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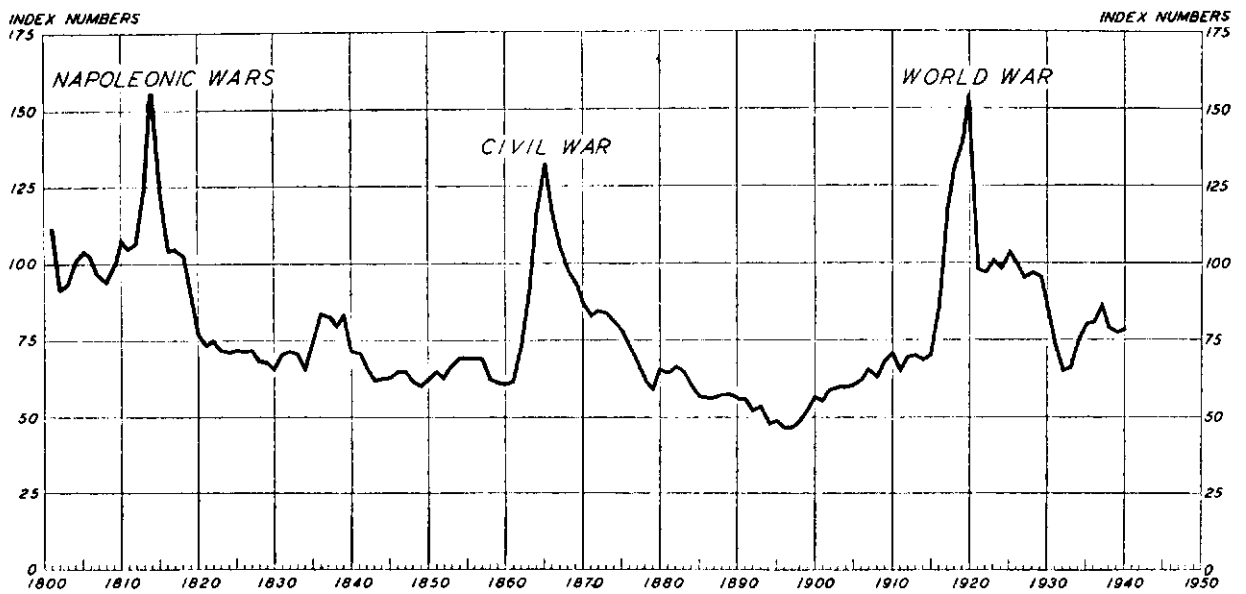
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THE INSTITUTE OF ECONOMICS
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PUBLICATION No. 84

WARTIME CONTROL OF PRICES

WHOLESALE PRICES, 1800-1940^a
(1926 = 100)



^a Wholesale price index of the U. S. Bureau of Labor Statistics. Figure for 1940 is average for first seven months.

WARTIME CONTROL OF PRICES

BY
CHARLES O. HARDY

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DIRECTOR'S PREFACE

This investigation was undertaken at the request of the United States War Department. The Department co-operated to the fullest extent by giving the author access to its files of materials pertaining to World War experience, and by subsequent discussions of the practical problems as they present themselves to the Joint Army and Navy Munitions Board. The War Department has no responsibility, however, for any of the conclusions presented. The National Archives also made much unpublished material available to us. The Institution is grateful for this effective type of co-operation in the investigation of a problem of great national significance.

Messrs. Aaron Director and George P. Adams, Jr., were associated with the author in the preparation of the volume until the research had been substantially completed. Mr. Director wrote the original draft of Chapter X, and Mr. Adams that of Chapter XI. In addition, the author was greatly aided by discussion with both Mr. Director and Mr. Adams of almost every portion of the work. Valuable criticisms were also received from Victor Abramson, Willard Atkins, and Spurgeon Bell.

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EDWIN G. NOURSE
Director

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INTRODUCTION

As the United States embarks in 1940 upon a great emergency defense plan, comparable in its effects upon the national economy to a war program, one of the most vital questions that presents itself is whether a price inflation similar to those of former times is again inevitable. Is it possible to devise methods of financing the program and of controlling prices which will prevent a repetition of the experiences of the past? It is this question to which the present investigation is directed.

The volume is divided into two major sections. Part I is a condensed analysis of the problems involved in the control of prices in wartime, leading to our conclusions with reference to the possibilities of price control and the methods which should be employed. It considers the influence of fiscal and credit policies, as well as more direct factors affecting the price situation. Part II, on which the analysis in Part I is in substantial degree based, is a review and appraisal of the price controls that were developed in the United States during the World War.

In order to relate the issues involved in the control of prices to the larger problem of economic mobilization, and at the same time to enable the reader to view the several aspects of the price-control problem in their inter-relations, we present as a preliminary an integrated summary of the analysis as a whole.

I. BASIC PROBLEMS OF WAR MOBILIZATION

To understand what is involved in wartime price control, it is necessary to consider its relation to the broad problem of mobilizing the nation's resources. Several

questions present themselves in this preliminary consideration:

1. *What are the sinews of war?*

The answer is—shells, bombs, torpedoes, guns, tanks, airplanes, battleships, fortifications. To make these useful there must also be food, clothing, transportation, hospital service, and the like for the fighting forces. Back of the military organization are the fundamental factors for the production of war supplies—steel mills, shipyards, airplane factories, ammunition plants, industrial establishments, farms, and mines—and the laboring population, agricultural and industrial.

2. *By what means can the government obtain these sinews of war?*

The resources which the government needs for carrying on a war are obtainable in three ways only. The first is to take up the slack in the economic system—putting idle plants and idle men to work, running industrial establishments at maximum capacity, working labor at maximum hours consistent with health and efficiency, increasing the output of farms and mines, making more efficient use of transportation facilities, reclaiming waste materials, and introducing production economies in general.

The second source is to shift production from non-essential peacetime commodities to essential wartime supplies—to turn out tanks or army trucks in place of pleasure cars, convert phonograph factories to the production of machine gun parts, turn private chauffeurs into truck drivers, curtail passenger train service offered the public in order to release facilities for transportation of war materials, and so on.

The third is to import materials and supplies from foreign countries. These may consist either of commodi-

ties of which domestic production is negligible, such as tin, rubber, and manganese, or of commodities of which the national production is large but insufficient for war purposes, or even of commodities to replace domestic consumer goods and thus release resources for war use.

3. *From the American standpoint, what is the relative importance of these sources at the present time as compared with the situation in 1917?*

The situation at the present time is different in one very important respect from that which existed at the time the United States entered the World War. In 1917 most of the industrial slack had already been taken up; whereas now the degree of non-utilization of plant and labor power is fairly large. Under present conditions the nation's ability to expand its imports is also more uncertain than was the case in the last war. This is because so large a proportion of the leading industrial nations are already engaged in hostilities, or have recently been eliminated from the field of international trade by conquest or blockade, or are likely to be drawn into war under any conditions under which we ourselves would be involved. Now, as then, there is little possibility of obtaining ships, airplanes, or munitions of war from foreign countries.

4. *What part does money play in the mobilization of a nation's resources for war?*

It is obvious that money is not one of the direct implements of war; it cannot be hurled at the enemy. It is of use only in facilitating the process of acquiring the war materials and services which the government requires. The Congress may appropriate, and the Treasury of the United States may raise, billions of dollars; but these sums of money become effective only as they make pos-

sible the production of the essential war supplies. In one way only can money obtain results otherwise than through facilitating the production of war supplies, namely, in the purchase of essential imports.

5. *What is the significance of price in a war economy?*

To the extent that a government chooses to rely on the price system in organizing a war effort the function of price is the same as it is in a peace economy; that is, to attract human effort and material resources into those uses in which the demand for products is greatest and to determine the distribution of the national product among the various claimants—individuals, business organizations, governmental units—in accordance with the valuations placed by the community on their respective services.

In so far as the government obtains goods and services by purchase in the open market, the price operates to mobilize resources for war effort by increasing the profits of those who produce what the government needs. The fact that through taxation and borrowing the government can utilize a virtually boundless stock of purchasing power would make it *possible* to carry through a war mobilization program with very little reliance on other controls. Indeed this is substantially what was done in all the wars in which this country engaged before the World War. But such a procedure has led to violent price disturbances and distortions, with harmful—frequently disastrous—consequences both for the war effort and for the postwar business readjustment.

II. POSSIBLE SOURCES OF PRICE DISTORTION

The extensive and intensive mobilization of a nation's resources for war purposes naturally has a great impact

upon the operation of the economic and financial system. We are here concerned with the way in which prices are disturbed in the absence of effective controls.

1. *What factors tend to create price disturbances in the initial stages of a war?*

Among the factors which tend to create *initial* price advances—at or even before the actual beginning of war—are the following:

(a) *Large government purchases on a competitive basis.* The Army and Navy Departments, assured of available funds, enter the markets and bid against private businesses and individuals for the limited supplies of war materials. During the early months of the World War these departments, together with foreign allies, sometimes bid against one another for scarce products, the result of which was to run up prices far above the level that would have been necessary if the buying had been co-ordinated.

(b) *The expansion of business purchases.* The imminence or outbreak of war tends to cause business enterprises to increase greatly their current orders for inventories—in anticipation of possible shortages or to get ahead of expected price advances. Commitments may also be quickly made for an expansion of plant capacity, which involves additional purchases of materials.

(c) *Speculation in commodities.* The recollection of experiences in past wars and the threat of the curtailment of supplies of essential commodities, especially those which have to be imported from overseas, may stimulate an outburst of speculation. This may be either organized speculation through the exchanges, or unorganized speculation through the withholding of stocks of commodities from the market—by dealers or inde-

pendent speculators. The advance buying of inventories in anticipation of price increases, noted above, is also a form of speculation.

2. What are the sources of price advances in subsequent stages of war mobilization?

As the war mobilization program gains momentum, several factors have usually combined to stimulate price advances cumulatively. The most important are as follows:

(a) *Unco-ordinated government buying.* Under the pressure of the war emergency each branch of the defense organization has striven to insure a completion of its own part of the program by placing orders and contracts without due regard either to the availability of funds or the adequacy of the industrial and transportation agencies of the country to perform the services expected of them. The professional civil and military purchasing agents of the government and the business men whose services are enlisted in the management of the mobilization program have all been trained in a situation where practically anything they wanted could be obtained by paying a sufficiently high price for it. They are slow to realize that the problem of war mobilization is too big to be handled by competitive methods, and that the only solution is to appraise the total volume of resources available and allocate them to different uses so as to develop a balanced and practical program.

Industrial concerns which are given government orders make the same mistake. They make commitments in the expectation that they will be able to secure the materials and parts from the accustomed sources and later find out that these same sources are relied upon by others to render the same services. Both government agents and in-

dustry attempt to meet the situation by bidding higher prices and by placing excessive orders, hoping that they will thus get enough even if the orders are only partly filled. The results are congestion in transportation and manufacturing, shortages of fuel and essential raw materials, and the skyrocketing of prices.

(b) *Competitive bidding for labor.* The withdrawal of men from industry to the military establishment decreases the available supply of labor at a time when the demand for labor, particularly of skilled types, is increasing. The competitive bidding for labor raises wages just as the competitive bidding for commodities raises commodity prices. The raising of wages in war industries tends to raise the level of wages in non-war industries as well.

(c) *The expansion of consumer buying power.* The money income of important sections of the population is increased by virtue of the increase in both the number of employed workers and the average length of the working week, the increase in wage rates, and the increased profits and dividends which result from the expansion in the volume of business.

This expansion of consumers' purchasing power leads to an increase in the demand for consumption goods and creates a "sellers' market," with a resulting rise in prices. This result can be avoided only if the increased purchasing power of the public is promptly absorbed by the government in the form of taxes or loans. That is to say, the government must divert this increased purchasing power to war purposes if it is not to operate in the market to raise the price of ordinary consumer goods.

(d) *The expansion of bank credit.* All the preceding developments involve an increased flow of funds through the channels of trade. Their intensity and timing are de-

pendent on the credit situation. To the extent that the government obtains its funds by borrowing through bank credit expansion it expands its own purchasing power without decreasing that of the public. Because the public has just as much money to spend as before, while the government now has added buying power, there is an increased aggregate money demand for goods; consequently, prices rise.

The result is the same if the government's securities are sold to the public and the public borrows from the banks the funds with which to buy them—as was done so extensively in the World War. Again, the result is the same if the Treasury, instead of borrowing from banks, simply issues paper money with which to buy commodities—as was done in the Civil War. It must be emphasized again that only when the government raises its funds by taxing the people or by selling its securities to the public, with the public paying for them out of *current income*, is the stimulus to price advances avoided.

An expansion of bank loans to private business may also, under certain conditions, promote price advances. In the early stages of a war, when idle productive resources are still available, it is necessary for industries to increase their borrowings from the banks in order to expand production. Such credit expansion is not only desirable but essential. But as soon as the nation's productive resources are being fully utilized the further expansion of bank credit cannot increase total production; it serves merely to increase the market competition for the already fully employed men and materials.

(e) *Increased rapidity of expenditure of funds.* When price inflation has reached an advanced stage a tendency develops for individuals and corporations to spend or invest their cash balances more quickly than they would

under ordinary conditions, because of their anticipation that prices will rise still further. As this tendency develops a given amount of money will support a higher and higher price level. This propensity was only a minor factor in our own wartime inflation, but a very important one in the more extreme inflations that developed in various European countries. The danger is much more serious in the United States at the present time than would ordinarily be the case, because of the unusually large volume of bank balances and the abnormally low rate of turnover which has developed during the long depression.

As the war mobilization progresses to the boom stage, the factors which we have been discussing tend to reinforce one another, and by a cumulative process bring about the familiar spiral of rising prices—rising costs—rising prices. The increase in prices creates “windfall” profits for business men; the rising cost of living stimulates further demand for wage increases; rising values of securities and of real estate and other properties, together with increased profits, expand borrowing capacity; which in turn encourages banks to expand loans still further.

III. EFFECTS OF PRICE INFLATION

Thus far we have been concerned only with describing the process by which war mobilization ordinarily brings about a great rise in prices. We are now ready to consider the effects of this price inflation.

1. *Does price inflation tend to expedite or to retard effective mobilization for war?*

The only point at which credit expansion (as compared with a program of financing out of taxes and out

of loans that are not supported by bank credit expansion) is likely to be of positive aid in bringing about mobilization is at the very outset of the mobilization program. If, as is the case in the United States today, there is a large volume of unemployment, both of men and of capital equipment, the addition of funds to the income stream facilitates the restoration of full business activity. And if the new money comes in through government expenditures it will, of course, tend to direct the added effort immediately into the mobilization program.

Beyond the early stage when the total volume of productive effort is still increasing, any further increase in the money stream does nothing to promote the mobilization program and its indirect consequences are adverse. This is because in an inflationary movement the increases in prices, profits, and wage rates are highly irregular and lead to endless controversies over wages, public utility rates, and "profiteering."

2. How does price inflation affect the distribution of the war burden among the various groups in society?

The inflation process creates arbitrary and useless changes in the distribution of income, bringing about an irrational allocation of the economic burden of war between different members of the community. Some lines of business obtain great increases in profits as a result of rising prices, while others, particularly regulated industries such as railroads and public utilities, suffer a reduction of profits or actual losses. Labor groups in a position to obtain constantly increasing wages may gain, while other labor groups, less fortunately situated, suffer. Most salaried groups suffer severely. Those receiving profits and dividends may gain, while receivers of interest and fixed rents lose. In short, when inflation occurs, real

purchasing power is taken away from individuals, not only to make it available to the government, but also to enrich other individuals. Although the illusion of prosperity caused by rising money incomes may temporarily make for greater satisfaction, the process cannot go far without creating widespread social discontent and cleavages, which militate against the united prosecution of the war.

3. *Does price inflation serve to increase or decrease the cost of a war to the nation?*

It is obvious that to the extent that the prices of essential war materials rise the cost to the government *in dollar terms* is increased. However, since this increase is offset by a proportional increase in the aggregate national monetary income, it would not be of real importance if the new price level were maintained after the war. (See below, question 4.) The immediate effect upon the cost of the war is found in the slowing down of the war mobilization program and the losses involved in the suspension of work as a result of strikes and the absorption of energy in trying to settle controversies and maintain the national unity so necessary to the successful prosecution of the war. The longer the war has to be continued the greater is the ultimate cost and suffering.

4. *What is the economic aftermath of wartime price inflation?*

The situation at the end of and following a war is complicated in two ways. (a) The specialized character of the production and price structures which have developed during the war necessitates, when war demands cease, extensive readjustments in the whole structure of industry. The prices of certain types of commodities may

be expected to rise somewhat, but in most of the important war lines sharp and extensive declines of demand will appear more quickly than corresponding increases in peacetime demand. A reorganization of industry, with accompanying changes in prices, becomes necessary—either immediately or within a relatively short period. This would be likely to cause depression even if there had been no inflation. But inflation makes the situation much worse, because it is always assumed, on the basis of past experience, that the general level of prices will in the not distant future inevitably fall to something approaching the prewar level. This expectation, often supported by a government policy which aims at restoring a prewar monetary standard or a prewar price level, greatly increases the difficulties of postwar readjustment.

(b) Inflation and the consequent high level of costs increase both public and private debt beyond what they otherwise would have been. If the wartime level of prices and incomes continued after the war, payments on the debts could be met without any more difficulty than if there had been no inflation, but with the fall of prices and incomes the burden of debt becomes correspondingly heavier.

5. Does government borrowing through bank credit expansion shift the burden of a war to future generations?

At first thought it might seem that if the public as a whole provides out of current income only a portion of the funds required by the government the balance of the cost is being shifted to postwar years. Closer analysis indicates, however, that, whatever method of providing funds is employed, the full costs of the war in terms of the material factors involved must be borne during the

struggle. Except to the extent that resources are obtained abroad (by borrowing or by exporting cash and securities), the people of the nation have to furnish, during the war, the necessary fighting forces and the necessary munitions, materials, and supplies; these cannot be left for the next generation to provide.

6. Is it possible to finance a war entirely from taxes and from loans paid out of current income?

The answer is clearly *yes* in the case of a minor war or a short conflict waged largely from accumulated munitions and materials. In the case of a major struggle involving total mobilization it is probable that the Treasury could not collect the necessary income through taxes quickly enough to meet the emergency requirements. It is also possible that the sale of bonds, requiring voluntary co-operation, may meet with resistance; and in any case there will be some lag. Moreover, because of inevitable shortcomings in administration, the receipts from taxes and public loans are not likely to keep pace evenly with expenditure requirements. Accordingly some temporary borrowing from banks will be necessary. This need not involve any harmful expansion of credit if the credits are shortly liquidated out of the proceeds of bond sales and the latter are not effected through bank expansion. The bulk of the funds required could undoubtedly be raised from current income during the course of the war—if the necessity of thus raising it were clearly recognized by the fiscal authorities, by Congress, and by the public.

At the present time, the fiscal situation is of course seriously complicated by the fact that the present war emergency arises at a time when we already have a fiscal deficit of several billion dollars.

IV. STEPS NECESSARY IN ORDER TO CONTROL PRICES

If an extensive rise in prices during wartime is to be prevented, it is obvious that price controls must be imposed at the spots where the price advances begin. The preceding analysis has indicated that there are a number of sources or causes of price disturbance. Each of these must be considered separately.

1. *The funds required by the government in financing the war should be obtained as far as possible from taxes, and from loans paid for out of current income.*

As was shown above, to finance the war by means of bank credit expansion gives the government purchasing power without taking away a corresponding amount of money from the public, with the result of rising prices, increased costs to the government, increased profits, and a diminution of the purchasing power of salaries, savings deposits, and all fixed incomes. An expansion of bank loans to industry after the existing plant and equipment and labor force are fully utilized has a similar inflationary tendency.

2. *Government purchases should not be made on the principle of paying whatever price is necessary to take supplies away from competitors.*

The War and Navy Departments should not be given blank checks with which to compete against each other on a price basis for limited supplies of materials. Nor should the military establishment as a whole compete on a market price basis with private enterprise for scarce materials. Contracts should be made so as to yield a reasonable return to producers rather than on a basis of what the emergency market situation might make possible.

3. *Some utilization of price as a means of procuring the additional output required is necessary, if private enterprise is to be maintained.*

But prices paid by government for essential war commodities which happen to be scarce should not be allowed to rise sufficiently to cover the cost of the higher-cost producers. As was shown by experience during the World War, in many cases such a policy enormously distorts the price structure merely for the purpose of calling forth a small additional output which could readily be procured by other means. (Compare pages 65, 132.)

4. *Some control of prices in private commercial markets is necessary.*

If effective price controls are applied at the sources of disturbance, as was indicated in Section III, the possibilities of a general price inflation will be substantially eliminated. It remains probable, however, that the prices of some types of commodities purchased by the general public may increase as a result either of unusual demands for scarce products or of rising costs of production. It is not necessary or desirable to perpetuate rigidly a peacetime price structure which no longer fits the facts. But the price-control authority of the government must be prepared to investigate the propriety of such price advances, and to intervene in cases where the price advance serves no social purpose except to enrich those lucky enough to control the scarce commodity, at the expense of the rest of the community.

5. *What about the plan to establish a "price ceiling" for all prices at the outbreak of a war?*

The answer is, first, that the plan does not touch one of the most important causes of price advance—namely,

fiscal inflation. Since it does not prevent the operation of a primary inflationary force, nearly all prices may in due course be expected to go through the ceiling if sole reliance is placed upon it. However elaborate the administrative machinery that is established, the price control will be inadequate because it does not strike at a primary source of the difficulty.

In the second place the plan is indiscriminating. It does not sufficiently recognize the need for a wartime price structure that is appropriate to war conditions; it tends merely to freeze the peacetime structure. In the third place, it would create an enormous and probably impossible administrative task at a time when the administrative resources of the government are urgently needed for more important tasks. (Compare Chap. VI.)

7. Is the view sound that high prices do not really matter since the resulting increase in profits can readily be recaptured by the government in the form of excess profits taxes?

In the absence of inflation, a properly drawn excess profits tax may serve a useful purpose by lopping off the major part of the windfall gain which results from unnecessarily favorable government contracts, or from other developments that put individual firms in a position to benefit from the wartime readjustment of industry. It cannot, however, prevent the adverse effects of an inflationary fiscal program which we have just pointed out. It will not correct the tendency of inflation to impair the speed and efficiency of the mobilization program. It will not remove the inevitable tendency of inflation to throw an unnecessary and inequitable burden on certain classes in the community, nor will it in the least reduce

the aftermath consequences of inflation on the process of postwar readjustment.

Moreover, the greater the rise in the price level, the more meaningless become comparisons of wartime profits with prewar, or calculation of invested capital, as a base for determining what are the "excess" profits. Hence inflation makes it impossible to distinguish accurately the genuine increases in profits from those which merely reflect the shrinkage in the purchasing power of the dollar, and therefore makes the excess profits tax itself a likely source of new injustices.

The conclusion to which our analysis leads is that a serious inflation of prices in time of war can be prevented. The explanation of the great price inflations in past wars is to be found in part in an unsound fiscal policy, in part in the unrestrained use of the competitive price mechanism as a means of bringing about war mobilization, and in part in the adoption of faulty principles of price control when finally the necessity for control was discovered.

V. ADMINISTRATIVE MACHINERY REQUIRED

The control of prices along the lines suggested requires the development of co-ordinated administrative machinery. It cannot be satisfactorily accomplished by a series of price-control agencies, operating independently of one another, nor can it be accomplished by a central price authority unless such authority envisages the problem in all its aspects and articulates the whole in a unified program. Moreover, the program must be co-ordinated from the very beginning of the mobilization program. (See Chap. V.)

PART I
PRICE CONTROL IN TIME OF WAR

CHAPTER I

NATURE AND SCOPE OF THE PROBLEM

Before beginning the discussion of the concrete problems involved in the control of prices in wartime, it is desirable that we orient ourselves by a brief consideration of the character of the so-called price system and the nature and scope of the problem with which we have to deal. What is the function of the price mechanism in the operation of the economic system in ordinary times of peace? What are the types of prices that should be embraced within a program of wartime control? What are the major sources of price disturbance? What are the principal forms or methods of control?

The general function of a price and profit system under ordinary peacetime conditions is to guide human effort and material resources into those productive channels in which the demand, as measured by willingness of someone to pay a price, is greatest. Stated in another way, rising prices and profits in any given line of industry lead to expansion, while falling prices and profits lead to contraction. The product resulting from economic activity is also distributed among the various claimants in the form of the prices paid for services—that is, wages, salaries, rents, interest, and dividends.

It should be noted, however, that even under normal peacetime conditions we no longer place exclusive reliance upon an unregulated price and profit mechanism to determine the allocation of human energy and the distribution of the national income. Upon some divisions

of industry the government has imposed direct controls of various kinds which make the allocation of productive energy and the distribution of income different from that which would result from unrestricted competition. Taxes, tariffs, the regulation of utility rates, restrictions on "unfair" competition, subsidies, wage and hour laws, special regulations such as the Bituminous Coal Act—all these and many more combine to produce a pattern of economic effort and of income distribution which is different from that which would exist under a completely free price and profit mechanism.¹

The problem of economic organization in time of war differs from that in time of peace in that it is essential to concentrate productive energies on an abnormal emergency objective—that of winning the war. The question therefore arises as to whether it is possible to realize this objective most speedily and economically by reliance upon the ordinary price and profit mechanism for allocating the nation's productive resources.

It should be noted at this place that prior to the world conflict of 1914-18 governments usually relied mainly upon the financial mechanism to obtain the materials and supplies required in time of war. That is to say, they used the money at their disposal—derived from either taxation, borrowing, or the printing press—to outbid other governments or individuals for the necessary supplies. Rising prices and profits in war lines were depended upon to attract additional labor and capital and bring a gradual increase in the production of the necessary implements of war.

During the early stages of the World War most of

¹ See Leverett S. Lyon, Victor Abramson, and Myron W. Watkins, *Government and Economic Life* (Brookings Institution, 1939), Vol. 1, pp. 10-13.

the belligerents again relied primarily upon the financial mechanism to procure the necessary supplies, either from abroad or from internal sources, but as the struggle developed into a war of resources and attrition, every nation deemed it necessary to lessen its reliance upon the price and profit mechanism and to establish more and more mechanisms for the purpose of preventing price distortions which militated against the effective prosecution of the war. The United States, in its turn, came increasingly to allocate resources by granting priorities in access to transportation, raw materials, and fuel, and to limit the rise of prices by government regulations under the Price-Fixing Committee of the War Industries Board and the Food and Fuel Administrations.

The present European war witnessed at the very outset the establishment of extensive price-control machinery in all the belligerent countries. In Germany the ordinary price mechanism has not been allowed to operate at all—though producers of war supplies are permitted to make some profits. In the democratic countries price control has been less rigid and less universal, but it may nevertheless be said that price control on a broad scale was conceived to be essential to the successful prosecution of the war.

The problem before us is clearly not whether there should be any price control in time of war. It is rather, "What should be the extent and character of the necessary price controls?" The answer to this question must, of course, wait upon the analysis contained in the following chapters.

I. TYPES AND PURPOSES OF PRICE CONTROL

Price control, both in our World War experience and in the thought of most of those who have discussed the

problem of price control in the event of another major war, is connected with two quite distinct types of activity. First, it relates to the prices paid by the government and its contractors and subcontractors for commodities and services which are needed by the government in the prosecution of the war. The second type of control relates to the prices charged by individuals in their dealings with one another, either within the country or across national boundaries.

Price determination in connection with the government's own purchases may take several forms. First, there is the case in which a single government agency establishes either a precise or a maximum price for the use of all governmental or quasi-governmental purchasing agents, without any compulsion on sellers to accept the price stipulated. A second case is one in which the seller is not free to reject an offer, either because his goods or services are actually requisitioned, or because he bargains under the threat that compulsion will be used if necessary. It is to this type of control that the term "price-fixing" is most applicable. A third case is one in which a minimum price for all producers is established and supported by government guarantee.

There is no debate as to the desirability of the first type of control, which is simply centralized bargaining. The purposes of such control are to keep down the money cost of the war to the taxpayers by eliminating competitive bidding between different government purchasing agencies; to relieve purchasing officers of the burden of investigating costs and other factors which determine the proper price, much of which would be duplicated by different purchasing agencies in the absence of centralized control; and to forestall public resentment against those who actually or presumptively

are extorting from the government prices that are excessive in comparison with cost.

Price-fixing in the second sense, that is, the offer of a price coupled with compulsion to sell, is a method by which the state insures the necessary shifting of labor and other resources from peacetime channels into war effort. Conscription, commandeering, requisitioning, compulsory orders—all involve either price-fixing or confiscation.

Price-fixing in the third sense, the establishment of a guaranteed minimum, is found only in exceptional cases. It is most likely to be useful when the number of producers is so large that it is not feasible to insure the necessary effort by separate individual contracts, or compulsory orders, and when the period of production is so long or the necessary investment so large that private individuals hesitate to make commitments for fear the war may end and the demand collapse before they can market their products. An alternative means of meeting this situation is for the government to assume the risks involved by advancing the capital and paying the company a management fee for the service rendered. This, however, can hardly be used when the producing unit is very small, as for instance in farming.

Control over prices paid by private individuals in their dealings with one another obviously rests on an entirely different footing from control over those paid by government. Prior to the World War there was in the United States practically no control over civilian prices during periods of war, though other countries had experimented long before with price maxima.² The

² A notable instance was the law of the maximum enforced during the French Revolution.

reasons generally advanced for special wartime controls over the prices paid by private individuals in their dealings with one another may be stated briefly as follows.

First, war is likely to bring about such acute shortages of particular commodities that the uncontrolled price would rise far above the level necessary to bring about an appropriate increase in the production of the scarce items. Second, wars have generally led to fiscal and monetary inflation, accompanied by large irregular increases in the prices of commodities which are not scarce—increases which serve to disrupt commerce rather than to direct effort into the production of the things that are most urgently needed. Third, rapid price increases, whether due to shortage or to inflation, give unnecessary windfall gains to shrewd and lucky individuals and these profits tend to undermine civilian and military morale, because people believe that they are being called upon to make sacrifices which do nothing but enrich others. Fourth, price control is designed to distribute the burden of war more equitably—specifically, to throw more of the real cost of the war on the rich by preventing them from bidding up the prices of the things that are scarce to a point where they will get more than they could get under the scheme of regulation. (Of course, for this purpose price regulation must usually be combined with some sort of rationing; if we merely hold prices down and put no limits on the amounts that individuals can buy, the rich still have an advantage.) Fifth, it is believed that a great rise of prices under war conditions increases the probability of a disastrous collapse after the war, with an attendant severe depression.

The validity of these points of view will be considered in the course of our analysis. It will be useful, however,

to indicate at this point the several forms of control which have been utilized or proposed. These may be classified as follows:

1. Fiscal and monetary controls, including treasury policies with respect to taxation and borrowing, and bank credit policies.
2. Direct selective control of individual prices.
3. Indirect control through increasing the supply of goods and services.
4. Control by fixing a general "price ceiling."

In the analysis presented in the succeeding chapters, we shall consider the merits and the relative importance of these various methods of price control. First, however, some attention must be given to the causes of wartime price advances.

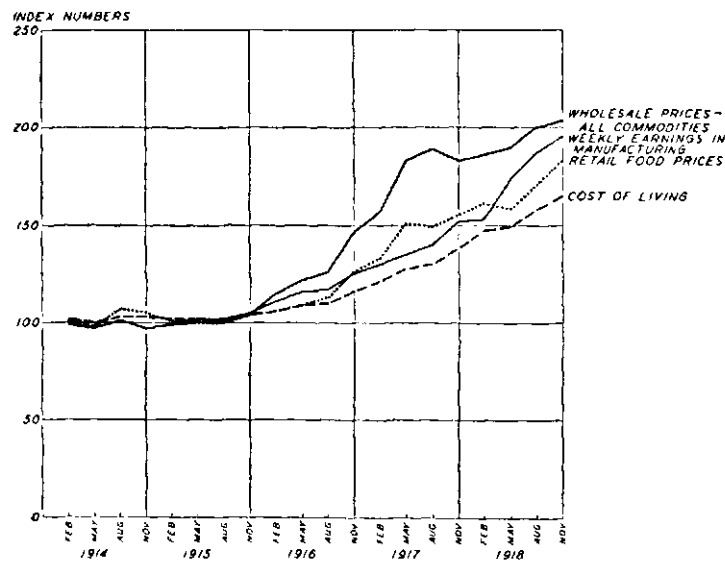
II. SOURCES OF WARTIME PRICE ADVANCES

The phenomenon of rising prices during war arises from two essentially different sources. These must be carefully distinguished if we are to avoid confusion in thinking about them. First, there are *specific* price increases which result from changes in the demand and supply situation with respect to particular commodities. Second, there is a *general* increase in prices extending in greater or less degree to all commodities and also to wages, rents, and security quotations. This is the phenomenon commonly known as *inflation*. It involves an expansion of the total money income of the nation without a corresponding increase in the volume of production. The extent of the inflationary advance which occurred during the World War is indicated in the chart on page 28.

Numerous factors may serve to increase the prices of particular commodities. The most immediate and im-

portant are the extraordinary demands of the government for materials and supplies essential to the war program. Speculative activities in the commodity mar-

GENERAL PRICE MOVEMENTS DURING THE WORLD WAR*



* Wholesale prices, U. S. Bureau of Labor Statistics, *Wholesale Prices, 1890 to 1919*, Bulletin No. 269, pp. 17-19; weekly earnings, P. H. Douglas, *Real Wages in the United States, 1890-1926*, p. 239; retail food prices, U. S. Bureau of Labor Statistics, *Retail Prices, 1913 to December, 1919*, Bulletin No. 270, p. 27; cost of living, National Industrial Conference Board, *The Cost of Living in the United States, 1914-1926*, p. 182.

kets and in the stocking up with inventories may hasten the process. There may also be an acute shortage in certain lines as a result, for example, of the curtailment of imports of essential commodities, or the inability of manufacturers in certain lines to obtain the necessary raw materials or skilled labor supply. Rising costs, owing

to increased prices of scarce materials or labor, also contribute to the process.

In a wartime rise of prices the picture is confused by the fact that shortages are abnormally numerous, while income inflation is also almost always present. Under war conditions, even without any increase in the available supply of money or in the rate of expenditure of existing funds, the demand for copper, iron, ships, and guns would rise, but other things would fall because expenditures on them would have to be curtailed. With inflation, the demand for almost everything, as measured in dollars, increases. Shortage results in certain prices' rising more than the general rise, but since the general rise can be measured only roughly, it is impossible to distinguish precisely the effects of inflation and of shortage. Nevertheless, any considerable amount of inflation or any serious shortage can be identified, and it is not important that the apportionment of their respective responsibilities for a price rise be exact. The broad distinction is important in determining the desirability of control and the type of control which is appropriate.

Analysis of the general inflation process requires consideration of factors or influences lying quite outside the realm of specific commodities. The increase of money income in the hands of the people arises chiefly from increased disbursements in the form of wages and dividends or profits. An increase in profits and wages may result merely from an increase in the volume of business and employment accompanying the taking up of slack existing at the outbreak of the war. It may also result from rising prices or increasing wage rates. In either case the increased purchasing power in the hands of the consuming public serves to create a "sellers' market" conducive to price advances.

Involved in these developments are the policies employed by the Treasury in financing the war and by banking institutions in extending credit. If the Treasury undertakes to finance the war by the printing of paper money, which becomes available for the Treasury's use without any reduction in the purchasing power already in circulation, the total supply of money increases relatively to the supply of goods in general. The result is similar if the Treasury procures the money by borrowing from the banks. This increase in purchasing power might be prevented from directly influencing general commodity prices by means of taxation. That is to say, it could be diverted from the consumer markets to the Treasury. This is why fiscal policy is of such far-reaching importance.

The inflationary process, once under way, tends to become cumulative in character. Rising prices, no matter how or where they originate, tend in due course to lift the level of costs all along the line. This higher level of costs, which affects both government and private purchases, calls for increasing quantities of bank credit expansion. If bank credit policies are distinctly liberal in character, the inflationary process is stimulated. In Chapter II we shall discuss the nature of the inflationary process, the various procedures that are necessary to control it, and the forces that contribute to its development.

CHAPTER II

CONTROL OF PRICES THROUGH FISCAL AND BANKING POLICIES

Discussion of the problem of wartime price control should begin with an analysis of fiscal, monetary, and banking policies. This is because these policies are usually among the most important sources of price disturbance and because they are so commonly overlooked by administrative agencies charged with responsibility for checking wartime advances in prices.

As a preliminary, a brief statement is necessary as to the significance of money in the mobilization of a nation's resources for war purposes. There is a tendency on the part of the public to regard money and credit as the vital factors in the winning of the war. The appropriation by Congress of billions for the defense of the nation is a matter of great satisfaction, for it is assumed that, once the government is provided with sufficient revenues, the success of the mobilization program is assured. Treasury officials and loan campaign orators, emphasizing the paramount necessity of making the campaign a success, naturally contribute to the impression that money is of primary significance.

The truth of the matter of course is that money is not one of the direct sinews of war, for it cannot be used by the fighting forces. Money is of importance only in so far as it assists in the effective mobilization of the nation's resources for war purposes. Under certain circumstances it may be used to purchase imports,¹ but in

¹ Compare pp. 48-51 below.

the main its function is merely to facilitate the process of speeding up domestic production and shifting productive activities from peace to war lines.

While money and credit operations are thus but incidental features of the war mobilization program, it remains true that fiscal, monetary, and banking policies may have a profound influence upon the level of prices and upon the distribution of the burden of war costs and the efficiency with which the war program is carried out.

I. METHODS OF WAR FINANCE

There are three ways in which a government may finance its wartime expenditures: by taxation, by borrowing a part of the current national income without expanding it, and by the creation and expenditure of new money. Under the first method, the Treasury simply collects taxes, which are ordinarily paid out of current income. The effect is to restrict the income of the public available for consumptive expenditures or private investment by the amount of the tax collected. Under the second method the Treasury endeavors to induce the public to part with a portion of its income through the offer of government obligations carrying an interest return. As in the case of taxes, such purchases correspondingly reduce the funds available for other purposes. Instead of spending money for consumer goods or investing funds in private enterprises unrelated to the war, we turn money over to the government for its use in purchasing, or inducing the production of, essential war materials.

The creation of new money with which to finance a war may be accomplished in more than one way. The simplest method is to have the Treasury print its own promissory notes and pass these out in meeting its financial requirements. In former times this method was the

one usually employed. It was used almost exclusively by the American Revolutionary government and by the Confederate States of America, and it was extensively employed by the Union during the Civil War. In more recent times, however, the customary practice is for the Treasury to sell its obligations to the banks, and accept in exchange for them deposit credits against which the Treasury can draw in meeting its requirements. To facilitate the operation, the banks are permitted and encouraged to expand their total assets and liabilities instead of lending only what they can divert from other uses. Sometimes the process is refined one step further—the Treasury selling its obligations to the public and the public borrowing the funds from the commercial banks. This method was extensively utilized by the United States during the World War. While this refined method is called *borrowing*, it amounts simply to the creation of new money. To the extent that the total volume of deposits expands, the process does not involve any diversion of funds from private to public channels.

A concrete illustration will serve to indicate how the third method operates. If the prewar income of a nation for a given period is 100 billion dollars and the government wishes to divert to war use one-tenth of the productive capacity of the country without levying taxes or confining its borrowings to current income, it may accomplish the purpose by creating and spending new money to the extent of something between 10 and 11½ billion dollars.² The expenditure of this additional

²The exact effect under any method is unpredictable, because of the indirect effect of the government's operations on the rate of expenditure of income by individuals. For instance, under the third method, while the creation of exactly 11½ billion dollars of new money would be necessary to give the government control of one-tenth of the available purchasing power, it does not follow that the funds would actually buy exactly one-tenth of the goods and services available. If there were no increase of production and no depletion of inventories this is the

money enables the government to obtain a portion of the national output of goods and services—with the result that there is available to the public a reduced volume of goods and services. The effect of this method is to generate what is known as “inflation” of the total money income, the results of which are considered in a later section of this chapter.

If banks are allowed to expand credit sufficiently, any amount of bonds can be sold, either to the banks themselves or to customers who borrow to buy, and the deposit currency expanded correspondingly. The competition of these new deposits, when spent by the government, reduces the spending power of the holders of old deposits, and thus restricts both consumption and investment,³ just as the printing of new currency would do.

amount that would be necessary, and prices would have to rise by $11\frac{1}{6}$ per cent. However, in the early stages of a program of expanding government purchases in this way there is likely to be some depletion of inventories, and following that some expansion of output, both of which tend to slow down the rate of the price rise and enable the government to secure possession of one-tenth of the output at the previous rate with a smaller creation of new money. To the extent of the depletion of inventories the former holders of those inventories are substituting cash balances for commodity stocks; it is only as these cash balances are expended that either the increase of production or the increase of prices is to be expected. Moreover, the increase in the flow of money incomes is likely to stimulate some additional saving in the form of unexpended balances in the hands of the community at large, which will increase the tendency for the price changes to lag behind the rate of money expansion. On the other hand, at a later stage of inflation, when the slack in productive capacity has been taken up and an expectation of further price increases becomes general, the price rise is likely to run ahead of the rate of expansion of money because of efforts of the population to reduce their cash holdings below the usual level, and accumulate things that will rise in price. In the later stages of violent inflations the rise in prices far outruns the expansion of money. At the peak of the German inflation of 1923 prices appear to have been inflated by about 30 times the ratio of monetary expansion.

³ Other than “investment” in cash balances.

The only money which the government can borrow in the absence of inflation is the fraction of income that is saved at the old level of prices and incomes, which may be figured at something like 15 per cent of national income produced under prosperity conditions. Not all of this is available for lending to the government, though the proportion may be raised by restricting alternative channels of investment. If more than the amount available is needed, resources must be diverted to the government from income that would otherwise go for consumption, which means, if inflation is to be avoided, either taxation or increased saving. The volume of saving can be augmented slightly by the offer of attractive interest rates, by appeals to patriotism, and by restricting the volume of goods and services that are available for consumers' use.

II. WHY INFLATIONARY METHODS ARE USED

In view of the unbroken line of precedents of inflation in the financing of major wars, it may be worth while to review briefly the reasons why inflationary methods have been used, in spite of the general agreement that their consequences are unfortunate.

Except in the case of postwar Russia, where an inflation was planned as a means of expropriating a propertied class, there is probably no case in modern history where inflation resulted from a deliberate decision to finance the government by creating money in such quantities as to lead to a major price rise. It is a policy which governments drift into, not one which they choose. What happens is that treasuries, confronted by urgent demands for funds, use on a larger scale the same procedures which they have been using in time of peace, and discover too late that they do not work in the same way as before.

Then, because of a lack of advance planning, and because they are held responsible for raising the money and not for the ultimate consequences, they do not take the necessary steps to check the inflation. Soon it reaches such proportions that it cannot be controlled, at least without the risk of hampering the war program.

Tax systems are somewhat rigid, and cannot be expanded fast enough to take care of the initial expansion of government activity. Borrowing is necessary⁴ and the easiest way to borrow is to put securities directly or indirectly into the banks. This indeed is a standard peacetime practice. No attention is paid at first to the fact that the enlarged volume of borrowing may be making it necessary for banks to expand rapidly the total amount of credit, whereas the ordinary peacetime borrowings have been effected by allocation of the existing volume of credit or by an expansion too slow to be harmful.

At first, indeed, the rising level of money incomes may help to speed up the reabsorption of unemployed resources into the productive process, and is certain to create a general feeling of prosperity. By the time the ill effects of inflation are apparent, the process has acquired such momentum and administrations have committed themselves to inflationary methods to such an extent that a reversal is not seriously attempted before the end of the war. Then a deflationary program is instituted, in order to restore some previous value to the currency at a time when industry, instead of being supported by war demands, is suffering the pangs of readjustment to a peace economy.

III. THE RESULTS OF INFLATION

The case against inflation rests in part on its inefficiency as a method of winning a war. The mobilization

⁴ Compare above, p. 13.

of human and material resources does go on under an inflationary financial program, but, as was noted above (pages 10-11), the process gives rise to much otherwise unnecessary friction and consequent impairment of national unity.

Beyond these considerations, a fatal objection to inflation is its disturbing effect on the allocation of the economic burden of war among different members of the community. The effect of inflation does not stop when the government has created and spent a given amount of money. For so long as the new money remains in the channels of circulation the whole level of money incomes and prices, though it is likely to recede somewhat, will remain higher than it was before. This would be of small consequence if the rise were uniform and if debts and contracts were automatically adjusted. But this is never the case. Some forms of income rise quickly and some very slowly. Thus purchasing power is taken away from individuals, not only to make it available to the government for war purposes, which is necessary, but to enrich other individuals—and not merely those whose services are most valuable or require the greatest reward to call them forth.

Inflation not only creates unnecessary profits for some, but it makes them appear larger than they really are, and on both counts it undermines the morale of those who do not share in them. It dries up the incomes of public servants, both military and civilian; it depletes the accumulated savings of the thrifty, especially those in moderate circumstances whose savings have taken the form of loans, savings deposits, life insurance policies, and the government bonds; it cripples public utilities by pushing their costs up, out of line with the rates under which they are required to operate.

If the new money is withdrawn from the channels of

trade after the price and income structure has been wholly or partially adjusted to it, the price level can be pushed down again, but the result is not to redress the injustices, but to start another series of inequitable transfers of wealth, and to increase greatly the burden of public and private debt. In addition, the contraction of money tends strongly to discourage productive activity.

The disastrous effects of deflation usually occur after the war is over. It is not suggested that either wartime inflation or postwar deflation is the sole cause of the usual postwar depression. The phenomenon is partly due to the inevitable readjustments involved in discontinuing production for war purposes with attendant unemployment of men and resources. But it is accentuated by the reaction from inflation, and prolonged by the increase in the burden of debt. The latter factor was especially important in the long-continuing distress of agriculture in both America and Europe following the Napoleonic wars, the great wars of 1857-70, and the World War. The time for deflationary fiscal and credit policy is during the war, when the trend is strongly upward; after the war, conditions are hard enough at best without the added burden of fiscal and monetary deflation.

IV. A NON-INFLATIONARY PROGRAM

We must now ask what, as a practical matter, can be done to forestall inflation in the event that a major war effort becomes necessary. The answer involves two phases of policy, fiscal policy and bank credit policy; and these must be considered separately, though in practice it is impossible to divorce them from each other.

Fiscal policy. The traditional program, always recom-

mended and never followed, is to finance the war entirely out of taxation, to the end that the expansion of war expenditure may be balanced by a corresponding curtailment of expenditure for other purposes. It is argued that the burden to be borne by the public during the war is no greater if all funds are raised by taxation than if part are borrowed. And it is true that the same proportion of total income is needed one way as the other. If 25 per cent of national effort is needed, and inflation is to be avoided, we can take 25 per cent of income by taxation and reduce purchasing power for civilian purposes by 25 per cent, or we can try to induce the public to save one-fourth of its income to buy Liberty Bonds, or we can combine the two methods. The income available for non-war purposes would be reduced by the same amount by either process. The financing of war through bond issues does not mean that the aggregate burden of the war is shifted to a future generation. It merely means that after the war a part of the public, the holders of bonds, are entitled to reimbursement from the proceeds of taxes levied on the public at large. The war itself still has to be fought with the physical resources available at that time. This is not a decisive argument against moderate borrowing; there are, in fact, some advantages in it. For one thing, as was pointed out on page 13, it is administratively impossible to keep an even flow of taxes coming in to balance expenditures. For another thing, there is less resistance to the absorption of income through the borrowing method than through exclusive reliance on taxation.

The possibilities of non-inflationary borrowing are genuine, though limited. If the limits are not to be exceeded there must be heavy taxation, but it is not necessary to go to the extreme of ruling out borrowing en-

tirely.⁵ The important thing is the source of funds, not whether the forms of taxation or of borrowing are used to obtain them. What is essential is that the funds shall be drawn from the existing income stream, not created to swell that stream, beyond the extent to which expansion of money income is balanced by an expanding output of goods and services. In other words, the initial stages of war effort, when borrowing is most necessary because tax yields cannot be increased immediately, is just the stage when credit expansion will be serving a useful purpose. This brings us to the second phase of our problem, credit policy.

Control of bank credit. The real danger to the price structure in a program of war finance is not in government borrowing in and of itself, but in the corroding influence of an extensive borrowing program on the standards under which the credit structure is supervised. Modern banking systems are highly elastic, tending at times to expand and at other times to contract, with disastrous consequences from both tendencies, if they

⁵ Incidentally, under present conditions a very substantial fraction of the cost of an armament program would be automatically covered by the rise in the yield of existing taxes which would result from a rise of industrial activity to the 1929 level, without any rise of prices, and another large fraction could be covered by diverting to war uses funds now used for CCC camps, WPA projects of peacetime character, unemployment benefits, and the agricultural program. We estimate that taxes at 1939 rates would furnish about 4 billion dollars more revenue with full industrial activity than they actually yielded in 1939, and that 3 or 4 billion more dollars could be diverted from the present budget to defense effort without impairment of the general standard of living, if employment were as abundant as it was in 1918. Beyond 7 or 8 billion dollars, if inflation is to be avoided, the cost of war effort must be met mostly through new taxes, paid by curtailment of non-war investment and of present standards of consumption. This achievement would still leave the current deficit in the budget as large as it is now, but such a deficit would probably be covered by non-inflationary borrowing, though higher interest rates would presumably have to be paid.

are carried to extremes. To mitigate both the inflationary and the deflationary possibilities that inhere in an elastic credit system, central banking institutions (in this country the Federal Reserve System) have been set up with the responsibility, and to a less extent the effective power, to minimize these movements.

The standards under which central banks operate are ill defined,⁶ but they do invariably recognize the duty of preventing, so far as they can, any extreme fluctuation of the price level (in the absence of a change in the monetary unit). And they are equipped with powers which, though inadequate to insure a high degree of stability, do enable them, in peacetime, to put brakes on the pace of a boom. In the United States these powers involve control over the volume and availability of bank reserves, through rediscount and open market operations, and in recent years authority to change the reserve requirements of member banks of the Federal Reserve System. Although the great growth of excess reserves in the commercial banks during the past eight years has weakened these controls, they are still probably adequate, if the reserve authorities wished to use them and were free to do so, to check an inflationary boom before it became dangerous. If they should prove inadequate, it would be easy to strengthen them.⁷

The real difficulty in the way of preventing a great expansion of bank credit does not lie in a lack of machinery for control. It is the conflict between the maintenance of credit standards and the convenience of the Treasury. If the Treasury elects to follow the traditional

⁶ Compare Charles O. Hardy, *Credit Policies of the Federal Reserve System* (1932), especially Chaps. I and II.

⁷ For instance, by allotment of quotas of uncovered deposits to individual banks, with freedom to lend or sell them, and requiring 100 per cent reserves against excess deposits over the quota.

practice of financing the war by borrowing huge sums beyond the amount that will be saved out of current income and voluntarily invested in government bonds, it must have recourse to the expansive powers of the banks, and induce or require the reserve authorities, if they disapprove, to keep their hands off.⁸

Regardless of whether the restraints on credit expansion are to be exercised by the Board of Governors of the Federal Reserve System, by the Treasury, or by some specially created war finance authority, the vital question is the standard by which action is to be guided. It is important that mobilization be not impeded even for the sake of preventing inflation. It is not essential that the budget be "balanced." It is not even essential that all government securities be floated without the aid of the banks. They can play a useful part as "go-betweens." But it is necessary that they shall not be made the tools for the manufacture of a vast sum of new money. We already have more than enough to finance full employment at the present level of prices.

The proper standard of both credit policy and fiscal policy, if a war is to be fought without inflation, is not the size of the government deficit or the total volume of government debt, or the absolute amount of credit outstanding, but the movement of the price level.⁹ For

⁸ During the World War the Federal Reserve Board at first made some effort to restrain the use of new bank credit in the purchase of government securities, and was advised by the Secretary of the Treasury that its failure to co-operate might make it necessary for the government to take over all the funds in the banks, H. Parker Willis, *The Federal Reserve System* (1923), pp. 1155, 1205.

⁹ We do not agree with the view that under peacetime conditions fiscal and monetary policy can properly be guided exclusively by moderate changes of prices, as was suggested by many critics of Federal Reserve credit policy in the twenties. Such factors as volume of employment, the accumulation of inventories, international movements of gold, and fluctuations of the exchanges must be given due weight. But under

this purpose the cost of living index seems to be far preferable to any other measure of the price movement in common use, first, because it will not be distorted by shortage prices of the very sensitive basic materials which enter heavily into the so-called wholesale price indexes, and second, because the cost of living index is much superior to the wholesale price index as a measure of the purchasing power of income, which is what we are interested in stabilizing.¹⁰

It may be added that a policy of credit restriction and monetary stabilization in time of war is entirely consistent with the spending-lending policy which has been followed during recent years, although it requires a complete reversal of practice. In fact, the argument against a policy of monetary expansion in time of war rests upon precisely the same principles that have led to the deliberate adoption of a policy of deficit expenditure and easy credit during the past decade in the United States and in most other countries. Consistency of *policy* always requires that *practice* shall be reversed when conditions are reversed, and the problem of governmental policy which is likely to arise in a major war effort is in most respects precisely the opposite of that which has confronted the United States along with other countries since 1930.

In a period of severe depression a sound policy looks

wartime conditions, when there is no risk of a failure of effective demand in the markets, when there is a labor shortage, when normal international financial relations have been suspended, and when the risk to be guarded against is that of disastrous price inflation, we see no better criterion of the need for an increase or a decrease in the supply of bank credit than the movement of the price level.

¹⁰Incidentally, stabilization of the cost of living index would have more "psychological" value in forestalling pressure for wage increases and consequent rising costs of essential commodities than would the stabilization of any other price average.

toward the prevention of general price *declines*; but in a boom, especially a war boom, it looks toward the prevention of general price *advances*. In a depression the problem is to stimulate the employment of labor and other resources; in wartime it is to find labor and other resources to increase productive activity. In a severe depression imports are generally discouraged in the hope of increasing the level of domestic employment; in wartime the greater the volume of imports the better. In a depression it is now generally agreed that a government deficit is beneficial, at least in the short run, because it checks or prevents deflation, and stimulates moderate inflation in the interest of recovery (though there is still some dispute as to whether the ultimate unfavorable effects of the deficit may not be greater than the temporary benefits). In a war boom the short-run effects of the deficit are harmful because they tend to re-enforce a prevailing tendency toward income inflation. In short, in a depression, public policy is properly directed toward increasing the dollar volume of national income or checking its decline; in wartime, once full activity is established, it must be directed toward preventing or moderating an increase.

We have suffered so long from depression that it is necessary to reverse the whole current of thinking which has become dominant, to encourage saving instead of consumption, and to stress the gains of technological progress instead of the risks and losses of technological unemployment.

However, in contrast to the situation in 1917 when there already existed a high state of industrial activity and prices were already undergoing an inflationary rise, the country is now contemplating the possibility of a war emergency in a period of depression. The conditions

which have led the United States to pursue for the past few years an expansionary credit policy without an undesirable degree of inflation may not change overnight, and until the unemployed resources of the country are substantially taken up, some expansion of the flow of money may continue to serve a useful purpose, financing expansion of output instead of merely boosting prices. But depression is not likely to last long in the face of a major war, or even a rearmament program of the magnitude now contemplated. The existence of the current degree of unemployment and the present relatively low level of prices do not lessen the necessity for planning to prevent a wartime inflation; they merely indicate that a moderate delay in getting an adequate wartime fiscal program into operation, which would be inevitable with the best of plans, will do no harm.

CHAPTER III

INDIRECT CONTROLS OVER PRICES

Before we discuss direct controls over the prices of specific commodities, the reader's attention is invited to a number of ways in which price advances may be forestalled by increasing the supply of goods and services or by curtailing demands that are considered non-essential.

Stabilization of prices through increasing the supply of goods is preferable to the same amount of stabilization obtained by controlling the money stream, because expansion of production contributes directly to our war potential and to the standard of living of the community, both of which are much more important than the price level. This is usually recognized with respect to the stimulation of domestic production, but it is often apparently overlooked with regard to imports.

Encouragement of imports. In the case of essential commodities which must be supplied entirely or preponderantly by importation, like rubber and tin, the encouragement of imports is a well-established wartime government policy. During the World War the procurement of essential imports was a large part of the function of the War Trade Board. The Industrial Mobilization Plan which has been prepared by the Assistant Secretary of War provides for extensive control of foreign trade with the same object in view.

But while there is this general recognition of the necessity of maintaining or increasing imports of essential commodities which cannot be produced at home, there is

no such general recognition of the advantage, for a country at war, of having a large volume of imports of goods in general. We are so accustomed to thinking in terms of discouragement of imports and encouragement of exports in the interest of relieving domestic unemployment that it is difficult to adjust our thinking to the fact that in wartime the situation is completely reversed. What is needed, after the initial shock of adjustment to a war economy is over, is not to maintain employment but to conserve labor. One way to do this is to utilize the productive resources of neutrals to the greatest possible extent. It is desirable to import not only munitions and those scarce minerals and tropical products which we cannot produce at home, but also any article of civilian consumption which otherwise would be produced at home, up to the point where production of export goods to pay for the imports would absorb more of our productive effort than the imports would release. There is in fact no reason except inertia why in time of war after full employment has been attained, the country should not suspend all protective tariffs, except for countervailing duties on commodities which are subject to excise taxation when produced at home.

The principal reservation with regard to unrestricted importation relates to a possible scarcity of ocean transportation facilities. If the United States should be involved in an overseas conflict and there should again appear an acute scarcity of shipping space, it may be necessary, as it was during the World War, to put drastic restrictions on the importation of certain kinds of goods. It may be considered unwise to allow vessels carrying goods and men to a war zone to wait for return cargoes or stop at neutral ports to pick them up. The available shipping space in in-bound vessels must be allocated to

products in the order of their importance, and it may be necessary to do this by authority rather than by the competition of shippers for space. But within the limits set by the availability of shipping space, every effort should be made to increase imports, first, of strategic and critical raw materials; second, of other war essentials; and third, of goods for general civilian consumption.

The importance of this point from the standpoint of a discussion of price control is that importation is an effective means of increasing the supply of goods and holding down the price level. The greater the flow of goods and services through the channels of trade, the less the price rise that may be expected to follow a given amount of financial indiscretion, and in so far as the flow is maintained without diverting labor and other resources from more important uses, the better it is for the national economy.

The wartime gain for importation is greatest if goods are bought through the flotation of credits in foreign countries. This is one of the very few ways in which it is possible to postpone the extraordinary burden of the war to a future generation. In less degree the same advantage is gained if goods are obtained through liquidation abroad of domestic and foreign securities or property owned by our nationals before the war.

Exporting gold and silver. During the World War all belligerents placed severe restrictions on the exportation of gold. France and the United States maintained central gold reserves practically unchanged during their belligerency, and Great Britain and Germany actually increased their central holdings. Yet it is obvious that the exportation of gold against the importation of goods would increase the resources available for fighting the war, either directly through the exchange of gold abroad

for munitions and war supplies or indirectly through replacing domestic production of civilian goods and thus releasing labor for other tasks.

We suggest that the price of gold should be sharply lowered as soon as re-employment is substantially complete, and that the government should institute a program of direct purchase of essential commodities, to be paid for in gold. These measures, especially if accompanied by a suspension of tariffs, as recommended in the preceding section, should insure an outflow of gold, balanced by an inflow of more useful goods.

The conventional objection to the exportation of gold in wartime is that it is needed to "support" the currency. It is assumed that even if gold cannot be obtained for money, the fact that it is in reserve and possibly available for future redemption of money will improve the valuation placed upon the money and encourage people to hold wealth in the form either of cash or of government securities with a fixed dollar value, thus slowing down the velocity of circulation of money and impeding the rise of the price level. Under certain conditions this point may be valid, but those conditions are not likely to be present.¹

The external purchasing power can indeed be maintained more effectively by the possessor of a gold reserve, so long as other countries stand ready to take it in settle-

¹It is true that under the money systems of a generation ago the valuation placed on money by a population depended largely on its present or prospective redeemability in gold. To a large extent, however, the connection has been broken by the monetary developments of the past generation, and especially those of the past decade. The gold redemption of currencies has been suspended everywhere for so long, and other techniques for maintaining the value of the money have achieved such wide recognition, that there is very little point in maintaining large gold reserves to bolster the internal purchasing power of a currency.

ment of balances, and the external purchasing power has a reflex influence on the internal purchasing power. But the maintenance of the value of a currency through the use of gold reserve requires that it be not hoarded as a show-piece for psychological purposes, but be used freely to maintain the exchange value of the currency against neutral currencies, and to bring into the country a supply of goods which will serve as a drag on a price level tending to mount under the influence of wartime scarcities and wartime inflation. This point is particularly applicable to such a situation as now exists in the United States where there is a huge stock of gold which is almost completely dissociated from the currency, the bulk of which serves no useful purpose.

The same argument, of course, applies with even greater force to silver. Whereas some gold is needed both under peace conditions and war conditions as a reserve to balance out the fluctuations in the supply and demand of foreign exchange, our silver hoard is useless in its entirety whether under peace conditions or war conditions. One prime objective of policy in the event of war should be to unload as much of the silver stock as possible in the markets of the Orient and South America in exchange for their essential products.² If, as during the World War, it proves to be politically impossible to release silver except under pledge that the Treasury will repurchase it when the price falls to a certain level, then that should be done, though certainly no silver should be repurchased until after the close of the war.

² It is doubtful, however, whether neutral nations will accept much of this gold under wartime conditions. Sweden during the World War set an intelligent example to neutrals by closing its gates to the entry of gold to protect itself against the depletion of its valuable resources with no compensation except an unneeded expansion of its currency.

It goes without saying that the subsidies now paid to the producers of silver should be discontinued immediately upon the outbreak of war. The only possible justification from the standpoint of national policy is to create employment during the depression; the war itself will furnish an over-supply of employment. Likewise the inevitable requests of gold-miners for subsidy, tax exemption, or other encouragement should be denied.

Exchange controls. Exchange control affords another illustration of the way in which sound policy involves a reversal of procedure when a country passes from a depression economy into a war boom. During the early thirties there were repeated efforts on the part of many countries to reduce the value of their currencies in order to encourage exports, discourage imports, raise domestic prices, and stimulate employment. The principal check on the process was the fear of retaliatory depreciation on the part of other countries. To reverse this process under the changed conditions of the war economy would accomplish the same purposes as the measures of tariff suspension and gold export suggested above, and would probably be politically more feasible.⁸

Moreover, raising the value of the dollar against neutral exchanges—if there are any neutrals—would not evoke retaliatory offsetting action on their part, at least not for a long time. The short-run effect of lowering the price of gold and the exchange value of neutral currencies would be to encourage their export trade to us and discourage imports from us. Whereas this country as a belligerent would benefit by such a change, neutral

⁸ In connection with this contrast it should be remembered that both Great Britain and France during the World War pegged their exchanges at a high level in order to increase their capacity to buy, while during the depression they depreciated their exchanges in order to increase their capacity to sell.

countries would not be injured by it. They would benefit, unless they were already in a violent export boom, because of the improvement of their balance of foreign payments and the stimulation of their export industries. In an extreme case, where a country was threatened with depletion of its natural resources, or where unrest was evoked by the rising cost of living, protective measures might be taken, as they were by Sweden during the World War, but for a time at least the neutrals would presumably co-operate in our efforts to maintain a high valuation on our exchange and to increase our net balance of imports from them. Prices in the United States would be held down by any stimulus to imports which might result from the lowering of the dollar price of foreign currencies.

Stimulation of domestic production. Little need be said on this topic, as its implications are obvious. If war should come while we are still in a state of depression, the first step in industrial mobilization is to take up the slack of unemployed men and resources; after that is done further increase of output for war can only be obtained by shifting efforts from the less essential to the more essential, and by measures designed to prevent waste. Selective sales and excise taxes could be used more effectively than they have been in past wars, not only to encourage shifting of effort from production for peace demands into war effort, but incidentally to keep down the prices of the things that are most needed.

In this connection attention should not be centered on the distinction between essentials and luxuries, but on discouraging those lines of activity that absorb types of material and types of skill that are needed for the war effort and leaving undisturbed those that do not. For example, it would be desirable to increase the manufac-

turers' excise tax on passenger automobiles and lower it or leave it unchanged on trucks. Free transportation of laborers to jobs and increased fares for general travel would accomplish a similar purpose.

It is unfortunate, but true, that in general the production of necessities is more likely to conflict with the war needs of government than is the production of luxuries. Housing, for example, is a necessity, but a postponement of new housing construction is probably the most effective single measure to release needed facilities for war work.⁴ The first step in bringing about this restriction, in the event of a war emergency, should be the suspension of the activities of the Federal Housing Administration in financing new construction (except perhaps in limited areas where there is likely to be a great influx of population on account of the war). Whether direct restrictions on the purchase of materials and on the financing of construction would be necessary would depend largely on the magnitude of the war effort and on the character of the government's financial program.⁵

On the other hand, although beauty shops cater to a relatively non-essential type of demand, their operation makes a comparatively slight draft on scarce resources that could be converted to war use. If they were closed under a general program of eliminating non-essentials the result might be merely to create unemployment rather than to stimulate productive enterprise.

Priority regulations, if established at an early date, can be used to maintain the production of commodities in which shortage appears, at the expense of those in relative abundance. Much needless curtailment of pro-

⁴During the World War this postponement was brought about in large part by the high level of prices and in part by direct restriction.

⁵Compare below, pp. 196-99.

duction and consequent upward pressure on the price level resulted during the World War from too rapid mobilization of the military forces and early mistakes in withdrawing skilled men from industry. If more care had been exercised to push the production of necessary equipment first and delay the mobilization of men until they could be properly equipped, and if first drafts had been confined to younger men, say those under 24, the program of economic mobilization would have proceeded more rapidly, without a serious retardation of the training of personnel.

Lack of co-ordination of governmental buying and deliveries caused terrific railroad and terminal congestion, and consequent shortages and suspensions of operation. As late as February 1918 it was reported to the War Industries Board that steel plants were operating at only 33 per cent of capacity for lack of coal, while at the same time coal was being delivered to breweries and saloons. The concentration of the industrial work in the interior, leaving the seaports free for shipbuilding and other naval work, would have helped to prevent labor shortages, housing congestion, and other factors making for high-cost output, restriction, and price inflation.

These items do not constitute a program. They are mentioned merely as samples illustrating the possibilities of the stabilization of prices and the promotion of the war effort which may result from planning activities that have nothing to do directly with price control.

Removal of restrictions on output. During the years since the World War we have developed an extensive set of legislative restrictions on productive activity which have seemed appropriate to a situation of chronic unemployment and falling prices but would conflict with the requirements of industrial mobilization in a period of

full employment when prices were tending to move upward. The most conspicuous examples are the restriction of agricultural output under the auspices of the Department of Agriculture and the restriction of hours under the Walsh-Healy Act and the Fair Labor Standards Act of 1938. All such laws should be suspended for the duration of the war, including "full crew" laws, apprenticeship regulations, and other working rules, in so far as they are designed to make work rather than to protect the health of the workers.

Speculation and hoarding. In general the importance of restrictions on speculation and consumer hoarding is more likely to be overestimated than underestimated. The hoarding of necessities by the civilian population may create a price flurry, but can only change the supply and demand relationships over a short period of time. Whenever consumers begin to draw on their hoards, market demand falls off, and as a rule it makes no difference in the end whether inventories are owned by dealers or consumers. Two exceptions should be noted. First, in some cases hoarding may lead to waste through deterioration under improper storage. This factor, however, is not likely to be important. Second, consumer hoarding may defeat the equalizing purpose of rationing, because by the time a shortage becomes so acute that rationing is necessary it may be too late to detect the ownership of hoards, and individuals may therefore be able to draw their rationed shares when they already have ample supplies. For this reason, when a shortage develops to where rationing is approaching, a useful purpose may be served by a preliminary restriction on large individual purchases, obviously for hoarding purposes, which can be put into operation more quickly than a complete rationing system. In general, however, the

difficulties of enforcement are probably too great to make the effort to prevent individual hoarding worth while, unless rationing is in effect or in preparation. As is noted below, it is probable that serious shortages of consumers' ordinary conveniences and necessities will appear only in very few cases.

Speculation in the sense of purchasing commodities for resale in anticipation of a rise, as distinct from consumer hoarding, is popularly regarded as a prime cause of price advances. This belief is in large part a fallacy. Some supervision of the commodity exchanges is necessary in order to prevent the development of such a situation as appeared in the spring of 1917 when the Allies had bought for future delivery more grain than it was physically possible for sellers to deliver. However, the supervision of exchanges under the Grain Futures Administration has been developed to the point where there appears little necessity for additional wartime restriction. Control is more likely to be overdone than neglected. Supply conditions in agriculture are so dependent on changing weather that price flexibility is needed. We see no necessity for, or advantage in, such regulation as that enforced by the War Trade Board during the World War restricting the privilege of importing various commodities to those who certified that the commodities were not for resale.

CHAPTER IV

SELECTIVE CONTROL OF PRICES

In addition to, or as a substitute for, the broad types of control discussed in the preceding chapters, the government may attack the problem directly by establishing maximum prices for a limited number of specific commodities, either for government purchases, or for all trade. As is shown below,¹ if a war is financed by inflationary methods, restriction of the prices of important commodities paid by the government will tend to keep down the rate at which the Treasury finds it necessary to create new money or to stimulate its creation by the banks, and hence will slow down the rate of expansion of total income and of prices.

The main purpose of selective price control, however, has to do with relative prices, rather than the general level of prices and incomes. It aims to prevent some individuals from gaining unduly at the expense of others because extraordinary war conditions have caused shortages of the commodities or services which they happen to have to sell, and also to iron out some of the inequalities in the speed with which different prices rise in response to inflation. It is an effort to moderate the disparities in the effect on individuals of the disturbances in the economic process which result from the war effort.

As was noted at an earlier point in our discussion, a program of selective price-fixing may be restricted to control over the prices which are paid by the govern-

¹ Pp. 93-94.

ment and its Allies and by contractors and sub-contractors in its service, or it may cover a narrow or wide range of goods and services sold in civilian markets. We shall discuss these two types of control separately in the next two sections of this chapter.

I. GOVERNMENT PURCHASES

Government purchases fall into three classes: (1) commodities which are used by the general public, of which the government purchases are not large enough to upset the market, and in the production and sale of which there is substantial competition; (2) commodities of special character which would not be produced, or if produced would be of substantially different character, in the absence of the war emergency program; (3) commodities of civilian use of which the government buys such large quantities that the output must be greatly increased or else civilian consumption must be substantially decreased. In general, the first class lends itself to open market purchase; the second to special contracts. It is the third class which raises most of the problems of price-fixing.

Open market buying. The method of purchasing in the open market, either on bids or at open market prices, is suitable to cases where the government buys only a small fraction of the total output and the number of independent producers is large enough so that there is a presumption of substantial competition between them. This would generally be the case, for instance, with paper, ink, paints and varnishes, soap, and other minor items. With reference to these items there is no reason to anticipate that the producers will be able to get abnormally high prices under the operation of the forces

of demand and supply in wartime any more than in peacetime.²

Some prices will rise, but if the war is financed without an income inflation, so that the total demand for all items does not increase materially, the shifts that take place within the price structure will, as a rule, be useful. The price increases will reflect the need of expanded production (or curtailed consumption) and the price decreases the desirability of curtailed output or expanded consumption. If there is a monetary expansion greater than the expansion of production, so that prices generally rise, profits will be unusually high, as measured in dollars, but such increases in profits will be a reflection of the diminished purchasing power of the dollar which is appropriate to the increased supply of dollars.³

Contracts. In a second large class of cases, the government must deal directly by contract with individual producers, and there is no opportunity for the application of uniform price controls. In this class fall the services of contractors engaged in the building of cantonments, ships, bridges, and other unstandardized items for which a price must be made in each contract. No central committee can supervise closely all the individual prices made in such cases. The government may pay a contractor a flat percentage of cost as a commission for man-

² Much of the apparent increase in demand is fictitious, the increase of government demand being an offset to the decrease of civilian demand, as men pass out of civilian life into the army.

³ In the transition from a lower to a higher price level, book profits will tend to increase more than proportionately to the diminished buying power of the dollar because of the rise in the value of inventories. However, unless the inventories are larger than normal at the time such an increase occurs, the profits so realized will be absorbed by the increase in the necessary working capital as measured in dollars. They will not be available either for distribution to the owners of the business or for the payment of taxes. See pp. 179-80.

agement, and furnish the materials and itself pay the wage bill. This method developed grave abuses during the World War, because the contractor's fee went up as the costs went up. Consequently modifications were worked out which provided for a flat compensation for management, or for a fee based on estimate of cost with a bonus for savings effected by the contractor.

Direct contracting with individual producers requires either competitive bidding or considerable discretion on the part of government officers in the negotiation of contracts. Competitive bidding has obvious advantages in peacetime, when the volume of orders for most commodities is small enough so that there is substantial competition for them. But in wartime the volume of orders for certain commodities is likely to be so large that sellers' competition will not be adequate to keep prices down to reasonable levels, while at the same time the disadvantages of competitive bidding in the way of delay and red tape become much more serious. It is clearly desirable in wartime to relax the stringency of requirements for competitive bidding, to permit more consideration to be given to the bidders' experience and reliability, and in those cases where the government is the principal buyer, to abandon reliance on competition to secure a fair price. In some cases, especially in the case of goods built to specifications, this will necessitate reliance on some form of the cost-plus principle. It does not, however, necessarily involve the form of cost-plus which caused the most criticism during the World War, namely cost plus a fixed percentage of cost. Obviously this is a bad device because it penalizes economy and efficiency. Better is cost plus a fixed sum, or cost plus an amount which rises as cost falls.

Since the World War, the War Department has re-

duced the number of purchasing contract forms in use from more than 400 to 8, all but two of which provide for either a fixed price for a commodity or a fixed fee for a service. Cost-plus as used in these two forms is intended for cases where the service in question is of so new a type that the costs cannot be estimated in advance with sufficient accuracy for the determination of a fixed fee. A "pilot contract" on the cost-plus basis is provided which is intended to be used for preliminary orders, with the expectation that the experience on these orders will make it possible to negotiate larger contracts on a fixed fee basis.

Standardized commodities. The question of price-fixing for government purchases arises chiefly in the case of bulk commodities which can be identified by grade or description and have an alternative market for other purposes to the extent that they are not bought by the government. Here the choice is between bargaining with individual producers and fixing a single price and requiring all producers to accept government orders at that figure. The advantage of the latter procedure is that it greatly simplifies the task of the purchasing authorities; the disadvantage is that in cases where there are wide differences in cost of operation between individual producers it is likely to result in the government's paying a higher price than it would need to pay if it dealt with each producer independently.

During the World War the decision was to pay one price to all producers of most standardized commodities. The price was usually high enough to encourage operation on the part of producers whose costs were near the top of the scale, and consequently to yield high profits to low-cost operators. Reliance was placed on the excess profits tax to recover the high profits which under

this plan were realized by the producers responsible for the bulk of the output.

The decision to pay a uniform price for standardized commodities was undoubtedly due in part to the early decision that the prices fixed should govern transactions between individual citizens as well as those charged the government and its allies. Obviously, prices to the public should be uniform for the same product, regardless of whether the particular item is produced by a high-cost or a low-cost producer.

If prices to producers are not also to be uniform, some plan of pooling is necessary, and this the War Industries Board did not wish to undertake, if only because of the administrative work involved. Hence the ruling made by President Wilson at the very outset of the price-fixing program, that all prices should be the same to the public and to the government, practically excluded selective price-making on the basis of individual producers' costs.

Bulk-line cost. The method of price determination adopted as a standard by the War Industries Board and the Price-Fixing Committee and also by the Fuel Administration was what was called the bulk-line cost method.⁴ The method involved the following procedure.

Average costs of each producer were collected by the Federal Trade Commission and listed in order from the lowest to the highest, in parallel column with the capacity of the respective producers. A certain percentage of capacity output was fixed upon as desirable. The "bulk-line cost" was the unit cost of the highest-cost producer whose output was necessary to meet this production requirement. Usually the bulk-line was so drawn that 90 per cent of the possible output of the country could be

⁴ For discussion of the extent to which the method was actually used, see p. 123.

produced at this cost level or below it. The accompanying table shows for three commodities the range of costs reported by different producers.

COSTS FOUND BY THE FEDERAL TRADE COMMISSION FOR SEPTEMBER 1918^a
(Production cost per gross ton)

Companies Producing up to Following Percentages of Total	Beehive Coke ^b	Pig Iron ^c (Basic)	Steel Ingots ^d (Open hearth)
Up to 60.	\$2.93-\$4.44	\$18.12-\$22.06	\$30.60-\$33.42
Over 60 up to 70.	4.44- 4.99	22.06- 24.32	33.42- 35.16
Over 70 up to 80.	4.99- 5.44	24.32- 25.41	35.16- 39.77
Over 80 up to 90.	5.44- 6.47	25.41- 27.49	39.77- 41.86
Over 90 up to 100.	6.47-11.45	27.49- 45.72	41.86- 66.34

^a P. W. Garrett, *Government Control over Prices* (1920), p. 404.

^b Government price \$6.00 per net ton.

^c Government price \$32.00 per ton.

^d Government price \$73.00 per ton.

The bulk-line cost having been found, an addition may be made, as noted above, to provide a "reasonable margin" of profit. This may be determined on any basis deemed appropriate. Fair return on capital and prewar average profit are the principal alternatives.

It is obvious that if there is much difference between the costs of different producers this procedure permits the low-cost producers who are responsible for the greater part of the output to earn a margin of profit much higher than the conceded "reasonable margin." During the World War there was considerable discussion of the alternative suggestion of dealing with individual producers on a cost-plus basis. The decision to fix a single price for the entire industry was due partly to the administrative difficulty of figuring costs separately for each producer and the fear of fraudulent practice;⁵

⁵ Cost figures were needed under both systems, but under the bulk-line principle the only cost figures that made any difference in the final result were those of concerns at and near the margin, whereas under any

partly to doubts as to whether the War Industries Board had legal authority to enforce varying price schedules on different producers; and partly to the belief that the bulk-line method was a fair imitation of the operation of competitive market forces under more normal market conditions. Finally, it was urged that any plan for varying prices according to cost would penalize efficiency and therefore lead to waste of resources.

The fixing of a price for government purchases is desirable whenever (1) the government's purchases have become so large that the small residue commands prices that are much higher than is necessary to stimulate the desired level of output, especially if production cannot be expanded quickly enough to make up the shortage, or if it is against public policy to permit the investment of funds and employment of labor which would be necessary to do this; (2) the commodity is sufficiently standardized so that a price can be set without reference to individual units of product or the specifications under which particular jobs are done; and (3) the commodity is bought by a number of different governmental purchasing agencies, so that in the absence of centralized price control there would be duplication of effort, lack of uniformity of policy, and possible competition between agencies.

We believe, however, that there should be no presumption that the government will pay the same price to all producers of the same thing, in cases where it absorbs so large a proportion of output that competition fails to establish a reasonable price. The one-price plan discriminates in favor of the low-cost producers of goods that are so highly standardized that it is possible to quote

form of cost-plus the cost figures of all producers had to be scrutinized with equal care.

a price for them by grade or general description. It is impossible to apply it to the construction of goods built to order, such as airplanes, bridges, guns, ships, and cantonments. In such cases—and they represent a much larger war expenditure than the basic raw materials and standardized finished products—the price is fixed either through some form of cost-plus contract or through bids which are controlled by producers' estimates of cost. So far as equity is concerned, the low-cost producers of standardized goods have no better claim to a return based on the costs of their less favorably situated competitors than do the low-cost producers of unstandardized goods and services. It is no more obligatory on the state to pay the low-cost steel producer a price for his services based on the costs of a marginal competitor who could not compete at all under ordinary market conditions than it would be to pay the same price for building cantonments in Mississippi as in New England.

When there are wide differences in cost between different producers, the bulk-line principle results in prices which yield very high profits to those who produce the larger part of the output. Since the prime purpose of the price-fixing program is to prevent "profiteering," and save money for the government, this is a serious objection. It is our opinion that the general approval given to the bulk-line principle during and after the war by administrators and commentators⁶ is not due to its intrinsic merits, but rather represents a reaction against the

⁶ Favorable comments on the principle include those of Professor Taussig, Lt. Colonel R. H. Montgomery, and Robert S. Brookings, all members of the Price-Fixing Committee; Professor Wesley C. Mitchell, who was chief of the Price Section of the War Industries Board; Professor L. H. Haney, who participated in the cost-finding work, and Professor W. F. Gephart, Federal Food Administrator for Missouri. The chief opponent of the system during the World War was William B. Colver, chairman of the Federal Trade Commission. See P. W. Garrett, *Government Control over Prices*, pp. 385-99.

cost-plus method due to the abuses which were associated with it.

Our contention is that in cases where the demands of government absorb so much of the supply of a basic commodity that competition fails to establish a reasonable price, and where there are large differences in cost between units of the industry, we should abandon the attempt to approximate in price-fixing the peacetime processes of competitive industry, and judge the equity of a transaction rather on the analogy of public utility rate-fixing. In that field the accepted principle is that the price fixed by public authority shall be high enough to permit a company with prudent management to make a fair return on investment—which may be computed in any one of several ways. No attempt is made to adjust the price to temporary aberrations of market demand, and no effort is made to see that all producers in the country receive the same price.

A number of alternative procedures are possible, without going to the extreme of bulk-line cost in the one direction, or simple cost-plus in the other direction. If the number of producers is small, the volume produced by each one will be great enough to justify the negotiation of contracts on the basis of individual direct costs and individual investment, just as is done in contracts for producing munitions, artillery, ships, and roads. This does not mean going back to a crude cost-plus system. It may better mean fixing a price for a period of time on the basis of recent cost records (as is always done with public utility rates) and then during the life of the contract letting the producers make all the profits they can by reducing costs, periodically revising the contract prices on the basis of new experience.

Or, if the popular objection to paying different prices

for the same service is too strong to be ignored, it may be evaded, in some cases, by buying the raw material and contracting for service in fabricating it instead of buying the finished product. For example, if one steel company has very high costs because of freight charges on iron or iron ore and coal, the government may deliver the raw material to it and pay it a fee to convert it into steel, thus avoiding the necessity of paying other steel producers located close to the raw material a price based on the high cost of raw material at the badly located plant.⁷ Or freight costs may be absorbed by the government instead of having them included in all costs at the level of the plant having the highest cost. Or, if a uniform price is to be paid, a bonus to cover deficits may be given to a few high-cost producers much more cheaply than prices sufficient to prevent those deficits can be paid to all.

These last suggestions, however, are makeshifts to avoid the worst effects of a bad system, and are only to be justified if that system cannot be uprooted. Once the public utility concept of fair price is substituted for the "competitive" concept in a field where competition has broken down, they become unnecessary.

II. PRICES PAID BY THE GENERAL PUBLIC

The fixing of prices for the general public involves a much more serious break with peacetime standards of individual liberty and peacetime methods of organizing industrial and commercial activity than is involved in fixing maximum prices for the guidance of all government purchasing agencies. It also requires, if it is to be

⁷ See Colver's comments on the effect of Bethlehem Steel's high costs of transportation on the price paid for steel to producers in the Pittsburgh and Chicago districts. Garrett, *Government Control over Prices*, p. 392.

effective, a much larger expenditure of administrative effort, both to enforce it and to appraise its effects with a view to correcting errors and obtaining the best economic results. War does not destroy those characteristics of the economy which make individual bargaining a useful social device for allocating resources and distributing income: it merely makes it probable that cases in which the method fails to work satisfactorily will be more numerous than they are in peacetime.

The case for selective price-fixing is strongest in cases where (1) there is such a shortage of immediately available supply that, in the absence of control, prices would go far above the level of costs; and (2) such high prices would not serve a useful purpose in bringing about readjustment of supply, either because there is no shortage of capacity, in which case supply will presently be readjusted without the necessity of extremely high prices to bring it about, or capacity is short and cannot be increased quickly, or it is contrary to public policy to allow it to be expanded. In all these cases a very high price is useful only as a means of allocating the short supply to the uses for which the highest prices will be paid for it. Price-fixing is justified if for social reasons this method of allocation of the short supply is considered unsatisfactory.

Proposals to fix prices charged the general public are likely to come up in connection with two classes of commodities: first, services or raw or half-finished products which are used in some industrial process; second, commodities and services which enter directly into the cost of living of the community. In general the two classes are quite distinct, coal and gasoline being the principal commodities which fall into both classes. With the first class of goods the price is part of the cost of production of something else; with the second class it is the con-

necting link between money income and real income.

Shortage of the materials used in industry sufficient to raise the question of price-fixing may be due to absorption of the bulk of the output into governmental uses, to obstruction of importation, or to interruption of the process of production by the withdrawal of labor, fuel, or transportation facilities for war uses. In most cases of this kind a price will necessarily be fixed for the government's purchases; and the question will arise whether to extend this same price to the general public, fix a different price for the public, or leave the civilian price uncontrolled. There are World War precedents for all three solutions, though the first was the standard practice. There were also some cases in which price-fixing proved superfluous because after the government's needs had been supplied there was no market demand sufficient to absorb the remaining output at the price agreed upon, and the market price fell below the fixed price.⁸

Most industrial materials enter into a range of products of widely differing importance, and will be diverted automatically from the less urgent to the more urgent uses if scarcity is reflected in price. They are also readily substituted for one another as relative prices change. Hence no simple formula will yield a cut-and-dried answer to the question whether, in cases where the government's needs absorb the major part of the output of a commodity, the distribution or pricing of the residue re-

⁸ If a war is financed without any inflation whatever, the money spent by the government will be balanced by a corresponding contraction of private spending, and the curtailment of supply caused by the government's purchases will be offset by contraction of demand on the part of taxpayers and buyers of government bonds. There will still, however, be shortages of some commodities—those for which both the demand and the supply are highly inelastic.

quires any specific governmental control. The following general statements, however, may help to clarify thinking in regard to the matter.

First, in cases where the government takes the bulk of a product the fact that from time to time competing buyers drive the price for small quantities for prompt delivery to very high figures does not imply that those prices should be paid by the government, or taken into consideration in any way in determining a fair price for the government to pay. But the fact that a price below the market is being established for government purchases does not necessarily indicate a need for control over the price paid by the public. As a rule there is no necessity for the fixing of maximum prices for the general public unless the shortage is acute enough to necessitate or justify some type of rationing. Second, high prices are themselves a rationing device, and should not be interfered with unless the government is prepared to substitute some other form of rationing. In some cases priority classifications or industries may suffice; in other cases it may be necessary to allocate specific orders to specific producers.

A real objection to permitting a free market for the fraction of the supply which the government permits producers to release for civilian use is the fact that it puts a premium on delivery of goods to the general public rather than to the government, and precautions must be taken against this. In the early part of the World War it was reported that in England the army had considerable difficulty in securing deliveries because concerns working for the general public and selling at higher prices than were paid on government contracts were able to bid away labor and raw materials. In the United States little difficulty was experienced on this

score. When necessary, compulsory orders were placed. Priority regulations were also used to put manufacturers working for the government in a preferred position as to coal, steel, and freight cars. In the case of caustic soda the Price-Fixing Committee excused certain high-cost producers from compliance with compulsory government orders placed at fixed prices, and allowed them to sell to the public at any price they could get. A similar practice was followed with the cement industry, though in this case it was the location of the plants rather than the cost of production at the plant which determined the placement of the government orders.

In a few cases where material has a very extensive non-military use in addition to a heavy demand from government, it may become necessary for the government to supervise the allocation of products in detail. The simplest procedure then may be for the government to buy the entire output and resell such portions as may be allocated to non-war work.⁹ The price need not be the same as that paid by the government, nor need the same price be charged to essential and non-essential industries. An appropriate procedure would be to set a relatively low price for public utilities and other preferred buyers, and for contractors working for the government on any sort of a cost-plus basis, and sell the residue, if any, to the highest bidder. This plan is equally appropriate whether the government is buying on the modified public utility basis suggested above,¹⁰ or at a uniform price such as that yielded by the bulk-line formula.

Consumer goods and services. Essential consumer goods as a rule are produced in highly competitive mar-

⁹ The government need not, of course, accept physical delivery; it may simply direct the producer to ship to designated buyers. The buyers pay the government and the government settles with the producer.

¹⁰ Pp. 64-67.

kets, and are not likely to be bought by the government in sufficient quantities to upset the market. Hence few occasions for price control are likely to arise except in cases when the supply of an essential commodity is curtailed because of import difficulties, or the demand is increased by the necessity of exporting food and textiles to allies or famine-stricken neutrals.¹¹ Suggestions of price control are likely to be offered if there is general inflation, because rising prices may create the illusion of a high cost of living when really incomes have advanced as much as prices, and supplies have not been curtailed. The crucial question, however, is one of availability of supplies. If the country produces enough of a commodity to provide for the customary standard of consumption of that commodity, the customary standard will be maintained. The consumer price level will adjust itself to the changed money income so as to clear the market; a fixed maximum price will either have no effect on total consumption or will decrease it (by discouraging production).

Aside from cases where export demand or import supply is materially affected by war conditions, the justification for price control will arise, if at all, from temporary local shortages of particular commodities which are very urgently wanted by large numbers of people, and would not be supplied quickly in much greater quantities if prices were allowed to rise. To be sure, price-fixing in such cases will not enable the population to have any more of the scarce commodity than it would have anyway. But control, especially if accompanied by ra-

¹¹ Supply may be decreased because adverse priority rulings force curtailment. But if a commodity is deemed to be so unimportant that its production is greatly reduced through priority regulations, no great hardship will result from letting the price rise high enough to bring supply and demand into balance.

tioning, may cause the short supply to be distributed among a larger number of people, the poor getting more of it and the rich less than they would if prices were left free.¹²

In general, at least in the first year or two of a major war, the high cost of living will be a question of inflation, not of scarcity. Selective price-fixing is indicated only in those cases (like sugar and wheat flour during the World War) where special conditions lead to an acute shortage and there are social objections to letting prices go high enough to bring demand and supply into equilibrium. In such cases rationing is a necessary complement of price-fixing, since in the nature of the case demand will be greater at the price fixed than supply.

Stimulation of the production of adequate supply rather than control of profits is the principal objective to be aimed at. In the case of commodities produced by a large number of individual concerns and having a long period of production, a guarantee of moderately high prices is likely to be the useful device, as it was with wheat during the World War.¹³

A fuller discussion of the problem of price-fixing in the civilian consumption goods industries will be found in Part II of this book, where we discuss the work of the

¹² It should be noted that though price restrictions, combined with rationing, deprive the rich of part of their advantage with regard to the particular commodities which they would otherwise monopolize by bidding up their prices, the restrictions may actually increase the total share of the national dividend that goes to the wealthy. To the extent that the price rise tends to be greatest with respect to the things that are bought by the people with the most money, a free price system results in a concentration of wealthy people's demands on the commodities that have risen most in price; thus the inequality of total real income is reduced, although the inequality of command over the things that are most urgently wanted is increased, by a free upward movement of the prices of the commodities of which there is a shortage.

¹³ Compare pp. 150-51, 154-55.

Food and Fuel Administrations and the control of rents during the World War.

III. WAGES

Past experience indicates that war has a very disturbing effect on the incomes of practically all classes of society, some gaining and others losing, and that there is little apparent relationship between the changes in rewards and the underlying changes in the usefulness of the various types of services which individuals are equipped to render. Control of wages presents, in a democratic country, the most difficult problem in the whole field of selective price control because of the unstandardized character of the services rendered by labor, the wide variation in local standards of pay, of working conditions, and of service expected, and also because of the great extent to which humanitarian sentiments, political strategy, and the monopoly power of labor organizations enter into the determination of public policy.

It is impossible to separate the wage question from the whole problem of industrial relations in wartime, including selective service and industrial exemptions, "work-or-fight" policies, compulsory training programs, possible restrictions on the freedom of workers in essential industries to strike, compulsory or optional utilization of governmental employment services, unemployment relief, and so on. An adequate analysis of this whole range of problems, taking into account the experience of this and other countries in present and past wars and in other emergencies, would require a volume in itself. Moreover, neither our wartime experience nor that of other countries affords a close parallel to the situation with which we are likely to be confronted if a war emergency should arise in the near future.

It is our judgment, however, that in a war of no more than two or three years' duration, involving effort no greater than was put forth in the last war, maladjustments are likely to arise from a tendency for wages to be forced upward, drawing the whole price and income structure after them, rather than from the converse tendency of certain types of wages to lag behind advances in the cost of living.¹⁴ Of course, in a war involving such complete disruption of economic life as has recently taken place in a number of European countries, it is inevitable that practically all real incomes be drastically curtailed.

Without undertaking to formulate a war labor program, the following points are suggested as basic to determination of a national policy which shall harmonize with the purpose to wage war without excessive price inflation and with as equitable a distribution of the burdens of war as can be attained without interfering with the success of the war effort itself.

1. Compulsory labor at wages which the worker is not free to reject must be confined to the direct service of the government. If the system of private enterprise is maintained in a large or small sector of the economy, individuals must be free, within that sector, to accept or reject offers of employment.

2. Within the area of government employment, the question of compulsory versus voluntary service is not one of principle, but of expediency. In general, the presumption is in favor of voluntary service as against conscription, but if voluntary enrollment proves inadequate, resort must be had to compulsion. Compulsory service should be paid for at rates which, taking into account sustenance and other perquisites furnished to the soldier

¹⁴ See chart on p. 28.

or worker, are adequate to pay for the minimum skill and strength required, but, of course, not adequate to compensate draftees for the sacrifices involved in devoting high-grade ability to low-grade work, some of which is inevitable in any draft program.¹⁵

3. As was pointed out in Chapter II, the national industrial problems of wartime, once initial difficulties of transition are overcome, are in many respects the reverse of those of a peacetime depression. The problem is not to find employment for labor, but to find laborers to perform needed services. It is not to stimulate a more rapid flow of money, but to restrain the forces of inflation. Consequently, all policies designed to make work or spread work among a larger number of individuals than are needed, or to push incomes above competitive levels, must be reversed. All restrictions on hours of labor, except those which serve a bona fide purpose of protecting workers' health, must be abrogated. Wage minima, designed to protect the incomes of the bottom strata of labor, are not likely to be harmful, but such measures as compulsory payment of time-and-a-half for overtime, which affect the surplus rather than the basic income, should be suspended for the duration of the war emergency.

In view of the great increase in the volume of government work, especially indirect government work, which

¹⁵ It is suggested that much of the unnecessary economic sacrifice caused by military conscription could be avoided by limiting conscription to the younger age groups; say first those of 21, then those 22, then those coming into age 21 after the program was started, then 20 and so on, working into the upper twenties only as large numbers came to be needed. This would have the triple advantage of giving the military authorities a homogeneous body of draftees of the age most easily trained, making the minimum interference with the industrial life of the country, and requiring only comparatively low pay to avoid placing an undue burden on the enrollees.

is bound to occur throughout industry, all distinctions between the labor conditions required on government work and those required on private work, like the Walsh-Healy Act, should be suspended for the duration of the war emergency.

4. To take the position that labor should make no contribution toward carrying the economic burden of the war would be indefensible. War effort requires an increase of individual effort and the increased effort, since it has to be directed to the product of war necessities, cannot result in a corresponding increase in consumable goods and services. If labor is to make any economic contribution to the cost of the war, the cost of living (including the workers' burden of direct taxation) must rise more than the wage rates (or conceivably fall less) than the wage rates, though it need not rise more than total wage income as affected by increased employment. If this does not happen it is an indication either that the increased effort is being wasted so far as the winning of the war is concerned, or that the workers' share of the burden is being shifted to others—either fixed-income classes or larger taxpayers.

5. Unemployment benefits should not be permitted to act as a drag on re-employment. To this end, claims should be rigorously scrutinized and should be allowed only during the interim reasonably necessary to effect the transfer of labor into essential industries. Such a policy will hasten the reemployment of labor and may also release substantial funds for investment in war securities in building up the reserves of the unemployment agencies.

6. While wage control is logically a phase of price control, the administration of labor is too large and diversified a task to be made subsidiary to the adminis-

tration of price control, and wages can probably be handled better by a labor authority than a price authority, though provision should be made so as to insure coordination of policy between them. Such a labor agency should have full control for the duration of the emergency over state and local labor agencies and peacetime federal agencies.

We are extremely reluctant to advocate a direct control over the wages paid by private industry, although this may turn out to be the only way in which an upward tendency of costs can be controlled. If the labor market were truly competitive we should regard wage changes as a useful method of bringing about the necessary readjustment of employment in wartime. There would be no reason to anticipate that wage changes would not reflect changes in the productivity of labor as measured in money terms. A general advance in wages, like an advance in the cost of living, would mean a general inflation, and should not be singled out for repression.

But through the development of collective bargaining, backed in recent years by direct efforts on the part of government, the wage rates in major industries have come to reflect in large degree the strength of organizations. Collective bargaining has become a quasi-legislative process. Wages that are forced upward by organized pressure, rather than drawn up by a rise in the value of labor's services to the employer, are a matter of grave concern to the public, because of the irresistible pressure they create for price increases to cover them. A successful drive on the part of labor organizations toward a general increase in wages in advance of a corresponding rise in the other parts of the national income, such as occurred

in 1937, would wreck any plans for waging a war without inflation.

We do not believe it is necessary to subject all wage bargains to governmental control, at least in the absence of a much more extensive control over other prices than our analysis indicates to be necessary. Some wage increases will be needed if labor is to be attracted without conscription into industries and into localities where the need is greatest. General increases may be justified because of the government's failure to adopt an adequate program of non-inflationary public finance. And, for reasons which are indicated more fully in Chapter VI (particularly pages 98-103), government control of all individual wage bargains would involve very great administrative difficulties.

Collective bargaining, however, presents a special case, and here the prospective need is greater and the administrative difficulties are less. The need is greater because the centralized control of a major labor organization is so powerful as to provide the opportunity, in a time when there is urgent need for united effort, for the exaction of unnecessary wage increases. The administrative problem is less serious, first, because the number of collective bargains is so much smaller than the total number of wage bargains, and second, because control over a collective agreement does not require administrative determination of all the detailed questions that would arise if every individual wage payment were subject to governmental scrutiny.

What is suggested, therefore, is that, as part of the general program of war labor administration, provision be made for review of all collective bargains involving, say, 50 or more employees, with power vested in the

labor administration to veto, in whole or in part, any agreement involving an increase or decrease of wages for substantially the same service.

In carrying out its duties, the labor administration should be governed by the following purposes: (1) to encourage absorption of labor in useful employment; (2) to permit prompt adjustment of wages to any shrinkage in the purchasing power of the dollar occasioned by fiscal and monetary inflation, but not necessarily to price rises that are occasioned by a curtailment of the available supply of goods and services; (3) to discourage any tendency for the rate of inflation, if there is an inflation, to be accelerated by a tendency for wage rates to run ahead of the general income expansion.

It is suggested, also, that employers having more than 20 employees be required to hire all new labor through the federal exchanges except with the approval of the war labor administration. This is to put a check on the efforts of employers to recruit labor by enticing it away from other equally essential employments.

CHAPTER V

THE MACHINERY OF CONTROL

If the decision is made not to rely on the freely working price system as the chief mechanism of economic transfer from peace to war conditions, it becomes necessary to create and endow with executive responsibility governmental agencies of economic intervention of far-reaching scope. World War and postwar experience reveal certain principles of control which should be adhered to in the interests of wartime efficiency and postwar readjustment.

In the first place, the responsibility for control should be wholly unified. Much wasted effort and imperfect performance may result from such a situation as the United States found itself in, for example, in 1918, when the price of hides was fixed by one agency—the Price-Fixing Committee—while control over a joint product—beef—was exercised independently by another—the Food Administration. Still more urgent is the desirability of avoiding interdepartmental competition in the purchasing of supplies. In the present European war that possibility was not eliminated by the Allies. Both in Great Britain and in France before its downfall, the air forces and the navies purchased essential supplies independently of the great central governmental purchasing agencies: in England, the Ministry of Supply; in France, the Ministry of Armaments.

This country apparently does not at present plan to establish a ministry of supply in the event of its being drawn into the war, but instead to utilize existing pur-

chasing departments. According to the Industrial Mobilization Plan these agencies must conform to the conditions of purchase formulated by a war resources administration and abide by the prices authorized by a price-fixing authority. For the sake of unanimity of policy, conservation of effort, recognition of responsibility, and general wartime efficiency, it is imperative that such governmental controls as are imposed be wholly unified and mutually consistent, emanating from one clearly defined source.¹

Second, the machinery of control should be civilian rather than military in character. In the event of a major war, which is the only kind likely to evoke such controls, the War and Navy Departments will have enough to do without this additional function. A great part of the personnel required by wartime agencies of industrial control will necessarily be drawn from civilian life, and nothing would be gained by regarding them as officers rather than as officials. Finally, given the traditions and characteristic attitudes of the American people, it seems likely that adjustment to the irksome character of wartime controls and the co-operation of industry with the agencies of control will be easier if these are civilian rather than military in nature. There is no necessity to

¹ An incidental advantage of centralization is the simplification of the task of industry in dealing with government. At a time when the direction of production must be rapidly altered, the volume of production expanded, and the cost of production minimized, the task of industry is difficult enough. It should not be made more difficult by requiring reports and questionnaires, many of them overlapping, to be sent to a multiplicity of agencies. This condition did exist in the United States during the World War, and it has appeared during the present war in Great Britain, where complaints are reported that the Ministry of Supply, the Board of Trade, and the service departments are all sending out industrial questionnaires. Divided governmental responsibility for industrial controls facilitates such confusion and duplication of effort.

labor these points further, since this point of view is probably already generally accepted.

Third, it is obvious that the machinery of wartime control should be non-partisan in character. One of the characteristics of a war economy is—or should be—the canalizing of all the national energies towards one objective. The opening of the control agencies to all qualified talent regardless of party would extend the field from which ability could be drawn, and would give expression to the unity of the national goal.

Fourth, any wartime agency which is established to *administer* price control should take the form of an authority with a single head, rather than a board. The pressing character of most wartime needs requires immediate adaptability on the part of governmental agencies and a capacity for instant decision that is not always to be had if responsibility is collective. This, also, is a principle which emerged in the course of the World War. It has been urged by Mr. Baruch and Mr. Brookings, on the basis of their wartime experience.

On the other hand, quasi-judicial organizations, like the Price-Fixing Committee of 1918, need not be organized in accordance with the principle of sole personal responsibility of one man. If wartime prices are to be controlled, a price-fixing agency presumably will operate to determine what prices shall be taken as fair under given standards of fair profit. In other words, it will be responsible not for enforcement but for the interpretation of facts and for the conclusions. This is not a one-man job.

The Industrial Mobilization Plan, issued jointly by the Secretaries of War and Navy in 1936, and revised in 1939, provides, among other agencies, for a Price-Control Authority and a War Finance Administration.

The Price-Control Authority is a quasi-judicial commission. It appears that the function of the War Finance Administration is confined to control of capital issues and the administering of government assistance in the financing of essential industries. It has no responsibility for fiscal or credit policies.

From the standpoint of the price problem, the chief defect of the plan is its failure to provide for the coordination of fiscal and banking policy with direct price control. It is suggested, therefore, that the plan should be amplified by provision for a War Finance Commission, the membership of which should include representatives of the Treasury and the Board of Governors of the Federal Reserve System, the chairman of the Price-Control Authority, and the administrators of war industry, war trade, and war labor. It would be the responsibility of this agency to formulate general plans co-ordinating fiscal, credit, foreign trade, and wage policies.²

The jurisdiction of the Price-Control Authority should cover all price-control activities of the government, though it might well delegate much of the work connected with certain commodities to agencies which have peacetime contact with the industries producing them—such as the Bituminous Coal Division of the Department of the Interior, the Grain Futures Administration, and the Federal Power Commission—reserving to itself the final decision in matters of policy.

Finally, it seems clear that the exercise of special wartime controls should be entrusted to agencies consti-

² The War Finance *Administration* of the Industrial Mobilization Plan might then be made a working body dealing with loans, subsidies, and capital issues under the War Finance Commission.

tuted for the duration of the war, to be liquidated as soon as possible thereafter. While some of the normal functions of the permanent government agencies can be curtailed in wartime—for example, most of the activities associated with the relief of unemployment, and the support of certain prices—it is unlikely that this curtailment can be sufficiently extensive to free adequate energies for the administration of war measures, even when these are similar in character to some peacetime activities. Thus, to entrust existing agencies with expanded wartime authority without so expanding their personnel as to make them in effect new agencies might jeopardize the war effort through sheer absorption in extraneous activities; and, if it did not, the resumption of normal peacetime activities following the war might be similarly jeopardized. Again, the very structure and tradition of most permanent agencies could only with difficulty be adapted to war purposes. The unified responsibility, the necessary flexibility, adaptability, and freedom from binding precedents which any successful agency of wartime control must have would not be easy to impart to most of the existing departments; and some of these characteristics it would be undesirable for a permanent peacetime agency to have.

In addition to this, the fact that many of the permanent departments and agencies are charged with safeguarding the welfare of particular interests is not in harmony with the wartime needs for unified national effort and for the postponement of partisan, sectional, or occupational objectives. It is possible that these agencies could forget these particular functions, but it is not certain, and the possibility of suspicion, justified or otherwise, could always be present. This, of course, is not to deny representation on wartime agencies to particular

interests, nor is it to deny to wartime agencies the opportunity of drawing upon the skill and experience of already established agencies. What should be avoided is the extension of national industrial authority to agencies associated with particular interests.

Another reason for establishing special, temporary wartime agencies of control is the special character of many of the measures of control to which no peacetime functions correspond. In a free system, for example, there exist no agencies for establishing and administering priorities, for vetoing capital issues, for fixing prices, and the like.

Finally, new and temporary agencies are likely to be freer in the selection of personnel than permanent ones, and are also likely to attract the best personnel more easily. Much of the talent that might be available to the government under war conditions is likely to be reluctant to serve, for a variety of reasons. That reluctance can possibly be diminished by making it certain that only an emergency need is calling forth measures of control and that the passing of the emergency will mean the passing of the control. In other words, to vest war controls in temporary agencies is to acknowledge that these controls are not deemed desirable for themselves and that their ultimate liquidation is intended. That liquidation can be facilitated by a minimum of alteration of the usual functions of permanent departments, and the entrusting of abnormal functions to temporary, abnormal agencies.

CHAPTER VI

CONTROL BY FIXING A PRICE CEILING

A procedure for the control of prices that has gained considerable support in recent years involves the establishment of what is called a price ceiling. The idea is to freeze all prices at the levels prevailing at the time of the declaration of war or at the average of the prices prevailing for some stated interval before the declaration of war. Transactions at any higher prices would be prohibited, except as some price-control authority might authorize advances for individual commodities.

The most prominent advocate of the price-ceiling plan is Mr. Bernard Baruch, who was chairman of the War Industries Board during the World War and also a member of the Price-Fixing Committee. The subject may be conveniently introduced by a brief statement of Mr. Baruch's plan and a review of his supporting argument, as presented in his book, *Taking the Profits out of War*,¹ and in testimony before the War Policies Commission in 1931² and before the House Committee on Military Affairs in 1935.³

I. NATURE OF THE PRICE-CEILING PLAN

Mr. Baruch's plan includes the following features:⁴

1. The proposal relates to "every price in the whole national pattern," including "rents, wages, interest rates, commissions,

¹ Privately printed; not dated.

² 71 Cong. 2 sess., *War Policies Commission*, Hearings on H.J. Res. 251.

³ 74 Cong. 1 sess., *Taking the Profits out of War*, Hearings on H.R. 3 and H.R. 5293.

⁴ Except as noted, the following summary is based on *Taking the Profits out of War*.

fees—in short, the price for every item and service in commerce.”⁵

2. Only maximum prices are to be prescribed; if conditions of demand and supply lead to a lower price there is to be no restraint on a decline.

3. The “ceiling” is to be determined by the prices of a particular date.

4. The first task of the price-control authority is to make adjustments by raising the maximum prices of any commodities whose prices were abnormally low on the date chosen as the standard, and lowering the maximum in cases where prices at that date were abnormally high.⁶

5. Import and export prices are to be brought into the scheme through a governmental monopoly of all foreign commerce. Export commodities are to be bought at the fixed, or “frozen,” prices and sold abroad at world prices; import commodities bought abroad at world prices and sold at home at the fixed or frozen price. It is assumed, or at least hoped, that the profit of the export trade would cover the losses of the import trade.

6. If, for any item, demand exceeds supply at the price fixed, the government is to assume control of the whole supply and ration it.

7. If the price of any commodity which is essential to the war program is frozen at a figure too low to bring out maximum production, the price-fixing authority is to revise it upward.

8. Price control is only one element in a structure including the elimination of competition among procurement agencies by funneling all demand through one central agency; rationing of shortage items; conservation, standardization, elimination of other than necessitous uses, prevention of hoarding, postponement of deferrable uses; substitution; discovery of new sources of supply; an excess profits tax on the return of low-cost producers.

Mr. Baruch’s argument in support of the plan outlined above may be summarized as follows:

⁵ The same, p. 21.

⁶ Hearings, 1931, cited above, pp. 806-807.

1. Emphasis is laid on the importance of preventing wartime inflation, the assumption being that the fundamental source of inflation is the existence of wartime shortages which start a cumulative process of price increase.

2. In wartime we cannot permit the highest bidder to take all, as we do in peacetime shortage. Since there is more business than all the facilities of the country can handle, competitors must become co-operators and control of this co-operation must rest in the government. In cases where supply is inadequate the government must assume control of the whole supply and ration or apportion it, not to the longest purse, but to the most necessitous use. "Because governmental determination (*and not price*) controls demand, and because only complete co-operation (*and not competition*) can produce supply in sufficient quantity, the law of supply and demand adjourns itself."⁷ These principles, however, apply only to shortage items; prices of items in ample supply are left free to fall below the "ceiling."

3. An attempt to control prices by the fixation of a few important individual prices is unsound for a number of reasons.

First, there is a strong tendency for costs to rise under wartime inflation, and it is impossible for any seller to accept a price which does not protect him against higher costs. As a result it becomes necessary to put purchase contracts on a cost-plus basis.

Second, fixing a few individual prices has only a fragmentary and minor effect in preventing inflation. This conclusion is supported by price data showing that the "all commodity" index rose from 170 per cent in April 1917 to 202 per cent in November 1918, and that the

⁷ Baruch, *Taking the Profits out of War*, p. 22.

prices of grains, iron and steel, non-ferrous metals, chemicals, and bituminous coal were all lower in November 1918 than in April 1917, though they remained much higher than in 1914. These facts are cited, not as evidence of the success of the control that was exercised, but as evidence that all that was accomplished by the control of selected individual prices was to slow down the rate of inflation.⁸

Third, individual price-fixing is basically unsound in theory, because the uncontrolled component costs of a fixed price will constantly rise and thus make the schedule obsolete, and it will be necessary either to adjust the fixed prices upward or to extend control over the cost of living (and thus presumably over wages).

Fourth, it is claimed that piecemeal price stabilization presents greater administrative difficulties than does general stabilization through the establishment of a ceiling. This conclusion is apparently based on the belief that the task will be practically finished when the prices that are abnormally high or abnormally low at the outset have been adjusted. Thereafter prices will remain stable because costs will remain stable.

II. APPRAISAL OF THE CEILING PLAN

The plan of establishing at the very outset of a war a ceiling for all prices is obviously intended, by beginning at the foundations, to prevent the development of an inflationary price spiral. By controlling all types of prices, including wages, interest, rents, commissions, etc., the procedure, it is assumed, would prevent a rise in the

⁸ It may be noted incidentally that grains were not, as Mr. Baruch here implies, subjected to control, except in the case of wheat. Futures markets for corn, oats, and rye were closed from August 1917 until April 1918, but spot prices of these grains were left practically free throughout.

general level of costs and thus avoid the necessity of an advance in prices all along the line. The fundamental question at issue is whether this plan can really prevent the development of inflation. Consideration must also be given to such questions as whether the plan permits sufficient flexibility in the price system and whether it is administratively feasible.

Inflation and the price ceiling. Advocates of the ceiling plan assume that the starting point of general inflation is a shortage of key commodities, because a rise in the price of these commodities will increase the cost of producing other things, and will also induce the producers of the scarce commodities to bid higher prices for labor and raw materials in order to increase their own output, thereby pushing up costs for everyone else. This assumption is not valid. It is true, of course, that in an inflationary movement the commodities that are in short supply rise more quickly and rapidly than the prices of things that are abundant. But this does not mean that the rise in price of the shortage items is the primary cause of the general upward movement. Shortages occur from time to time under peace conditions, and ordinarily they do not give rise to any general upward movement of other prices. Instead of cumulatively expanding, the price disturbance gets weaker as it spreads through the system, and dies out as the ripples do when a stone is thrown into a pond. But when all prices are subjected to the upward pressure of a fiscal or credit inflation, while a shortage may serve to touch off a general advance, it is not essential.

If the only cause of the disturbance in the price level was a shortage of a limited number of commodities, the difference between the price-ceiling plan and the plan of selective control over the short items would be found

chiefly in names and legal forms, because the ceiling prices of most commodities would be as high as the prices would be without control. Mr. Baruch and his followers apparently are thinking of a situation like that of 1915, when the only prices that showed a strong upward tendency were those of commodities that were subject to extraordinary demand from the belligerents. Prices in general did not show an upward trend although money incomes were rising, because production was also rising; supply was keeping up with the expansion of income.

Where a ceiling plan would differ from other plans is in a case like 1916 or 1917-18, when there is a general expansion of quantity of funds flowing through the channels of trade and production is not correspondingly increasing. In 1916 the income inflation was due to the fiscal policies of belligerents coupled with a passive attitude on the part of our own Federal Reserve System. In 1917-18 it was due primarily to our own fiscal policy, which was not checked by a restrictive bank credit policy on the part of the Reserve System. The real test of the ceiling plan is the latter sort of case, when there is more than enough money in the hands of the public to buy, at the old price level, everything that is available for purchase. If such a situation appears—we shall consider in a moment whether the ceiling plan will prevent its appearance—what would the ceiling plan do?

Assuming for a moment that the ceiling could be enforced—we comment below on the difficulties of enforcement—it is clear that demand would exceed supply not merely for scarce items but for substantially everything. The rationing problem would no longer apply merely to genuine shortages but to a relative shortage of every-

thing in comparison with the volume of monetary demand.

The key to the problem is found in Mr. Baruch's comment that "unless complete co-operation (and not competition) can produce supply in sufficient quantity, the law of supply and demand adjourns itself." This principle, as he notes, applies only to shortage items. The rest of the economy is disposed of by permitting prices to go below the ceiling. This would be all right so long as they did tend to fall below the ceiling. But the test of the system would come in a situation when so much money was forthcoming that substantially all prices were pressing upward. There were not many shortage items in 1916-18 compared with the number of things that were in normal supply, yet the cost of living rose by 14 per cent in 1916, 19 per cent in 1917, and 19 per cent in 1918—this too in spite of selective control in 1917-18 over the things that were really short and over some that were not. Given the money incomes that were available, and given the limitations of productive capacity, the only alternatives were to permit prices to rise or to allocate nearly everything by some arbitrary test at the ceiling prices among people who had the means and were willing to pay more.

We are not arguing for the classical quantity theory of money which would explain the causal relationship as running entirely from the monetary situation to the price situation. We agree that, given an inflationary fiscal policy, any procedure which keeps down the cost to the government of goods and services will correspondingly reduce the amount of monetary expansion which such a policy requires. This is the element of truth in the doctrine that it is possible to check inflation by direct

price control. The better the bargains that the government is able to drive, the less the pressure on the Treasury for the creation of more and more new money. The same thing applies in less degree to the expansion of bank loans for non-war production. Higher prices beget larger loans, and consequently larger deposits, and these in turn beget higher prices.

The truth of the matter is that we are concerned with a double-barrelled problem. The inflationary process cannot be completely checked by an attempt to control individual prices and costs of production regardless of what is happening with respect to the total money income available for expenditure in consumer markets. Nor is it practicable, even if it were desirable, to prevent all advance in prices by concentrating solely on the fiscal and credit aspects of a problem. Theoretically, an advance in average prices might be prevented by a sufficiently drastic restriction of bank credit; but such a policy would be very dangerous because of its adverse effects upon the production of key commodities. If the inflationary process is to be controlled it must be attacked both directly and indirectly, that is, from the side of fiscal inflation and expansion of money income and from the side of prices paid by government buying agencies, and, in extreme cases, by regulation of civilian prices.

In short, the price-ceiling method fails to reach the heart of the inflationary process. As was shown in Chapter II, the essence of inflation is the expansion of money income which results from an unsound fiscal and credit policy—a policy that puts a constantly increasing supply of liquid funds in the hands of the public and leaves the public free to compete with these funds against one another, and against the government, in the purchase of a limited supply of commodities and services. While it is

true that rising costs resulting from an increase in the prices of basic commodities, advancing rates of wages, and similar causes will *force* prices upward, it is equally true that increasing money income in the hands of the public will *draw* prices upward. Unless the money incomes of the public, available for expenditure in consumer markets, is held in check it will be found an enormous task to prevent a rise in prices, both final prices to consumers and the costs of industry.

As a result of his experience in wartime, Mr. Baruch is naturally preoccupied with the cost difficulties with which industry is confronted when the inflationary process is once well under way. He is right in emphasizing that the process must be checked at the source; but he has evidently failed to appreciate that one of the primary sources of disturbance is in the methods of financing commonly employed by Treasury officials. As was indicated in Chapter IV, the writer concurs in his emphasis upon the importance of checking by direct means the price rises of those important commodities of which there is a real shortage, not primarily because of their effect on other prices but because the prices that could be obtained may be indefensible on their own merits. But we cannot accept the conclusion that this is enough to prevent inflation.⁹

Practicability of selective control. The argument that the plan of individual price-fixing is impracticable is not sustained by the experience of the War Industries Board.

⁹ That Mr. Baruch's plan neglects the fiscal precautions which we believe to be necessary is indicated by the following quotation from *Taking the Profits out of War*, p. 59: "Of course it [inflation] *must* go on when we fix only a few prices leaving the rest free to rise—as rise they must if only because of inflation of the currency which is an inevitable concomitant of any war. Individual price-fixing can never stop inflation." Neither can general price-fixing, if currency and credit inflation is accepted as inevitable.

The conditions with which the board had to deal were especially difficult because when we entered the war a rapid inflation of prices had been going on for nearly two years and the prices that had risen most were precisely the ones which it was most important to regulate from the standpoint of cost of war to the government. Nevertheless, the War Industries Board succeeded, for example, in bringing down the price of black steel sheets from \$8.00 to \$5.00 per hundred pounds; plates from \$9.00 to \$3.25; sulphuric acid from \$25.00 to \$18.00 a ton. As the war went on it was believed necessary to make upward adjustments in some of the fixed prices, on a showing by producers that their costs had risen. These cost increases consisted chiefly of wages, and the wage increases were in part justified by the cost of living, although in the case of the leading war industries they appear to have been due more to the strong bargaining position of labor than to an increase in the cost of living. It does not appear that this task of readjustment would be different in character under the plan of individual price-fixing and the price-ceiling plan, except that under the latter plan the issue would arise in a great many more cases, because permission must be obtained to raise any price, instead of only those which have been put under control.

Administration. The ceiling plan, instead of reducing administrative difficulties, would enormously increase them. Indeed, it appears that the administrative burden would be so great as to constitute one of the most decisive arguments against the ceiling plan. In the case of the World War, the difference is well illustrated by the contrast between the simple procedures of the War Industries Board, and later the Price-Fixing Committee,

in dealing with a few basic materials of which there was a genuine shortage, and the enormous administrative task and resulting confusion in the Fuel Administration and the Food Administration where the effort was to control the prices involved in the day-to-day transactions of the entire population. In undertaking to appraise the extent of administrative work involved in reasonable enforcement of a price ceiling, a multitude of difficulties may be expected, among which are the following.

There are many cases in which it is impossible to say what are the prices of a given date, either because the service is unstandardized or because of the divergencies of price between localities and between individuals and firms in the same locality. Academic students frequently assume that there exists in ordinary times a wholly mythical degree of price definiteness and price uniformity, largely because they think in terms of the large impersonalized industries where jobs and commodities are standardized and where there is necessarily somewhat more uniformity of price than in smaller units because relations with buyers are impersonal and responsibility is delegated to subordinates. Even here, however, published prices frequently do not mean what they seem to mean.

Contract work presents, perhaps, the greatest difficulty. What is the price today of the services of a contractor who erects a government building in Washington? What is the price of painting a house? On the same job, bids now range as far apart as \$200 and \$300. At the present time, in the vicinity of Washington, the price of finishing a floor will range from 3½ cents a foot to 8 cents a foot, depending partly on the contractor, partly on the varying amount of work involved in getting rid

of an old finish, partly on whether the person by whom the work is done is a building contractor or a private individual.

Who knows what is the price of a piece of land? Is it the cost to the present owner or the price he has been trying to get? The following data apply to a tract near Washington: cost to the owner in 1933, \$225 an acre; recent price of adjacent land sold by the acre, \$350; recent price of adjacent land sold in small lots, about \$600 an acre; asking price, \$425 an acre.

In the merchandising field, both wholesale and retail, prices are largely indeterminate. Under the price-ceiling plan, if a grocer stops delivery service and sells at the same price he has been asking, has he raised the price? Or, if he curtails credit terms? Prices quoted to retailers by manufacturers and wholesalers now frequently include free window display material and other "dealer helps." If these are cut off as part of a program of eliminating non-essentials, has the price of the commodity been raised? If a price-cutting firm stops cutting, is the ceiling broken?

Application of the ceiling principle to labor involves even greater difficulties. Does the principle mean that the price shall not be raised for the same individual's services or for the same service? If hours are shortened, does the principle require no higher pay per hour or no higher pay per day? Is the answer the same for laborers who have been paid by the hour, the day, and the week? Does promotion violate the principle? If not, how is a promotion to be distinguished from a pay raise? If labor were transferred from piecework to timework, or timework to piecework, is the proper comparison on the basis of each individual's piecework record, or the average performance of the group, and if the latter, average

under peacetime or wartime standards of efficiency? If one man undertakes to do the work two men have been doing in order to release someone for military service, does the ceiling principle permit him to get the same pay that both have been getting heretofore? How are changes in quality of goods taken account of? Wartime substitution is likely to raise this question in acute form.

Most of what we have said relates to the difficulties of getting started. We believe also that even in the absence of fiscal inflation there would be very great pressure for reconsideration of special cases, after the plan got into operation. A fundamental point overlooked by advocates of the plan is that costs may rise even though the prices of the elements of cost remain fixed. It seems to be assumed that if the prices of the constituent elements of cost (chiefly wages, raw materials, fuel, and transportation) are stable, costs will either be stable or will fall because of increased volume and consequent lowered overhead cost per unit. This is much too simple. Some industries will reduce their unit costs by spreading overhead over a larger volume, but the expansion of output of essentials will have to be secured in large part by curtailment of production of less essential things, and in the shrinking industries overhead cost per unit will rise. Moreover, dilution of the quality of the labor supply may result from employment of persons now out of work and women not previously in the labor market. Semi-skilled men will take skilled men's jobs. Costs may have to be incurred to compete with other industries which seek to draw away labor by offering better "working conditions," and better working conditions often mean less output per dollar of wages. If railroad congestion occurs, with consequent irregularity of deliveries, this will again increase costs, both for railroads and for

shippers. Substitution of inferior materials and fuel may be necessary.

In short, rising prices of the factors of production are only a part of the picture of rising costs. The prices of a fixed date reflect the conditions of that date and become inappropriate as fast as those conditions change. In war-time they will change with special rapidity. All these factors will create administrative tasks.

Many of the difficulties cited above may seem trivial. The individual case is trivial, but if the system is not to break down some one must provide authoritative answers to just these questions and thousands of others like them, and they must be answered in such a way that the morale of the population will not be undermined by its consciousness of ineptitude on the part of the Price-Control Authority. The first thing to ration is administrative ability. It should be conserved for tasks which have some relation to the winning of the war, not wasted on experimentation with a detailed control of consumption running beyond that now practiced by Germany.

Inflexibility. The price-ceiling plan makes for unnecessary and undesirable inflexibility. In its emphasis upon the importance of freezing the price structure, allowing changes to occur only when they are demonstrated to be necessary, there is a tendency to overlook the necessity of allowing prices to adjust themselves in the light of shifting conditions. As was pointed out in the introductory chapter, the price mechanism serves a useful function in directing labor and materials from one line of production into another in response to changing demands. In fact, it is one of the most important elements in our established mechanism of control over the complex integrated economic system.

The ceiling plan, in order to forestall a possible un-

desirable general inflation, abrogates this function of the pricing process, except in so far as it may be performed by the decline of certain prices below the level existing on "P" day. As a substitute it proposes that the direction of the flow of effort be done by governmental authority, not merely in those cases where the price system is failing to work satisfactorily, but everywhere. A price ceiling does nothing to facilitate the necessary readjustment of productive activity to wartime needs; on the contrary, its tendency would be to maintain under war conditions the structure of production that existed under peacetime conditions. By freezing the returns from different types of activity at their existing level it would weaken or destroy the incentive of producers to readjust their activities to wartime conditions. This is not to prevent disorganization, but to obstruct reorganization.

The ceiling plan would need to be supported by an extensive program of direct allocation of resources. By allocation we mean here not only the rationing of consumers' goods to the civilian population, through bread cards and similar devices, but also the allocation of raw materials, freight service, labor, banking accommodations, and other productive facilities to different stages and branches of the productive process. As was indicated in the preceding section, the role of government in the direction of the economic activity would have to be enormously expanded if the price ceiling were established. "Because governmental determination (*and not price*) controls demand, and because only complete cooperation (*and not competition*) can produce supply in sufficient quantity, the law of supply and demand adjourns itself."¹⁰ But the method of governmental determination is only hinted at. The scheme needs to be

¹⁰ Baruch, *Taking the Profits out of War*, p. 22.

elaborated by planning for the rationing of goods and services. Neither the ceiling plan nor the War Department's Industrial Mobilization Plan contains any provision for such an enormous task.

Our own experience with rationing in the past, so far as consumers' goods are concerned, is limited to coal, sugar, and flour. European experience covers a wide range, but still, outside Russia, is confined chiefly to necessities. Now, in the case of things that are bought by everybody, whether actual physical necessities or conventional necessities like tobacco and gasoline, it is not difficult to ration by authority. Everybody is given a share. But when it comes to things that most people ordinarily do not buy, there is no obvious criterion for the rationing agency.

The case of domestic servants is an extreme illustration of the difficulty. The supply will presumably be decreased by the transfer of women to war industries. Who is to decide which families are to continue to get servants at the old price and which are to do without, though willing to pay the going price, or more? If the rationing agency has more important things to do than to decide such questions in order to prevent a rise in the wages of domestic servants, what would probably happen is that servants would be given extra inducements to serve those who wanted them worst, in the form of shorter hours, free transportation, lighter duties, or laxer discipline. This would be a sort of disguised increase of pay and much inferior to raising wages as a way of distributing the under-supply. The servants would get the gain from increased competition for their services in ways that were not worth as much to them as the added pay would be, while the employer would get less for his

money under either plan. This extreme example illustrates a defect that runs all through the plan.

What was said of domestic servants applies to employees engaged in tasks that are more important than domestic service. If employers cannot compete by offering higher wages, they will compete by other concessions which will either increase the incomes of the workers or decrease the service demanded. The latter alternative means decreasing the national output at a time when there is the greatest need for increased effort.

Similar difficulties arise in connection with the prices of goods. The most obvious effect of the ceiling would be to create a "sellers' market" in everything for which the demand was such that prices tended to press against the ceiling. The peak of the boom in 1920 affords many illustrations of the tendency of a sellers' market to cause deterioration of quality. Domestic coal containing 20 per cent of stone was sold in Chicago. No dealer dared reject it because he could not be sure of getting any coal at all in its place, while the coal companies claimed that they were also helpless because they could not enforce better work on the "breaker boys" who were hired to pick out the stone, and could not replace one if they discharged him for poor work. A truck driver, instead of repairing or reporting a broken down truck, might walk away from it and get another job. This situation was not due, of course, to a price ceiling, but it would have been much worse if buyers' competition for the output of coal or for the services of labor had been conducted under a restriction that prices must remain below what people were willing and able to pay, because under that condition demand would have been still greater and supply still less.

Medicines can be rationed, as can salt or sugar or shoes. But suppose silk became scarce because of war conditions, as might easily happen if Japan were involved in the war, and silk stockings were not allowed to rise in price. Is it necessary, because we are at war, to set up a government agency to decide who would have to wear rayon or cotton?

It is not meant to suggest that these questions are unanswerable. Plans can be devised for taking care of them. But (1) the price-ceiling plan is not a plan at all till the principles of allocation are included in it; (2) at best it would do nothing to increase production and probably it would lead to lower standards of effort on the part of labor; (3) it would do nothing to direct effort into the channels most important either for the winning of the war or for the support of the civilian population. Priority for the war needs could be secured, of course, by compulsory orders, commandeering, and appeals to patriotism, but no more readily than without the ceiling.

Enforcement. There are also serious difficulties in the way of enforcement. This problem was comparatively simple under the plans used during the World War. The prices of basic materials fixed by the War Industries Board and the Price-Fixing Committee were nearly all applied in cases where the number of producers was comparatively small and the bulk of the output was taken by the government. It seems probable that the regulations were generally well obeyed. In coal also there was comparatively little complaint of violation of the price regulations; the difficulty was in transportation and in rationing.

There probably was a good deal of evasion of the regulations of the Food Administration in regard to

profit margins. Enforcement here was much more difficult because of the numbers involved and the necessity of scrutinizing accounting records to check violations. But enforcement of the proposed price ceiling would be still more difficult, because the number of potential violators would be practically the entire adult population, and once the novelty of the first announcements had worn off there would be no general consciousness of any wrong-doing in violation. The experience of the National Recovery Administration is instructive. Its regulations could be enforced on big units, but in many fields of small business it was fast becoming a farce. Even in such a large-scale industry as coal-mining, successful pressure for the passage of special coal legislation resulted, before the invalidation of the National Industrial Recovery Act, from the complete failure of enforcement of code provisions in wide areas.

Lack of necessity. Finally, a few general comments may be offered on the present setting of the problem. We are easily misled by the assumption that the next war will be just like the last one. In contrast with the situation in 1917, we are contemplating the possibility of being drawn into war at a time when prices and interest rates are depressed and there is a large volume of unemployment. We have been trying for years to stimulate business expansion by measures designed to raise prices. The situation will not be changed over night by the mere fact of our entry into war. The first task of war mobilization is the identical task of peacetime effort—to put our unemployed resources to work.

Control of specific prices may become necessary because of shortages of particular commodities which force their prices higher than is necessary to call out the desired expansion of effort. If inflation is not prevented it

may become necessary in a few cases for the federal government to intervene as a war emergency measure, because public utility rates are not advanced rapidly enough to keep pace with costs. The proposal for a price ceiling would tie our hands, committing us in advance to an enormous task of dubious success and more dubious value, before we know what the real needs of the situation will be.¹¹

ADDENDUM

While, as suggested above, our conclusions with reference to the establishment of a price ceiling are unfavorable, we suggest that in case the responsible authorities deem such a program to be advisable, the following classes of prices should be exempted at the outset from the limits imposed by the program.

1. Substandard wages. Exemption of wages below a fixed level, say 30 cents an hour, in line with national policy of attempting to level up the wages of substandard groups.

2. Wages of persons outside usual working age. Wages of persons under 16 years of age and over 60 years of age, if employed, might well be exempted. These wages are generally low anyway, and it would be desirable to encourage entry of such persons into productive work where needed. The number is not likely to be large enough so that their wages will seriously influence the general cost level.

3. Wages in risky employment. Exemption of pay of persons who are exposed to increased risk of personal injury or impairment of health on account of war conditions.

¹¹ It may be worth noting that the maintenance of a ceiling over all prices would involve a degree of interference with the normal processes of exchange greater than has been undertaken by any of the present belligerents.

4. Small establishments. Exemption of wages in establishments employing less than eight persons. This is suggested because the administrative task of enforcement would be at a maximum in the case of the small establishments, and the total number of workers involved is comparatively small.

5. Perishable foods. Prices of perishable foods fluctuate so widely that efforts at stabilization do not seem worth while.

6. Second-hand goods. Prices are too indefinite to establish a ceiling.

7. Public utility rates.

8. Inclusion of specific taxes in price. Where a specific tax is imposed on the manufacture or sale of a commodity after the establishment of the ceiling, dealers should be permitted to add the exact amount of the tax to the price.

9. Interest rates. If inflation is to be prevented it is desirable that interest rates should be permitted to rise, as low interest rates encourage credit expansion and thus increase the flow of purchasing power.

10. Capital assets. Stocks, bonds, real estate, and other properties which are valued on the basis of their present and anticipated earning power. In many cases such assets have no ascertainable value as of a particular date. Moreover, since exchanges of capital assets are outside the flow of transactions by which the productive process is organized and do not enter into the cost of living, there is no basis in public policy for restriction of the freedom of individuals to buy and sell such assets at whatever price seems appropriate. The proper price is nothing but an estimate of the present worth of the future earnings and does not itself determine those earnings. It changes with every change in the prospective earnings.

PART II

PRICE CONTROL IN THE UNITED STATES
DURING THE WORLD WAR

CHAPTER VII

INTRODUCTION

War broke out in Europe in 1914 at a time when this country was suffering from a mild depression. The first effect of the war was to aggravate this condition severely, because of the loss of central European markets, especially for cotton, and the serious difficulties of transportation and of finance which were involved in trading with the belligerents. The prices of wheat and rye rose immediately and those of chemicals very soon, but many other commodities declined moderately in price, so that during the first year of the war the general average showed practically no change.¹

Prosperity returned in the middle of 1915 as the allied governments began to place enormous contracts for war materials in the United States. By 1916 there was a tremendous boom. The purchases of the Allies were financed by gold shipments, by the sale of securities, and in part by borrowing in the United States. The larger part of the borrowing consisted of short-term credits extended directly or indirectly by the banks. Gold imports swelled the reserves of the banks at a time when they were already superabundant in consequence of the reduction in the legal requirements which accompanied the inauguration of the Federal Reserve System in November 1914. Thus an abundance of loanable funds was available at moderate in-

¹ The movements of wholesale prices of all commodities and of the cost of living from January 1914 to November 1918 are shown in the diagram on p. 28.

terest rates both for foreign and domestic requirements.

As a direct consequence of the export boom there was an enormous increase in bank loans and deposits after the middle of 1915. In the year ending June 30, 1916, the demand deposits of the banks rose from 10.3 billion dollars to 13.0 billion, and money in circulation rose from 3.4 billion to 4.0 billion dollars. National income, in dollar terms, rose from 36.2 billions in 1914 to 48.2 in 1916.² By the end of 1916 the general wholesale price index stood at 144 as compared with 101 in August 1914 and 99 in June 1915. The index of prices of metals had risen to 218 and that of chemicals to 162. Even building materials, which were affected least of any major group, had risen from 108 to 119. Thus, as would be expected, the impact of European buying was felt first in the prices of commodities which were bought in large volume by the belligerents, and later spread throughout the economic structure as the increased supply of money and the optimism generated by rising profits reflected themselves in wages, incomes, and the monetary volume of investment.

Prior to our entry into the war no attempt was made by the government to exercise direct control over prices, and very little attention was paid even to the expansion of credit. The only agency which might have felt a responsibility to control the situation was the Federal Reserve Board, and it was not implemented to exercise control, even if it had thought it wise to do so. The Reserve banks had substantially no bonds which could be sold, and their rediscount rates were ineffective in a situation where there were no rediscounts to start with, and where commercial bank reserves were constantly

² Maurice Leven, Harold G. Moulton, and Clark Warburton, *America's Capacity to Consume* (1934), p. 148.

being augmented by the inflow of gold. Moreover, as is usually the case in the earlier and middle stages of a prosperity movement, there was very little public sentiment in favor of restricting the expansion of credit. The price rise was a reflection, not of a shortage of commodities, but of an increase of incomes, and the complaints of those who suffered from the rising cost of living counted for less than the general satisfaction at the expansion of employment and the rise of wages and profits.

With the entry of the United States into the war, the situation changed. The war demand of the United States government was superimposed on that of the Allies in a situation where the productive capacity of the country for basic material was already as fully utilized as it ever is in time of peace, and the buying power of the government, backed by the hitherto unused expansive powers of the Federal Reserve System, was superimposed on that of the Allies. The result was a very sharp upward spurt of prices, particularly of those basic commodities that had already advanced the most.⁸ For example, the Bureau of Labor Statistics index of prices of metals rose from 247 in March to 333 in July. From March to May wheat prices rose by over a dollar a bushel, reaching \$3.25 a bushel. There was a much smaller rise in the prices of commodities that were not subject to special war demands, in wages, and in the cost of living. From March to July the prices of foods rose about 30 per cent, clothing 13 per cent, and building materials 25 per cent. In spite of a very sharp rise in fuel prices, industrial costs in general rose much less than did the prices of basic commodities. Hence there was an enormous

⁸ Compare chart, p. 125.

margin of profit in certain lines of production, in so far as capacity was available to take advantage of the high spot prices. The bulk of industrial capacity, however, was already booked up before the advance occurred.⁴

The problem of shortage, as distinguished from that of inflation, thus appeared first in the summer of 1917, and appeared only in commodities for which demand had suddenly increased. It appeared in wheat and flour because of the heavy demands of the Allies on the exporting capacity of the United States; in iron and steel, copper, certain chemicals, and a number of other basic commodities because of the sudden expansion of purchasing on the part of the United States government; and in coal because of the expansion of demand from war industries and the withdrawal of men from the mines for military service and into war industries. Speculative anticipation of shortage led to price boosting in a number of commodities of which there was as yet no actual shortage. Consequently price increases in these commodities ran far beyond the rise in the general level of prices and incomes. This led to a popular demand for control. This was particularly true of coal, one

⁴The very high open market prices of basic commodities in the summer of 1917 are not a valid index of the incomes actually received by producers of these commodities, or the prices paid for the bulk of the output. The wheat prices were for the tail-end of a small crop, most of which had been used up before the price got above \$2.00. Most of the output of coal, copper, steel, and many other basic materials was sold by contract, not in the open market. The quotations represent the prices that were bid in the open market by necessitous buyers for relatively small quantities in order to secure priority of delivery from concerns which were already booked up to capacity on contracts let at lower prices, or to induce fortunate holders to resell. They really represent prices paid for priority of delivery. The difference may be seen clearly, in the case of coal, by comparing the average spot prices, as published in P. W. Garrett, *Government Control over Prices*, p. 153, with average "realization" prices (the same, p. 170).

of the few commodities bought by the general public which was included in the group that shot up above the general level of prices.

The price-control program of the United States which took form in the summer of 1917 embraced two principal types of activity. One type of control related to the prices of those basic raw materials and half-finished products which were being ordered in such large quantities by the government and its allies that the forces which normally tend to keep prices in some reasonable relationship to costs were broken down. Control was designed primarily to protect the government by eliminating competitive bidding of governmental agencies and allied governments against one another. Civilian prices were included in the scheme partly because of popular resentment against profiteering, and partly to equalize in some degree the returns of producers working on government orders and those selling to the general public. Control was made effective chiefly through negotiation and agreements with formal or informal trade associations of producers. It was usually applied only to prices at the point of production; occasionally to wholesalers' or jobbers' prices; never to prices at retail. In fact, most of the commodities that were controlled had no retail markets.

The other type of control was exercised primarily in the interest of the consumers, and related chiefly to fuels and foods. Here the objective was to control the retail prices, processors' and wholesalers' margins (and in the case of coal and a few foods, producers' prices also) being brought under control in order to strengthen the control over the final price to the consumer.

The first type of control was exercised chiefly by the Price-Fixing Committee of the War Industries Board

and its predecessor organizations; the second by the Fuel Administration and the Food Administration. A number of other agencies exercised some control over prices, the most important case being the control exercised by the War Trade Board over shipping rates and the prices of certain imports.

Congress never granted to the President or to any other agency specific authority to undertake a general program of price regulation. The control of the prices of different commodities rested on different legal bases, and in some cases the legal authority was very dubious. The Food and Fuel Control Act (Lever Act) of August 10, 1917 provided specifically for the control of fuel prices, and established machinery which could be utilized for food price control. For wheat a guaranteed price of \$2.00 a bushel for the 1918 crop was fixed, this being the only instance of direct regulation by Congress. Under authority of this act a Fuel Administration and a Food Administration were set up. Control over the prices of basic commodities bought by the government rested on a much less definite legal basis. It was exercised chiefly by the War Industries Board and the Price-Fixing Committee.

In the next three chapters we describe the work of the principal price-fixing agencies. In the cases of the War Industries Board, the Price-Fixing Committee, and the Food Administration, each of which dealt with a large number of commodities, the details of the program are discussed with reference only to certain selected commodities. These offer illustrations of the most important problems that were faced and the principles that were applied.

CHAPTER VIII

CONTROL OF PRICES OF BASIC MATERIALS

The control of prices of basic raw materials and half-finished products, which centered in the War Industries Board and later in the Price-Fixing Committee, was a gradual development beginning with scattered activities of the Council of National Defense and its subsidiary agencies.¹ In this chapter we shall begin with a brief consideration of the preliminary steps toward price control taken under the authority of the Council of National Defense, and then proceed to a discussion of the more elaborate system which was developed after June 1917.

I. BEGINNINGS OF CONTROL OF PRICES OF BASIC MATERIALS

The Council of National Defense was authorized under the Army Appropriation Bill of 1916 but was not organized until March 3, 1917, just before our entry into the war. It consisted of six cabinet officers and an advisory commission of seven members. Its general function was defined as "the co-ordination of industries and resources for the national security and welfare." While the council never became an active administrative body, many of the important war agencies were developments out of its early plans and its early committees. The Food Administration grew out of the council's survey of the food problem. The Aircraft Production Board started as a committee of the coun-

¹ P. W. Garrett, *Government Control over Prices*, pp. 196-202.

cil, and its Committee on Coal Production went over into the Fuel Administration. The War Industries Board, organized in July 1917, consolidated the work of three agencies of the Council of National Defense, the General Munitions Board, the Committee on Supplies, and the Committee on Raw Materials, Minerals, and Metals.

The General Munitions Board endeavored, with considerable success, to end the practice of competitive bidding on the part of rival government agencies. It devoted much study and discussion to the determination of non-competitive fair prices, and concluded that where a definite figure could not be agreed upon, a cost-plus basis should be followed. In numerous cases, in order to obtain prompt delivery when prices were in dispute, the board authorized acceptance of delivery subject to later determination of price, with a guarantee to the producer of cost plus 10 per cent.²

What was apparently the first authorization to fix prices was given to the General Munitions Board on April 17, 1917 by the Secretary of War, in the following terms: "I authorize the General Munitions Board both to act on questions involving the determination of fair and just prices for munitions and related supplies, when called to do so by a Department head."³ This authority, of course, had reference only to prices to be paid by the government, and involved direct control only over the buying agencies, not the sellers.

The Committee on Supplies of the Council of National Defense was an advisory council to help coordinate requirements of the War and Navy Departments for clothing, equipment, and subsistence. A num-

² *Minutes of General Munitions Board*, May 5, 1917.

³ The same, Apr. 17, 1917.

ber of its subcommittees later became commodity sections of the War Industries Board. The Committee on Raw Materials, Minerals, and Metals, headed by Bernard Baruch, also set up war service committees representing specific industries, which developed later into the commodity sections of the War Industries Board. The principal work of the committee was a survey of raw material capacity. The committee itself negotiated a purchase of copper in March 1917, at 16.67 cents a pound, which was less than half the open market price. Considerable purchases of steel, zinc, lead, and lumber were also negotiated at prices below the nominal market. These prices were applicable only to the specific transactions in connection with which they were agreed upon.

II. PRICE CONTROL BY WAR INDUSTRIES BOARD AND PRICE-FIXING COMMITTEE

The work of the War Industries Board and the Price-Fixing Committee can best be discussed together, as the latter agency continued the work of the former, and the principles followed and techniques used by the two agencies were substantially the same.

The War Industries Board was created on July 28, 1917 by an order of the Council of National Defense approved by the President. It took over the duties which had previously been performed by the three agencies of the Council of National Defense just discussed, and expanded their work. It was an independent body reporting not to the council but directly to the President, and after its formation the council ceased to play an important role in the mobilization of industry. The board contained representatives of the Army, the Navy, a labor representative, a representative of the Allied

Purchasing Commission, and four other members. Its task was not primarily to control prices, but to co-ordinate industrial war effort. Such phases of its work as allocation of orders, commandeering, clearance, and especially priority were more important in promoting the war effort than was the fixing of prices, and were considerable factors in the price situation. The promotion of conservation and economy was also given much attention. The board did, however, control the prices of a number of raw materials and other basic products essential to the war program, until the creation of the Price-Fixing Committee in March 1918, and in one or two instances continued its control after that time.

The work of the board, including price negotiations, was done largely in collaboration with war service committees of leaders in the several industries. In most cases the number of firms in the industries concerned was small enough so that control could be exercised through contact with the war service committees, without the necessity of much propaganda among, or compulsion upon, individual business men. Consequently no licensing system or other machinery of enforcement was set up. Prices were fixed by negotiation and agreement, and were binding, as maxima, on all government purchasing agencies. Except in a few cases where compulsory orders were placed by the Army or Navy, there was no legal compulsion on any one to sell at these prices. Though the threat of requisitioning, compulsory orders, and commandeering was used as a bargaining weapon, there was extreme reluctance to make extensive use of these devices. There was no enforcement division. Complaints of non-observance of the fixed prices in non-governmental trade were referred to the Department of Justice, but apparently legal action was rarely if ever taken

concerning them. Prevailing opinion in the War Industries Board was that there was no legal basis for enforcement.

In March 1918 the Price-Fixing Committee of the War Industries Board was set up under the chairmanship of Robert S. Brookings, its membership including the chairman of the War Industries Board, the labor member of the board, and one representative of each of the following agencies: the War Department, the Navy, the Fuel Administration, the Tariff Commission, and the Federal Trade Commission. The committee reported directly to the President, and was only nominally an agency of the War Industries Board.

The Price-Fixing Committee, like the War Industries Board before it, operated by negotiation. Its technical work in the investigation of costs was done by the Federal Trade Commission, while its general information as to conditions in the trade was derived chiefly from the commodity committees of the War Industries Board. It did not itself organize any considerable staff.

The primary interest of the Price-Fixing Committee was in the prices paid by the government, but under a ruling made by the President in the summer of 1917 the prices it fixed were in most cases made applicable alike to governmental, allied, and private purchases, except that pre-existing contracts were not disturbed. The work of the committee was rigidly confined to dealing with commodities of which the government purchases (actual or anticipated) were so large that the markets were "upset"; that is, so large that in the absence of control the residue could have been sold at prices considerably above the level which would have been fixed by the ordinary conditions of competition. Only maximum prices were established, but since control was introduced

only in cases where shortage was believed to exist, these maximum prices generally became the only ones at which business was done. In a few cases, where the market demand proved insufficient to absorb the output of an industry at these prices, the maximum was lowered or price-fixing was abandoned.

In every case the prices fixed by the committee were made applicable alike to sales made by low-cost and by high-cost producers. The committee received numerous suggestions for classifying producers and establishing a variable scale of prices, or pooling the sales and distributing the proceeds to producers so as to equalize the returns of low-cost and high-cost producers, but these were invariably rejected.

The Price-Fixing Committee did not draw up any formal statement of its policies until July 8, 1918, when the following statement was adopted:

First.—Where the different purchasing departments of the Government require so large a proportion of any commodity as to produce such scarcity of said commodity as to require price control with a view of avoiding a runaway market, the Price-Fixing Committee is expected by conference with the said manufacturers of said commodity to stabilize prices by agreement. Failing to agree, the Price-Fixing Committee will fix a price and enforce same through some purchasing department of the Government, using to that end not only the various purchasing Enabling Acts, but such indirect pressure as priority in fuel, transportation, etc, will permit.

Second.—Where a scarcity is produced in part or in whole by limitation of imports, it is the Government's duty through the Price-Fixing Committee, and a system of import licenses under control of the War Trade Board, to see that control is secured of said importations through an option reserved in the import licenses so as to prevent a runaway market in said imported commodity.

While prices as above outlined may only be arranged for

the Government and those associated with us in the war, they, as a rule, are made for the public as well, and where made for the public, the price paid both by the public and the Government is made the same, and, while it is the custom to make maximum prices only, it is generally understood that unless there is a larger supply than the demand, the maximum prices will by necessity also become the minimum price, and the purchasing departments of the Government are usually expected to pay this price.

Third.—While the different purchasing departments of the Government are expected to fix prices on their current purchases where there are no special problems involving a lack of supply, the Price-Fixing Committee may, on application, solve any special price fixing problems, the nature of which would seem to require its jurisdiction, and which are in scale with the time involved⁴.

In general, especially in the later stages of its work, the committee adhered to the bulk-line principle discussed above.⁵ However, because it operated so largely by negotiation rather than by the exercise of authority, the decisions reached did not follow any consistent pattern. Both the use of authority and reliance on the bulk-line principle, however, appear to have had increasing vogue in the later months of the committee's work.

The policies and practices of the War Industries Board and the Price-Fixing Committee may be illustrated by a few typical cases. For detailed description we have selected the cases of iron and steel, copper, and southern pine lumber. In the cases of ferrous metals and copper, the government absorbed the bulk of the output and the open market prices soared to extraordinary heights in the spring and early summer of 1918. In fact the price-fixing program was initiated largely because of the price situation in the markets for these metals.

⁴ *Minutes of the Price-Fixing Committee*, Pt. 2, pp. 849-50.

⁵ See pp. 62-67.

The problem of southern pine lumber differed from that of the commodities just mentioned chiefly in that the number of producers was very much larger and that the proportion of the commodity absorbed by the government was much smaller and tended to decrease as the program of cantonment building was completed.

Changes in the prices of pig iron, steel sheets, yellow pine and copper are compared with an index of wholesale prices in the chart on the page opposite.

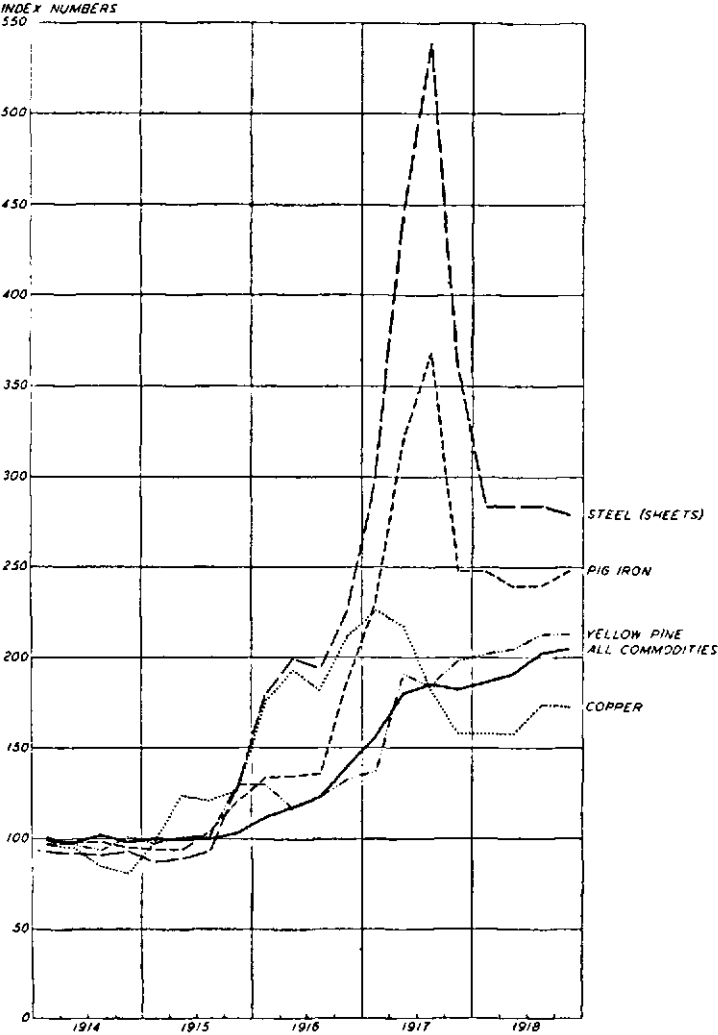
Iron and steel. Iron and steel products were purchased in this country in very large quantities by the Allies in 1915 and 1916, and prices advanced considerably more than did the general level of commodity prices. When the United States entered the war the quoted prices immediately jumped to much higher levels. Bessemer pig iron, which had sold below \$15.00 per ton in the last half of 1915, went above \$50.00 per ton in the spring of 1917. Steel billets reached \$95.00 per ton, and Connellsville coke, which had sold below \$2.00 per ton in 1915 and below \$3.00 in the first half of 1916, ranged during the first half of 1917 from \$9.50 to \$12.75 per ton.⁶

As was noted above,⁷ this rapid advance was not representative of the prices at which the bulk of the output was being sold. Most of the capacity was under contract to the Allies or the United States government or large industrial consumers at very much lower prices, and the quoted prices really represent premiums paid for priority of delivery of relatively small amounts. Even in the absence of control, it is not likely that contracts would have been let for large quantities at any such prices—assuming that the Allies and the United

⁶ Garrett, *Government Control over Prices*, p. 245.

⁷ P. 114.

PRICES OF CERTAIN BASIC COMMODITIES COMPARED WITH
GENERAL WHOLESALE PRICES DURING THE WORLD WAR^a



^a All commodities, U. S. Bureau of Labor Statistics, *Wholesale Prices, 1890 to 1919*, Bulletin No. 269, pp. 17-19; individual commodities, P. W. Garrett, *Government Control over Prices*, pp. 524-29, 546-47.

States government had pooled their purchasing or otherwise eliminated competitive bidding among themselves.

Immediately after the establishment of the War Industries Board in July 1917, that organization turned its attention to the prices of iron and steel. In its early discussions of the prices of this group of commodities, several of the most important general questions of price-fixing policy were threshed out and settled. These included the establishment of prices by negotiation and agreement, rather than by decree, with a presidential proclamation of prices following the agreement; the prescription of equal prices for the government, the Allies, and the public; the rejection of proposals to pool the market so that the profits of low-cost concerns would be shared with high-cost operators; the rule that existing contracts should not be disturbed; and the stipulation that there should be no reduction in wages as a result of the reduction of prices.⁸ These precedents were usually followed in dealing with the prices of other commodities.

Apparently the War Industries Board and the industry had considerable difficulty in reaching an agreement. On September 18 the board agreed that "should the steel interests not be willing to give their full co-operation because of the price fixed, the War Industries Board should take the necessary steps to take over the steel plants." (*Minutes of the War Industries Board*, p. 58.)

The first public announcement of fixed prices, issued on September 24, 1917, related only to coke, to pig iron, and to steel bars, shapes, and plates. The accompanying table shows the character of the schedule and

⁸ *Minutes of the War Industries Board*, Sept. 28, 1917, p. 71; Abraham Berglund, "Price-Fixing in the Iron and Steel Industry," *Quarterly Journal of Economics*, Vol. 32 (1918), p. 610.

the extent of the reduction from the nominal quotations of the open market.

PRICES FIXED SEPTEMBER 24, 1917 AND AVERAGE JULY QUOTATIONS*

Commodity	Basis	Price Agreed Upon	Average July Price
Iron ore (non-Bessemer, 51.50 per cent iron), per gross ton	Lower lake ports	\$5.05	\$5.05
Coke (blast furnace), per net ton	Connellsville	6.00	12.75
Pig iron (No. 2, foundry and basic), per gross ton	Valley and Chicago	33.00	52.50 to 55.00
Steel bars (not including sheet steel and small shapes under 3 inches per pound), per cwt.	Pittsburgh or Chicago	2.90	4.50
Shapes, per cwt.	Pittsburgh or Chicago	3.00	6.00
Plates (3/16-inch thick or heavier), per cwt.	Pittsburgh or Chicago	3.25	9.00

* Abraham Berglund, "Price-Fixing in the Iron and Steel Industry," *Quarterly Journal of Economics*, Vol. 32 (1918), pp. 597-620 (data taken from *Iron Age*). It is to be noted that prices for August and September were considerably lower than those shown in the table for July, basic pig iron, for instance having fallen by \$2.00 per ton. In part the decline was presumably due to the prospect of government price-fixing, and in part to the elimination of independent bidding on the part of the Allies.

While the cost data collected by the Federal Trade Commission were discussed in connection with the negotiations, the prices fixed were considerably higher than the costs reported by the commission would have justified. The prices were in fact intended to be high enough to make it possible to operate on a profitable basis practically any iron or steel plant in the country. There was no pretense that any such prices were necessary in order to maintain production at the large well-situated plants, particularly the fully integrated companies, whose costs were considerably lower than those

of companies that bought either iron ore or pig iron in the open market.

In October and again in November prices were fixed for a number of additional forms of steel and wrought iron pipe and scrap iron.⁹ The price schedule of the industry was so complicated, however, that the War Industries Board made no effort to draw up a complete list of prices but turned over to the American Iron and Steel Institute the task of determining differentials for other products than those listed in the price findings. A trade association of steel manufacturers thus became virtually the price-fixing authority for hundreds of products, though operating within a range determined by the basic price decisions of the War Industries Board. Originally scheduled to expire on December 31, the price schedules were extended to cover the first quarter of 1918, and later, with a number of small reductions, they were extended over the second quarter. For the third quarter the only changes were a small increase in the price of iron ore and the elimination of Chicago as a basing point for steel. In September the price of iron ore was increased for the fourth quarter by 25 cents per ton and pig iron prices by \$1.00 a ton. At the end of 1918 all controls over steel prices were allowed to expire by limitation.

Proposals that different prices should be paid to different producers of steel came up, chiefly in connection with the Bethlehem Steel Company, which reported very much higher costs than did other steel manufacturers.¹⁰ The suggestion came from various sources

⁹ With some exceptions the commodities priced in the October list were more highly processed than those in the September list, and those in the November list were still more refined.

¹⁰ Largely because they were cut off from their customary foreign ore supplies and consequently had to incur heavy freight costs for bringing ore from the interior.

that Bethlehem be paid a higher price for standard steel products than was paid to other producers. For instance, the Railroad Administration recommended in September 1918 that a price for steel rails be fixed for each producer on the basis of cost plus a reasonable profit.¹¹ At about the same time the National War Labor Board advised the Price-Fixing Committee that substantial wage increases had just been granted to the employees of Bethlehem Steel, and recommended that if, as a result of this act, the cost of production of steel should be found to have been materially increased, the price of steel to be paid the company be equitably advanced.

The committee, however, was firm in its adherence to the single price policy, and was unwilling to give all other producers an increase to cover the increase of cost to Bethlehem. In this connection the latter company was advised that the Price-Fixing Committee hoped that the company's profits on ordnance, ship-building, and other products would compensate them for any loss there might be on rails.¹² Chairman Colver of the Federal Trade Commission was of the opinion that a readjustment of rail rates should be made to enable Bethlehem Steel to secure ore, coal, and coke cheaply enough to make it a fairly low-cost producer. "Rather than permit Bethlehem to upset the whole steel industry," he added, "it might well be operated on government account and so be removed from the equation."¹³

Copper. The case of copper is peculiar in two respects. First, the peak of prices was reached in the late winter of 1916-17, before the United States entered

¹¹ *Minutes of the Price-Fixing Committee*, Sept. 27, 1918, p. 1428.

¹² The same, p. 1432. For the committee chairman's rather curt reply to the National War Labor Board, see the same, p. 1442.

¹³ Garrett, *Government Control over Prices*, p. 392.

the war. Second, in the copper-mining industry, the range of costs between the corporations which produced the bulk of the output and the high-cost concerns which produced the last 10 per cent was extremely wide, presumably because of the influence of the boom of 1915-16 in bringing into existence or keeping alive concerns which under ordinary peace conditions would not have been able to operate at all.

In the early spring of 1917 the Committee on Raw Materials, Minerals, and Metals negotiated a purchase of 45 million pounds of copper at a price of approximately $16\frac{2}{3}$ cents a pound; this was at a time when the market quotation was 35.74 cents per pound. The price was arrived at by averaging the selling prices over the 10-year period from 1907 to 1916 inclusive. The sale of this comparatively small amount of copper was a patriotic gesture on the part of the principal producers, and though the transaction probably was profitable for those who participated in it, the price was far too low to cover the costs of a great number of producers. At the time the War Industries Board was formed, negotiations were under way between the Navy Department and the copper producers for 30,000 tons of copper which was tentatively priced at 25 cents a pound. The Secretary of the Navy had offered to pay 75 per cent of the price on delivery, leaving the final price to be adjusted after cost data had been compiled by the Federal Trade Commission. When the War Industries Board took over the negotiations it followed the Secretary's plan, raising his offer to $22\frac{1}{2}$ cents a pound, but leaving the difference between that price and 25 cents to be adjusted in accordance with the Trade Commission's cost data.

On September 5, 1917, the War Industries Board

passed a formal resolution fixing the price at 22 cents a pound. The action was not made public, however, and in the course of the next few days representatives of the industry protested so strongly that the board reconsidered its decision and agreed to split the difference, conceding a price of $23\frac{1}{2}$ cents, with the understanding that outstanding contracts were to be fulfilled and wages were not to be reduced.¹⁴

There was no claim that any hardship was worked on the large producers by the fixed price of $23\frac{1}{2}$ cents,¹⁵ but complaints constantly came in from the high-cost concerns and these became more serious as wages and other costs of producing copper continued to move upward. There were repeated sessions of the committee at which the small copper producers presented their case, but no relief was given them until July 2, 1918, when the price was raised to 26 cents. It was admitted, however, that by this time costs had advanced so much that 26 cents was no more remunerative than $23\frac{1}{2}$ cents had been in 1917, so that the plight of the high-cost mines was not improved.

Because of the very wide spread of costs, and the urgent desire of the government to obtain maximum output, the case of copper affords a good illustration of the objections to the bulk-line cost method which were discussed above.¹⁶ The price fixed was far above the

¹⁴ The industry was operating under a sliding scale according to which wages rose and fell with the price of copper. The effect of the stipulation against wage reductions was that the miners continued, after the price was set at $23\frac{1}{2}$ cents, to receive the high wages which according to contract went with a copper price above 30 cents.

¹⁵ A memorandum submitted to the Price-Fixing Committee in August 1918 states the average costs of four leading companies as follows: 1917, 11.6 cents a pound; first quarter 1918, 13.48 cents; second quarter, 13.85 cents; third quarter (estimated), "over 17 cents."

¹⁶ Compare pp. 62-67.

costs that were claimed by most of the major producing units, yet not high enough to be satisfactory to a very large number of small mines. So long as the government was buying 90 per cent of the output, there would undoubtedly have been, in the absence of control, a civilian market for the output of these small mines at prices considerably higher than those that were established by the War Industries Board and the Price-Fixing Committee. The claim of the high-cost miners was that since they could have found a market for their copper at remunerative prices in the absence of price-fixing,¹⁷ they were entitled to a remunerative price under price-fixing. They recognized, however, that under the one-price system, this would necessitate paying much higher prices on at least 90 per cent of the product in order to relieve the distress and maintain the operations of the producers who accounted for the balance.

The solution offered by the small mines was a plan somewhat similar to that discussed on pages 66-67 above. They suggested that the producers be put into two classes, and that the second class, consisting of small high-cost producers who were responsible for about 10 per cent of the output, be given a materially higher price than was paid to the rest of the industry. As precedents they cited the action of the Fuel Administration in setting a higher price for anthracite coal produced by the independents than for that produced from the large railway-controlled anthracite properties. It also pointed out that the government's action in compensating the railroads on the basis of their earnings in a prewar base period meant that different roads would in the end be paid different prices for similar services.

The Price-Fixing Committee rejected the proposal,

¹⁷ Only, however, because of the absorption of the low-cost output of the big companies by the government and the Allies.

contending that in effect the producers were asking the government to pay a subsidy to perpetuate the existence of concerns which under peacetime conditions would have been unable to operate at all. No attention was paid, so far as published records indicate, to the fact that under such a plan the price paid to Class I, the low-cost producers, could have been considerably lowered, so that the government would have saved a great deal more money on its purchases from the large producers than it would have paid out in the so-called subsidy to the small producers.¹⁸

Under ordinary peacetime conditions, of course, the small high-cost producers would have had no ground for complaint if the price was set by the competition of the low-cost producers at a figure at which they could not operate. Under war conditions, however, when the price was being held down, not by competition, but by government regulation, the case is entirely different. In effect the copper-mining industry was being treated as a public utility and was being required to give priority to extensive government orders. So long as the ordinary mechanism of competition was kept inoperative, the decision to pay the leading copper producers a price 50 per cent above their admitted costs in order to get an additional 5 or 10 per cent of product from the small mines, was, we believe, neither businesslike nor politically sound.

¹⁸ In addition it was claimed by some critics that the policy of keeping the small high-cost mines in operation actually operated to reduce total output, because it enabled these mines to keep laborers on their pay rolls whose services would have been more effective if they had been compelled to transfer to the employ of more efficient concerns which were faced with a shortage of labor. The practicability of increasing production by shifting labor in this way was disputed by representatives of the high-cost producers, and we have no way to determine the merits of the issue.

It may be added that in the case of caustic soda, where a similar situation existed, a procedure similar to that suggested by the high-cost copper producers was actually followed. A price was set for government orders, which were then allocated to the low-cost concerns, and the high-cost producers were left free to sell in the civilian market for what they could get.

Another complication arose from the existence of long-term contracts between copper ore producers and smelters and refiners. These contracts, which covered periods of 10 and 15 years, were entered into in order to make it safe for refiners to provide adequate capacity to take care of the needs of their large customers. Because of the rise of costs during the war, the contracts became burdensome to the smelters and refiners, who tried repeatedly to get the Price-Fixing Committee to intervene and secure for them a larger share of the final price of copper. The Price-Fixing Committee took the position that it had no authority to allocate the price among the various factors of production, though it was admitted that there was no great difference in principle between what they were asked to do on behalf of the refiners and what they had already done on behalf of labor in stipulating that wages should not be reduced after prices were fixed. The Price-Fixing Committee did tender its services as a sort of mediator by calling a meeting of the producers and refiners to discuss the question in the spring of 1918, but refused to exercise any authority in the matter.¹⁹

¹⁹ It appears probable that the basic reason for non-action was that the Price-Fixing Committee believed that if it secured a general upward revision of refining charges it would have to raise the price of copper correspondingly, although the beneficiaries of these long-term contracts who were asked to pay more than the contracts called for were chiefly large-scale, low-cost producers who were getting a very

Southern pine lumber. Southern pine lumber was the most important item in the lumber trade of the country during the World War, being the standard material used by the government in the construction of cantonments in the eastern and southern sections of the country. As was noted above, the price-fixing problem differed from that in the two industries just discussed in two respects; first, in that the output taken by the government was comparatively small, though sufficient to create local shortages and to make possible the maintenance of a considerably higher price to the public than would obtain in the absence of the special demand for the government; and, second, in that the industry was highly competitive, with thousands of independent units.

Negotiations concerning the price of southern pine were begun very early in the war, a Committee on Lumber being appointed to act under the Raw Materials Division of the Council of National Defense in April 1917. The first step was to bring about the organization of trade associations in various branches of the pine industry and to have them send representatives to confer with the Lumber Committee. At this stage the objective was not only to protect the government against the risk that prices would be excessively high, but also to allocate orders to the various mills on the basis of their capacity and location, and thus avoid the risk that some mills, by making close prices or by special sales effort, would get more orders than they could handle

much higher price for the product than they could possibly have expected to get on the basis of their own costs. It was apparently hoped that some increase of returns to the refiners might be granted voluntarily by these low-cost producers, who would thus divide their excess profits with the refiners without increasing the charges to the marginal producers whose costs, under the bulk-line principle, determined the price. Considerable increases were, in fact, conceded.

effectively. On June 13, 1917 an agreement was made between the committee and the lumber representatives, fixing a price of \$23.20 per thousand feet for run-of-the-mill southern pine. This price, which was not based on a study of costs, represented an advance of more than one-third over the price at the close of the preceding year.²⁰

Aside from a small readjustment in September, this agreement stood until after the appointment of the Price-Fixing Committee in March 1918. No price was fixed for the public, in spite of the general policy which had been announced by the President that all prices fixed should apply alike to sales to the government, the Allies, and the general public. The attitude of the War Industries Board in this matter is indicated by the following letter which was addressed to the President by the chairman of the board, on December 7, 1917:

I am directed by the War Industries Board to say to you that we are advised that there is now no law authorizing the fixing of prices for the public or the Allies on lumber and no means of compelling obedience to such prices if disregarded. The prices imposed upon the steel manufacturers and copper producers, if resisted, could have been enforced by seizing the mines and factories under power conferred upon the President and upon the Secretary of War and the Secretary of the Navy in certain Appropriation Acts; and the existence of this power was sufficient to compel obedience to prices without exercising the power. But it is obviously impossible for the Government to seize and manage lumber mills, forests, etc. The Board therefore feels that it should not undertake to fix the prices of lumber and like products of industries which it is impracticable for the Government itself to take over and operate, because if such prices should be disregarded when there is no law providing penalties or other means for enforcing obedience to the order, the result would be to discredit the whole

²⁰ Garrett, *Government Control over Prices*, pp. 327-28.

price-fixing program. In short, we think it wise to fix prices only in those cases where there is some means, direct or indirect, of compelling obedience.

For these reasons we are not submitting for your approval prices to be charged the public on lumber.

This situation has led the War Industries Board to make a report to the Council of National Defense (which if approved may reach you) recommending legislation investing the President with power through such Agencies as he may select to fix prices during the period of the war on such articles and commodities as he may deem necessary.²¹

By the spring of 1918 open market quotations were much higher than the government price, ranging up to about \$33.00 per thousand. The Price-Fixing Committee discussed the question at one of its earliest meetings, but took no action until June 1918. In the middle of that month there was a long heated controversy between the Price-Fixing Committee and the representatives of the industry, involving three basic questions of principle: first, the one-price policy; second, the valuation of "stumpage"; and third, the choice between bulk-line and average cost. It appears from the record of discussions that in the case of this commodity not only had no price been fixed for the public, but no attempt had been made to apply the bulk-line principle.²² The lumber interests contended that the price had previously been fixed on the basis of the open market competitive prices, while the representative of the Lumber Section of the War Industries Board contended that average cost (plus an allowance for profit) had been taken into consideration.

The Price-Fixing Committee was willing to concede some increase of prices because of increases in wages and

²¹ *Minutes of the War Industries Board*, pp. 149-50.

²² *Minutes of the Price-Fixing Committee*, Pt. 2, pp. 618-98.

effectively. On June 13, 1917 an agreement was made between the committee and the lumber representatives, fixing a price of \$23.20 per thousand feet for run-of-the-mill southern pine. This price, which was not based on a study of costs, represented an advance of more than one-third over the price at the close of the preceding year.²⁰

Aside from a small readjustment in September, this agreement stood until after the appointment of the Price-Fixing Committee in March 1918. No price was fixed for the public, in spite of the general policy which had been announced by the President that all prices fixed should apply alike to sales to the government, the Allies, and the general public. The attitude of the War Industries Board in this matter is indicated by the following letter which was addressed to the President by the chairman of the board, on December 7, 1917:

I am directed by the War Industries Board to say to you that we are advised that there is now no law authorizing the fixing of prices for the public or the Allies on lumber and no means of compelling obedience to such prices if disregarded. The prices imposed upon the steel manufacturers and copper producers, if resisted, could have been enforced by seizing the mines and factories under power conferred upon the President and upon the Secretary of War and the Secretary of the Navy in certain Appropriation Acts; and the existence of this power was sufficient to compel obedience to prices without exercising the power. But it is obviously impossible for the Government to seize and manage lumber mills, forests, etc. The Board therefore feels that it should not undertake to fix the prices of lumber and like products of industries which it is impracticable for the Government itself to take over and operate, because if such prices should be disregarded when there is no law providing penalties or other means for enforcing obedience to the order, the result would be to discredit the whole

²⁰ Garrett, *Government Control over Prices*, pp. 327-28.

price-fixing program. In short, we think it wise to fix prices only in those cases where there is some means, direct or indirect, of compelling obedience.

For these reasons we are not submitting for your approval prices to be charged the public on lumber.

This situation has led the War Industries Board to make a report to the Council of National Defense (which if approved may reach you) recommending legislation investing the President with power through such Agencies as he may select to fix prices during the period of the war on such articles and commodities as he may deem necessary.²¹

By the spring of 1918 open market quotations were much higher than the government price, ranging up to about \$33.00 per thousand. The Price-Fixing Committee discussed the question at one of its earliest meetings, but took no action until June 1918. In the middle of that month there was a long heated controversy between the Price-Fixing Committee and the representatives of the industry, involving three basic questions of principle: first, the one-price policy; second, the valuation of "stumpage"; and third, the choice between bulk-line and average cost. It appears from the record of discussions that in the case of this commodity not only had no price been fixed for the public, but no attempt had been made to apply the bulk-line principle.²² The lumber interests contended that the price had previously been fixed on the basis of the open market competitive prices, while the representative of the Lumber Section of the War Industries Board contended that average cost (plus an allowance for profit) had been taken into consideration.

The Price-Fixing Committee was willing to concede some increase of prices because of increases in wages and

²¹ *Minutes of the War Industries Board*, pp. 149-50.

²² *Minutes of the Price-Fixing Committee*, Pt. 2, pp. 618-98.

freight costs, and there was no difficulty in reaching an agreement as to a fair price on government orders. In fact the government's needs could apparently have been supplied without compulsion on the industry at a price below \$26.00 per thousand. The industry representatives insisted, however, that on sales to the public (which, as was noted above, made up a much larger part of their total business than was the case with most commodities whose prices were fixed) they were entitled to a valuation of the underlying natural resources on the current market basis. The committee seems to have held to the view that the book values of the stumpage shown in the records of the various companies, which in many cases reflected prewar costs, should not be written up to the current market. This would have made little difference if the bulk-line principle was to be applied, but it made a great deal of difference if a finding was to be made on the basis of average costs.

There was also considerable difference of opinion as to the proper margin of profit, the Price-Fixing Committee at first holding out for a margin which was estimated to yield only 5 per cent on investment. This difference, however, turned out to be reconcilable, as it was agreed that a much higher margin was proper in a finding based on average cost than on one based on the costs of marginal producers who under normal conditions cannot expect to earn profits comparable to those received by the better situated companies. Representatives of the industry proposed that two prices be established, one of \$28.50 for the government and one of \$30.00 for the public. Representatives of the War Industries Board were called into conference with the Price-Fixing Committee with regard to this proposal, but the chairman of the War Industries Board stated

that the President was emphatic that prices fixed should apply both to the government and to the public, even if the government had to suffer thereby.²³ The proposal was therefore rejected. A price of \$28.00 was finally established. The record is ambiguous as to whether it was agreed to by the industry or established by the committee without agreement.²⁴

In September 1918 an unsuccessful effort was made by the industry to obtain higher prices. In this connection Professor Taussig stated that the committee had decided to refuse the increase (in spite of the fact that costs had advanced) for the reason that the time had come when the industry would have to look forward to some curtailment and that the prices fixed were sufficient to permit the continued operation of enough lower-cost units to provide for the needs of the country under the changed conditions of war. Professor Taussig explained the decision as follows:

In maintaining the present prices we face the fact that that means virtually a new bulkline in a way, a new principle of dealing with the industry. In our price-fixing hitherto we have

²³ The same, Pt. 2, pp. 652-53.

²⁴ The minutes of the Price-Fixing Committee give no indication that the representatives of the industry agreed to this price, and the published announcement made no reference to any agreement with the industry. A month later, when a committee of the industry appeared before the War Industries Board in connection with the administration of the price-fixing arrangements, the question was raised as to whether the prices had been established by agreement or by decree. The industry representatives, in order to eliminate the point from discussion, agreed that the order might be considered as agreed to then (July 9) as of June 14, but stated that the committee had left Washington on June 22 "with the very distinct impression that no agreement had been entered into." The board accepted the committee's assent in the form it was tendered, but put itself on record to the effect that "the order of June 14, 1918, was in fact expressly assented to by the members of the committee then representing the industry." (*Minutes of the War Industries Board*, pp. 345-46.)

rather gone upon the ground that the industry is to be maintained substantially in its existing dimensions. The present price looks forward . . . to the possibility that some high-cost concerns that are non-essential will have to readjust.²⁵

By this time the situation was quite unfavorable to the lumber industry. The government's program of cantonment building was complete and private building operations had fallen to a very low level, partly because of direct restrictions of large-scale market financing by the Capital Issues Committee and partly because of high costs and the shortage of building labor. There can be no dispute as to the correctness of the Price-Fixing Committee's judgment that further curtailment of the scale of operations of the lumber industry was in the public interest. It may be questioned, however, whether it might not have been better, instead of holding down the price so as to discourage production, to let it rise so as to discourage consumption and side-step the rationing problem. There was no prospect that under either policy the industry would be able to maintain its current scale of operations.

III. APPRAISAL

We have already discussed in Part I the basic price policies of the War Industries Board and the Price-Fixing Committee; hence it is unnecessary at this point to do much more than restate our conclusions.

1. Our analysis indicates that it was probably a mistake to lay down the general principle that prices fixed by the government should apply also to sales to the general public.²⁶ Unquestionably this policy resulted

²⁵ *Minutes of the Price-Fixing Committee*, Pt. 3, p. 1355.

²⁶ In a number of cases the principle was not applied, but the tendency seems to have been to apply it more and more generally as time went on.

in higher prices on government purchases than would have been necessary, or even asked for, if prices had been fixed only on direct and indirect sales to the government. In some cases, where the government was taking an overwhelmingly large portion of supplies, the added cost to the public on government purchases was much greater than the saving to the public on private purchases.

2. As we have endeavored to show in Part I, the bulk-line principle was given a much wider application than its merits warrant. Its principal usefulness was in cases where, first, the number of producers was too large to make it feasible to negotiate prices directly with individual producers; and second, where a price was being fixed for the general public. In cases where the number of producers was comparatively few the best procedure would apparently have been for the government to negotiate its own purchases by individual bargaining with producers and then, if necessary, fix a price for the general public on the bulk-line principle, or some modification of it.

3. We do not criticise the decision that existing contracts should not be disturbed on account of price-fixing, though cases might arise which would justify a different procedure.

4. The information at hand is not sufficient to enable us to pass judgment on the policy of stipulating that wages should not be reduced when prices were reduced by the price-fixing agency. We have found in the committee's records no discussion for the reasons for this ruling. Presumably it was an application by the War Industries Board, and later by the Price-Fixing Committee, of a policy which was established by the President or by some other executive agency for reasons

which had little or no connection with the price-fixing problem.

5. We offer no criticism of the form of organization or administration procedures of the Price-Fixing Committee. The creation of the committee in March 1918 was presumably a recognition of the fact that as the scope of price-fixing expanded the job was getting too big to be handled properly by the War Industries Board, which had a considerable variety of other duties. Had the scope of price-fixing expanded further it seems likely it would have been necessary to create some special enforcement machinery, and to have defined the authority of the Price-Fixing Committee by specific legislation.

CHAPTER IX

PRICE CONTROL BY THE FOOD ADMINISTRATION

If the experience of the Food Administration is studied only in its bearing on the problem of food administration in a future war, it is of comparatively little significance, since for the present at least there appears no probability that war would involve a serious problem of food shortage or of any undesirable rise of food prices, aside from a possible general price inflation movement. Even under World War conditions there were shortages of only a few important food commodities, and during the years since the World War the food-producing capacity of the country has expanded faster than the market, with the result that public policy has been directed toward restricting production and maintaining prices. How rapidly this situation would change under war conditions would depend on the effect of the war on foreign markets, but it seems highly improbable that there would be such an increase in the consumption of American food products as to create a problem of shortage.

The price control experience of the Food Administration, however, is of interest from a broader point of view, that is, for the light it throws on the technique of control of prices in general. The methods of the Food Administration were more varied and in some cases better thought out than those of the Price-Fixing Committee, and it had much more extensive experience

with the problem of enforcement. It is of interest, therefore, to summarize the principles of price control which the Food Administration followed, and to discuss their merits.

The United States had been a producer of much more food than it consumed, and the war did not change this situation. The food control problem of the United States arose chiefly from four sources: (1) the necessity of providing food, chiefly meat, wheat flour, and canned foods, for the Allies in much greater quantities than their normal peacetime importations from this country; (2) concentration in the Cuban and North American producing areas of much more than the normal proportion of the world's sugar demand (because of shortage of ocean shipping space); (3) the frictions involved in adjusting the prices of necessities to a rapidly expanding level of money incomes, with the usual inequalities and injustices of inflation; and (4) in a few cases internal transportation difficulties.

The Food Administration's activities covered a wide range. They included, besides the direct control of prices, the establishment of maximum permissible rates of profit for concerns engaged in the processing and distributing of food products; allocation of supplies to different uses and different regions; control of food exports and centralization of the purchasing of food products for the Allies; campaigns to prevent waste and bring about curtailment of consumption of scarce items; and the stimulation of production. We shall discuss only the price control program, including under that category the closely related controls over profit margins and profit rates, restriction of speculation, and control of trade practices, in so far as the latter were intended to prevent evasion of the price and profit regulations.

I. ORGANIZATION AND PROCEDURE

The beginnings of food price control date from the day following our entrance into the war, when the Council of National Defense requested Herbert Hoover to become its adviser on food problems. Mr. Hoover returned from Europe and set up an office in Washington on May 4, 1917. On May 17 he was appointed Food Administrator of the United States and began the organization of a staff. In the interval before the Food Administrator's office was given real authority by the passage of the Lever Act, on August 10, 1917, an organization was formed, and a large number of conferences were held with members of the trade, and some important agreements were negotiated.

The Lever Act conferred very extensive powers on the President for the control of production, distribution, and prices of foods, feeds, fuel, fertilizer, and the equipment required for the production of foods and fuel. It specifically prohibited, in the industries and trades to which it related, the destruction of goods for the purpose of enhancing the price; wasteful practices in production, manufacture, and distribution; hoarding; monopolization; discriminatory, unfair, deceptive, or wasteful practices; and unjust and unreasonable rates of charge.

The President was also authorized to requisition foods and to buy, store, and sell them, and to take over for operation by the government factories or plants manufacturing necessities; to regulate or prohibit the operation of exchanges and boards of trade; and to commandeer distilled spirits. To encourage wheat-growing, provision was made for a guaranteed price for the 1918 crop if sold by May 1, 1919. The guaranteed price was \$2.00 a bushel for No. 1 Northern Spring Wheat at Chicago, with freight differentials for other markets,

and with quality differentials based upon the existing federal grain standards. The President was given discretion to increase the guaranteed minimum.

The government did not engage in the direct production of food, nor, except for grain and its products and sugar, in extensive trading on its own account.¹ No subsidies were granted. In the few cases where the government did engage in trade, it made some profit from its operations. This is in contrast to the situation in Europe, where food was sold by governments at a heavy loss, to keep down the cost of living.

The backbone of the administrative procedure was found in the licensing provisions of the act, which authorized the President to require licenses from dealers and processors engaged in the production and distribution of necessities. Farm and garden producers and retailers with annual sales of less than \$100,000 were specifically exempted. The licensing system was established by a series of proclamations requiring dealers in specified foodstuffs to obtain licenses from the Food Administration. The first proclamation covered only wheat and rye, and the second covered sugar and sugar products. On October 8, 1917, practically all staple food commodities were added to the list. Small retailers were brought under control by requesting them to sign an agreement to comply with the regulations of the Food Administration, including its control over prices and profits, and then prohibiting licensed wholesalers and processors from selling goods to retailers who did not comply.

¹ In 1918 the Food Administration Grain Corporation did some trading in butter oil, beans, and peas, but these commodities constituted less than 2 per cent of its volume. "Report of the Food Administration for 1918," in 66 Cong. 1 sess., *Cold-Storage Legislation*, Hearings before the H. Committee on Agriculture, Pts. 1-11, pp. 808-09.

The administration of the Food Control Act was more decentralized than that of any other federal price-control agency. A federal Food Administration was set up in every state, and a considerable degree of independence was given to the state organizations in the establishment of "fair prices," and in dealing with minor infringements of the regulation. The general license regulations and the basic policies were established in Washington, and reports from licensees were assembled at the Washington office.

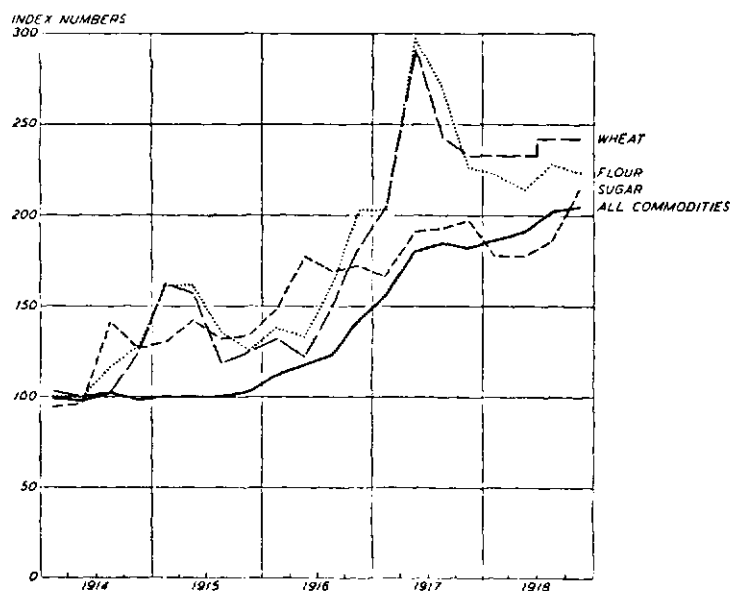
The major food problem of the United States during the World War was not to provide for the needs of its own army and its own citizens, but to feed the population of the allied countries. The Allies' demands on the North American continent had increased greatly at the beginning of the war, and the concentration became much greater when the submarine blockade created a shortage of shipping which necessitated concentration of overseas purchases in the nearest markets. The food demands of the Allies were concentrated on comparatively few commodities—those non-perishable food-stuffs which provided the maximum food value for a given bulk and weight; in other words, sugar, canned fish, wheat, flour, and meat—especially pork. These commodities, therefore, were subjected to special controls, more extensive than were imposed over other commodities, and will be discussed separately. Changes in the prices of wheat, flour, and sugar are compared with an index of wholesale prices in the chart on p. 148.

II. CONTROL OF SPECIFIC PRICES

Wheat. Before the war the normal exports of wheat from the United States had ranged from 70 million to 140 million bushels, averaging about 100 million.

They rose sharply at the outbreak of the war, and totaled 575 million for the two crop years 1914-15 and 1915-16. Prices rose earlier than those of any other important commodity, but the advance was moderated by the very large harvests of 1914 and 1915, and in

PRICES OF CERTAIN FOODSTUFFS COMPARED WITH GENERAL
WHOLESALE PRICES DURING THE WORLD WAR^a



^a All commodities, U. S. Bureau of Labor Statistics, *Wholesale Prices, 1890 to 1919*, Bulletin No. 269, pp. 17-19; individual commodities, P. W. Garrett, *Government Control over Prices*, pp. 546-49.

early August 1916 the price at Chicago was only about \$1.00 a bushel. About this time, however, it was learned that the spring wheat crop had suffered extraordinary damage from black rust, which brought the total production for the year down to 635 million bushels—only about 50 million more than the normal consumption of

the United States. There were, nevertheless, heavy exports to Europe during the winter, and very heavy purchases of forward contracts by the Allies. In the spring of 1917 it became clear that the crop of that year would be scarcely larger than that of 1916, that there would be hardly any carryover, and that the Allies held contracts which it would be impossible for sellers to fulfill. This acute shortage, combined with uncontrolled bidding by the Allies, the rapid growth of the money income of the population, and apprehensions arising from our own entry into the war, forced the price of contract wheat in Chicago to \$3.45 by May. The distress of sellers was so acute that the Board of Trade intervened, as under its rules it was authorized to do in an emergency. Futures trading was suspended, and contracts were liquidated at arbitrary prices. As the new crop came in, the price declined, reaching about \$2.25 in August, but it was believed that if there was no control over foreign buying the price might go, before the end of the crop year, to fantastic figures.²

The entry of the United States into the war changed the situation by creating an obligation on the part of the United States government to co-operate with the Allies in securing for them at reasonable prices whatever wheat could be spared, and an obligation on the part of the Allies to refrain from competitive bidding for more than that. The allied governments were insistent that heavy imports of wheat from the United States were absolutely essential if the war was to go on, their own 1917 crop being more than 200 million bushels short

² The relatively low prices of the late summer were presumably due to the lack of hedging facilities which made it difficult to find purchasers for the new crop as it came in, even though there was an acute prospective shortage, and to the uncertainty as to the duration of the war.

of normal. They were urgently asking for 150 million bushels from the United States before the harvest of 1918, yet on the basis of previous consumption there was no exportable surplus whatever.

The new Food Administration thus was faced with the double problem of squeezing as large an amount as possible out of the scanty American supply, and preventing the skyrocketing of prices to a level which would create hardship for the consumer without correspondingly increasing the available supply. The Allies were pressing for a price of \$1.50 a bushel, farmers were clamoring for \$3.00 a bushel or more, and consumers were complaining of their rising cost of living.

The first steps were the creation by executive order of the Food Administration Grain Corporation, with a capital of 50 million dollars (afterwards increased to 500 million dollars), and the centralization in this agency of all purchasing of grain and flour for the Allies. Since competitive bidding on the part of the principal buyers was thus eliminated from the wheat market, it was deemed advisable to determine a fair price for governmental and allied purchases and to stabilize the civilian market at the same figure. The Lever Act had established a minimum for the 1918 crop with a view to encouraging production, but the fixing of a price for the 1917 crop was intended primarily to fix a maximum in order to protect the civilian market in view of the prospective shortage. A commission was appointed to recommend a fair price. On August 30 it recommended unanimously a price of \$2.20 a bushel. This recommendation was accepted by the President and the Food Administration, and the Grain Corporation was directed to maintain the market at that price, which it did by buying all the wheat offered to it.

Because it was understood that the price would be maintained at a fixed level throughout the crop year, farmers had no inducement to hold any wheat off the market, and as a result during the four months from August to November 1917 wheat poured into the markets at a rate far in excess of the capacity of the mills to grind it, or of shipping to carry it abroad.³ In the absence of the steadying influence of the Grain Corporation's purchases, the price would undoubtedly have been seriously depressed during these months, especially since in the absence of a futures market it was impossible for dealers and millers to hedge their stocks, and since speculators could not hope to profit by buying wheat to carry over the winter unless prices should go considerably below the maximum at which they could expect to be allowed to sell in the spring. The levelling off of prices in fact made it unprofitable for any one to carry grain through the crop year beyond immediate needs.

After November, consumption and exportation exceeded receipts from farms, and the Food Administration's activities were then directed toward preventing a rise in the price of wheat above the "fair" price. The price was held down by sales from the stock accumulated by the Grain Corporation in the fall, and by restricting the profits of licensed millers and dealers and prohibiting them to count as cost any higher price of wheat than the established fair price. In combination with conservation measures and control of the export

³ During these four months, over 60 per cent of the total marketings of the crop year took place, and only about 40 per cent of the grinding. (Frank M. Surface, *Stabilization of the Price of Wheat during the War and its Effect upon the Returns to the Producer* (1925), p. 41.) A similar concentration of movement occurred in 1918. The ratio in the early twenties, without control, was about 51 per cent. (Computed from data relative to receipts at primary markets, published in annual reports of the Chicago Board of Trade.)

market, these regulations prevented any important rise in the price of wheat, although the supply and demand situation in the spring of 1918 would probably have made possible an even higher price for the "tail-end" of the crop than that of the spring of 1917.

The combination of two successive short crops and increased exports made necessary a drastic curtailment of domestic consumption, while the fixed price of wheat was not high enough to induce an adequate contraction by diverting demand from wheat to other foods. The Food Administration, therefore, was faced with the problem of bringing about an adequate curtailment of consumption and an acceptable allocation of supply to different uses.

The only alternative to direct rationing was to secure the necessary curtailment of consumption by prevention of waste, by stimulating the use of substitutes, and by voluntary or semi-voluntary diversion of demand from wheat to other foods. An attempt was first made to stimulate voluntary conservation by propaganda, with but slight success. There was no visible curtailment of the consumption before the mid-winter of 1917-18.

Direct pressure was therefore initiated. All licensed mills were required to dilute the flour so as to get about 8 per cent more flour out of a bushel of wheat. This was estimated to have resulted in an increase of about 3 million barrels. A campaign for the release of hoarded flour resulted in the return of at least 1 million barrels to the Food Administration. Bakers were required to mix substitutes with wheat flour, and retail buyers were required to purchase substitutes with each purchase of wheat flour. The mixing of substitutes in bakers' bread was credited by the Food Administration with a saving of nearly 4 million barrels of flour, and restriction of

the use of flour in crackers, breakfast foods, macaroni, and similar uses with a saving of one-half million barrels. The effect of the requirement that household buyers should buy substitutes along with flour was admittedly difficult to estimate, but the Food Administration believed that it resulted in at least a 25 per cent reduction in domestic consumption of wheat flour for several months. As a result of these measures it was possible to ship 85 million bushels of wheat and equivalent flour between the first of the calendar year, when no exportable surplus whatever was visible, and the beginning of the next crop year.

The Food Administration undertook the regulation of millers' and dealers' profit margins, on the theory that while a high price was necessary to stimulate production, the services of processors and middlemen required no special stimulus, so that the impact on the consumer of the relatively high farm prices might be softened by control over the intermediate stages. For the 1917-18 crop year flour millers' profits were limited by agreement and regulation to 25 cents for each barrel of flour and 50 cents for every ton of feed. Since the cost of milling was greatly affected by the scale of operations, and since milling was very heavy in the fall and very light in the spring, it was necessary to permit excess profits in the first part of the year with a view to averaging down in the latter part of the year. Toward the end of the crop year millers who had made excessive profits were required to make sales of flour to the government at a low profit or a loss, in order to bring their profits within the prescribed amount.

For the crop year 1918-19 a different arrangement was made, each licensed mill being given an individual price schedule at which it might sell its flour and other

products. The price of flour in bulk was calculated for each mill by taking the fair price of wheat at the nearest terminal, plus freight to the mill, plus a flat allowance of \$1.10 per barrel for milling, minus the estimated value of feeds recovered. Scheduled extra charges were permitted for sales to certain classes of customers, and for the cost of sacks. This plan involved the making of 8,500 separate price schedules, but it got rid of the necessity of continuous readjustment as individual costs fluctuated. Under this plan there was no restriction on the amount a mill might add to its earnings by reducing its costs.

There was no general regulation of the price of bread, though local administrators in many localities published "fair prices" and bakers who wished to sell at higher prices were required to submit evidence that such higher prices were necessary.

The following conclusions with regard to the wheat control program seem to be justified:

1. The principle of the guaranteed minimum, which was not applied to any other food product,⁴ appears to have been successful. The guarantee accomplished its purpose in stimulating an increase of production. Wheat acreage rose from 45 million acres sown in 1916-17 to 59 million in 1917-18, and 76 million in 1918-19. The guaranteed price was a few cents below the market price at the time it was established, and it is probable that there would have been a considerable expansion of acreage even without a guarantee, since the price had doubled within a year. But the guarantee relieved farmers from what then appeared to be very serious risk. Winter wheat must be sown eight or nine months in advance of the harvest. In the absence of the guarantee

⁴ For a partial exception see discussion of pork products below.

the farmer would have had to plant very high-priced seed with the risk that the war might end long before the crop could be sold. There was a general expectation that the ending of the war would bring about an immediate collapse in wheat prices (an expectation which was not realized). It may be questioned whether about the same results might not have been obtained by a guarantee of a lower price than that actually fixed, say \$1.50 a bushel, with no restriction on advances up to say \$2.25. In view of the urgency of the program, however, and the small outturn of the crops of 1916 and 1917, no serious criticism on this score is warranted.

2. The most important method used to keep down prices was the centralization of purchasing for Allies, for the government, and for the Red Cross in the hands of the Grain Corporation. Under ordinary conditions, the system of competitive price-making used in the wheat market works well, but the competitive bidding of the Allies in the spring of 1917 had undoubtedly carried prices far above the level where the advance had served any useful purpose. Centralization of control over exports eliminated the prime cause of such wild advances.

3. The elimination of the speculative market and the creation of the guaranteed market maintained by the Grain Corporation were complementary measures. Without the Grain Corporation the hedging market would have been essential, and without the hedging market the Grain Corporation was essential. From the standpoint of the farmer, the advantage of the stabilized market was that it relieved him of the task of guessing at the trend of prices, and enabled him to do his marketing when it was most convenient. The disadvantage was that it led to a congestion of marketing in the fall

months, straining the storage facilities and throwing a heavy burden on the already overburdened railway system. As it happened, however, so far as 1917-18 was concerned, this probably did little harm, since the severity of the winter and the increasing difficulty of moving coal and raw materials created even worse railway strain in the later months than existed when the congestion of wheat movement occurred. In 1918-19 it would probably have been better if the movement of grain from the farm had been more gradual.

Sugar. One of the first actions of the Food Administration was to establish control over sugar prices. The sugar problem arose from the cutting off of supplies from Germany, which made Great Britain, France, and the North European neutrals dependent chiefly on Cuba. Large stocks of sugar accumulated in the East Indies because of lack of shipping space, while supplies in America and Europe were relatively scanty. The wholesale price of raw sugar at New York was above 6 cents when the United States entered the war, as compared with 3.3 cents in July 1914. As in the case of wheat, the Allies were bidding against one another and against the American market, and were willing to pay very high prices rather than tie up shipping in the East Indian trade.

In August 1917 Hoover announced that the beet sugar producers of the United States had agreed to sell their new crop at \$7.25 per 100 pounds, plus freight from the Atlantic seaboard refining points.⁵ A Sugar

⁵ Of course beet sugar was not actually refined at the Atlantic seaboard. Cane sugar grown in Cuba and Louisiana was refined at the coast refineries, and beet sugar by prewar trade custom was sold at prices which met this competition. The result was that in general the farther away from the refinery beet sugar was sold, the lower the price. Under the Food Administration the practice was reversed, beet

Distributing Committee was appointed to allot the available sugar to different localities, in order to economize transportation and equalize supplies.

To control the price of Cuban sugar, an International Sugar Committee was formed, representing England, France, Italy, and the United States, to buy the Cuban crop and allocate it among themselves. A committee of American refiners was then appointed to allocate among our refiners the foreign sugar that was allotted to the United States. The remainder of the Cuban crop of 1917 was bought at \$6.75 per hundred pounds, delivered duty paid in New York. The entire 1918 crop was bought at \$4.60 at Cuban ports, which was equivalent to about \$6.00 for raw sugar delivered in New York. The refiners' margin was placed at \$1.30 per hundred pounds, which was later increased to \$1.45. Wholesalers' and retailers' margins were fixed on the basis of normal prewar profits. Because of the availability of Cuban supplies at moderate prices, the Food Administration was able to secure an agreement with Louisiana planters, fixing the price of the domestic cane output at \$6.35 at New Orleans.

This procedure undoubtedly kept down the retail price of sugar but it did not solve the question of distribution, since demand was greater than supply at the prices fixed. There was an especially acute shortage in the fall of 1917, before the beet sugar crop was available, a period when sugar from Java is ordinarily used. In New England, household consumers had to stand in line to buy sugar in half-pound lots. The shortage on the Atlantic Coast was intensified by the fact that the Louisiana crop did not come east in its usual quantity.

sugar being sold at inland points at seaboard price of cane sugar, plus freight from seaboard.

This was partly due to the transportation difficulties, but was also due to a blunder in price-fixing. The schedule of prices fixed for Louisiana sugar was such that it was more profitable for the producers to prepare clarified sugar for sale to western manufacturers of confectionery and bakers' goods than to ship the raw sugar east for refining.

Restrictions were put on use of sugar by manufacturers, but did not become effective soon enough to prevent considerable absorption of sugar for purposes generally considered less essential than domestic consumption. At first the manufacturers were directed to reduce their consumption to 50 per cent of the amount they had used during the first six months of 1917, but after the Louisiana and Cuban crops became available the allowance was increased to 80 per cent. This requirement was not enforced by any rationing plan and was apparently unsuccessful.⁶ In the spring of 1918, after it became apparent that the shortage would continue during the next crop year, control was tightened by requiring manufacturers to obtain from the Food Administration certificates showing the amounts they were entitled to purchase and to present these when sugar was ordered. After July 1 the allowance for most industries was again reduced to 50 per cent of normal requirements, and the certificate system was extended to all buyers of sugar except household consumers. During the 1917-18 crop year, domestic consumers' total purchases were not controlled, except locally, though limits were placed on the amount they could buy at one time. In the summer and fall of 1918 retailers were forbidden to sell sugar to

⁶ The "Report of the Food Administration for 1918" (p. 495) states: "... it is doubtful whether it was observed by any but the more patriotic manufacturers."

domestic consumers in excess of 3, and later 2, pounds per month.

For the crop year 1918 it was deemed necessary to raise the price in order to provide more stimulation for domestic production. An agreement was entered into by which the wholesale price for the 1918-19 domestic crop was set at 7.28 cents for raw, and 8.82 cents for refined sugar. Beet sugar refiners agreed to pay a fixed schedule of prices to beet-growers, considerably higher than previous prices.

As it did not prove necessary to pay so high a price for Cuban sugar, a plan was devised to equalize prices to the consumer of American and Cuban sugar, and also to equalize the prices of the old crop and new crop domestic sugar. The United States Sugar Equalization Board was incorporated, with authority to deal in raw and refined sugar. It bought up at the old price all the 1917-18 sugar in the hands of refiners and wholesalers, and immediately sold it back to the same owners at the new price, making a profit of $1\frac{1}{2}$ cents a pound. It bought the United States' share of the Cuban crop and sold it to American refiners at the same price they were paying for domestic raw sugar.

The most important features of the sugar program were: first, the elimination of competitive bidding between buyers whose operations were so large and whose demands were so insistent as to destroy the ordinary balance of a competitive market; and second, the equalization of prices through the pooling stocks in the hands of the Equalization Board. The first was an unquestionable necessity, and was far more important as a price-stabilizing factor than any other part of the program. The second, the equalization plan, furnishes a precedent which should be given careful consideration in case it becomes

necessary again to apply control over the civilian prices of any commodity of which one part of the supply is produced at substantially lower cost than another part. Beet sugar producers, Louisiana producers, and Cuban producers got different prices, but the government equalized the prices to the consumer and made a substantial profit on the Cuban low-cost portion of the supply. The equalization of prices between two crop years involves different issues, which are discussed below.⁷

Meat. The regulation of meat prices presents only two features of special interest, namely, the provisional guarantee of a minimum price for live hogs and the regulation of the profits of packers. The prices of meats were never regulated directly. Except for pork products there was no serious supply problem in connection with meats. Meatless days and meatless meals were prescribed at various times, while at other times, when cattle were coming to market in large numbers on account of the high price of feed, the public was encouraged to substitute beef for other foods.

Pork was in demand in large quantities for export, and here, as in the case of wheat, the Food Administration endeavored to maintain a price that would stimulate production. On November 3, 1917, following a break in hog prices, the Food Administration announced that it would use its best efforts to keep the price from going below \$15.50 per hundred pounds, and would also endeavor to stabilize the price of hogs farrowed in the spring of 1918 so that farmers would receive, for each hundred pounds of hog, 13 times the average cost per bushel of corn fed to the hogs, a ratio which was highly favorable to the feeder. This was not an absolute

⁷ Pp. 175-82.

guarantee: the Food Administration had no authority to make such a guarantee. It was successful in stimulating an increase in hog-raising. The number of hogs slaughtered in 1918 was over 41 million, as compared with 34 million in 1917 (43 million in 1916). Exports of pork products to Europe in 1918 amounted to over 1 million tons, as compared with about 550,000 tons in 1917 and 580,000 in 1916. In spite of this increase of exports the stock of hog products in storage at the end of 1918 was much larger than at the beginning of the year.

Control of the meat-packing industry presented unique features, which arose chiefly from the great diversity of products that are made from slaughtered animals and from the fact that the larger packers were engaged in producing many commodities that were neither animal products nor foods. Licensed packers were divided into two classes, the five companies with annual sales exceeding 100 million dollars forming one class, and those with annual sales of less than that amount, but more than \$100,000, the other.

Since the prices of live animals were not subject to control, and it was impossible to determine the cost of the materials which went into an individual product, regulation consisted only of limitation of the rate of profit. The Class I packers were required to keep separate accounts for three classes of activities, namely, (1) the production of meat products; (2) the production of foods and other items which contained relatively little material derived from slaughtered livestock, together with highly fabricated products of the livestock industry; and (3) all other operations, such as livestock raising, operations in foreign countries, the operations of financial institutions and other outside activities. The

investment in each of the three classes of activity was segregated, and profits from activities of the first class were limited to 9 per cent per year on the investment (including borrowed capital); those from the second class were limited to 15 per cent; while those of the third class were left unregulated. Profits of Class II packers were limited to 2½ per cent of the gross value of sales, with exemption from control over their non-manufacturing operations.

Licensees were required to close their books at least once in ten weeks, to make extensive reports to the Food Administration, and to give access to the representatives of the administration to all books and records, including those of subsidiaries in which the licensee held 50 per cent or more of the capital stock. Within the range of total profits permitted by these regulations, packers were permitted to fix the price of individual products at will, except that for a short time at the close of 1918 the price of oleomargarine was limited to cost of raw materials plus 6.3 cents per pound.

Other commodities. Aside from the three cases just discussed—wheat, sugar, and hogs—there were only a few instances in which absolute maximum prices were fixed by the central administration. Prices of cold storage butter and eggs were fixed for a short time in 1918. For California dried fruits, sardines, and salmon, the prices received by producers were controlled directly. In all these cases there was a high concentration, either of production or of buying from the original producers, so that the enforcement of price control was much simpler than it would have been for the scattered producers of such commodities as potatoes or apples. Except in the case of wheat, maximum price control was never applied to producers unless there existed such a concentration

point. The converse, however, was not true. There were a number of cases—like milk and citrus fruits—where control could have been, but was not, applied at the initial stage of distribution.

In addition, there was a large amount of virtual fixing of retail prices through the publication of fair price lists, compiled by state and local food administrators. Although the observance of these prices was not mandatory, their publication made it difficult for any retailer to charge more, even though under the regulations his costs might justify a higher price. Moreover, the Food Administration put the burden of proof on the retailer to show cause why he should be permitted to go above the posted fair price list. This system placed a large amount of authority in the hands of local agencies and caused much complaint from the trade, the justification of which cannot now be determined.⁸

III. PRICE POLICIES

While, as was just indicated, there was little control over producers' prices there was an extensive system of control of the margins obtained by dealers or processors. This discrimination was partly due to the political influence of farmers and partly to the hostility of both producers and consumers to the whole middlemen system; but it also had another justification. It was considered very important to stimulate production, and at the same time it was desired to hold down the cost of living as much as possible, both because of the effect on civilian morale and because of the general belief that

⁸ For instance, it was reported in trade journals that when a wholesaler or processor made a low price on a large order placed by a government purchasing agency, local food authorities sometimes made that price the basis of computation of fair retail prices, although the retailer could not in fact buy at that price.

wages were greatly influenced by the cost of living. It was believed that, while high prices were necessary to stimulate production at the farm, once the raw products were produced and brought to market the packers, millers, wholesalers, and retailers would do their part without as high margins as they would be able to get in the absence of control.

Dealers' and processors' profit margins. The basic principle of control was the general rule that all profits should be reasonable. The Food Administration was the final judge of what was reasonable, and was also the principal agency of enforcement. As was noted above, the enforcement mechanism was built around the requirement of a license and the discretion of the administration to revoke licenses without court action. An important supplemental method was the use of publicity.

Details of administration varied widely from one trade and industry to another, but most of the plans that were followed fall into one of four classes: (1) establishment of maximum margins, either in cents per pound, barrel, or other unit, or in the form of a percentage of selling price; (2) prescription of maximum total profit per dollar of invested capital; (3) prescription of trade practices such as accounting methods, packaging, delivery, and other services, and commission merchants' relations with their clients;* (4) special regulations designed to prevent speculation, usually a limitation of forward contracts to 60 days, with prohibition of speculative transactions outside the organized exchanges.

The first type of price regulation—prescription of special margins—was generally applied in cases where

* Regulations intended to implement price control were only part of the structure of trade practice control, as many regulations were imposed in the interest of conservation.

middlemen's operations were relatively simple, involving a single raw material or half-finished product which was merely resold or was processed in such a way that the ingoing material and the corresponding outgoing product could readily be identified in their relationship to one another. Much dealer regulation was of this character. For example, late in 1918 wholesalers of sugar were allowed a maximum margin of from 15 to 35 cents per hundred pounds, retailers 1.5 cents a pound on bulk sugar and 1 cent on package sugar. On bulk rice wholesalers were allowed to make 10 to 12.5 per cent, retailers 20 to 25 per cent.¹⁰

For many types of processors the rules were necessarily more complicated than for dealers. Reference has already been made to the fixing of a margin of 25 cents a barrel for millers of wheat flour in late 1917 and early 1918, and to the margin of \$1.30 (later \$1.45) per hundred pounds allowed sugar refiners on the 1917-18 crop. Cottonseed crushers in 1917 were allowed to sell all products so as to yield a margin of \$13.00 a ton above the cost of seed, with the further requirement that the crusher might not pay any higher price for seed in one market than he paid for similar seed in any other market.

In most cases the problem was too complex to be handled in this way, either because of the variety of materials included in one product, or because of the variety of products derived from one commodity, or because costs were highly variable, or cost data were lacking. In such cases, since it was impracticable to fix margins above the cost of materials, chief reliance was

¹⁰ Where two margins were quoted, different classes of services were involved. For instance, for retailers the lower margin applied to cash-and-carry stores, and the higher to those which gave credit and delivery service.

placed on restriction of total profits to a fixed ratio of total investment. As was noted above, this was done with the packers. Such restrictions were also used as a supplement to control of margins on specific products, as in the case of the flour millers.

Trade practices. The regulation of trade practices was the most minute regulation of business ever attempted in this country, except under the National Recovery Administration, which in some respects it resembled. The prohibition of resales between dealers in the same class necessitated minute regulation of the functions of different classes of dealers. Regulations were issued covering such details of practice as prompt remittance by commission merchants and auctioneers, assessment of responsibility for locating shipment upon arrival, supervision of sizes of orders (to prevent breaking up orders when higher margins were allowed on small orders than on large), the extent to which warehousemen might lend on the security of stored goods, allowance for weight of paraffin in figuring the weight of paraffined cheese, and so on.

Repression of speculation. In general the Food Administration was extremely hostile to speculation in the commodities under its control. Organized speculation through boards of trade and produce exchanges was restricted, but not wholly eliminated. The butter and egg boards were closed very early in the history of the Food Administration. Future trading in wheat, which had already been suspended by the various boards of trade before the organization of the Administration, was not resumed, the stabilization of prices by the Grain Corporation leaving no necessity or opportunity for speculation in this commodity. Future trading in corn, oats, and rye was suspended in August 1917, but the markets

were reopened in the spring of 1918, with restrictions on the volume of individual trading. This was done in response to claims of millers and dealers that their operations were seriously hampered by lack of hedging markets, since the prices of these grains at the farm were uncontrolled and fluctuated widely.¹¹ Since a primary function of a hedging market is to transfer risks from the "legitimate" trade to speculators, it was impracticable to reopen the markets exclusively for hedging. Accordingly they were reopened to speculators as well as millers and dealers, with a restriction of individual holdings to 200,000 bushels. Prior to the reopening of the speculative markets the price risk was recognized by permitting dealers and millers to earn a wider margin of profit than would otherwise have been permissible. But obviously this procedure did not lessen the risks involved in individual transactions.

Speculation outside the commodity exchanges was forbidden to licensed dealers, brokers, and processors, but not to the general public. General regulations provided that no licensee might buy or sell any food commodity for his own account unless he was regularly engaged in and held himself out to the trade as conducting the business of distributing that commodity, or used the commodity in manufacture. Licensees were also prohibited from selling any food commodity to a licensee who was not entitled to buy under the rule just cited. In addition to the general rule, three methods of control were used: prohibition of forward contracts running beyond 60 days; limitation of the amount of any

¹¹ Since millers and dealers were required to take the gain or loss from hedging operations into account in figuring their profits, and were subject to restriction on the total profit they could earn, the effect of hedging was to lessen the risk of loss, or of making a profit less than permitted, but not to raise the level of permitted profits.

commodity which a licensee was allowed to own at one time (usually 60 days normal requirements); and the requirement to sell at a fair profit on the basis of original, not replacement, cost.

Aside from the general prohibition of hoarding, there was no restriction on speculation by farmers in their own products, or by the public generally, except as they were restrained by limits on the amounts which dealers were allowed to sell to them at one time.

Rationing. Surprisingly little attention appears to have been given to the problem of allocating short supplies. If the administration was as successful as it claimed in keeping prices lower than they would otherwise have been, demand at those prices must have been expected to exceed supply, with consequent necessity for some administrative determination as to which bidders would have to go without.

The policy generally followed was to repress certain types of demand for scarce commodities by conservation measures, and to allocate short supplies by regional allocations, avoiding direct rationing except as a last resort. In cases of local shortage the burden of allocation was put on the distributors by a general requirement that supplies should be distributed equitably.

In 1918 flour mills were required to cut their shipments into any territory to 70 per cent of the amount shipped in 1917, and similar restrictions were applied to jobbers. Mill feeds were prorated by states for a short time after October 1, 1918. Sugar was prorated in both 1917 and 1918, and as was noted in a previous section, consumers were rationed. This was the only case of nation-wide rationing of consumers. The fact that no more careful supervision of distribution was necessary probably indicates that in general prices were

not much lower than they would have been in the absence of control, though there may have been many temporary local exceptions.

Summary. The main features of the Food Administration's system of price control may be summarized as follows:

I. POLICIES

1. Governmental and allied buying of critical foodstuffs was centralized.
2. Limited guarantees of minimum prices were given to producers of certain critical foods.
3. Producers' prices were allowed to move freely except in a few cases where primary purchasing was highly centralized.
4. Middleman's margins were controlled in the following ways: (a) profit margins were limited, sometimes in cents or dollars per unit and sometimes in percentage terms; (b) profit rates were restricted in relation either to investment or to gross sales; (c) resales within a trade were restricted.
5. Speculation was repressed (a) by closing certain exchanges; (b) by limitation of size of inventories; (c) by requiring sale on basis of actual, not replacement, cost; (d) by limitation of length of forward contracts.
6. The maintenance of more than one price in the same market was permitted.
7. Excess profit was eliminated by requiring offsetting sales at low profit, or at a loss.
8. In the case of sugar, equalization of costs was effected by pooling stocks in the Equalization Board for resale to the trade.

9. There was no general system of rationing, but licensed dealers were required, in case of shortage, to distribute the available supply equitably. Manufacturers' use of sugar and wheat was restricted. Sugar was rationed to consumers, both at grocery stores and in hotels and restaurants.
10. Control was not limited to commodities in short supply, but covered the whole range of processing and distribution. It also covered producers' prices in the cases of fisheries and a few agricultural products.

II. ADMINISTRATION

1. In the earlier stages of control, there was extensive use of agreements with large firms and with trade associations.
2. Licenses were required, and there was increasing reliance on control through power to revoke.
3. Trading corporations were used to control distribution as well as prices.
4. There was extensive use of propaganda and publicity for "fair" prices.
5. Much power was delegated to local agencies.

IV. APPRAISAL

Centralization of governmental and allied buying. Centralization of purchases on government account and for export to Allies was an effective means of restoring stability in the markets that were most seriously disturbed, and was probably the most important phase of the whole system of control. Because the Allies were food-deficit countries, and because transportation conditions made it imperative for them to supply their wants

as far as possible from North America, a situation had developed in which the prices they had to pay were a minor consideration. Prior to the establishment of control, their purchasing agents and those of the United States government were bidding recklessly against one another for wheat, sugar, meat products, and canned goods. So long as this competition continued, backed as it was by what amounted to blank checks on national treasuries, there was practically no limit to the level to which prices might be driven, particularly in the latter part of a crop year when supplies were small and wholly inelastic. The pooling of these demands under control of the Food Administration meant the substitution of monopoly for competition on the buying side and necessitated the establishment of arbitrary prices by the buying agency high enough, but not higher than necessary, to stimulate adequate production. This measure alone would have been sufficient to restore stability to the markets that were most disturbed.

Guarantees. Guarantees, or virtual guarantees, of minimum prices were used successfully to stimulate production of wheat, hogs, and sugar beets. This precedent might usefully be imitated if it again becomes necessary to stimulate production of a non-perishable commodity produced by a very large number of small units.¹² It is not probable that the guarantee imposed any greater burden on consumers than they would have had to bear in the absence of regulation; its significance was in relieving producers from risk rather than actually increasing their incomes. Without the guarantee, prices would probably have been lower dur-

¹² In the case of commodities produced by a comparatively small number of units, the guarantee is unnecessary, since the same result can be attained directly by placing contracts for government purchases with producers.

ing the period of heavy marketing in the fall of 1917, but higher in the spring of 1918—assuming that exports would have been as great as they were under the system that was adopted.

Free movement of producers' prices. Our analysis indicates that the Food Administration set a sound precedent in refraining from any attempt to control primary producers' prices, except in the cases where there existed a high concentration of production or primary marketing. Such concentration already existed in most of the cases where control was applied (dried fruits, sugar, salmon); in the case of wheat, concentration was created partly by the establishment of the Grain Corporation and partly by agreements with the principal grain buyers and millers. The success of this latter measure indicates the practicability of establishing control in some cases where concentration does not exist under peacetime conditions, but only at the cost of undertaking a very large administrative task, which would not be justified except in the case of commodities of such crucial importance as was wheat in the World War.

Control of profit margins. The experience of the Food Administration demonstrates the practicability of exercising a very extensive control over intermediate and final prices, at least so long as such control is generally regarded as a reasonable means of dealing with an emergency. Our information as to the extent of evasion is, of course, scanty, and there are indications that enforcement was far from being complete. The essential thing, however, was to prevent extreme broadening of profit margins in cases where temporary shortages, chiefly local, tended to create temporary virtual monopolies. This purpose was probably accomplished quite effectively.

Repression of speculation. The Food Administration was much more concerned about the prevention of speculation than in our judgment the importance of the issue warranted. There is, of course, no function for the speculator in a market which is controlled either by a price-fixing authority or by a governmental trading corporation such as the United States Grain Administration or the Sugar Equalization Board. But in so far as prices are left free to move under competitive influences, as were most food prices, it does not seem important to prevent speculators from shuffling the supply around among themselves, so long as the supply situation does not lend itself to the establishment of monopoly controls. The situations which call for the repression of speculation are pretty much the same as those which call for complete control of the marketing process.

Successful speculation, apart from the infrequent cases where markets are cornered, rests on correct anticipation of price movements, not on causing them. The temporary fluctuations of a speculative market are, of course, different from those of a non-speculative market, but what the speculators' demand takes off the market one day it adds to the supply on another day. This fact is well recognized by the clientele of futures markets, who regard the purchase of wheat for export as more significant than the purchase of many times as large an amount by speculative interests.

The issues involved are quite different in the case of organized speculation through exchanges and in that of inventory speculation by dealers in commodities that are not traded through the exchanges. The closing of the organized futures markets during the earlier phase of the Food Administration's history seems to have been a mistake. These markets perform an important

function in distributing the risk of price changes by transferring it from dealers to speculators. The difference between the wheat case and, say, the corn case is that in wheat the administration not only stopped speculation but itself assumed the risks; in corn it undertook, at first, to leave the risks on the trade while repressing the operations by which the risks had formerly been allocated. The importance of the speculators' function was recognized by the administration at first in permitting wider profit margins to the trade in corn, oats, and related products than would have been permitted if hedging facilities had been available, and later by permitting reopening of the futures markets themselves.

We suggest that whenever prices at the farm or point of import are left free, organized speculation through futures markets be permitted, subject to the usual peacetime regulation (which is now much more extensive than it was at the time of the World War).

Inventory speculation by dealers in commodities not traded on exchanges presents a slightly different case. Here the valid objection is not to the effect of speculation on prices, but on the distribution of the supply in the event of shortage. If formal or informal rationing becomes necessary the fact that one dealer has accumulated excessive stocks while others have little or none may add seriously to the difficulties of securing an equitable distribution of the supply between regions or between the customers of individual dealers. We see no necessity, however, for general restrictions such as were imposed by the Food Administration on the stocks of commodities which could be held by dealers, irrespective of the presence or absence of shortage in the supply of particular commodities. Most food products

are produced seasonally and the entire supply produced in one season has to be owned by some one until the next year's crop comes in. Aside from possible difficulties of rationing, it makes no difference to the public whether the dealer buys his supply early in the season or late.

Multiple price policy. The requirement that licensees sell on the basis of their own costs involved the maintenance of more than one price for the same commodity. Differences in cost, with consequent differences in selling prices, arose in two ways: first, from differences in location, efficiency, character of equipment, established position in the trade, and similar factors affecting operating costs; and second, from differences in the time at which, or circumstances under which, processors' raw materials or dealers' stocks had been bought. Under a competitive regime the first kind of differences give rise to more or less permanent differences in profit, while the second kind generate much larger temporary differences, because price changes bring about sporadic windfall profits and losses. These are frequently independent of the efficiency of the recipients. For convenience we may call the first class operating differentials and the second speculative differentials.

The Food Administration's policy was to wipe out both by establishing a ceiling for profits, though, of course, regulation was never minute enough to bring about complete equalization. In fact, in many cases no attempt was made to equalize differences in operating margins. Instead, specific mark-ups were permitted, presumably based on a guess at bulk-line operating cost, and the licensee was then permitted to make all the profit he could out of this margin. This was notably the practice with regard to sugar. In such important

cases, however, as meat-packing and the first crop-year of control of flour milling, the attempt was to control mark-ups in accordance with individual operating costs. In these cases the speculative differentials were ironed out by requiring that the permitted profit, whichever way it was calculated, be based on the actual cost of raw materials to the individual dealer. The effect of this rule was to compel him to pass on to the public any gain which he might otherwise realize from skillful or lucky buying.

From the standpoint of the consumer, control of the operating margins was of comparatively little importance, since the cost and profit margins of processors and dealers in most food trades are not large enough so that the differences between one and another make any important difference in the cost of living. For example, the administrative effort exerted to regulate the profit margins of flour millers cannot have saved the consumers more than a few cents each since the margin of 25 cents per barrel permitted in 1917-18, which was regarded as liberal, amounted to only 30 or 40 million dollars on the entire domestic consumption. A reduction in prices of canned goods made in 1918, on the basis of an elaborate investigation by the Federal Trade Commission, was claimed by the Food Administration to have led to a saving of 7 million dollars on the wholesale price, or about 7 cents per capita for the entire population.

As far as these operating differentials are concerned, we see no need or justification for equalization of profits on commodities sold to the general public. When equalization was effected by requiring different organizations to sell at different prices, the plan amounted to a cost-plus system applied not to government contracts,

but to ordinary trade. It was open to all the objections which lie against all cost-plus plans, which destroy the incentive to economical operation and thus lead to waste of resources. On the other hand, when the equalization was effected by requiring low price sales to government to wipe out excessive profits, it amounted to an excess profits tax of 100 per cent, collected in full immediately. This was highly discriminatory, as the excess profits tax on other industries at that time did not rise above 65 per cent, and the taxpayer had a year in which to pay.

If it is necessary to fix margins in civilian trade at all, it seems far better to fix them on the basis of past performance or bulk-line cost, and let those who can operate most cheaply make the highest profits. The Food Administration apparently was working toward this conclusion, as is witnessed by its shift from uniform margins to fixed prices for the flour-milling industry in the summer of 1918.

A more difficult problem arose from the differences in cost which resulted from price advances affecting inventories of raw materials and goods in process. In the flour-milling industry this issue did not arise, because the stabilization of wheat prices substantially eliminated inventory gains and losses. For sugar the issue arose in two ways: first, because of large differences in the cost to the refiner of Cuban sugar and American sugar which did not correspond to any difference in quality; and, second, because of the abrupt rise in prices at the end of the 1917-18 crop-year. As was pointed out in a preceding section, both these differentials were absorbed by the Sugar Equalization Board.

Thus in the cases of wheat and sugar the problem of the two prices in the same market was substantially

avoided. For most products, however, prices of basic materials were not controlled, and their general tendency was upward during the entire period. In these cases the rule that prices should be based on actual rather than replacement cost delayed the impact of rising prices on the consumer and led different dealers in the same market to sell at different prices.¹³

The case in favor of the rule is simple. The fact that rising costs, short crops, or increased competition of demand for other uses necessitates a higher price at the point of production does not necessarily mean that the dealer or processor needs a higher margin of profit. If he passes his existing inventory on to the consumer at his usual mark-up, disregarding replacement cost, he makes the same money return as he would if the price advance had not occurred. But if he sells on the basis of replacement cost, he makes a windfall profit to which, in line with the modified public utility concept of service involved in the establishment of fixed margins, he is not entitled. The cost of living ultimately goes as high under the one rule as it would under the other, but the rule followed by the Food Administration causes the rise to be delayed in reaching the consumer until his dealer's low-cost inventories are used up.

It is clear, however, that if advancing prices are justified by a shrinkage of supply or an increase of demand for a particular commodity, it is desirable that the rise on consumers' prices should occur immediately, so as to divert consumer demand to other commodities. It is just as important that the public should curtail consumption of the scarce commodity while old inven-

¹³ The rule against resales in the same class of trade was intended chiefly to prevent the absorption of differences by stepping up costs as one dealer sold to another.

tories are being used up as it is after the new high-cost supply makes its way through the channels of processing and distribution. Moreover, since not all dealers' stocks will be exhausted at once, the effect of the rule is to give arbitrary advantages to favored or lucky customers without any reference to their needs or the importance of their particular demand.

Viewed from the standpoint of the dealer, the rule works inequitably in two respects. First, it works only in one direction. When prices fall the dealer must sell his inventory in competition with the new low-cost supply, and the loss which he incurs when commodities fall in price cannot be recouped from the extra profits on those which advance in price. Second, even if prices remain on a permanently high level, the effect of the rule is to deplete his working capital to the extent of the rise in the cost of his permanent basic inventory. In any going concern a certain minimum inventory constitutes a permanent investment. If the cost of the basic inventory advances, say from \$100,000 to \$120,000, and sales are made during the transition on a replacement basis, the dealer does make, on paper, a windfall profit of \$20,000. But that \$20,000 is tied up in the inventory and cannot be realized except by liquidating the business.¹⁴ If he has to sell out the old inventory for \$100,000 plus his operating costs and normal profit, he must raise additional capital or liquidate other assets in order to maintain his real position unchanged.¹⁵

¹⁴ Whether under price control he can earn anything on this investment depends on the control policy. If he is allowed a fixed margin per physical unit of product he gets no benefit from the increase in inventory value; if he is allowed a percentage mark-up the added investment presumably pays its way.

¹⁵ The same thing is true in lesser degree if he sells on the basis of replacement but has to pay excess profits taxes on the rise in value of inventory.

While there are valid arguments on both sides of the question, we believe that it was an error to base prices on individual cost without regard to replacement cost in cases where the price of materials advanced during the period of control. Certainly the consumers had no just claim to the benefits of this rule, a benefit which was allocated in arbitrary fashion to those consumers who happened to be customers of dealers who had large stocks on hand when prices rose.

Equalization of sugar prices. In the case of sugar the two parts of the equalization plan must be appraised separately. The Equalization Board's procedure in buying the entire crop of Cuban sugar and selling it at a price equivalent to that paid for American sugar was sound. There was no reason why refiners should make an extra profit by selling low-cost Cuban sugar at a price determined by the price allowed producers of American raw sugar. Neither was there any reason for maintaining two prices in the domestic market. The equalization of the carryover of 1917-18 sugar with the 1918-19 crop was less justifiable, since this carryover was permanent inventory on which dealers were carrying the risk of future price changes, and the profit for an advance in its price would have been absorbed in carrying stocks at the higher price level. The case was not a special one; it involved the same principle as did other price advances except that the greater stability of the market made the price risk somewhat less serious.

It may be objected that if the Food Administration had permitted sales on the basis of replacement cost there would have been a tendency for licensees to restrict sales and accumulate abnormal inventories at the time when prices were expected to rise. For example, in the case of sugar it was known in advance that prices would

rise by a different amount on a different date and it would have been possible, if sales on a replacement basis had been permitted, for dealers to accumulate some excess inventory by slowing down sales in anticipation of the change, thus accentuating the current shortage and carrying unnecessarily large stocks into the next crop year when they were less urgently needed. This situation does not arise in an uncontrolled market because the price changes cannot be predicted accurately and because in general prices fall when a new crop comes in. Such a situation as arose in sugar in 1918 could be handled by a compromise measure. This would consist of allowing each dealer a normal inventory, based on past experience, and requiring him to refund to the administration the profits on any stock held in excess of this normal inventory at the time the price advance occurred.

Rationing. In contrast to the attitude that was taken toward price control, rationing was regarded as an emergency measure, to be undertaken when the ordinary processes of trade failed because of the existence of local or nationwide shortage. We do not criticize this policy. We believe, however, that the central administration probably left too much leeway to local authorities and the trade in the matter of rationing scarce commodities.¹⁶

Scope of control. The Food Administration's price-control program was much the most ambitious experiment in this field that was undertaken in the United States during the World War. The Fuel Administration never fixed the price of anything but coal and coke, omitting petroleum products and wood, and the War Industries Board and the Price-Fixing Committee regulated only the wholesale prices of a limited number

¹⁶ Compare below, pp. 185-86.

of basic commodities which were bought by the government in such large quantities as to create a real or anticipated shortage for other purposes. Under the Food Administration, on the other hand, control was the rule and not the exception. Substantially nothing was left unregulated which it was within the scope of its authority to regulate, and in several cases prices that were outside its jurisdiction were controlled indirectly through control over a later stage of production or distribution.

We believe that the scope of price control was unnecessarily broad, and that it would have been better to confine price control, as was done with rationing, to those cases where serious inadequacies were evident in the operation of the ordinary price and profit controls over the production and distribution of foods. These would have been chiefly cases in which governmental and allied purchases absorbed a large share of the product, and those in which ordinary distribution was interrupted by transportation breakdowns. Flour, feed, sugar, pork, and certain canned goods were the cases in which such interference was most needed; very little would have been lost if price control had been limited to these commodities.¹⁷

¹⁷ It may seem to the reader that there is an inconsistency between the position taken here with regard to the uniformity of the prices to be charged by high-cost and low-cost producers, and the position taken at pp. 66-67 with regard to the pricing of basic commodities. At that point we suggested as a substitute for the bulk-line principle the public utility principle of services for a fair return. We do not believe the two recommendations are inconsistent. The difference is that at the earlier point we were discussing primarily the prices to be paid by government for commodities usually produced by a few large concerns, while here we are discussing the prices of services rendered by great numbers of people, primarily for the civilian population. We do not suggest with regard to either class of commodities that the prices paid by the public for different portions of the supply should vary according to the respec-

Administration. The only features of the administrative organization used in controlling food prices which require comment are the use of trading corporations to control distribution and prices, the license system, and the extensive delegation of power to state and local food administrations. The trading corporations were two, the Food Administration Grain Corporation and the United States Sugar Equalization Board. These agencies provided much more effective control over prices of the respective commodities which they handled than was exercised over prices of other foodstuffs. The Grain Corporation, by buying the wheat surplus in periods of heavy marketing and selling it in the spring, greatly facilitated the stabilization of the price, the unsatisfied export demand making it perfectly safe for them to purchase whatever was necessary. The Sugar Equalization Board provided an effective machinery for equalizing the prices of sugar derived from high-cost and low-cost sources, and for bridging the transition between

tive costs incurred by the producers. What was suggested at the earlier point was that the price paid by the government for such a commodity as copper should be determined by individual contracts with large producers, these contracts varying with the level of costs. If prices to the public are controlled at all it can best be done by pooling the entire stock in the hands of a government corporation and reselling to the public at a single price—following the precedent set by the Sugar Equalization Board. Such a proceeding is, of course, impracticable with reference to the services of farmers, retailers, and small wholesalers. There is no reason why the government should not fill its own needs for foodstuffs by direct contact with large producers or dealers—like the packers and the co-operative marketing associations—at special prices negotiated independently of the price paid at retail by the public. Incidentally it may be noted that the precedent set by the Food Administration with regard to wheat after June 1918 suggests a better procedure than cost-plus for government contracts with low-cost producers. The prices were based on estimates of cost plus a fair return, with freedom to the producer to make as much profit at those prices as he could. This and not cost-plus is, of course, the principle followed in general in public utility administration.

the two crop years, and absorbing the inventory profits, which in the case of other commodities had to be collected from individual dealers as refunds or offset by compelling individuals to sell at the special prices required to even out the individual profit records. Both corporations returned substantial profits to the government.

This administrative method may be endorsed without reference to the merits of the policy itself. It is suggested that a similar device might usefully be employed in order to effect the pooling of high-cost and low-cost products of basic raw materials in the event that a shortage should make price control necessary.

The licensing plan provided a very effective scheme of administration for enforcing not only price control, but conservation and other objectives of the Food Administration. The power to revoke licenses was used freely to enforce compliance without the necessity of proving in court actual violation of law. Such unchecked power as the licensing plan gives an administrative body would be intolerable in peacetime. But if and when it is justified by a genuine war emergency it can be used to centralize control over economic life much more rapidly than the purpose can be accomplished through threats of commandeering, requisition, and prosecution of offenders in the courts.¹⁸

¹⁸ A minor criticism relates to the multiplicity of questionnaires and reports which were required in connection with the enforcement of the regulations, particularly those relating to profit margins. Both the industry and the Food Administration suffered because of the flood of reports which piled up in the Washington offices, far beyond any possibilities of adequate scrutiny, although 500 clerks were employed to handle them. This situation was due in large part to the pressure of time, which worked against adequate planning of the work. The superfluous character of much of the reporting was recognized by the administration, and during the late summer and autumn of 1918 the requirements went

The most dubious feature of the administrative organization, in our judgment, was the extensive delegation of power to local agencies, often made up of individuals who were not disinterested. These local administrators, largely drawn from the interested trades, exercised considerable control over details of trade practice, such as the hours that stores remained open. Their power to formulate and publish fair price lists involved the exercise of even more arbitrary control over the incomes of individuals than was involved in the central administration's fair profit regulations. The central administration did not have an adequate supervisory system to insure that this power be not used for the benefit of one section of the trade against another. On the other hand, when power was exercised by persons drawn from the general public outside the trade, there was obviously considerable risk of maladministration through lack of expert knowledge.

The history of the local administration of food control was not satisfactorily recorded, and our investigations are not adequate to justify a definitive judgment on the fairness and efficiency with which state and local food administrations functioned. It is clear, however, that the system was such as to give influential business men very large and virtually uncontrolled power over their competitors.

It is our judgment that if similar powers are again exercised by a food administration, local authority might better be delegated to full-time employees of the administration who, if drawn from the trade, could be assigned to other communities than those in which they

through a rapid process of reduction and simplification. The number of reports received currently at the time of the Armistice was less than one-fourth the number that was coming in at the peak.

have business interests. This procedure might necessitate a somewhat less ambitious program of control, but we believe that a more highly professionalized and detached administration of a smaller range of activities would be more useful.

CHAPTER X

PRICE CONTROL BY THE FUEL ADMINISTRATION

The prices of coal, like those of other basic materials, ran up to fantastic heights in the summer of 1917. While direct purchases of coal played a comparatively small part in government expenditures, the fact that coal enters directly into the cost of living of the average consumer, in addition to the difficulties which high coal prices created for the railroads, whose finances were already strained, made the coal situation one of the most important factors leading to the establishment of price control. Moreover, the blundering administration of government purchases in the summer of 1917 made conspicuous the need of some new system of control.¹

The wartime control of the prices and the distribution of fuel was effected under authority of the Lever Act, which specifically authorized the President to establish and maintain governmental controls of specified necessities, including fuel, and "to fix the price of coal

¹ In June the Secretary of the Navy was offered 1,700,000 tons of coal at \$2.95 a ton at a conference called by the Committee on Coal Production of the Council of National Defense. He rejected this proposal and placed a compulsory order for 1,700,000 tons of coal at a tentative price of \$2.335 per gross ton, the final price to be determined later on the basis of the Federal Trade Commission's cost data. The committee then called another conference of coal producers in which the Secretary of the Interior and the Secretary of the Navy participated. At this conference an agreement was effected by which a maximum price of \$3.00 a ton for mine-run coal was established, effective July 1. This agreement, endorsed enthusiastically by the Secretary of the Interior, was flatly repudiated by the Secretary of War, who was also president of the Council of National Defense.

and coke, wherever and whenever sold, either by producer or dealer." Control was administered by a Fuel Administrator, who was appointed by and responsible directly to the President. In general the principles followed by the Fuel Administrator in the regulation of production and primary distribution were the same as those followed by the War Industries Board and the Price-Fixing Committee, while those followed in the regulation of wholesale and retail trade were very similar to those of the Food Administrator.

The Fuel Administrator was appointed on August 23. Two days before this, however, the President has already announced a price schedule for each of 29 bituminous coal districts, the prices ranging from \$1.90 to \$3.25 for mine-run and \$2.15 to \$3.50 for prepared sizes. These prices were based on incomplete cost studies which had been made by the Federal Trade Commission, and it was announced that they would be reviewed, and if necessary revised, by the new Fuel Administration. Pre-existing contracts (of which there were large numbers at prices below the market, and below the new prices) were not disturbed. On August 23, the day of appointment of the Fuel Administrator, the President announced maximum prices for anthracite coal. This decree contained one unique feature, namely, that prices were established for 16 individual producers (the leaders in the industry), and all other producers were permitted to charge 75 cents a ton more than were these 16.

The early work of the Fuel Administration, so far as producers' prices were concerned, consisted of making adjustments in the prices which had been hastily set by the President. These adjustments were of three kinds. First in time came the subdivision of producing areas

to take closer account of regional differences in costs; then there was a re-examination of the cost basis and cost data on which the original and adjusted prices were determined; and later adjustments were made in consequence of wage increases.

The prices fixed by President Wilson were below the prevailing spot market prices and a storm of protest followed their announcement. The Fuel Administrator, therefore, permitted producers to bill coal at the fixed prices, with the understanding that costs would be examined and that invoices on "free coal"² would be subject to rebilling at a later date if the investigation proved that the prices fixed were too low.³

When complaints were received each complainant was required to submit, on forms prepared by the Federal Trade Commission, annual cost data for 1916 and monthly data for 1917. If a complaint seemed to be justified, a provisional increase was authorized, and the Federal Trade Commission then asked to send an investigator to study the original cost records. All the adjustments that were made were upward.⁴

While the Fuel Administration was being organized, the operators and miners of the central competitive fields were meeting informally to consider demands for a wage increase.⁵ Out of this joint conference came an agreement to increase wages, with a proviso that the agreement was to become effective only if the price of bituminous coal was advanced by the United States government to cover the extra cost. The Bureau of

² That is, coal not covered by contracts.

³ *Final Report of the Fuel Administration*, pp. 240-42.

⁴ The same, pp. 175-77.

⁵ The Fuel Administrator asked them to adjourn the meeting until he had completed the organization of his administration, but in September he agreed to let the joint meeting proceed.

Labor of the Fuel Administration approved the increase necessary to cover this extra cost, and on October 27, 1917 the President issued an order adding 45 cents to each of the prices he had fixed on August 21, 1917.⁶

Early in January 1918 the Fuel Administrator appointed an Engineers Committee, charged with the duty of making a general review of costs in the coal industry, and to study the methods of fixing prices.⁷ The committee used the cost data gathered by the Federal Trade Commission. Its report was the most systematic application of the bulk-line method which has come to our attention. The analysis consisted first of adjusting the original returns so as to make them consistent, grouping the data by districts, and charting the results to obtain the bulk lines. In general this analysis "confirmed" the prices already fixed by the President. It also confirmed the estimates of increased cost due to the labor advance of November 1, 1917, referred to below.⁸

In the case of anthracite coal detailed studies resulted in only one change in the fixed prices. This was made on October 1, 1917, consisting of a reduction of 60 cents per ton for pea coal. An upward adjustment to allow for a wage increase was made on December 5, 1917, and another on November 1, 1918.

Jobbers' margins. The presidential order of August 23, 1917, which fixed anthracite prices, also established

⁶The increase was not to apply to coal sold at mine under existing contracts containing provision for an increase of price in the case of an increase of wages.

⁷*Report of the Committee of Engineers*, p. 12. With respect to the latter point it considered (1) cost-plus method; (2) modified cost-plus, that is, profit graduated, decreasing as costs increased; (3) average cost method—average for a district; (4) pooling method—coal to be sold at average cost of each district, plus profit, and returns to each colliery adjusted on basis of its cost (pp. 12-13).

⁸The same, pp. 14-20.

gross profit margins for jobbers of both bituminous and anthracite coal. Jobbers of bituminous coal were limited to 15 cents per ton of 2,000 pounds as total gross margin on a given shipment, regardless of the number of jobbers who might successively handle it. Jobbers of anthracite coal were limited to 20 cents per ton of 2,240 pounds for deliveries east of Buffalo, and to 30 cents for deliveries west of Buffalo.⁹

Retail prices. At the outset the Fuel Administration intended to leave the control of retailers' margins to state and local fuel administrators, co-ordinated by a control section in the Fuel Administration.¹⁰ But on October 1 the Fuel Administrator issued an emergency order dealing with retail prices, without waiting for the completion of the state organizations. This order specified that the average retail gross margin added to the cost of any class of coal should not exceed the average gross margin added by such dealer during 1915 by more than 30 per cent, nor exceed the average gross margin added in July 1917.¹¹ Revision and ultimate determination of retail prices was left to local organizations. The Administrator issued an order which con-

⁹ Gross margins could be increased by five cents per ton where jobbers incurred the expense of rescreening at Atlantic or lake ports for transshipment by water.

¹⁰ In the certificate of appointment of state administrators, Garfield outlined their powers as follows. Subject to the act of Congress, and rules and regulations of the President or the Federal Administrator, each state administrator was to "have power and authority in respect to coal and coke within said state to fix and approve retail prices and gross margins to be charged by dealers, to prescribe and administer reasonable rules for the regulation of the sale, shipment, distribution, apportionment, storage and conservation of coal and coke within said state. . . . All such prices, gross margins, and regulations shall be subject to modification, revocation or cancellation at any time by the President of the United States or the U. S. Fuel Administrator." (*General Orders*, p. 32.)

¹¹ The same, pp. 199-201.

firmed and approved all maximum retail gross margins and prices "heretofore and hereafter" put in effect by state administrators, subject to modification by the administrator making it, or by the United States Fuel Administrator. In a few instances flat maximum prices were established.

Each state administrator was requested to choose a committee of citizens (composed of persons not in the coal business) in each county and city of over 2,500 population. Among the duties of such committees was that of reporting to the state administrations "reasonable retail margins," after investigation of local costs of distribution. In conjunction with producers' prices and jobbers' margins already fixed, such margins, if approved, would determine the maximum prices to consumers.

It is not clear to what extent the United States Fuel Administration exercised further control over retail prices. The Bureau of State Organizations of the administration is referred to as having the assistance of the field section of the Federal Trade Commission¹² in the determination of margins. But it is not clear whether this bureau exercised control over local prices, or merely assisted in localities where difficulties in determination of retail prices were encountered. Where such difficulties were encountered, a member of the field force was designated to make an investigation, and where this procedure did not result in an agreement, public hearings were held. A system of appeal from state administrators was set up on August 16, 1918.

Oil. No attempt was made to regulate the price of oil until the middle of 1918, and even then price-fixing re-

¹² This section was transferred to the Bureau of State Organizations on July 31, 1918.

sulted from a voluntary agreement on the part of petroleum producers not to raise prices.¹³ In fact there was little occasion for price-fixing in this industry. The price of crude petroleum had fallen sharply in 1914-15 as a result of the opening of the deep sands of the Cushing Pool in Oklahoma. After September 1915 prices recovered somewhat, but in the last quarter of 1916 they were only slightly above the average for the year 1913. Further increases took place in 1917, but the average for the year was only 31 per cent above the 1913 level, and even for the first quarter of 1918 the price (\$3.88 per barrel) was only 58 per cent above the 1913 level.¹⁴

On May 17, 1918 the Director of the Oil Division of the Fuel Administration advised the oil industry that the government would not view with approval any further advance in the price of crude oil, and that the industry would be expected to co-operate in the maintenance of existing prices as maximum prices.

As a result of this letter numerous conferences were held, and the National Petroleum War Service Committee submitted a plan for the stabilizing of prices on August 6, 1918. Under this plan sub-committees of the committee were appointed in the various oil-producing sections of the country, maximum premiums for oil produced in various fields were established, and provision was made that crude oil should not be diverted from the channels through which it was delivered on May 17, 1918 without the approval of the local committee. The findings of sub-committees were to be reviewed by the committee. The Oil Division of the Fuel

¹³ The Lever Act did not contain any express authorization for the fixing of oil prices.

¹⁴ *Final Report*, p. 270.

Administration was to function only when the interested parties failed to reach an agreement. This plan was approved by the Director of the Oil Division on August 8, 1918, and was to continue in effect until November 1, 1918. It was subsequently extended for a further period of three months after November 1, 1918. Thus in this industry the control of prices was really vested in a more or less representative organization of the industry itself.

Appraisal. The organization and procedures of the Fuel Administration involved no important issues that have not been discussed already in connection with other agencies. The Fuel Administration's policies were like those of the War Industries Board in the establishment of a single price for public and private buying, and the use of the bulk-line principle. It was like the Food Administration in that the scope of its activities covered not only producers' prices but the margins of wholesalers and jobbers and the prices and profit margins of retailers. The distinctive features were the breaking up of the producing industry into regional groups for price-fixing purposes and, in the case of anthracite coal, the setting of different prices for two groups of producers.

The coal industry afforded one of the best cases that can be cited in favor of the bulk-line principle: first, because the number of producers was very large; second, because the cost data for individual producers were very imperfect; and third, because private purchases were the major factor in the market so that a single price for coal produced within a given competing area was practically a necessity.

An appraisal of the effectiveness with which the Fuel Administration carried out its task of stimulating pro-

duction and allocating coal to essential uses would be beyond the scope of this volume.

With reference to a possible future war, the situation has been entirely changed by the creation of the Bituminous Coal Commission with extensive peacetime powers of control over prices. Should the question of wartime emergency control arise, the most effective procedure would probably be to entrust the task to the Coal Commission, extending its jurisdiction to cover anthracite coal, but giving the price-fixing authority supervision over the policies of the commission sufficient to insure a reasonable conformity of its practice to that followed in fixing other prices.

CHAPTER XI

THE CONTROL OF RENTS

During the winter of 1917-18 complaints began to be made of inadequate housing facilities and rising rents. There was no general shortage of housing in the country as a whole, and rents generally lagged far behind most prices on the upswing. But the war effort did result in local congestion, especially in three types of communities: (1) cities such as Bridgeport, Bethlehem, New London, and Erie, where huge industrial contracts were placed, and where the influx of laborers quickly exhausted the available housing facilities; (2) remote communities where proving grounds, shell-loading plants, and other dangerous industries were placed for reasons of safety, and where no housing facilities whatsoever were available; (3) shipbuilding communities and navy yards, particularly on the Pacific Coast, where existing housing facilities were adequate only for the normal peacetime working force.¹ In a class by itself was Washington, D.C., which suddenly had to find accommodations for the influx of thousands of wartime government employees.

Complaints of inadequate housing and high rents emanated from various sources, including individuals, labor unions, arsenal and navy yard commanders, presidents and employment managers of corporations with

¹ See U. S. Housing Corporation, *War Emergency Construction*, Vol. 1 (1920), p. 1; 65 Cong. 2 sess., *Public Buildings and Grounds*, Hearings before H. Committee on Public Buildings and Grounds on H. R. 12818, p. 28.

war contracts, local councils of national defense.²

For example, the Inland Steel Company reported early in 1918 an urgent need for from 2,000 to 3,000 houses in Erie. The Pusey and Jones Company reported to the House Committee on Labor that if they had adequate housing facilities in Wilmington they could increase the efficiency of their plant by 50 per cent; the Newport News Shipping and Drydock Company reported that if they could find adequate housing for employees they could reduce their time of delivery by six or eight months. The Bethlehem Steel Company complained throughout the winter of 1917-18 of a shortage of from 5,000 to 8,000 men which they claimed was reducing their output by approximately 40 per cent, and attributed this shortage to a lack of housing. The commandants of the Bremerton and Mare Island Navy Yards on the Pacific Coast reported that their respective shipbuilding and repair activities were being materially delayed because of their inability to hold the necessary labor on account of inadequate housing facilities.³

² See, for example, 65 Cong. 2 sess., *To Provide Housing for War Needs*, Hearings before H. Committee on Labor on H. R. 9642; U. S. Department of Labor, Bureau of Industrial Housing and Transportation, *Report of the United States Housing Corporation, Dec. 3, 1918* (1919); Edward L. Schaub, "The Regulation of Rentals during the War Period," *Journal of Political Economy*, Vol. 28 (1920), p. 4; Council of National Defense, Committee on Production, *Weekly Reports*, Jan. 29, 1918-Apr. 13, 1918, National Archives. The instances of housing difficulties which follow are taken from these sources.

³ A very large number of these complaints had to do with migration of labor and it seems improbable that the responsibility for this can be placed entirely upon the absence of adequate housing. The competitive bidding for labor which was so characteristic of our war industries, especially in the shipyards, must have been a factor of at least equal weight. It is possible also that business men used the housing situation to some extent as a convenient excuse for failure to meet production quotas, when other factors were more important.

It is clear from the weekly reports of the Committee on Production of the Council of National Defense (which on May 28, 1918 became the Advisory Committee on Plants and Munitions of the War Industries Board) that a real housing shortage did exist in the shipbuilding and most of the steel manufacturing cities. In congressional hearings upon housing problems, special emphasis was naturally given to the shortage of houses in Washington. It was reported that during the war years Washington had a steady net increase in population of approximately 1,000 per week for whom existing housing facilities, if they existed at all, were often unsuitable.⁴

Changes in rents. Many bitter complaints were received by federal authorities concerning the cases of alleged rental "profiteering." Most of these complaints, however, appear to have related to isolated cases which were not at all typical of the general situation.⁵ In this respect the situation throughout the country was very uneven. The National Industrial Conference Board reported⁶ that for the country as a whole rental increases between July 1914 and February 1919 averaged 28 per cent; the national income had more than doubled in this period, with less than average building activity. An examination of rental movements, in com-

⁴ 65 Cong. 1 sess., *Antiprofitteering Rent Bill*, Hearings before S. Subcommittee on the District of Columbia, H. R. 9248, p. 18; Report of the Committee on Requisitioned Houses, quoted in the *Report of the U. S. Housing Corporation*, p. 141.

⁵ The hearings, for example, on the antiprofitteering rent bill of the Senate Subcommittee on the District of Columbia, p. 12, reveal great indignation at "four or five" cases of rental increases of 300-400 per cent. See the same, pp. 13, 14, 45, 107, 122; the hearings already cited of the House Committee on Labor, pp. 55-56; and the *Report of the U. S. Housing Corporation*, p. 43.

⁶ *Wartime Changes in the Cost of Living*, Research Report No. 14 (1919), p. 11.

parison with the movements of other significant elements in the cost of living in particular cities reveals great disparity, but in no case was the increase in rentals anywhere near as great as the increase, for example, in the cost of food. Very rarely did rental increases exceed 40 per cent, whereas food often rose more than 90 per cent and clothing more than 100 per cent.⁷ The accompanying table indicates the reported change in rentals for a number of industrial cities.⁸

From these reports it appears obvious that the outcry against rental increase was, on the whole, unjustified, in view of the general income expansion and the much greater increases of prices of other items in the cost of living. The costs of building and house equipment, and the costs of services and repairs increased much more than did rents.⁹

Control of rentals. Nevertheless, complaints at these increases led to some action to hold rentals down. Aside from the legislation for the District of Columbia noted below, this effort did not involve federal legislation except that protection was extended by Congress to soldiers and their dependents in premises renting for \$50 per month or under; the Navy was authorized to

⁷ See William F. Ogburn, "A Study of Rents in Various Cities," *Monthly Labor Review*, Vol. 9 (1919), p. 617.

⁸ The computations reported in these tables were made after various types of rental control, later to be reviewed, were imposed, and therefore do not show what the movement of rentals would have been in the absence of this control. It is not likely, however, that this fact is of material significance, since the degree of control differed greatly from city to city, and all cities show very moderate increases in rentals as compared with any other element in the cost of living. In part, of course, the lag is due to the existence at any one time of lease contracts made at an earlier period.

⁹ See Hearings before S. Subcommittee on the District of Columbia, p. 19 ff., 33, 113-14, 133, 134; *War Emergency Construction*, Vol. 1, p. 100 ff.; Schaub, "The Regulation of Rentals," pp. 1-3.

requisition residential property for the use of men engaged in constructing torpedo boat destroyers and parts thereof; and authority was given the Shipping Board to requisition houses for construction workers.¹⁰

PERCENTAGE INCREASE IN CERTAIN ELEMENTS OF THE COST OF LIVING^a
FROM DECEMBER 1914 TO DECEMBER OF YEAR INDICATED^a

City and Date	Food	Clothing	Fuel and Light	Housing
Baltimore				
1917.....	64.4	52.1	25.5	3.0
1918.....	96.4	107.7	46.0	13.8
Boston				
1917.....	45.8	47.5	29.2	0.1 ^b
1918.....	74.9	117.5	56.6	2.8
Chicago				
1917.....	53.4	50.6	19.3	1.4
1918.....	78.7	138.9	37.1	2.6
Houston				
1917.....	57.3	51.5	22.7	7.7 ^b
1918.....	86.1	117.3	47.5	1.7 ^b
Los Angeles				
1917.....	33.4	45.0	10.4	0.6 ^b
1918.....	61.8	109.1	18.3	4.4
New York				
1917.....	55.3	54.2	19.9	2.6
1918.....	82.6	131.3	45.5	6.5
Portland, Ore.				
1917.....	42.2	44.4	20.2	22.2 ^b
1918.....	70.6	96.6	30.9	12.3
Seattle				
1917.....	38.7	36.4	23.9	0.6 ^b
1918.....	72.5	88.0	51.8	44.3

^a *Monthly Labor Review*, Vol. 11 (1920), pp. 480-84.
^b Decrease.

After several proposals for legislation restricting rental increases in the District of Columbia, the Saulsbury Resolution was passed by Congress on May 31, 1918. This provided that tenants holding leases of one month or longer were protected against rental increases and against eviction provided they paid their rent, kept their agreements, and behaved themselves. Premises

¹⁰ *War Emergency Construction*, Vol. 1, p. 104.

sold to bona fide purchasers, or wanted by the landlords for their own occupancy, were exempted.¹¹

Elsewhere rental disputes between landlord and tenant were dealt with by negotiation, often without any clear legal basis. Under the auspices of the Bureau of Industrial Housing and Transportation of the Department of Labor, community committees, representing real estate operators, labor, the legal profession, and the public were organized in 76 communities; in 50 others pre-existing organizations, such as local councils of defense, were utilized to adjudicate rental disputes.¹²

Of these committees and other organizations, 78 reported a total of 8,029 disputes brought before them,¹³ of which 1,102 were decided in favor of the landlord, and 3,456 in favor of the tenant, while in 1,535 cases concessions were demanded from both parties. Evictions prevented through persuasion amounted to 752.¹⁴

Various means were used by these committees to overcome recalcitrancy. Most of them can be comprised under one or more of the following headings:

Appeals to reason, patriotism, civic pride, or sense of fairness.
Reference to fair rental standards set in many cities by the real estate operators themselves.

Mediation of friends or officials.

Disapproval of (or threats of expulsion from) real estate boards, Chambers of Commerce, and similar organizations.

Threats of increase of taxes.

Threatened or actual refusal to list rooms or houses.

¹¹ The same, p. 103; Schaub, "The Regulation of Rentals," pp. 32-33.

¹² "Adjustment of Rent Profiteering Cases by the Department of Labor," *Monthly Labor Review*, Vol. 8 (1919), pp. 899-901; *Report of the U. S. Housing Corporation*, pp. 16-17, 35-36; *War Emergency Construction*, Vol. 1, pp. 29-30, 101.

¹³ An extremely low number, if rental profiteering had been as common and as serious as many of the complainants intimated. This supports the position taken above that rent profiteering was not common.

¹⁴ *War Emergency Construction*, Vol. 1, pp. 29-30.

Pressure brought to bear by the health department, city council, or tenement house authority.

Threat to cut off fuel supply, through the co-operation of the Fuel Administration (Philadelphia).

Support of public officials (sheriff's delay in serving eviction notices, district attorney's refusal to press proceedings).¹⁵

Standards of fair rentals. In spite of this talk of fair rental standards and the imposing list of sanctions, there appears to have been little agreement among the committees as to what standards should be followed. Some cities used the rental established at some base date;¹⁶ others added a fixed percentage to the rental of some base date.¹⁷ Another method was to permit rates amounting to a standard percentage of the appraised value of the property.¹⁸ In other communities return on investment varying from 6 to 10 per cent was accepted as standard.¹⁹

Alleviation of the housing shortage. The federal agency primarily responsible for dealing with this housing question was the Bureau of Industrial Housing and Transportation of the Department of Labor. This agency instituted a building program in various cities, under the control of the United States Housing Corporation. New building, however, was kept to a minimum because of the cost of construction, the length of time involved, which necessitated other emergency measures

¹⁵ The same, pp. 104-05; Schaub, "The Regulation of Rentals," pp. 32-33.

¹⁶ For instance, Bath, Me., used the rates of Aug. 1, 1914.

¹⁷ Wilmington, for example, took 1914 rental plus 15 per cent; Newark, 1914 rental plus 20 per cent.

¹⁸ For instance, Sharon, Pa., permitted 10 per cent; New London, Conn., "10 per cent plus one-third, with allowances for significant alterations."

¹⁹ *War Emergency Construction*, Vol. 1, p. 103; Schaub, "The Regulation of Rentals," pp. 30-31.

while construction was going on, the urgent demands for resources elsewhere, and the fear lest housing capacity should be unduly expanded in regions from which population would flow at the end of the war.²⁰

The corporation professed to stimulate and aid private capital to build houses for war workers, but no instances of activity beyond mere exhortation have been found. Early in 1918 it refused to grant the Bethlehem Steel Company a grant-in-aid, or even a loan, for the construction of workers' houses.²¹ The War Finance Corporation made no advances that can be identified as aids to housing.²² The Priorities Committee of the War Industries Board granted blanket priorities to certain specified types of industrial housing.²³

Some effort was made to extend and improve transportation facilities within the commuting radius of congested centers. Where it was possible at all, this method was favored above the construction of dwellings, by reason of the lower cost involved, estimated at \$35.00 per man per year.²⁴ Most of this work, however, seems to have been concentrated in the New Jersey area.

Finally, systematic efforts were made to bring about the maximum utilization of existing housing facilities through vacancy canvasses and appeals to householders to take boarders. But the fact that rents in congested

²⁰ The U. S. Housing Corporation expended a total of \$42,000,000 (\$28,000,000 in 1918 and \$14,000,000 in 1919) on construction. See its own *Report and Construction Activity in the United States*, pp. 15, 18, 87. It reported that the per capita cost of dormitories was \$550 per man, and of dwelling houses \$1,750 to \$2,250 per man.

²¹ *Weekly Report* for the week ending Feb. 2, 1918, of the Committee on Production. This committee had itself previously recommended that such aid be denied. The same, for the week ending Dec. 1, 1917.

²² See its *First Annual Report*, 1919.

²³ Compare, among others, *Priorities Circular No. 21*, Sept. 3, 1918.

²⁴ *Report of the Housing Corporation*, p. 15.

areas were not permitted to rise militated against the complete success of this attempt.²⁵

Summary and conclusions. During the period of American belligerency in the World War, certain areas suffered from housing congestion. The resulting strain was blamed for a considerable part of the admittedly bad labor conditions, particularly in shipbuilding and steel manufacturing cities. It seems likely that the individuals most concerned with housing conditions exaggerated this responsibility, since other important factors were omitted or touched upon only lightly. Various methods of alleviating the shortage were tried, but only after considerable time had been lost.

Still more exaggeration seems to have been attached to the extent and magnitude of rental profiteering. To the extent that price inflation exists in wartime, landlords as a class are likely to be hit rather harder than many of their tenants. The complaints which were made in the last war were bitter, but surprisingly few in number.

The following conclusions seem to be justified:

1. As in other cases of wartime price advance, a distinction must be made between advances of rentals that are due to housing shortage and those that are due merely to the fact that because of inflation the population has more money income with which individuals can bid against one another for desirable housing. The necessity for control arises only in connection with shortages. Increases of rentals due to inflation are not likely to constitute a problem calling for restrictive action, since rents tend to lag behind the rise of the general price level and the cost of living.

2. Housing shortage is a local issue—or rather a

²⁵ Compare the same, pp. 16-17, 35-36.

series of local issues—arising from wartime shifts of population. War does not cause an increase in the total amount of housing needed; on the contrary it delays the establishment of many new separate homes and reduces the size of existing households. In a war of not more than two or three years' duration, the total supply of housing would not decrease materially, even though new building was greatly restricted. In time, of course, in the absence of new building, fire losses and general deterioration will cut down the supply, but this is a very slow process (unless cities are subjected to bombardment).

3. Scarcity of building materials and of skilled labor will restrict private building activity, but this decrease is desirable and should be stimulated by priority regulations and restrictive control over the raising of capital funds. Such control is especially likely to be necessary with regard to municipal expenditures, since cities are less concerned than individuals and corporations as to whether the future level of costs will be lower than the present level.

4. Acute shortage of housing is likely to develop in a few centers where population is increased on account of concentration of war work. An effort should be made to locate new plants built for war work in localities where there is already an excess of housing facilities.

5. Although it is now believed that the situation will not be acute in Washington, D.C., plans should be made in advance for the transfer out of Washington of such peacetime government activities as can effectively be carried on elsewhere.

6. In cases where it is necessary to bring large numbers of workers into a new area, plans should be made to provide bus service so that they can live at a con-

siderable distance, rather than to build new housing in the vicinity. This is likely to be more feasible than it was during the World War because of the great improvement of highways and of motor transport.

7. In the case of acute local housing shortage, restrictions should be placed on the advance of rents. The administration should be local, but some central authority (preferably the price control authority, if one is set up as provided by the Industrial Mobilization Plan) should have supervision over all local controls. The most appropriate control is a percentage limitation on the permissible increase of rents above the prewar basis. Increases permitted should be ample to take care of any rise in the level of operating costs. Landlords' net incomes need not be protected any more than other forms of income against the impact of war, but neither should they be singled out for repression if income generally is rising.

8. In most cases where the shortage is severe enough to necessitate rent controls, rationing will also be indicated. The purpose of rationing is not to bring empty houses into use—that will take care of itself—but to compel individuals who have unutilized space in their homes to take in additional occupants. Ordinarily it should not be necessary to billet specific individual lodgers on individual householders, but simply to require that each house show a certain minimum ratio of occupancy to floor space. If people who do not have to live in the congested community are induced in this way to move somewhere else, that will be clear gain.

9. Any rent restriction imposed should apply alike to renewals of old leases and to new leases, but existing valid contracts should not be disturbed. Special protection for existing tenants whose leases have expired or

who rent only from month to month is an unnecessary obstacle to free movement of the population, as employment and other conditions change, and may induce people to stay in congested areas who otherwise would move out. This was a serious objection, for instance, to the system of rent restriction used in various European cities after the war.

CHAPTER XII

LESSONS OF THE WORLD WAR EXPERIENCE

The control measures that were put into effect during the World War constituted the first serious experiment in the history of the United States with the centralized control either of prices paid by different government agencies, or of prices paid by members of the civilian public in their dealings with one another. The program was improvised in haste at a time when the attention of government agencies and of the public was largely centered on other issues. Naturally there was no extensive discussion either of the proper objectives of such a program or of the best means of accomplishing them. Moreover, the problem was extraordinarily difficult even for a war emergency for several reasons. An extensive price inflation had occurred before the United States entered the war. The Federal Reserve Board, which was the agency responsible for important parts of any program of control over the price level, was new to its task and had not developed the necessary prestige or appropriate techniques. Moreover, the breakdown of transportation greatly accentuated the problem of shortage.

Nevertheless, noteworthy progress was made in dealing with the most serious problems. Had the war continued longer undoubtedly price control would have become more extensive and better co-ordinated and more effective in administration. The experience of the price-control agencies indicated that, in spite of the novelty

of the whole idea of price control, the public was willing to accept a large degree of control over the prices paid by individuals in their dealings with one another, and that producers were willing to co-operate in extensive controls, especially over the prices paid by the government, even in the absence of any clear legal obligation to do so.

The most important positive contributions of the World War experience may be summarized as follows:

1. The most important step in the process of price control was the centralization of the buying operations of the various governmental purchasing agencies, the Allies, the Railroad Administration, and various ancillary organizations, such as the Red Cross. This centralization in some cases took the form of joint buying agencies, as in wheat, and in other cases the establishment by a centralized body of a maximum price which any agency was allowed to pay, as in copper. While centralization was far from complete, it did eliminate a prime source of abnormal price increase at certain points where the problem was very serious.

2. The experience of the War Industries Board and the Price-Fixing Committee showed that substantial results can be obtained in dealing with industries where the number of producing units is small, by means of negotiation between trade association representatives and the government agency. Even in the case of southern pine lumber, where the number of units was large, substantial results were obtained in this way.

3. The experience of the Food Administration showed that effective control could be exercised through the use of a licensing system even when the number of units was large.

4. Experience under the guarantee of a minimum

price for wheat and pork products showed that this is an effective means of stimulating increased output in industries where the number of units is too large for either direct negotiation with individual producers or effective control through trade associations.

5. The experience of the World War points to the conclusion that direct control of prices is an appropriate means of dealing with individual cases of acute shortage, but it does not afford support for the idea that it is practicable in this way to check a general upward movement of prices which is supported by an inflationary fiscal policy and a passive policy of credit control.

The principal shortcomings of the wartime program may be summarized as follows:

1. Although the taxes imposed during the war were heavier than those of most warring countries, there was no serious effort to insure that the funds which were borrowed by the government should represent savings from current income rather than the proceeds of bank credit expansion. On the contrary, the public was exhorted to "borrow and buy." Suggestions on the part of the Federal Reserve Board for restricting the use of newly created bank credit to support the Liberty Loan campaigns were inhibited by Treasury protests backed by the threat of drastic action. In consequence there was a steady expansion of the volume of money and bank deposits and of the flow of funds through the channels of trade. The money income of the community continued to increase after the output of goods and services had reached its peak, and the price level advanced steadily.

2. Control was applied late, and some agencies responsible for control, notably the War Industries Board and the Price-Fixing Committee, were given inadequate

legal powers. Price decisions for which there were no legal sanctions were enforced by the threat of commandeering on requisition, and their effectiveness, especially in the first six months of control, depended to a considerable extent on the practicability of utilizing such indirect sanctions in a given industry.

3. The responsibility for direct price control was divided among a number of agencies and there was little provision for co-ordinating their policies.

4. The range of control over prices paid by the government was too narrow. Except in rare instances, no central agency reviewed the contracts for unstandardized goods and services made by various government agencies. The work of the Price-Fixing Committee was confined almost entirely to raw materials and half-finished products.

5. The range of control over civilian prices exercised by the Food Administration was unnecessarily broad, extending to many goods and services for which there was no reason to believe that unjustifiably high prices should be obtained in wartime any more than in peacetime.

6. The principles of price determination that were followed were faulty in some respects. In particular there were too many cases in which the costs of a few high-cost producers were used to establish the price paid by the government to an entire industry.

7. There was undue reliance on the excess profits tax to correct unnecessarily high prices paid by the government.

In summary, it may be said that in its use of direct controls the government's policy was basically sound and that, in view of the difficult conditions under which it was applied, it was reasonably effective. There was,

however, almost a complete failure to recognize the bearing of fiscal policy upon the price problem, and there was no co-operation between Treasury and Federal Reserve authorities and the agencies concerned with the direct control of prices.

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