Farm Price Controls in a Garrison Economy

Stronger Monetary and Fiscal Measures the Only Alternative

Rapidly growing tension between the United States and Communist-controlled nations has necessitated further expansion in our defense program, making more likely the imposition in the near future of direct controls over prices and distribution of many commodities, including farm products. Such a development is in prospect even though the basic productive capacity of American agriculture is at the highest level ever achieved and many farm products are in large supply. This favorable supply situation probably will not be sufficient in itself to offset the effects on prices of further large increases in personal income and of reductions in supplies of other goods and services available to consumers. An increased requirement for farm products is now indicated, as a result in part of the transfer of more persons from civilian to military activities, population growth, and attempts to increase inventory holdings of some items by Government agencies and commercial firms in both the United States and other countries. These factors appear moderate, however, and probably would not be sufficient in themselves to support a substantial and sustained further advance in farm product prices. The real threat, as indicated above, is from further large increases in personal income and, to a lesser degree, the transfer of consumer expenditures to farm products from other consumer goods in reduced supply. Monetary and fiscal measures now in prospect may not be adequate to the task of restraining the rise in disposable personal income, with the result that “direct” control of prices will be politically necessary.

Meat a Likely Candidate for Control

The Defense Production Act of 1950 authorizes the President to establish and maintain ceiling prices for farm products at a level no lower than parity or the highest price received by producers from May 24 to June 24, 1950, whichever is higher. Farm product prices at mid-June prior to the outbreak of hostilities in Korea averaged 97 per cent of parity. Cattle, calves, lambs, wool, and soybeans were the only important commodities then above parity. Prices advanced sharply thereafter to an average of 103 per cent of parity at mid-July, but cotton was the only additional farm product to exceed the parity level. Farm product prices averaged 105 per cent of parity at mid-November. At that time rice, cottonseed, and some types of tobacco had joined the above-parity group. Prices of most farm products, however, continue below parity and can still rise appreciably before becoming subject to direct price control. This does not mean, of course, that all or even most farm product prices must be above parity before ceilings will be established.

Meat is likely to be the first important farm product for which direct price control is seriously considered. The demand for meat increases rapidly with rises in personal income. Although seasonally large supplies have limited price advances in recent months, smaller supplies are expected in the late winter or early spring. The combination of greater demand and smaller supplies will come at a time when the effects of the defense program are becoming more noticeable, and may result in advancing prices and demands that ceilings be imposed.

The United States Department of Agriculture, in evaluating the impact of the defense program on agriculture, has repeatedly called attention to the favorable supply situation for most farm products and concluded that there is no need currently for extensive direct controls. Rather, emphasis is on the need for increased production, sufficient to provide “enough of the right kinds of food and other farm products to fill every need at reasonable prices.”

In World War II a program of specific crop goals for individual farms was used to assure necessary supplies of needed farm products. No such program is indicated yet in the present defense effort. The Secretary of Agriculture has stated that the Department is “thinking in terms of over-all guidance” relative to “total production needs” with “acreage and marketing restrictions on commodities in strong demand” being eliminated with the hope that each farmer will “make those increases in production which will best utilize his resources.”

Farms, at present, are generally well equipped, but a continuing flow of farm production materials is necessary if output is to be maintained or expanded to new high levels. An Office of Materials and Facilities has been established in the USDA to act as claimant for production materials on behalf of farmers, food processors, and producers of farm equipment. The sharp cutback in production of farm machinery early in World War II is considered by many to have been a mistake. As the war progressed, it was found necessary to allocate larger supplies of critical materials to agriculture at a time when military requirements were near a peak.

An Office of Requirements and Allocations also has been established in the USDA to integrate demands for farm products and arrive at estimates of over-all needs. If shortages develop, this agency would also balance off requirements of civilian, military, ECA, and other outlets with available supplies.

In addition to providing authority to control prices, the Defense Production Act of 1950 authorizes such important measures as the direct allocation and requisitioning of materials essential to the national defense, limitation of inventories, and purchase and resale of commodities for industrial use or stockpiling. These devices were used extensively in the World War II mobilization.

(Continued on Inside Back Cover)
Democracy's Arsenal Reopens

Arms Program Speeded to Meet National Emergency

Before the entrance of the Chinese Communists into the Korean war, Federal expenditures for defense had been scheduled to reach an annual rate of 30 billion dollars by mid-1951, double the rate of last June. In present circumstances this is only a start toward a fuller mobilization of the nation's resources. Arms outlays of the proposed magnitude cannot be imposed upon an economy already straining at the seams without severe dislocation. As the year 1951 proceeds, most of the economic controls which were found necessary during World War II will probably be invoked once again.

Authority to impose a wide variety of direct controls was provided on September 8, 1950, when the Defense Production Act became law. Since then the President has had authority to impose priorities and allocations, institute wage and price controls, requisition critical materials, supply funds to finance industrial expansion, and control real estate construction credit. Also, the Act authorized the Board of Governors of the Federal Reserve System to exercise consumer credit controls.

On December 15 the President announced the establishment of an Office of Defense Mobilization to direct "all mobilization activities of the government, including production, procurement, manpower, transportation, and economic stabilization." He appointed Mr. Charles E. Wilson, who has resigned as president of the General Electric Company, to be director of the office.

In ordinary times the price system tends to allocate the nation's resources to the most desirable uses as determined in the market. When prices of particular goods rise, it may be a signal that production can be expanded profitably. In the war economy, however, priorities and allocations are necessary to assure adequate production of military supplies and equipment. Vast programs for industrial expansion are now under way, but these plans require a year or two at least to complete for most types of processed materials. Even if the nation possessed the basic capacity now planned for the end of 1952, current military requirements could not be met without diverting substantial amounts of materials from the production of consumer goods. For the second time in a decade America must demonstrate that conversion to military production can be accomplished speedily and efficiently in order to cope with totalitarian aggression.

THE NATIONAL PRODUCTION AUTHORITY

Immediately after signing the Defense Production Act, President Truman delegated his priority and allocation powers to four Governmental agencies. The great bulk of products will be handled by the Department of Commerce, but certain items are assigned specifically to other agencies. The Department of the Interior has authority over petroleum, gas, solid fuels, and electric power; the Department of Agriculture over food, farm equipment, and fertilizers; and the Interstate Commerce Commission over domestic transportation, storage, and port facilities.

Each of the organizations possessing priority and allocation power has created one or more new agencies to administer its responsibilities. Most publicized of the new agencies is the important National Production Authority (NPA), which was created in the Commerce Department by Secretary Charles Sawyer and is headed by William H. Harrison.

PRIORITIES AND ALLOCATIONS SO FAR

Inventories—Since the establishment of the NPA and its conferences with industrial leaders, its orders, and its projected orders have appeared on the financial pages almost daily. The first order of the NPA, Regulation 1, instituting general inventory controls, became effective September 18. The purpose of the regulation is "to prevent the accumulation of excessive inventories of materials in short supply. It does this by limiting the quantities of such materials that can be ordered, received or delivered."

Materials specified in Regulation 1 include a variety of chemicals, building materials, and other items such as rubber and textiles, but emphasis is placed upon metals, metal products, and scrap. Metal products named specifically in the order include various forms of iron and steel, aluminum, columbium, cobalt, copper, magnesium, manganese nickel, tin, tungsten, and zinc.

The effectiveness of the general inventory control order is questionable. Stocks are supposed to be kept to a "practicable minimum," defined as "the smallest quantity from which a person can reasonably meet his deliveries . . . on the basis of his currently scheduled rate of operation." Violators of the regulation are threatened with fine and imprisonment, but no special reports are required, and the NPA lacked any kind of enforcement machinery until the establishment of a Compliance Division early in December. Furthermore, the order came at a time when most business firms using the enumerated materials might be able to justify very substantial increases in inventories on the basis of record rates of operations.

Since the original inventory regulation, the NPA has limited inventories of certain critical items to a specific number of days' supply. Holdings of aluminum, cobalt,
copper, nickel, and zinc are restricted to a number of days' supply varying from 20 to 60 or to a practicable working minimum, whichever is less.

**Priorities**—The second major step taken by the NPA came on October 3 when Regulation 2, concerning priorities, was issued. Regulation 2 created the “DO rating,” a single priority rating which is currently being applied to defense orders of the Defense Department, Atomic Energy Commission, the Coast Guard, and the National Advisory Committee for Aeronautics. When a contractor receives a DO order, he must postpone other contracts until the defense order is filled. The rating may be passed on by prime contractors to subcontractors and suppliers.

To allay fears that certain firms might be served with a disproportionate amount of rated orders which would interfere with normal business, the NPA has placed ceilings on the amount of DO orders that one contractor must accept and has set “lead times,” in advance of delivery dates, which must be observed by procurement agencies in placing rated orders. Steel orders, for example, must be received by producers 45 to 90 days before the first of the month in which shipment is requested. Otherwise, the priority may be rejected. No steel producer need accept DO orders in any one month of over 15 per cent of his average monthly shipments of carbon steel during the first eight months of 1950 or over 25 per cent of his shipment of alloy steel. Specific limitations on DO orders are also placed on each type of product.

**Cutbacks**—The allocation problem has also been tackled from the end product side by limiting the use of strategic materials in the production of consumer goods. Nonmilitary use of copper and zinc in the first quarter of 1951 must be cut to 80 per cent of the amount used in the first six months of 1950. Similar cuts for other metals include 35 per cent for nickel and aluminum and 50 per cent for cobalt. All columbium steel must be used to fill defense orders. Other measures taken include substantial cuts in the use of natural rubber and the banning of all construction for recreational purposes.

**Certified Orders**—Another type of regulation utilized by the NPA has been the “certified order.” These orders have been used to assure that supplies to steel will be set aside for the building of 10,000 freight cars a month and the construction of 12 Great Lakes cargo vessels. Some confusion has arisen as to whether these certified orders take priority over the more usual DO orders.

**More Rules To Come**—The priorities and allocations system is still fluid. New orders are being added, and existing rules have been modified one or more times. Most of the metals have been covered by specific orders, but new rules applying to the use of other materials are expected in the future. Businessmen, particularly manufacturers, are watching for new regulations which may affect their industries. Recently, NPA officials have revealed that manufacturers may soon be forced to substitute abundant materials for those which are critically short, for example, molybdenum for tungsten as a hardening agent in steel.

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**AN ALLOCATIONS RECESSION?**

Fear that a business recession might occur in the first quarter of 1951 as a result of an attempt to cut back civilian production “too much, too soon” has been expressed by spokesmen for business and labor. They believe that allocations and priorities piled upon credit controls and higher taxes could cause unemployment and hurt certain types of business before large-scale arms production is under way. The NPA and other agencies possessing similar authority have moved slowly in the past three months; many observers would say too slowly. They have been working under the severe handicap of knowing very little about the amount and kind of supplies and equipment that the services intend to order in the months ahead. If raw materials actually begin to pile up in the hands of producers, the NPA will certainly relent on the restrictions now ordered.

A number of factors are working toward the prevention of any important downturn in business activity in the foreseeable future. All classes of industry are spending heavily for new capital equipment, and most manufacturing firms are endeavoring to build up inventories. Consumers generally are convinced that they had better buy now lest prices rise or goods become unobtainable. At the same time, every attempt is being made to speed up rearmament as a result of the more critical foreign situation which has developed in the past month.

**TRIAL AND ERROR IN WORLD WAR II**

The nation was somewhat shocked to learn in 1941 that American industry could not furnish the war materials required by a vastly expanded defense program and maintain production of civilian goods at the same time. Basic metals, chemicals, and textiles simply could not be produced in sufficient quantities to supply the increased demand, despite the fact that in most cases industries producing these items were operating well below capacity early in 1940.

The Office of Production Management (OPM) was created in December 1940 in an attempt to expedite the defense production program. During the first half of 1941, the OPM instituted a series of priorities which gave preference to defense orders and ranked civilian orders according toessentiality. Aluminum needed for the huge aircraft production program was the subject of the first OPM priorities order on March 22, 1941. Other extremely scarce materials included copper, steel, certain chemicals, nickel, rubber, rayon, and silk. By June of 1941 it became obvious that defense requirements could be met only if substantial cutbacks of civilian goods were effected.

On May 31, 1941, the President's authority over production was broadened and clarified. He was given the power, at that time, to speed any orders necessary or appropriate to promote the defense of the United States.

At the end of August, the President created the Supply Priorities and Allocations Board (SPAB), which was superior to the OPM. Recent orders of the NPA are
strongly reminiscent of SPAB's early moves. Increases of capacity for the production of all basic materials was recommended. Curtailment of a number of important products, such as automobiles, refrigerators, metal office furniture, and other products which required materials in short supply, was ordered. Restrictions were placed upon nonessential building and construction, and the use of copper in most civilian goods was prohibited.

By the time America entered World War II some progress had been made in the trial-and-error process, which culminated in the smooth-running arsenal of 1944, but major problems were still unsolved. The administrative organization of the defense agencies was too complicated, and indistinct lines of authority resulted in feuds and bickering among the various civilian and military bodies charged with expediting defense production.

At the time of Pearl Harbor about 15 per cent of the nation's industrial production was being devoted to armaments. The President's call for 60,000 planes, 45,000 tanks, and 8 million tons of shipping in 1942 obviously required a much greater effort and a more closely controlled economy. In January of 1942 the War Production Board (WPB) under Donald M. Nelson replaced both SPAB and OPM at about the same time the OPA was established on a statutory basis and given power to stabilize prices and eliminate hoarding. From then until V-J Day the principal responsibility for industrial production and related matters was centered in the new agency.

Over 100 billion dollars of war orders were placed in the first half of 1942. But then as now appropriations and orders on the books did not equip the armed forces. Production schedules were hampered by the same problems which confront the NPA today: a lack of data, confusion as to responsibilities, and indecision upon the part of the armed services concerning the amounts and kinds of materials needed.

In March 1942, the Army-Navy Munitions Board was given authority to assign priorities to armed forces procurement. Ratings were dispersed so lavishly that they soon exceeded in volume the allocations made by the Requirements Committee of the WPB, with the result that a priority became a mere "hunting license." By mid-1942 the priorities system, which had by that time become an extremely complicated procedure involving numerous gradations and designations, broke down completely.

About this time the WPB was reorganized and was given increased powers. To replace the discredited priority system the famous Controlled Materials Plan (CMP) was worked out and introduced in the spring of 1943. Under CMP, requirements and supplies of scarce materials were totaled, and then available goods were assigned to the various programs of the procurement agencies and to essential civilian uses. Prime contractors were granted allocations which they divided among subcontractors. The Controlled Materials Plan, fully effective after July 1, 1943, gradually brought order to the production program by completely controlling certain key commodities such as aluminum, copper, and steel.

During 1943 materials control became a less urgent problem, and the primary attention of the WPB was shifted to the development of a smooth method of gathering component parts for assembly and establishing priorities for end products. The Component Scheduling Plan, introduced in July of 1943, eventually solved these problems by collecting information on manufacturers' production schedules and making certain that components were on hand, when needed, in the proper quantities to bring maximum output of end products.

**TEN YEARS LATER**

The enlarged defense program of today has unlatched the same box of troubles which plagued the productive effort during the years 1940-43. Complaints already have arisen that in some cases priorities issued exceed the portion of total production assigned to these orders. The NPA is hampered by a lack of information on which to base orders. Jurisdictional disputes among defense agencies suggest that lines of authority are not sharply drawn. No steps have been taken as yet to assure that essential civilian goods and MRO (maintenance, repair, and operating) supplies will be provided.

The appearance of these problems does not mean that the experience of World War II is being ignored. Rather, the defense effort is in the throes of its first growing pains. Part of the NPA's problems can be traced to an inadequate staff. The control of important portions of American industry is an extremely intricate task requiring many trained workers. At its peak, the WPB had 23,000 employees. It is necessary that at some point the "single-band" priority system give way to multiple ratings which take account of varying degrees of urgency. Limitation orders must be placed upon the production of luxury or near-luxury products, and a sequence of essentiality drawn up for various items which have claims against supplies of scarce commodities. An official of the NPA has suggested that a controlled materials plan similar to that used during World War II will soon be necessary, possibly by the summer of 1951.

After reviewing the difficulties experienced in gearing America's productive machine to wartime conditions during the early forties, some observers have reached the conclusion that a democracy cannot act as quickly and efficiently to meet an emergency as a dictatorship. These views are not supported by the captured records of German and Japanese production agencies. Mistakes made by our wartime administrators appear to have been less serious and were corrected more swiftly than those made by their counterparts in the Axis nations. Americans generally are convinced that an economy left as free as possible serves the nation best in the long run, but in the present situation they have shown a willingness to accept the proposed pattern of controls as the only logical method of assuring the success of the rearmament program. The over-all cooperation between business and Government which characterized the World War II period is vitally needed once again.
Rising Tide of Money and Credit

Financial Trends Mirror Domestic Inflation, International Conflict

The entrance of Communist China into the Korean war has dramatically changed the complexion of that conflict. At best, such a broadening of the war presages a long period of increased international tension, military rearmament, and civilian sacrifice. At the same time, the domestic economy is under uneven but powerful pressure from growing civilian demand. Even though the increased military effort has not yet begun to claim a much larger portion of the nation’s output, demands of consumers and businesses are in many areas significantly in excess of supply. As an inevitable result, pressure on the price structure is steadily mounting.

Developments in the financial field in the last half of 1950 traced out the domestic impact of national and international pressures ushered in by the outbreak of hostilities in Korea. The new wave of private spending drew a good deal of its impetus from a more rapid turnover of the volume of money. Between July and November, individuals and businesses spent demand deposits held in reporting banks in leading cities outside New York 13 per cent more rapidly than a year ago, and 9 per cent faster than in the first half of 1950. During September, at the end of the period of widespread “scarf buying,” the average demand deposit dollar in leading cities throughout the country was being spent once every 12 business days. Futhermore, the rate of spending declined only slightly in October, and then rose to a postwar high during the month of November.

Not only did people spend each dollar more rapidly, but the total supply of dollars increased sharply in the months after Korea. During July, August, and September, demand deposits of individuals, businesses, and state and local governments rose at an average rate of one billion dollars a month to an all-time high of 88.1 billion. Since that time, the growth in such demand deposits has probably been even more rapid, inasmuch as during October and November an average increase of nearly 800 million a month was provided by reporting banks in leading cities alone.

NEW LENDING ADDS TO SPENDABLE FUNDS

Most of the increase in the money supply came as a direct result of the unprecedented spurt in bank lending after midyear. Between June 30 and October 4, total loans made by member banks throughout the nation rose nearly four billion dollars. Only in the inflation-ridden year of 1947—when the loan increase between June and October was 4.04 billion—did a greater expansion occur. Business demands for credit induced most of the spectacular increase in loans; commercial and industrial loans accounted for two-thirds of the total rise. Continuation of the record rise in consumer loans and the near-record rise in real estate loans accounted for the remaining one-third of the increase. Loans between banks and for financial purposes remained relatively stable, as a decline in loans for purchasing and carrying securities approximately offset a 400 million rise in all other loans, including loans to banks.

In part because of the concentration of numerous types of large-scale business borrowings in the New York financial market, that city reported more than 25 per cent of the total June 30-October 4 increase in member bank loans and a somewhat larger rise in dollar volume than that reported by all country member banks combined. A more specific explanation of the New York City experience was provided by a recent Federal Reserve survey, which indicated that about three-fifths of the total expansion in business credit at reporting banks since mid-year reflected loans to dealers and processors of agricultural commodities. Credit demands by these concerns generally are concentrated in the central money market, and it is in primary products such as agricultural commodities and metals that price rises have been most pronounced.

In the weeks following October 4, the rate of growth in most types of bank loans slackened moderately. As compared with the hectic eight weeks prior to October 4, the increase in business loans at reporting banks in the eight weeks from October 4 to November 29 was one-third smaller. Likewise, the rise in real estate loans was one-third smaller, and in consumer loans was only one-half as large. In total, these three types of loans rose 2,425 million at reporting banks in the eight weeks before October 4, and 1,517 million in the eight weeks thereafter. Nevertheless, by the middle of November the rise since midyear in loans at all banks totaled a record five billion.

The usual seasonal slackening in credit demands, the imposition of Regulation X covering housing credit, the tightening of consumer credit terms under Regulation W, and the lessened availability of Federal Reserve credit which brought with it some rise in short-term interest rates, probably all contributed to the slowing in the rate of credit expansion. The fact must be recognized, however, that any increase in bank loans tends to bring a concomitant increase in the money supply which is inflationary in time of full employment. Even loans which are considered to be for productive purposes fall in this category, for when the nation’s stock of labor, capital, and materials is already fully utilized, producers can thus borrow funds only to bid away resources from one productive use to another. Prices are pushed up without any net increase in the nation’s real output.

1 See Business Conditions, October 1950, for a detailed discussion of these policy actions.

2 See Business Conditions, October 1950, for a detailed discussion of these policy actions.
Generally speaking, the increase since midyear in the rate of turnover of money has been somewhat smaller within the Seventh District than in the nation as a whole, while the District increase in most types of bank loans and in demand deposits has been slightly larger. During the fall months the rate of turnover of demand deposits in leading cities of the District was about 14 per cent higher than a year ago, slightly above the nation's 13 per cent rise. The District turnover rate was only 6 per cent higher in the fall than in the first half of the year, however, compared with a 9 per cent increase in the country's leading cities outside New York.

The District expansion in demand deposit volume, on the other hand, was greater than the national average. Adjusted demand deposits in District reporting banks were boosted 7.5 per cent between June 28 and November 29; the rise in the national series was 5.4 per cent. Between these same dates, reporting banks within the District indicated an increase of 26 per cent in business loans against the nation's 26 per cent, 14 per cent in real estate loans against the nation's 11 per cent, and 21 per cent in consumer loans against the nation's 19 per cent. Furthermore, in commercial, industrial, and agricultural loans the District's reporting banks had not yet shown a slackening in the rate of increase commensurate with that reported over the nation generally.

District banks outside the leading cities, however, have not been so active in loan expansion. Call report data show that country member banks contributed only 93 million of the District's 447 million loan increase between June 30 and October 4. Central reserve city banks in Chicago accounted for half of the rise, almost entirely because of their 215 million jump in commercial and industrial loans. The District as a whole reported a 322 million rise in real estate loans on residential properties and a 77 million increase in holdings of automobile and other retail installment paper were the other major components in District credit expansion in the first three months after Korea.

**BANK CREDIT AND THE ECONOMIC OUTLOOK**

The strong upsurge in bank credit, both reflecting and creating inflationary pressures, brought forth several anti-inflationary steps on the part of the monetary and fiscal authorities. As early as last August the bank supervisory agencies warned of excessive credit expansion and urged individual bankers to scrutinize carefully all new loan applications. Later, the Federal Reserve System imposed broad restrictions on housing and consumer credit and induced a rise in short-term interest rates as part of a policy of reducing the availability of commercial bank and Federal Reserve credit. More recently, Chairman McCabe of the Board of Governors of the Federal Reserve System, in a letter to the presidents of all member banks, stated:

*Continued growth of bank credit would put additional upward pressure on prices, impairing the buying power of the dollar and adding to the cost of the defense program . . . . Every bank lending officer has it within his power to make an important contribution to sound money by limiting his loan extensions, and by advising would-be borrowers to hold their borrowing requirements to the lowest limits consistent with their rock-bottom needs . . . . Your customers may momentarily object to postponement of major purchases but they will be rewarded in the long run by smaller inroads on their incomes to pay for past purchases, and by a greater purchasing power of their incomes and savings dollars.*

Some additional anti-inflationary influence stemmed from the offer to refund eight billion dollars of U.S. Government bonds and Treasury certificates of indebtedness, maturing on December 15 and January 1, respectively, with a new 1⅞ per cent five-year note. The refunding terms were attractive to many holders, and the longer maturity of the new issue reduced investor liquidity positions somewhat by lengthening the average maturity of Government securities portfolios. Inasmuch as lenders acquired a major portion of the new issue, the effect was to somewhat reduce their willingness to sell additional Government securities in order to accommodate further loan demands.

Even as these anti-inflationary steps were being taken, however, the President was compelled by the worsening nature of the Korean war to send a second supplementary appropriations request to Congress. On December 1, he asked for an additional 18 billion dollars for defense and atomic energy activities. Congressional approval of the request will raise estimated budget appropriations for the general category of defense to about 50 billion, more than triple the original 1951 budget figure set last January. Total budget requests for funds, together with contract authorizations, now amount to 75.5 billion, and there are indications that further requests will be made of the Eighty-Second Congress.

Little of the 17.1 billion of supplementary funds asked for by the President and granted by Congress last August has thus far been spent. The bulk of these funds, and of the funds from new appropriations, will not begin to materialize as competing demand for domestic production until the spring of 1951. Yet the economy is already beset by serious inflationary pressures arising from the record level of private spending, in part in anticipation of shortages and price rises resulting from the enlarged defense program. With each passing month, the accelerating needs of government and the unabating demands of businesses and consumers push total demand still further beyond the economy's capacity to produce. In such a situation, more drastic controls over private and public nonessential spending are a necessity if intolerable inflation is to be avoided. Many private desires for goods and services are postponable; the nation's defense needs are not.

Even price and wage controls, however, cannot by themselves effectively postpone or restrain private expenditures. Direct controls must be accompanied by higher taxes, curtailment of private credit expansion, and a general willingness on the part of the public to accept such restraint, if total private demand is to be held within the limits which our contracting civilian production can satisfy.
The International Wheat Agreement

A Summary of the First Year’s Experience

Exports of United States wheat and flour under the International Wheat Agreement (IWA) from August 1, 1949, through July 31, 1950, totaled 162,557,000 bushels, slightly more than two-thirds of its adjusted yearly quota of 235,858,000 bushels. However, the United States filled about 83 per cent of an effective quota of 197 million bushels which takes into account only the actual period of time that late-joining importing nations were in the agreement. The United States filled a smaller proportion of its quota than any other exporter, possibly reflecting that importing nations were spending scarce dollars for wheat in this country only when supplies could not be obtained elsewhere. Of the remaining three exporting countries, Canada filled over 90 per cent of its quota while Australia and France succeeded in filling their quotas.

Normally, we annually consume between 700 and 750 million bushels of wheat in this country. However, since 1944 we have consistently produced crops exceeding one billion bushels. In 1950, even with a 16 per cent acreage reduction and unfavorable weather in some wheat areas, another billion bushel crop was harvested. If our exports (including the IWA quota) decline to 270 million bushels, we will be adding to our surpluses in normal years as long as this volume of production is maintained. Our carry-over on July 1, 1950, amounted to 417 million bushels. However, due to the Korean situation the Department of Agriculture set the 1951 wheat allotment at 72.8 million acres—slightly above the 1950 seeded acreage. Normal yields for 1951 would result in production well above one billion bushels and would provide ample reserve for any emergency.

GENERAL BACKGROUND

The IWA of 1949 was successfully negotiated on March 23, 1949, by delegates of 37 importing and five exporting nations. In general, it consists of a multilateral trading arrangement under which exporting nations are provided markets and importing nations are assured supplies at seemingly equitable and relatively stable prices.

The agreement, as adopted, covers a four-year period—1949-50 through 1952-53—and a maximum annual volume of 456 million bushels of wheat, equal to about one-half of the total international trade in wheat in recent years. Five of the major exporters were included—United States, Canada, Australia, France, and Uruguay. However, Uruguay did not ratify the agreement during the period allowed for ratifications, and Russia and Argentina, the other two important exporters, elected not to sign the pact. Due to adjustments made necessary by nonratifying importers and additional importing members added, total membership on July 31, 1950, showed a net gain with 40 importers and four exporters. A ceiling price of $1.80 per bushel and a floor price in world markets ranging from $1.50 the first year, dropping 10 cents each year, to $1.20 the fourth year are provided.

The United States share of the export quota was originally set at 168 million bushels, second only to the Canadian quota of 204 million bushels. However, on March 15, 1950, the western sector of Germany became a member of the IWA with an import quota of 66 million bushels, and there were several adjustments in the guaranteed purchases of importing countries resulting in a net increase. This raised the total quota to 525 million bushels. Consequently, the United States export quota for 1949-50 was increased by the amount of the German import quota plus its share of the net increase in the guaranteed purchases of importing countries. For the ensuing three years, however, the United States quota is to be reduced moderately and the quotas for Canada, Australia, and France increased by corresponding amounts (see Table 1).

United States wheat exports during and after World War II increased proportionately more over prewar than those of any other country, reaching a peak of 503 million bushels in the year beginning August 1, 1948 (under the agreement the marketing year begins August 1). Since then our exports have diminished, with further decreases likely to be checked only in the event of a world emergency. The 1949-50 United States export quota of 236 million bushels was only slightly more than one-half the average volume of United States wheat exports for the 1945-48 period (see Table 2). This percentage is much less than for Canada and Australia. However, the United States quota is over three times the 1937-40 pre-

### TABLE 1

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<th>Countries</th>
<th>Guaranteed Quantities 1943-51</th>
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<td>432,139</td>
<td>535,723</td>
<td>535,723</td>
</tr>
</tbody>
</table>

*Preliminary.

SOURCE: (Official reports) U.S. Department of Agriculture.
war export volume of 72 million bushels. With exports for the year 1949-50 estimated at 300 million bushels and with lower exports in prospect for subsequent years, the United States export quota under the IWA might very well constitute the bulk of our total wheat exports.

Since the maximum price of agreement exports is below domestic wheat prices, export subsidies are involved. The CCC is authorized to purchase wheat and flour and sell it to agreement importing nations at a loss. The cost of the program for 1949-50 is estimated at 54 cents per bushel of wheat exported under the agreement, or an aggregate of approximately 88 million dollars. The loss is absorbed initially by the CCC, which later is authorized to request repayment for these expenditures from appropriations made specifically to cover the costs of the IWA.

MECHANICS OF OPERATION

The obligation of exporting countries to sell wheat, under terms of the agreement, applies only when prices are at the ceiling and of importers to buy wheat only when prices are at the floor. Between the floor and ceiling prices wheat is free to move on terms agreed to between buyer and seller with no obligation for either as to volume of sales, purchases, or the countries involved. However, agreement countries must keep in mind their obligations at the maximum and minimum prices. Any country realizing that its obligations under the agreement may be imposed sometime during the marketing year will be likely to trade with agreement countries in approximately the amount necessary to fulfill its quotas. Therefore, the trade pattern established in the agreement is likely to be carried out even in years when prices are between the minimum and maximum levels.

Escape clauses are provided for member nations which in good faith attempt to fulfill their obligations under the agreement. These permit an exporting nation to be relieved of all or part of its commitments in a particular crop year if a short crop results and an importing country to be relieved of all or part of its commitments for a particular crop year if necessary to safeguard its balance of payments or monetary reserves. In the latter case, release from its obligation is contingent upon a majority vote of the International Wheat Council. Provision is also made for any country (importing or exporting) which considers its national security to be endangered by the outbreak of hostilities to withdraw from the agreement. If a defaulting country is not cleared of its obligation, it may suffer loss of its voting rights or be expelled from the Council for breach of the agreement.

Canadian wheat and Canadian currency were used as the base in formulating the agreement because Canadian wheat is usually considered as the "standard" for transactions in world trade. The maximum price of $1.80 per bushel specified in the agreement is for No. 1 Manitoba Northern Wheat in store Fort William/Port Arthur, Canada. Prices for United States wheat exported under the agreement differ from the Canadian price due to transportation costs and quality differentials. Quality differentials are to be mutually agreed upon between the buying and selling nations involved.

Flour is included in total guaranteed sales and purchases, the amount of wheat flour to be supplied by exporters and accepted by importers being determined by agreement between buyer and seller in each transaction. If they fail to agree on the amount of wheat flour, the decision will be made by the Council with consideration given to the industrial programs of each country as well as to normal traditional volume and ratio of imports of wheat flour and wheat grain imported by the importing nation concerned. Private trade in wheat is not prevented, and exporting and importing countries are free to fulfill their guaranteed obligations through private trade channels. Exports of any member country are not limited to the quota amounts. As long as a country meets its agreement obligations, it may export any additional quantity of wheat, at any price, to any country that provides a market.

OVER-ALL APPRAISAL OF THE IWA

Compared with previous agreements, the 1949 IWA is primarily a marketing agreement and avoids on an international basis such restrictive features of prewar agreements as (1) curtailment of acreage by exporters; (2) nonexpansion of acreage by importers; (3) maintenance of carry-over stocks by exporters to fulfill the following year's obligations; (4) export quotas based on fixed relative shares for participating exporters; and (5) minimum and maximum prices to be fixed annually with policing by export governments to prevent sales at prices outside these limits.

The present agreement is flexible and can be altered during its period of operation. It refrains from interference with the internal policies of the individual countries, but indicates that individual countries shall not operate their internal policies to interfere with the free movement of prices between the maximum and minimum limits specified by the IWA. This provision is important since all three major wheat exporters—the United States, Canada, and Australia—operate domestic price support programs. The agreement does not prohibit these programs, and the burden of proving any hindrance to the free movement of wheat prices apparently lies with the importers. The agreement does not indicate how such a complaint could be substantiated; it only states that the importing country "may draw the attention of the Council

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**TABLE 2**

<table>
<thead>
<tr>
<th>RELATIVE IMPORTANCE OF EXPORT QUOTAS TO THREE LEADING INTERNATIONAL WHEAT AGREEMENT EXPORTING COUNTRIES (Amounts in millions of bushels)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Country</strong></td>
</tr>
<tr>
<td>United States</td>
</tr>
<tr>
<td>Canada</td>
</tr>
<tr>
<td>Australia</td>
</tr>
</tbody>
</table>

*This percentage for the United States will decrease, since the United States quota for the last three years of the IWA will decrease each year. Similarly, this percentage will increase slightly for Canada and Australia, since quotas for these countries will be larger for the last three years of the agreement."
to the matter and the Council shall inquire into and make a report on the complaint."

This clause is not likely to permit the price of wheat to fluctuate between the allowed limits under the agreement in a manner similar to prewar grain price movements. Price is more likely to move all the way from one limit to another, depending on the supply of available wheat and price support programs in exporting countries. Although the wheat agreement clearly indicates that it in no way prevents private trading, the existence of price support programs in exporting countries may require export subsidies or other Government activities to permit the program to function.

The first year's operations of the IWA were watched with considerable interest for, despite changes from prewar schemes, many still remember those failures. A short time after the agreement came into operation, currency devaluation occurred in many countries. About one-half of the member countries were affected, and the agreement price of wheat in Canadian, Australian, and French currency automatically increased because of the gold dollar basis of the stated maximum and minimum prices. Maximum IWA prices were below world free market prices, and with this relationship one might expect importers to take up their full quotas. However, since most of the wheat shipped under the IWA was "dollar wheat" (from the United States and Canada), many importers would have had to pay 30 to 43 per cent more for such wheat in terms of their own currencies. Thus, devaluation may have made it more tempting to barter than to continue monetary payments. However, the fact that wheat prices outside the agreement were above the maximum price served to check the extensive impact of devaluation upon agreement prices and operations. Wheat prices in the United States did not fall as low as they would have under free market conditions. Apparently, prices will not fall materially as long as we maintain high supports.

Opponents of United States participation in the IWA have characterized it as a "heads they win, tails you lose" proposition. They point out that our share of the exports is comparatively small, the cost to our taxpayers will be high, importing nations are required to take their maximum quotas under the agreement only when the price falls to the floor, and the escape clauses leave no guarantee of a minimum market after the European Recovery Program ends.

In general, favorable support in the United States has been accorded our participation in the IWA. By holding forth a prospective market for well over 200 million bushels of wheat, in addition to what we sell to non-member countries and what we send to Japan, it complements our domestic wheat program by helping to reduce surplus stocks. However, despite the IWA and as previously indicated, our successive production of crops of over one billion bushels of wheat will probably aggravate rather than alleviate our wheat surplus situation.

It is difficult to determine the over-all net effect of the IWA as to the effect on the volume of our exports. In a world of highly organized national economies, more products can probably be traded by engaging in agreements on a multilateral basis than by bilateral and closed agreements. So long as member nations and those outside the agreement refrain from price cutting, we, taking into account our present domestic farm program, are probably exporting more wheat than if we had not entered into the agreement. Certainly, by recognizing export subsidies as a legitimate tool of world trading, the agreement provides a mechanism for reconciling autonomous price support programs in exporting countries with price levels in importing countries. Without such export subsidies there is no doubt that the world trade in wheat would be less than its present level.

The Millers' National Federation has urged the Department of Agriculture to raise the subsidy rates for IWA wheat and flour and to establish a subsidy program for United States wheat and flour sold outside the IWA program. This group feels that the IWA subsidy program does not provide adequate price differentials for quality and that it has failed to keep pace with Canadian prices. However, Department of Agriculture and other Federal officials feel that the slight lag in United States sales below those of Canada is not great enough to make any changes. Charges that Canada is undercutting the United States price are weakened by recent large wheat purchases in this country by the United Kingdom. Officials feel that the free dollars would have been spent in Canada if the latter's price had been more attractive. Cumulative sales of United States wheat to November 21, 1950, against 1950-51 IWA quotas are 85,586,000 bushels, compared to about 23,000,000 bushels for the same period last year. The agreement received a late start in 1949 since provisions for CCC payment of export subsidies on IWA shipments were not effective until October 28, 1949.

The United States failure to fill its export quota is not as disappointing as it might have been if the Korean war had not started. As a result, the United States has a larger wheat reserve for possible emergency use, and outlays from the Federal Treasury were smaller than if the quota had been filled.

Good faith and genuine cooperation of all member nations are essential to the survival of the IWA. Otherwise, the agreement will fall apart on the slightest provocation. The United States is the key nation in the scheme for, after rejection of the 1948 agreement by our Senate, that pact disintegrated despite having been already approved by several other nations. It appears that the agreement is more vital to member exporting countries than to member importing countries at the present time, as the former are burdened with huge surpluses while trying to maintain high domestic prices. However, in the event of a world-wide conflict, these surpluses could prove beneficial. Importing countries are in a strong bargaining position, and if supplies cannot be secured at a satisfactory price within the scope of the agreement, they have a possible alternative of securing wheat from exporters outside the agreement. Everything considered, the first year's operations of the IWA are encouraging, but not conclusive. Its ultimate success or failure is yet to be determined.
of agriculture and may become important again. It has
been necessary already to restrict exports of cotton, and
the Commodity Credit Corporation is attempting to
stockpile wool to meet military requirements.

WORLD WAR II CONTROLS PARTIALLY EFFECTIVE

The experience with direct price controls generally
has been that, once they are implemented, too much reli­
ance is placed on them as an anti-inflation measure. Since
such controls do not correct the underlying forces gener­
ating inflationary pressures, they can at best only att­
enuate and postpone the effects of such forces on the
price level. Consequently, prices usually continue to ad­
vance after controls are applied, although at a slower
rate. This occurred in the United States during World
War II and probably will occur again.

An important additional reason for the continuing ad­
vance of agricultural as well as other commodity prices
was the variety of measures written into the price con­
trol law to protect special group interests. Most of these
“protective measures” have reappeared in the Defense
Production Act of 1950. Farm product prices, as already
noted, cannot be fixed at less than parity, and parity rises
as prices advance of things farmers buy. Processors of
“agricultural commodities, including livestock” must be
allowed “a generally fair and equitable margin.” “No
action shall be taken with respect to wages . . . which
is inconsistent with” laws requiring overtime pay for
work beyond 40 hours per week and the like. Labor
unions were successful in World War II in obtaining sup­
port for the “parity-like” idea that basic wage rates should
keep pace with the “cost of living.” This idea has been
incorporated in numerous employment agreements in re­
cent years and is likely to be accepted as a policy guide
in the present defense effort.

To break up the wage—parity price—cost-of-living
spiral, which developed in World War II and for which
the groundwork has been laid again, subsidy pro­
grams were developed. Subsidy payments were made to dairy
farmers starting in October 1943 to compensate for in­
creased feed costs and to prevent shifts to the production
of less essential items at lower relative levels than prices
are produced from the same resources. Land, fertilizer,
labor, and other resources tend to be used in the pro­
duction of those things which yield the greatest financial
return. Therefore, controls must not hold prices of the
more essential items at lower relative levels than prices
of less essential commodities which can be produced from
the same resources. For example, early in World War II
more and more milk was being diverted to the manufac­
ture of specialty products for the bakery and confection­
ery trades at the expense of cheese and evaporated and
dried milk. Measures which facilitate enforcement of the
price and rationing regulations must be used extensively
if the direct controls are to be effective. Licensing, per­
mits to operate, product identification, shipping author­
izations, set-aside orders, and the like are examples of
such measures.

The many problems inherent in direct control of the
prices and distribution of agricultural products should
provide additional incentive to achievement of the
USDA’s goal of abundant production and avoidance of
direct controls as long as possible. A difficulty, however,
is that over-all production expansion in agriculture is a
relatively slow process. Year-to-year percentage changes
in the volume of farm output generally are small. From
1940 to 1945 total production increased about one-fifth,
and last year’s level was nearly five per cent above that of
1945. While further production increases from the present
near-record level are possible, they may not be sufficient
to provide all that is desired by consumers at prices low
enough to avoid direct controls.