, every worker, knows that, whatever degree of restraint, whatever degree of sacrifice, is imposed, it has a definable end. In addition to that definable end, they have the obvious and dramatic purpose of winning the war. The challenge we face now is that we shall be required to do more than we have ever done before without a definable goal, with no guess as to the end of the task, and for substantial intervals of time without the drama, the compulsion, of the existence of a daily battlefield.

I don't envy you the responsibility that will be yours. I don't envy the responsibility of the Government. I don't envy the responsibility of businessmen seeking to function in the environment which I have described. I don't envy the responsibility of labor, organized and unorganized. In short, there isn't a thing about the totality of American life which a sensible man can envy except one. We are the world's last chance. We are the world's only hope. We are our only available salvation. We have perhaps a 50 percent chance of staying free--maybe that much. I know of no painless way of achieving freedom.

QUESTION: Mr. Cherne, you have said that Washington doesn't know what the resources of the country are. As a civilian whose job it has been as a civil servant to work out such estimates, I indorse everything you say. I would likewise add that industry doesn't know what the resources of the country are. And so my question to you is this: As one who has been engaged in your own profession in contact with industry and in contact with government, what would you propose as the method to acquaint Washington and Federal agencies with the urgency of knowing what its resources are? I think that I could perhaps mention an episode to you that would make even your hair stand on end as indicating what we don't know.

MR. CHERNE: As with many things, my source of information is largely the Government. So I made that statement based upon private confessions to me by responsible people.

It takes so much less talent to be a critic than it does to be a doctor. I have no concrete proposal other than this: I regard it as urgent that the two top agencies concerned with this basic problem--the National Security Resources Board and the new production agency which will be chaired by Charles Wilson--gather the best available team of technicians from industry, labor, and government who have been concerned with the problem and who know some of the methods for gathering the necessary information--first, of course, having admitted the urgent need for it.

I would throw into the government group one or more folks from Budget and Census and devise at the earliest moment a method able to give us at least a rough estimate of capacity within a period of six months. What those techniques are I don't know. What concerns me is that no one person knows the techniques now. Therefore I can only recommend that a conference be called to explore the possible methods and agree on a modus operandi.

QUESTION: My question was not specifically what you would recommend we do to determine what our resources are, but what would you do to make the government agencies realize the urgency of doing it? What would you do to get them to call this conference that you talk about?

MR. CHERNE: My guess is that they know it. My guess is that they know the urgency. I think there is only one major restraint to their taking the necessary action, and that is that it involves a confession, perhaps a public confession, that they don't know what our capacity is. That is the restraint.

I am sure, for example, that in both the National Security Resources Board and the Council of Economic Advisers to the President there is today an acute realization of the lack of knowledge and the need for it. I have heard expression of it quite high up in both places. It couldn't go much higher and the expression couldn't have been more graphic. I know of no other way to determine whether or not they know the need.

QUESTION: Then what is the difficulty in having that high authority reluctant to at least stir up the lower workhorse, the fellow on down below that does the work?

MR. CHERNE: Two of the three agencies I have discussed just don't have the staff now. Incidentally, it is one of the things businessmen don't know--that the number of people employed in the solution of some of these problems wouldn't be adequate to merchandise a simple product in business. The number of people in Washington today concerned with these problems is almost incredibly small, and as a result they have been able to no more than scratch the surface of any one of the problems that have been thrown at them.

QUESTION: I would like to have you enlarge upon your statement about the possibility that government does not know the capacity of industry. I assume from your statement that you believe industry does know its capacity.

MR. CHERNE: No. I certainly do not mean to imply that. Individual firms know their capacity. Some industries know their industry's capacity, though that is unhappily rare. But industry as a whole does not know its capacity.

QUESTION: It is my understanding that the NSRB has sent out circulars to all industries to indicate their capacity in their particular line. That is all I know about what they have done. The question in my mind arises whether we are expecting the NSRB to find out whether they do or do not have information on the capacity of the United States so far as industry is concerned.

MR. CHERNE: I am not in a position to comment upon any individual steps they have taken. Undoubtedly, steps have been taken. But I do know that there is no agency of the Government today which really knows the capacity, including NSRB.

Now, I am not criticizing NSRB in saying that. I am not sure that with the staff it has and in the limited period of months in which NSRB has been working on every conceivable mobilization problem, it could have come much closer to meeting this one than it has in meeting others. But I do know that the full information does not now exist within NSRB or within any other agency of the Government.

QUESTION: You have laid down a general priority of effort from now on. Just what mechanism do you propose to use? Do you think it should be primarily a CMP type, or do you think it should be a combination of a number of different things—CMP plus a multiple band rather than a single-band preference rating system and these limitations on the civilian economy and so on?

MR. CHERNE: Well, my guess is that we should move as rapidly as possible toward CMP, because I have not the slightest doubt but that is where we will land ultimately. I don't see any use in fiddling around with half a dozen other approaches before we finally wind up with the ultimate bedfellow.

QUESTION: You think we only need one?

MR. CHERNE: That is right. But that doesn't mean that I think CMP accomplishes all your material location or diversion problems. CMP is not a technique that will help solve the need for limitation, the need for conservation, the need for the sharp curtailment of certain types of nonessential activities. What CMP does do is handle the most important of the critical materials, the key materials, in the most intelligent way with a minimum of conflict.

QUESTION: Government contracts normally concern only the end items; these items are usually made up of many, many components over which the Government has no control. Is industry or the National Manufacturers Association or any similar organization therefore contemplating the creation of any association or central bureau within industry itself among businessmen to coordinate the many components so that small business can clear through that group to take part in our national program?

MR. CHERNE: I know of no such contemplated formation of an industrial group for that purpose.

QUESTION: Are they not in a better position to handle that problem than the Government?

MR. CHERNE: I am not sure that they are, because I am not sure that the National Association of Manufacturers, for example, is in any sense the appropriate agency to work for the maximum degree of subcontracting, since the National Association of Manufacturers quite obviously within its membership contains the concentration of the largest businesses of the United States. I am not sure it is either to the interest of those businesses or to NAM, nor, for that matter, to do the necessary work for the vast multitude of businesses that fall outside NAM. Nor, incidentally, do I believe that this is a job that can be done by any voluntary or ad hoc association of industrialists. It seems to me that certain very rigid steps must be taken by government, and particularly by all the agencies concerned with procurement, to assure the maximum degree of subcontract participation, because otherwise the move will be to more and more concentration. That is the natural tendency. It is much easier. If I were to do the contracting, I would rather deal with one firm that is capable of undertaking the entire responsibility than with half a dozen companies whose separate work I would have to coordinate.

Let me sum up my feeling about the problem of small business and subcontracting by putting it this way: We must face the blunt fact that in many, if not most cases, the larger company is the best equipped to do the munitions job, and no amount of concern for the plight of smaller companies can change that fact. However, the large prime contractor does bring smaller outfits into the picture through his subcontracts--so that the most fruitful line of aid to small business may well be the development of better channels for this subcontracting process.

It is less a matter of hooking the small firm directly to the Government as a prime contractor than a question of how to let small companies know where the subcontracting opportunities lie, and how to get hold of them.

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There have been government steps in this direction—for example, the information services of local Commerce Department offices. But they fall short, if only because many businessmen still do not know and use these services. Here again a job of business education and public relations is a must.

I also suggest that the Government might develop a formal technique to stimulate business-cooperation programs like the York Plan of World War II. The businessmen of York, Pennsylvania, got together and worked out a program of cooperation which effectively made use of maximum tool-power and manpower in the community. The chain of contracts and sub-contracts was closely woven so that there was a minimum of lost time and hunting around on the part of either prime contractors or the smaller shops with free capacity. It would seem entirely feasible to send government teams to such industrial centers to present the outline of the York experience to business leaders who could adapt the plan to local conditions.

COMMENT: You seem to feel that the higher people in government that are concerned with these things are pretty well acquainted with our lack of knowledge on industrial capacity. Yet do you know that here at the college we have a large number of people representing some of these agencies that seem to be pretty well satisfied that they are pretty well acquainted with what we can produce and what we can't, mostly what we can't. I am particularly impressed with the two news articles that came out this morning: One by Dewey, in which he recommended pretty heavy mobilization; and a report of an interview by Secretary Marshall in which he said that we couldn't possibly go any further than we are going or any faster, because we have already reached a heavy impact on our industry. Yet down here we have had representatives of a good many agencies that told us very specifically that we have a great vacuum right at the moment in our capability of production. We have people faced with unemployment. We have capacity not being utilized at the moment. So it is obvious that people at the top are not well acquainted with the situation at the moment. Since that is so, it seems to me that probably civilian concerns like your own might be more capable of getting the dope to the top people than, for instance, this audience.

MR. CHERNE: We can only get the dope to the top people when the top people ask for it. The Research Institute found itself in a position during and prior to World War II in which it was requested by government agencies on many separate levels and for many separate purposes to function as an independent outside agency for either the solution of particular problems or the acquisition of certain information. To the extent that we are not requested to do it, the most that we can do is speak with as much frankness as there is at my command before a group such as you this morning.

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Now, I do very firmly believe that we are not using the available capacity in the country today; that there is this vacuum; that there are thousands upon thousands of businesses that are clamoring for some kind of participation in a rearmament effort; and that even among those who are large, there is not as much participation as they would wish.

I can't identify the group here, but I had a conference out on the west coast with twenty-five of the leading industrialists of that section. They are among the most important names in the entire country. I have never heard such a graphic description by a group of responsible men of their inability to get rolling. They want to get rolling.

Now, I am not sure where the responsibility for that rests. Nor can I say with absolute conviction that in these six months there was very much of an alternative. I don't know. I do know that capacity used during the last war for arms production is available today and is not yet being used for military production.

QUESTION: We have heard a good deal about the necessity in government contracts of issuing government-furnished equipment, not only production equipment but of building new plants. Statements have been made that in the majority of government contracts today it is necessary for the Government to actually furnish equipment in order to persuade industry to take over, or to find industry that can take over, these contracts. That was specifically stated with reference to the electronics industry, but it was also generalized for other industry. I wonder if you would like to comment on the reception of that by industry generally.

MR. CHERNE: I am not in a position to give you a very informed answer to that. I doubt very much that the only way of getting industry participation today is to provide the particular business with the equipment, the plant, the facilities, the tools, and so forth. I doubt that very seriously.

Quite the contrary. I think you will find that business, having realized the depth of the emergency and facing the first real material curtailment, will be falling over its feet to scramble into the armament picture.

Now, there is a natural tendency on the part of businessmen--it was evident prior to and during World War II--to stay out of war work and keep civilian customers happy so long as possible. If your normal civilian business is profitable, why get into all the headaches of procurement, renegotiation, and so on? But if you are cut off from supplies of labor or material, then the only way you can stay above your break-even point is to get into the defense effort. You will find that businessmen will regard it of importance to themselves, if they have no other alternative, to get into the show, regardless of whether you give them plants, tools, equipment, or anything else.

QUESTION: What measures do you think can be taken to attain a greater degree of subcontracting in military procurement? I am thinking particularly in regard to the Armed Services Procurement Act, which requires a fair proportion of military business to be placed with small business and yet quite frequently large business underbids small business.

MR. CHERNE: Well, for one thing, I think I would reactivate an agency of the Government which existed during World War II, the one that for a period of time was under the direction of General Robert Johnston, the Smaller War Plants Corporation, as I recall it. There should be an agency concerned solely with getting the maximum quantity of contracts into the hands of small business.

Let me say that in making this recommendation I recognize that the agency was substantially ineffective—because, as I pointed out before, the normal process is to place the business in the hands of the big fellow, for reasons of money, convenience, and speed.

The only thing you can do is to throw up barriers in the way of the big fellows. For that purpose I would set up some kind of official needling group within the procurement organization. They won't be 100 percent effective, but they'll at least accomplish more than pious expressions in a law or regulation.

QUESTION: Production allocation planning has been an activity in the Department of Defense, specifically in the Munitions Board, for a number of years. Admittedly the information is based on estimates and also on World War II experience. I understand—my figures are subject to question—that some 40,000 or more plants have been investigated and some 10,000 allocations have actually been made. Would your opinion be that this is needless and that you can't place credence in it as a knowledge of industry by the Government or an approach in that direction.

MR. CHERNE: No. I am not overly familiar with that activity today. I was very familiar with that activity up to 1943. I regard it as one of the effective steps in the direction of securing information on capacity, particularly the production facilities available. But I doubt that even today it is held out as an exhaustive knowledge of available productive facilities, and it never was represented as being an inventory of the Nation's productive capacity. I think it is extremely valuable as far as it goes, but it doesn't go far enough.

QUESTION: I believe you stated that as an economist you do not favor the excess profits tax. I wonder if you would indicate a little more fully your reasons; and, second, if you would indicate to us the instruments which you do favor as means of financing our present mobilization.

MR. CHERNE: Well, the major reason I don't favor the excess profits tax is because I believe it to be the most inflationary tax that can be devised. The reason is that it gives every incentive to business to use government dollars for the purpose of inflating their own expenditures.

Unhappily, the excess profits tax also makes very sharp distinctions among industries and among businesses, with neither equity nor logic in these distinctions. Railroad stocks, for example, have reflected within recent weeks the pleasure the industry gets from the fact that it is exempt from the excess profits tax.

The excess profits tax is based upon the belief that it takes back for the Government those profits which are excess as a result of the pressures of war. It does nothing of the kind. The excess profits tax is a very modest revenue producer. It has no relationship at all to profits which are excess or in relation to war. Renegotiation is your method, if appropriately used, for the purpose of recapturing excessive war profits.

I believe that the method of accomplishing the same objectives, with far more revenue for the Government, is an increased corporate tax. In other words, I am not urging that corporations escape the burden of taxation. I am urging that the burden of taxation upon corporations be equitable, that it apply uniformly to the entire group, that it not make for inequitable and illogical distinctions as between industries, and particularly new and expanded businesses, particularly civilian.

In my remarks I have emphasized to you the importance of expanding particularly in those areas where more capacity is required—but that is precisely where the excess profits tax has the most negative effects. The excess profits tax seeks to limit some of its inequitable effect by automatically exempting small business. Well, I have expressed myself previously in favor of small business, but I see no particular reason for exempting small business from any type of corporate taxation.

These are some of the reasons I am opposed to an excess profits tax. I emphasize again, the most important reason is that an excess profits tax produces little revenue, because the corporations learn how they may spend their money in such ways as to avoid or minimize the levy.

I should not complain. Let me be quite candid with you—let me explain the effect of an excess profits tax as it functions, for example, within a research institute. The Research Institute has available services for businessmen. Particularly in an interval of this kind the businessman finds it difficult to get along without such information and guidance on taxation, on government contracts, on labor regulations, on the whole multitude of defense regulations.

Well, a businessman securing the services of the Institute at this moment, if there is an excess profits tax, pays for those services with government dollars. In other words, for every hundred dollars he spends, he spends twenty and the Government pays eighty. If he didn't

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spend those twenty, the Government would get them. And so you will find that all activities of this character will become inflated as a result of the existence of an excess profits tax. Some will be desirable in a defense economy, others may not be.

Now, an excess profits tax has an additional deficiency. The one which was used in World War I and the refined law used in World War II had to contain special provisions for relief. We spent 20 years following World War I processing the special relief claims under the first excess profits tax, and we have not yet finished processing those under World War II. That, in my judgment, is not a proper form of taxation. A form of taxation which is not automatically acceptable to the community is, in my judgment, not enforceable.

COLONEL BARNES: Mr. Cherne, unfortunately our time has run out. You have pointed up a lot of real dilemmas in this field this morning. Although I believe the class was conscious of a good many of them, you have thrown further light on them, and our thinking has been stimulated, as we hoped it would be. Thank you very much.

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