to see what the other fellow's responsibilities are and what he is trying to do, and I think that that goes for the people throughout the country, as well as for the people who are trying to do a job in Washington.

President Williams: Thank you, Mr. Garfield. I think we can conserve time if we postpone questions until Karl Bopp has discussed what the alternatives are that are before us. Then we will go into the Production Act of 1950 and afterward narrow the discussion down to specific problems such as those that confront auto dealers who think they can't sell their cars on current terms.

THE ECONOMICS OF CONTROLS

Mr. Karl R. Bopp: My discussion really will be concerned with elaborating some of the points that Frank Garfield already has made.

As he indicated, people generally feel that the basic forces from here on out are inflationary forces. What that means is simply that the demand for goods and services will almost certainly exceed the supply of goods and services at current prices, and that this excessive demand, with each individual trying to get more of what is available, bids up prices.

There are two general methods of trying to attack the problem of inflation, as Frank mentioned. The first is the method of direct controls. It proceeds somewhat in this fashion: one sees a given area of the economy in which prices have risen most rapidly and in which demand seems particularly strong, and it seems a very easy way to solve that problem by simply saying that we will not permit prices to rise; we will clamp a ceiling on those prices. It doesn't take long to find out, and the Production Act of 1950 itself recognizes, that if selling prices are limited something has to be done with respect to costs, and a most important item in total cost in the economy as a whole and in many individual industries is, of course, the cost of labor. So price controls lead either immediately or in very short order to wage controls. So offhand it would seem that that solves the problem.
But as one looks a bit farther, he finds that it doesn’t; because the only reason for putting on the price controls is the fact that not everybody who is willing to pay established prices for goods can get them. The very imposition of price controls means that some people are not going to be able to satisfy their demands, and therefore you have people who are willing to pay the price and can’t get the materials. What do they do? They are ingenious; we are all ingenious. We say, “Is there any substitute that I can get hold of to take care of my needs?” We find a substitute and increase the demand for the substitute, which immediately forces those prices up. Our problem is shifted from the area that has been controlled to part of the uncontrolled area, and you try to solve that problem by putting price controls there, which in turn soon leads to other wage ceilings.

But in addition to that, since not everybody who is willing to pay the price can get the goods which he wants, somebody must determine who will get them and who will not get them. In other words, if you have direct price controls, someone has to determine those people in the market who shall be favored to get the goods and those who shall not. Typically, one starts with a priority system. As soon as a priority system is inaugurated, the pressure on the part of those wanting the goods is to get a high priority. If I recall correctly, Frank, shortly after priorities were established in the second World War, anyone who had less than the very highest priority was simply out of the market entirely.

Now, if everybody has top priority you are not much better off with them than without them. You therefore find that priorities alone don’t solve the problem, if it becomes at all severe, and you go into a complete allocation system. We found during the second World War that it went very far. You all remember the blue and red points that we had for food. That is the way in which direct controls work. If we should decide that that is the way in which we want to go, I think it would be quite unfair to blame a bureaucracy. A large bureaucracy must be established to administer direct controls; because if individual prices have to be controlled, somebody has to determine what those prices are going to be. Somebody has to determine who will receive these goods that are available at those prices, and who will not get them, and it takes an awfully large staff to do it.
If we go in the direction of control, we should envision that we have to have people to make these decisions, and that those decisions are in large part arbitrary in the nature of the case. Even with the best spirit in the world, that is the way that operates. So the method of direct controls begins at a given area and extends gradually until in a period like the second World War, it may cover almost the entire economy.

But unfortunately, even that isn't the whole story, as we found out very recently, after the second World War, when the direct controls were taken off. All that has happened is that one has postponed facing up to the real issue. We found when price and wage and other controls were removed in 1946 that we immediately had a terrific demand for goods, and prices went up.

Most of that increase in prices, most of the inflation which became evident in 1946, was merely revealing or bringing to the surface the inflationary pressure we had pumped into our economy during the war period—pressures on which we had tried to put a lid during the war period itself.

In short, the method of direct controls tends to extend itself over larger segments of the economy but does not solve the problem ultimately. At best, it merely postpones facing that issue of trying to liquidate this excessive demand which you have in the market.

Nevertheless, there are times when that seems to be the better method of handling the problem. Let's see what those conditions are. In the second World War, you may remember that our gross national product reached about $225 billion and that the Federal Government itself was spending about $100 billion. In other words, Government was taking about half of the entire product of American business and industry. That is point number one: the effort relative to our total economy was an enormous effort, the rough order of importance being one-half.

Second, during the second World War, we were quite sure that it would take a terrific effort but that there was a terminus. We didn't know exactly how long it would take. The general discussions were in the order of four or five or six years, and actually, as you know, the United States was involved from 1941 to 1945.
So that the two points you had at the time of extensive direct controls in the second World War were, first, an enormous defense program relative to our total output, and a terminus. And we also had the powerful stimulus of wartime patriotism.

Is that the kind of condition which we face today? Well, Frank Garfield has given you the general situation. What now seems to be in prospect is not a 50 per cent effort but a 10, 15 or 20 per cent effort. That is still a very large effort but it is a whale of a lot less than 50 per cent. So we are confronted with a large but not excessive effort. For how long? No one knows. Frank said our foreign commitments won't be solved today or tomorrow or this month or next month. Our children may still be having to finance a defense effort against the Russians. It may be five years, ten years, twenty years—who knows how long?

That is a very important point in one's decision as to the direction in which he wants to try to control this problem. If we head in the direction of direct controls as our basic reliance, we then face not a prospect of getting rid of them in five or ten years but that they will continue over a long period of time; and furthermore, though I say a 15 per cent effort is a significant and big effort, it is something like having the tail wag the dog because we still have the other 85 per cent. Those are some of the limitations of the direct method, and particularly the dangers if there is in prospect a long period of heavy effort, but not excessive effort.

Is there another method of attacking the problem? As one looks at the basic nature of it, namely, an excess of demand over supply of goods and services, there clearly is another method. That is to do something about demand and particularly about civilian demand, since Governmental demand will be much larger than we have been accustomed to over a number of years.

There are a number of ways in which demand can be restricted. First, Government fiscal policy. At a time like this, when the prospect is for many years of 10 or 15 per cent of our total effort going into defense, the Government should secure in taxation every penny that it spends, and that means high taxes. But I think we are deluding ourselves if we think that we can avoid the real issue, which is our standard of living. The Government is going to take things in real terms. It is going
to want steel, copper, men, material; and those things that the Government takes are simply not going to be available to civilians. If we then have added income, we will not get any more real materials but simply bid against ourselves for the materials that are available for civilian purposes, and that means prices will be forced up.

It is not doing a disservice to our economy to say that, when the effort is of the order of magnitude we are now thinking about, every penny of those expenditures should come out of our civilian incomes in the form of taxes so that the Government will pay as it goes.

That is essential; but it isn't enough. I think experience shows it isn't enough. We have had experience with this problem after the second World War. You may remember that there was a Governmental surplus, though we tend to forget that there ever was. Actually, the Federal Government did for two years have large cash surpluses. Yet during that period of relatively large Governmental cash surpluses, inflation went on its merry way, with the exception of those spring interruptions which we had each year. Why was that? It was because as fast as the Federal Government repaid its debt, the private civilian economy went into debt. Consumers did it in buying consumer durable goods, they did it in purchasing houses via mortgage credit, and business did it in building plants, equipment, and inventories. We had the private economy going into debt as the Government was going out of debt. So inflation kept on going.

We won't solve the problem unless we come close to balancing the Federal budget. But, even with that we need to restrict civilian demand. There are a number of ways in which that can be done. One is general monetary policy. As you know, the Federal Reserve System is fully aware of the fact that the American banking system can expand only if it has excess reserves or is able to get additional reserves. The Federal Reserve System therefore has said that if we wish to control the volume of reserves we will have to make the acquisition of them sufficiently expensive so that people will prefer to hold their present assets rather than try to get reserves for them. That is the reason the Federal Reserve System, as the chart on interest rates shows, has allowed an increase in short-term interest rates on Government securities.

The discussion on that doesn't concern one-eighth of one per cent; the discussion concerns—shall we control the total volume
of reserves available to the banking system so as to limit in a
general way the total amount of credit that is available to the
economy? These are the two basic general types of control:
first, fiscal; and second, general monetary control. In addition
to that, we have the selective credit controls. These specific
regulations on credit, though they are not the general type but
are selective, have an advantage over many so-called direct meth­
ods, such as price controls, which do not do anything about
demand. A restriction of credit does limit demand and therefore
has that advantage. As one looks over the economy to see where
expansion of credit has been enormous, there are two fields that
seem perfectly clear. Those two are the fields of housing and
consumer durable goods. It is in those two fields that we have
the specific regulations.

The Federal Reserve, as you know, has argued very strongly
that we should at this juncture prefer general, over-all indirect
controls to direct controls. Without limitation on demand
through indirect controls, the direct controls could not be limited
in scope or be effective in the long run. It is recognized, of course,
that even with limitation of over-all demand, some direct controls
may be needed in specific areas. But the case should be over­
whelming before they are introduced in any area. I would like
to point out that it isn’t the Federal Reserve alone which has
favored this approach. I would like to give some indication to
you as to the variety of individuals and organizations who favor
general controls as against specific direct controls.

First of all, and this is before Korea, the so-called Douglas
Committee, which examined into the whole operation of our
monetary and credit system, reported in January of this year:

We recommend not only that appropriate, vigorous, and coordinated
monetary, credit, and fiscal policies be employed to promote the purposes
of the Employment Act, but also that such policies constitute the Govern­
ment’s primary and principal method of promoting those policies . . .

We believe that the advantages of avoiding inflation are so great and
that a restrictive monetary policy can contribute so much to this end that
the freedom of the Federal Reserve to restrict credit and raise interest rates
for general stabilization purposes should be restored even if the cost should
prove to be a significant increase in service charges on the Federal debt and
a greater inconvenience to the Treasury in its sale of securities for new
financing and refunding purposes.

So we have here a Joint Congressional Committee, consisting
of both Democrats and Republicans, Senators and Representatives
—men whose general economic philosophies vary widely—who yet agree unanimously on this particular statement.

Here is another group. You may have heard of the Committee for Economic Development. It is a group of progressive businessmen who during the war period felt that they should analyze their function in the American economy to try to keep it strong. From time to time they issue reports on what they think is the most appropriate policy for us to follow. Here is their statement—and this is after Korea. It is from a pamphlet which they call Economic Policy for Rearmament:

The key to success is adequate limitation of non-military demand. Given this, the problem becomes manageable. Without it, nothing else will suffice.

The chief reliance in restraining demand should be placed on fiscal, monetary and debt measures. As we pointed out in previous statements, fiscal, monetary and debt policies are the appropriate means for attacking the problem of instability in a free society. The fact that our present problem of inflation results largely from a military program does not make these instruments less appropriate. They are appropriate because they can be effective. They are appropriate because they do not involve Government decisions about all the details of the economic system. They leave the economy as free as it can be to operate efficiently and to grow.

The President, in his Midyear Economic Report on July 26, after the invasion of Korea, says:

First of all, for the immediate situation, we should rely in major degree upon fiscal and credit measures. These general measures can be helpful not only in restraining inflationary pressures, but also in reducing the civilian demand for some specific products, such as automobiles and housing, thus making available for necessary military use a larger proportion of an already short supply of some critical materials. The more prompt and vigorous we are with these general measures, the less need there will be for all of the comprehensive direct controls which involve the consideration of thousands of individual situations and thus involve infinitely greater administrative difficulties and much greater interference with individual choice and initiative.

On August 7, and this is again after Korea, Senators Douglas, Flanders and Fulbright joined in a statement with respect to public policy, and they have this to say:

At their best price and wage controls and rationing are not methods of preventing or curing inflation. They deal with effect, rather than cause. They treat the symptoms, rather than the disease itself. They postpone the evil effects of inflation and, in the absence of effective methods of dealing with the causes, they compound the disastrous effects of inflation.
The primary method of dealing with inflation should be the coordinated use of proper monetary, credit and fiscal policies, which can actually prevent inflation.

On October 24, 1950, a report in the New York Journal of Commerce carried the following headline: "Keyserling and Nourse in Accord on Peril of Premature Curbs." Here are statements from the report:

The present and former chairmen of the President's Council of Economic Advisers agreed yesterday that a sound economy is the keystone of American military strength and warned against premature or unnecessary economic controls which might throw it out of gear.

Leon H. Keyserling, the present chairman, and Dr. Edwin G. Nourse, his predecessor, emphasized this point strongly in talks delivered far apart...

The two men, frequently at loggerheads when both were members of the CEA, joined in arguing against an 'all-out' mobilization program, buttressed with multiple controls, on the grounds that it might not only fail to meet the needs of the present period, but could seriously weaken our ability to meet a first-class world crisis if it should arise in the future.

Finally, dispatches in the Wall Street Journal for October 26 and November 1 indicate that both Mr. Symington, Chairman of the National Security Resources Board, and Mr. Valentine, Economic Stabilization Administrator, favor indirect controls.

So I think it is good to get into the record that there is wide agreement as to the principles with respect to how this particular problem should be attacked, and that is in accordance with what Frank mentioned. Obviously, these principles must be carried out if they are to be effective.

President Williams: Our objective, gentlemen, in giving you this general preliminary discussion is to lay a solid foundation for our analysis of the specific regulations that come under the magnifying glass this morning—Regulation X and Regulation W.

But first let us present the highlights of the Defense Production Act of 1950. Jim, will you give us a word or two on this?

Mr. Vergari: Before I do that, several additional persons have come in that we ought to present to the group. First, Mr. Warren Whittier, the Chairman of our Board of Directors. And Mr. Donald P. Horsey, President of the Pennsylvania Bankers Association is now here.