

The Economics of National Defense



FIFTH ANNUAL REPORT
to the PRESIDENT *by the*
COUNCIL *of* ECONOMIC
ADVISERS • *December 1950*

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Letter of Transmittal

COUNCIL OF ECONOMIC ADVISERS,
Washington, D. C., December 28, 1950.

The President.

SIR: The Council of Economic Advisers herewith submits its Fifth Annual Report in accordance with the requirements of Congress as set forth in the Employment Act of 1946.

Respectfully,

Leon Keyserling

Chairman.

John D. Clark

Roy Blough

ERRATA SHEET

The sentence at the top of page 23 of the Fifth Annual Report to the President by the Council of Economic Advisers should be corrected to read as follows: Manifestly, this increase in the total volume of wages will add to inflationary pressures as long as it is impossible to increase the supply of civilian goods; and yet no one would propose that this situation be counteracted by reducing the money wages paid by employers to those who have been working all along.

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THE sinister forces threatening the freedom of the world have mobilized enormous resources of manpower and materials. Yet the free peoples, by mobilizing their potential strength, can attain a clear margin of superiority. And in this mobilization, the United States must necessarily take the lead.

Speed, and more speed, is imperative in all that we do to reach the goals we set for building up our maximum strength. We must achieve this strength as quickly as possible. But first of all, we must define what composition of strength we strive for. There are many elements in our total strength—including economic and military—and since we cannot build them all up with equal rapidity, we must decide the relative weight to be accorded to different elements. This in turn depends upon constant strategic appraisal of the world situation. Speed is not achieved by doing the wrong things first, nor by trying to do everything at the same time.

The economic aspects of the task of mobilizing our strength, in a country such as ours, involves every sector of the population. Our industrial power underlies our military capacity. The operation of our economy stems from every factory, farm and fireside, and affects everyone. Not only must all understand; in addition, all must act.

This presents a broad challenge to economists in the public service. They must wrestle with facts and evaluate policies not only in the field of government, but also in the field of private enterprise. Since their task is to recommend what it might be well for others to do, they can be useful only insofar as their findings meet with public understanding and acceptance.

In its Fourth Annual Report to the President a year ago, the Council of Economic Advisers sought to enlarge the areas of understanding between business and government, by defining their common objectives and their related responsibilities. In this Fifth Annual Report, the Council is seeking further to foster the practical application of economics in a democracy. We wish to focus attention upon some of the major economic problems which arise early in the course of a mighty defense effort. We suggest some general approaches to these problems. But we do not here offer detailed programs, since the established place for such programs is in the Economic Report of the President, accompanied by the Council's Annual Economic Review. These will come in January.

I. The Efficient Use of Resources

The economic resources of our nation, broadly defined, constitute its ability to produce and distribute the goods and services which the population needs and wants, including those necessary for national security. This ability includes certain measurable assets—natural wealth, plant and equipment, manpower, a monetary and financial system, and technology and skills. There are also intangible assets—the purposefulness and drive of the people, their spirit of cooperation, and all the things which are embodied in our way of life.

The most efficient use of our resources, for the purposes we value most highly, is our major economic objective. In a period of peace, this was defined well by the Employment Act of 1946 as “maximum employment, production, and purchasing power.” Maximum employment means opportunity for useful service for as large a part of the labor force as is willing and able to work. Maximum production means utilizing this labor force effectively to turn out the largest practicable quantity of needed goods and services. Maximum purchasing power, properly defined, means the kind of income flow to various parts of the economy which will promote stability and growth without inflation or deflation.

A major task of the economist in the public service is to evaluate what policy tools—both private and public—will help to achieve these objectives. This task is imposed clearly by the Employment Act itself. On the public side, these policy tools include almost every program which importantly affects the economy, from taxation to industrial regulation. On the private side, these policy tools include every significant course of action by groups of workingmen, businessmen, farmers and consumers. These tools are used most wisely when they result in the most efficient use of all of our resources for the purposes we hold in common as a nation.

In peacetime, economic policy takes account of the fact that there is no one pattern for the most efficient use of resources. This is because resources are used to serve human wants, and the priority of these wants cannot be measured exactly insofar as they involve subjective values. Some people may feel that the government should spend relatively more for roads and less for schools; others may prefer more schools and less roads. Among goods privately produced, some people may prefer buying a good automobile and living in a shabby house, while others may prefer the reverse. More generally, the population as a whole may choose to translate increasing productivity into more goods or into more leisure. And there are subjective choices involved in means as well as ends. Some may prefer more rigidity and uniformity where it

results in more output; others may prefer more freedom and flexibility even at the sacrifice of some output.

The economist has not much to contribute in his professional capacity to the choice among ultimately competing values. He necessarily accepts the standards of the culture in which he lives. But there are times when he can point out that the excessive pursuit of one value may destroy it in the long run, or destroy other values which the country clearly wishes to preserve. It is not his job to tell the people for what purposes they should use their resources, but rather to advise what kind of management of resources will help most to effectuate these purposes. Rapidly mounting national defense activity reflects a change in the purposes of the people; the specific aspects but not the general character of the economist's responsibilities are also modified.

II. How Much of Our Resources Can We Afford for Defense?

The basic economic changes of a rapid defense build-up are simple: We suddenly decide to devote a much larger proportion of our resources, both of manpower and of materials, to defense purposes than in normal peacetime. Consequently, we have a smaller proportion of our resources left for other purposes. But we still have the problem of making the most efficient use of our total resources to accomplish our objectives, however much the character and priority of these objectives may change with the advent of a national emergency.

This rapid shift in our objectives raises the problem of allocation of productive resources among primary defense needs, industrial needs, and general civilian needs. All of these needs must be met in proportions which do most to maintain national strength and safety. This raises a question frequently stated: What proportion of our resources can we afford to convert to national defense without doing ourselves more harm than good? More popularly phrased: How much can we afford for national defense?

These questions may first be considered in terms of the primary build-up of the defense effort—the amount of our resources devoted to the maintenance, training, and supply of our armed forces.

The economist must approach this issue in a different spirit from that applied to most problems of resource allocation in normal peacetime. In such times, since roads and power developments both contribute to the strength of our economy, the economist can help to measure which contributes more, and thus help to establish a priority when we have not enough resources to build all the roads and power de-

velopments desired. But our armed forces, to the extent that they are necessary for the defense of the country, are an absolute first priority and leave no room for this kind of evaluation by economists. The economist claims no skilled judgment as to how large these forces should be to make us reasonably secure. Such judgment must rest with experts in military and international affairs, and in the final analysis with the President and the Congress responsible to the people as a whole.

Hence the economist cannot properly interpose objections to the size or speed of build-up of the military establishment on the ground that such outlays are "uneconomical" in the traditional sense; all such outlays are "uneconomical" in the sense that they do not add directly to the productive power of our economy nor increase the satisfaction of consumer wants. Nor can the economist object on the ground that these outlays impose a strain and burden upon the economy and the people; by definition, they do just that. Nor can he object on the ground that the primary defense build-up increases inflationary pressures, although that is a certain consequence under conditions now prevailing. When the primary military build-up is found to be necessary for national security, the economist cannot object because it causes hard problems; he can do so only if the speed and magnitude of the build-up is clearly beyond the range of our industrial power or threatens to destroy it.

Clearly, no military build-up now in contemplation is of a size or speed to justify objection by the economist on this ground. During World War II at its peak, we allocated more than 40 percent of our total output to primary military purposes; and yet we emerged from that terribly costly struggle with a more powerful and productive economy than we had ever known before. In contrast, at the present time we are devoting only about 7 percent of total output to primary military purposes. If other outlays related to the international situation are included, the percentage rises to only about 8½ percent. The concentration of our productive efforts upon defense objectives could rise far above this point, and we could still maintain a vigorous national economy capable of meeting additional demands upon it.

The economist, however, of course has the duty of showing what the economic costs and effects of the primary military build-up will be. He may also point out that our defense strength depends upon much more besides the size of the military establishment. It depends also upon all the supporting forces, economic, psychological, political and moral, which make up both the resisting power and the striking power of a nation. In the strictly economic sense, it depends upon our productive capacity and how well we use it, not only to supply military needs, but also to supply those industrial and general civilian pursuits without which the military build-up cannot be carried forward or endure. Our strength depends also upon how well we combat inflationary forces.

The Council stresses that we need now, even more than in normal peacetime, to maintain maximum total production, although we must make far more rigorous efforts to produce the most vital kinds of goods and to cut back on others. We need now, even more than in peacetime, to maintain maximum employment and to enlarge the size of the labor force in view of our greater total requirements for goods and services. We need now, even more than in peacetime, to influence the flow of purchasing power so that it does not generate inflation.

From this broader viewpoint, the real question is not what portion of our resources we harness or can afford to harness to the purposes of national defense. The truth is that, in a defense effort of the size now being contemplated in the face of great peril, the whole nation and all suitable resources should be dedicated to increase our power to resist aggression and to fight for freedom if we must.

This means that we should make an all-out effort on the economic front and on other fronts. But talk about an all-out effort does not determine just what we should do, any more than an all-out effort to win a football game determines whether the player should kick or pass or run. There must still be judgment as to what division of our resources among various purposes—military, industrial and civilian—will give us our greatest strength for the kind of struggle we think we face. We must get the most efficient use of our total resources, and to this extent the problem is the same as in normal peacetime. But just as that most efficient use in peacetime depends upon evaluation of *which* things we want and need most when we cannot have them all, so in a national emergency the most efficient use depends—and depends far more urgently—upon an entirely new set of priorities concerning what we need most and must do first.

III. What Constitutes an All-out Effort?

According to those most competent to judge, our peril is great and time is short. Because the problems before us are now so grave, because the need for speed in their solution is so acute, and because the policies needed are so vigorous and comprehensive, it is frequently stated that we must make an “all-out effort.”

This statement is correct in a vital sense. We must let nothing interfere with, and we can exempt no sector of the population from participation in, a maximum national effort to achieve lasting security founded upon justice. But emphasis upon an “all-out effort” does not define what should be done, especially because the specific content of such

an effort must vary under differing circumstances. This specific content must above all be attuned to the factor of timing, which in turn depends upon the basic strategy of our defense policy in the light of world events.

We want to make an "all-out effort" to achieve as speedily as possible an armed force of a size which will maximize our primary security. But what the immediate target for armed strength best designed to accomplish this purpose should be, depends upon the best informed judgment as to the tempo of the contest and as to when the danger may be greatest.

An "all-out effort" on the economic front must be geared to the same strategic concept which governs the military effort.

An "all-out" productive effort is one which achieves as speedily as possible the type of economic strength we need to cope with the world situation. But when such questions arise as apportioning scarce materials among military purposes and stockpiling on the one hand and the expansion of plant capacity on the other, the decision depends upon whether or not it would be wisest on balance to delay a portion of the immediate military build-up in order to develop more industrial strength to increase our future military potential.

We must make an "all-out effort" to use our labor force efficiently and fully. By depending upon the timing factor, we may decide to draw certain groups into the armed forces immediately with less skills or permit some of them to get more education before they are drawn into the armed forces.

An "all-out" civilian effort, which is desirable, involves whatever exertions and sacrifices our national security demands. A similar principle applies to the imposition of controls. But a particular set of sacrifices and controls, which would strengthen us under one pattern of economic and military build-up, would weaken us under a different pattern. There is no strength in sacrifices and controls for their own sake. Those sacrifices and controls are best which synchronize best with our basic targets for military build-up, industrial production, and protection of the public.

All this is to illustrate that the *kind* of "all-out effort" we must make should be founded upon some primary assumptions concerning the nature of the contest in which we are engaged. It would be fortunate if things were so simple that we could adjust all of our efforts fully to the contingency of a total war tomorrow, and at the same time adjust all of our efforts fully to the contingency that total war may not come for some time or may be avoided entirely through deterring of aggression. But there is no such thing in complex national and world affairs as preparing equally for all contingencies at once, because different assumptions call for different kinds of preparation. It is necessary to determine which contingencies seem most likely, and to make an "all-out effort" to get

ready for those; although at the same time enough should be held in reserve and enough flexibility maintained to alter our course rapidly if other contingencies become more pressing.

Economic mobilization in times like these should strive to be “all out” or “complete,” in the sense of moving as rapidly as possible toward accomplishing defined objectives. These objectives comprise a new pattern of resource use. This new pattern is not the same, and does not call for exactly the same measures, as in the event of a full-scale war or full mobilization of our total armed strength. But the type of economic mobilization we are now undertaking means, at the very least, an enormous shift in our current pattern of resource use. The effort will be successful to the extent that this shift is rapid but also sensible. The effort would fail if the shift were either tardy or ill-considered.

Obviously, the nature and timing of this required shift must be defined before it can be accomplished. Thus the definition of the new pattern of resource use called for by the emergency is the starting point and *sine qua non* for all rational economic policy in a mobilization period.

IV. The Programming of Requirements and Supply

The central task before us, consequently, is to define as speedily as possible our new goals or targets for resource use, and then to achieve these as fast as we can.

The process by which this new pattern of resource use is defined is radically different from the processes by which resource use is determined in normal peacetime. Then, the pattern is determined partly by custom. In any one year, it is almost the same as in the year before with only slight variations. But in a national emergency, the very nature of the problem is to set aside custom and break sharply with the past. Another difference is that in peacetime the changes in the requirements of the economy result from myriads of decisions by millions of people, and supply is gradually adjusted to changing requirements through the operations of the free market. In a national emergency, the biggest change in requirements—for the primary military build-up—must not only be defined by the Government but must also be effectuated by the Government through public purchase of goods and services and public recruitment of manpower into the armed forces. This undertaking in itself is so large that it makes the Government the prime conditioner of resource use throughout the whole economy.

Further, there is an inescapable relationship between the satisfaction of primary military requirements and the pattern of resource use in other sectors of the economy. The Government is not only concerned

with the direct military build-up. It is equally concerned that the consequent reduction in the availability of manpower and materials for other purposes shall not result in a decline of activity in those sectors of the economic front which are essential to support the military program. As a derivative, the Government must see to it that manpower and materials are not absorbed in nonessential activities. The problem of inflation control is but one aspect of preventing excessive competition for scarce resources. Above all, the speed with which the rearmament program must be consummated, in the interest of national security, demands far greater concentration of decision-making than we countenance in normal peacetime.

The logic of the situation requires that the Government must accept and exercise the primary responsibility for defining almost all of the broad phases of the new pattern of resource utilization in a defense emergency. This does not mean that the Government should program and determine every minute detail in the scheduling of production and distribution throughout the economy. But it does mean that the Government, in a period of economic mobilization, must determine broadly the size and weight of these main competing requirements: (1) primary military requirements, (2) stockpile requirements, (3) international requirements (military and economic aid abroad), (4) industrial requirements, (5) requirements to serve the consumer public.

The determination of and reconciliation among major requirements is at the very heart of economic mobilization. The determination can never be final; it must be altered as time flows and circumstances change. But at any given time, it must be characterized by comprehensiveness and firmness. In addition, this scheduling of necessary requirements, to be realistic, must be constantly balanced against a comparable inventory and scheduling of supply. There must be a continuing process of meshing the two. This flowing evaluation of basic requirements and supply may be called programming. Or it may be called the determination of priorities. Whatever it is called, its importance to economic mobilization is supreme.

A programming and priority operation of this scope draws its initial guidance from the size and speed of the primary military program. That program is the starting point of reference to which other efforts must be adjusted. Hence it is essential to effective economic mobilization that the military program be defined as quickly and clearly as feasible, although it was never defined exactly at any stage in World War II, and cannot be defined exactly now for a variety of reasons.

But it is a dangerous fallacy to assume that comprehensive programming and priority operations must await complete crystallization of this military program. There are many important aspects of the general programming and priority operation which can be carried forward to a high stage of development without awaiting final clarification of mili-

tary targets. Thus, many of the decisions can be founded safely upon assumptions about the military program within a fairly wide band. Moreover, all other requirements are not deduced entirely from military requirements. Some of them are so large in themselves that they must be included in the initial approach to the whole problem. Indeed, the development of other requirements and military requirements interact upon one another, and the process of developing all of them must go forward simultaneously and coordinately. On the supply side, there are many paramount problems which can be pushed closer to effective treatment without awaiting any more knowledge about the military program or the general international situation than we already have.

Since the programming and priority operation is the central machinery for defining what use of resources is most efficient in a defense emergency, all of the specific economic programs must rely for guidance upon this central operation. For all of these other specific programs are designed to guide the use of resources, and cannot be fully effective until we know what our resource-use objectives are. To illustrate, until we know what level of consumption is consistent with other essential requirements, we are handicapped in developing tax programs. Until we know what level and kinds of business investment will be most helpful to the defense effort, we cannot very effectively determine the desired impact of taxes upon business. Similarly, wage and price policies must be related to objectives for consumption and investment, because most consumers are wage earners, and prices and profits have a bearing upon business operations. Even more clearly, the allocation of materials toward one purpose and away from another must rest upon evaluation of how many purposes our resources can fill and which ones have the highest priority.

Finally, the setting of specific goals or targets for some lines of production and utilization will have a galvanic and unifying effect throughout the economy and among all the people by making it clear in concrete terms just what we as a nation are striving to do and why. It will dispel any notion that sacrifice is being asked for its own sake. In fact, it will replace the negative concept of sacrifice with the affirmative concept of service, by drawing all into an affirmative program directed toward positive results. The target of 50,000 airplanes, set near the start of World War II, is an outstanding example of the forcefulness of this approach.

In world terms, the quantitative development of specific goals by a nation which has always shown the power to accomplish what it sets out to do will mightily encourage our friends abroad and give pause to our opponents.

V. The Importance of Production

The programming of resources and requirements serves to reveal shortages of varying degree in many goods and services. In many cases, the problem of shortages can be cut, like the Gordian knot, by rigidly allocating existing supplies among various requirements according to priority. But restraint of demand will not and cannot meet the whole problem. In many instances, production must be expanded—and in the long run, this is the more fundamental remedy.

It is obvious that, on the economic front, wars whether hot or cold are won or lost on the production line and not simply by restraints. This justifies discussion of why major emphasis in the kind of mobilization now under way should be placed upon production.

First of all, the current rate of output of some items vital to the defense effort is not enough to satisfy even the primary military and stockpiling requirements which we should now be meeting or will have to meet shortly. Even allowing for an expansion of imports (but allowing also for the possibility that international developments might curtail some imports) the only safe answer in these cases is to expand production of these items.

Another situation exists in cases where the supply is sufficient for military requirements and stockpiling alone, but not sufficient to cover also the industrial and consumer requirements for an economy supporting a high and expanding mobilization effort for a long time. There has been a tendency in some quarters to subtract the military and stockpiling requirements from the total supply, and to conclude that the situation is not serious if the remainder is well above zero. This neglects the fact that other essential requirements, even with restrictions and sacrifices, may be far above zero and may even exceed the military and stockpiling requirements.

More generally, the experience in World War II illustrates that, while many lines of production were cut back and many restrictions imposed, total output swelled enormously. On an annual basis, it rose by about three-quarters between 1939 and 1944. If this gain had been only one-half as great, we might have lost the war no matter what else we did.

In some respects, the expansion of total production, although in an entirely different pattern from in peacetime, may be just as imperative now as during World War II. In a total war, the nation had to draw down very heavily upon its industrial and civilian strength in order to support the military build-up. This follows from the very nature of a total war. In the different situation which we now face, there is no telling how long the burden of the military build-up will last, but informed opinion is that we face many years of very high defense outlays.

We must weigh carefully the extent to which we now draw down our industrial and civilian strength, because we do not know at what year in future—if at all—we shall be called upon suddenly to drain that strength to the utmost in support of a total military effort. The safest course, under these circumstances, is to combine the military build-up with the largest feasible support of our underlying industrial and civilian strength. This is necessary not only for purely economic reasons, but also because of the psychological strain involved in carrying a military burden in a democracy without the pressure of an all-out war. The conclusion is that to serve these various needs we must expand total production if we are to achieve optimum strength for the long pull.

We cannot expand total production anywhere near to the extent that we did between 1939 and 1944, because we had more slack resources in 1939 than we have now. But current and foreseeable planning do not contemplate anywhere near the diversion of manpower and material from availability for the production line to service in the armed forces that was undertaken in World War II; and this differential compensates in substantial measure for the fact that we had more slack resources in 1939 than we have now.

Moreover, it does not follow that we do not have a great production expansion potential within our economy just because we were near “full” utilization of manpower and plant by the middle of 1950. We have a growing population and a growing labor force. We can work much longer hours. We have a marvelous technology, and must strive through it to increase productivity. We can further apply the latest results of science and invention to the practical problems of production. It should be possible to increase the total of private and public output by about 25 percent over the next five years. This is a considerably higher rate of growth than has been experienced in normal peacetime, but the Council believes it can be obtained with the harder work and larger effort which the emergency now imposes upon all.

A wide range of tools, skillfully employed, will be needed to expand the right lines of production with sufficient rapidity. They include procurement policy, technological development, financial aids for increasing capacity, informational guidance, and training programs. Even restrictive measures, such as taxation, credit controls, allocations of supply, and price and wage controls can contribute to production, by selectively curbing unwise resource use without stifling necessary types of incentive, investment and expansion. It is not the Council's role, at least in this report, to advance detailed production programs.

We can say this: Whatever controls we may adopt, they will fall far short of those of an opponent whose entire economic and political system is founded upon the most rigid control of every button and every grain turned out by every factory and farm. But we can enlarge our

productive superiority, and in setting out to do so we will be choosing the weapon which we know best how to use.

VI. Uses and Limits of Controls

The argument thus far has been that the first task of economic mobilization is to define and reconcile competing requirements, to match these requirements against available supply, and to service these requirements in accord with priority of need.

It has also been pointed out that the most fundamental approach to the satisfaction of necessarily enormous requirements is by accenting production. Goods must be made before they can be used.

But there are various compelling reasons why, in addition to promoting production, it is necessary to restrain demand. The output of some items cannot possibly be expanded rapidly enough to meet the needs of the primary military build-up without cutbacks elsewhere. Reliance upon the competitive bidding up of prices, to determine the allocation of goods which are in short supply relative to the total need, does not service competing needs on the basis of the priorities of national interest. Such hectic price movements create grave inequities which undermine public morale and contribute to the inflationary spiral. In brief, the traditional mechanisms of the free market, which in peacetime are relied upon to balance supply and demand and to respond to the relative wants of a free people as determined by themselves, must be supplemented in a period of economic mobilization.

While the expansion of production may ultimately reduce the specific inflationary impulses which arise from shortages of specific commodities, it takes allocations and other controls, in many instances, to make scarce manpower and materials available for the most needed production lines. Besides, the expansion of production does not and cannot remove the general inflationary problem in a period of very high and constantly rising defense spending. The reason for this is that the volume of income received by producers and consumers (and thus available for spending) is generated by the totality of production, and increases as the total increases. The only goods available for these buyers, however, are total production minus the large amount purchased by the Government for the defense program and for other programs. Thus, the "inflationary gap" is not filled simply by expanding production. It is accordingly necessary to reduce consumer and business demand below levels they would otherwise reach.

Controls—both indirect and direct—are needed to deal with this inflationary danger. There are several different methods which may be employed for restraining demand. First and foremost, incomes may

be absorbed through taxation, thus cutting down the amount which consumers and businesses have to spend. Heavy excise taxes may also be used to reduce demand for goods in short supply. Second, demand may be restrained through restricting the expansion of credit. Limitations may be placed on credit used specifically for purchasing durable consumers' goods and housing, and on credit expansion generally. Third, allocations of supply operate to restrict the demands of producers, thus reducing pressures on the prices of scarce raw materials. At the consumer level, rationing may be used to restrict demand for particular goods which are in short supply, although it does not reduce total inflationary pressures. Fourth, demand may be prevented from increasing by keeping incomes from rising. This is the way in which price controls and wage controls help restrain demand. A rise in the prices of goods or services which a person sells results in an increase in income available for spending.

Finally, demand may be reduced by promoting net saving, that is, by decreasing the spending of current disposable income and previously saved assets. Strong emphasis will need to be placed on the enlargement of saving, as it will be extremely difficult to prevent the amount of disposable income after taxes, which people would normally want to spend on consumption, from exceeding the available supply of consumer goods. To enlarge saving sufficiently, however, will not be an easy task. Several of the control methods listed above operate to encourage net saving, namely, heavy excise taxes, specific credit controls, and rationing. The central effort to increase saving will undoubtedly be through vigorous patriotic campaigns to buy government bonds. No method for increasing saving should be left unconsidered.

The different kinds of controls—priorities and allocations, price and wage controls, credit controls, and taxation, both general and special—differ in their operation and effects. In general, controls, when wisely used, supplement the price system in achieving the purposes of the defense program in three ways: First, controls can promote production by channeling resources into the most desirable uses; second, controls can promote economic stability by restraining excessive demand; and third, controls can promote equity in the distribution of goods and services.

But while controls are useful in promoting these results in a defense program, they may in some degree interfere with them. The outcome depends on how wisely they are used. Thus, it is clear that if the goals are to be achieved, the controls must be geared to the programming of requirements and supply. This will help to indicate clearly the new pattern of resource use which the defense emergency dictates. The nation will then be able to shape the controls more accurately to fulfill their appropriate tasks.

In particular, controls may interfere with production if they are not

applied with great care. It is important to reconcile the imposition of controls with rapid acceleration of some lines of production and with the maintenance and expansion of total production. Actually, controls should be regarded as the handmaiden of production, because even cut-backs of some kinds of goods are ordered to facilitate the production of more of other kinds of goods which are in greater need.

In the long-drawn-out effort now confronting us, there will be many cases where programs to expedite production and programs to impose restraints complement one another effectively. But there will be other cases—and these will be the hard ones—where to achieve maximum production it is necessary to relax controls at particular points and thereby run the risk of price increases. There is no one rule which will reveal the more desirable of these two alternatives in all cases. Each situation must be handled pragmatically. But it may be safer to run the risk of a minor effect on specific prices than to err on the side of smothering or handicapping our productive genius. In the final analysis, our security depends more on how rapidly we expand our armed strength and productive power than on whether all inflationary forces are rigidly contained over a given period of time.

This report is not the medium for discussing the details and effectiveness of various controls. That effort is held in abeyance until the January reports transmitted to the Congress by the President.

But the foregoing discussion points up to this conclusion now: In the worthy desire to be vigorous, we should look where we are going. And we should not too rapidly sacrifice on the altar of automatic conformity the dynamic qualities which thus far have made our industrial system almost as productive as those of all the rest of the world.

VII. Taxation in the Defense Program

No discussion of the economics of defense would be complete without some special reference to taxation. The major combination of methods by which resources are redirected by Government consists of expenditures through which the requirements of Government are exerted, and taxes through which other demands for resources are reduced. In peacetime, this combination of expenditures and taxes is ordinarily sufficient to divert resources without resort to other control measures. The fact that in the defense period other measures also are found necessary to redirect resources for the most efficient promotion of defense purposes, does not alter the prime importance of taxation and Government expenditures.

The diversion of resources to the defense program must be made for

the most part from private spending and investment. To the largest extent feasible, however, diversion should be made from other governmental programs by reducing non-essential expenditures. When citizens are required by a shortage of goods and services to cut their less essential individual spending, not to cut less essential collective spending would make for inefficient use of scarce resources.

The order of priorities among governmental programs is drastically altered by the international danger. Many governmental activities which have a high priority in peacetime must give way in a period of mobilization. In the rearrangement of priorities, however, it should not be assumed that no governmental expenditures except those made directly for the military program are important to the defense effort. A healthy, efficient labor force with high morale, an increasingly productive industrial plant, and well-conserved natural resources, are foundations of a maximum defense effort. Governmental programs that support these foundations retain a position of high priority. Some of these programs can be contracted; some may have to be expanded. There are other programs which can and should be reduced or postponed. But when everything to this end has been done, it is inevitable that the reductions will be far outweighed by the increases in defense expenditures. There will accordingly be a large net increase in governmental demand for goods and services.

Because taxation offsets the increased demand of Government expenditures, it is the basic measure for attacking inflation. In addition, taxation at the levels required by the inflationary pressures also may have important effects in restricting or redirecting production.

The positive importance of paying the cost of the defense effort from month to month as it is incurred is based on the anti-inflationary effects of taxes. The alternative method, borrowing, presents serious dangers of present or future inflation. Unless the borrowing is accompanied in the present by a decrease in spending (an increase in consumer saving) or by a reduction in business investment, the inflationary pressure of increases in Government expenditures will not be offset and immediate inflation will result. Even borrowing which is noninflationary in the present may well lead to inflation in the future, when the lenders seek to change their securities into liquid funds and spend or invest them.

The prospect that the defense effort will be prolonged makes it particularly important to cover the cost through taxes. Borrowing has its place in the financing of a short, intensive effort; but it is dangerous for a long drawn-out effort.

The positive case for a pay-as-we-go tax policy is so strong that there is general agreement that it should be followed. Some arguments have been raised for an unbalanced defense budget, however, and the more important ones will be examined.

First, it has been said that if it is proper to incur deficits in depression

years, it is surely all right in the defense period. This reflects a misunderstanding of the reason for having an unbalanced budget in some depression years, namely, to support private demand when this was so low as to cause widespread unemployment. Obviously, a period of heavy inflationary pressure is not a period in which private demand needs such support; on the contrary there should preferably be a substantial surplus to offset the excessive combined private and governmental demand under defense conditions.

Second, it has been said that taxation is a great burden on the people and that, with all their other burdens, they should be spared this one by postponing it to later years. But it is not the imposition of taxes which creates the burden under existing circumstances; it is the defense undertaking itself. When the nation decides to withhold millions of its men from production in factory and field, and to place them in the armed forces, that places a burden upon our economy. When the nation decides to use materials for planes and tanks instead of for automobiles and homes and roads, that places a burden upon our economy. Defense efforts, in the main, must be paid for out of current production, and most of the cost cannot be truly postponed. Taxation to pay the cost is simply recognition of this fact. Whether these burdens are too large is a question to be determined in the light of the dangers by which they are prompted. They are not created by taxes, and they will not be reduced by failing to finance the defense effort through taxes.

Third, it is sometimes argued that the burden of pay-as-we-go taxation will be greater than our economy can stand over the next few years. In its main elements this is the same argument as the last one and the answer is the same. In the longer run we should be able to stand as large a tax burden as a defense burden, since the tax burden is merely a financial reflection of the defense burden.

In the shorter run, to be sure, defense outlays might rise so rapidly that it would not be practical to balance the budget in the current year because of the lag of tax collections behind tax legislation. Moreover, the outlays might rise to the point that the increase in rates required to balance the budget would be so great and so rapid that serious loss of incentive would result. But defense expenditures are not yet within that range. The "pay as you go" principle should not be relinquished unless it should become absolutely hopeless to maintain it. It is a sound principle; once it is relinquished, finding a workable standard to take its place is difficult indeed. For example, if a deficit were found to be required in the rapidly expanding defense economy, what clear demonstration can be made to the Congress that the deficit should be 10 percent, or 20 percent, or 40 percent of expenditures?

In providing for more tax revenues, care should be taken not to measure how much more is needed solely by looking at the then current level of public outlays. Many tax collections lag far behind tax enactments.

Moreover, the level of appropriations and the expectancy of things to come build up inflationary pressures long before the flow of funds takes place and even before the placement of defense orders. Conclusive proof of this is contained in the sharp upward movement of prices and wages and credit after the Korean outbreak, long before there was any increase in the actual placement of defense orders or in the total size of public outlays. Consequently, the tax program, as rapidly as possible, should be oriented to the best judgments about the economic situation six months or a year ahead.

The really challenging tax issue is *from where* taxes should be collected. Clearly, tax policies, like other policies, should contribute to achieving the defense program. To implement the defense effort and to combat inflation effectively, taxation should be designed to restrain the undesirable use of resources without crippling imperative uses.

It is not possible to treat taxation purely as an instrument of economic stabilization and redirection of production, for taxation performs other functions at all times. Thus, it is relied on as a method of distributing the economic burden among persons and groups in an equitable manner. Moreover, taxation is the best indication of cost as the public seeks to weigh the benefits of expenditure programs against their cost.

In considering the distribution of the tax burden, three special considerations should be kept in mind in the defense period. The first is that if the taxes are to have the desired effect in offsetting inflation, they must be imposed where they will reduce spending. This means that much more emphasis should be placed upon restraining general consumption than would be desirable in an expanding peacetime economy turning out an ever-increasing flow of goods for civilian use. The tax program must be adjusted to the cold fact that longer hours and harder work will swell the volume of personal income, while for a year or two at least the total volume of consumer goods cannot be expanded and may have to be reduced.

If tax increases are to be successful in reducing spending, they must not be used as the excuse for raising the prices, profits, or wages of those on whom the tax is intended to rest. If any major economic group is able to escape the burden of the tax increases by securing a compensating increase in income, both the intended burden distribution and the intended reduction in spending are frustrated. It then becomes necessary to increase the burdens and reduce the spending of other economic groups. This is unfair and enlarges the required volume of taxation, thereby intensifying all the problems which high taxes produce.

Price and wage controls can help to prevent those who pay higher taxes from shifting the burden to the consumer and thus nullifying in part the anti-inflationary effect of the increased taxes. But it is even more clearly true that, without adequate taxation, the other efforts to control inflation rest upon quicksand. Price controls, for example, do

not reduce existing demand or narrow the "inflationary gap." If that gap is too large, the successful use of direct controls is undermined. This cannot be reiterated too frequently, lest the public be beguiled into seeking a painless but superficial cure for inflation in the direct controls alone.

A second special consideration is that the distribution of taxes should be such as to promote the maximum cooperation of the public in accepting necessary sacrifices and restraints during the defense period. This means that the public must believe that the tax system spreads the burden fairly. The excess profits tax and the progressive income tax are generally accepted as necessary parts of a fair tax system under current conditions.

A third consideration is that of using taxes to reduce the demand of commodities in particularly short supply. Heavy excise taxes on scarce commodities do this by raising their effective price to the consumer. The resulting price increase goes into the Federal treasury; unlike other price increases it does not add to the profits of businesses or stimulate the demand of wage earners to share in such profits.

Because of the diverse purposes to which taxes must be geared, as well as some differences of opinion regarding the way in which different taxes affect various segments of the economy, there is an understandable variation of viewpoint about just what forms and rates of taxation should be applied. Enough is known about taxation to avoid the clearly harmful and to choose generally among the more desirable approaches. It is far more important to get an effective and sufficient tax program quickly, than to hope for an ideal program at any time. In these times particularly, everyone shares in the responsibility to submerge relatively minor disagreements and to seek agreement on the achievement of broad purposes.

VIII. Price and Wage Policy

The die has now been cast for price and wage controls, which will cover progressively more of the economy as the necessary organization is expanded and as the defense program mounts. It is idle now to speculate how much of this might have been avoided if a far more extensive tax program had been adopted far more quickly, or if certain powerful groups within the economy had shown more restraint. Nor will the Council in this report discuss the details of which controls should be imposed first, in what sequence action should be taken, or what procedural method should be employed. Some of these matters are clearly within the responsibility of operating agencies but outside the purview of the Council. Others will be dealt with in the more programmatic reports transmitted to the Congress by the President in January, including the Economic Report and our Annual Economic Review.

While these controls are now inevitable, the wage and price policies under which these controls will be put into effect are still to be interpreted and applied. It is therefore appropriate for the Council in this report to say something on the general economics of price and wage policy under current conditions. Relatively too much attention has been diverted to the mechanics of price and wage controls, and not enough to the economics of price and wage policy. Too often has it been forgotten that controls are designed to effectuate a policy, and not to substitute for it. In all of the discussion about when, where, and how controls should be applied, there is room for an insistent reiteration of the question: "For what purpose are they to be applied?"

It is not a sufficient answer to say simply that they are to be applied to fight inflation. This does not reveal just what ought to be done, for there are many ways both good and bad of fighting inflation. Nor is the economist completely satisfied with the answer that "the public wants controls." The public will not want them after it gets them, unless they are demonstrably successful. Nor is it sufficient to say simply that all prices and wages should be frozen just where they are. We do not comment here upon whether it would be administratively more practical to begin with a general freeze before adjusting, or to begin first with limited controls and then move on to more extensive ones. In either administrative approach, both economic considerations and the maintenance of public support require the development of policy to implement a set of objectives. The proper sequence is first to define the objectives, and then to develop the implementing policy along with the machinery and procedures which will best effectuate the policy.

In peacetime, the economic function of prices and wages is to promote maximum employment, production, and purchasing power by facilitating the most efficient use of resources. All this has been alluded to earlier in this report. At the start of 1950, before the new international developments, the Council undertook to delineate general price and wage policies for stability in an expanding peacetime economy. On the price side, we advocated in general the maintenance of the then current level of prices. We held that a generally declining price level was likely to retard economic growth, and that a generally rising price level was more or less incompatible with economic stability. We recognized the need for individual variations within this general rule, and that some prices should be reduced where there were extraordinary technological gains or where these prices had already mounted above a sustainable level.

On the wage side, the Council took the position at the start of 1950 that, in the dynamics of the American economy, stability and growth were more likely to be promoted by level prices and rising money incomes than by level incomes and falling prices. Of course, we felt that these increases in money incomes should be consonant with increases in pro-

ductivity so as not to generate inflation. It was on this basis that we looked with general favor upon the new types of contracts arising in some of our major industries, which inaugurated a stable wage policy for a number of years ahead by relating periodic wage increases to assumed and realizable increases in productivity for the economy as a whole. We did not register objection to the inclusion of "cost of living" adjustments in these formulae, so long as they did not subordinate the general idea that incomes should keep pace with the swelling volume of consumer goods which a peacetime economy at maximum employment and production would be turning out. We recognized, on the wage side no less than on the price side, the need for individual variance in a complex economy, and we advocated that the application of these price and wage policies be left to the processes of managerial decisions and collective bargaining.

The need for reconsideration of the price and wage policies put forward in early 1950 now arises obviously from the fact that the international emergency has changed the economic situation in two vital respects. In the first place, while we must continue to use our resources most efficiently, the pattern of resource-use must be readjusted drastically because new priorities of need have entered into the picture. And secondly, this drastic change, in the interest of national security, must take place much more swiftly than would be possible through the free play of market forces alone.

But it remains true even now that prices and wages will have a bearing on whether we achieve the most efficient use of our resources for the purposes at hand. Even pending the further development of programming and priority guides, it is feasible to formulate some general rules about price and wage policy. In the case of prices, generally speaking, it is even more desirable now than in normal peacetime to hold the average of prices as near as possible to a fixed level. We do not pass here upon the extent to which this should be done by controls or by business decisions. Upward price movements are even more disruptive under current conditions than in normal peacetime. The comment we made a year ago, that almost all important prices were high enough to provide adequate funds and incentives without further increases, is even more valid today. Yet even these general conclusions are subject to some qualifications already hinted in this report. Insistence upon absolute price rigidity should not interfere with some flexibility where it is needed to get vital production. In rare cases, price increases may be required to induce production, or subsidies may be necessary to hold the line with respect to the cost of living.

Turning to wage policy in the current situation, one may look at wages as the nominal amount received by the wage earner from his employer (which is significant as a factor in business costs). Or one may look at wages as the amount available for expenditure by the wage

earner, after the imposition of taxes and other compulsory or voluntary restraints (which is significant from the viewpoint of the inflationary problem of the relationship between consumer demand and the availability of consumer goods, and from the viewpoint of the standard of living).

Looking first at wages as the amount paid by the employer, it is obvious that wage policy cannot countenance increases in wages of a size which would necessitate price increases. There may be a few exceptions to this rule, where the remedying of inequities is more important than the effect upon the defense effort which would result from price increases in particular fields. But these cases should be limited to instances of real hardship.

Looking next at wages as the amount available for spending by the worker after the imposition of taxation and other restraints, the sound economic policy is to adjust these wages as closely as feasible to trends in the availability of goods for consumer use. This is the way to fight inflation, and when wage earners as a whole get more money than this for current spending purposes they really gain nothing.

It is apparent under present and immediately foreseeable conditions that the total amount of wages available for spending after taxes and any other forced restraints cannot, in real terms, rise in accordance with the formulae which we regarded sympathetically in early 1950 under peacetime conditions. For if total wages available for spending rise as fast as productivity increases and are also adjusted upward for changes in the cost of living, while an increasing proportion of the enlarging production is bought by the Government for national defense, then excess of wages over available goods aggravates inflation. If some wage earners benefit by using the early 1950 formulae while others do not, they do so at the expense of other consumers who constitute a majority of the population and most of whom are relatively less fortunately situated.

Although the size of defense outlays has not yet crystallized, it already seems clear that the defense effort will at least be so large that during the next year or two if not for longer the total availability of goods for consumers cannot be increased, and in all likelihood will decline somewhat. Thus, wage and tax policies should aim toward preventing increase in the total amount of wages available for spending, since there is no evidence now of an over-all insufficiency of total wages measured against the proportion of total output which wage earners should buy.

Thus there emerge two standards to be applied in the development of wage policy: first, that the trend of wages paid by employers should not force prices to rise; and second, that the trend of wages available for spending after taxation and other restraints should be kept in line with trends in the availability of consumer goods. The second standard is much tighter than the first one, and probably much more important from the viewpoint of combating inflation.

There are two main ways by which wages available for spending can be kept in line with the availability of consumer goods. The first way would be for the general level of wages paid by employers to workers to be held approximately where they are now until that time in the future when consumer supplies can again be expanded. The second way would be to maintain formulae of wage increases roughly similar to those desirable in peacetime (including in some instances productivity and cost of living adjustments), but to prevent a growth in current spending power by sufficiently higher taxation or through deferred wage payments or some combination of the two.

Each of these alternatives has some points of superiority. The first method is simpler to administer, and does not raise the perplexing question of just what the right formulae for wage increases are or how they may be generally applied in various industries. The second method may have the advantage of providing some mild incentive to the wage earner—which is just as important as incentives to business—and has the further advantage of not seeking to deprive workers of what they believe to be legitimate gains embodied in contracts already signed; but it has a disadvantage insofar as it might be unlikely that taxes would be increased sufficiently or quickly enough to keep the wage gains out of the spending stream so long as civilian supplies cannot be increased. Much the same issues arise in considering the economics of overtime rates of pay for longer working hours.

Perhaps some combination of the two approaches may prove most practical; but any combination should move vigorously toward the objective of holding wages available for spending in line with the supply of goods. This conclusion of general policy bears upon wage trends in general. There are some hardship or exceptional cases, which would need to be treated differently until a larger measure of equity is established.

In the case of wages no less than in the case of prices, the achievement of general stabilization should be reconciled with some individual variations of treatment when necessary to encourage maximum production. There will be a few instances where, because we do not rely upon forced labor, some wage adjustments will be among the tools required to get and hold workers where they are most needed. That is why the word “stabilization”, which leaves room for some realistic discretion, is more suitable to our economy even in these times than the word “freeze”. Nonetheless, the objective of leaving enough flexibility to enable the system to work should not be allowed to interfere with the rapid achievement of a general situation which holds wages firmly in line with the availability of goods for wage earners to buy.

The problem is made even more difficult because the defense effort will bring millions of additional workers into the active labor force, and also lengthen the hours of many who are already working. Thus, there

will be a great increase in the total volume of wages even without pay increases. Manifestly, this increase in the total volume of wages will add to inflationary pressures as long as it is possible to increase the supply of civilian goods; and yet no one would propose that this situation be counteracted by reducing the money wages paid by employers to those who have been working all along. That would be both unfair and impractical. This underscores the importance of taxation as the primary method for draining off excess purchasing power from all types of income recipients, and of greatly increasing personal saving. It also underscores the fact that, because millions of additional workers will cause total wage income to rise while the size of the defense effort will prevent consumer supplies from rising, the bulk of wage earners already employed at high wages should recognize that these wages cannot be allowed to spiral still higher under current conditions. It goes almost without saying that it will be easier to accomplish this objective if the cost of living is stabilized.

It is certainly not too much to ask that wage earners in general forego efforts to increase their living standards, during a time when the economy simply cannot produce more civilian goods and also carry the heavy burden of rapid rearmament. These living standards are already far higher than elsewhere in the world; and they are much higher than they ever were in this country before World War II. Within two or three years, if total production grows as it should—and this is one reason why that growth is so important—it may be feasible to resume some gains in living standards even if the defense program remains very high. But if the size of the defense program should reach the point where large absolute reductions in living standards should become necessary, this too the American people must be prepared to undergo.

It would be unfair to suggest such rigorous wage policies, if it were not stressed at the same time that restraints and sacrifices can be imposed upon one group in a democracy only when there is a sense all around that the total burden is being fairly imposed upon all. In this connection, for example, a freeze of prices and a freeze of wages are not equivalent, because it is profits and not prices that are the reward to management. Thus the treatment of profits through the tax system, and the effect of other national policies upon other types of income, are inseparably connected with the treatment of wage policy and of inflationary pressures. The foregoing discussion has indicated particularly the intimate interaction between wage policy and tax policy.

It follows that none of these policies can proceed successfully in splendid isolation. There must be some top point at which they are all reconciled and synthesized. And whoever is responsible for this reconciliation must be armed with the tool provided by a comprehensive programming and priority system, to enable him to discern basic objectives before he seeks to reach them.

IX. Public and Voluntary Efforts

The popular discussion of controls versus voluntary action has tended to obscure a very basic issue. This issue is what middle ground between the freedoms we enjoy in normal peacetime and the unlimited compulsions of a State Economy will maximize our strength for the task ahead. To assume that there is no middle ground would be to acknowledge that we can contest Stalin's aggressive designs effectively only by aping all of his methods. That would also assume that in peacetime there are many differences between our kind of economy and political institutions and those of the Soviets, but that in a hot or cold war there are no differences. The whole history of our achievements in war no less than in peace belies these naive assumptions.

If by voluntary action we mean that each individual or group or industry or labor union go its own way, with only vague perception of a common national purpose, then manifestly we cannot afford this degree of voluntary action in these perilous times. No rational person will deny that in these times we must do more by central authority, and less by free and scattered decisions, than in normal peacetime.

But the exercise of authority in a democracy does not involve the abandonment of reason and persuasion. It does not involve abatement of the constant effort to obtain the understanding and consent without which laws can neither be enacted nor made effective, and without which Executive action cannot achieve full results. It does not involve surrender of the strength and inspiration to be derived from participation in the making of decisions, and not merely in carrying them out. All these things are more true of the economic phases of mobilization than of any other phases, because the economic phases—as was said at the beginning of this report—must be executed by all the people throughout the country, and not only by a few people in seats of authority.

It may be helpful, at a time when the choice to some seems an oversimplified decision between compulsion and freedom, to identify a few of the areas where voluntary efforts should be in the main stream of economic mobilization.

(1) The vast production effort, which supports the whole economic mobilization, is preponderantly in the hands of businessmen, workers, and farmers. The Government may provide them with some targets, subject them to some controls, and encourage them with some stimuli. But the Government alone cannot spark their initiative, maintain their morale, nor kindle their ingenuity. These are attributes which lie in these groups, and which can be maximized only if these groups are not wrenched too severely from their customary methods and relationships. We must adapt the American economic system to the new purposes of a defense program; but we cannot afford to junk the system.

(2) The establishment of major targets or goals in a defense emergency is primarily a Government responsibility. There is no other possible location for this responsibility, and it must be exercised. But the development of these targets or goals should not be undertaken solely by public officials. They should receive help in the formulation of these targets by those who will be called upon to achieve most of them. The goals must be crystallized at the top; but they should not be handed down from the top.

(3) The development of systematic policy to guide the imposition of controls is necessary to prevent these controls from bogging down in irrational or conflicting purposes. The question of whether these policies are enforced by authority or left to voluntary action is secondary. The first question is *how* these policies are formulated. Decisions must be made by the Government, not by bodies representing economic groups. But in formulating policies, there should be the fullest possible consultation with representatives of those who not only will be affected by them, but who also will have to carry out many of them and support all of them.

Care must be exercised not to swing between extremes from day to day, asserting one day that everything will be accomplished by voluntary cooperation, and asserting the next day that it is too late for anything but compulsion. Under the American system, a constant blending of authority and freedom, of uniformity and flexibility, is essential to the best results. A defense emergency requires more ability and patience—which should not be confused with slowness—to achieve this blend. And the ratios of these ingredients change in times of stress. But if we ever lose the desire or ability to achieve this blend, we shall have lost the greatest single asset in our total strength as a nation.

X. High Points for Immediate Action

No matter how large the resources of the nation, it cannot do all of everything at the same time. It is forced to make choices between the things it values more and the things it values less. In a national emergency, the relative order of our needs is more clearly apparent. But there are limitations upon the application of policy to achieve these objectives, no less than limitations upon resources. Even an all-out effort does not mean applying all policies at once in helter-skelter fashion. Policies must be fitted into some scheme of their relative importance, and deployed in some systematic relationship. Some policies are more important than others. Some policies cannot be effectively imposed

until others are first adopted, although in the long run those which come later may be even more important than those which come earlier.

There are certain efforts which should have top priority now in the process of economic mobilization, and proceed with utmost speed. The listing is not necessarily in the order of relative importance, nor even in sequence, since in general these efforts must be carried on simultaneously. But taken together, they constitute the Council's thinking concerning the high points for immediate action. These high points are only a framework. Details of policy must be developed elsewhere than in this report on economic policy for national defense.

First. The size of short-run military requirements should be crystallized as rapidly and completely as possible, not only in terms of dollars, but more importantly in terms of goods and services. All other policies cannot await this, but no other policies can proceed very far until this issue takes fairly definite shape. The situation here must remain fluid; but it cannot be formless.

Second. Economic mobilization rests above all on the most efficient use of our total resources, geared to a set of purposes determined by the national emergency. This most efficient use can be defined, and subsequently achieved, only by a consistent and comprehensive programming of basic requirements, matched constantly against available supplies. This basic programming effort should be located in one place under one direction and, being the primary tool of major policy, requires at least very close affiliation with the authority for directing and coordinating defense production and economic mobilization. Every specific economic policy should contribute to satisfying program requirements, whether this be accomplished by expansion programs, cutbacks, allocations, indirect controls like taxation and credit, or direct controls over prices and wages.

Third. On the basis of this programming operation, there need to be developed some vital goals or targets to guide the efforts of the nation. The most important of these are some targets for production, because of the great importance of expanding production and adjusting it to defense needs.

Fourth. The tax program should be expanded, with continued adherence to the policy of balancing the budget as the basic measure for combatting inflationary pressures. The distribution of the incidence of new taxation should be guided particularly by the objectives of reducing inflationary pressures, distributing sacrifices equitably, maintaining public morale, and not discouraging desired production.

Fifth. The control of prices and wages now having been initiated, the programs should move forward to forestall insofar as possible the further lifting of price and wage levels and the resulting distortion of price and wage patterns. Both price and wage policy should be inte-

grated with other policies in promoting the defense program, and this will require some flexibility in controls.

Sixth. Ingenuity and experimentation should be directed toward building up processes of consultation and cooperation between government and the major economic groups. This will help not only in the formulation of policy, but also in its execution. It is superficial and dangerous to conclude that a defense emergency must convert us into a totalitarian state.

Seventh. Increasingly better methods must be developed for disseminating to the public the fullest and most candid information about the need for and the methods of economic mobilization. The imperative need of public support, based on the facts, cannot be overlooked without paying a penalty of incalculable size.

XI. Adjustment of the Council's Work to Defense Problems

We conclude this report with a statement concerning the adjustment of our work to the new economic problems of recent months, and our relationship to other agencies dealing with these problems.

The Council of Economic Advisers is in the nature of a general economic staff, established by law in the Executive Office of the President to report directly to the President. The primary function of the Council, also defined by statute, is to assist the President in preparing recommendations to the Congress and to the country to promote economic stability and growth. The Employment Act of 1946 measures economic stability and growth by the criterion of "maximum employment, production, and purchasing power."

The range of policies which the Council must consider in the performance of its duties is necessarily broad. In normal peacetime, the Council must consider all of the major policies and programs, whether undertaken by private action or by public authority, which importantly affect the whole national economy. In a period of economic mobilization, whether partial or complete, the task of the Council becomes in some respects more difficult and complex. The problems of maintaining economic stability become more intense. The need for maintaining the economy in full health and strength becomes more imperative, although this strength must be diverted to a new set of purposes. The range of government intervention in the economy becomes necessarily more extensive, and consequently the need for evaluating a wide range of public policies and programs in an effort to achieve consistency and efficient results becomes even more pressing than in normal peacetime. In short, as

the problems of the Chief Executive multiply, so do the problems of those who serve him in a primary staff capacity.

Though the Council primarily serves the President, the effective performance of its work must bring it into contact with many groups. It must work and consult with the functional groups within the general economy—businessmen, workers, farmers and consumers. It must maintain contacts with other agencies—Federal, regional, State and local. It must furnish, upon request, information and advice to members of the Congress who are concerned with economic policy. In these respects, the members of the Council are not dissimilar to some other officers of government, although the fact that the members of the Council are called “advisers” has led to some misinterpretation. For while officers in other fields may, unlike the members of the Council, operate specific programs, yet these officers are also advisers to the President on major matters of policy. He alone, to the extent that he accepts their advice, transmits it to the Congress for action where legislation is requisite. Or, in matters of major policy, it is only with his consent that recommendations are transmitted by others.

The Council is nonetheless distinguishable from most other agencies of government. It does not operate programs nor carry out policies. To this extent, it is not an executive agency. Nor is the Council in conflict with those agencies which develop policies in specific areas; its task is rather to evaluate specific policies in terms of the over-all economic situation.

In carrying out its central task, the Council is charged by statute with two main supporting functions. The first of these is to gather facts, and to appraise their significance both as to recent trends and as to foreseeable developments. The second is to appraise policies already in existence, and particularly to review the programs of government, so that the Council's thinking about new policies may take account of what is already being done and how well or poorly it is working. The word “review” in this connection means to consider and appraise, not to direct.

To gather facts and weigh their significance, the Council maintains a wide network of contacts with business groups, private research and educational institutions, and public bodies. The Council does not itself accumulate nor process huge masses of facts. It selects what seems important to its work from the huge deposits of facts gathered by larger and more specialized agencies.

Toward reviewing existing programs of government, the Council members have maintained a constant and harmonious relationship with those Cabinet members and heads of important agencies who are concerned with facets of economic policy. Similar contacts have also been maintained at the staff level. In the course of preparation of the various reports required under the Employment Act, the Council canvasses thoroughly the views and experience of these individuals, and always sits

down with them for a series of conferences before the January and mid-year reports to the Congress are presented.

Developments since the middle of 1950 have neither altered the basic purposes of the Council nor drastically changed its methods of work, although of course this work must now be turned to new types of problems. There is no conflict now, any more than previously, between the functions of the Council as a small advisory staff unit primarily serving the President, and any new or old agencies entrusted with various other tasks either on the operational side or on the policy side.

We are planning a small expansion of our professional staff, from 20 to 26 (including the three members of the Council), to help carry our increasing work load. But we are still one of the very smallest agencies of Government, and we intend to remain that way because this is most consistent with the efficient performance of our type of service.

The development within the Council of a small group of experts has received recognition in many parts of the Government. Some of the technical studies of the Congressional Joint Committee on the Economic Report have involved close cooperation between its staff and members of our staff. Responsive to requests, we have lent members of our very small staff for periods ranging from a week to six months to the Department of Defense, the Economic Stabilization Agency, the President's Water Resources Commission, and in connection with the Report to the President on Foreign Economic Policies. While this has drained our slender resources, it has been useful to bring the benefit of our generalized work to bear upon the solution of specific problems.

The work of the Council in recent months has been meshed with that of other agencies whose attentions have been directed mainly to the problems of a defense economy.

A member of our staff, by request, sits in as an "observer" at meetings of the National Production Authority in the Department of Commerce. This may be of some help to that agency; it also brings to us constantly information about developments in that sector which is essential for our own work.

During the time when the head of the National Security Resources Board was serving as Coordinator of the various economic programs connected with the defense effort, there was a close staff relationship between his agency and ours. In addition, the Chairman of the Council sat in at the regular weekly meetings between the Coordinator and the heads of various control agencies. This helped to make available to those charged with control responsibility the continuous study and thinking of our group without setting up duplicating functions. It also helped to bring the Council closer to activities about which it is obligated to advise the President.

In certain aspects of the work of the National Security Council, bearing upon the interrelationships between the defense program and the

whole domestic economy, the Chairman of the Council has sat in on an *ad hoc* basis, along with some other officials of Government. This type of coordination has also been carried forward at the staff level.

In addition to our semi-annual reviews and our monthly Economic Indicators, which are published, the Council for several years has been making quarterly and monthly reports to the President on the economic situation. These reports, sometimes written and sometimes oral, are of course not generally available. Since the middle of this year, we have enlarged this type of service to include weekly reports to the President on the economic situation which highlight important developments. These reports, with the President's permission, have been circulated also to a few of the important officers of Government on the economic front. This has made it unnecessary for such officers to duplicate this particular kind of service in their own agencies.

We hope to be able to perform the same kind of service in the case of other new agencies which have been set up, thus avoiding the necessity of having one unit servicing the President while another similar unit services some other agency working directly under the President.

One of the chief assets of the Council is its divorcement from program operations. It is not charged with seeing that any particular job gets done. It does not have to "ride herd" on others or expedite their actions. It has no functions of administrative coordination, and issues directives to no one. For these reasons, it is in a relatively objective and unharassed position to observe and study in their relationships the programs being operated by other agencies. This constant scrutiny of the whole economic situation as it is evolving, from a vantage point committed to no particular program or policy, was what the Congress manifestly intended when the Employment Act was passed. Such work has utility in normal peacetime. We think that it can be of increasing value in these more difficult times, when the very urgency of a situation which requires so many to attend to pressing details calls also for some application of general perspective.

The need for economic policies to accompany the military aspects of the defense program calls upon the Council of Economic Advisers to advise action which will surely test the American people.

It has always been a source of pride in our democracy that the people are willing to take deliberate action to protect and strengthen the nation, whatever burden or sacrifice it may impose upon the citizen. We have now entered a long period in which the people must be asked, in support of the policy of girding for defense, to subject themselves to many restrictions and levies which they would not tolerate in more peaceful times.

That they are willing to have their young men torn from their families, their education and their careers, and placed in the front line before an enemy—this they have amply demonstrated. But are they willing to adopt positive policies resulting in the infinitely lesser hardship of economic restraint?

To this question the whole country awaits the answer. Will some spokesmen for business insist that there be no restraint upon prices which would reduce business profits below the highest levels in history? Will some spokesmen for farmers insist that rising farm price support levels are sacrosanct in this period of emergency regardless of their nullifying effects on the effort to stabilize the cost of living? Will some spokesmen for labor, even during the emergency, insist upon a peacetime wage policy which would absolve those they represent from sharing fairly in the inevitable burden of national defense? These are blunt questions, but these and others like them are vital to our future.

Is there going to be a scramble for self-protection, or common dedication to the protection of the United States?

It is not only justifiable but essential that we be ever-vigilant to prevent any exploitation of the present emergency to strike down policies which have contributed to the economic and social advance of the last generation. But the hard fact is that our defense program cannot be carried forward faster, without slowing down on many other things. If every economic group uses its power only to protect its own position, or if each demands that it be the last to do its part, the nation will fail in its great purposes.

To gain public support for stern policies requires that the public understand the reason why. Toward that end, this report is written.

