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PRICE CONTROL

by

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AIC 195 (3/24/39)13 a

PRICE CONTROL

Colonel Miles and Gentlemen

I realize in talking to you on this subject that I am trying to discuss a problem that you could get many different slants on from many different economists. In fact, it is probably one where the proverb about Washington economists would be especially applicable. You have probably heard that one, "If all the economists were laid end to end they would not reach a conclusion".

In presenting the ideas I have to present, however, I will try to separate those things on which they do not. Some of the material that I will have to summarize is on points that are relatively uncontroversial. I will try to indicate which parts those are. Then there are other parts which are on subjects where there is a great diversity of opinion, where you could get many different slants, and I will try to indicate which those are.

First, on this subject of price control you can think of it in two parts, as the control of specific individual prices, or as the control of the general price level as a whole. I will take up the latter first.

The question of what happens to price level as a whole is really related to a very much deeper problem of fiscal policy, which can be stated in a very simple question When you have to run a war, will you choose to run your war by price inflation or will you choose to run your war by taxation? This is one of the subjects on which economists generally, I believe, do agree. There are really only those two alternatives. You can finance the cost of a war either by borrowing the money, issuing notes to pay for it, or by taxation. As the World War experience demonstrated, if you pay for your war by borrowing the result is almost inevitably to drive up the general level of prices. That, however, has one reservation. It doesn't necessarily drive up the level of prices if at the time you start borrowing, your economy is not operating to full production. If you have some unused capacity in your economy, the result of borrowing is not to put heavier pressure upon what you are already producing, but rather to call forth more production. You then may borrow, get increased production for war purposes, and yet not drive up the price level.

I will now show you a chart of our recent experience which illustrates the two general possibilities. I have brought together here some of the key facts from our fiscal and financial history, during the World War period and subsequently. The upper part of the chart shows two lines, the top line the total of Federal expenditures; the bottom line the total of Federal receipts. The area blacked in represents the excess of expenditures over receipts. This shows the tremendous expenditures of the World War period, during which we were spending at the peak, over $18,000,000,000 a year and taking in in receipts only $5,000,000,000 to $7,000,000,000. Then we have a period following the World War when receipts slightly exceeded expenditures, and a small surplus year by year, cross-hatched, then the recent periods since the beginning of the depression, with the mounting Federal expenditures and Federal receipts mounting more recently, but still running a heavy deficit. We have there two periods of financing, by spending more than we were taking in, as far as the Federal Government was concerned, by issuing bonds or other obligations.

Now what was the effect of those two periods of heavy expenditures on industrial activity and on price level?

The next grid shows the changes in industrial production during this period expressed as percent departures from a long-time trend. You will notice at the time we entered the war there began a heavy expenditure. Our industrial production was already pretty high, running 10 to 15 per cent above the long-time trend. Those tremendous expenditures did not increase our total industrial production at all. As a matter of fact, during 1917 and 1918 our industrial production declined rather than increased. So the only effect of those tremendous expenditures was to divert from what we had been producing before to something else. We took buying power away from houses, clothes and other things in order to produce more munitions, ships, etc. Of course, at the end of the period when we cut off expenditures suddenly after having adjusted ourselves to the war-time economy we had the depression following, with the several years of readjustment and, of course, repercussions on world economy which we are feeling still.

Now in contrast to that period, we had the recent period of expenditures greatly in excess of receipts. That really large excess of spending started when our industrial planning was running way below capacity, when we were down to 50 or 60 per cent of normal. During this period the heavy expenditures have resulted in a material expansion in industrial activity over the period which runs through 1937, a fairly steady growth in activity along with the deficit expenditures. The last two years are not on the chart. They would show a sudden shrinkage in excess expenditures in 1937, a renewed depression in 1937 and 1938, then expansion of expenditures again in the middle of 1938 and into 1939, and an industrial pick-up six months or so following, if this were drawn on a monthly instead

910

of an annual basis. This figure shows the relation of expenditures to production, at one time when we were already operating to capacity, expenditures not increasing production, at another time when we were not operating to capacity, expenditures increasing.

The bottom grid shows price level. As of course you are quite aware, during the war period the increase in expenditures, although it did not succeed in increasing production materially, instead drove up the price level very, very sharply. It had risen some at the time we entered the war, from about a level of 70 before to a level of 110, it went up still more rapidly after we entered the war and after starting the heavy expenditures. In the more recent period, operating below capacity, the heavy expenditures had only a slight effect on price level. In other words, you can state it this way Operating on unbalanced budget by borrowing acts as a great stimulus to the business system, almost like a heart stimulant. In case the business system is not operating to capacity you can push it up to capacity. If it is already operating up to capacity it doesn't push it up any further, but simply increases its blood pressure, as shown in terms of prices. So really your first problem there is, are you going to finance by borrowing or by taxation, if you are already operating at capacity, or have you enough unused capacity so that you can finance by borrowing without driving up the price level?

I think one thing that hasn't been generally recognized in discussions of this point is that regardless of whether you finance a war by borrowing and inflation or by taxation, it is still paid for in normal times by reduced consumption on the part of your general public. You see, we have two different circumstances. If you started a war today with ten million people unemployed, low industrial activity, and you financed it by borrowing you would simply put a large part of those ten million to work, use your capacity more, and it really wouldn't cost you anything to fight the war. You would simply put people to work, use facilities that otherwise weren't working, and make through increased production the material which you would burn up in fighting. (But not the men who will be killed or wounded.) On the other hand, if people were fully employed and you start in either by taxing or by issuing bonds, you would be running the war by taking away from something else.

Now the way in which the World War expenditures taxed the general public can be shown in a little chart I drew up hurriedly this morning. This simply shows the effect of that inflation in prices on different groups in the population. Farm prices rose very, very rapidly. Of course they were already up high before we went in because of the demands from

Europe. Living costs followed farm prices, although not quite so rapidly, between 1915 and 1918 living costs rose to about 155 per cent of the pre-war level. Wage rates followed up, very much more slowly, so that by 1916 wage rates were up to about 135 of pre-war, while living costs were up to 155. That is the normal effect of inflation, that it drives up prices and living costs a lot faster than wage rates can follow. Of course people who are dependent on fixed incomes, such as those who receive their income from bonds or from government jobs, had no increase in income generally during that period and had to take a much lower standard of living. So in effect what happened in the World War was we followed policies that drove prices up very rapidly. Those high prices took buying power away from the general mass of the public and diverted buying power to the war purposes. So, in effect, we did tax the rest of the public but we also left the increased debts to be paid for later. If instead we had imposed very heavy taxes to cover the war expenditures we could have financed the war concurrently without any rise in the price level and without probably any more burden on the rest of the population than there actually was. Certainly there would not have been such a joyride as to produce the great reaction as was produced in 1920 and 1921, after the heavy expenditures were stopped.

It is rather interesting to contrast with this what has been done in Germany the last few years. Of course Germany has been going through all the motions of fighting a war for the last three or four years. She is now spending much more of her national income in preparations for war than we spent for war purposes at the peak of our war-time activity in 1918-1919. We spent about 16 per cent of our national income for military purposes then. Germany has been estimated to be spending 25 to 30 per cent for military purposes now and has financed that tremendous expenditure to date without any rise in price level by a combination of the two things I have just suggested, on the one hand by deficit expenditures which put back into use capacity not already being used, and on the other hand, by terrifically heavy taxation, that is, by reducing the standard of living of the civilians in order to pay for the military expenditures. Some of the English economists have estimated at the present time Germany is taking something over 45 per cent of the national income either in taxes or in forced loans, so diverting, you see, almost half of everything that is being produced for the services of the state, including war preparation.

Now we will turn from the general problem of price level to the specific problem of individual prices. Incidentally, I might remark that if you do follow a policy that leads to an expansion in buying power much more rapid than goods can be expanded you are bound to get a rise in price regardless of any control you apply. That is, when you pour a new money into circulation by the tens of billions of dollars and you can't have new goods to balance the new money, prices are bound to go up because prices as a whole are merely the result of an equation in which quantity of goods times the price level of goods on one side equals the amount of money in circulation on the other side, or equals the amount of money times the velocity of money. While many economists question the precise mathematical validity of that statement, no one questions the general result that tends to follow.

Within the general situation, no matter what you have made it, what can be done about the control of specific prices? I take it that is what most of you are interested in.

We have two classes of prices in our present economic system. The one class of price is prices that are set by the market through continuously fluctuating market processes, as on the Chicago wheat pit or the New York Stock Exchange or the cotton exchange. Those prices vary constantly except where controls have been applied. They vary with changes in the demand situation and the supply situation. The price itself is a result rather than a cause. If you attempt to regulate the price without going to the underlying cause you may not affect the situation in the slightest. For example, you could arbitrarily, by a legal fiat perhaps, hold the price of cotton at ten cents a pound under economic conditions which would tend to cause it to rise to twenty cents a pound. But if you held down the price you couldn't then get the supply which the twenty cent price would call forth. If you hold the price of cotton down to ten cents a pound under conditions when farmers would not maintain their production short of the twenty cent price you would simply get a great reduction in cotton output. So, to a considerable extent rises of these competitive prices have the same relation to the supply and demand of the commodity that the thermostat on the wall has to the heating system that maintains the temperature of the house. It is possible that you can regulate the price by working directly on marketing price in exactly the same way that you can drive up the temperature in the thermostat by holding a lighted match under the thermostat. But if the house is cold and you need more coal on the fire, simply holding a match under the thermostat is not a very effective way of heating the house. Some of our methods of price control tend to work out in that same way. That applies to the whole range of prices that are still set by competitive bargaining, prices of both goods and services. There are, however, in addition a range of other prices that are not set on a competitive market but are set by corporate business decisions or by other decisions. It is obvious, for example, that the price of a Chevrolet car is not set in the same way as the price of a bale of cotton or the price of a bushel of potatoes. At the beginning of the season the concern producing the cars decides on the basis of their appraisal of the market how many cars they think they can sell, the cost to produce, what their competitors are likely to charge for their cars, and the price they think they can maintain for that season for the volume they hope to get. Then they set that price and hold it to the end of the season without any change, regardless of whether they sell twice as many or only half as many as expected at that price. That same sort of a situation holds true in a large range of basic industries, steel, cement, copper to a less positive degree, aluminum, etc.

If you are interested in looking into the economic conditions which theoretically should prevail where prices are set, not by one single monopoly but by a group of large concerns competing with each other, I would suggest you read a recent book called "Monopolistic Competition" by Dr. Chamberlin of Harvard. It is one of the most significant new developments in economic theory and is now generally accepted as explaining the theory of the way prices will work where you don't have complete monopoly on the one hand or don't have free competition on the other, but where you do have what he calls "monopolistic competition" of half a dozen large concerns competing with one another in the restricted way in which large concerns do compete instead of the unrelenting way in which a large group of small concerns must compete. The general result in such cases is that prices tend to be rigid or administered, that supplies are never as large as if free competition prevailed, and that prices are never as low as under competition if the same cost prevailed. For example, the average profits of some of the monopolistically competitive industries such as the automobile and tobacco companies were something like ten per cent per year on their book assets, as reported to the Bureau of Internal Revenue, through the depression and through the previous years, whereas the competitive industries averaged one or two. That shows the difference in whether or not you are sheltered from competition.

In industries of this sort it is possible that a somewhat differenct type of control could be applied to prices by the Army than to the competitive industries, that is, you have a wider range in which to work. For example, in 1937 General Motors Corporation was making a net profit of around $115.00 on the average on each unit produced. If you were going to have a situation where war orders and others were making an assured market for that many or more units and even if the cost of some of the materials were rising it would be quite possible to insist that prices of cars not rise above a certain point because you know that with a large volume they were making very satisfactory returns.

Before going into the various techniques that might be used to control the prices which may be subject to control because of this business control back of the price, I want to discuss very briefly what is now being done by the Government to control prices. After all, this subject isn't quite as theoretical as it was twenty years ago when we entered into the World War period, because there has been a lot of experience since in other types of control and we have been able to see where they worked and where they didn't. Of course there is a wide range of prices definitely set by public ation. The Post Office rates are set by Congressional fiat, the railroad rates are controlled by the Interstate Commerce Commission, our utilities in general are controlled by utility commissions. It is control, however, with a great deal of wrangling and with a good deal of political influence from the part of the concerns being controlled over the commissions that do the regulating, and finally control without much regard generally to the economic conditions of the rates being set. That is to say, we have not put on any one commission the responsibility, not only for seeing what railroad rates should be but also for asking what the relation of railroad rates was to railroad wages and to other railroad charges. We have not directed them to take any special responsibility for the relation of the rates set to the business activity that could be carried on under those rates. That is partly because we haven't said to the utility commissions, "It is not only your responsibility to try to see that the concerns that you are administering or regulating yield a satisfactory return on investment, but it is also your responsibility to see that the rates you set are such that they are conducive to the prosperity not only of those concerned but to the country as a whole." Apparently we are only beginning to get a slight appreciation of that on the part of some of the regulatory commissions. Their lack of appreciation of the significance of that, though, can be seen by the fact that railroad rates were maintained practically unchanged throughout the period when prices were rising so rapidly in war time, then just at the time prices were coming down rapidly at the end of the war freight rates were jacked up to equal the war-time prices, and held very high practically all through the post-war period, contributing very sharply to the post-war maladjustment, then some downward readjustment, then they were increased during the depression at the very worst time. That type of regulation hasn't shown itself to be regulation with any sense of the significance of the economic conditions of the rates set. I am going into this merly to indicate that even though you are controlling rates completely through a regulatory commission you can't get away from the economic effect of those rates. The fact that railroad rates were abnormally high during this period was partly responsible for the rapid development of the truck traffic to the large extent it has developed in competing with the railroads, and also partly responsible in the case of agriculture, for many industries shifting nearer to their point of consumption. After all, if it costs you too much to ship fruit from a long distance you would cut down production so that the result of maintaining rates at uneconomic levels has actually been to produce less traffic for the railroads, both by the truck substitution and by the actual reduction in the amount of traffic moved. In other words, we have encouraged decentralization of industry, and in a sense decentralization of agriculture perhaps to an uneconomic degree by our insistence on what in the long run might have been an uneconomic level of rates. It is true the railroads have a very high fixed charge, they have to meet indebtedness, and 10 per cent difference in their volume of traffic may make 20 or 40 per cent difference in their net profits. So as a result of the rates being too high a considerable portion of their traffic is lost. Their net income may be much lower than it would have been with somewhat lower rates and higher traffic.

Another type of regulation under Government today is through the Coal Commission which has power to develop fixed prices for all grades and varieties of coal. They have been at it a long while and are just about ready to announce their prices. They don't have any control whatever over production. They can just fix prices and all the concerns in the industry have to follow those fixed prices, and then they can make such changes in production or such changes in sales as they wish to in the light of the prices established. It is partly because of that that the Commission has taken so long to work out its schedule of prices. Obviously, if they fix prices too high or too low that would encourage purchasers to shift their orders to the place where they could buy advantageously, or if too high for one grade and too low in another consumers would tend to shift purchases from one mine to another. I mention this to show you how complex it is to administer prices in detail. It is interesting to note that in the attempt to regulate the prices of this one commodity the Coal Commission has spent more than five millions of dollars in administrative investigation work and in its Consumers' Counsel, in trying to develop the schedule of prices of coal by grades, by locations, by mine points, and it hasn't yet announced the series of prices. So if you think you can just wade in and say such and such is the price for such a thing, that gives you some idea of how difficult a job it really is.

Finally, in agriculture we have a somewhat different attack on the question of price control, in the sense that most of it does not attempt to regulate prices directly. But we do attempt in general to go back to the conditions of production and consumption, of supply and demand underlying prices, and to secure changes in prices indirectly by controlling the conditions of supply or demand. Of course, as a matter of fact, we can't do very much about the demand for farm products. We have tried to stimulate it a little by developing new uses for products, cotton to make roads and houses, and developing lowered marketing costs and increased markets, and increased uses of farm products among low income people by buying surpluses through the Surplus Relief Corporation or by making the supplies available to those on relief at reduced prices. However, in general our efforts to adjust agricultural prices have had to be through controlling the supply, by adjusting the production to what the market would take, recognizing the very low industrial activity you have had during this period, the resultant reduced domestic buying power, and the closing off of world markets for a number of reasons of which you are well aware. We have had for the time being to bring down farm production to what the existing market would take. We haven't been overly successful in bringing production down all the way to the market. In the case of wheat we had two or three years of drought, and this being the crazy kind of work it is, farmers were very prosperous as long as the drought lasted, and those lucky enough not to be in the drought areas got a very good price for a good output. Those in the drought areas enjoyed a high price but had very little to sell.

In the case of cotton, prices were increased quite a bit for several years but then we happened to run into one terrifically big crop and that piled up a heavy excess. Meanwhile, world trade was dwindling away still further, in part for reasons completely disassociated with out farm program. Even there the control program has been only moderately effective, although cotton farmers' income has been better maintained than in the previous years.

Along with the efforts to adjust production, however, has gone one technique that you would be interested in, and that is a technique to limit the range of price fluctuation in high years and low years, by making loans on crops to lay up a reserve supply in years of large supply and low prices, with the intention of releasing those storage supplies in years of short crops and high prices. That part of the program I think has been moderately successful, with the single exception of cotton. In the case of corn there were several years of heavy rains. There were large increases and heavy supplies of corn laid up in storage. The availability of those supplies of corn during subsequent years of drought prevented the reduction in livestock numbers from being anything like as severe as otherwise would have been, and provided a more stable price of corn through that period. In turn, by preventing too great a shortage and too high a price of livestock, it helped prevent too rapid an expansion in livestock numbers subsequently. This year we had quite heavy corn supplies. The corn loan is holding up the corn supplies and putting part of those supplies in storage. Of course we can't tell what crops will be in 1939, but we are going into 1939 with somewhat increased number of hogs and heavy reserves of corn in storage, but nothing like as great an increase in hog production as we would have had in the absence of this "ever-normal granary" system. I think that technique of putting supplies into storage has more significance from the point of view of war-time price control than perhaps do the techniques of directly adjusting production. In general, those last techniques may take longer to use than you would have to use in time of war, unless the war lasts a very long time.

Coming back to the subject of war-time control itself, after this sketch of some of the major things Government is doing, in general there are two techniques you can use for particular prices, apart from the general problem of whether you use such a method of financing as to cause all prices to rise or not. You can use an indirect or a direct technique.

Of the indirect methods there are two that are possible. One is laying up a reserve of the materials you are going to need before the time of war. Of course that has been much discussed in terms of the imported strategic materials that you might have difficulty in shipping in in time of war. I believe, however, it could be developed very effectively, not merely for imported materials but for the domestic materials which are so non-perishable that they could be laid away. We have a particularly good opportunity for that in view of the fact that our industrial production is still quite low, and as a result of low industrial production, many of our industries, steel for example, are only operating at something like 40 or 50 per cent of capacity. Since they are operating at that low capacity we could make a deal with them to produce today supplies for storage of the types of things that you are sure you were going to need in war time, not necessarily the finished products but steel and iron, partly finished in various types and sizes and shapes, of the kinds you knew you were going to need. You could get that at an exceedingly favorable price. I will show you why you could get it very reasonably. Here is a chart based on the operations of the U. S. Steel Corporation from their quarterly reports. It shows the cost to them of making iron and steel -- the price here is a composite price of iron and steel as published weekly and monthly in the Survey of Current Business. It also shows how that cost of production varies, first with wage rates and second, with the volume of composite operating. The two lines show the cost of production at low wages, 65 cents an hour, and at higher wages, 85 cents an hour. The 85 cent rate is approximately the present rate. The other coordinate across the chart is the operations in percentage of capacity, quarterly sales in per cent of the plant capacity of the concern. What it shows is this when they are operating at 20 per cent of capacity under the present wage rates, it costs them about $41 a ton to produce iron and steel. As their rate of operations increases, that cost falls until it is about $29 a ton, at about 40 per cent of capacity. As operations increase still further, the cost falls until it is only $24 a ton, at 80 per cent of capacity. They are operating somewhere around 40% capacity now, with about $30 a ton cost. If you sign contracts with the steel industry to produce over the next year or two enough steel to build up a war-time reserve of the things you need, you could sign a contract with the industry to produce that steel at much below present prices because they could produce that at the greatly reduced cost they would get from the large volume of operations that would make for the. Of course if you don't do that, if you wait until war time, when they might be already operating at capacity to supply foreign nations, and then ask for further production for your needs, they either have to divert production or build new plants in a hurry, under those conditions only if you pay very fancy prices can they do it.

A second possibility of indirect price control is by applying an economic plan by working out with the concerns involved how much production you want, how much they are going to produce for you, and plans for producing it ahead of time.

Of course, the sort of thing being done already in the experimental orders is a step in that direction, but compared to what is being done under the experimental orders, is, of course, a drop in the bucket compared to what would have to be done to actually wage a war in modern methods.

Now, those are the two possible methods of indirect control, lay up reserves ahead of time so you can draw on those reserves for a considerable period, and meanwhile, during the time you are drawing on them, bring about the economic readjustments necessary to continue the operation, or prepare plans for increased production, the plans to be put into action when the war breaks out, or even other ways, as I will indicate directly.

Direct methods of control by legislative fiat involve some kind of price regulation that says it shall be illegal to raise or increase the prices of all commodities, or it shall be illegal to raise the prices more than such and such a per cent. The result of that can only go a short way. It may work within the range of the previously existing profit of a company, as in the case of automobiles, where, as I indicated, profit gives them a margin in which to work, where for a while they can supply the increased demands without raising their price. After a time, if you try to hold the prices too low, especially if you are working through inflation and prices generally are rising, you simply won't get the production you want. That is, you can by law say you must not sell above a certain price but you can't by law say you must produce X quantity and not sell that X quantity above a certain price, at least not without going into the courts on the ground you are taking property without due process. You can fix price or quantity, but not price and quantity at the same time, at an uneconomic level.

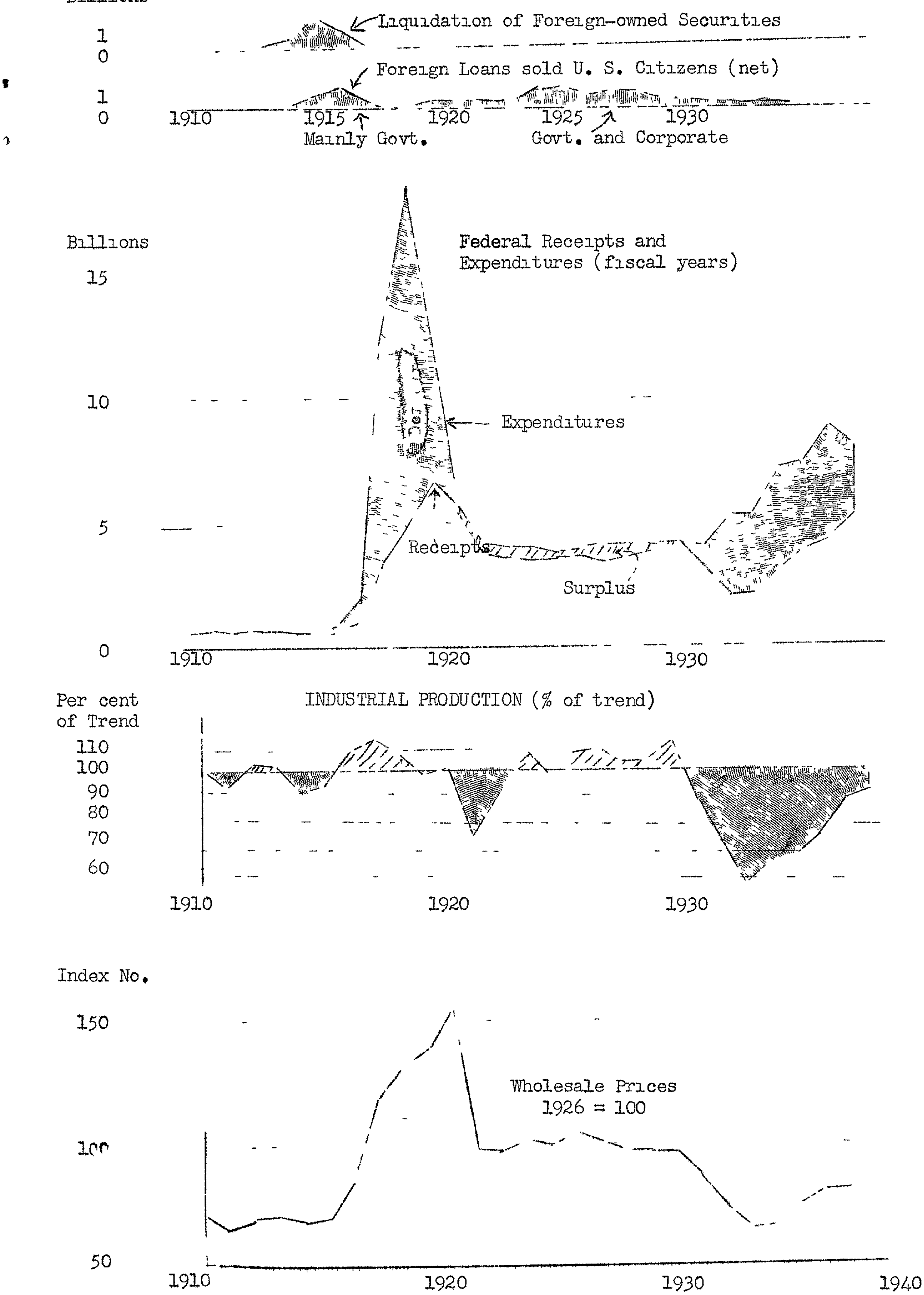
If you study the price regulations of the World War period I think you will find that what happened then was that the fixed prices were compromises with the market situation. A price would be fixed and then after a time it would be found the price had been fixed too low and you would raise the price until you could get the quantity you wanted. So, the fixed prices were really just a way of sort of evening out what would have been otherwise under competitive conditions. So your direct price fixing is in part really just kidding yourselves as far as ultimate result goes. It may be able to moderate the movement of prices, it can't really control them if you fix them at a price that is not economic. If you plan ahead both the production you want and the price at which it can be produced and work the thing by planning, you may be able to validate your fixed price, but then you are not depending on your definite fixed price but on the economic planning which underlies it.

That brings me down to the final issue I wanted to raise and that is this As I understand it, in general the present plans of the War Department and Navy Department call for war to be waged, if we were to get into a war, under the private profit motive, that you pay such prices as are necessary to get the production, with such controls as necessary to prevent runaway prices but try to maintain private profit, try to prevent any approach toward a war-time socialism.

I would like to raise this issue: Is it possible to wage a war by the private profit motive, using such planning as necessary to make that work, if you haven't worked out prior to the war the techniques necessary for economic planning under capitalism? I have mentioned just this one problem of the Coal Commission, the time and cost that has been involved there to work out workable prices for one commodity, without attempting to follow them through. If you visualize trying to work out workable prices for many commodities under stress of war conditions, under the stress of getting the supplies you need rapidly, and with efforts to prevent prices from rising, aren't you simply up against an impossible job of economic planning to do under the stress of emergency? I would hazard this kind of guess, that if we get into a major war and if we attempt to operate our industrial system in that war purely through the private profit motive without having worked out the techniques of necessary economic planning ahead of time, we will be in a war-time socialism within a very few months after the war has started. We will find it impossible to operate under private profit. We will actually take over in some form of Government direction the industrial system of the country and be operating under a war-time socialism, much more thorough-going and more far-reaching than in the past World War experience. On the other hand, there is a possibility that we could develop a system of economic planning which would work under capitalism which would figure out ahead of time what production is needed of each product each year within limits through a system that is both democratic and adapted to individual ownership. I won't attempt to outline such a system now. My recent book "Jobs for All", proposes that we now, regardless of war or peace, go ahead to plan what we need to consume in this country and how we could produce it. It outlines how we could establish prices and wages which would make that volume of production and consumption possible, which would increase the buying power of the country rapidly enough to consume what we are now capable of producing and rapidly enough to put back at work over two or three years the ten million workers we haven't been able to absorb over the past six years. Such a system, I believe, if worked out slowly and gradually as we go along, can be developed without destroying democracy at all, but can actually develop more democracy than we have had in the past and can maintain a considerable degree of private initiative and private responsibility. If we work out such a system of economic planning through capitalism and under democracy, if we work that out in peace time, we could use that same system of planning very effectively in war time to provide the different needs of the country in war, as contrasted to those in peace. If we continue to slide along without working out any such system and do get into a war, I am very skeptical whether it would be possible technically to do the necessary planning in time of war and have it work. I have worked on economic program-making, and seen how infinitely complex and difficult it is to work through. That is why I suggest as a final, concluding point that if you want to avoid socialism in time of war you will probably have to help work out, along with all the rest of us, some effective system of economic planning in time of peace.

AIC 195 (3/24/39) 13a

HOW THE WAR AND THE RECOVERY WERE FINANCED IN U. S. A.



Discussion following lecture on

"Price Control"

by Doctor Mordecai J. Ezekiel

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Q. Dr. Ezekiel, I know very little about this subject of price control and don't know whether I have the proper conception of what I have read, but it appears that Mr. Baruch is of the opinion that to start a war with a general balanced condition as concerns prices, the regulation and the keeping of that balance by general action by putting a general seal over the whole price structure and allying the operation of economic law in some way or more normal fashion under that seal is practical and quite simple. Then if you start out with a serious lack of balance you're driven to particular action. But that action with reference to particular commodities is never very effective and frequently has no effect at all. Now you wonder if possible some of the difficulty of the Bituminous Coal Commission, for instance, may not be due to the fact that they are attempting to deal with a particular commodity rather than having jurisdiction over an entire field. Will you give us a comment on that?

A. That is a very large question. Of course, the Bituminous Coal Commission is starting out with a situation in which there is a great lack of balance in the industry. Their regulating it has greatly over-expanded capacity. There is very intense competition that continuously forces prices down to the bare cost of production and it is a situation where really they are going to eventually have to control production if they are going to maintain anything like a satisfactory increase in prices that will cover even out-of-pocket costs and bring return on investment at all to the operators. I doubt if their difficulty in establishing is more because they are dealing with one commodity than because they are dealing with many commodities. If they were dealing with a wide range of commodities they would still have the problem how to bring the price of coal in reasonable adjustment with other commodities. As a matter of fact, they are assuming the other commodities are to stay at the levels they are. What they are trying to do is raise the price of coal into a somewhat more reasonable relation with the other commodities in view of its greatly decreased condition because of the over-exploitation of mines and excessive competition from industry. Now I would like to make one comment. That is, it seems to me that he overlooks in that reference to initial balance one very serious point - that is, regardless of how good the balance is your economy prior to war is in itself an unbalancing factor. You don't want in time of war to go ahead producing the things you produced before the war;

you want to produce a great many more of some things and if you have already been on the go at the capacity beforehand necessarily you will have to produce a great deal less of other things if you are going to produce a great deal more of some things and if you are operating for profit you will have to encourage your producers to raise the things you want in price, and increase the demand for them. That means a shift in your economy and an inevitable rise in price of many products you are going to want. It may always mean a sharp fall in the price of other products as, for example, World War cotton took a sharp drop and this was because in spite of its use to make T.N.T. and other products, when you start putting men into wool you don't need so much cotton. I am rather skeptical whether the thing can be handled as the statement envisages. He overlooks the key factor as to how to finance the war. If you are going to finance the war by borrowing and you are operating at full capacity which you'd have to be - most people say we were moderately well-balanced before the World War - when prices weren't fluctuating very widely and most people were employed - if you start under those conditions, your first real decision of policy is going to be, are you going to finance it by taxation and if you decide to finance it by borrowing any attempt to put a general seal over all prices just won't work.

Q. Granting that government spending increases the activity of industry a great deal, the question that comes up in my mind a lot is when and how will the balance occur and how is that terrific government debt and excessive expenditure going to be offset?

A. There is a very interesting relation between industrial activity and taxes. If you take industrial activity changing from 57 to 112 - that is, of course, very approximate - as industrial activity changes that way, revenues change something like this - 4 billion 8 billion, 12 billion, and 4 billion revenues corresponding to about sixty of industrial activity, then as industrial activity rises to one hundred revenues rise to about 6 billion; as it rises to 120 it should be around 12 billion. It's a curve that goes up like that. Our expenditures are running around 8 billion across here. We are now at about 100 on industrial activity. If we can get industrial activity up to about 125 we'll have a national income of about 80 billion dollars and with existing tax rates Federal revenues would balance Federal expenditures. If we go on further to a level of about 150 which is what we'd have if we were fully employed, now as we were in 1929 we would have a net balance of something like 23 or 24 or 25 billion dollars excess of receipts above expenditures even if we didn't raise present tax rates in the least. Simply increased income in the taxable brackets. We could use that increased return either to pay war or old-age pensions, provide more health and education as well as more armament or use it in part to reduce taxes and still have plenty left over to reduce, balance the budget, and start paying off the old debt. The real problem is this - it isn't generally realized that Federal borrowing is merely an offset to private lack of borrowing. I was looking over recently the figures of just a few days ago of the Chrysler Motor Company for last year. Last year they took in ten million dollars more than they spent. In other words, working it out on the dollar basis, for every hundred dollars they took in they only paid back to its wage earners, its dividend receivers, the salaried officers, and to those who build plant and equipment for them ninety-eight dollars and fifty cents and hoarded the dollar and a half. As long as that corporation pays out less cash than it takes in and hoards part of the balance, some one else has got to spend more than they receive to keep the people of the country able to go on living. The fact is that every one saves regardless of the amount of business activity - many people save every year - all of us save when we pay insurance premiums - we spend less currently for our living expenses than is paid to us in dollars. If the insurance company took that money and lent it to somebody who built a building with it that would balance all right. That would mean somebody else was spending the money we'd saved and it would show up an expenditure again. Under recent conditions there hasn't been as much borrowing as has been saved. We have a persistent excess of savings over spending. Partly through business hoarding, it's through concerns like the Chrysler Company taking in more than they are paying out. As long as some concerns and some individuals have a net deficit of spending over what they receive either the Federal government has to make up the balance by spending more than it receives or you are going to have a reduction in prices or a decline in business activity or both. You can't maintain the market for a hundred dollars worth of goods by giving those who buy those goods only $98.50. That's the reason why the government has been given to spending to maintain the buying power of the people of the country. It actually produces more national income for government to spend, more general welfare, if we would only be willing to spend enough to drive national income fast enough to get beyond the balancing point but we haven't the nerve to do it. I'm a little skeptical as to whether we'd raise our spending, as again I have posed in my book.

Q. Why is our government so deadly opposed to bartering? As a specific case, I see from the press where we have some several million bales of cotton that the government owns and can't sell on the world market. I see that Germany would like to have this cotton and barter with us, but we won't barter.

A. I'll have to give you the illustration Secretary Burley gave in the lecture Monday night. They asked him why some of the South American countries didn't like barter. He said the reason was that when you can sell something you'd rather sell it for dollars that you can use to buy what you want instead of buying what the other fellow wants to sell you. To get the case down to the simplest form, one of his Colombian friends said, "After all, there is a limit to the number of opera glasses the people of Colombia can use." We are following in our international trade policy the basis of expanding foreign trade by reducing tariffs under what is known as the most favorable nations method which means every time we sell a country you can sell to us as a reduced country. We say to every other country, "You can sell to us at reduced tariff." Everybody sells for dollars and everybody uses those dollars to buy what they want. We buy, for example, a great deal from South America - coffee and flaxseed and things like that - it happens South America produces the same products agriculturally which we produce so it isn't traded but they do buy industrial products from England and England buys wheat from us to balance the account. So a large part of our trade is a trianglar trade. England sells to South America, South America sells to us, we sell to England. When you impose a barter deal you don't increase the trade - you reduce the trade to the smallest of whatever those two countries bought from each other. We can't both follow the wisdom of trying to restore the volume of world trade on this free basis of those favorite nations and make barter deals with any one country since we say we don't believe in barter and we do believe in restoration of world trade, a free basis-that is the policy to follow; that is the reason we refuse to make any barter deals with Germany. All our experience with such things has been to get more and more unworkable and mean less and less trade and the reason Germany is in such economic straits is because of her internal expenditures and externally she is following this barter technique and is finding more and more countries that have as many opera glasses as they need. I'm always afraid of the complex processes. Sometimes I think you can't see the ultimate effects. Now in wartime no less men work except in the critical industries where you have to control supply and then as one commission suggested, take the profit away by taxation. That is pretty much what we did during the World War in spite of our attempts at price control. Pretty much we let prices go up as much as possible and tried to take away this by taxation. I think what matters is what happens after time of war-if you're willing to pay two prices for everything you get and have a very chaotic price situation you can get most of your materials for war needs under those conditions but you so disorganize your economy that after the war's over you may have years of national chaos before you get your economic system functioning. I think probably the real pressure for some kind of economic planning comes in part from what is going to happen after wars as well as fighting the war. There is another problem too and that is where you can depend on merely the profit motive to bring about the readjustment you want promptly enough and rapidly enough to enable you to win the war with the least loss of life and the least expenditure. If you wait for a high price to encourage manufacture to expand and manufacture you may use a great deal of lives before that profit motive has brought the material needed. You make advance plans to have the plants built that are going to build the estimated material as soon as war is declared or ahead of time you start making preparations to have the capacity you'll get from production, rather than just letting supply and demand work. Supply and demand works after a fashion but they don't work anything like instantaneous or anything like automatic. The case of these fixed prices industries - automobile, copper, etc., - you may get supply and demand working under the monopolistic theory so that fifty per cent is net profit to the country. Copper has the same kind of production chart as this - that is, as production goes up costs go down but under monopolistic production what happens to prices is like this: the very times when the cost is going down because there is a market for it, they put price up and up and supply and demand don't work freely, don't work properly in buying industries where you have that limited competition. So, that is, the freeplay of supply and demand would be fine if this were free trade. But the free trade does not exist. What does happen is what men decide to do and left to themselves the human being being what he is and having been brought up in the situation in which he has been brought up, they take the biggest profit they can grab if you let them.

Colonel Miles. I think what Dr. Ezekiel has said about planning is one very good argument for our allocation system in time of peace in which we attempt to do that very thing and that is one good reason why the Navy should jump in on them.

Q. I'd like to return to this chart for just a minute. I have a question there. In order to force industrial capacity up to 150 wouldn't it be necessary to raise our horizontal line there up to 12 billion and the two lines would then cross if we are going to raise it by government spending?

A. As far as our data run they indicate that an expenditure of eight billion a year is about high enough to maintain our 70 billion national income to keep it increasing at perhaps a few million a year. Every billion of expenditure adds about three billion to national income. The actual multiplier of expenditure is something like 76, enough to balance the expenditure if you raised your level from eight billion to ten so that would mean you are adding about a billion a year to national income and if we were spending ten billion a year for two or three years we'd be carried way above this point and balancing it through it. There is no instance of such acceptance of the people or Congress to make that at all probable. There is a possibility. That is, it is possible for a government to spend money without it showing the deficit at all. Part of government financial operations are organized as through the R.F.C. or the Farm Credit Administration where this takes credit for its assets and sells ventures to the general public - farm credit has a good many bills outstanding in mortgages which they use as assets to justify the issuance of debentures sold to the general public. Where the Federal Government carried on drives in investment activity, commercial production, that pay their own way they are instead of paying thousands out of the general debt it pays for them but the special resources - road and rail production, etc., if we could add a couple of billion dollars of those products we would get a very rapid rise in national income without any corresponding increase in the debt. It would make it possible to balance the thing without it looking too bad on paper. This whole talk of Federal debt is pretty much a matter of paper accounts. I have taken the figures for a large corporation and looked those over to see how they would look if we made that corporation show its accounts and those figures show that out of the ten years the corporation has spent more than it receives - a horrible deficit. It doesn't mean that. Any one looking at that would say the corporation was failing. Its assets have increased more than its debts. Its regular corporation balance sheet also shows assets exactly equal to the liabilities but you go into your liabilities and find they are a great mixture of debts owed to somebody else and some items are so mixed you can't tell what they are. If we set up a balance sheet system for the Federal Government productive assets such as the new buildings here, such as the national forest which yields trees, parks and playgrounds, yielding recreational facilities, no doubt we'd find for the past six years that the public assets have been increasing much faster than the public debt but merely because we force the Federal government to show its accounts we get into this whole mental fear of something terrible going to happen in spite of the fact that this is the richest country. The amount owed is very low compared to the national income.

Q. Dr. Ezekiel, I'd like to go from this bill. Some time in the past two weeks there has been quite a bit of press discussion of British trade treaties as related to the cotton program. They say they can't buy cotton from the United States on this trade agreement due to the fact that the price has been paid up enough and they will have to fall back on that agreement. Would you discuss the economics of that very point they bring up?

A. The difficulty there isn't that our cotton is so high but that other cotton is so cheap. There is a very real difference related to the cotton program. The laws passed by the country a year ago applies. The department had to make mandatory loans of given level regardless of conditions. Once those loans were made the government cotton was tied up until the end of the cotton season. In spite of the fact that the cotton under lien to the government in storage at the end of this season, there is an actual shortage of free cotton. The entire supply almost has been tied up. You see it isn't very high. But with this large supply available and the knowledge of this supply to be available later out cotton has been held out of relation both to the price of Indian cotton and to the future market. Ordinarily the future market works itself out so that the future price of cotton next May is worth about what cotton is worth today plus the cost of holding it. If the price goes down in the meantime he is protected from loss because he makes in the sale of the future what he loses in his spot cotton. This large ownership holding of cotton has thrown the future prices out of line. The future prices are below the spot price. It's known this cotton will e available at the end of the season since the future price is below present prices they bring. We have pegged the whole world market but our cotton is sold just enough below ours to take advantage of it. The cotton would still be too high as long as the present situation prevails. There are various measures in Congress which Congress is trying to help through without waiting to the end of the season to correct that situation. In other words, any time you do peg a price higher than it should be or lower than it should be you are likely to induce all kinds of trouble.

Q. I'd like to ask you another question about the national debt. Perhaps it's true the size of this national debt is not such a critical matter but something you haven't commented on is the shift in the burden of this national debt; to my mind this national debt is penalizing a certain portion of the population unduly or will, I mean. The middle class is supporting the lowest part of the population . The wealthy classes will not be hit by an inflation which may be inevitable but there is a transfer of wealth on which the middle class will have to bear the burden. Would you care to comment or that? It's not the size of this thing but what it does to a certain element of the population, the fixed assets of professional people, fixed salaries, the value of life insurance. I think that is being taken away from a certain class of the population.

A. I think you'd have to correct your statement to say if and when the national debt increases so rapidly to raise in price level; the rise would itself be penalizing the population. That depends on fixed returns. A rising national debt does not cause a rising price level. Until such time as it does cause a great rise in prices because you have exceeded your current production, it boils down to this: as long as you haven't succeeded in driving your national capacity up to full use you're not having inflation; as long as you haven't succeeded in restoring full production you don't have any danger of inflation or any loss from inflation. Your argument is this: if you kept on spending to build up the debt rapidly until you produced full production and spending continued until you brought up the price level you'd be exploiting those who receive fixed incomes but there is no indication of doing that . Every pressure will be to start using some of the increased income to pay off the debt as soon as it is possible to earn the money until the time you do succeed in driving your production up to full capacity. Your prices are not rising. Inflation consists in increasing buying power faster than goods are being produced. Inflation consists in prices rising. That is not any change of spending enough to increase full production. We are going to spend so much more that we'll both reduce full production and rising prices beyond that.

Q. You feel there is a point where income will equal expenditures?

A. When income equals expenditures you do not have to continue spending more than you take in but you'll use part of the excess to pay the cost. As soon as your taxes rise above your spending you start using part of those taxes to pay off the debt. That becomes a deflationary factor. The real factor becomes whether you can use that much to pay off without causing damage. The process of expanding the debt would be inflationary. If you were operating at full capacity, this would occur. There are certain automatic checks, I think. As long as we have a great worry over excessive spending there is no danger of maintaining excessive expenditures at all at the time when excessive expenditures might produce a rise. We probably cut it off too soon, not too late.

It would be almost certain to produce the same result produced when a rapid expenditure was made in 1936 and 1937.

Q. Doctor, I spoke about the undivided profit of the Chrysler Corporation. I'd like to ask you how a business can remain healthy and expand unless it is allowed to retain some undivided profits in good years to counter-balance losses in lean years?

A. Peculiar thing is the effort of business in times of rapidly rising production to build up a reserve . It has been one of the major factors bringing on the lean years. Any time a business wishes to expand its plant it can do so perfectly easily by selling new stock or selling new bonds, as for example the Consolidated Electric has done. The Consolidated Electric Edison wanted to expand its plant. It didn't cut down on dividends in order to expand its plant. It simply sold new stock or bonds and increased the money and borrowed the money with which to expand. Chrysler has added some million dollars a year for four years to the cash reserves. Each year their cash reserves are so tremendous, their cash on hand was more than the total value of all plants and equipment. I can't see any need for that or anyway to call it except just hoarding. As a matter of fact, I happen to own a very minute number of shares in the corporation and I wrote, saying, "I notice in your annual report you make no explanation to your stockholders why you are doing that," but I haven't heard back yet. The real point is that if corporations generally do hoard a great deal of money in a period of rising business by very reason of that fact tend to bring on subsequent periods of contrasting business. If they didn't do it they wouldn't have so many depressions.

Q. I wonder would you care to continue on the possibility of the utilization of the pre-organization of the department in the event of war for the control of farm prices. For example, with their existing statistical organizations and various administrative branches and also on the general question of this whole food administration such as we had in the last war?

A. I would say that whenever a development in the last six years in the field of agriculture has been made, the most complete system of economic planning of an industry through democratic procedures that is in use anywhere in our society today. That perhaps nine-tenths of production is economically being conducted in accordance with national plans laid out year by year for each year. Those national plans in the laying out of those planning farmers cooperating both in county, state, and national meetings and discussing what problems there are. Once the plans have been drawn up the production on each farm being related to fit into the national total problem today has been to hold down production. If it were necessary to increase production, that also could be done. There the same mechanism could be used. I think the point made here is quite correct - that it could not be necessary in time of another war to establish another food administration because you have now an organization for the economic planning of agricultural production and to a large extent marketing. We do have reserves built up at the moment. In time of war any shift could be made through the planning machinery there and any price control could be made through the existing action and power of the department to regulate prices with some modifications or wartime needs. As a matter of fact, what I suggest for a positive expansion of production and con umption is in part a modification of the technique used in agriculture of this central planning of the whole output with individual responsibility, individual judgment in carrying out the plans. It would be a great expansion instead of the contraction when industry does not expand.

Colonel Miles. We have kept Dr. Ezekiel on his feet for a long time.

Q. I'd like to ask the Doctor's opinion on the Leed Bill. He re-introduced a bill relative to financing a war which had some support in the last Congress. I'll try to state this briefly. We'll budget what we presume to be a fair estimate of what the war debt might be.

We'll take an inventory of each individual in this country; that debt will then be pro-rated against those assets and that the Government will pay an interest of one per cent on the amount that is borrowed. If the individual has not sufficient cash to advance that allotted part of the debt he'd need he may borrow it from the government at a rate of six per cent.

A. I'm not sure I understand the mechanism wholly but if I do understand it I'm afraid the result would be much as it was during the World War. While you'd have a forced loan, it would be a loan that individuals in turn would go to their banks to raise the money, that probably for the time being most of them couldn't raise the money. A person who owns a $5,000 house and is called upon to loan $2,500 dollars to the Government isn't going to have to borrow it. Even though it was a forced loan instead of a Liberty loan they were sold it would still result in financing your war by borrowing and price inflation. I would prefer to see heavy taxation for a straight ten per cent income tax on every one with perhaps about five hundred dollars with perhaps a heavy profit tax of sixty per cent of war profit, perhaps income and profits paid , so it wasn't a fact that it paid for the war as you went along without any borrowing. It won't cost the individuals any more than it would cost them in the end or the general economic chaos that inflation produces. I realize wars might not be so popular under such a system.

Q. Just one more question. With reference to that chart I wonder if you care to discuss the effects of this duplicate taxation not from the Federal taxation from the states and municipalities. On that curve which you have up there.

A. That curve is with reference to the relation of national income which I have stated there as industrial production to Federal revenues. In practice all states, the bulk of state and local taxation comes from real estate taxes rather than from either income taxes or sales taxes or other yield taxes as the result of which state revenues do not rise as rapidly with rising national income as did the Federal income; of course, there is a considerable portion of state taxes based on sales taxes and in those cases they will go up too. As I might say, that chart might better have been drawn this way as far as the Federal government is concerned. When national income rises like that Federal revenues rise like that. Now state and local revenues. The reason I mentioned national income rising like that, state and local revenues would rise like that. So whatever duplication there is, whatever burden of duplication would tend to become less and less as you get higher and national income and higher and higher Federal revenues. They would represent, since local and state revenues become a decreasing part of the total, the duplication problem would be minimized rather than increased.

Col. Miles. We all want to thank Dr. Ezekile for coming over and giving us his time and I'm sure we have all got a great deal out of what he has said and I think the sum total of the intelligence of this class has been raised very greatly.