

Mr. Williams,

Ken:

Could you & Dick
digest this in a memo for
the Chairman? He would
like your combined judgment
as to whether this makes an
intelligent economic pattern
→ if not, wherein you think
it inconsistent or
insufficient. He has a first
impression that it were
political than economic!



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

File
Office Correspondence

Date August 4, 1945

To Chairman Eccles
From Kenneth B. Williams *KBW* and
Richard A. Musgrave *RAM*

Subject: Third Quarter Report of
Director Vinson of the Office of
War Mobilization and Reconversion.

Evaluation

As a matter of personal preference we both dislike the way this report is written. The tone seems to be much too flippant and over-dramatic, and there is an evident conscious striving for telling phrases--all of which reduce the dignity of the report as an official document, and obscure the seriousness of the issues involved. The tone is also exceedingly optimistic and self-congratulatory. The impression is left that everything, with one or two exceptions, is just "dandy" and every agency is doing a wonderful job.

On the whole, the general policy statements and the economic analyses underlying them seem good. The postwar chapter, which is really the most significant part of the report, takes a basic position not unlike the so-called "White Paper" you and the Director of the Budget sponsored last fall.

The report, however, does leave an impression of inconsistency as well as one of reaching for political effect. The inconsistency, we think, is more apparent than real. It seems to be largely a result of trying to include in one brief report specific factual material about the immediate transition problem and policies along with general over-all statements concerning long-run postwar goals. The net impression left by this combination of material tends to give too little emphasis to the very serious short-run problems, especially the immediate danger of inflation. If the report had been directed solely to the short-run situation, the treatment could have been and might well have been much sharper. As the report stands, these serious short-run problems are stated but they are slipped over so quickly that the reader doubtless is left with the impression that the dangers are not particularly serious. The way in which the whole problem of inflation of capital assets is handled in two or three sentences and without any reference to its tax aspects illustrates this tendency.

In view of Vinson's new position, his views on the importance of fiscal policy and on the overhauling of the tax structure are particularly pertinent. Except for the recommendation that the excess profits tax be removed after V-J Day, there does not seem to be much in his fiscal comments that is inconsistent with your position on these matters.

Summary

The Report is divided into ten chapters dealing with problems and policies both for the transition period between V-E and V-J Days and for the long-run period after V-J Day. Nearly all major fields are covered and broad policy statements are made for each field. The discussion covering the period

before V-J Day is largely a summary of general opinion around Washington with little that is new or unfamiliar in it. For the period after V-J Day, Director Vinson outlines in very general terms a nine-point postwar program for the United States.

Chapter I - Faces Turn West

This chapter states the main goals toward which the Office of War Mobilization and Reconversion is directing its energy. The goals are:

1. To meet the requirements of the Pacific war;
2. To reconvert and expand civilian production as fast as possible to increase the supply of goods and provide jobs for those released from the armed forces and war work;
3. To protect human resources insofar as possible in the inescapable shock of reconversion;
4. To provide food and other aids to the liberated countries to help them to become self-sustaining; and
5. To work toward a high-level economy in order to maintain in peacetime abundant production and full employment.

Chapter II - Finishing the Job

This summarizes the main military problems ahead. In finishing the war in Asia the difficulties of distance and redeployment and the magnitudes and general character of the cutbacks in the munitions program are outlined. Cutbacks are expected to reduce the munitions program from its early 1945 scheduled level of \$61 billion to a little less than \$40 billion by the middle of 1946. The cutbacks are to be concentrated heavily in shipbuilding and aircraft. The main production problem will be to assure priority for munitions production, to prevent a flight from war production, and to maintain a strategic margin for emergencies.

Chapter III - How and Why of Reconversion

This chapter is devoted to a discussion of the problems, prospects and policies for reconversion, both before V-J Day and after. It is estimated that by mid-1946 the rate of production of civilian hard goods, including both producers' and consumers' goods, probably will exceed the 1939 level. It is indicated that about 44.6 million civilian jobs are not likely to be much affected by physical reconversion and 6.6 million workers, mostly in aircraft, shipbuilding, ordnance, signal equipment, and Federal war agencies, are likely to be most

affected by the cutbacks. Of course, the physical problem is not the serious one and the employment situation would be far different if total demand becomes inadequate.

Government controls will be retained where necessary to:

1. Protect war production;
2. Promote the smooth flow of materials into civilian production;
3. Give small business equality of opportunity in the race for civilian markets; and
4. Ward off inflation.

On the manpower issue, the report states that manpower is no longer a basic bottleneck, although several industries and areas are still suffering from severe manpower shortages. Munitions employment declined by 500,000 in the three months ending May 31 and the rate of layoff is accelerating. Unemployment has begun to rise in several local areas although total unemployment has not risen significantly. At present, laid-off munitions workers do not lack job opportunities although the problem of fitting workers into the right jobs in the right locations and at the right pay may become difficult.

Chapter IV - To Speed the Switch-over and Cushion the Shock

This chapter points out that Government responsibility in reconversion goes beyond the relaxation, simplification, and elimination of controls. Inevitably there will be some unemployment, business losses, and hardship. The Government cannot undertake to see that every plant stays in business, every worker immediately finds a job, and every company gets financial help. Nevertheless, the Government can undertake measures to facilitate reconversion and re-employment and to cushion the shock. These measures have taken or are taking two forms:

1. Direct aids to business:
 - (a) Cutbacks are being distributed evenly.
 - (b) Contracts are being settled promptly.
 - (c) Government-owned property must be removed promptly from contractors' plants.
 - (d) A reconversion pricing program is being established which is flexible, permits prompt decisions, and should encourage reconversion and re-employment. The general objective is to hold general retail prices at about the 1942 level.

- (e) A reconversion wage program establishing wage rates for types of jobs which have not existed for a long time. The policy here is to set rates that are in balance with existing rates and do not either raise or lower the general level of wages.
- (f) The Joint Committee and the Treasury recommendations for advance payment of refunds under the excess profits tax and for raising the excess profits tax exemption from \$10,000 to \$25,000 beginning in 1946 are endorsed.

2. Direct aids to individuals:

- (a) The inevitable dislocation and unemployment through reconversion can be minimized by providing an abundance of jobs. Also, the United States Employment Service will help by providing job seekers and employers with up-to-date labor market information. The Employment Service should be continued on a national basis during the transition.
- (b) Many special provisions have been made for veterans, including mustering out pay, unemployment allowances, loans, educational grants, rehabilitation, hospitalization, etc. In general, these seem adequate but Congress is urged to increase the unemployment allowance from \$20 a week for all unemployed veterans to \$25 a week for veterans without dependents and to \$30 for veterans with dependents. Also, the legal uncertainties surrounding re-employment rights of veterans must be cleared up. A study of this is in process, but Congress may have to legislate the solution.
- (c) The unemployment compensation system for civilians is not adequate because weekly benefits are too low, duration of benefits is too short in many States, and large groups of workers (agricultural workers, domestic servants, Federal employees, employees of small firms, etc.) are excluded. President Truman's proposal for the Federal Government to supplement benefits under the State programs so that weekly benefits can run as high as \$25 a week, payments can continue for 26 weeks, and the number of workers covered is increased, is strongly endorsed as the number one legislative requirement for reconversion.

Chapter V - Surpluses

The Surplus Property Board is guided by three main principles:

1. To dispose of surplus property at fair prices through normal trade channels if possible;
2. To prevent the creation of monopolies and encourage the development of competitive enterprise and small business; and
3. To foster mutually advantageous economic relations with other nations by the orderly disposal of surplus property abroad.

After allowance for the amounts remaining overseas and for things that have no direct civilian use, it is estimated that some \$10 billion of civilian-type goods (exclusive of construction projects and ships) will remain after the war to be disposed of in the domestic market. The Government owns about one-fifth of the nation's manufacturing capacity. Of the total Government investment of \$16 billion in plants, about \$6 billion is probably unuseable for peacetime purposes and the remaining \$10 billion will also constitute a disposal problem.

Although the Surplus Property Act has been severely criticized by many, Vinson says that, by and large, adherence to the spirit--and even the letter--of the Act does not present insurmountable obstacles.

Chapter VI - Economic Stabilization

Inflation is a continuing threat for which the best antidote is increased civilian production. However, there is no short-term possibility of supplies increasing fast enough to remove the serious danger of inflation. Textiles, shoes, food, housing, and other essentials will continue to be seriously short. While the objective is to eliminate price and wage controls as quickly as possible, inflationary pressures are too strong to permit any relaxation as yet.

No general tax reductions should be made until V-J Day. Continuation of the Renegotiation Act is essential to prevent unreasonable profits. Sales of war bonds to individuals must continue to be pushed vigorously.

Wage controls must be maintained if the price level is to be held. However, as hours and overtime pay are reduced, some upward adjustment in basic rates will have to be permitted to prevent severe declines in take-home pay. Such wage readjustments can be made and prices still be maintained because of lower costs arising from elimination of overtime premiums, downgrading of jobs,

and increased efficiency of workers. To prevent inequities and hardship, Vinson also urged Congress to raise minimum wage standards from the present 40 cents under the Fair Labor Standards Act to at least 50 cents with provision for further permissive increases to be worked out by industry committees. This recommendation means little since the War Labor Board is already operating on a 55 cent minimum standard in allowing increases under the stabilization program.

Rationing of goods in short supply should be continued.

Liquid assets in the hands of individuals and business are estimated at \$230 billion and such a volume of funds cannot be counted upon to remain idle. The rise in urban and farm real estate suggests that these funds are already seeking outlets. "Such advances so far have been moderate. ...Studies are being made of ways to check such a development [speculative spiral] in its incipient stages--through credit measures."

Chapter VII - Food

The tight food situation is attributable to four major factors:

1. Total food production will decline this year for the first time since the war began;
2. Military demand is still increasing;
3. Relief needs in Europe are increasing sharply; and
4. United States ate too much in 1944 and the first half of 1945. At one time it appeared that surpluses of some foods might develop and allotments to consumers were increased beyond that production justified. Per capita food consumption last year was at a new high--10 per cent above prewar. This year the per capita supply will fall 5 to 7 per cent below last year. While this is not serious in terms of the total, severe shortages will exist in such basic foods as meat, sugar, and fats and oils.

Chapter VIII - Aid to Liberated Europe

Aside from humanitarian considerations we are concerned with helping Europe because economic conditions are related to political stability and without political stability, maintenance of peace will be difficult. Food is the main requirement but Europe also needs clothing, transportation equipment, coal, industrial machinery, etc. United States as the biggest producing nation must be the biggest single supplier of relief to Europe. New legislation will be needed to assure adequate financing of our supply program for liberated countries.

Chapter IX - What V-J Day Means

Today 45 per cent of American energies are concentrated on war and war supporting activities. A year from now only 30 per cent will be required. Employment in munitions industries will decline from about 8.6 million workers to less than 6 million.

V-J Day will signal the removal of most wartime controls. However, continued allocation of a handful of commodities may be needed after V-J Day and we may have to continue our efforts to obtain the production of low and medium priced textiles and shoes. To protect programs for liberated areas, manufacturers may have to continue to set aside a certain percentage of their output for export.

Controls after V-J Day will have one main purpose--to smooth the transition from war to peace. Whether controls are necessary and for how long will be determined largely by when V-J Day comes.

There is danger both of deflation and inflation. The sharp cut-backs in munitions employment, loss of overtime pay, and the shifting back to lower wage industries will result in a drop in income of the workers affected. This could produce a secondary decline in income elsewhere. On the other hand, history may repeat and inflation develop as after World War I. The cure for either inflation or deflation is production.

If re-employment is slow and a deflationary spiral threatens, the government must be prepared to undertake public works. While some programs are planned and ready to go, the total volume ready for operation ought to be far larger. Public projects must be careful not to compete with private construction and should be timed to fit in when private construction falls off.

The need for increasing unemployment benefits to cushion the shock of unemployment is emphasized again in this chapter.

Chapter X - The Bridge Between Today and Tomorrow

After the war, the American economy must be dynamic with expanding business, expanding markets, and expanding employment. This expansion requires positive policies by business, agriculture, labor, State, and Federal Government. The accumulated liquid assets are a new factor in the economy; they can be, if properly handled, a self-starter for the postwar, and a "fly-wheel" for the years to come. Efforts of business and labor to reach and maintain a high level of activity will not be enough. The Government must also share in a responsibility for adopting constructive policies. Vinson outlines a nine-point postwar economic charter for the United States. His nine points are:

1. Taxation. A complete modernization of the tax system is needed and is considered as the foundation of the entire program. Government revenue needs after the war will be three times as high as before the war. The following principles should be followed in revising the tax program:
 - a. Taxes should have the least harmful effect possible on the expansion of business investment and the creation of jobs;
 - b. Taxes should have the least harmful effect possible on the maintenance of markets and purchasing power;
 - c. The tax burden must be equitably distributed; and
 - d. Taxes should be integrated and a fiscal policy designed to prevent both inflation and deflation.

These principles mean that the personal income tax should be the main source of revenue and the base should be broad. Insofar as possible sales and excise taxes should be eliminated. The excess profits tax should be repealed after V-J Day. The sooner uncertainty about postwar taxes is removed, the sooner business can make firm postwar commitments for expansion.

2. Small Business. Basically, small business needs what all business needs. However, small business does have special need for access to technical knowledge and adequate sources of financing. The emergency war measures to assure working capital for small business should be continued through the reconversion period. The problem of providing adequate long-term and equity capital to small business calls for added legislation by Congress.
3. Competition. Competition is the heart of our economic philosophy. As soon as possible we should resume vigorous enforcement of the anti-trust laws. Some action must also be taken to see that the patent system is not used for monopolistic purposes. In addition to these negative measures, we must develop a positive program to encourage competition.
4. Labor Management and Wages. The Labor Charter sponsored by the Chamber of Commerce, A. F. of L. and C.I.O. represent a spirit of teamwork which is vital in working out postwar problems. Business is coming to realize that a high wage policy is in their interest as well as the interest of the nation. Labor is increasingly realizing that higher productivity per man is a requisite for higher wages. To protect

unorganized labor and to safeguard markets for business, government should put a floor under wages. A determined effort must be made to substitute arbitration for strikes and violence.

5. Foreign Trade. The objectives of our foreign economic policy are simple:
 - a. Our consumers and businesses want the right to buy and sell in all markets without discrimination;
 - b. We must cooperate with other nations in promoting world peace and economic and financial stability; and
 - c. We should promote the free international movement of capital so as to channel our investment funds into uses productive to us.

There are a number of measures which must be taken to achieve these objectives:

- a. The Trade Agreements Act should be renewed and the Bretton Woods Agreement should be ratified.
 - b. The Export-Import Bank should be strengthened and allowed a broader sphere of operation; and
 - c. The prohibition against loans to governments in default of their obligations to the United States should be repealed.
6. Social Security. Social Security is not merely a humanitarian measure but is also sound economic policy. Adequate protection against major hazards of modern society is necessary to maintain purchasing power and full employment. We should consider broadening the coverage of unemployment compensation, old-age insurance, provision of sickness and disability benefits, provision of better medical care, larger grants-in-aid to states for hospitals, and better equalization of educational opportunities.
 7. Farm Program. During the war, agricultural production has increased over 30 per cent, while the number of people living on farms has declined 20 per cent. The basis for postwar prosperity for farmers is the maintenance of full employment. In addition, Vinson urged exploration of direct subsidies for some products as a substitute for the maintenance of artificially high prices.

8. Public Works and Construction. There is a great accumulated demand for housing, roads, community facilities, and new industrial and commercial plants and equipment. We need 1-1/4 million new non-farm dwellings a year for ten years, one-third more than we ever built in the past. Construction should rise to an annual level of at least \$15 billion.

We should prepare plans for all kinds of future construction activity, including Federal construction projects such as low-cost housing. The timing of expenditure for public construction should be integrated with fiscal policy. There is also great need for examination of the factors contributing to the failure of construction to keep pace with technological progress in other industries. Restrictive practices, whether in materials, labor, or finance, should be eliminated.

9. Fiscal Policy. It is reasonable to expect that the Government will be spending about \$25 billion a year on the average after the war. The management of a budget of this size will have a tremendous influence on the level and stability of the whole economy. Whether or not to manage the budget is no issue. It must be managed. We need to formulate a total budget in relation to the total economic situation. Each type of tax and expenditure must be appraised in terms of its economic consequences. The Murray-Patman Full Employment Bill "which I have endorsed in principle establishes a mechanism for discharging this necessary function of government--budget planning--in a way which will help fulfill the necessary responsibility of Government, full employment."