BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 16, 1946

To Chairman Eccles

Subject: OPA Extension: Amendments

From Kenneth B. Williams and
Richard A. Musgrave

The Act as reported to the House is a compromise. It is nowhere as good as it should be but in view of the strong pressures for completely destroying OPA's effectiveness, it is not bad. The worst features are 1) the elimination of MAP and 2) the prohibition against retail cost absorption in some cases. The better features are that extension is recommended for a full year; that the requirement to guarantee profits for each product is omitted; that the Pace Amendment is not yet included in the bill. As reported to the House, the Act contains these amendments:

1. Extended the life of OPA one year to June 30, 1947 at which time it is to be abolished. This is a victory for stabilization as there was talk of extension for 9 months or 6 months.

2. A requirement to eliminate subsidies by June 30, 1947, by progressive stages beginning not later than October 1, 1946. The amount of funds provided for subsidies is all right and this amendment is unofficially acceptable as a compromise in place of a rigid legal schedule for removing subsidies or for elimination of subsidies by January 1947. There was no hope for an unhampered extension of the subsidy program.

3. A requirement that the President continuously examine the supply and demand situation and remove from price control (subject to later reinstatement if necessary) any commodities in "which the domestic demand has been satisfied".

This amendment is administratively difficult since presumably the President could not delegate his responsibility to OPA or OES. He might feel compelled to delegate it to CPA, Agriculture, etc., in which case removal of ceilings might be premature. The only thing in favor of the amendment is that it may ward off a more rigid legal standard such as the requirement that an article must be removed from control when supply equals 75 per cent of demand.

4. Eliminating MAP, the maximum average price program through which OPA, assisted by material allocations from CPA, encourages production of lower priced clothing. MAP prohibits a manufacturer from selling his goods at a higher average price per unit than he charged in the corresponding quarter in either 1943

or 1944, depending on the commodity. By this procedure, the manufacturer had some leeway in distributing his output by price lines and at the same time there was some assurance that production would not be concentrated entirely in the high price lines.

This amendment is extremely bad. It leaves the administration almost helpless in obtaining production of lower priced clothing goods.

5. Limiting cost absorption in some areas by prohibiting OPA from reducing unit profit margins at retail for products largely out of production during the war (automobiles and other consumer durables) below pre-war standards until sales volume for six months has equalled or exceeded its 1939-41 average for the product.

This is an extremely serious blow to stabilization. It is discriminatory in favor of automobiles. Porter says it will increase the average price of an automobile by $85.

6. Authorizes OPA to take account in its rent ceilings of differences in costs, etc. between transient hotels and residential hotels. This apparently is fairly harmless.

7. A requirement that ceilings on any items made of cotton or wool must cover the cost of cotton or wool computed at parity or current cost, whichever is higher, plus other costs and a reasonable profit.

This is very undesirable because: 1) it requires that a profit be permitted on each product instead of for the industry; and 2) since cotton and wool are above parity and being pushed higher by speculation, it creates a little inflation spiral of its own.

Not now attached to the OPA Act is the Pace Amendment to the minimum wage bill. The President is expected to veto the minimum wage bill if passed with the Pace Amendment. If he does, the Pace Amendment is likely to be tacked onto the OPA Act. The Pace Amendment requires parity prices for farm products to reflect the imputed wages of farm operators and family workers as well as the wages actually paid hired labor. The effect of this requirement would be substantially higher parity prices. OPA estimates that it would result in a 15 per cent increase in the retail cost of food. Needless to say an increase in food prices of this magnitude would go far to destroy the present stabilization base and would be extremely dangerous.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 2, 1946

To Chairman Eccles

Subject: OPA Testimony

From Richard A. Musgrave RAM and
Kenneth B. Williams KBW

Attached are (1) draft for statement before the Senate Committee and (2) summary of House bill.

In addition to the usual story, we emphasize two major points which Chester Bowles has been unable to get across and which are difficult to present. They are likely to be raised anyhow, and have been brought out repeatedly by the more able oponents of OPA (such as Taft) to show how well they understand the basic issues.

Attachments

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 1, 1946

To Chairman Eccles

From Kenneth B. Williams KBW and
Richard A. Musgrave RAM

Subject: Price Control Extension as Passed by the House

The Act as passed by the House means, for all practical purposes, the end of price control. It has little resemblance even to the weakened version reported to the House by the Banking and Currency Committee, as discussed in our preceding memorandum of April 16. The only good thing about the Act is the retention of rent controls.

The amendments to the Act obviously were hastily drawn and voted on in a general atmosphere of unrestrained irritation. Some of them are not clear as to intent nor entirely consistent with each other. Without clarification, administration even of the little that is left of price control would be difficult. The worst amendments to the Act call for:

(1) Immediate removal of price ceilings on half or more of the goods in the economy. Price ceilings must be removed from any commodity whenever production of that commodity in the latest 12-month period exceeds that in the year ending June 30, 1941. This formula presumably would require the removal of price controls on nearly all food, most farm products, petroleum products, coal, house furnishings, woolen and rayon fabrics, most women's garments made from these fabrics, shoes, bus and truck tires, cigarettes, and a large part of the basic industrial materials and their products in such fields as textiles, leather, chemicals, rubber, stone and glass, machinery, and certain metals.

(2) Price ceilings on each product high enough to cover the industry's current cost of production on each product plus a reasonable profit, not only for producers but also for wholesalers and retailers.

(3) Eliminating the subsidy program on December 31, 1946, by rigid progressive stages of at least 25 per cent every 45 days. Corresponding advances in price ceilings must be made as subsidies are reduced.

(4) Elimination on June 30, 1946, of subsidies on livestock and meat products. OPA estimates this would increase the nation's meat bill by about 7 times the cost of the subsidy.

(5) Elimination of MAP, the maximum average price program, now used to encourage the production of low-priced goods.

(6) Abandoning OPA's cost absorption program for wholesalers and retailers on reconversion products, such as automobiles, radios, and large household appliances, until unit sales have for a six-month period reached the average volume of sales of that product in 1939-1941.

(7) Requiring ceiling prices for products made of cotton and wool to reflect not only parity prices but current prices for raw cotton and wool. This would leave clothing and textile prices practically at the mercy of cotton speculators.

(8) The termination of price controls by March 31, instead of June 30, 1947. OPA specifically must be abolished by June 30, 1947, but the President is required to report to Congress not later than January 2, what if any commodities, including housing, are so short in supply as to necessitate continuing his powers after June 30, 1947.

Statement of Marriner S. Eccles Before the
Senate Banking and Currency Committee on the
Extension of the Stabilization Laws
May 2, 1946

In appearing before this Committee I do not have to bring any new facts to bring to your attention. I have stated my position repeatedly and in detail before this Committee and more recently before the Banking and Currency Committee of the House. I am anxious, however, to appear before you to join Mr. Bowles, Mr. Porter, and others in urging you to extend the Emergency Price Control Act for at least a year without weakening amendments. Unless the ~~Bill~~ Act is extended, the victories of the war may well be lost in a torrent of inflation.

The anatomy of the inflation problem is simple enough: Demand has piled up during the war years when many goods were not available for civilian consumption and business expenditures for replacement had to be postponed. Now that the war is over, this demand, more than amply supported by an excessive money supply, is being released and is pressing upon the market. Production, while in high gear, is not yet sufficient to meet the record demand. It can not be sufficient to meet it for some time to come, however fast production + the reconversion process. Because there is this excess of demand over the supply of goods, prices are threatening to rise all along the line. The danger is extreme because the push towards higher prices is not limited to a few goods or small

segments of the economy. Unless controlled, the situation contains all the makings of a disastrous inflationary spiral of price and cost ~~and price~~ increases.

Behind this pressure of excess demand, sustained by a record level of current income, there lurks a huge volume of liquid assets, accumulated during the war as a result of war financing. These liquid assets, now ~~at the beginning of this year~~, amount~~ed~~ to about 270 billion dollars as against 80 billion before the war. Their magnitude is difficult to comprehend, it is so large. Demand deposits and currency alone are more than 100 billion, or nearly three times the pre-war level. Holdings of Federal securities are eight times as large as before the war. The existence of ~~the~~ these assets currently contributes to a higher level of spending and thereby accentuates inflation pressures. Moreover, and more important, the millions of consumers and businesses holding these 270 billion dollars of liquid assets are in a position to greatly increase their rate of spending at a moment's notice, should they wish to do so. They may wish to do so if they are given reason to believe that the purchasing power of their cash or Government security holdings will be reduced or lost in the upsurge of a general price rise. Should that happen, the consequences would be disastrous, not only here but also abroad. To prevent it, everything must be done to assure the investor, the businessman, and the consumer, that the purchasing power of his money and his Government securities is good and will remain so.

To hold the line, we must approach the problem along these fronts:

(1) We must retain price controls for the period of the inflationary emergency.

(2) We must balance the budget and forestall further monetization of the debt.

(3) We must take vigorous steps to check the inflation in capital assets.

I shall comment briefly on each of these points:

The first and foremost step is to remove any uncertainty whatsoever that the Congress will continue effective price controls as long as the inflationary emergency lasts. The Price Control Act must be extended and hampering amendments must be avoided. There is no alternative. Price control, admittedly, deals with the symptoms, rather than the causes of the inflation problem. The basic causes are the scarcity of supplies, the accumulation of backlog demand during the war years, and the vast increase in the money supply and security holdings as a result of our methods of war financing. But these basic causes can not be eliminated at once. Increased production and the wearing off of backlog demand will take time. The money supply problem can be attacked vigorously, but available purchasing power is bound to remain very large. Price controls must thus be continued for the time being, until a better balance between demand and supply is restored.

At the same time we must do all we can to prevent further additions to incomes and the money supply through continued budget deficits. We must balance the budget and make a vigorous effort to retire public debt. As indicated in the President's recent budget statement, good progress is being made. For the first quarter of 1946, we had a budget surplus of 800 million dollars--the first surplus since 1930. For the second half of this year the budget deficit will remain between 3 to 4 billion dollars, ~~and we~~ but the Treasury will have a surplus of almost this amount in the trust funds and other special accounts. We should definitely be out of the red before the turn of the year. No tax reductions whatever should be considered for the time being. If present tax rates are maintained, some debt retirement out of current receipts, as well as out of accumulated Treasury balances, may be anticipated for next year.

The outlook has similarly become more encouraging in the Government security markets. The Treasury's debt retirement program has tended to decrease holdings of Government securities of both commercial banks and Federal Reserve banks. The narrowing of the differential between short-term and medium-term interest rates has reduced the incentive of banks to shift from short to medium-term holdings, which for more than a year has been an important factor in the expansion of credit. The preferential discount rate granted by the Federal Reserve Banks on advances to member banks secured by Government obligations with less than one-year maturity has been eliminated, and other steps are under consideration which will prevent further shifts of security

holdings from non-bank investors to commercial banks. The problems involved are being studied by the Board of Governors, and I believe that a solution can be found which will prevent further monetization of the debt and still not involve an increase in the cost of carrying the public debt. There is good reason to hope that the expansion of the money supply has come to a halt and is being reversed.

Finally, we must devise proper means to check the already alarming inflation in the field of capital assets, particularly real estate. The excessive rise in values which has now been in process for several years results in serious inequities and undermines the basis of future prosperity. At the same time, it increases incomes and thus adds new fuel to the fires of inflation. Much valuable time has been lost already in dealing with the problem, but good may still be done by taking action now. As I have stated repeatedly, I believe that the tightening of capital gains taxation is an essential step in this direction.

To meet the dangers of inflation, vigorous policies on all these fronts will be required, but failure will be certain if effective price controls are not retained until a better balance between supply and demand is reached. Those who wish to discard price controls should do so in full awareness of their responsibilities; no one should be misled by fallacious reasoning as to the consequences of discarding or weakening price controls. The public should be warned against the pied piper's song that everything

will be well at once if only ~~prices are permitted to rise and~~ the natural operation of "supply and demand" is restored.

This law of supply and demand has become the most quoted, if least understood, law of our time. Properly interpreted, it expresses the sensible rule that in a free economy changes in individual prices act as a signal by which production or supply follows consumption or demand. This rule can be relied upon under competitive conditions to channel production into the right markets and to see that businessmen will produce the kinds of goods that consumers want. But there are other things for which it can not be relied upon. Mainly, it can not be relied upon to adjust the level of total demand to the level of total supply without unemployment on the one hand or unreasonable increases in the price level on the other. Thus, there were no price controls in 1929 or 1930, but the law of supply and demand did not operate to prevent a drastic deficiency in total demand and a disastrous deflation. Similarly, we can not during the months ahead rely upon the law of supply and demand to prevent people from trying to purchase more than is available at present prices. We can not rely upon the law of supply and demand to prevent inflation when we have a situation in which total existing demand greatly exceeds the supply that can be made available.

If price controls are abolished now, the forces of supply and demand to be sure will operate, but they will operate to accelerate inflation, not to check it. The quantities of supplies which can be made available during these months will still be

limited. They will not be increased by permitting prices to rise wildly. On the contrary, production will be disrupted and supplies reduced. By permitting an excessive demand to press upon still scarce supplies, prices will be driven up and wages will follow. With it, purchasing power and demand will increase further. An inflation spiral will ensue and continue to its inevitable collapse, which will bring depression and unemployment. Clearly, this is not the way out; the only way out is to retain effective price controls until the pipelines of production and distribution have been filled, the brunt of backlog demand has been met and the feverish upward pressure on prices has subsided. Some prices at such time will still tend to rise; but others will tend to fall, and the free play of supply and demand will take care of this by increasing production of some things and curtailing production of others. The question will again be one of adjusting the lines of production to the lines of demand; it will no longer be one of holding total demand within the limits of total supplies.

It is impossible, of course, to predict the exact date by which price controls can be dispensed with safely, but I believe it unlikely that the period will exceed 12 to 18 months. Certainly, there is no validity to the argument--repeatedly voiced before your Committee--that those who advocate the retention of price control now must in effect advocate its retention on a permanent basis. More production, this argument runs, can not reduce inflation pressures since the relief obtained in increased supply

from the production of more goods will be offset on the demand side by the creation of additional income with which to buy them.

This argument disregards first of all the kinds of products which are produced. During the war consumers incomes vastly exceeded civilian supplies, as half of the economy was employed in the production of war materials. Recently Aggregate production for civilian use has been at record levels, but we are still engaged in getting ready for the production of many consumers goods, in filling the pipelines from raw material production to the retail counter. In a short time the composition of total output will have shifted towards the output of finished products and a much greater supply of goods will become available for direct consumption. A large number of industries will reach the stage where final products will come to flow to the consumers markets on a vast scale. This will obviously reduce the urgency of demand and thus moderate inflationary pressures.

Moreover, the argument disregards the fact that the present high level of demand is of an abnormal sort. Current demand is swollen by the backlog needs, foreign and domestic, which have been accumulated during the war period. These needs will be satisfied in the course of time and people will again return to normal buying habits. When this occurs, liquid assets will lose their inflationary significance. People will want to add to their savings, rather than use them for current purchases. In time, we

may again be confronted with the problem of deflation, rather than inflation and the availability of savings may then be helpful in sustaining an adequate level of purchasing power. The continued existence of a large volume of liquid assets thus does not mean that inflation will be a permanent factor in our economy or that price controls will be needed after the temporary excess demand and unusual supply shortage has been taken care of.

As I see it, there is no hope for a prosperous and free economy if the scourge of inflation is permitted to take its course. An inflation spiral is bound to collapse. It is bound to bring with it the resumption of Government controls on a much larger scale, on a scale from which the free enterprise system may well be unable to recover. The issue is not: Discard price controls now or forego the hope for a free economy later. The issue is: Retain effective price controls now so that a free economy may be safely restored at an ~~later~~ early date.

My background, as you know, is business and banking. I am familiar with and sympathetic to the irritations which price controls impose upon the business community. I am in favor of doing our utmost to minimize such irritations. But, I am also firmly convinced that these irritations will prove to be minor in comparison with the difficulties and chaos that would ensue if price controls were made ineffective now. If adequate price controls are retained, production is allowed to continue to expand

government expenditures are kept below receipts, rapidly, ~~the budget is brought into balance~~, and debt is retired, we shall be safely on our way towards a stable and prosperous peacetime economy. Unless effective price control is extended, I am frankly fearful of the consequences.

RAM/KBW

May 2, 1946

With the Committee's permission, I should like to offer for the record a statement I presented to the House Committee because it sums up the main reasons why I think it essential to continue the Price Control Act without impairment for another year. Then, if I may, I should like to supplement that statement briefly by a few additional comments.

1. An effort has been made to persuade this Committee that the volume of money competing for the still inadequate supply of goods and services at this time has been exaggerated, and that, therefore, price controls can be safely removed. The fact is that liquid assets belonging to the general public at the end of last year totaled 275 billion dollars. This consists of currency, bank deposits and Government securities owned by individuals and business, outside financial institutions. I sometime wonder if too many of us have not lost all sense of perspective with respect to such huge dollar figures. This total is nearly three and a half times the aggregate of these items in 1940. The problem of inflation control would be serious enough if it were confined to preventing this enormous potential purchasing power from bidding up prices. But this is only a part of the picture. In reckoning with present inflationary pressures, it is important to remember that in addition to this ~~huge and~~ unprecedented accumulation of readily available funds, the general public is getting ~~has~~ billions upon billions of current income. Current incomes are estimated to be at the rate of 150 to 160 billion dollars a year, a volume of buying power that is more than twice prewar levels and more than sufficient by itself to take off the market all the goods and services as yet available. This is not all. To the extent that the banking system lends to its customers, and to the extent that consumer and other forms of credit expand, the aggregates of buying power are further increased. I think the danger inherent in the money supply side of the equation has been greatly underrated -- not exaggerated.

2. There is another rather widespread misconception: that price controls are enough, by themselves, to hold the line. It is idle to talk about holding the line unless price controls are continued. But we should not forget ~~delude ourselves into believing~~ that other safeguards are necessary in order to make price controls as effective as they should be. One is to avoid further reduction of taxes. It is unfortunate that taxes have already been reduced as much as they have, and that we have not used the instrument of capital gains tax to curb speculation in capital assets, especially in homes, farms and business properties. We should exert every effort not only to balance the budget, but to have as large a surplus as possible with which to pay down the public debt. In particular it is important to reduce commercial bank holdings of the debt, for that will reverse the process by which the Government has created an excessive supply of money. The volume of Government created funds ought to be reduced on balance as private credit expands through the banking system. New supplies of bank credit -- new additions to the money supply -- result just as much from banking lending to private borrowers as from lending to the Government. As this Committee knows, price controls, like curbs on stock market or consumer credit and other similar devices, deal with the effects, not with the basic causes, of the inflationary danger. The way to get at the causes is, on the one hand, to reduce the excessive money supply, and, on the other hand, to reach quickly the highest possible sustainable levels of production. The violent struggles we witness today on many fronts for higher wages, profits, and prices -- the strikes and the shutdowns -- all combine to defeat the purpose of price controls and to tear the fabric of the economy apart. The inflation danger will not be overcome and the deflationary collapse that would be certain to follow will not be avoided unless there is a far greater sense of national responsibility on the part of some of the leaders in labor, industry and agriculture than has been exhibited lately.

3. OPA is by no means perfect. Its most loyal workers are frank about admitting its shortcomings. There is no more thankless public service than this -- or any more deserving of understanding help from all of us. It will be wrecked, however, no matter how able its leadership and its staff if the general public tolerates and patronizes black markets. This bill to extend the Act is already long overdue, as the Committee knows. The organization has thus been weakened by losses in the staff, and enforcement has been injured. Its morale can be greatly restored by passing this Act, without hampering amendments, and by a vote that will show the country that the Congress is determined to have the law respected and enforced in order to protect and preserve this nation.

5/6/46
ET:b

Mr. Wason's arithmetic reminds me of the old story to show that you don't work but a couple of days a year. For example, there are 365 days in a year. You get 8 hours a day for sleep, which amounts to 122 days. Then you get 8 hours more for recreation. That's another 122 days. Then you get, say, 30 days vacation and 10 holidays. You don't work Saturday afternoons, which is another 26 days, and you don't work Sundays, which is 52 more. Now, all that adds up to about 362 days, which goes to prove you work only 3 days a year. That is, of course, tricky aritmetic.