OFFICE OF PRICE ADMINISTRATION

WASHINGTON, D. C.

MEMORANDUM

To: All Members of OPA Advisory Committees

From: Chester Bowles, Administrator

Subject: Our Pricing Objectives in the Reconversion Period

For two and a half difficult years we have been striving to maintain a stable wartime economy. In general our efforts have been successful.

Since the Spring of 1942, when price control first became effective, the Department of Labor tells us that industrial prices have risen less than three percent. The cost of living, expressed in the individual prices of items purchased by the average middle income family, has, according to the same authority, risen only about nine percent in this same period.

It has been the responsibility of the OPA under the Stabilization Act to administer the actual pricing of 8,000,000 products and services, and to establish rents for 14,500,000 dwelling units. It has been a staggering task.

The ground over which we have travelled has been new and unfamiliar. There have been no sign posts to guide us. Our policies have been developed laboriously by trial and error. Inevitably there have been mistakes, delays and irritations.

FOUR REASONS WHY

There are, I believe, four basic reasons why we have been able to establish this record:

1. The tremendous wartime production of American farmers and American industry, which, in addition to our huge production earmarked for war, has provided us with 90 billion dollars worth of consumer goods and services in the past year.

2. The patriotic desire of the American people to save their money instead of spending it during wartimes.

3. The basic honesty of the American people which has kept the vast majority of them from patronizing the black market.

4. The government stabilization program authorized by Congress in the Stabilization Act.

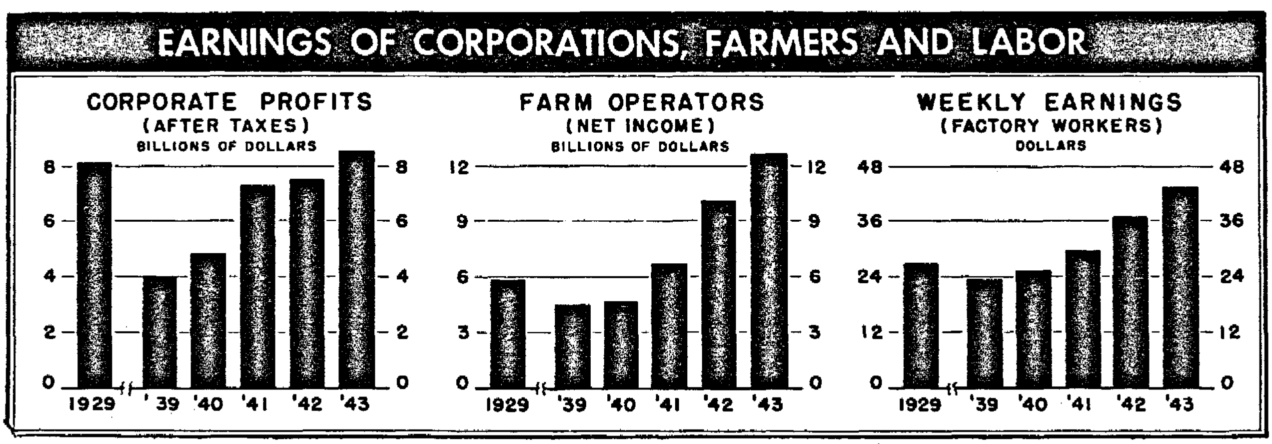
ALL GROUPS HAVE BENEFITED

But the fact remains that the job so far has been accomplished. Prices and rents have remained relatively stable. Moreover, this stability has been accomplished without hardship to any major economic group.

Industry profits in 1943, even after the payment of high wartime taxes, actually exceeded net profits after taxes in 1929. They were more than double the net profits after taxes in 1939. Net farm income after all expenses exceeded prewar levels by 170 percent. Industrial wages are at an all time peak.

V-E DAY WILL BRING NEW PROBLEMS

The pricing policies which we have followed during the war period have been effective under wartime conditions. But today we look forward to more and more cut backs in war production and the increased production of peacetime goods.



During the next ninety days we are hopeful that the war will be brought to a close in Europe. During the next 18 months or so we are looking forward to victory in the Pacific. As our economy partially reconverts to peacetime requirements we will be called upon to face rapidly changing economic conditions.

Within three months after Germany is defeated it is estimated that plants now producing 40 percent of our war goods can be freed for the manufacture of civilian goods. More than 4,000,000 war workers will be made available for the production of goods for which the American people are eagerly waiting.

The Federal Government has made it clear that industry will be assisted and encouraged to resume the manufacture of civilian goods as rapidly as possible. To this end, the War Production Board has announced that it will lift controls over most materials and manufacturing immediately after V-E Day. The War Manpower Commission has stated all manpower controls will be lifted except in relatively few areas where they are essential to continued war production.

The only lasting answer to inflation is full production of civilian goods with all possible speed. For this reason we in the OPA welcome these developments as a major aid in holding prices stable.

But even under the most favorable conditions our pricing task will be a ticklish one. A weak price policy during the next few months can set in motion all the powerful inflationary forces that surround us. A rigid price policy in which no allowance is made for legitimate increases in costs could stifle employment and production and head us straight for a major depression.

WHAT HAPPENED IN 1919

In 1919 we met this same problem, on a greatly reduced scale, and fumbled it badly. While there are many factors now which are totally different from those we faced after the last World War, it will be wise to examine carefully what happened to prices immediately after Armistice Day 1918.

During the first World War, with a minimum of price control, the cost of living increased by 62 percent from July 1914 to Armistice Day. Both corporation profits and net farm income rose to record levels.

Immediately after the Armistice, in November and December, war controls were dropped. In March 1919 the price level again started upward as a wild scramble for inventories and new goods developed.

This postwar inflationary rise continued at an increasing pace. By June 1920 living costs had risen to 108 percent above the 1914 level - an additional 46 percent increase after Armistice Day. Wholesale prices, which had risen 102 percent, went on to a peak of 148 percent above prewar levels. Wages and payrolls, business earnings and farm income - these too continued their climb.

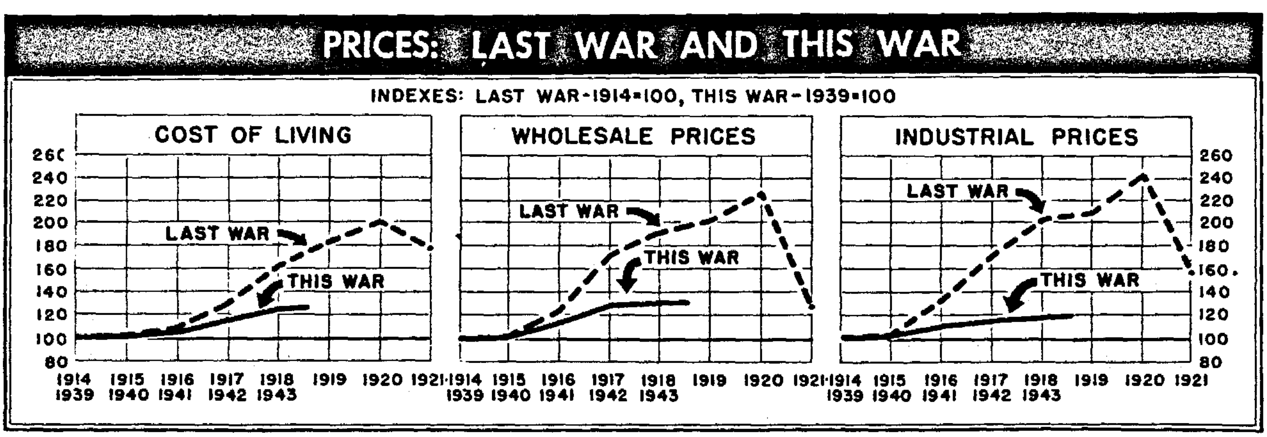
And then came the collapse. Within 22 months factory payrolls dropped 44 percent to bring misery and privation to millions of our workers. Net farm income dropped 66 percent. 436,000 farmers lost their properties through foreclosures during the next four years.

Corporate profits after taxes dropped from $6,419,000,000 in 1919 to a net loss of $55,000,000 in 1921. Inventory losses, amounting to 11 billions, wiped out practically all the reserves accumulated out of wartime profits.

That's the story of our price levels after the last war. Everybody had moved up together and everybody came down together. We went up fast; we came down hard. It's a story that provides a perfect lesson on how *not* to handle our pricing problems during the next few months. It's a story which we must all be determine shall not be repeated this time.

During the war our efforts have aimed solely at checking inflation. On V-E Day the picture will change. When the telegrams go out canceling war orders, the forces of deflation will begin to develop.

From that day on until full production is achieved and supply and demand come into reasonable balance, the forces of inflation and deflation will exist in our economy side by side. Right now it is impossible for anyone to say with finality which will be the greater.



THE DANGER OF INFLATION

Let's first take a look at the huge inflationary pressures all ready to push prices up as soon as the war in Europe ends.

By the end of 1944, 100 billion dollars of wartime savings will be waiting in the hands of people who have been unable to buy many of the things they wanted most - a new car, an electric refrigerator, a washing machine, a sewing machine, a new stove, new farm machinery, a new house.

Obviously, it will be impossible to produce all of these articles in sufficient quantities immediately. But people don't like to wait. The pressure of buyers with good jobs and a backlog of wartime savings will be tremendous.

Merchants will be anxious to be among the first to offer new goods for sale. The retailer who can quickly build a good inventory will be in a position to capture the business.

Every manufacturer, too, will want to be among the first to produce these goods. The competition for materials will be considerable. To back up this competitive desire for inventories and raw materials are billions of dollars in wartime reserves.

THE DANGER OF DEFLATION

But, as I have pointed out, inflationary pressures are only one-half the story. Deflationary pressures - some of them inescapable, some of them potential, are equally dangerous.

The closing of plants built only for war production (which probably cannot make peacetime goods) will require an estimated 2 million people to look for peacetime jobs elsewhere. Millions of others will face temporary unemployment while the plants in which they work set up their new production lines for civilian goods.

In all plants changing over to civilian production, the return to the 40 hour week will reduce the workers' weekly take-home pay. Even a 10 percent cut in hours, which seems probable soon after V-E Day, will cut salaries and wages by something like 12 billion dollars in a year.

Adequate unemployment compensation will, of course, help to some degree to hold up purchasing power. Our huge backlog of savings will also serve as an anti-depression asset. But fear of prolonged unemployment can make people hesitant to spend their savings except for necessities. A man out of work goes slow in building a new home - even though his savings account is still ample.

Up to now business and industry have been able to absorb the men - more than 1,250,000 of them - who have been mustered out of the armed forces. However, when our soldiers and sailors start coming home after V-E Day there may be more men than jobs until industry hits its stride.

If reconversion is slow, the national income will be dangerously down while millions of workers are waiting to return to work. Slowness in reconversion would also mean a let-down in demand for basic raw materials.

The Government has been spending about 70 billion dollars a year for war materials and construction, and that money has provided good jobs at high wages. Within three months after the defeat of Germany it is estimated that this will be cut to about 40 billions. To a major extent that's money out of our pockets, until we get civilian production going on a comparable scale.

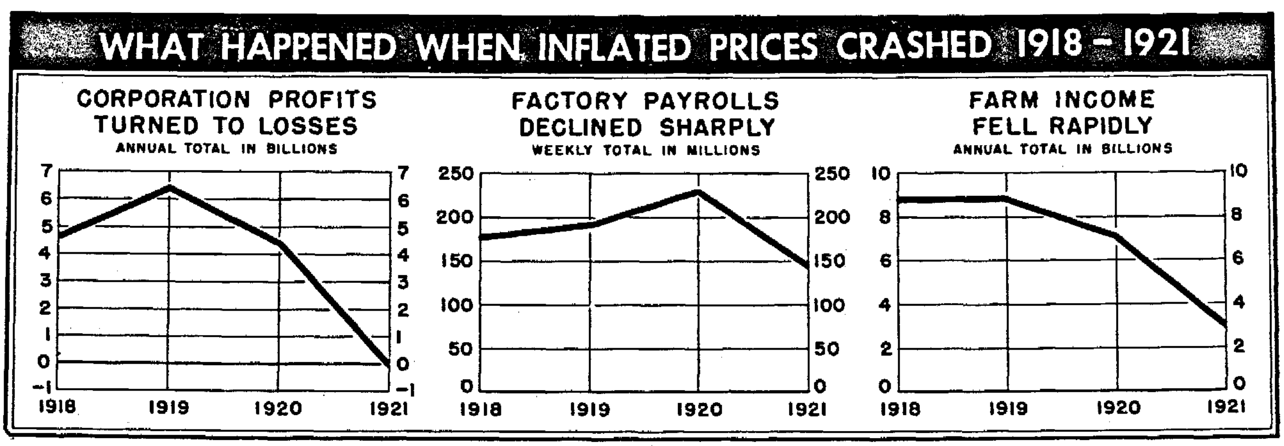
Some of these deflationary threats we cannot hope to avoid. Some of them are temporary and the speed or slowness of reconversion will determine the extent of their influence. Others may not materialize, unless businessmen and their customers -- frightened of the future -- are afraid to invest and spend their money.

But after V-E Day the threat of deflation cannot be ignored.

WE MUST RESIST BOTH FORCES

Statistics alone cannot measure either of these dangerous economic forces. Behind them lie the psychological factors of over-optimism on the one side or fear on the other. Both of these are products of uncertainty.

Uncertainty about prices is one of the most dangerous. It could lead to a wild speculation or to a drying up of purchasing power. That is why we are determined to do all in our power to hold prices stable during the months ahead.



It will take careful planning and intelligent cooperation on the part of all of us as a nation - Government, industry, labor, farmers - if we are to guide ourselves successfully through this difficult transition period.

There are many factors which will determine our success or our failure. The pricing policy we follow is only one of them. Our export policy, our tax policies, our disposal of government owned war plants and surplus war goods will all play an important part.

But our OPA responsibility is for pricing and for pricing alone. What shall our reconversion price policies be?

WHAT OUR PRICING POLICY MUST ACCOMPLISH

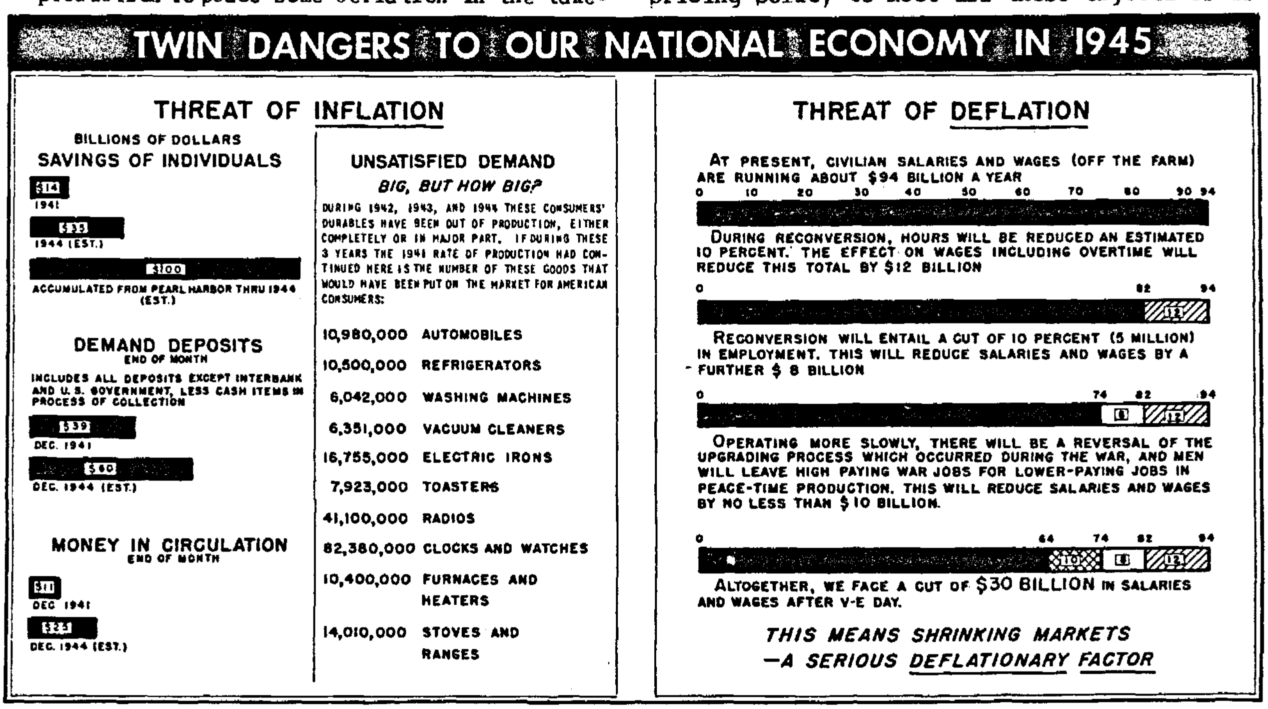
The pricing policy on the reconverted civilian products which we adopt to meet the difficult conditions which lie ahead must, in my opinion, accomplish the following:

1. It must encourage maximum production. It must not stand in the way of the manufacturer's desire to produce to the limit of his capacity. This means prices which yield good profits for business, large or small, on the basis of high volume production.
2. Our pricing policy must be easy to apply. Decisions must be made rapidly. Manufacturers have a right to expect from us the quickest possible answers on requests for prices on new items. We must realize, however, that prices cannot be set without adequate information from the businesses affected.
3. Our pricing policies in the reconversion period must encourage the continued payment of high wage rates. When wages are reduced purchasing power begins to dry up. Through the loss of overtime and through some unavoidable unemployment, as plants are reconverted from wartime production to peace some deflation in the take-home wages of our industrial workers is inevitable. If this trend were increased by pricing policies that would result in a general lowering of wage rates, we would soon face a serious depression.
4. Our pricing policies must continue to protect the public against general increases in the cost of living. Rents, food prices and clothing prices must be held at no higher than present levels. On consumer goods which have been out of production for some time, price increases must be given only when absolutely necessary, and then held to the minimum amounts needed to encourage volume production.
5. Our pricing policy must not contribute to any repetition of the farm collapse which followed the inflation in prices after World War I. The ability of our farmers to purchase industrial products and generally to increase their standard of living has been tremendously improved during the war period.

   With sustained high purchasing power our farmers can furnish one of the largest and most profitable markets for industrial products. In my judgment that market, in the reconversion period as well as during the postwar period, must be encouraged vigorously and sustained. The responsibility for that, of course, lies in other agencies.
6. Our OPA pricing policy must call for the elimination of price control as rapidly as possible. This means that ceilings should be removed on each product or in each industry one after another, when there is no longer any danger of inflationary price rises in that particular field.

   If we decontrol too quickly we will find ourselves in serious trouble with the possible need for reimposing controls at a later date. But if we hold controls in effect after they are no longer needed it will tend to discourage production and initiative on the part of industry.

It is obvious that the development of a pricing policy to meet all these objectives is



a difficult task. But if we are to achieve a vigorous, full production economy with a high standard of living and with full opportunity for every group, it must be successfully accomplished.

THE SIZE OF THE JOB

Let's take a look at the types of companies and products thathave been under price control. Let's compare them with the others that will need to have their ceiling prices reviewed. In other words, let's take a look at the job ahead from the standpoint of administration.

Many companies have continued to make peacetime products throughout the war production period. Others have continued the production of civilian goods, side by side with wartime commodities. Still others have for at least two years been wholly converted to the making of war materials. Some peacetime products have been entirely off the market since the first quarter of 1942. During the next few months they will become available to the general public for the first time in more than two years.

Price control now covers all civilian goods and many services. The principal consumer items now under price control have an estimated 1943 retail value of 78 billions of dollars, or 85 percent of total consumer expenditures in 1943. Among the most important of these are food, clothing, rent, furniture and furnishings, fuels and certain services.

The regulations setting up ceiling prices in the fields now covered have been geared to the individual requirements of the businesses and industries affected. With few exceptions they have been fair both to buyers and sellers. They need the legal obligation that they must be "generally fair and equitable."

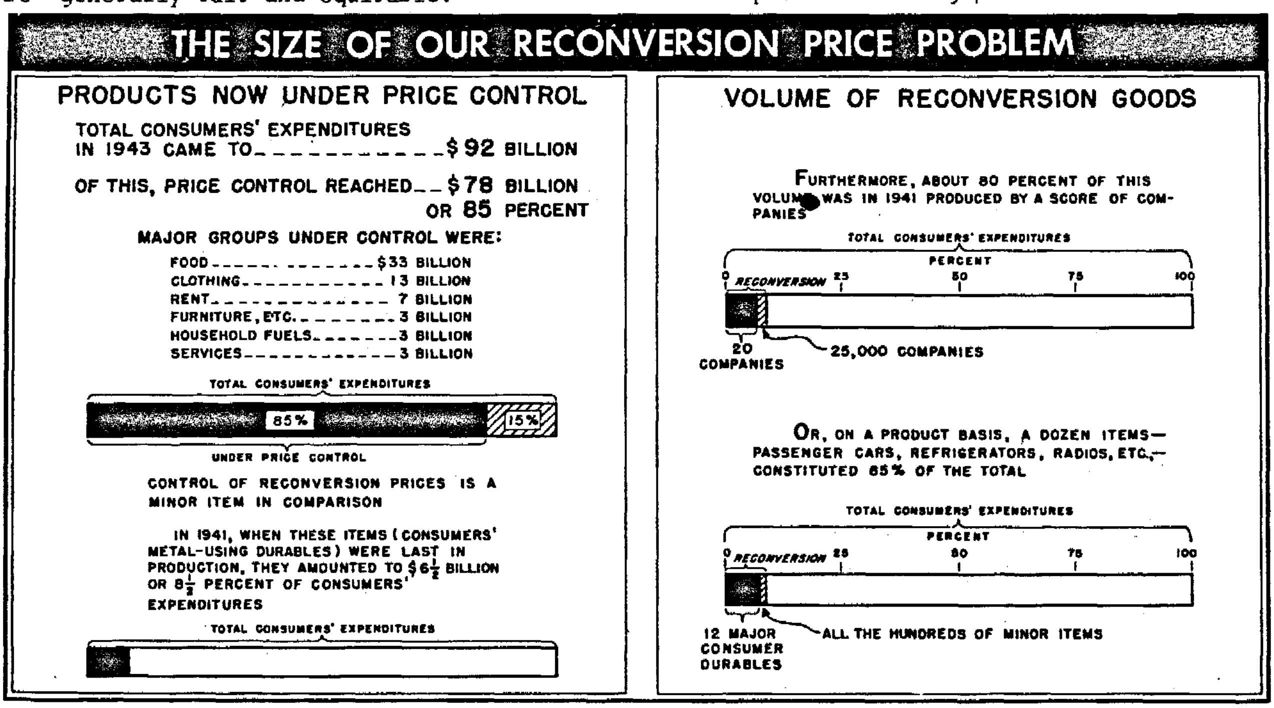
The important point is that these ceiling prices are already in effect and are working. They have stood the test of time and, as the record amply demonstrates, they have permitted full production and record profits. Our hard-earned experience in setting them has given us the know-how to work out ceilings for the industries coming back into civilian production.

These present price controls present no new problem. They will be continued in substantially their present form. We shall continue to use the same pricing standards, standards which during the last few months have been carefully reviewed and approved by Congress. In other words, we will expect absorption of cost increases on less profitable items, as well as on more profitable items, by industries which manufacture several lines and whose total profits are satisfactory.

We have been adjusting prices in cases of individual hardship ever since ceiling prices were established, and we will, of course, continue to do so.

We will also continue to allow price increases to industries whose profits have fallen below the level of the 1936-39 period. But in most of these consumer lines now in production, volume should increase as war restrictions are removed and as raw materials become more plentiful.

Overtime payments will probably decrease, and more efficient labor will become available. As a result of these factors, unit production costs should decrease. It is my belief, therefore, that with relatively few exceptions, firms which are now manufacturing consumer peacetime products will continue to prosper under present ceiling prices.



PRODUCTS WHICH HAVE BEEN OFF THE MARKET

What industries may need new ceiling prices? As we see it, they will be largely in the metal using industries in the consumer durable goods fields - industries which for the most part have been out of civilian production since early 1942.

The retail value of the products made by these industries in 1941 was 6.5 billion dollars. That represents only 8.5 percent of total consumer expenditures in 1941. Obviously, the percentage may differ for 1945, depending upon the speed and extent of reconversion, the progress of the war in the Pacific, consumer spending power and many other factors. But it gives us an idea of the size of the problem.

Fewer than a dozen types of goods make up over 85 percent of the value of all items which many need a reconversion price. These are automobiles and parts, refrigerators, sewing machines, washing machines, vacuum cleaners and other electrical household appliances, radios, phonographs, pianos, heating and cooking equipment, clocks and watches.

The hundreds of miscellaneous items in the durable goods field amount to only 15 percent of the problem. These, like the 85 percent, may or may not need new prices.

About a score of companies manufacture 80 percent of *all* the items which will soon be coming back into production. The remaining 20 percent are produced by about 25,000 additional firms of varying sizes.

From our administrative point of view the problem is substantial. But it is not as great as generally assumed. It is smaller than others which we have handled successfully in the past.

WHAT WILL NEW PRODUCTS COST?

In general, our objective in setting ceiling prices for these new goods will be the manufacturer's own 1942 prices. These are the prices he was charging when he converted from civilian to war production. And, with few exceptions, these are the ceilings in effect today for any manufacturer still producing the same or similar goods.

This means that any manufacturer who is planning to put new civilian goods on the market at 1942 prices or less knows *now* that his ceiling price will *not* be lowered. As soon as production and manpower controls are released, he can proceed at once. Reconversion pricing will not be one of his problems.

In practically all consumer durable goods industries there have, of course, been increases in wage rates and some increases in material prices. But we know from the wartime experience that increased wage rates and material prices need not be fully reflected in price increases for the finished product.

In industries now under price control, such as textiles, meat packing, paper and pulp, for example, substantial increases in either hourly wages or materials prices, or both, have occurred. In none of these cases, however, has it been necessary to allow price increases anywhere near equivalent to the cost increases.

In most cases the price increase has b[illegible] only a small fraction of the full equivale[illegible]. Nevertheless, profits have moved up sharply - so sharply, in fact, as to suggest that the cost increases should often have been entirely absorbed without unfairness to the industry.

In cotton textiles, average hourly earnings increased 25 percent between December, 1941 and May, 1944, while materials prices rose 19 percent during the same period. To offset these increases in full, a price rise of 17 percent would have been necessary. The actual price increases during this period averaged only six percent. Profits of the industry before taxes nevertheless rose 33.3 percent between 1941 and 1943.

In slaughtering and meat packing, the experience has been similar. To reflect fully increases in average hourly earnings and material costs between 1941 and 1943 would have required a price increase of 30 percent. The actual increase (including subsidies as a 10 percent price increase) was the equivalent of only a 16 percent price increase. Cost absorption here was therefore about 50 percent. Yet industry profits in 1943 were 68.2 percent above 1941 levels.

In the paper and pulp industry, average hourly earnings have increased 17.7 percent since 1941. Material costs have increased [illegible]9 percent during the same period. If these [illegible]creases had been fully reflected, prices would have had to increase by 14.6 percent. Actually, paper and pulp price increases during this period averaged only 4.2 percent while industry profits have continued at the 1941 level.

Our experience in these fields and dozens of others strongly suggests that in the consumer durable goods industries, where increases in wage rates have been no greater and increases in materials prices have been substantially less, production for most companies can be resumed at approximately 1942 prices.

There are some companies, however, and perhaps a few industries whose costs have risen so far above their 1942 level as to make full absorption impossible. These will need new prices. They will need them quickly, and we intend to see that they get them.

HOW NEW PRICES WILL BE SET

It is our hope that ceiling prices for the major fields can be arrived at through industry-wide conferences in Washington. We are now planning meetings with members of the automobile, electric refrigerator, washing machine, radio and a few other industries - represen[illegible] on a dollar volume basis 80 percent of the entire reconversion pricing problem.

At these meetings we will discuss the volume each industry plans to achieve; what they are going to pay for labor and materials; the savings they expect to make through increased plant efficiency, and lower sales costs. We will also be guided by prices which they feel, on the basis of their own experience, are most likely to assure the wide-scale consumer buying necessary to maintain volume production.

In those cases where an increase over the 1942 price level is really needed to bring any product back on the market, an increase will be given. We will make every effort to set ceilings at a point that will lead manufacturers to expand, not restrict, their production.

PRICES FOR 25,000 SMALLER MANUFACTURERS

I am well aware that any delay on our part in setting prices would be an even greater hardship for small manufacturers than for large ones. We must make sure that any manufacturer who needs a new price can get a decision quickly. In order to do this, we will authorize the 93 OPA District Offices, located in all parts of the country, to set the final ceiling prices for all reconverted products not on the key list of 12 major items.

Many firms have already indicated that they plan to sell at their 1942 prices, or even lower, as soon as they can get back with civilian production. They will not need to call on our field offices at all.

Firms whose higher production costs make a price adjustment necessary will be able to present the facts to the nearest office and receive a price based on a set of standards arrived at in Washington. These will be standards that can be quickly applied without referring back to Washington.

The exact method by which the prices for the smaller firms will be set and the standards which will be followed are now under discussion with many of our advisory groups and with our field officers, on whom much of the administrative burden will fall.

Barring the sudden end of the war in Europe, the details will be withheld until these discussions are finished.

A complete plan, including pricing standards for the smaller manufacturers, however, has been fully developed. If necessary, we are prepared to announce full details of the pricing procedure that each manufacturer (with the exception of those making the "major items" listed above) will follow within 48 hours after V-E Day.

Finally, we are studying the possibility of completely exempting from price control certain manufacturers in the consumer durable goods field. This might be done in two ways: First, by exempting all manufacturers doing less than a certain annual volume of business - say $100,000; second, by exempting manufacturers of minor parts or miscellaneous products.

We are anxious to do this in order to eliminate as rapidly as possible all unnecessary red tape and needless regulation. We are investigating the extent to which this can be done without endangering effective price control in the consumer durable goods field.

WHEN WILL CONTROLS BE LIFTED?

We have always looked upon price control as a stop-gap, a stabilizing wartime control to be dropped as soon as production brings supply and demand reasonably in balance. The last war, with its false economic calm after the Armistice, followed by a ruinous inflation and collapse, taught us the danger of moving abruptly and thoughtlessly. To maintain controls needlessly even for a few extra months would be equally mistaken.

The wartime lack of balance between supply and demand made price control necessary. When supply and demand come back into balance price controls will not be needed. As soon as there is no further danger of price increases in a particular commodity field there will be no reason for price ceilings in that field and we will drop them.

The exact timing will vary widely from item to item. But, working with Industry Advisory Committees we will watch each field closely. We will rely heavily on their recommendations as to when controls can be safely removed.

INDUSTRY'S RESPONSIBILITY FOR THE FUTURE

(Some Personal Observations)

In this memorandum I have discussed government wartime controls over prices and rents. I would like to add, however, a few personal thoughts on the problems which industry will face when all government controls have been eliminated.

I must emphasize that these ideas represent my personal opinion only. They are based on my own experience and observations gathered in my own business before the war and, more recently, in dealing with policy problems as a wartime employee of our government.

Most of us think of free enterprise as a system in which prices are set by competition and the law of supply and demand. Unfortunately, before the war this concept was true only in part of our economy.

In too many industries prices were held up artificially in order to provide higher unit profits. Because of this policy, in some industries full production and employment were curbed. In many cases, business men pursued a policy of high unit profits based on curtailed production, rather than going after the larger total profits that might have come through larger volume at a lower profit per unit.

During the war we have all had an opportunity to learn much about our economic system. Before the war few of us visualized the tremendous productive power of our American economy. The fact that this miracle of production has been achieved during wartime will have a significant influence on our peacetime industrial planning.

It is unlikely after the war that our people, including our 11,000,000 returning service men, will long tolerate any economic system which does not provide reasonably full production with reasonably full employment at a high standard of wages and farm income.

As a practical matter, we cannot go back to the production levels of 1940. The Department of Commerce recently estimated that if in 1946 we were to go back to 1940 total production at 1940 hours of labor there would be 19 million unemployed. There would be a cut of more than 30 percent from our present level of production.

Such an economic reversal would mean shrinking markets and falling prices for farm products as well as the products of our factories. It would mean that our farmers, our workers, and our returning soldiers would again have to compete bitterly with each other for their frugal individual shares of economic scarcity. It is obviously unthinkable.

If we attain full production and experience a corresponding increase in the national purchasing power, the Department of Commerce says we would be able to spend 40 percent more for food - in terms of a more varied diet, better qualities and increased services in connection with processing and distributing food products - 45% more for clothing, 55% more for refrigerators and other electrical equipment, 70% more for household furniture, 90% more for new farm machinery and 2½ times more for new homes than in 1940.

We who have been close to American industry during the war period believe that industry can successfully meet this test of the future. But I believe we are all aware, both in government and in industry, that in order to reach this goal we must establish and maintain close cooperation among all groups - business, labor, farmers and government.

During the next five years, of all period our history, we will need economic courage, good sense and a common understanding of the problems that we face.

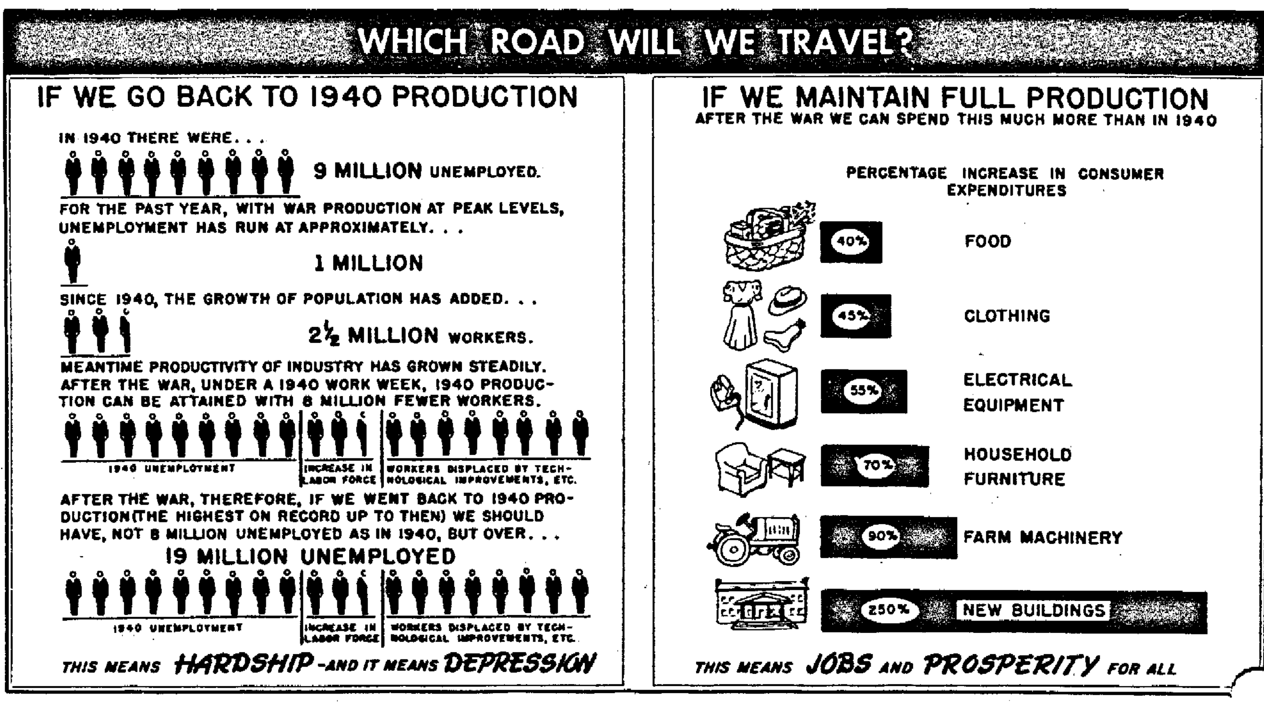
If, during the next few years, major segments of American industry operate on a high price, high unit profit basis, we are going to have deminished production and dangerous unemployment. If major segments of American industry attempt to cut prices by depressing wage rates, we will face the dangers of another disastrous depression.

The basic answer to our economic future, it seems to me, lies in the maximum hourly production on the part of labor; high wage rates, low unit profits and the greatest possible volume on the part of industry; the maintenance of high farm income; and the joint realization of all groups that the prosperity of each depends on the prosperity of the others.

During this difficult war period we have all learned to cooperate and to work together on a constructive give and take basis. We are winning the war today because each group - our soldiers and sailors, our industrial workers, our leaders of enterprise, our farmers and our government - have worked as part of a team.

We have had our occasional differences of opinion. But we have never had to argue about where we wanted to go or the speed with which we wished to get there.

Our economic future, like the winning of war, rests in our own hands. This challenge is as great as the war itself.



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