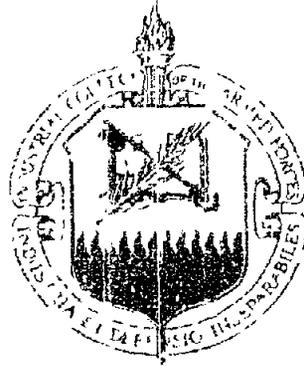


ADVANCE COPY



DIRECT CONCEPTS - ECONOMIC STRATEGIC PLANNING

M. E. L. R. G. G. G. G. G.

This lecture has not been edited by the speaker. It has been reproduced directly from the reporter's notes for the students and faculty for reference and study purposes until such time as the edited official copy is available.

No direct quotations are to be made either in written reports or in oral presentations based on this unedited copy. Quotations may be made only from the final edited, published lecture.

INDUSTRIAL COLLEGE OF THE ARMED FORCES
WASHINGTON, D. C.

1955 - 1956

**DIRECT CONTROLS: ECONOMIC STABILIZATION
PLANS**

20 September 1955

CONTENTS

	<u>Page</u>
INTRODUCTION: Capt. J. D. Gerwick, USN, member of the faculty, Industrial College of the Armed Forces	1
SPEAKER: Mr. Edward F. Phelps, Jr., Assistant Director for Stabilization, Office of Defense Mobilization	
GENERAL DISCUSSION	

Reporter: R. W. Bennett.

Publication No. *256-33*

INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

DIRECT CONTROLS: ECONOMIC STABILIZATION PLANS

29 September 1955

CAPT GERWICK: Good morning, General Hollis, General Calhoun. Good morning, gentlemen.

This is the second of our series of economic stabilization lectures. The first one, on indirect controls, is followed very logically by this morning's subject, Direct Controls: Economic Stabilization Plans.

Our speaker, the Assistant Director for Stabilization in the Office of Defense Mobilization, has had a wide background in the business world. He is charged with the responsibility for coordinating all of the Government's plans for economic stabilization. You might say that he is charged with directing and controlling the direct controls. He has also served the Government in the Office of Price Administration, and as Director of Price Operations in the Office of Price Stabilization. He has had a great deal of practical personal experience with direct controls.

Last year he lectured to us, participated in a seminar, and answered many, many questions for individual students during the course of the college year. This year again he will lecture to us and participate in a seminar. It is a privilege to have him back with us, and it is a pleasure to introduce him to this class.

Mr. Edward F. Phelps.

MR. PHELPS: Thank you.

General Hollis, General Calhoun, members of this class:

Last March in discussing this subject with your predecessors I indicated that it was not a particularly fascinating subject unless you were fascinated by what is somewhat horrifying. This year it is no mere fascinating. I think it is somewhat more horrifying, largely because the assumptions which underlie the work in this field are gradually becoming more horrifying. I also indicated that it was a complex and a difficult and a controversial subject. These aren't necessarily unique attributes. I am sure many of your speakers open their remarks by indicating that their subjects are indeed very difficult and complex. So that perhaps I am not being novel in that respect. But it is a fact beyond dispute that this subject is as complex and controversial as any in which the Government of the United States can be involved nowadays.

It is also a relevant subject, regrettably. It's a war baby, but, nevertheless, I am sure that in my lifetime, and probably in your own, it will continue to be relevant, even though most people would prefer not to have to think of it, or not to have to talk about it or work on it. It's that sort of question, that sort of problem. But for as long as we live in the kind of world which surrounds us these days, I am sure this will be as relevant a subject as any other and perhaps more so a good deal of the time.

I also indicated last March a willingness to be guided by the scope which was given me--and I don't get a chance to use that term very often in the course of a year; so I will use it here--but I also said

I wouldn't be confined by the scope. That is true today. I may wander somewhat afield in the course of trying to make my points. But I hope also we will be able to do some partial justice to the subject embraced by this scope.

The great problem for anyone who is asked to share a unique or esoteric kind of experience with an audience such as this, or any other, I think, is to decide what to say, how much to say, what to concentrate on, and what to leave unsaid, how to interest his audience, how to hold their interest when it stands to reason that, quite logically, the interest of any audience is going to ^{be} desultory in some of you and only a passing interest to others. There is a great tendency to speak in terms of art, which in the final analysis means that the speaker is really talking to himself. I hope we won't fall into that trap today. But it is easy in this particular field, because I think no other science, if it may be called that, has more terms of art, has more technical connotations.

Last March also, to get last March out of the way, I tried an approach to the subject which I thought might be workable. I think that it may have been, but I don't want to repeat the same approach, because it isn't any particular fun or very stimulating to simply go around saying the same things over and over again. It would save my energy and your patience perhaps to just have it recorded and let it go at that. But today I am going to try to get at the subject from a somewhat different viewpoint, a somewhat different angle, and hope

that this approach will work as well as any other.

A couple of years ago it would have been pretty easy to treat with this subject. It would have been very easy, as a matter of fact, to make you a pleasant, dull, uninteresting kind of speech on the subject, outlining the use of emergency economic controls in World War II and in Korea. I think that we would have done reasonable justice to the subject, and all would have been as happy as possible under the circumstances. Nowadays that's only half the story, and thereby hangs the problem. I hope that because it is only half the story, incidentally, it won't mean I am unwittingly twice as dull as I would have been. But that's a risk you will have to run.

To get started, let's take a quick look at what we call our economy and pass it on to you as some new phrase. Our economy is a gigantic thing. Most of the time we seem to accept it as something vague, something that is there, but without really exposing it to any sharp examination. So just for a couple of minutes let's take a look at the kind of economy we are surrounded by.

It consists of some four million businesses. Those businesses manufacture or produce probably eight to nine million items. There are perhaps three hundred thousand manufacturers involved in this economy. There are at least two million distributors of all kinds. There are several hundred thousand service establishments, rendering all kinds of service to all kinds of people and in all kinds of circumstances. There are six million farmers in our economy. There are some sixty-

*

five million people working, or the best part of sixty-five million people. We have a gross national product--another term of art--which today has in the neighborhood of 380 billions of dollars, which the experts say in the not far distant future will be 400 or 450 or 500 billion dollars.

This economy is frequently called by many names. Some call it an entrepreneurial system. Some call it a free economy. Some call it a free enterprise system. It has all sorts of names. It has been productive of the highest standard of living which any country has ever known, which any civilization or any economy has ever produced. We have had that drummed into us for generations by every politician who wanted to make a point.

It is welded together by an intricate system of credit and money,
which are part of the reason or the manner in which it works and the
success with which it works. Yet, while we call it a free economy, it really isn't a free economy. It is oftentimes regulated. Sometimes it regulates itself. Other times it is regulated either by the action of external forces or by specific devices of government or of man which are intended to try to regulate it.

In balance, most of us, I think, would argue very strenuously that it is a good economy, that it is the best kind of economy, and one we are interested in protecting and extending for as long as possible. Its parts are related to each other. They are interrelated. It is an interstate economy, it is an intrastate economy, it is an international

economy. It is much affected by government action; equally affected sometimes by government inaction.

We accept it, generally speaking, rather matter-of-factly, as we do any other thing. We squawk about the deficiencies in this economy, and we take for granted the advantages of the same economy. In the past we have tended to accept the ups and downs that are a natural part of such an economy. And we have worried from time to time or generation to generation as to how we could overcome some of the deficiencies without changing it inherently and basically, and while maintaining the advantages.

Now, this was the situation approximately when World War II commenced to loom on the horizon. Our economy--and this description doesn't even commence to do justice to it--had been at one of its periods in a severe depression, as you all know. It had not yet recovered from that depression when World War II or the threat of it commenced to appear. It gradually became obvious that we were going to become involved, and it gradually became obvious that this economy would have to undertake some very large changes and a very extensive expansion in order to do justice to our position as it was likely to develop.

It was during the period of 1940 and 1941 that a relatively small group of people, brought together to think about this subject of the impact of a possible war on this economy, in effect gave birth to what has become known as the whole family of emergency economic stabi-

ization measures, methods, and devices. It was simply concluded that an economy which, obviously, had been pretty well prostrate for quite a long time, simply could not take on the sudden impact of war-time expenditures and of a war without very serious economic reverberations, and that therefore something would have to be done. That something was the gradual development of methods of emergency economic stabilization.

Now, very briefly let us take a quick look at that, because you, I think, must have this frame of reference in the back of your minds if you are going to go forward very far in this subject.

Emergency economic stabilization, as we know it, boils down essentially to two broad kinds of measures or methods or controls. They are the so-called indirect controls and the direct controls. Stated as simply as possible, I think indirect controls are those which go to the sources or causes of a war-born inflation, an inflation, in other words, which springs out of a sudden impact of war expenditures and the gearing of an economy to whatever the war effort may be. Indirect controls are vital. They are more scholarly in many points of view than are direct controls. They have more status, and they have more respectability than do direct controls.

Direct controls are in effect just what the term connotes-- direct controls on the price structure, on the wage and salary structure, and on rents. They also embrace the whole field of distribution, that is, consumer rationing.

Now, included in this family of indirect controls are such obvious things as taxes. When a war comes along, and expenditures obviously are about to rise, or do rise, you can either forget the fact that the expenditures are moving up, that the cost of operating the Government and the country is going up, or you can undertake to pay for the expenditures as you go along, or at least pay for some part of them. Of course, in that event you have to borrow all kinds of funds in order to pursue the war effort.

Now, to the extent possible, tax increases in time of war are intended not only to help pay for the war as you go, but to drain away from consumers and from business and from any other holders of these war expenditures, the source of what otherwise would be a war-born inflation, a price or wage inflation.

By the same token, credit controls are generally exerted in such a situation, controls to see to it that credit is not used loosely or speculatively or unwisely, and to guarantee to the extent possible that credit in a time of war will be used in the national interest, in the interest of necessary expansion, and so on. In some situations it is a kind of control that not only applies to business credit and bank credit, but it also goes further and directly controls consumer credit. And thereby, as in World War II, we have the family of consumer credit regulations which dictated down payments, the terms of payment, and so on.

Now, these kinds of controls, having to do with our tax policy, our fiscal policy, and our credit policy, are the indirect controls.

They seek to take away from the economy, before it can be seriously damaged, that sudden impact, that sudden surge, of potential inflation.

That's not enough, however, in any period of war. The best proof of that, of course, is the fact that, despite increased taxes, despite credit controls, despite every available method then known, our national debt as a result of our borrowings and our expenditures in World War II increased by more than two hundred billions of dollars. Likewise, of course, despite the use of these controls and many others, we had a rather substantial price and wage inflation over the period 1941 and 1942 to 1946 or 1947.

Now, the direct controls, of course, are intended to deal with some of the effects on the economy of these expenditures that you are applying the indirect controls to. They are a sop, perhaps, for some of what you couldn't control or stop at the source. To some extent they work. But they also breed the gravest kinds of controversies, complexities, and headaches, I guess, in modern times. And there will always be questions as to the extent of their workability.

As you know, price control is simply an attempt by mere mortals to substitute an artificial price structure for the kind of price structure which this economy I described would ordinarily produce on its own motion. Therefore I think that without any great embellishments you can understand that the job of sitting down and undertaking to recreate or to create an artificial price structure which will let this economy adapt itself to war needs and demands is quite a trick.

and
Wage stabilization/ salary stabilization are almost equally complex, because they seek to guide the rate at which people will be paid for their work, and because the methods available for doing that kind of job are somewhat limited and equally controversial, equally misunderstood, and equally susceptible of all kinds of arguments.

Rent stabilization in many respects is a politician's dream. It is easy, because all you have to do is use historical data on which you tell the landlords and tenants, "Your rents are frozen" and let them fight it out. On the other hand, it is an easier kind of approach, an easier kind of direct control, to administer, if you have a thick enough skin, than are the other kinds.

Rationing, as we know it and as we used it, involves the use of ration currency, ration books, and all of the trappings of that kind of rationing system.

In every case these direct controls were born only over a period of time. Time was available during which you could bring together competent people, during which you could get business, agriculture, labor, the public, Congress, and others together and arrive at some tentative compromises with respect to most of these questions. So in one way or another these kinds of controls were developed and were initiated and were administered.

Now, it isn't a simple problem just to impose a freeze on prices, wages, and rents. Underlying direct controls, whether it be price or wage controls or rent controls, are certain basic concepts, philoso-

phies, or rules of equity; call them what you will. I think it must be obvious to you that in this complex economy, this complex society, at no time are all the parts of the whole in perfect balance, in perfect relationship, to each other. Agriculture at the moment, for instance, is arguing that its position is not equitable as compared with that of business or of labor. At any other given time any one of the three or four major segments of our economy will argue the same thing.

Now, in a period of direct controls any set of direct controls must have as their basic foundation some kind of rule of equity, so that you can say to each broad segment of the economy: "We are going to treat you fairly and equally. We are going to treat your colleagues on the agriculture or labor side fairly and without discrimination. These are the rules we are going to follow."

You can't have a clear understanding of this subject of controls unless you understand that these rules of equity are inherent in such an operation. I will give you only a very brief sample, so that we won't have to dwell too long on this aspect of the subject.

When you control prices in this country, you start generally by freezing prices. That is the easy way to do the job. It is almost the only way to do it unless you start selectively one industry and one commodity at a time. The simple way, the emergency way, and the way in which we dive into the whole field, the way to do it at one fell swoop, is the freeze, the general freeze.

But you don't freeze this economy, remembering all of the

intricacies and complexities of it, as you will, and then walk off and leave it there. Immediately upon freezing it, you have to start thawing it. When you thaw it, you have to have some standards, some rules, follow some guides.

At that point it is necessary to develop a set of so-called price standards which will provide equity for the business community, which will permit the Government to say: "Your prices are frozen; but if you can show us that your cost increases are sufficient in scope or in magnitude to warrant price increases, and if you can meet certain tests, we will automatically grant you these price increases for your industry or for your company or for your commodity, as the case may be. This will be our yardstick, this price standard."

With respect to prices, we have developed the so-called earning standard, which simply says that if your earnings in the industry have been deteriorated by virtue of the absorption of cost increases, you can get an automatic price increase. There are several others, but I won't bore you with them now. In any event, that is a kind of rule of equity that is developed to insure nondiscriminatory treatment of the business community.

Then we move over to the labor side. Labor, quite properly, is not going to have its cost of living moved up while it is exposed to a wage freeze. So it has to have a rule of equity or standard for use during this period of emergency control. Therefore in Korea particularly, the rule of equity developed was the so-called cost-of-

living escalation policy.

That is not as bad as it sounds. It simply says that if the cost of living moves up, then automatically any industry may receive an increase in its basic wage rates to keep pace with the cost of living. This was intended to insure equity for the labor part of our economy, so that that group would not be discriminated against. If prices could be stabilized and held down, then the cost of living would not move, and theoretically wages would not move. On the other hand, you usually start at the other end of the argument and decide that perhaps, if you could hold labor costs down, there would be no pressure on prices, and so on.

Now, to move over to the agricultural economy. Farmers, of course, have to have some kind of equity during this period of controls. Their rule of equity has always been written into the law. It is the famous term embraced by "parity." We won't discuss parity here, fortunately for you, and for me. But, in any event, parity is simply a device adopted for wartime use to try to guarantee to agriculture that it too will receive equity during the life of a direct control program.

All of these basic standards, these basic concepts, of stabilization are underlying and must exist if there is to be a successful period of direct controls in this country. When you are undertaking to conclude how the Government should enter into this field, how it should operate, if you are called upon to so conclude, keep in mind that there is much more to this science of direct controls than just

throwing a freeze into the economy. That's the easy thing to do. It's a regrettable fact that, if I were given an hour's warning, two hours from now it would be possible to impose a general freeze on this entire country, this whole economy. The problem would come of the thawing of that freeze, of making it workable, of adapting it to the needs of the economy as it sought to do the war job.

In any event, on this kind of basis, using this family of direct controls, using these standards and many others to try to guarantee equity and non-discriminatory treatment, and also trying to accomplish some measure of stability in a period when there were severe inflationary tendencies, we managed to get through World War II. As a matter of fact, while we were surrounded almost from start to finish with horror stories and by a realization that this was an almost impossible job, while we were beat around from pillar to post as administrators, while the country and the business community suffered greatly, not so much in basic terms as in terms of aggravation and irritation from the imposition of controls, we did manage to survive.

Economic historians are already commencing to view that period in rather mellow terms. They don't worry about the horror cases, the congressional hearings, the kinds of monkey shines which are part of any period of direct controls. They look back on them from the safety of ten or fifteen years to see what the net effect may have been, and today they are commencing to write in about these terms: "Never in civilized history has any country or economy geared its productive

capacity so rapidly and so successfully to the fighting of a war. Never have so many people been employed. Never has a job been done with such little economic consequence in terms of what that consequence might have been." In other words, they are commencing to suggest that, despite our deficiencies and despite our newness, despite our lack of knowledge in this field, a reasonably good job was done. And in future generations I suppose that is how history will view the subject.

It permits you, if you have been exposed to experience in this field, to shrug off the horror stories and the controversies in which you have been involved. If I could do so--and I am sure I can't--but if I could, I would be quite content to go up on the Hill and testify before the various congressional committees to the effect that I agreed with them one hundred percent that the job of direct price control in this country is virtually impossible; but in the next breath I would argue that it would have to be undertaken anyway.

I would be willing to admit that you can't really control the price of perishables, of meat, dairy products, fresh fruits, and vegetables; that you can't really do much about them. If you start out by controlling the price of frozen fish, and some wise guy lets it thaw out, it turns into fresh fish, thus commanding a different price. I would be willing to agree without any argument that you can't really control the price of a dress, which by virtue of having a button removed from down here and put up here, becomes a new item, a new garment, commanding a higher price. There is no sense arguing that kind of

thing, although in time of war every controller must be able to go up there and argue from breakfast to dinner the fact that he can do the job, that he is doing it, and that it is a necessary and vital job despite the headaches, and that, Mr. Congressman, things are all right.

Now, everything is not all right, and it never will be.

There are almost no happy answers in this field. So don't ever abuse your mind with the notion that you can have a benevolent or happy kind of period in which direct controls are operating. You can't. They are always making a mess of our economy. But, on the other hand, they will make much less of a mess than would be the case if we let this economy go its way in a period when it is exposed to the kind of impact that a modern war can bring forth. I won't belabor that point, but I think the record will indicate that it is a fact.

Anyway, we got through the war. We did the job one way or another. And while, of course, when the war ended, we dumped controls pretty hastily and thereby suffered an immediate price inflation, which nearly wiped out or more than wiped out all that we had saved during the war, we at least did the wartime job.

I think this may raise an interesting academic question, one that you and I won't need to solve right now. But it does suggest that a question exists as to when you start a period of direct controls in an emergency, at what point you are going to be building a dam against a post-war force, and at what point you are going to let that dam go and take whatever licking you are going to take. We did this in 1946, 1947,

and 1948. Then, while we took a good licking, if we had gone in the other route, it is conceivable that you would never have ended this period of direct controls. So I guess this is simply an unanswerable argument at this point, and perhaps may always be.

Now, having dispensed with our structure of controls as soon as the war ended, we were all happy to go back to something approaching normal. This, of course, was not confined to economics. It was true also of our defense establishment to a very substantial extent, and to many other attributes of an economy which had been geared to war.

Between World War II and the outbreak of the Korean War very little successful planning went forward in this field. Very little attention was paid in this country to coping with it except in relatively small groups of individuals within the Government and to some extent outside the Government. Therefore, when the Korean War broke out and the Congress authorized the President to enter into the field of emergency economic stabilization again, we were substantially unready except for the reservoir of experience and talent which had been acquired during World War II.

So, moving swiftly to avert inflation--to use the phrase OPA used over and over again--the Government hesitated for three or four months and finally wandered into direct controls in early 1951 through the imposition of a general freeze. It then sought in effect to recreate just about what existed in World War II. Again we had a

period of direct controls and a period of so-called indirect controls, all of them seeking to deal with the potential inflationary threat of the Korean War.

Well, it turned out that this potential threat was pretty much of a dud, because as soon as we entered into this arena, our entrance promptly cut across the psychological inflation which had been going on, and there was virtually, with a few exceptions, no need for intervention by the Government in this whole area. Nevertheless, controls aren't half as easy to get out of as to get into. So after another three years the administrators of the program were still struggling with a standard that would rationalize their backing out of controls. Meantime it was belabored by politicians and by business people and by consumers on all the usual grounds, on the one hand, that they were giving the country away because they could no longer live within their incomes, and, on the other hand, that they were ruining the country because this was an entrepreneurial system and here they were exerting controls for controls' sake, and so forth.

In any event, that was exactly what happened in Korea, without a lot of conversation. It was an unhappy period for controllers, because you never could be certain that the whole structure of controls was necessary. We learned relatively nothing in this field during the Korean War except that it is pretty difficult to operate this kind of program. It is even more difficult when the guns are seven thousand miles away, and when the great bulk of the country isn't too sure a

war is going on.

This, therefore, is perhaps the briefest comment I could offer and feel that I have said anything about our economy, the way in which controls have some impact on it, and the history of controls in World War II and Korea. I simply have the feeling of not having dealt with the subject very much, because it would permit us to stay here all day long, I guess. I don't know how many millions of words have been written on various aspects of the total subject. You don't have the time, you don't have the patience, and I don't have the strength. So I think we will have to assume that we have touched on some of the fundamentals that are necessary to a clear understanding of this subject as we go a little further.

I could embroider the thing a little bit more. I might suggest to you that economists have said that the exercise of direct controls during World War II probably saved this country a hundred billion dollars as the minimum in terms of what otherwise would have been the cost of the war. There were a lot of interesting statistics and things of that sort which could be used. But I think that this is a sophisticated audience, one which has also survived a couple of wars, at a minimum, and which has had some experience with some of these issues. So there is no need for me perhaps to comment further.

The trouble is that after using up all this breath and energy, this is still only half the story. I now have to open the door to the brave new world in which we live nowadays, and in which we are going

to live in the future, apparently.

I don't want to be overly dramatic about it, because I don't know that I could be; but this is a world, for instance, in which we have the NIKE installations around Milwaukee, around our inland cities. This is a world in which it is possible to have breakfast in England, have lunch in New York, and dine again in England. It is a place where some new forces have been released, forces which none of us really comprehend. At least I don't and I know I speak for millions of others. There may be a few of you who understand them. Most of us don't know what makes a doorbell ring. How on earth can we understand the influence of the forces which scientists and others have released on our kind of world? It is a force where the TNT equivalent of a single bomb, as I understand it, is now, or can be, may be, greater than that of the TNT equivalent of all the bombs dropped on Germany by the Allies. We are using incomprehensible terms now. Maybe they are not to some of you people, but they are to most of us. We are not conditioned to that kind of thing.

It is the kind of world where we find something over 70 percent of our productive capacity and more than 50 percent of our working force located in some fifty metropolitan areas, centers of population, in this country. They are really targets. They are part of the real targets of any potential enemy. It is a world, incidentally, where these potential enemies are presumed to be not very far from the point where they could launch an attack on this country which would be capable of

causing temporary or general collapse of our credit and monetary structure and quite possibly therefore of the economy, which I tried to describe briefly and remind you about.

They are capable, as I understand it, or will be shortly, of inflicting destruction and damage on this country which is almost unbelievable. The cost to us, if we could survive and emerge triumphant, as I assume we would intend to do, would enter into the trillions, not just a mere 251 billions, or whatever the debt may be at the moment.

It is also the kind of world, for contrast, where the budget for civil defense in the District of Columbia last year was \$115,000, but where the budget for the national zoo was something over eight million. This is a questionable kind of statistic, but I think you will have to admit that it is a useful way to make a point. So I indulge, with your kind permission, the propensity for using that kind of statistic.

Now, it is that kind of world and many other kinds besides. Meantime this economy of ours is commencing and is continuing to grow and to expand and to prosper in a sense--a nice, big, ripe, juicy target for the kind of damage and destruction which these new forces are capable of producing.

Now, then, what are the economic consequences of attack on this country, this kind of economy? This is a rhetorical question. I haven't the faintest notion of what they are. I don't imagine that you have either. No one has. And yet this is one of the problems of our time. We have to try to discover what those economic consequences

may be, and what, if anything, we can do in advance of such a situation to protect ourselves and to support our survival or rehabilitation and our defense posture.

This, therefore, begs the question of what kinds of emergency economic stabilization methods are relevant or appropriate. Surely it doesn't make sense for an OPS agent to go zooming into a crater which was New York waving a price regulation and talking in terms of price freezes and so on. On the other hand, stabilization measures of some kind, of many kinds, may be absolutely vital.

Now, I suppose that because a few of us are accepting government funds or working in the preparedness field, we should be able to describe to you a mystic set of plans to meet all these exigencies. But that's just not the case. I will go back to last March. I said at that time that our status, in my mind, in this field was terrible. It is no better than terrible right now. Have we just wasted our time? I have to say that there has been some improvement, since I have spent another six months at it. But this may be overstating the case just a little bit. The situation is still pretty bad. We are only commencing to realize and to understand the nature of the problem with which we have to contend.

We are getting at it in this way: I can't describe all of it to you. In the first place, I am not sure all of it would make sense, and therefore I don't want to become any more vulnerable. But in any event there are some things which can be said about it.

If we have any yardstick to guide us in this business of trying to prepare for emergency stabilization, it is that we have borrowed from the Manhattan Project of World War II and tried to compartmentalize the total problem. We have decided that there is no sense in trying to get people or Congress or executive agencies or anyone else to digest and understand and absorb this whole subject and give it the thoughtful kind of attention that it needs. So we decided that we would take the total subject apart and divide it into compartments and see if we could advance preparedness with respect to the various compartments. I don't know if this makes any sense, and I don't know how we will get along in the future; but at least it gives us the feeling of being able to turn from one closed door where we are not arousing any interest or help and go to another compartment and find just a little bit of interest and have the feeling of making just a little bit of progress.

This particularly, of course, has to do with respect to the so-called orthodox stabilization measures and the orthodox global war situation which supports them. But, unhappily, the more time that passes, the less relevant these orthodox stabilization measures are in this so-called orthodox situation. It would be comparatively easy for us to profit by the experience of World War II and Korea in this whole field of controls, whether direct or indirect. We could, if we had the patience and the maturity and the forbearance, find people who would spend time, during the time it takes, on various aspects of

trying to profit by experience. But the trouble is that it seems less and less likely that we will again be involved in a global war like World War II, where we have a year or two of warning, where we have time to prepare, where the war never touches you, is a long way off.

So that while that kind of preparedness, I suppose, is useful and permits you to examine more closely in retrospect what you did and why you did it, it may or may not be very relevant. Therefore we have to enter into another compartment simultaneously, and that has to do with an examination of the likely economic consequences of attack on this country. And here, as I have said, it may be you enter into a world of science fiction. It suggests a kind of situation which almost beggars our imagination. And so I think it will be a long, long time before we can really feel that we know or understand what the potential economic consequences of an attack on this country would be.

Nevertheless, we know we have made some progress. We must spend an increasing amount of time seeking to arouse an awareness of this problem, seeking to get other people interested in various aspects of it. We are doing that these days in two or three ways.

An example, of course, is the fact that we have war games. We will have them from now on, at least once a year. These war games are viewed variously by various people. They may be considered to be anything from boy scouting to a trip to the country. And certainly, speaking of the one in which you individually participated last summer, the food was about as incongruous and irrelevant to an attack on this

country as you could imagine. We had what must be the all-time best cooking school preparing our food for us. So most people spent seventy-five percent of their time eating.

But, in any event, the war games offer us an opportunity to condition ourselves, like Pavlov's rats, gradually over a period to this kind of atmosphere that might exist in an attack on this country. Whether this is useful conditioning, only time will tell. But it does permit us to arouse subjects which otherwise would lie dormant.

As a single example, we succeeded in getting the whole subject of war damage indemnification and the availability of credit after an attack out of our tent and all the way through the various agencies involved up to the President during the course of the three days of the war games last June. The President, quite properly, as always in such a recital, said he knew that such a subject existed, and, as I recall, added: "This subject is very interesting and I certainly think more work should be done on it." He didn't quite buy our proposals, which was understandable. The point is that merely by virtue of his saying: "This is an interesting subject and deserves more attention and more thought," we have a plug that we can use to balance the deal, to beat into submission or acquiescence any of our colleagues or others who otherwise might take a dim view about wasting their time on such a subject.

Now, if only in that sense, these war games can be extremely useful in all these fields where there is so much controversy and

complexity. From another standpoint I think they can be useful too, because they do let you get in the frame of mind of being heroic, of facing the exigency, and being forced to do some things under peculiar conditions which otherwise we never would face in the course of a year. I look for them to be extremely useful as time passes and as it really shows up the good work done last summer.

Through the war games, and through the appointment occasionally of consultants, people who are particularly expert in some of these fields, we hope to go on compartmentalizing this whole subject of attack on this country and its economic consequences, with the thought that over a considerable period of time we may be able to get a better realization of what is involved and what possibly the United States Government might do to prepare itself for such a situation. I won't bother you to try to dream about all these things at this time. It may be getting past my deadline. But, in any event, I will mention one or two aspects of the problem.

In the first place, war damage indemnification becomes a really relevant subject and a part of the emergency stabilization problem. How do you indemnify, or do you indemnify, for the damage done by this kind of attack on this country? If you don't indemnify, how do you create confidence in our economy, in our government, in our capacity to rehabilitate ourselves and to survive? How do you permit the credit and monetary structure to get back on its feet if it really receives the kind of blow which is said to be possible?

You understand, I can't afford to talk about whether we are going to retaliate like that or whether this can happen to us or not. I am proceeding on the assumption that the things told to us by the Security Council and your establishment broadly in terms of what our enemies are capable of doing are true. Whether they succeed in doing them is another matter. So this question of war damage indemnification becomes a vital one, absolutely fundamental.

One of the first things, in all likelihood, that the Government, or the remnants of the Government, would have to do would be to announce following attack what the Government intended to do with respect to indemnifying war damage. Whether it would be ten percent indemnification or a hundred percent or 60 percent, I don't know. But it seems probable that some form of indemnification, of insurance, would have to be forthcoming.

Likewise, I think that the Government--and don't ask for the source of the funds; it would be for the Government to find them-- would have to would be to make vast sums of money available in terms of credit. It would not have to be worried this time so much about controlling credit as it would about making credit available through the form of guaranteed loans and through actual loans. It would have to undertake no doubt to enter into the field of what the economists call, I think, income maintenance. People can't go to work because there is no place to go to, if they have escaped. Their place of livelihood has been destroyed, their income has been interrupted.

They have no money, no source of income. What do you do? Of course you have a gigantic public-feeding problem on your hands, among other things; but you also may face the problem of undertaking to maintain their incomes sometime, if these first survival measures can be undertaken with some success. We are dependent on them.

In many cases it appears that the problem will involve the reverse of the orthodox emergency stabilization methods which have been relevant in past wars. The problem opens up new vistas, wholly new, without precedent and without experience which can be used to guide us.

Now, out around the country, in the undamaged portions of the country, it may be quite proper that some of the normal attributes of a controlled economy will commence to appear. It may very well be proper for a general freeze to be imposed in those areas which have escaped damage, in order not to let the impact of what happened elsewhere demoralize their community, their cities or areas.

Again I don't know if that makes any sense if the economy has collapsed, because no one can know the responses of people and of organizations to this kind of catastrophe. General Ludicke, of the Special Weapons Project, was talking to me one day and he used this term "responses" and it stuck with me ever since, as one of the really relevant comments I have heard. What he said was that we know a lot about the effects, that we are learning all the time about the effects, but we don't know anything about the responses. We don't

know whether all the people in this country will head for the hills, whether money will lose its value in income maintenance and something else will take on value, whether you would be trapped with a barter system or some other kind of system. I can't say. But this is the problem of economic stabilization preparedness from now on. It looms larger with every passing day.

Emergency rationing and confiscation are certainly going to be fundamental parts of life in any part of these United States following a massive attack. Martial law is a subject which, of course, came up during the last war game. I heard it said that it aroused much consternation among the reporters. The President, faced with the first report of simulated damage done by a relatively moderate strike, concluded that martial law was his only answer. But our preparedness plans had not been carried forward with any idea that martial law would be in the picture, even though I am sure many people in the military establishment felt that obviously and fundamentally, martial law would be required. I recall that when I was here last March, there was considerable interest on the part of the military students in this attack situation, and statements were made to the effect that it would make good sense to have the military more a part of our preparedness work, since in the last analysis we would probably be stuck with a great deal of work in damaged and perhaps in undamaged areas following an attack.

The President, in choosing to go the martial law route, mentioned a good many activities, some frenzied and some more dispassionate.

perhaps some of the civilian establishments have been looking at various aspects of martial law somewhat more carefully than was the case prior to those war games. And I have no doubt that this time, this June or whenever the games are held, this can again be an extremely relevant subject; in fact, may play a greater part in the game. It certainly suggests that people in the Military Establishment would be vulnerable if somewhere along the course of their training they had not picked up a reasonably good knowledge of some of the aspects of life in a mobilization economy. Whether you all line up where nobody would ever want to be caught dead is beside the point. The fact remains that, since military people are to become more and more a part of preparedness and more and more a part of the activities following an attack on this country, then knowledge about such fields as this becomes a pretty important aspect of training and of the life of the Military Establishment.

Anyway, without discussing that at any more length, let me say that it would appear to me, insofar as we have made any progress, that the key to survival in this kind of attack situation will probably lie in local action--local action which will work to recreate the situation that existed as of the time of the attack or at least work in that direction, and local action which will seek to support basic survival measures, with the thought that over a period of time, and as the Federal entity gradually gets on its feet and gets back into operation

and restores a sense of administrative communication and so on, it will weld together all of these local actions and theoretically, therefore, pave the way toward general rehabilitation and that sort of activity.

Now, there is danger in leading yourself to the conclusion that in any such period of time defense and production are simply out the window, that therefore no such thing could exist during this period, and that therefore this war will be over with just one strike and our retaliation and that is it. I don't know if that is true or not. But it is an interesting thing to think about that and turn it over in your minds as you try to sort out the wheat from the chaff in this whole field.

Now, I don't want to leave you with the feeling that we think absolutely nothing has been accomplished in this field. A great deal has been. This Administration in the last six or eight months has agreed on a set of principles to guide us in planning for emergency stabilization. I mention that only because there is always a question as to whether this is an Administration which would impose controls if we get into trouble. There is no problem in that connection. That simply is not a problem. Any responsible government, no matter who might or might not be administering its affairs, would have to impose all kinds of controls, if it could, in an emergency, and perhaps many kinds that we have not yet dreamt of.

In addition, in the last few months the Cabinet and the President have approved a wartime organization for dealing with emergency stabilization. This again is relevant as long as it is going to be an orthodox war, when our enemies invite us to go into, where they let us know

when they are coming and where, so we can get set for them. But it may not be that kind, and therefore this organization, if it is to be any good, must be such that it can be adapted to the establishment in time of crisis.

Remember, we have no legislation, we have no people, we have no status, we have no buildings, we have no regulations, we have nothing in this field, because it is not the kind of area which supports a lot of active aggressive peacetime work. So that when the warning comes, you start from scratch. You have to work with only what you have been able to get set quietly during the time of peace. And, of course, in my view, even if we are able to get some things set, they will be useful only to the extent that we can get them across to the local people. It will have to be the local people, whether they are governors or mayors or civil defense people or military people, who are in a position to deal with some of the legal and economic problems which they will have to contend with.

Also, we have appointed some consultants, such as Dr. Chandler of Princeton to work with the Federal Reserve and the Treasury on this field of war damage indemnification, insurance, credit availability, and so on.

Finally, by dint of much painful conversation, as lengthy as this here this morning, we are going around the country gradually trying to create a little awareness of this problem at business meetings, through community groups, seminars, and various other things. Progress is

slow, but it is a part of the preparedness job in this field. Of course, we are doing some physical things, like working in the area of relocation of sites, stockpiling of currency, protection of the Federal Reserve, and so on.

Perhaps these things would be more suited to a seminar than a lecture, but I might merely touch on some of the problems that we have to contend with.

As time passes, it would appear that anything approaching orthodox emergency stabilization, as we know it or as we may learn it, is becoming more and more passe, becoming less and less relevant.

As to police actions, it is almost useless to talk about them. If we should get into another so-called police action a la Formosa, a decision would have to be made at that time on its potential economic effect. If a decision were made that some kind of government intervention were needed, it would, of course, be the orthodox kind of intervention--a general sort of usual structure of regulations. This seems to be unlikely to be a situation that could happen. So I don't see any sense in spending a great deal of time talking on that area.

The real problem in an attack would be its economic consequences. Studies with respect to what kinds of economic measures might possibly make sense in that kind of situation should be carried on.

But I think that you are going to have to be charitable. You must avoid being categorical. This is indeed gradually becoming a world of science fiction. We know little or nothing about living in it or surviving in it. We certainly have no idea of the economic conse-

quences of that sort of situation. We don't know anything about the answers that will have to be forthcoming.

There is no categorical answer. The job of the planners in my field, if I survive--and that is always open to question--is going to consist very much of just one or two things: of trying to discover the real economic implications and consequences of a massive attack, and of trying to conclude whether any of our past experience in this field makes any sense, whether it can be adapted and modified to use in this sort of situation.

On that note, it seems to me I have merely spoken unto some parts of the subject. I hope that as you pursue this course, somewhere among your group there will be some inspiration which will lead to some helpful conclusions and some contributions. I have tried to make it a practice of reading the output of these classes, and I find some of it interesting and some of it bordering on science fiction. Thank you.

CAPT GERWICK: Any questions, gentlemen?

QUESTION: We start with the assumption that perhaps the American people are as good as or equal to the British and the French. What experience did they have during the war, when they had their economy disrupted by bombed-out plants, which might be helpful to us?

MR. PHELPS: I think your first assumption is valid. In all those countries an attempt was made to provide for indemnification for war damage as a matter of national policy. In most of those countries there was also a program of so-called war damage insurance.

For that matter, this country had such a program. We paid something like a quarter of a billion dollars worth of claims, much of which was for damage done to our territories, but also there were some claims paid with respect to damage done out in the Northwest. I think we were shelled by a submarine or something like that. In any event, we had a war damage operation in this country which involved the payment of premiums. The premiums were collected for two years; and then, when it became obvious historically that we weren't going to be hit directly, it became such a profitable enterprise that no more premiums were collected, and they just paid off those claims that were forthcoming.

Now, I know that England had a program of war damage insurance, and that it paid its claims, which helped individuals and businesses and others to at least make a start in connection with rehabilitation, reconstruction, and so forth. I believe, though I would want to check on it again, that England also made one token payment out of its promises to indemnify for war damage. I am not certain of that, but I think they did. In the other countries--in Germany, for instance, and in Japan--the promises to indemnify for war damage collapsed when the government collapsed. Therefore the pledges and promises were never honored.

In England particularly, for instance, in places like Coventry, I understand that almost as soon as the bombs ceased falling and the dust had settled, air raid wardens or the equivalent would hustle around

town and make sort of a running inventory of what was left and what was available. They would collect things as they went along, like blankets and canned goods. This informal sort of arrangement, as I understand it, was quite widespread in the cities and towns that were hit.

But, despite the damage done to Great Britain, that damage never reached the proportions which actually caused a threatened or an outright collapse of the whole economy--the monetary and credit structure especially. Remember that England had allies which girded their shoulder in various ways trying to help with all sorts of help. You might make an analogy, I think, with the disaster up in my home state of Connecticut a few weeks ago. We had quite a disaster. These things were little atomic attacks on little Connecticut towns like Norwich and Putnam. They were without precedent, and so sudden as to catch everyone wholly unprepared.

Now, the thing which, in addition to the people's spirit and ability to rise to the emergency, helped most in that situation was that all the surrounding countryside, as a matter of fact, the whole country, was able to pitch in and help by making available all sorts of help--money, clothing--all sorts of things. The Government, too, was turning handsprings trying to be helpful.

This was just a little localized disaster. But it was the type of situation that could find the entire eastern half of this country almost obliterated, with very small scores that would support life, and the ground zero areas in many cases uninhabitable for a year or a year and

a half. I know of one relocation site that, according to one expert, would be uninhabitable for three and a half months. I don't know what anybody could be doing there in terms of carrying out preparedness duties during those three and a half months.

That kind of situation, you see, makes somewhat irrelevant what has happened in the past and what has happened elsewhere. England survived, but it *did* so by putting its shoulder to the wheel, by doing some orthodox things, and by doing some unorthodox things with the help of its allies; and because the tide was turned before they reached the end of their resistance.

Germany is alleged to have dropped 77,000 tons of TNT on Great Britain. That would be the equivalent of or a little more than the equivalent of three of our first baby atomic bombs like the ones we dropped on Japan. I don't know how much more it would take to destroy England or destroy its economy. They never got that much frightened. With all of the pressure and all that sort of thing, they managed to survive. Their experiences are interesting to us, and we have collected all of them. We mean to use them as far as we can. But in essence they are not really so very relevant or helpful when you look at the massive kind of destruction or damage which would overhang us.

That isn't a very brief answer, is it? I don't know even that it is an answer.

QUESTION: I am concerned with our conferences with industry and talking them into our plans. I wonder if you might in this field of

attack make your military strategic plans and put them away with our classified data until they are ready to be executed. What do you think of the potentialities of making plans for the economic progress of the country in such an attack and holding those in a safe in Washington ready for execution in time of emergency?

MR. PHELPS: Well, personally, I would support that wholeheartedly, because it would make life a lot easier for me if I could sort of go into a closet, close the door after me, come up with some plans, deposit them somewhere, and quietly leave town. But this subject is a different subject from military planning. You can plan in the military field and have some status. It is a sensible thing to do, to prepare our defense and get our military establishment in good shape, train our officers, and all that sort of thing. But when you are trying to spread the gospel around that it makes equal sense to plan for price and wage controls and rationing, we don't even mention that word very loudly. Start planning for any of these eventualities in the economic field and you immediately get a loud response to the effect that this is foolishness, or it is just another sign of interest in controls for controls' sake. Then you get a whole lot of other reactions because of the nature of the subject.

So that I think that the actual preparedness in this field has to be quiet and conservative, but not actually secret. You have to bring into it gradually the people who are going to be affected and who are going to make it work. It seems to me quite proper to try to increase

the awareness in the business community, in agriculture, in labor,
in Congress, and everywhere else that it is part and parcel of the
nature of the problem.

That is really the gist of our problem. There is no awareness of this subject out around the country now to speak of. I'll bet you wouldn't get to first base in your next parlor argument if you tried to talk to your antagonists, or whatever you want to call them, about bomb damage, radioactive fall-out, and all those matters. People don't want to talk about them for very long. They don't want to think about them for too long. And when it comes to making them translate the consequences of some of those things into preparedness actions, it is tough.

So I think we have just got to struggle along gradually conditioning ourselves, gradually telling more, and gradually increasing the awareness. But I don't think you can really do it secretly, except to the extent that in the last analysis, leaders always have to pose solutions. Therefore it is up to the expert to be a leader, a molder, of action. I am sure the Government will have some kind of reaction and response ready if it is hit in an emergency before it gets the kind of blueprints that it would like to have.

I used to use the analogy once that if you answer a question long enough, you won't have too many questions. I mentioned in March the fact that it should not surprise anyone that our plans are not what they ought to be. That is really what I meant when I said that none of

us ought to fall into the pit of having categorical answers. We just invented these bombs and we just unleashed these forces a few years ago. We have only used them once. We are improving them and perfecting them day by day. At the very same time we are still learning about the effects of the use of these weapons. We are doing that by having all these tests out in the deserts and that sort of thing, which may or may not be relevant, but it adds to our knowledge of the potential effect. It makes sense during the same few years when we have evolved these weapons and unleashed these forces to study all the effects to the point where we feel we know what is going to happen.

At the same time, we must not fall into the pitfall of thinking that we can have blueprint plans. I think this is a problem for a generation or two of planners. A year from now, if any of you are planners and take hold of this same subject, you may have some different slants or some new assumptions to work with that are not available to me today, that in turn I didn't have last March.

Maybe gradually over the years, future generations, if we have enough sense to withhold the use of these weapons, may have learned enough so that we can improve our preparedness to the point where we can obviously in no sense use the weapons. I don't know of any other answer to this question. But that is philosophy, and I suppose that is verboten in this kind of gathering.

CAPT GERWICK: Our schedule has caught up with us. We thank you very much, sir.