ECONOMIC STABILIZATION AND MOBILIZATION

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Publication No. L52-21

INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

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DR. REICHLEY: The orientation unit of our course on economic mobilization concludes today, with a lecture this morning introducing economic stabilization and a class discussion this afternoon on points of particular interest brought out during the past three weeks. You have heard numerous lectures on various phases of economics with many of the speakers referring to economic mobilization as one of the most important factors in mobilizing our economy for war.

In addition to this the term has appeared on the front pages almost as much as the term "Korea" during the past 12 months. So this morning we hope to come to full grips with this problem. To help us we have called on Dr. Clark of Columbia University, who is not only one of the country's most outstanding economists but has also been an expert consultant to the Federal Government all through peace and war; has been honored by many foreign countries; has written so many books and received so many degrees that I won't bother mentioning them this morning. You will see them in his biography. It is a distinct pleasure and honor to welcome the dean of the economists, Dr. John Maurice Clark of Columbia University.

DR. CLARK: Members of the Industrial College of the Armed Forces: I was assigned to talk about "Economic Stabilization and Mobilization." It is a foregone conclusion that I can't cover the subject. I will try to indicate its scope without even attempting a full catalog of heads and subheads, and I shall try to say something about a number of factors that seem fairly basic.

For instance, one is the economist's arithmetic way of attacking this problem--balancing a sum of dollars against a sum of goods, inflation or deflation depending on whether the dollars exceed the goods at current prices or fall short. That is important. But I think perhaps the factor that tends to be neglected in this arithmetic is the psychological one or the factor of the imponderables; how people feel, how they react; the relation of goods not only to supply of money available to be spent, but to needs and to people's ideas of their equitable shares.

Another of the subjective factors is the extent of the patriotic incentive in determining how people may react in a given mobilization emergency. From this standpoint the defense type of emergency is more perplexing to deal with than the outright war type, because the patriotic incentive is less strong and dependable. Then there are questions of amount and speed; of probable duration; some of which make a very vital difference to proper policy, affecting what can or cannot safely be done.

The present type of defense drive is more moderate in its immediate demands than all-out war would be, but is of indefinite duration, making it necessary to keep the private economy in a healthy and expanding condition; whereas in the all-out war drive, which is urgent and expected to be temporary, production for private demand is expected to shrink in those parts of it that compete with war needs; and, perhaps, if the emergency is very severe, that would include practically all parts. At present we face demands which, though moderate by comparison with the all-out war type, still call for considerable increase of effort; but we need to make that effort in a fashion that will not tap our last resources. We need to keep these last resources in reserve for possible use in the greater emergency of all-out war if it comes. So far as feasible, we need to meet the lesser emergency in ways that strengthen our reserves available for meeting a possible greater emergency, rather than depleting them.

That applies to our resources, psychological as well as material, including resources of willingness to comply with controls and of readiness to act in the national interest under spur of national need. Americans seem to have a rather limited amount of that; it is a very important resource, needing to be conserved.

The word "instability" appears in the outline of topics I was invited to cover. We have different kinds of instability. There is instability downward, below the level of full employment, which I take it was dealt with in Tuesday's talk. There is instability upward, pressing against full employment limits and against the limits of increased supply for particular products.

This can happen in peacetime, in an industrial boom. There the principal problem created is the problem arising from its temporary character; the fact that it means increasing capital equipment at a rate that can't be kept up; concentrating two years' expansion in one. If the increase comes from government defense demand, it is likely to be more insistent than if it comes from private sources, leading to sharper price inflation. And for the purposes of this talk, price inflation seems to be the most serious form of instability.

"Mobilization" means, for our purposes, a conscious redirection of a country's resources to meet a large and urgent public need, added to normal private needs. New demands arise. If they are substituted for existing demands, then spending more on one thing means spending less on others; it is essentially a problem of reallocation. But if the new demand is an addition, it naturally operates so that spending more for one thing causes more money to be available for spending on other things, for reasons we shall examine. This means cumulative expansion. If it is a peacetime boom, it may within limits be welcome. But in war or defense mobilization, indiscriminate expansion of civilian demand is not welcome. It interferes with defense requirements, and leads to inflation.

In peacetime there is ordinarily no great shift in any one year, and the new demand represents a fringe of expansion of our economic power into things we did not have before. The fact that we had previously been getting on without them argues that they were not absolute essentials; they represent added luxuries and conveniences, easily postponable, not vital necessities. Hence people will not generally bid desperately for them. Also, not very much is commonly added to the amount of money available, ready to be spent. That kind of rather moderate movement, or moderate expansion, the market is suited to handle. I think economists in the past have found it adequate to handle the kinds of mobilizations to which they were accustomed, to such an extent that they did not pay enough attention to the limits on the kind and degree of mobilization that it can successfully handle. In the light of recent emergencies, it does look as if the market mechanism was suited to handle movements or mobilizations of rather limited extent and speed and urgency, and that the kind of defense drive we have now, and still more an outright war drive, calls for a good deal more than a free market alone can do, if it is to be done successfully.

In "Mobilization," as we are encountering it, the total sum of needs is increased, and that is one of the psychological factors that influences the result, compounded with the more mechanical factors of amounts of money versus amounts of goods. The Government's demand is highly inelastic, and the needs of private citizens have not shrunk. The r esult is likely to be an added monetary demand, leading to inflation, more or less regardless of whether the actual literal monetary supply is increased or not. Under those conditions the monetary supply is likely to be increased, and that accentuates the effect I am suggesting. But even without that, government and the people between them will spend money faster, with inflationary effects.

I have some notes on why inflation is an evil, but I will pass that over. I assume this group doesn't need to be told that inflation is not a nice thing and can be pretty serious.

Its cause is often expressed as "more money than goods." A more accurate statement would be, a desire and ability to spend money, in a larger amount than the value of goods that people are able and willing to sell, reckoned at previous prices. This defines two comparable quantities. Spending ability is chiefly based on money income, but can exceed it, with the aid of credit. Another feature in the expansion is the fact that when somebody spends beyond his income, that spending turns into added income for somebody else who, if he spends in a normal relation to his increased income, proceeds to expand his spending. This is the well-known cumulative effect that takes place not only in defense inflation but during ordinary industrial expansion. Demand of that sort can be implemented on the money side by private credit or public credit, public borrowing, or deficit spending, or by just plain faster spending of the balances people already have, if something happens to make them feel like spending faster. That is one of the reasons why it is very hard to check spending by checking the flow of disposable income, or by checking the more obvious kinds of credit. There are too many ways of finding money, if one is eager to spend it, in spite of such restrictions.

Another feature is the fact that this kind of expansion with which we are dealing concentrates heavily on a particular sector of the economy, especially metallic durables and the supplies of the metals that go into them. So that if it represents a special demand amounting to 15 or 20 percent of the normal gross national product, it may mean 50 percent, or more than that, of normal utilization of some special key factors or materials.

Then there is the subjective element in causation. People expect scarcities. What do they do? They order more than they expect to get, thus multiplying demand, or they expect higher prices in the future and they rush out to buy before the price increase. They increase inventories, partly on a speculative basis, partly as a normal precaution when they expect there may be trouble in the near future in getting orders filled. That extends to sheer hoarding, both by trade and industry, and by consumers. Some of the consumer hoarding, during the late unpleasantness, by solid citizens, was a rather disgusting exhibition of the sort of unprincipled selfishness that can create unnecessary shortages.

Then there's another angle. What happens on the cost-of-production side? Of course there are some cases in which, in order to increase supply, you have to tap particularly expensive sources of materials; in copper mining, for instance, on a minority of the total output. But what I am thinking of more particularly is the wage-price, wage-cost spiral. It may begin anywhere around the circle; but, if wages go up without corresponding increase in productivity, money costs go up, and if prices are raised to correspond, and if that increase in price gets into the cost-of-living index, it affords a further impulse to further demands for increased wages.

Farm prices, under parity, introduce a special form of spiral between the industrial urban sector of the economy and the farming sector If food prices go up as a result of increased farm prices, there's an addition to the cost of living, and that leads to wage demands, aside from other causes. Then if increased wages raise prices of things farmers buy, that raises parity, and with it the support prices of farm products.

When we come to the question of price control, we will be reckoning with the fact that a vigorous, intelligent system of price control can combat an excess of demand over supply fairly successfully; it did so more successfully in the last war than most economists would have dared to expect would be possible. But when money costs go up, because wage cost has gone up, then the price line has to give in recognition of it. And, in the aggregate, in the economy, wage costs are the majority element; about two to one, as compared to the other elements, including profits. Of course, in a single industry, wage cost may be no more than 24 percent, for example, of the total gross sales, because a great of production cost goes for materials, furnished by other industries, payment for which, however, enters into the wage cost of those industries.

Now, as to the main methods of dealing with inflationary pressures, I notice J. K. Galbraith, in a recent article, noted four different types of people, tending to concentrate on four different classes of remedies, each stressing one of them as all-sufficient. The four remedies are: the remedy of increased production; the fiscal remedy; the monetary and credit remedy; and the direct controls remedy. Actually, all four are essential parts of a comprehensive picture, no one of them is sufficient by itself.

Take increased production first—naturally, that is highly desirable. It will reduce the excess of need above supply, and that is not a negligible element, as I have tried to stress at the start, in speaking of the psychological factors. But it does not remove an excess of money over goods. As you increase production, and as that increased production is paid for, you pay wages to the workers who produced it, and the industries that produce it earn profits. Those pass into the money incpmes of those parties, so that the total of money incomes, is increased, along with the increased supply of goods. So far as inflation is an excess of monetary income, increased production has not automatically removed it.

It may be circumstances are such that people in receipt of that kind of income will save an unusually large amount of it. If they think it is a windfall, they may do it for that reason. If the things they might spend it for have been taken off the market, as new passenger cars were taken off in the last war, they may wait till a new supply comes back, and that may be a practical reason for not spending all their added income. Or war bond drives may stimulate saving. But it is only as the increased income is not all spent that you can expect an equilibrium of the inflationary pressure to come about; not merely by increasing production.

The fiscal method, like the monetary and credit method, acts by restricting the monetary flow, which is sometimes called the indirect method of dealing with inflation, as distinguished from the direct method. What can or can't the fiscal method do? The simplest formula is balancing the Government's cash budget, usually with the Federal Government in mind. There are State and local governments also, if you are taking a comprehensive picture, and it is the cash budget, not the fiscal budget, that's the important thing for this purpose. That is, if government adds its spending to the market demand, government takes away an equal amount of funds from private individuals and businesses in the form of taxes, and so reduces the available disposable income by taxes as fast as it is increased by government's own direct spending. Some extremists seem to speak as if that were the all-sufficient way to solve the problem. Well, there are many very cogent reasons why it is not, especially in all-out war.

In all-out war it is not only politically impossible, but economically and administratively impossible, to levy taxes heavy enough to balance the budget, without doing things that would cripple the economy as a result of the impact of the taxes. We don't face that impossibility on the present scale of operations. I think we did at the height of the last war effort, say, from 1942 to 1944.

If we can raise taxes enough to balance the budget, we should, but that still will not be enough. Why not? One answer would be simply from experience; we had substantially a balanced budget in the last half of 1950, and we had a very substantial inflation during that period. Some of the reasons are given below.

First, that private spending, including business spending, can be inflationary just as much as public spending. During that period, industry was expanding its capital outlays for equipment and getting the funds out of an expansion of our elastic credit system. That was a very large factor. At one point in our recent expansion, plans for increased capital outlays for the next year, I believe, were estimated at 28 billion dollars for durable equipment only, not including the large factor of increased inventories.

Second, there are the special shortages that I have indicated, which will raise the prices of key factors, particularly key materials. This raises costs for products in general. It is due to the concentration of demand in a particular sector of the economy, and no sheer increase of taxation will automatically take care of that.

Third, there is the wage-cost push, which will not be taken care of by fiscal policy. And if costs are forced up by increase in money wages, the urgency of the Government's demand is an ample guarantee that it will have to raise its buying prices to whatever is necessary to bring out the goods and expand its financing accordingly. Other prices will necessarily follow.

Lastly, it is not a mere question of the amount of tax but of its distribution. If you increase public spending 20 billion dollars and if, by a political miracle, you increase tax revenues 20 billion, it may take a further political miracle to distribute that tax in such a fashion as to reduce private spending by 20 billion dollars. This cannot be done by business taxes plus personal income taxes falling chiefly on top-bracket incomes. Such taxes have insufficient effect in reducing private spending. In any case, if you took all that is possibly conceivable from the top brackets, there would not be enough money there for the purpose.

We simply can't get out of the income tax the amount and kind of revenue that is needed without taxing widely down to moderate and even small incomes. And that is painful to many voters; hence painful to members of congressional committees.

As to the monetary and credit method, it can do a great deal; but it also has its limitations and difficulties. I have suggested some. It is hard to stop all avenues of access to funds. Another point is that it needs to be selective. There are some kinds of spending you want to check, which may use credit. There are other kinds of spending that you want to promote, especially industry expansion that may help to break bottlenecks, as against industry expansion on nonessential things. Our general credit mechanism for furnishing funds to industry and commerce is not easily turned into a selective mechanism which would act on such considerations, with a concerted purpose over the whole economy. The selective features are in the hands of individual bankers, who handle them largely on commercial principles.

Consumer credit is a fairly large inflationary element and it is of a sort where restriction can be selective—especially installment credit, which is just the kind of credit that can expand demand for just the kind of consumer durables which compete most acutely with the Government's expanding defense demand.

Direct controls include controls over products and production and controls over the wage-price structure. Looking at the first, government may limit the using-up of materials in production, in two main ways. It may limit or prohibit the production of a particular product; for example, production of passenger cars was stopped during the last war. Or the thing may be done in a different way, prohibiting or limiting the use of particular scarce materials, without forbidding production of the particular product; so that, if you can find ways of producing the product without using the scarce material, or within the limits of restriction on its use, you are free to do it. That method may be used to conserve scarce types of skilled labor also.

There are obvious advantages to that, in the way of stimulating economy in the use of scarce resources, with a minimum disturbance to the free economy. That, of course, is peculiarly pertinent to a defense drive, as distinct from a war drive. As to the apportionment of existing supplies, there are various methods. The first, but not the simplest, is priorities. A more thoroughgoing method is allocation; and still more thoroughgoing is a welding of allocation into a system of full programming of production. First, as to priorities—normally, priorities are a confession of the controlling authority's uncertainty as to how supply and demand are going to balance. Somebody get first rating; somebody else has to take what is left after the first ratings have been satisfied; and the authorities don't know how much that is going to be. If they did, there need be only one priority--you get it, or you don't get it. In other words, it would be allocation.

Primarily, a system of general use of priorities is a makeshift, transitional method before government is ready with the necessary data and organization to go on to allocation. The natural tendencies of this method were very well illustrated during the last war. Priority certificates proved to be a form of paper currency that tended to very rapid overissue and depreciation; and when the amount of top priorities issued exceeded available supplies, they had to be supplemented by extra-top priorities and so on, in a considerable series. So far, I believe, in the present defense drive, the authorities have carefully avoided such overissue and pyramiding of priorities.

Even under allocation, there may be an unallocated margin of supply, and allocation may be of the "open-end" type. Professor Donald H. Wallace, in a recent memorandum (not at present published) has discussed the feasibility of that method. The scramble for the unallocated remainder needs to be prevented from developing into a form of "black market."

If there is scarcity enough to call for allocations, it calls also for preventing overaccumulation of inventories, by particular producers or dealers. I have spoken of the tendency to hoard at such a time. Hence the purpose served by limitation of inventories is obvious.

Allocation must meet a good many requirements if it is to be effective in the present kind of world emergency. It calls for international allocation of some of the major key materials, and steps are being taken in that direction. In some cases the free nations between them comprise pretty well the main sources of supply; in other cases they must in the aggregate get a considerable part of their supplies from outside the group of nations that would be actively cooperating in such an arrangement for international sharing.

On a more mechanical level, allocation calls for translating bills of finished products into bills of materials and labor. Labor requirements may usefully be included as guides to manpower policy, though labor is not to be allocated. It is surprising how difficult it is to make this translation with even a useful approximation to exactness--real exactness is out of the question. That problem is being wrestled with at present. I believe the Bureau of Labor Statistics and the Air Force are jointly working on something they call "input-output analysis," based on the works of Professor Leontief at Harvard, to assist in furnishing useful approximations to guide the process of allocation.

These difficulties are obvious when one considers the military methods of procurement, where the decisions on the number of tanks or airplanes may be made at one time and place, and the decisions on the character of the units, determining the amount of material they call for, would be made at another time and place.

As to manpower, direct assignment of manpower to jobs is one of the things this country would not do unless forced to it by an emergency greater than the emergency of the last war. An emergency is conceivable in which we might suffer direct and heavy casualties to our industrial plant, necessitating a big revision, vitally urgent, in our economic program. Then the need for manpower assignment might appear compelling. But, short of that, we should not consider direct assignment. The emphasis lies on prepatory canvassing of needs, training, and voluntary inducements. One very important part of the inducements consists of housing and the facilities that go with it. This problem can be minimized to the extent that it is possible to bring the work to the workers instead of trying to move the workers to the work. This needs, of course, to be weighed in connection with the defensive value of decentralization of industry.

This brings us to direct control of prices and wages. Price controls may be general or selective. The selective type may concentrate on materials, parts, subassemblies, and so on, which are limited in number, or they may go on to the finished products, in which case you have a very large number of prices to deal with. If control goes on to the retail level, it has a terrific number of prices or margins to be controlled, a tremendous expansion of the job.

The techniques are many--different ones being suitable to different situations. OPA learned a great deal during the last war about the different kinds of techniques and the situations to which they are suitable. There is the freeze--both the general freeze and the temporary special freeze. The general freeze is probably best thought of as a transitional measure when you are within sight of being ready to tackle the problem of the enormous number of retail cases, and you want to hold things fairly stable while you develop, as rapidly as possible, organizational units capable of dealing with those many situations. This takes time; the full plunge into a comprehensive system of "tailored" price ceilings cannot be made all at once. And an inflationary wave may not wait, so a stopgap may be needed.

Bernard Baruch, before the last war, advocated a general price freeze as an over-all complete method. He argued that if the entire wage-price structure were frozen it could stay frozen. But since the price structure is never in equilibrium, some changes are inevitable and would occasion others, with demands for rectification of inequities. Hence it seems safest to regard a general freeze as a point of departure for revisions.

There are many problems in determining a fair return to an industry. One of the difficulties in the defense drive is that the fair return has to be more liberal than it needs to be in an all-out war. In an all-out war the country is prepared to accept some shrinkages in the civilian sector of the economy, under the pressures which war necessities require. But in this kind of a defense drive we can't afford that result; the civilian sector of the economy has to be kept in healthy and expanding shape. Therefore, the problem of a basic, fair rate of return has to be handled more flexibly, more liberally.

Incidentally, the fair return can't be a percentage rate of return on investment; the figures for investment are not available. It is impossible to grant a "fair return" to each individual producer; it has to be a fair return for an industry as a whole. Some concerns may make profits; others losses. Under OPA, the return had to be defined for practical purposes as a dollar aggregate for the industry for a base period, in which case the problem of additional investments since that base period had to be handled by simply allowing a percentage return for such additional investment, so that the standard became a hybrid. That creates obvious problems for any system that is to go on more or less indefinitely. Additional investment will gradually cause it to be increasingly dominated by the element of a percentage rate of return on investment; this will change its character. Such a standard is peculiarly suited to a temporary emergency.

Rationing of goods to consumers is another headache. Fortunately, it seems to be demonstrated that it is not necessary to ration everything that is controlled in price. The public has considerable tolerance for rationing by dealers, where price is set below the level at which supply and demand are equal, and there is some unsatisfied demand. Dealer rationing is not ideal, but government rationing is such a clumsy instrument that it will not and should not be undertaken unless the evils from not doing it are great enough to offset all the blunders, clumsiness, and so on, that are inherent in the instrument itself. In fact, that statement applies to direct controls as a whole.

What happens to quality under controlled prices? Several things can happen to it. The cheaper grades on which smaller margins are made tend to drop out of production, while the quality of given grades deteriorate. Yet there may be some things that might be regarded as deteriorations in quality which are in the public interest as ways of economizing on scarce materials. There may be other economies of a less useful sort. The problem of policy with respect to quality is peculiarly many-sided and complicated.

In an extreme emergency we may come down to what are called "utility models" standardizing quality at a simple and cheap, but serviceable, level. How the producers of luxury grades of a product, say automobiles, would react to that is obvious. It is equally obvious that we are unlikely to go to that length in a mere defense emergency. A kindred drastic measure may be considered if an all-out war causes heavy shrinkage in the output of some industries which are unable to convert to war uses, and therefore are operating at a fraction of capacity and at high cost. This may be met by concentrating production in a limited number of plants, operated at efficient rates, with some equitable treatment of the owners of the closed plants. Britain employed both these policies during the last war, but in this country such projects were stillborn. (In Canada, a price was set on "utility" funerals.)

Anti-inflationary wage controls, even more than price controls, need voluntary support and cooperation. Under the best conditions, wage increases can be slowed to a creep; but there will always be "correction of inequities," with a net upward effect.

Direct controls are at best a necessary evil. Therefore officials are pinning much faith on the prospect that after a period of expanding equipment and munitions, the peak of the effort may be passed and the pressure may ease sufficiently to allow most of the direct controls to be taken off. This could happen if the emergency does not get hotter in the meantime. For more reasons than one, it is earnestly to be hoped that this easing of the economic pressure may materialize.

COLONEL BARNES: Gentlemen, this is your last chance of the current series of economics lectures to get all the questions cleared up.

QUESTION: Dr. Clark, appreciating that military orders and deliveries have a lag of about 6 to 18 months, and that therefore payments do also, and if we have a military budget of say 60 billion dollars a year, also an expanding gross national product that is going up maybe 25 billion a year, is there any reason that we could not sustain a 20 percent military budget permanently?

DR. CLARK: The question is as to the relation of that lag to the capacity to sustain. I am not sure I get the idea. So far as the initial impact goes, if the actual Federal payments are lagging, that is largely offset, isn't it, by the financing that the supplier has to do? He has to finance his costs of production as they are incurred. We could sustain a 20 percent military budget indefinitely, and an expanding gross national product would help, but I'm not clear that the lag in Federal payments helps. It seems to be offset by the private supplier's financing.

QUESTION: Our income is increasing every year. Isn't gross national product increasing? It would seem to me that we are acquiring more and therefore could foot last year's bill with it.

DR. CLARK: Well, I hadn't thought of it in those terms; I would want to do a good deal of thinking about it before trying to give an absolute answer. There is the angle of taxes. Of course if the gross national product increases by 10 billion dollars, that doesn't necessarily represent 10 billion more taxes that you could take; and, as I say, I am not sure that the lag of actual Federal payments is an important element there.

QUESTION: Doctor, you indicated that we could not solve the problem of stabilization by the one method of fiscal management. It is clear that you meant that there were many factors outside the laws of economics which would govern it. For that reason it would be impossible to make it work. I would like to ask as a theoretical assumption, if we did apply the pure fundamental laws of economics and used fiscal controls to arrive at a balanced budget, would not the effect be cumulative so the entire thing would become Utopian and resolve another problem by applying tax on the people where it hurt, and wouldn't our ramifications go all through the economy and end up by a balanced budget and a high standard of living?

DR. CLARK: I have tried to indicate that a balanced budget is necessary, but not sufficient. It does not solve all the questions, such as tax distribution, concentrated impact of scarcities on particular things, wage boosts, and so on. Economists in this defense emergency were, I think, on the whole surprisingly in agreement on differences that arise in the defense emergency as compared to the all-out war emergency; one of those differences was that they were much more reluctant to go over to direct controls in the defense type of emergency than they were in the case of an all-out war expected to be brief.

We could stand that kind of interference with normal economy for a limited time, partly because we expected it to be over shortly and partly because there was a more powerful patriotic incentive to promote a spirit of cooperation. In the present case, economists have been much more inclined to rely not only on the fiscal mechanism but on the credit monetary mechanism as heavily as they possibly could. They avoided recommending direct controls as long as possible; but they were finally forced, with very great reluctance, to accept the idea that direct price controls after all were a necessary part of this defense emergency, at least for a time. It may have been wishful thinking on their part that they emphasized very heavily the idea that there would be a "hump" in the defense drive when we were building up to a level beyond which the thing could go onto a replacement basis and the actual requirements might, it was hoped, diminish, in which case the direct controls might be reduced to a limited number of selective controls of the special scarcities, not the degree of general direct price control that we have now.

It is particularly true under the conditions of a defense drive that direct price controls need to be backed up by fiscal and monetary-credit controls that limit the amount of money available to spend. We always need that in order to avoid putting too great a strain on the machinery of direct controls. I think that in the last war one of the bad results of adopting direct controls was the tendency for everybody in charge of all the indirect controls to ease up and pass the buck to Leon Henderson.

QUESTION: Dr. Clark, I would like to ask you a general question rather than one directed at your lecture. From hindsight we know that economists of 50 or 100 years ago were greatly in error because they did not evaluate factors which developed such things as gross national product. Today we are in an atomic age--an electronics age. You can't mention electronics without realizing that they are going to have an impact not in the immediate future but in 5 or 10 years. Unless the economist today is trying to analyze those factors, how can we have any confidence in his predictions or his reasoning?

DR. CLARK: I might make it a little stronger. Suppose he is trying his best to analyze those factors, still, how much confidence can we have? That kind of a factor would remain fairly unpredictable. Economists have a record going back a good many years of proving that things were impossible or that they could not happen without disastrous consequences, after which some of those things happened and the disastrous consequences did not always arrive, at least not obviously. I am reminded of one phase of the last war situation, the contest between General Somervell and the civilian supply authorities over the question whether the military should get its full requirements and the civilian economy get what was left, or whether there should be a certain small quota of civilian requirements, really essential to the war effort itself, that should be set up and given priority; and General Somervell, I was told, very persuasively told the civilian people that they had always done so much better than they had expected in producing supplies that he was quite sure they would be able to find whatever they needed, even if the armed forces were given what they were asking for. I think the worst thing about that argument of General Somervell was, there was some truth in it. But when the military requirements came to exceed the total supply, then something different had to be done. However, in a more moderate defense drive, it may be feasible to give military requirements the full right of way.

QUESTION: Dr. Clark, what do you think would be the effectiveness, as a deflationary measure, of a drastic devaluation of gold, say from the present 35 dollars an ounce to about ten dollars an ounce?

DR. CLARK: One tends to think of gold nowadays as a rather negligible factor in currency computations. I should be inclined to discount the effectiveness of a thing like that, although such a radical revision as you are suggesting is a bigger thing than one would ordinarily even consider as a possibility. I would not be prepared to conjecture what the incidental impacts might be. But it is not conceivable to me that, in the situation we have now, such a devaluation would be allowed to lead to a vast shrinkage of the available supply of currency.

QUESTION: Dr. Clark, does your objective study of these questions of the four controls that you have outlined enable you to evaluate our use of them up to this point, to this extent: Would you say we have succeeded in applying these various controls sufficiently so that we have the total picture under control reasonably well?

DR. CLARK: If we were fighting the last war, perhaps, yes. This new kind of a defensive emergency has so many perplexities that were not in the last picture that I would not say the lessons from the last war enable us to think that we really have under control the present situation. We have to feel our way amongst new dangers and difficulties. With respect to direct controls, for instance, we have to attempt to make them work with less patriotic incentive to help, with less of the saving feeling that after all it is only temporary, with less willingness to see the private sector of the economy shrink. For the future, there is the danger that direct controls could become imbedded permanently in our economic system and develop something inconsistent with the health of a private enterprise system; or that the controls might degenerate as the willingness of compliance wears thin; so that we might exhaust their effectiveness before the time we need them worst, namely, in the contingency of an all-out war emergency.

One interesting angle is that in principle it was easier to ration automobiles on a basis of 100 percent stoppage of production than it would now be to ration them on the basis of a 25 percent stoppage--administratively easier, criteria were less of a problem.

QUESTION: I would like to ask a question, Doctor. Why do you say that priorities are classified as an uncertainty? It appears to me they are not uncertainties because you determine you need a priority established to determine what you are going to do with your materials and supplies; therefore, you establish it. That places the priority more in a certain category than it does in an uncertain one, does it not?

DR. CLARK: What I had in mind was that if you knew precisely what the demand was and what the supply was, you could allocate the supply and it would be, humanly speaking, a certainty that each industry would get the amount allocated to it and nobody else would get anything. But priorities are an open-end proposition; there is a certain amount of priority "A"--whatever it is that has been granted--and whenever you say a "certain amount" you mean an uncertain amount--and it is expected that there will be some supply left over, but it is not known how much. That is what I had in mind.

QUESTION: Isn't a priority more or less like just a hunting license? That doesn't insure that you are going to get any game at all.

DR. CLARK: It doesn't insure it?

QUESTION: No, it is just a hunting license.

DR. CLARK: I suppose the greatest danger is that "A" grade priorities might be issued in excess of the available supply. Of course a full system of programming and allocation would go further, when you know what supplier you can go to to get the material.

QUESTION: Does the President have in the executive department an agency which is qualified to keep him constantly advised on the changing economic conditions, and does he use that?

DR. CLARK: The President's Council of Economic Advisers ought to be so qualified. They have some good men on the staff and they have the power to call on the services of the other larger established agencies. As to the extent to which the President makes use of that agency, beyond what is obvious in the published reports, I have no inside information.

QUESTION: Doctor, can you discuss how the Federal debt can be used as a stabilizing influence in the economy?

DR. CLARK: That is a large field in which I am not a specialist, and it is quite a technical one. Of course a debt can be a destabilizing agency if the Government simply borrows from banks; that contains obvious inflationary possibilities. If the Government issues bonds of a sort that the banks can use as a basis for borrowing funds from the Federal Reserve which they can use as reserves, on a basis of which they can in turn expand their credit, there is an obvious inflationary possibility there. Those may perhaps be countered in various ways, including increasing the reserve requirements of the banks or making special requirements of reserves to be held in the form of bonds to reduce or eliminate those extra inflationary features.

The anti-inflationary form of government borrowing is the borrowing that taps private funds that would otherwise be spent, and so turns potential spending into saving. The popular bond drives are attempts to bring that about. That is a stabilizing factor to the extent that it succeeds.

COLONEL BARNES: Dr. Clark, that is all we have time for today. On behalf of all of us, I thank you for giving us your time and discussing this complicated subject for us. Thank you very much.

(26 Nov 1951—650)S/RSB