

Inflation  
and  
the  
American  
Economy

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SEYMOUR E.  
HARRIS

## Inflation and the American Economy

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by SEYMOUR E. HARRIS

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# Inflation and the American Economy

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BY

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FOR  
ALVIN H. HANSEN

# Preface

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Before proceeding to personal acknowledgments I wish to express my appreciation for the statistical material presented in the *Bulletin* by the Board of Governors of the Federal Reserve System. This material, well analyzed and well presented, is of great aid to the scholar. Similarly, the *Survey of Current Business* (Department of Commerce), with its excellent tables, articles, and condensations, has been invaluable. No foreign government, to my knowledge, publishes an official bulletin comparable to these two.

Those who read the preliminary draft of this volume early in 1944 will, I hope, scarcely recognize it two years later. I should acknowledge especially the aid I received at that time from Profs. J. M. Clark and Carl Shoup of Columbia; Prof. W. L. Crum of Harvard University; Dr. Edwin E. Witte, public member of the War Labor Board; Dr. William Haber, adviser on labor and man power to the Director of War Mobilization and Reconversion; Miss Alice Bourneuf and Dr. Evsey Domar of the Federal Reserve Board; and Mr. John Lintner, Junior Fellow of Harvard University. The Graduate School of Public Administration of Harvard University and the Harvard University Committee on Research in the Social Sciences provided necessary financial aid.

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SEYMOUR E. HARRIS.

FOUR WINDS FARM,  
WEST ACTON, MASSACHUSETTS,  
October, 1945.

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# List of Abbreviations

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<i>A.E.R.</i>	<i>American Economic Review</i>
<i>F.R.B.</i>	<i>Federal Reserve Bulletin</i>
<i>R.E.S.</i>	<i>Review of Economic Statistics</i>
<i>S.C.B.</i>	<i>Survey of Current Business</i>
BEW	Board of Economic Warfare
BAE	Bureau of Agricultural Economics
BLS	Bureau of Labor Statistics
CED	Committee for Economic Development
CIO	Congress of Industrial Organizations
CMP	Controlled Materials Plan
EPCA	Emergency Price Control Act
FHA	Federal Housing Administration
FRB	Federal Reserve Board
FEA	Foreign Economic Administration
GMPR	General Maximum Price Regulation
GNP	Gross National Product
L-orders	Limitation orders
M-orders	Material Conservation orders
LSF	Little Steel Formula
MPR	Maximum Price Regulation
NBER	National Bureau of Economic Research
NHA	National Housing Agency
NICB	National Industrial Conference Board
NPA	National Planning Association
NRPB	National Resources Planning Board
NWLB	National War Labor Board
OCR	Office of Civilian Requirements
OES	Office of Economic Stabilization
OPA	Office of Price Administration
OWI	Office of War Information
OWM	Office of War Mobilization
OWMR	Office of War Mobilization and Reconversion
PCA	Price Control Act
PRP	Production Requirements Plan

*LIST OF ABBREVIATIONS*

SPA	Surplus Property Act
SPB	Surplus Property Board
UNRRA	United Nations Relief and Rehabilitation Administration
WFA	War Food Administration
WLB	War Labor Board
WMC	War Manpower Commission
WPB	War Production Board
WSA	War Shipping Administration

# Introduction

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A study of inflation requires in fact a study of the whole economy, both war and postwar. Inflation is a symptom of disease, of a general breakdown of the economic body. As a physician cannot thoroughly prescribe for his ailing patient without a complete study of the patient's entire system—his circulation, respiration, metabolism, psychological setup, and so forth, and of the organs connected with these functions—so the investigator of inflation must study the whole economic system. To conclude prematurely that the symptom, inflation, results from an excess of money or from an excess of income, of wages, of diversion of supplies to the war economy, or results from large exports to foreign countries, or from lack of confidence in the currency, or from an inadequate tax system—to conclude without an over-all study that any of these is the cause, is unsound investigation.

*The task we set is to find out, or ferret out if necessary, all the variables that may be relevant and to give them their proper weight in the general picture. That is why a study of inflation requires in fact a study of the war and postwar economy, the emphasis, however, being put on the price aspects of the problem.*

The sources on which this book is based are largely published materials. They consist for the most part of government documents printed for the use of the general public; but the materials also, in no small part, consist of various memorandums that were circulated within the departments and agencies of the government and yet were not of a secret nature.<sup>1</sup> As a government servant, being on the inside, if only in my own small orbit, I learned much, and in this book, naturally, I have leaned heavily on what I learned without, however, revealing any confidential material.<sup>2</sup> The reader will soon find that I have used, to a considerable degree,

<sup>1</sup> For a good summary of the legislative and executive background of the war, see Senate Doc. 224, *Domestic Stability, National Defense and Prosecution of World War II*, 1944.

<sup>2</sup> My official work since 1941 has been as follows: Member of the Policy Committee of the Board of Economic Warfare, Director of the Office of Export-Import Price Control (OPA), Advisor on Stabilization Programs to several Latin-American governments, and Economic Advisor to the Vice Chairman of the Office of Civilian Requirements of the WPB.



statistical material made available by government agencies, some of which I frequently adapted to my own purpose. The 154 tables and 116 charts in this volume constitute perhaps the most comprehensive statistical history of our war economy and blueprint for the future yet made available. The reader will find in them summary histories of all the various important aspects of the inflationary process, and, therefore, of the vital aspects of our war and postwar economy.

During the war we greatly increased our supplies. This was brought about as a result of increasing productivity in war industry, the rise of the number of workers employed and in the number of hours per worker, conservation of materials, remarkable success in finding substitute materials both at home and abroad, and, so far as the civilian economy is concerned, the failure to divert a larger proportion of our economic factors to war industries. In World War II the government required at least ten times as many dollars (and of a higher purchasing power) than in World War I and approximately twice as large a proportion of the gross national product; yet prices rose only one-half as much as in World War I—and probably by the peak of the inflationary period the relative proportion will be even smaller. We have done a much better job in our fight against inflation in the course of our \$300 billion (?) World War II than we did in the course of the \$30 billion World War I.

A significant contribution was made toward keeping demand down. Taxes might have risen somewhat more. Yet the contribution of rising taxes was substantial. In the course of the war, Federal taxes rose from about \$5 billion to \$45 billion. Moreover, these taxes were imposed largely on money incomes and were, therefore, not to raise prices directly. This is not to deny that businessmen, in some part at least, passed their taxes on in higher prices. Demand was also kept down as a result of the large and unexpected rise in savings. From an average level of less than \$10 billion in the thirties, individual savings rose to approximately \$40 billion in 1944. This unexpected rise of savings is to be explained in part by the rise in incomes and the failure to adjust consumption correspondingly, and, related to that factor, the unavailability of goods at what were considered reasonable prices and standard quality.

Supply was, therefore, at a high level and demand was kept under control through the unexpected rises in taxes and savings. These were to a considerable degree an offset against the large rises in wages, farm incomes, and profits. The siphoning off of the excess was not adequate,

however, to prevent an excess of demand over supply at prewar prices. The excess was absorbed in part in rising prices, but more largely through the introduction of vigorous price and related controls, and hence through a reduction of demand and the maintenance of prices below what might be considered the equilibrium level.

My main conclusion is that in the postwar period the dangers are more likely to be deflationary than inflationary. In the short run, however, and especially in the 1, 2, or 3 years following the reconversion, there may be pressures to raise prices and especially in particular markets. In general, however, the large decline of employment and of wage payments and the like will tend to bring about a general deflationary pressure which may largely offset any particular pockets of inflation. We should, however, be on the watch for potential inflationary pressures and maintain controls in markets where the dangers remain substantial.

At this point I would offer a word of guidance to the reader. In the companion volume on *Price and Related Controls in the United States*, I dealt comprehensively with the subject of controls and the related one of subsidies, and, therefore, I treat the subject of controls in rather a summary fashion in this volume. Inflation is a complicated subject, taking us into an investigation of many aspects of our economy. It may be more helpful for the general reader if he follows the unconventional procedure of reading the last chapter, entitled "Conclusions," first and then Part I, which (except for Chapter I) is elementary. I hope very much that businessmen, government servants, and students will profit from the rest of the book, although it is not so elementary as Part I. It will give them the main outlines of our war economy and the important problems confronting us in the transition and postwar periods. This book assesses the anti-inflationary forces: production, economies of investment, treatment of bottlenecks, removal of excess purchasing power, controls, savings, taxation, etc.; and it evaluates the inflationary forces: the rise of labor and other incomes, the loss of goods to foreign markets, the expansion of consumption demand, the requirements of the military. For the transition and postwar, we estimate the weight of inflationary pressures by periods: money, savings, deferred demand, premature removal of controls, delays in resumption of production; and we take account of the deflationary factors: reduction of employment and pay rolls, termination of war contracts, the burden of taxes, disposal of gov-

ernment surpluses, excess industrial plants, any collapse of prices and income abroad—and so on. An attempt is made to lay down the broad lines of policies in the areas of taxes, spending, control, trade and exchange, money, etc., which will protect the country against both inflation and deflation.

# Conclusions

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This volume requires no lengthy conclusion. Summaries are presented in most chapters and frequently in sections. Chapters I and II include numerous conclusions especially relevant for Parts I, II, III.

1. Now, in 1945, the great wartime inflation envisaged by many in 1940, 1941, and even in 1942 is fortunately still unapparent. What were the reasons for our relatively stable wartime prices? The most important reason that we have not had a wartime, galloping inflation is undoubtedly the large expansion of output, this expansion being explained by (1) the rise of numbers on the labor market; (2) the lengthening of the working week; (3) the construction of approximately \$20 billion of new plant; (4) the conservation of scarce materials, the switch to imported materials to replace scarce ones; (5) increased productivity (and especially in agriculture and in war industry). These are the most important factors contributing to increased expansion of output, *i.e.*, supplies. We know that the larger our supplies are—other things being equal—the lower our prices are.

2. Was the rise of supplies as great as has been insisted upon by official organs? According to the official figures, gross national product (GNP) was up by 125 per cent in 1944 over 1939. On the basis of the official deflation index, this represents an increase of GNP in *real* terms of between 85 and 90 per cent. Some economists, notably Dr. Kuznets, are inclined to put the rise of GNP substantially lower. They emphasize in particular the inefficient use of the factors of production by war industries and the high prices paid for these factors by many industries in order to secure them. In other words, according to these economists, the apparent rise in output was to a much larger extent due to a rise of prices rather than to a rise of output, the official figures notwithstanding. The official figures indicate a rise in output of 90 per cent; Dr. Kuznets would probably not put it at more than 70 per cent.

3. The reader should not forget, moreover, that the rise of supplies was largely, if not almost exclusively, in our war output. Whereas the prices of war supplies may have gone down substantially as a result

of the expanding output of war materials, the same cannot be said for civilian goods. Here the diversion of factors from civilian to war output had a very serious effect on the supply of civilian goods. The main increases in supply, therefore, were clearly in the noncivilian areas and the rise of supply should not be given important weight, therefore, as an explanation of the small rise of prices for civilian goods.

4. A significant though not the most important factor in keeping wartime prices down has been the deprivation of resources required by nonessential industries to maintain or expand capital. The net effect has been a very small amount of net capital formation for nonwar purposes and a very large reduction in the total supply of capital available for nonwar purposes. Our nonwar plant has steadily deteriorated in recent years. So far as we failed to keep our nonwar plant up and prevent normal expansion, more resources were made available either for war or for the output of consumption goods. Prices were, therefore, lower than they otherwise would have been.

5. In this country we have relied primarily on a rise of output and only to a relatively small degree on resources diverted from capital uses. In contrast, the British have not relied nearly so much on a rise of output and have depended much more than we have on reduction of consumption and on the use of resources that otherwise would have gone into nonessential capital uses. The British have, moreover, been able to obtain large supplies through sales of capital assets abroad, and through new borrowings, lend-lease, and the like. From 1939 to 1944, the rise of GNP by \$110 billion here made possible an expansion of war expenditures by \$85 billion and a rise of consumption by \$25 billion. Actually consumption rose \$36 billion, the remainder being accounted for largely by a reduction of private investment of about \$9 billion. In the British case, however, the recourse to capital was much greater and, whereas at prewar prices our consumption had risen about 15 per cent (1939 prices), British consumption had fallen about 20 per cent. In Great Britain the rise of government expenditures and consumption (in current sterling) was substantially in excess of the rise of output, the difference being made up largely through substantial savings on capital formation and resources obtained from abroad.

6. Whereas on the supply side more goods were made available, we must remember that on the demand side higher incomes, which are used to buy goods, were also made available. This rise of income is

associated with more members on the labor market, longer hours, higher productivity, and the like, and secondarily with increased rewards for a given amount of time or effort. Wage rates, for example, were higher and farmers received higher prices per unit of output. The largest expansion was of course in wages and salaries although here the rise in man-hours, upgrading, the increase in overtime, productivity, and the like were together much more important than the increase in the basic wage rate.

7. Supply and demand then were kept in equilibrium at reasonable prices. The wartime increase in the cost of living was, according to official index numbers, only around 25 per cent and, even if we allow for deficiencies in our index numbers, the rise was indeed surprisingly moderate. In part, the unexpected rise of savings and in part the large increase of taxation explain the failure of prices to rise more. Controls of both supply and demand and direct price controls, moreover, made an important contribution. The rise of personal taxes from around \$3 billion before the war to \$19 billion in 1944 and the rise of personal savings from around 10 per cent of national income before the war to about 25 per cent in 1944 were certainly decisive considerations. In 1944 personal savings were estimated at no less than \$39 billion. In part this rise may be explained by the unavailability of goods and in part by the increased savings that automatically go with rising income.

8. As compared with World War I, the rise of prices in World War II was much smaller relatively and the rise of output much larger. We have therefore had a very large *monetary* inflation and a relatively small *price* inflation. Whereas in World War I prices rose much more than money, in this war the rise in the supply of adjusted demand deposits and currency has been of the order of five times the rise of prices. Furthermore, in World War II (through 1944) the rise of GNP was very large—the percentage increase was four times the rise in the cost of living and three to four times the rise in wholesale prices. This would seem to indicate that the monetary expansion which accompanies sales of bonds to banks has contributed toward the required expansion of output.

9. Monetary expansion brought declining rates of interest, monetary ease, and general liquidity in spite of an increase in the amount of borrowing of more than \$200 billion. That the expansion of money brought an increase in demand for government securities, thus keeping their prices high, and yet did not bring a corresponding rise of com-

modity prices is explained by the factors enumerated above. These large supplies of money are, however, a threat to postwar stability and should be watched carefully.

10. We have a legacy of high liquidity left by the war. In the short run, large inflationary pressures may result, particularly if controls are relaxed too soon and if reconversion is delayed unnecessarily. Relaxation of controls of demand, prices, exports, and wages all will tend to increase the inflationary pressures in the immediate period ahead. What is more, the relaxation of controls by the War Production Board, for example, makes it much more difficult to impose effective price and export controls. It is therefore imperative that governmental agencies integrate their demobilization of controls just as they strove to integrate their mobilization of controls. Any significant relaxation of price control may start once more the upward spiral of higher prices, higher wages, higher farm prices, and so on. These are inflationary pressures that must be taken into account.

11. On the whole, however, the author leans toward the side which holds that the greater dangers for our country lie in the shoals of deflation. In the longer run, especially, this is true. Even in the next few years some very serious deflationary pressures may prevail, though at the same time that deflationary pressures are felt, specific pockets of inflation may exist. Even immediately after VJ-day there has been a substantial reduction of pay rolls and therefore of GNP. Although this deflationary factor will be offset to some extent by payments under the Social Security Act, the Servicemen's Readjustment Act, and the like, and a reduction of taxes, the net effect may well be deflationary. A slow reconversion may have a serious effect on total spending and particularly on the spending of accumulated savings. Once the people become fearful of their jobs, they may very well not only fail to spend their accumulated savings but may hold on to their current income as much as possible. These deflationary forces did not appear after Germany's defeat because cutbacks were not large.

12. It is, in fact, after VJ-day that the important deflationary factors begin to be felt. Wages and salaries may fall as much as \$30 billion and the total reduction of GNP (in *dollars*) may be substantially more, say, 20 to 25 per cent. (In real terms the decline should be much less.) Should conversion be slow, should the termination of contracts not yield adequate financial resources, should foreign credits not be made available in time, should the social-security program not be

extended to war workers, should we not make a greater progress than we have made so far in our public investment program, should credit not be made available in adequate amounts, and should refunds of taxes and payment on war contracts not be made expeditiously, then a very serious deflation may occur. This deflation may last 6 months to a year and may take the form of reduced employment and spending. Then for the next 1-3 years strong inflationary factors, as well as general deflationary pressures, should be watched (*cf.*, Addendum).

13. In the longer run the deflationary pressures are likely to be greater. We must never lose sight of the \$75 billion or thereabouts annual reduction in governmental expenditures. Although it is not necessary to replace the entire amount, it is necessary, in order to have a high level of employment, to make up the largest part. A high level of employment in the postwar will require an increase in consumption in current dollars of 100 per cent over the immediate prewar amount and in terms of 1939 dollars of more than 50 per cent; and our capital expenditures will have to rise several hundred per cent above the level of the 1930's.

14. We shall, therefore, have to revise our tax program and depend less on taxes that discourage consumption and investment. We also need a more flexible price policy on the part of business, a reduction of trade barriers which would yield more exports and ultimately even larger relative rises in imports. Even with equality of exports and imports at higher levels, more jobs will be available because imports are complementary to as well as competitive with exports.

15. Any deficiencies of spending that remain either will have to be corrected through an increase of public spending on investment, or consumption, or we shall have to resign ourselves to a high level of unemployment.<sup>1</sup>

16. The deficiency of spending may be made up, as I have indicated, through increased public investment. This investment may be financed through borrowing from banks, through the absorption of idle savings, or through an increase of taxation. On the whole, financing through loan expenditures is likely to be more practical than financing through a rise of taxes. Sir William Beveridge has shown that a net

<sup>1</sup>A large majority of the 17 prize essays submitted in the Pabst Postwar Employment Contest interpreted the employment problem primarily as that of finding adequate offsets to savings. Thirteen of the winners urged compensatory stimulation of construction by Federal guarantees or loans or outright compensatory public investment policies. E. B. Smullyan, "Seventeen Post-war Plans—The Pabst Awards," *A.E.R.*, March, 1945, pp. 120-127.



addition to spending through a public investment program will require a considerably larger amount in taxes than in loans. This follows because the imposition of taxes tends to reduce spending from private sources; whereas loan expenditures are largely superimposed on private demand. The favorable effects on the latter are, moreover, multiplied in successive cycles of expenditures, whereas the unfavorable effects of increased taxes also are then aggravated in successive cycles. This unfavorable effect of a rise in taxes can be reduced, however, if the rise is not made largely in the field of excise and consumption taxes.

17. We should also adjust our spending and our taxation according to the requirements of the whole economy. When private spending is at a high level, public spending should be reduced and taxes increased, and vice versa when private spending is at a low level. Such programs can easily be introduced through adjustments in our income taxation and especially in our pay-roll taxation. In depression some economists would rely primarily on increases in public investments (Keynes); others would rely largely on tax reductions (Lerner); others propose public investment and consumption paid for by public funds and/or tax increases (Beveridge). These economists would all agree that more taxes should be imposed on surpluses and less on consumption—and more in prosperous and less in depression times.

18. This leads us to the problem of public debt: if public spending and public investment rise, then the public debt will also rise. It is not likely that a substantial part of the \$5 to \$10 billion (annually on the average) of public investment that might be required, if deflation besets us, will be financed through increased taxation. How much public debt the country can stand depends first and foremost upon our national income and the kind of tax system that we have. Mr. Crowther has estimated, for example, that in the year 2000 we shall have an income, on very conservative assumptions, of  $5\frac{1}{2}$  times the income of the thirties. In other words, our income, exclusive of interest on public debt, should be about \$300 billion. This income will not be achieved, however, if we have large spells of unemployment which steadily pull us down. In fact, we may argue that we shall have this income of \$300 billion only if we are prepared to pursue a compensatory fiscal policy which involves more public spending when private spending declines. Public spending will then contribute toward the maintenance of a high income, not only because of the total effect on private spending but also because we assume that the public investments will yield income

directly which will be a direct offset against the increased debt charges. It is easy to show that even at an income of \$200 billion, instead of the conservative estimate of \$300 billion, we can afford to increase our debt on the average of \$5 or \$10 billion a year. The additional debt charge would then be only \$100 or \$200 million a year, whereas our income should rise by \$2 or \$3 billion a year. Against the rise of debt charges, moreover, there will be the earnings on public investment. We should also be prepared to pay off debt in periods of expansion and rising prices. No program of full employment will work unless measures are taken to prevent the inflationary effects which may otherwise accompany a full-employment program; and the way to deal with this problem is through increased taxes and debt reduction in periods of relatively full employment and rising income.

19. The large expansion of monetary supplies and savings indicates to many economists great inflationary dangers. That approximately \$45 billion of the \$65 billion increase in liquid assets of individuals over 3 years of war accrued to those, according to the Federal Reserve Board, with incomes from \$2,000 to \$5,000, also supports this general conclusion. On the other hand, we must take into account the fact that at higher incomes, larger amounts of cash are required; also at higher incomes and lower rates of interest the public tends to prefer liquid to illiquid assets—*i.e.*, to keep a larger part of their total resources in the form of cash or bank deposits. For these reasons and also because public investment should involve substitution of purchasing power for inactive money to a greater extent than additions to the monetary stock, a rising public debt may not constitute so great an inflationary threat as is often assumed.

20. In this volume we conclude that, in general, business will have adequate funds during the transition, and therefore deflationary pressures should not result from a deficiency of business funds. This conclusion follows from an examination of the total demands on business in the early postwar period and of the available supplies of liquid assets. In particular, it should be noted that the requirement of capital will not be large. A dollar of capital goes a long way, and, in addition, we have to take into account the large rise of capital assets during the war period. Furthermore, there is a considerable amount of unused banking credit. It is easy to envisage, in terms of current income and the current state of indebtedness to the banks, a rise of bank loans of at least \$20 billion. The capital market is, moreover, relatively un-

tapped. Nevertheless, individual industries and businesses may be in some difficulty; and it is important that the government cooperate through rapid payment of debts on war contracts and tax refunds, and that the banking and capital market make the largest possible contribution.

21. It is clear that even at relatively high levels of GNP, substantial amounts of unemployment may occur. In fact, even at the peak several million may be unemployed, and at the trough of the depression unemployment may then well be twice as great. How much unemployment there will be will depend in part upon the number of hours of work and also upon the numbers, ordinarily not members of the labor market, who decide to remain. A substantial contribution to the unemployment problem may be had through a voluntary reduction of hours and the efflux of large numbers from the labor market. In the transition period the large reduction of wages and salaries, particularly after VJ-day, may be a significant factor in cutting spending and bringing about a depression. A very rapid and successful reconversion will be required and, even if it is attained, the disappearance of \$30 billion of wages may have a substantial effect in bringing about a cumulative decline. Insofar as prices fall *pari passu* with the reduced pay rolls, the real decline is reduced. A large decline in total pay rolls and spending may be harmful, however, in that total output is not taken off the market or is taken off at reduced and unfavorable prices. It is, therefore, very important that wage rates should not be reduced and, in fact, should at least keep up with rising productivity which is possible at high levels of output.

22. We should emphasize the following aspects of the international situation: Most countries of the world are determined to isolate themselves against deflationary forces that originate from abroad. In order to do this they are prepared to manufacture money in adequate amounts to maintain their price levels and relatively high levels of employment. If they succeed in these policies, one of the most important causes of deflation, *i.e.*, external forces, will have been removed. They will be helped in this particular policy if this country provides larger supplies of dollars, and particularly in a transition period during which they prepare to readjust to a peacetime economy and improve their export position. In other words, free monetary policies on the part of other countries will encounter difficulties unless the perennial problem of the scarcity of dollars is solved through increased imports on our part

and temporary loans and ultimately through increased exports on the part of other countries. A more favorable exchange-rate relationship with the dollar may also help these countries. What is required above all is a strengthening of the international position of other countries and a *relative*, not absolute, weakening of our position.

23. An adequate total demand is certainly the most crucial problem in the postwar period. It is clear, for example, that most of the estimates of consumption in the postwar period and even of investments, which are required for a high level of employment, are fairly optimistic, given the relationships of the years preceding World War II. Somehow or other through special measures the propensity to consume and to invest must be increased. Yet even if we have adequate total demand, we may have many unfilled jobs and widespread unemployment at one and the same time—a result in part from the unusual distribution of man power, occupationally and regionally, remaining from the war. In the last few years, the rise of incomes, deposits, population, etc., has been most uneven over the country. Unless the government takes special measures to move workers in accordance with the requirements for their services, large amounts of unemployment will develop almost irrespective of the level of demand. The government must also be prepared, where it becomes very difficult or impossible to move workers into the appropriate areas, to subsidize plants or to encourage the movement of industry into the areas where there are large surpluses of man power. In the absence of such measures, this country may well be confronted with a problem of depressed areas, which has plagued the British since World War I.

24. The country faces a serious transition from war to peace. It is imperative that reconversion to nonwar output should be successful, for, if it is not, the results may be disastrous. What happens in this brief period may determine whether capitalism survives. It is appropriate here, then, to summarize the new legislation and a few of the main issues of the transition.

By the early part of 1945, four significant measures had been passed by Congress dealing with the transition period. First, there was the Servicemen's Readjustment Act which provides for the orderly absorption of the veteran into private life. *Inter alia*, it provides him with some cash to cover expenses of his transition to civilian life. He is also provided with educational aids and some help to tide him over periods of unemployment.

Public Law 395, the Contract Settlement Act of July 1, 1944, provides for immediate settlement of contracts and generous provision for interim financing, as well as the expediting of the removal of government property from plants. This legislation will make it easier for business to obtain the necessary liquid funds to carry on after work on their war contracts is finished.

Public Law 457 of Oct. 3, 1944, the Surplus Property Act of 1944, provides for the orderly disposition of public property estimated at from \$50 billion to \$100 billion. Commodities are not to be sold in a manner to disrupt the market. It is assumed that in periods of deflation the sale of surplus property and commodities will be discouraged and that in periods of inflation the release of government property and supplies would tend to counteract inflationary forces. Provision for absorbing supplies through stock piling should also reduce the deflationary effects of the disposal of public property.

Finally, Public Law 458 of Oct. 3, 1944, the War Mobilization and Reconversion Act of 1944, is an attempt to integrate our reconversion policies. The broad general policies are laid down in respect to the termination of contracts and the release of supplies and materials for civilian use. Furthermore, an attempt is made to integrate or put under the general supervision of the Director of Demobilization and Reconversion the Office of Contract Settlement, the Surplus Property Board, and the Retraining and Reemployment Administration.

In general, the transitional problems are those of keeping up demand and also of preventing the inflationary pressures from becoming excessive. It is probable that deflationary pressure in the transition period can be averted if adequate programs of public works and social security are introduced, if a speedy reconversion is effected, and if commodities are not disposed of indiscriminately by the government. Excessive wage reduction should, moreover, not be tolerated, and controls should not be continued if they interfere *seriously* with the orderly flow of the factors of production. It is also necessary to keep the threat of inflation in mind and, therefore, controls should be retained as long as, in essential markets, there is any danger of an excess of demand over supply at current prices.<sup>1</sup>

<sup>1</sup> For excellent summaries of the problems involved see B. M. Baruch and J. M. Hancock, *Report on War and Postwar Adjustment Policies*, Feb. 15, 1944; Hearings on House Res. 408: *Postwar Economic Policy and Planning*, Part 2, 1944, pp. 467-473; NRPB, *Postwar Plan and Program*, February, 1943, pp. 1-12.

25. We must also deal with the long-run problem. Here the question is how far the country is prepared to go to assure a high level of employment. In the year-end report of the War Contract Subcommittee to the Committee on Military Affairs, pursuant to Senate Resolution 198, the subcommittee proposed a full-employment bill, popularly known as the "60-million-job bill." Similar proposals were also made by Sir William Beveridge in his *Full Employment in a Free Society*. In this country, the issue seems to be largely as to how far this country should go in the direction of public investment when a lack of private spending threatens to bring about a large amount of unemployment. In Great Britain the issue seems to be more largely as to how far the government should go in the socialization of industry and the control of the movements of labor and capital in order to assure full employment. Sir William Beveridge, for example, argued that a program of public investment will be inadequate, especially since even at the peak of employment there have been large amounts of unemployment in the last 50 years and since public investments are not adequately flexible. He would, therefore, not only provide large amounts of public investment but would rely primarily on consumption sponsored by public agencies and also upon the direction of labor into the proper industries and upon the direction of capital investment both regionally and occupationally. In short, his argument is that, though the adequacy of total demand (or the socialization of demand) is the most important consideration, it is also necessary to make certain that labor and capital are where they can be fully employed. Otherwise adequate total demand may be accompanied by unfilled vacancies in some areas and large amounts of unemployment in the others. In the Murray Bill it was suggested that, first, measures be taken to stimulate private expenditures. Failing to get adequate private expenditures then, the government should be prepared with a program for public investment and other spending which will assure the necessary jobs.<sup>1</sup>

<sup>1</sup> See especially Sir William Beveridge, *Full Employment in a Free Society*, 1944, especially Parts I and IV; H.M. Stationery Office, *Employment Policy*, 1944; Year-end Report of War Contracts Subcommittee to the Committee on Military Affairs, *Legislation for Reconversion and Full Employment*, Dec. 18, 1944, pp. 10-19; NPA, *Public Thinking on Postwar Problems*, October, 1943; E. A. Goldenweiser, "Postwar Problems and Policies," *F.R.B.*, February, 1945, pp. 112-121.

# Reconversion Viewed After VJ-day

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## 1. THE OCCASION FOR THIS ADDENDUM

This volume has been in preparation since 1943. Most of it was written long before VE-day and VJ-day, and the manuscript was sent to the printer a few days before victory in Europe. The sudden end of the war with Japan came while we were in the midst of reading galleys, and necessitated many revisions.

Reconversion viewed after total victory (even though the last chapter of reconversion is still to be written) is important for our study of inflation: we require an over-all survey of the interval between VE-day and VJ-day and of the early reconversion period (period 3, after VJ-day).

## 2. VE-DAY TO VJ-DAY

In general the developments from May to August, 1945, followed the trend started in 1944. Money continued to increase. Incomes rose somewhat. Savings continued to mount. Prices, nevertheless, remained relatively stable.

Table 153, for example, presents a statistical comparison of changes for the first half of 1944 and the first half of 1945. Net national income,

TABLE 153.—SIGNIFICANT ECONOMIC VARIABLES, 1944-1945  
(In billions of dollars, annual rate)

	First half of 1944	First half of 1945
Gross national product.....	197.4	206.0*
War expenditures.....	93.2	93.2
Expenditures on consumers' goods and services...	95.7	101.0

SOURCE: S.C.B., July, 1945. \* Estimate for second half of 1945 is 182.

income payments and personal taxes were all somewhat higher in the first half of 1945 than in 1944. Personal taxes rose from \$19 billion to \$23 billion (annual rate). Net savings of individuals decreased—from \$39.9 billion to \$38.5 billion.

For the fiscal year 1945, net financial results for the Treasury were similar to those for the preceding year, as indicated in Table 154. An

TABLE 154.—TREASURY EXPENDITURES, RECEIPTS AND DEFICITS, 1944-1945

(In billions of dollars)

	Fiscal year 1944	Fiscal year 1945
Expenditures.....	93.7	100.4
Net receipts.....	44.1	46.5
Net deficit.....	49.6	53.9

SOURCE: F.R.B., August, 1945.

examination of the distribution of holdings of government securities reveals, moreover, that the banks absorbed close to the same proportion of new issues as in the previous year.<sup>1</sup>

In view of the continued inflationary pressures, a rise in the cost of living of but 1 per cent in the first half of 1945 was moderate indeed. In this period the OPA and WPB worked hard to divert available fabrics into the production of low-priced clothing, for inflationary symptoms were especially evident in the price of clothing.

During the brief one-front-war period—i.e., from May to August, 1945—controls were dropped at a rapid rate. Although because of our military reverses in December, 1944, the WPB had modified its vigorous decontrolling program which it had contemplated in the fall of 1944, nevertheless, once Germany was defeated, plans progressed for rapid demobilization of controls. In the fall of 1944 and the early months of 1945, Congressional and business pressures for removal were felt by government agencies. *Rapid demobilization of controls at that time might have been justified had cutbacks in war contracts been large. Then the release of materials and man power would have resulted in increased flows of supplies which might have matched the renascence of demand, now freed from restraints.* Actually, however, cutbacks were small. Munitions production in the second quarter of 1945 was but 4 per cent less than in the

<sup>1</sup> *Treasury Bulletin*, August, 1945, pp. A-30, 47-48; F.R.B., August, 1945, p. 721.



first quarter. It was estimated in June, 1945, however, that munitions production and non-munitions war expenditures would be, respectively, 20 and 10 per cent less in the fourth quarter of 1945 than in the first quarter. Even at these rates of curtailment, the program to release controls seemed oversanguine.

In May, 1945, the WPB announced a vigorous program for the demobilization of controls. Between VE-day and VJ-day approximately 200 controls were removed. Open ending of CMP for steel, copper, and aluminum was provided—delivery to be made after July 1. (Open ending allowed free bidding for supplies left over after the most essential military and civilian needs were met.) It was proposed at this time, however, to retain limitation orders on production of important consumers' goods, some standardization and simplification orders, and control of distribution of scarce textile fabrics, tin, paper, lumber products, chemicals, etc. Programing, as an aid to production of civilian goods, was slated for abandonment, except under unusual conditions. Preference ratings were to go: the only exceptions were a military rating and the special *AA* (later *CC*) preference ratings for the most essential civilian needs. Most distribution controls were also on the way out. Other controls were to go gradually—*e.g.*, those on imports, exports, and construction. It was agreed, however, that the program might be revised if cutbacks did not attain their expected level. In fact, plans were revised many times before VJ-day, for the cutbacks were much smaller than had been anticipated.

Fortunately in the period between VE-day and VJ-day the OPA and the WLB were not inclined to remove controls rapidly. The former in particular urged the WPB to retain controls of demand and supply—indispensable adjuncts of price control—and influenced the WPB to some extent. In the view of the OPA, the EPCA required the WPB to aid the stabilization programs: without WPB L and M orders, priorities and the CMP, the possibility of effective price control was slim indeed. Moreover, decontrolling by one agency inevitably leads to general decontrolling. If the WPB should remove controls of demand and FEA controls of exports, then the OPA, unwilling to be saddled with a responsibility which it cannot fulfill without the aid of other agencies, would be less disposed to maintain its controls.

Contrary to the expectations of many, fairly rapid removal of controls prior to VJ-day did not have any serious inflationary effects, and for the following reasons: Essential civilian requirements were still

protected by the WPB; and effects of actual demobilization of controls were not felt immediately—in part because man-power controls and other serious shortages (e.g., components) tended to restrict demand. It takes time to break the numerous bottlenecks. All civilian industries may be allowed to bid for limited supplies of iron and steel; but some demands will be excluded because labor or textiles, rubber, or some short component is not available. Finally, before the full effects of the demobilization of controls after VE-day were felt, VJ-day had arrived.

### 3. THE PRESIDENT'S BLUEPRINT FOR RECONVERSION

In an executive order of Aug. 18, 1945, President Truman set the key of reconversion: The broad objectives were "to promote a swift and orderly transition to a peacetime economy of free, independent enterprise with full employment and maximum production in industry and agriculture and to assure the general stability of prices and costs and the maintenance of purchasing power, which are indispensable to the shift of business enterprise from wartime to peacetime production. . . ."<sup>1</sup>

In this executive order, the President proposed to adhere to the EPCA and the Stabilization Act as a means of excluding both inflation and deflation. He asked that modifications in control over wages, prices, materials, and facilities be made if they should prove necessary as a condition of orderly transaction. The price administration and other stabilization agencies were authorized "to make such adjustments in existing price control as are necessary to remove gross inequities or to correct maladjustments or inequities which would interfere with the effective transition to a peacetime economy." In order to preclude rises in the cost of living, the agencies were to improve and tighten price controls in important fields.

They were also "to move as rapidly as possible without endangering the stability of the economy toward the removal of price, wage, production, and other controls. . . ."

An important concession was made to labor in President Truman's executive order. It was provided that the appropriate agencies could allow wage increases voluntarily entered into which would neither involve the government in higher contract prices nor be used as a basis

<sup>1</sup> The President's executive order followed the broad outlines of the report of Aug. 15, 1945, by the director of OWMR to the President, *From War to Peace: A Challenge*.

for seeking an increase in price ceilings or for resisting justifiable reductions in price ceilings.<sup>1</sup>

A blueprint for the WPB was also provided: "It shall use all of its authorized powers to expand the production of materials which are in short supply; limit the manufacture of products for which materials or facilities are insufficient; control the accumulation of inventories so as to avoid speculative hoarding and unbalanced distribution which would curtail total production; grant priority assistance to break bottlenecks which would impede the reconversion process; facilitate the fulfillment of relief and other essential export programs and allocate scarce materials or facilities necessary for the production of low-priced items essential to the continued success of the stabilization program."

In a long message to Congress on Sept. 5, 1945, President Truman presented the policy of his administration more fully than in his executive order of Aug. 18. In this message and in the supplementary statement by the OWMR appended to the message, the Administration proposed a comprehensive program both for the transition and the longer run postwar period.

In general, the same principles as announced on Aug. 18, 1945, were to prevail: orderly decontrolling of the economy, protection of consumers through a stabilization program buttressed by WPB controls, reconversion supported by active participation of the government. In this message the President was perhaps a little more emphatic concerning inflationary dangers, and a little more outspoken in his demand that the WPB give the stabilization authorities all possible aid, than in the executive order of Aug. 18.

The government proposed a rapid termination of contracts for the transition. Within a few days after VJ-day the Army and Navy had canceled \$25 billion of contracts. As an offset to the unexpectedly rapid cutbacks, the government proposed (1) to settle expeditiously \$40 billion of contracts awaiting settlement; (2) to advance credit on unpaid claims (for the purpose of expediting reconversion in general); (3) to provide 13 million noncovered workers with transitional unemployment insurance and increase benefits and duration of benefits for most of the 40 millions covered; (4) to cut taxes to some extent; (5) to encourage rises in wage rates; and (6) to facilitate the sales of government-owned factories and equipment. Most of these measures would

<sup>1</sup> The President, a few days earlier, had directed WLB to approve the type of wage increases discussed in this paragraph.

tend to fill part of the void left by a reduction of Federal expenditures. (It was estimated that munitions production by December, 1945, would fall 80 per cent below July, 1945.) The objective was to increase spending even as cutbacks were reducing outlays, and thus to mitigate the deflationary effects of reduced Federal spending.

In this early period of reconversion the government was determined also to preclude inflation. Once reconversion was effected, the net pressures on prices might well be upward. The release of Federal supplies would tend to keep prices down, as would retention of various controls not yet ripe for removal. The OPA was also to force absorption of cost increases on distributors and to tighten price control in crucial areas. These measures, it was hoped, would more than offset the effects of termination of almost \$2 billion (annual rate) of food subsidies and the support price policies for food, to be implemented on behalf of farmers.

The government also made specific proposals for the longer run: *e.g.*, its support of a full-employment program—and one to be validated by a sizable public-investment policy. Among the specific parts of the investment plan, the government mentioned in particular a potential program of between 1 and 1½ million homes annually for 10 years; a \$3 billion road program over 3 years; and plans for expenditures to improve rivers, for slum clearance, airports, and state and local government projects. In all of these the Federal government was to participate. In addition the message stated that plans for a comprehensive social-security and educational program were in the final stage.

#### 4. CONTROL POLICY AFTER VJ-DAY

VJ-day was the signal for the scrapping of controls in earnest. On Aug. 20, 1945, with but one stroke 210 of the 340 controls still in effect had been removed by the WPB. Restrictions on the output of most durable consumers' goods were lifted, and the restriction on automobiles was removed a few days later. By early September, only 160 WPB orders and schedules were in force as compared with 650 at the war's peak.

The government was also quick to remove many rationing controls. WPB policy was well summarized in the news release of Aug. 21, 1945.<sup>1</sup> "In a series of sweeping moves to facilitate the reconversion of industry

<sup>1</sup> WPB Release 8903, Aug. 21, 1945.

and speed the flow of a wide variety of peacetime products into the hands of consumers, while still avoiding price inflation, preemption of scarce supplies, or a buyers' scramble, the WPB has dropped 210 more individual controls over industry. . . ."

We have so far discussed WPB policy. But at least one other agency was not so disposed to scrap controls quickly. Despite the rapid removal of related controls by other war agencies, the OPA adhered to a vigorous price-control policy. For more than a year before VJ-day it had been working on an orderly reconversion policy.<sup>1</sup> It was deterred neither by protests nor by the hesitation of other agencies (*e.g.*, WPB and FEA) to support its program through the retention of related controls; nor was it held back by the large excesses of purchasing power available, which of course were a constant threat.

The OPA could no longer count heavily on support from controls of demand or improvement of supply through conservation and simplification orders. A rapid expansion of civilian output and the release of surplus military supplies might tend to keep prices down near the ceiling levels. A release of 9 million men from the armed services in a period of 10 months, and of many more millions from war industries, was expected to relieve the man-power shortage in civilian industries. In other cases, wage and price adjustments might bring a better distribution of factors of production and thus induce increased production of scarce commodities. Soon after VJ-day it was announced, for example, that the War Department was cutting its procurement from a total of \$2.4 billion a month to \$435 million a month. Gasoline purchases were to drop 44 per cent; textile items, 75 per cent; Army cancellations were to eliminate 99 per cent of its steel and 98 per cent of its copper and aluminum consumption, 82 per cent of its consumption of cotton textiles, 75 per cent of its leather and lumber.<sup>2</sup>

These reductions in demand, the release of government stocks, and an early renewal of production would indeed help keep prices down. Yet serious shortages would still plague the country for a year or more; of the many components required for construction, crude rubber, tin, paper pulp, coal were the most important.

<sup>1</sup> The essentials of reconversion pricing policy were discussed in Ch. XXX.

<sup>2</sup> Figures from OWMR, *From War to Peace: A Challenge*, August, 1945, and OWMR *Report of Sept. 6, 1945*.

## 5. OPA PRICING POLICY IN THE RECONVERSION PERIOD

In Chapter XXX we discussed to some extent the principles of pricing policies for the reconversion period. With reconversion well-launched soon after VJ-day, the broad outlines of reconversion and reconversion pricing became more apparent than they were when that chapter was written. Let us note first the following principles.

1. When there is full employment, price concessions tend to divert resources from one industry to another or from one firm to another—but not to expand output. (These diversions are indeed limited by controls.)

When there is a significant amount of unemployment (say 5 million as estimated for the end of 1945, and 8 million or more for the spring of 1946), then a rise of prices may be effective in expanding output. But at this point one must watch the effect on scarce components and raw materials. With price concessions the favored products may draw scarce factors away from others—it is therefore desired that so long as scarcities prevail, generous treatment be accorded to more essential industries or products rather than to nonessential industries.

2. With increased unemployment and the gradual disappearance of scarce factors, the case for liberal pricing improves. To some degree the rise of unemployment brings its own cure; prices tend to drop below ceilings.

But in many cases price action will be required. The OPA will have to set prices or revise them upward. *And the regional approach will be especially effective and appropriate.* As we saw in Chapter XXXII, the rates of movement of income and population have been exceedingly uneven. In the course of the war incomes rose 3 and 4 times as much in some states as in others. With large cutbacks some states (*e.g.*, Michigan, Connecticut, and California) will suffer. With the reduction of military training other states (*e.g.*; Texas and Florida—the location of many camps) will also be hard hit. With any significant decline of farm incomes Kansas, Wisconsin, etc., will suffer. *Large pockets of unemployment will develop despite inflationary pressures over large parts of the country.*

3. In these circumstances, it is incumbent upon the OPA to see to it that price policy is sufficiently flexible so that high wages the country over or high prices of raw materials in the face of fairly rigid prices do not act as a depressant. We need more and more regional pricing as demobilization strikes one area while leaving another untouched.

4. Price control is related to the changing economic picture in 1945.

*a. First and foremost there are cutbacks, demobilization, and unemployment.* These require flexible pricing, special provisions for reconversion pricing (see below), and a sufficient degree of precision on future price policy to make it possible for business to make commitments.

*b. Second, there is the demobilization of controls related to price control.* So long as supply-and-demand controls play a decisive part, the government largely determines what is to be produced and even how much. As demobilization of controls proceeds, this situation changes. Then pricing once more begins to play its historic role as the determinant of the flow of man power, material, and capital. It will be the OPA, not the WPB, which will affect the use of scarce materials, the objects produced, etc., not so much as a matter of policy but rather as an inevitable accompaniment of policy. That is why the agency responsible for production becomes more interested than ever in price control and prices even as its controls and those of the FEA and WMC are removed. Appropriate price movements then will help to find employment for unemployed resources, to move factors into the reconversion industries, and to move them into areas of unemployment.

The EPCA provides that the WPB "within the limits of its authority and jurisdiction is to work toward a stabilization of prices, fair and equitable prices, fair and equitable wages, and cost of production." It is indisputable that the OPA's greatest successes in price control have been in markets where price control has been tethered to WPB controls. To avoid inflationary price rises, the OPA may therefore be the less inclined to relax on price controls although other controls are removed. Every relaxation becomes doubly dangerous when the inflationary effects may not be damped by related controls which hold demand in check.

As for the details of reconversion pricing, little need be added to what was said in Chapter XXX. Reconversion pricing applies unfortunately to the resumption of production only of goods whose wartime production was a small part of prewar production: automobiles, refrigerators, etc. Ideally, reconversion pricing should deal not only with items coming back into production but with all goods and services. All price ceilings should be reviewed in terms of the objectives of 1945-1946. *Price regulations which were issued when employment was full and when the sole danger was inflation are not appropriate for an economy which faces the twin dangers of unemployment and deflation.* Detracting further from the

usefulness of these regulations is the fact that they were generally based on a historical experience currently much less relevant than when originally issued.

In general, in reconversion pricing each industry was allowed a price equal to its 1941 costs plus legal increases in raw-material prices and basic wage rates. The producer was then to receive at least the ceiling price. If this formula did not yield the current ceiling price, he might under adjustment provisions obtain his profit margin of 1936-1939, or the profit margin of the industry, or some percentage of the latter. Provisions varied, however, as among industries and according to the size of firms. In automobiles, for example, where no industry price regulation was provided, each manufacturer was entitled to a price equal to 1941 costs plus the legal increase in raw-material prices and basic wage rates. If the resulting prices were below ceiling prices in effect, the manufacturers might add one-half of the industry's 1936-1939 profit margin.<sup>1</sup>

It is not necessary to discuss the pros and cons of OPA's generosity.<sup>2</sup> Its avowed policy is not to interfere with reconversion and not to allow inflation to develop. Perhaps its policy is less than generous in view of the relaxation of wage controls. But whether its policy is niggardly will depend first on the volume of output attained (a large volume yields both high profits and low prices). In his message to Congress, President Truman emphasized the need for low prices and high volume—thus seeming to support the OPA policy which had been under attack.

#### 6. WHAT IS WRONG WITH RECONVERSION POLICY?

Demobilization of controls proceeded at a rapid rate in the month following VJ-day, with relatively few controls left after September, 1945. Where supplies were adequate or promised to be so in the near future, or even where supplies were short but with serious effects unlikely, the WPB was disposed to terminate controls. In view of existing scarcities and great demands, one wonders whether the WPB was wise to terminate controls so quickly. Certainly the scarcities of numerous construction items, for example, would indicate that many controls in the building industry may well have been removed too soon. In many cases where scarcities threatened to materialize, the only protection given potential consumers against excessive demands was export con-

<sup>1</sup> See OPA, S.O. 119, issued July 18, 1945.

<sup>2</sup> Cf. Ch. XXX.



trol. Yet when export is only a small part of total demand, export control is obviously not enough.

All control agencies did not seem disposed to heed the President's warning against premature removal of controls, first made in his VJ-day message and repeated and underlined in his message to Congress. It is not easy even for the President to make an operating agency do what it is not disposed to do.

Aside from the retention of many old controls, new temporary controls were required which were not forthcoming. (Temporarily it would be helpful, for example, to control distribution of durable consumer goods.) According to a WPB survey, the public was prepared to buy 5.8 million mechanical refrigerators, as of April, 1945; and demand was rising at the rate of 2 millions per year. Corresponding figures for radios were 5.1 and 2.4 millions. Yet for 6 months to 3 years after the resumption of production, output of consumer durables, including housing, should be most inadequate in the light of accumulated demand at fairly stable prices, the exact period of deficiency depending on the product and the amounts required to fill pipe lines. Even for the end of 1945, the production rate for many items was estimated below 1939 levels. These figures, indeed, suggest the need of new, transitional controls.

During the period of deficiencies, a large black market is almost certain to develop. Even if manufacturers abide by price ceilings (though quality deterioration and excessive recourse to high-priced models may well occur), when supply is significantly below demand, distributors may pocket the difference between high prices to be had and legal prices. Once supplies at legal prices fall below demand by more than a certain amount, controls break down. Bribes, open or concealed, of middlemen, reduction of services, resale by final(?) consumers are among the techniques that may be used to evade price regulations. *What the manufacturer is denied under ceilings will be obtained by others along the line from manufacturer to consumer.*

The collapse of both Germany and Japan within a short time of each other made reconversion more difficult. The authorities were not well prepared for this contingency. In fact the unpreparedness might be ascribed to the opposition of the military, which before victory had discouraged preparation for reconversion.

One of the unfortunate aspects of reconversion which certainly contributed to delays and lack of integration was the administrative setup.

In view of developments since June, 1945, and notably the failure of WPB to maintain needed controls, the proposals of the Meade committee were almost prophetic: "In preparing for peace, the OWMR should have a strong reconversion division with actual operating functions. . . . But this office has never had a large staff and has functioned mainly as an over-all policy body and referee rather than an operating agency."<sup>1</sup> Despite strong pronouncements against hasty demobilization of controls by President Truman and the OWMR, the operating agency (WPB) continued its policy of rapid demobilization of controls.

#### 7. THE TIME PATTERN OF INFLATION

In the light of the rapid demobilization of controls after VJ-day, (which indeed was demanded by the public, by most businessmen, and by the politicians) what are the price prospects for the years 1945-1948?

First, as to the reconversion period proper, which for most important items other than some for construction may last from September, 1945, to March-June, 1946. Here premature removal of controls may bring about some inflationary pressures in particular markets and notably in consumer durable goods and temporarily in some textiles. The effects should not, however, be serious. Against these pressures are to be weighed the deflationary effects of a reduction of wages by perhaps \$25 billion (annual rate), a reduction of gross national product now estimated at \$40 billion, and the decline of spending associated with uncertainty. Government deficits for the fiscal year 1946 were estimated late in August, 1945, at \$30 billion, a reduction of approximately \$20 billion over the fiscal year 1944-1945. The reduction in turn accounted for a much larger decline in GNP.

*The main criticism to be leveled against government policy lies in the failure to retain more controls and even introduce several new controls (e.g., distribution of consumer durables) which would undoubtedly prove useful in period 4 (the catching-up period); and also in the failure to provide adequate help for those who lose wages. That is to say, the government has not done all it might to maintain fair distribution during the reconversion period.*

If inflation is a threat, the greatest dangers lie in the period after reconversion, say beginning about the middle of 1946. With considerable relief in taxes and the public ready to spend a substantial part

<sup>1</sup> Senate Report 110, Part 4, *Investigating the National Defense Program*, Fourth Annual Report, July 30, 1945, pp. 30-31.

of pent-up savings (in particular, a significant part of its \$200 billion or more of liquid assets), with restraints on consumer credit removed, with other controls ancillary to price control abandoned, with wage rates tending upward with rising employment (and reconversion largely effected), with the removal of the restraining influences of the Little Steel formula, with an insistent demand for our goods from abroad backed up by \$20 billion of cash and large potential loans, and with weak inventory controls in the light of unprecedented inventory demands—with all of these factors conducive to rising prices, a significant price rise seems likely. The OPA, by then either disbanded or weakened, will be unable to hold the inflationary spiral in check. *We may well be confronted with a high-level employment economy without the controls and sanctions imposed by war.* Inventory controls (which did not work well in the war) and a few other controls may still be on the statute books. Who would say that these paper controls will check the tidal wave of inflation after the war?

Against these, two factors will hold inflation down: a reduced GNP, and hence a reduced demand, over 1944–1945, and an unusual amount of excess capacity. *The net result will be many inflationary and speculative pockets—but these may be checked to some extent by the considerations mentioned here.*

Every inflation brings a collapse and the greater the inflation, the more serious will be the ensuing drop in employment, wages, and prices. All the more serious will be our failure to provide an adequate social-security program, a full employment bill with its support of a spending program, a policy of reallocation of industry according to labor availability and/or redistribution of labor. Indeed it is incomprehensible that with the limited success in planning public works, the Colmer Committee on Postwar Economic Planning should propose to put the burden of public investment on states and local governments—a proposal which rules out public investment.

Above all, the economists and other technical advisers were determined that we should not repeat the mistakes of World War I. Yet the pattern is almost identical: a reconversion period, with both inflationary and deflationary factors at work but total demand declining; an inflation period beginning 6 to 9 months later, hastened and accelerated by a premature removal of controls and wage inflation; and then the long pull when we may not be so fortunate in the revitalization of private enterprise as we were in the twenties.

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