

PRICE CONTROL

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PREFACE

THE most important single factor affecting general business conditions at present and in the immediate future is the financing of the defense program. The choice of fiscal methods involves a decision vital to economic welfare and to the defense effort itself. The problem is complex, and only a few vital principles can be set forth in this short treatment.

This pamphlet is the second of a series to be published by the University of Oregon Bureau of Business Research on Federal fiscal policy. The first, entitled *Financing the Defense Program*, contains a simple statement of the nature of the problem and the possible solutions. The present study aims to present the most recent relevant data available, and to give special consideration to pending tax measures and to the General Maximum Price Regulation established by the Office of Price Administration in April 1942.

This pamphlet is not addressed to the economist or expert banker; it is definitely nontechnical and is designed to meet the needs of those businessmen who, because of training and work in other lines, find themselves somewhat perplexed by the complexities of this vital economic problem.

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I. INTRODUCTION

THE basic economic task of America today is to mobilize the nation's productive resources in such a way as to rapidly produce the large additional supply of war goods needed, while maintaining production of a supply of consumer's goods sufficient to support an efficiency standard of living. The obstacles are industrial or technological, and financial. This study deals with the latter alone.

Although the essential *task* is industrial and physical, some of the most difficult *problems* faced in pursuing this task lie within the field of finance. Indeed, an unsound fiscal policy could easily cause this nation to lose the war by preventing full achievement of the industrial task. For this reason, the consequences of inflation and the methods adopted for price control must be judged primarily upon whether production is affected favorably or unfavorably. Quantity and speed are the necessary components of a successful production program; and any fiscal policy or device which slows down the production of war goods must be regarded, under existing circumstances, as definitely unsound.

The many evils of a spiral of inflation, including the deleterious effects upon the production of war goods, have been universally recognized.¹ Congress and the Administration have agreed that a drastic rise in the general level of prices should be prevented. The financial question before the nation today is not *whether* to check inflation but *how* to check inflation. Vigorous and unusual methods have already been adopted to solve this problem, and further measures are being discussed and planned. The purpose of this study is to consider the nature, effectiveness, and certain secondary effects of existing price-control measures.

At the outset the reader should have in mind the relevant statistics showing the degree of inflation already attained and the magnitude of the forces producing inflation.

¹ For an analysis of effects of inflation, alternative methods of price control, and a statement of the industrial and financial problems involved, see E. G. Daniel, *Financing the Defense Program*, School of Business Administration, University of Oregon, December 1941.

II. THE STATISTICAL BACKGROUND

Inflation, defined here as a rise in the general level of prices, results when the money stream (quantity of money times its velocity of circulation) increases more rapidly than the quantity of goods to be purchased. In the current situation there are several causes operating to increase the money stream and thereby to produce inflation.

The greatest single cause of the rising price level is the sale of Federal securities to commercial banks. These securities are paid for out of surplus funds of the banks, and each purchase injects additional money into circulation.

The amount of Federal securities held by all commercial banks increased from \$16.3 billion in December 1939, to \$21.8 billion by December 1941, an increase of 33.7 per cent.² This increase in commercial-bank holdings of Federal securities has injected \$5.5 billion additional bank money into circulation.

The practice of financing war expenditures by government borrowing from commercial banks is not only the most important factor causing the rise in prices already experienced, but offers the greatest potential force promoting inflation in the near future. Under existing taxation, the Federal deficit for the fiscal year ending June 30, 1942 will be about \$18.7 billion; and, even including the \$7.6 billion of new taxes proposed by the Treasury, the deficit for the fiscal year 1943 will be about \$35 billion. If any large portion of this deficit is financed by selling securities to commercial banks, the forces promoting inflation are likely to be irresistible.

In the face of public sentiment against inflation, and in spite of warnings against this type of Federal financing, the sale of Federal securities to commercial banks was greater during the fiscal year 1941 than during the fiscal year 1940 by \$2.7 billion.³ A still more significant indication of the recent trend is the fact that during the four weeks ending April 15, 1942 the holdings of government securities by banks in leading cities increased by nearly \$700 million.⁴

The magnitude of these figures reveals that the central issue in present Federal fiscal policy is whether the large and growing deficit is to be financed by continued reliance upon commercial-bank loans or whether the deficit is to be met by taxation and noninflationary forms of borrowing.

² *Federal Reserve Bulletin*, May 1942, p. 482.

³ *Loc. cit.*

⁴ *Ibid.*, p. 456.

During the same period that \$5.5 billion of additional money was being injected into circulation by bank purchase of Federal securities, \$4.5 billion of additional money was created by expansion of commercial-bank loans to private business.⁵ Thus during the two years ending December 31, 1941, about \$10 billion was added to the money stream by commercial banks.⁶

These data reveal the principal *causes* of the increase in the money stream. The *magnitude* of this increase is indicated, and these causes are reflected, by two other statistical facts. The most important constituent of the money supply is bank demand deposits subject to check. Total demand deposits of Federal Reserve member and of nonmember banks rose from \$58.3 billion in December 1939 to \$70.8 billion by December 1941, the latter figure constituting an all-time high for this country. This represents an increase in demand deposits of \$12.5 billion—an increase of 21.4 per cent. The effect on the supply of money of existing methods of financing defense is indicated by the fact that demand deposits increased by \$10.2 billion since June 1940, when this country first began seriously to prepare for war.⁷

In addition to this increase in bank money, "money in circulation," which excludes demand deposits, increased by \$3.6 billion during the two years ending December 31, 1941.⁸

The large increase in the money stream shown by these figures would not have produced inflation if the increase in output of goods had kept pace. It is true that the absorption of unemployed productive resources has caused total output to increase. The Federal Reserve adjusted index of the physical volume of industrial production rose from 114 at the outbreak of the war in September 1939 to 167 by De-

⁵ *Federal Reserve Bulletin*, April 1942, p. 343.

⁶ Commenting upon the expansion of bank loans to commercial and industrial borrowers, the *Federal Reserve Bulletin* of January 1941 (p. 3) reported that "The rapid increase in loans began shortly after the launching of the defense program in the summer of 1940, and appears to represent in considerable part demands for bank accommodations by producers and suppliers of war goods." It has been argued that some degree of inflation is desirable in that it would stimulate production of war goods. This argument is not valid if increased consumer-money purchasing power is permitted to compete with the government for labor and materials. However, the argument could be completely valid without affecting the conclusions reached in this paper. The expansion of the money stream through bank loans to industry, and particularly bank loans to finance war contracts, is sufficient to provide the inflationary money profits that might be needed to attain a maximum rate of war-goods production. The thesis upheld in this paper is that the financing of the Federal government itself should not be permitted to cause serious inflation.

⁷ *Federal Reserve Bulletin*, May 1942, p. 469.

⁸ *Federal Reserve Bulletin*, Feb. 1941, p. 137; May 1942, p. 467.

cember 1941.⁹ But the increase in the money stream was so much greater that the wholesale index of prices rose from 79.1 to 93.6, an increase of 18.3 per cent, during the same period. This index had risen to 98.6 by the end of April 1942.¹⁰

From August 1939, the month previous to the outbreak of war, to the last of April 1942 the wholesale price level rose by 31.5 per cent.

CHART I. UNITED STATES WHOLESALE PRICES

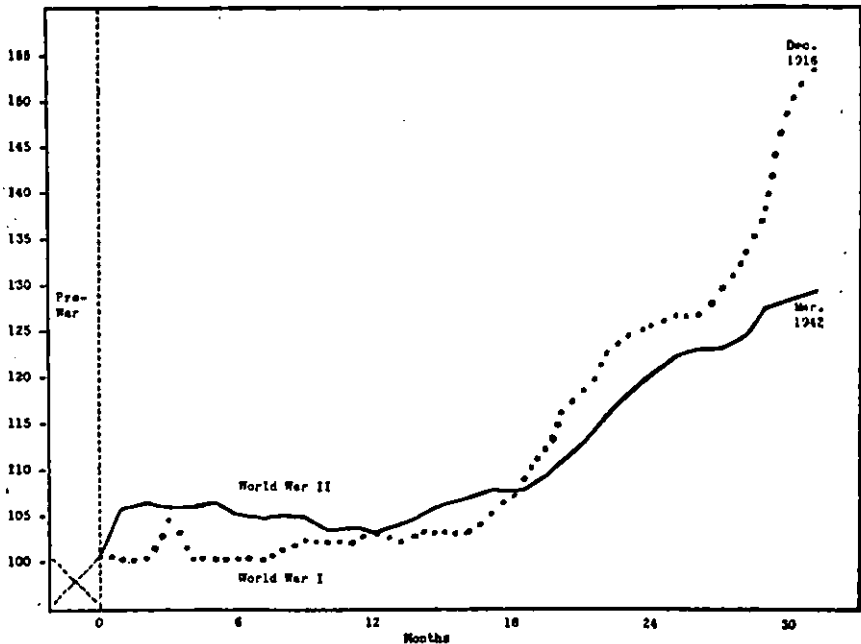


Chart I shows that during the first twenty-six months of World War II wholesale prices followed the same general trend which in World War I ultimately led to a rise of 150 per cent. The steep rise of prices which began in the twenty-sixth month of World War I has not been duplicated in World War II, although the trend is consistently upward. However, up to the present time the rise in prices has been tempered by a large increase in production. Now that the nation has come much closer to capacity output, the total supply of goods cannot increase in the future as rapidly as heretofore. Continued injection of additional money into the money stream at the same rate

⁹ Five-year average, 1935-39 = 100. *Federal Reserve Bulletin*, May 1942, p. 487.

¹⁰ Index number of the Bureau of Labor Statistics. 1926 = 100.

achieved during the first thirty-two months of this war will lead to a spiral of inflation similar to that of World War I unless the present price trend is opposed by deliberate and very forceful methods.

It is apparent that we have already drifted a significant way toward serious inflation. The degree of inflation has depended upon the magnitude of the Federal deficit and the method adopted to meet this deficit. The prospects for continued inflation during the new fiscal year beginning July 1 will depend upon these same factors.

TABLE I. FEDERAL EXPENDITURES FOR DEFENSE AND NONDEFENSE, FISCAL YEARS 1914-1943¹
(millions of dollars)

Fiscal Year	Total ²	National Defense ³	Nondefense
1914	709	253	456
1915	727	258	469
1916	697	274	423
1917	1,925	1,456	469
1918	12,648	11,771	877
1919	18,459	16,795	1,664
1920	6,308	4,613	1,695
1921	4,989	2,691	2,298
1922	3,213	844	2,369
1923	3,054	829	2,225
1924	2,810	711	2,099
1925	2,801	649	2,152
1926	2,779	611	2,168
1927	2,738	612	2,126
1928	2,798	662	2,136
1929	2,957	694	2,263
1930	3,152	730	2,422
1931	3,560	734	2,826
1932	4,434	752	3,682
1933	3,793	679	3,114
1934	5,947	531	5,416
1935	6,933	689	6,244
1936	8,611	900	7,711
1937	8,121	929	7,192
1938	6,993	1,029	5,964
1939	8,532	1,206	7,326
1940	8,786	1,657	7,129
1941	12,711	6,301	6,410
1942 ⁴	30,576	23,997	6,579
1943 ⁴	58,928	52,786	6,142

¹ Sources: *Economic Record* (National Industrial Conference Board), Jan. 1942, p. 19 (through 1940) and the *Budget Message*, p. xxi (1941-43).

² Data for 1914 to 1921 not strictly comparable with later years.

³ Includes expenditures for the Army, Navy, United States Maritime Commission, United States Shipping Board, lend-lease, loans to the Allies, and other national-defense activities.

⁴ Estimated.

Table I reveals the absolute and relative magnitudes of Federal expenditures over a thirty-year period. Two related facts are outstanding: the significant shift in the ratio between defense and non-defense expenditures and the astronomical growth in total expenditures during the last three years.

The rapid and continuous growth of defense expenditures by months is shown in Table II.

TABLE II. FEDERAL DEFENSE EXPENDITURES,
FISCAL YEARS 1941 AND 1942¹
(millions of dollars)

	Army	Navy	Other	Lend-lease	Total
FISCAL YEAR 1941					
July 1940	79	98	8	.....	185
August	91	108	11	.....	210
September	82	136	7	.....	225
October	134	150	14	.....	297
November	196	169	14	.....	379
December	281	179	10	.....	470
January 1941	346	216	8	.....	569
February	404	172	8	.....	584
March	544	185	19	.....	748
April	516	220	28	.....	763
May	456	338	37	7	837
June	507	247	43	15	812
Total	3,636	2,217	206	21	6,080
FISCAL YEAR 1942					
July 1941	508	339	79	34	960
August	579	416	60	69	1,124
September	700	377	103	140	1,320
October	786	442	107	192	1,527
November	704	442	94	198	1,437
December	976	494	121	256	1,847
Six-month total	4,253	2,509	563	889	8,214

¹ Source: *Economic Record* (National Industrial Conference Board), April 1942, p. 119.

Total expenditures for defense increased by 339 per cent during the fiscal year 1941 and by an additional 92.4 per cent during the first six months of the fiscal year 1942.

If these expenditures were matched by equal increases in tax revenues there would be no deficit and Federal financing would cause no serious inflation. Table III shows the actual Federal budget for the fiscal year 1941 and the anticipated expenditures, revenues, and deficits for the fiscal years 1942 and 1943.

The magnitude of the forces causing inflation may be viewed in another way. The greater the conversion of productive resources to war-goods production, the greater is the "inflationary gap" between the money incomes of consumers and the quantity of goods available for them to buy. This inflationary gap will exist unless an equal amount of money purchasing power is converted to war-goods production by taxing away or borrowing consumers' surplus money income.

In a statement accompanying its price order of April 28, 1942, the Office of Price Administration estimated the total of individual incomes in 1942 at \$117 billion and personal taxes and savings at \$31 billion, leaving \$86 billion available for spending. Against this the

supply of consumers' goods and services left after the government's requirements is estimated, at present prices, at \$69 billion. The difference of \$17 billion is the "inflationary gap" for the calendar year 1942.

TABLE III. FEDERAL RECEIPTS AND EXPENDITURES, ACTUAL FISCAL YEAR 1941 AND ESTIMATED FISCAL YEARS 1942 AND 1943¹
(millions of dollars)

Item	Estimated Fiscal Year 1943	Estimated Fiscal Year 1942	Actual Fiscal Year 1941
RECEIPTS			
Internal revenue	17,261.4	12,198.7	7,361.7
Railroad Unemployment Insurance Act.....	9.5	8.5	6.8
Customs	297.0	368.0	391.9
Miscellaneous receipts	284.2	240.9	508.1
Gross receipts	17,852.1	12,816.1	8,268.5
Less transfers to security funds	1,364.9	872.1	661.3
Net receipts	16,487.2	11,944.0	7,607.2
EXPENDITURES			
Legislative, judicial, and executive	43.5	41.3	38.5
Civil departments and agencies	797.4	844.5	782.5
Post office deficit .....	.....	14.0	30.1
General public works	578.2	713.5	573.1
National defense	52,786.2	23,996.5	6,301.0
Veterans' pensions and benefits	590.1	578.1	559.3
Aids to agriculture	854.0	1,117.1	779.2 ²
Aids to youth	100.0	235.1	347.2
Social security	537.8	462.0	444.4
Work relief	480.1	942.4	1,437.9 ²
Refunds	87.0	89.0	89.7
Interest on public debt	1,750.0	1,250.0	1,110.7
Retirement funds	298.6	267.2	217.1
Supplemental items—regular	25.0	25.0	.....
Total, excluding debt retirement	58,927.9	30,575.7	12,710.7
Net deficit under existing taxes	42,440.7	18,631.7	5,103.5
Receipts from proposed taxes	7,610.0	.....	.....
Net deficit under proposed taxes	34,830.7	18,631.7	5,103.5
Debt retirement	100.0	100.0	64.3
Gross deficit	34,930.7	18,731.7	5,167.8
Public debt at end of year	110,421.0	70,612.2	48,961.4

¹ Source: *Budget Message*, p. xxi.

² Return of surplus funds from government corporations have been deducted. These amount to \$315 million for aid to agriculture and \$14 million for work relief.

The United States began its defense program in June 1940. From that date to April 1942, the wholesale price level rose by 27.2 per cent. Since this degree of inflation was experienced with Federal deficits during the fiscal years 1941 and 1942 of \$5.2 and \$18.7 billions respectively, the inflationary force of a \$34.9 billion deficit financed in the same way during the fiscal year 1943 will be enormous. It is quite

significant that the Bureau of the Budget has increased its estimate of the war expenditures for the fiscal year 1943 from \$53 billion to \$70 billion. Unless Congress passes the \$7.6 billion tax measure recommended by the Treasury, the deficit for 1943 will be \$42.4 billion at the \$53 billion estimate of war expenditures and \$59.4 billion at the later and higher estimate.

It is crucial that Federal fiscal policy be re-examined, that sound conclusions be reached and sound policies be formulated, and that vigorous action be taken promptly—if the consequences of inflation are to be avoided.

III. REMEDIES FOR INFLATION

There are two methods of attack which the government may adopt to combat inflation. First, the strength of the forces promoting inflation may be decreased by a fiscal policy designed to avoid the sale of Federal securities to commercial banks. This method strikes directly at the cause of inflation. Second, the forces causing inflation may be resisted by "direct control" of prices through specific price fixing or blanket price ceilings on commodities and costs. This method does not strike at the causes of inflation.

The government has, in fact, adopted both methods *in part* by attempting to lessen inflationary borrowing and by the establishment of price ceilings.

Accepting the realistic assumption that the existing program of Federal war expenditures is necessary, inflationary borrowing may be avoided by a reduction of nondefense expenditures, by noninflationary forms of borrowing, and by increased taxation.

Reduction of Nondefense Expenditures. Any diminution of non-essential expenditures leaves a corresponding amount of room for expanded war expenditures without increasing the Federal deficit or necessitating increased taxation. For these reasons the curtailment of all nonessential Federal expenditures is a first duty of the financial engineers.

Table I, presented on an earlier page, indicates that Federal non-defense expenditures planned for the fiscal year 1943 are \$987 million less than for the fiscal year 1940 and \$268 million less than for the fiscal year 1941. Federal nondefense expenditures, which were \$6.4 billion in 1941, are estimated in the present budget as remaining above the \$6 billion level during 1942 and 1943. The reduction being achieved

is too small and too slow to have much influence upon the Federal deficit. The budgets for 1942 and 1943 contain many items of expenditure which could be substantially reduced or removed with benefit to the war programs. For example, significant savings are possible in the category of "aids to agriculture." In spite of the fact that farm cash income is double the \$5.9 billion average for the years 1931 through 1935, the 1942 budget estimate for the Department of Agriculture includes expenditures for aids to agriculture at the record high level of \$1,117,082,000. The 1943 budget includes the sum of \$854,050,000 for this same purpose.¹¹

It is clear that some principle must be uniformly applied to distinguish which nondefense expenditures are nonessential. For the benefit of the future, we cannot afford to lose too much ground in connection with the social improvements and public betterments already achieved. At the same time it is vital that the war program be pursued with as much vigor and speed as possible. The most reasonable solution of these conflicting needs appears to be the application of the principle of *repair and maintenance* to all nondefense activities, and the utilization of the remainder of the nation's resources for winning the war. Rigid application of this principle would mean the postponement of new or additional nondefense improvements and the curtailment of existing nondefense activities up to the point where further curtailment would render it difficult or too expensive to restore the service in the postwar period.

The civilian economy has been officially placed upon a repair-and-maintenance basis; yet the Federal government has failed to apply this principle to its own nondefense activities. The high cost of ships, cantonments, and other essential defense construction has been due in part to the government's own competition for materials, for labor, and for skilled engineers. The present emergency demands that the repair-and-maintenance principle be given general application. This principle should be applied not only to the civilian economy; it should be applied also to all nondefense projects of Federal, state, and local governments. Such a procedure would achieve the double purpose of releasing essential materials for war industries and checking inflation.

However, although curtailment of nondefense expenditures to a minimum is vital to the success of the war program, the savings reaped in this manner can be regarded only as a very limited damper on inflation. With the anticipated Federal deficit of at least \$34.9 billion

¹¹ *Federal Budget (1943)*, p. xxiii.

for 1943, the reduction of Federal nondefense expenditures from \$6.1 billion to \$5.1 billion would still leave a deficit of \$33.9 billion. Chief reliance must be placed upon other checks to inflation.

Noninflationary Borrowing. The sale of Federal bonds to commercial banks or to individuals and institutions that pay the bond price out of idle funds is inflationary borrowing. Noninflationary borrowing is the sale of securities to individuals or institutions that pay the security price out of income that otherwise would be spent or invested by the purchaser. A Federal bond-sale drive will be inflationary only to the extent that purchases are made out of heretofore idle funds; this method of raising revenue is unlikely to cause a *serious* rise in prices. The present bond-buying campaign, therefore, represents an important attack upon inflation; and the degree of its effectiveness depends mainly upon the volume of the sales.

Under existing taxes the Federal deficit for 1942 will be approximately \$19 billion. Under proposed increases in taxation the deficit for 1943 will be approximately \$35 billion. If taxes are not increased

TABLE IV. PURCHASE OF WAR SAVINGS BONDS¹

Month	Total	Small Savers ²	Large Savers ³	Percentage that Small Savers Bear to Total
1941				
May	349.8	34.3	315.5	9.8
June	314.5	40.3	274.3	12.8
July	342.1	51.1	290.9	14.9
August	265.6	48.4	217.4	18.2
September	232.3	46.1	186.1	19.8
October	270.7	55.0	215.7	20.3
November	233.5	52.2	181.3	22.3
December	528.6	162.4	366.4	30.7
1942				
January	1,060.5	?	?	?
February	703.2	?	?	?
March	557.9	?	?	?

¹ Source: U. S. Treasury Department.

² Bonds with denominations of \$100 or less.

³ Bonds with denominations of \$500 or more.

further than is now proposed, the volume of noninflationary types of bond buying must reach close to these deficit figures for the respective years. The actual volume of war bonds sold up to the end of March 1942 is shown in Table IV.

During the first nine months of the fiscal year 1942 a total of \$4.2 billion of war savings bonds were sold. The volume of sales has steadily declined since the peak in January. But, even assuming that the volume

sold in March continues to the end of the fiscal year on June 30, the total sales for 1942 will reach only approximately \$5.8 billion. This is far short of the amount necessary to meet the \$18 billion revenue deficit. To meet this deficit an average sale of \$1.5 billion in war savings bonds per month would be necessary for 1942. During the four months of actual war from January through March, the average volume of sales was \$0.7 billion or *less than one-half the rate required* to avoid borrowing from commercial banks.

The same conclusion is reached by consideration of the data for the *calendar* year 1942. The Office of Price Administration estimated that the "inflationary gap" between consumers' money purchasing power and the supply of consumers' goods available at 1942 prices to be \$17 billion. If the volume of sales during the first quarter of the calendar year 1942 is repeated for the remaining three quarters, the total sales will be approximately \$9 billion and only one-half the amount required.

The volume of voluntary war-savings-bond purchases is inadequate from another standpoint. To avoid inflation it is necessary to defer consumption by those small-income groups that are outside the existing schedule of war taxes. The mass of purchasing power lies in those groups with annual incomes of less than \$3,000. If these groups are not to be taxed heavily, then this purchasing power must be reached through the sale of war bonds to these groups.

In this respect also the record is disappointing. It may be safely assumed that individuals purchasing war bonds in denominations of \$500, \$1,000, \$5,000, and \$10,000 are in the large-income groups. In fact some members of these large-income groups will buy bonds of smaller denominations. But, even assuming that *all* purchasers of war bonds in denominations of \$100 or less are in the small-income groups, the records show that a small proportion of the total volume of sales is to the lower-income groups which it is desirable to reach. Table IV reveals that during the last eight months of 1941 an average of only 19.3 per cent of the funds borrowed through war savings bonds came from the low-income groups. This percentage would be reduced still further if allowance could be made for the purchase of small-denomination bonds by members of the large-income groups.

Three conclusions may be reached. First, the total volume of war-bond sales is only about one-half the amount required to check inflation. Second, reliance upon voluntary purchase of war bonds is not tapping sufficiently the income of those lower-income groups in pos-

session of the mass of purchasing power most likely to force inflation and particularly most likely to force up the prices of those commodities consumed by the masses. (However, it is to be noted from the last column of Table IV that the percentage of bonds bought by the small-income groups is steadily increasing.) Third, existing methods of taxation and borrowing are raising revenue mainly from the same high-income groups. The decided decrease in bond sales in March was due largely to income-tax payments. This conflict between taxation and borrowing will increase under the war-revenue proposals of the Treasury. Under the program of voluntary bond purchases, approximately 78 per cent of all war bonds purchased were sold to income groups that will bear the weight of any further increases in the income taxes recommended by the Treasury.

The alternative to voluntary purchase of bonds is some method of compulsory purchase or "forced loans." So far the Federal Administration has favored the voluntary program, and officials have expressed the hope that \$2 billion per month can be raised by voluntary lending. Price Administrator Leon Henderson and Marriner S. Eccles, chairman of the Federal Reserve Board of Governors, favor a compulsory program of bond purchases to raise the full \$17 billion needed to bridge the inflationary gap. Although Congress and the President wish to give the voluntary loan a fair trial, both have expressed the view that, unless this method provides sufficient revenue, a compulsory loan program will be necessary.

The failure of the voluntary purchase program to meet the revenue needs for the fiscal year 1942, the continued decline in bond purchases since January, and the estimated deficit of \$34 billion for the fiscal year 1943 all strengthen the belief that the voluntary purchase plan will continue to fall short of meeting the revenue deficit and will fail to check inflation. The chief reason for doubting success of the present voluntary purchase plan is its failure to tap that mass of purchasing power which lies in the hands of consumers receiving less than \$3,000 income per year. On this point the *National City Bank Bulletin* of last May contains the following comment:

The principal threat of inflation lies in the swelling payrolls of the mass of consumers, who buy the bulk of the goods and services available . . . 70 per cent of the increase in national income in 1941 was in wages and salaries.

The volume of revenue needed could best be obtained by extending the scope of income taxation to include the lower-income groups.

By this time it is evident that Congress does not choose to meet the deficit in this manner. Therefore, since it is not politically feasible to rely mainly upon increased income taxes, some form of compulsory purchase of bonds is now advisable and likely to develop in the near future.

The chief disadvantage of forced loans is that they increase the national debt and subject the people to the evils thereof. The chief advantage is the backlog of purchasing power placed in the hands of the lower-income groups whose members would certainly spend it during the postwar period and thereby promote and facilitate the return to a peacetime economy. Adoption of forced loans would place upon Congress the duty of carefully weighing advantages against disadvantages in order to find the most appropriate balance between the volume of taxation and the aggregate loans forced upon the public.

Taxation. The majority opinion among economists and officials of the OPA is that taxation should provide the chief source of revenue. In April 1941, Secretary Morgenthau proposed to Congress that two-thirds of *all* Federal expenditures be raised by taxation. The case for a "pay as you go" policy has been presented and supported in a previous pamphlet, to which the reader is referred.¹²

The chief cause of inflation, we have seen, is the sale of Federal bonds to commercial banks. Insofar as taxation is relied upon to raise war revenue, this cause of inflation is avoided. Sole reliance upon taxation would completely avoid *deficit-induced inflation*. Viewed from another angle, an appropriate system of taxation would draw into government use the surplus money income of consumers and thereby close the "inflationary gap."

↪ No matter whether inflation is checked by an appropriate plan of borrowing or by taxation, the target of the revenue measure must be the mass of consumer income lying below the \$3,000 bracket. This is true because:

First, the great bulk of the national income lies below this bracket.¹³

Second, existing progressive income taxes already severely tax the higher brackets, and the level of exemptions leaves untapped a large proportion of the total money income of consumers. Roy Blough, Treasury tax expert, estimated in March that \$30 billion of consumer income remains untapped under existing tax laws.¹⁴

¹² E. G. Daniel, *Financing the Defense Program*.

¹³ Cf. W. L. Crum, "The Maximum Possible Yield of Ability Taxation," *The Watch Dog* (National Economy League), March 1941.

¹⁴ *Tax Front* (The Tax Foundation, New York City), April 1942, p. 3.

Third, a tax program itself may be inflationary if, by heavy progressive taxation and government spending, a large volume of funds are transferred from the wealthier groups who habitually spend a small proportion of their income to the lower-income groups who habitually spend a large proportion of their income. It should be remembered that the present Administration deliberately attempted to promote recovery and higher prices (inflation) by collecting highly progressive "soak the rich" income taxes and spending the proceeds on public works. This same process will have a much greater inflationary effect in the present boom period than it had as an instrument for economic recovery. The present period is no time to apply a stimulant to consumer spending. This same criticism applies to the practice of financing the war effort by the sale of bonds to commercial banks—this is the depression device of "priming the pump."

There is considerable support, both inside and outside of Congress, for a "pay as you go" policy. The Administration thus far has not approved such a program. It has instead adopted a program designed to attack the problem of inflation "from all sides" by the simultaneous application of several anti-inflationary measures.

IV. PRESENT FEDERAL TAX POLICY

On January 7, 1942, President Roosevelt presented to Congress the budget estimates for the fiscal year 1943. According to these estimates, the Federal government will spend a total of \$58.9 billion, of which \$52.8 billion will be for defense. The President estimated that existing taxes would yield \$18 billion during the fiscal year 1943, and recommended that \$7 billion more should be raised by new taxes in addition to a \$2 billion increase in social-security taxes. Thus the 1943 budget calls for a total of \$27 billion in taxes, which is 45.8 per cent of the budget estimate for total expenditures. This is far short of the sum demanded by the rule that two-thirds of total expenditures should be raised by taxation.

Secretary Morgenthau, on March 3, 1942, presented to Congress the Treasury's tax program designed to fulfill President Roosevelt's request for \$27 billion in taxes. Actually the program submitted by the Treasury called for \$610 million more than was recommended in the budget message. Meanwhile, more recent estimates of the Bureau of the Budget place war expenditures at \$70 billion instead of the original budget estimate of \$52.8 billion. On the basis of this estimate

in regard to expenditures and the Treasury's proposed taxes, total expenditures for the fiscal year 1943 will reach \$76.2 billion and taxes will raise \$27.6 billion, which is 36.2 per cent of total expenditures. The new tax proposals of the Treasury are shown in Table V.

TABLE V. TAX INCREASES PROPOSED BY THE TREASURY DEPARTMENT

<i>Tax</i>	<i>Estimated Revenue (millions)</i>
Increased personal-income taxes	\$3,200
Increased corporation taxes	3,060
Increased estate and gift taxes	330
New and increased excise taxes	1,340
Plugging loopholes	680
Apparent total	8,610
Less conflicting taxes	1,000
Net total increase	7,610
Increased social-security taxes	2,000
Total tax increase	\$9,610

The bulk of the proposed increase in tax revenue is to come from increased rates of personal and corporation income taxation. Secretary Morgenthau has asked for retention of the present \$750 income tax exemption for single persons and \$1,500 for married persons, with \$400 additional exemption for each dependent. Under the proposed tax the first dollar of a person's taxable income would be taxed at the rate of 16 per cent instead of the present minimum rate of 6 per cent. Tax rates would increase rapidly until a maximum of 90 per cent would apply to incomes in excess of \$5 million instead of the present maximum of 81 per cent. Over all, the increase in personal income taxes would average 60 per cent. However, the increase is more than 100 per cent in the lower brackets where the bulk of the national income lies.

The Treasury would "plug loopholes" in the present income tax by taxing the income from existing and future issues of state and municipal securities, by abolishing the 10 per cent earned-income credit, and by requiring joint returns of married couples.

The principal change proposed in the corporation income tax is the abolition of the present surtax of 6 and 7 per cent and the substitution of a special war surtax of 16 per cent on corporations earning less than \$25,000 annually and up to 31 per cent on corporations with greater earnings.

The chief criticism of the Treasury's tax proposal is that the increases are not sufficient to prevent serious inflation. It appears that

only about one-third of total expenditures is to be raised by taxation instead of the two-thirds formerly recommended by the Treasury.

Price Administrator Leon Henderson clearly recognizes this inadequacy of proposed tax measures. In April he expressed the opinion that the tax measure now pending in Congress would absorb only about one-half of the "inflationary gap" and would leave between \$15-20 billion of surplus purchasing power to compete for consumption goods. He concluded that the general price level "is of a highly explosive character but has not been touched off."¹⁵

The main defect of the Treasury's proposed income tax is that it fails to reach down low enough into the income brackets to tap the mass of increased purchasing power. This previously explained defect is still left uncorrected.

A second important defect of the proposed income tax is the time lag between the receipt of income and the tax payments on that income. The income-tax revenue for 1942 is settled because rates on 1941 incomes will remain unchanged. Revenue from taxes on 1942 incomes will, unless some withholding plan is instituted, not be available until it begins to be paid in March 1943. In the main, individuals react to taxes as they become payable and not as they accrue. Thus a rise of 1942 income-tax rates won't curtail consumption until 1943, and a rise in 1943 income-tax rates won't curtail consumption until 1944.

Both of these defects in the existing and proposed income tax are being used in Congress as arguments for a Federal general sales tax. But these arguments give equal support to an income tax collected at the source and at the time the income is received, a superior method of remedying these defects.¹⁶

It should be noted that, inadequate as the proposed tax program is, even the Treasury proposals have not yet been enacted into law. Delay caused by controversy over the new tax bill will almost surely prevent the increase in Federal revenues from reaching the \$9.6 billion asked for by the Treasury. The chairman of the House Ways and Means Committee has stated that he would be surprised if the tax bill reached the President for signature before late summer or early fall. Increases in personal and corporate income taxes would be made retroactive to cover the 1942 calendar year, but delay in putting the new taxes into effect would cause the Treasury to lose revenue from the proposed excise taxes, inheritance and gift taxes, and levies

¹⁵ *Tax Front, loc. cit.*

¹⁶ *Cf. E. G. Daniel, op. cit., pp. 30-32.*

on state and municipal bonds, none of which would be retroactive. Furthermore, if Congress is to levy a sales tax *in lieu* of the proposed income-tax increase, the loss of revenue would be very great, since a sales tax could not possibly be retroactive.

In summary, the Federal fiscal policy at present has not gone far in diminishing the *causes* of inflation.

V. DIRECT CONTROL OF PRICES

The new moves of the Administration against inflation were explained in President Roosevelt's message to Congress on April 27, 1942. In his seven-point program the President included recommendations for establishment of price ceilings, stabilization of wages, and stabilization of the prices received by the farmer. The President did not recommend any definite measures for putting his program into operation. The only specific proposals were that "undue" or "excess" profits be absorbed by taxation, and that taxes should take all individual incomes in excess of \$25,000.

The Emergency Price Control Act of 1942 provides that whenever, in the judgment of the price administrator, the prices of commodities have risen or threaten to rise he may establish by regulation such maximum prices as will be generally fair and equitable and will effect the purposes of the act.

In accord with the authority granted by this act and consistent with the President's recommended program, the Office of Price Administration issued its General Maximum Price Regulation of April 28, 1942.

This price-freezing regulation had been in preparation for a considerable period. At the time Canada established its blanket ceilings on September 1, 1941, the OPA believed that such a measure was unsuitable for the United States. This belief was based upon the greater population and area, greater complexity of distribution, and correspondingly greater difficulties of enforcement.

Further, the OPA believed in the efficacy of selective price controls. After this country entered the war, the OPA gave growing support to establishment of blanket ceilings. This shift in opinion was due to the more rapid rise in the cost of living, which threatened to produce an inflationary spiral, and to the spread of restrictions on the production of consumers' goods. In every case where serious scarcity developed, the OPA was forced to decide whether distribution of the scarce goods should be achieved through the ordinary process of

automatic changes in market price, or whether specific ceilings, and in some cases rationing, should be established. In fact, by last April, ceilings became so widespread that *selective* control was rapidly approaching a *general* freezing of prices. In view of the other features of the Administration's fiscal policy, the General Maximum Price Regulation was the next logical step.

The General Maximum Price Regulation. The sweeping blanket price order of the OPA applies to the majority of commodities and to many services utilized by the American consumer. In general it applies to the retailer, wholesaler, and manufacturer. The first section of the regulation provides :

On and after the effective date of this Regulation, regardless of any contract or other obligation :

- (a) No person shall sell or deliver any commodity, and no person shall sell or supply any service, at a price higher than the maximum price permitted by this Regulation ; and
- (b) No person in the course of trade or business shall buy or receive any commodity or service at a price higher than the maximum price permitted by this Regulation.

The regulation aims to freeze the price structure as it existed in the base period until a judgment can be made as to what adjustments are necessary. Thus the general rule is that no seller shall charge more for his commodities or services than the highest price he charged during the base period of March 1-31, 1942.

The price order covers all clothing, about 70 per cent of foods, all tobacco products, drugs, toilet articles, furniture, and hardware. Services included are tailoring, shoe repairing, automobile repairs, laundering and cleaning, and storage. In regard to rents, the OPA designated 302 new communities as "defense rental areas" and recommended the establishment of March 1, 1942 rent levels in four-fifths of them. For 64 areas, it was recommended that rents be cut back to levels in effect on specified earlier periods in 1941. If these recommendations are not adhered to within 60 days, the OPA may issue maximum rent regulations. The rent areas covered by these recommendations house about 86 million people.

The order exempts a considerable number of commodities and services. The chief commodities free from the maximum price ceiling are "any raw and unprocessed agricultural commodity or greenhouse commodity while it remains in substantially its original state," eggs,

poultry, cheese, butter, flour, domestic ores and concentrates, used automobiles, and publications. The chief service charges exempt are fees of professional persons such as doctors and lawyers, prices of barbers and beauty shops, "any personal service not rendered in connection with a commodity," motion pictures and entertainments, public utilities and common carriers, real-estate fees, and any "service of an employe to his employer"—that is, *all wages*.

For enforcement, the OPA requires that licenses be obtained to do business in the articles and services covered by the order. Licenses may be suspended for twelve months by court action for violations. All the sellers affected must register with the OPA and must keep records of maximum prices, and retailers must mark important cost-of-living articles with maximum prices. Housewives may report to the local War Price and Rationing Board when they believe they are being charged a price above the maximum.¹⁷

Difficulties Faced in the Direct Control of Prices. The chief obstacle to success of the direct control of prices is inherent in the method of attack itself. The price-freezing regulation attempts to hold down prices while the chief causes of inflation are still operating. When prices are fixed by law, any additional purchasing power placed in the hands of the public through Federal bond sales to commercial banks causes the money demand for goods at their fixed prices to exceed the available supply of goods. The competition for these scarce goods exerts a powerful upward pressure on prices. There is constant temptation to evade the law by making secret additional payments, changing the conditions of sale, or changing the quality of the product sold. Because purchasing power exceeds the supply of goods at their regulated prices, rationing of the scarce goods becomes necessary to secure justice in distribution. This imposes another difficult task upon the price-control agency. Enforcement is especially difficult because evasion is to the immediate personal advantage of both buyer and seller; and, as both are legally liable to penalty, neither is likely to betray the other. Ample evidence of evasion of price regulations is available from the experience of attempted enforcement of the National Industrial Recovery Act during the first term of the Roosevelt Administration.

The OPA is charged with a very difficult task. It is obliged to solve a price problem needlessly created by another branch of the Federal government through borrowing from commercial banks; successful

¹⁷ For the full text of the General Maximum Price Regulation, see *Wall Street Journal*, April 29, 1942, p. 8.

performance of this task may prove to be impossible. No one recognizes these difficulties more clearly than the price administrator himself. In Leon Henderson's opinion, the tax measure now pending in Congress will absorb only about one-half the inflationary gap, and the remaining excess purchasing power is too large to be handled effectively by direct price controls. Increased taxes, rather than direct price control, he believes, form the keystone to the anti-inflationary arch.¹⁸

Enforcement will not only prove to be difficult, if not impossible, but will require the services of many trained men who under a sound Federal fiscal policy could be profitably employed elsewhere. During the first week of June 1942, Leon Henderson asked for 90,000 *new* Federal employees (and \$210 million) to enforce the price-control program. This is about 70 per cent as many men as there are in all the state and local police and detective forces in the country. It is more than 20 times the peak staff, in bootleg years, of Federal prohibition agents; and it amounts to one Federal employee for every 19 retail outlets in the United States.¹⁹

In addition to the obstacles inherent in the method of attack, the OPA is faced with important defects in the price legislation itself. The added weight of these defects, if uncorrected, makes success of direct price control still more doubtful.

By legal necessity the OPA price regulation specifically exempts the price of labor—the most important price in the economy.²⁰ For industry as a whole, wages form the chief item of cost. If labor is successful in raising money wages sufficiently to avoid any decrease in their standard of living, then either profits will be seriously reduced or annihilated and the incentive to production seriously diminished, or the price ceilings will be broken.

Through a mistaken labor policy, the forces causing inflation may be permitted to work through wage increases. That is, these forces may as effectively raise prices by raising costs as by raising effective

¹⁸ *Tax Front*, loc. cit. See also E. G. Daniel, *op. cit.*, pp. 26-27; S. E. Harris, *The Economics of American Defense* (New York, Sept. 1941), p. 204. Federal Reserve authorities are equally skeptical of the effectiveness of direct price control. The *Federal Reserve Bulletin* contains the following opinion: ". . . there can be no effective price control while at the same time there is so large an amount of excess purchasing power. Price regulations must not only be promulgated; they must be accepted and where necessary enforced. The full pressure of excess purchasing power would insure the disregard of law." (May 1942, p. 445.)

¹⁹ Cf. *Time Magazine*, June 8, 1942, p. 77.

²⁰ Wages and salaries of employees constitute about 65 per cent of the national income and a still larger percentage of costs of production in the accounting sense.

money demand. A successful move by labor to protect itself, under war conditions, from a fall in its customary level of consumption will increase the supply of money in two ways.

First, wage earners insist upon an increase in money wages to offset rising costs of living which are due to *decreased efficiency*. It is common experience that boom periods, in peacetime and especially in wartime emergencies, are accompanied by a reduction in the output *per unit* of productive resources employed.²¹

In the war emergency, increases in wage rates are unlikely to operate to cause unemployment. Under these conditions wage-rate increases enforced to offset price rises brought about by decreased efficiency must lead to higher costs and hence to larger incomes supported by new money. Private industry meets these higher labor costs, in part at least, by borrowing from banks. The consequent creation of additional bank money operates to raise general prices. If wage earners again demand wage increases to meet this second rise in prices, the whole process is repeated. This process can continue indefinitely. It is independent of the way in which the Federal Treasury raises its revenue. Some part of the \$4.5 billion increase in bank loans to private industry during the last two years is undoubtedly due to this cause.²²

Second, the money cost of goods consumed by labor is rising because the Treasury is borrowing from commercial banks. The new money created in this manner results in "deficit-induced" inflation. Labor is admittedly attempting to protect itself from rising prices due to this cause. Rising money wages will force up the prices the Federal government must pay for war goods in order to give "fair compensation" to producers. This rise in cost to the government of its war supplies causes a larger dollar deficit and, under present Treasury financing, causes the government to borrow still more money from banks, thereby raising prices again. This process too can go on indefinitely. It results from the way in which the Treasury is raising its revenue.

At present, both of these causes of an increased supply of money are operating through wage increases. Organized labor is quite successful in preventing a lag of money wages behind rising costs of living.

²¹ The economist and manufacturer need only be reminded of the law of diminishing returns and the existence of external diseconomies.

²² For a more extended explanation of this "wage-induced" inflation, see A. C. Pigou, "Types of War Inflation," *Economic Journal*, Dec. 1941, pp. 439-48.

In spite of the declaration of organized labor for fullest cooperation in the war effort, demands for higher pay have continued.²³

Congress has refused to pass the Smith amendment which, for the duration, would remove the requirement to pay time and one-half after forty hours of work in one week. At the present time a ceiling on wages seems unlikely.

Adjustment of money wages to compensate fully for the rising cost of living is not justified under present war conditions, which require from everyone a decrease in consumption. War goods in sufficient quantity can be produced only by decreased production of peacetime goods. There is no valid reason why labor should be exempt from its just share of this general public duty. More important than this question of justice is the inescapable fact that a failure of labor to curtail consumption would greatly impede the transfer of productive factors into war-goods production and thereby hinder the war program.

The absence of a definite national wage policy adjusted to fit war conditions is placing a great obstacle in the path of the OPA. Price Administrator Henderson, speaking before the National Farm Institute, stated that :

. . . in view of the supply situation that faces us any general increase in basic wage rates will compound an already difficult problem in the price field. . . . The principle of adjusting wages to the cost of living should in my opinion be limited to those workers who are really on a sub-standard level. The spread between the wages in this group and the wages of the better paid, better organized workers should be reduced. If wage increases are permitted according to bargaining power, this spread will be increased. . . .²⁴

The influence of organized labor over wage rates is indicated by the fact that the average weekly *real* wages (money wages adjusted for the increase in cost of living) paid in all manufacturing industries increased during the first 28 months of World War II by three times as much as during the first 28 months of World War I.²⁵

The extent to which wage increases will be permitted to hamper the work of the OPA will depend a great deal on the policy of the War Labor Board. William H. Davis, chairman of the board, has stated that he interpreted President Roosevelt's direction to "stabilize wages" to

²³ For examples see the *Management Record* (National Industrial Conference Board, New York), March 1942, pp. 80-81; April 1942, p. 127.

²⁴ *Management Record*, March 1942, pp. 80-81.

²⁵ *Ibid.*, p. 72. This conclusion is based upon data furnished by the Bureau of Labor Statistics.

mean that the board should follow a flexible wage policy rather than a frozen wage policy, and that the board aimed to allow no wage increases except to remove existing inequalities and impractical low standards of living. Successful adherence to this principle would greatly mitigate the wage-price problem.

Wage rates and farm prices are directly related. The rise in farm prices has been based upon the parity formula, under which the parity price rises automatically with the rise in price of the industrial products the farmer buys. At the same time, the pressure of labor for higher wages has been based upon the rise in cost of living. Wages and agriculture prices thus interact to create a spiral.

The Price Control Act prohibits the OPA from placing upon agricultural prices any ceilings which are below 110 per cent of parity. The effort of the OPA to check advancing living costs by *selective* price control is weakened by this virtual exclusion of agricultural prices from its jurisdiction. Likewise, the new *blanket* ceiling regulation is weakened by the exemption of "any raw and unprocessed agricultural commodity" and a substantial list of other agricultural products.

Both a reduction in the level at which agricultural prices may be stabilized and a removal of some of the existing exemptions are necessary if direct price-control methods are to check this wage-agriculture price spiral. According to the Bureau of Labor Statistics index, the prices of the farm-products group have risen by more than 70 per cent since August 1939, whereas the average advance for all other groups combined is only 24 per cent. President Roosevelt has asked for legislation permitting ceilings on farm prices at parity rather than at 110 per cent of parity, but so far Congress has not followed this recommendation.

Success of the OPA and of direct price control is sacrificed in a large measure to the interests of labor and agriculture pressure groups which involve Congress in political controversy.

The administrative difficulties of direct price control would be tremendous even under more favorable financial, legal, and political conditions. At present the OPA must face these inherent difficulties as they operate within a milieu of very unfavorable conditions. A few examples will help to make this point clear.

In April, Leon Henderson protested against two practices by which coffee dealers were evading the green-coffee price order. Some dealers refused to sell coffee to large dealers in lots of more than 25 bags in order to obtain the 7.5 per cent premium, over regular ceiling prices,

allowed on small-lot sales. Other dealers were selling coffee only at gross weights, thus failing to allow the customary discounts for the weight of the empty cover. These dealers were operating within the rules, but not within the intent, of the price order.

The new General Maximum Price Regulation provides that dealers must make the customary discounts and allow the same differentials to special types of customers as were offered in March. If in March a dealer made a discount to a purchaser in order to correct an inventory surplus of a particular commodity, this discounted price would be, for the future, the dealer's maximum price to that purchaser.

If a grocer who has been delivering his wares daily to customers finds that, in order to conserve rubber and gasoline, he must curtail or cease delivery service, the OPA must decide whether this decrease in service constitutes an evasion of the price ceiling. If the decision is in the affirmative, the grocer must continue to perform delivery service or suffer penalties. If the decision is negative, then dealers generally can evade the price ceiling by a decrease in service.

The vast number of such cases which will arise throughout the industry and trade of this broad country will probably overtax the resources of the price authority.

The exemption of certain commodities and services from the price ceilings leads to anomalies. If a pint of ice cream is purchased to be taken home, the store is not permitted to charge more than its maximum March price. But, if a pint of ice cream is purchased and eaten at a soda fountain, any price can be charged, because foods and beverages sold at hotels, restaurants, and soda fountains are exempt from the price ceilings. A grocery store cannot charge more for a jug of cider than the maximum March price, but the farmer operating a roadside stand can charge any price he pleases so long as his monthly sales total no more than \$75. Under such conditions what incentive is there for the farmer to sell his products to the grocer? If the farmer refuses to supply the grocer under such circumstances, then the price regulation has deprived the grocer of a portion of his business.

There will be changes in *quality* of commodities as producers are compelled to use substitute materials. If the same ceiling price is charged for an inferior quality, this is virtually a rise in price. If the price authority permits a decrease in quality, then any producer can evade the price regulation by deterioration of his product. If deterioration is not allowed, then the price authority must extend its activities to include investigation and control of quality.

A difficulty often overlooked is presented by the fact that the unit cost of a commodity may change without any change having occurred in the prices of the materials used or in the rate of wages paid. With a given size of plant and equipment, the unit cost of production will vary according to the volume of output, because the fixed amount of overhead costs are distributed among a greater or smaller number of units produced. Further, as men trained in specific lines or production are withdrawn into military service, their place in industry must be filled by men with less training and experience. The result is certain to be diminished output per average worker employed and a consequent rise in unit cost to the producer. *Frozen* prices permit no adjustments for such changes.

Price control cannot be successful without control over wages. Yet control of wages presents great difficulties. Suppose that the price authority orders and labor accepts the freezing of wages at their present status. Immediately many problems would develop. If a worker receives an increase in pay because of an increase in his efficiency, has the wage ceiling been broken? If not, then how can the price authority distinguish this type of increase in pay from any other type? If such wage increases are regarded as illegitimate under the price order, then this must mean that any monetary rewards for improved efficiency are suspended for the duration. Enforcement of the wage ceiling in such a circumstance would be both difficult and opposed to the interests of the war effort.

In the present emergency it will often happen that two laborers will be called upon to do the work of three in order to release one worker for military service. Ordinarily this will not demand increased hours of work but will call for an increased rate and volume of work during the factory hours. In such cases would a wage ceiling permit two workers to get the wages formerly paid to three? Or would the two men be compelled under the wage ceiling to do the work of three men without an increase in pay?

These are only a few of the numerous problems that will arise to to impair the effectiveness of direct price control. Such difficulties are magnified by the clash of political and economic interests, by the lack of authority over certain prices and wages, and by the strong upward pressure upon prices exerted by an improper financing of Federal expenditures which injects surplus money purchasing power into circulation.

A question quite different from the administrative difficulties arises in regard to the wisdom of *attempting* to use the method of direct price control. Even when the doubtful assumption is made that direct price control would check inflation, it still remains questionable whether it is wise to adopt a general program of price fixing or price freezing which is inherently inconsistent with the principles by which our economic system is accustomed to operate. No matter what type of economic system is evolved in the postwar period, at present we have a system which is guided and regulated by price movements. Obviously, price *freezing* is opposite to price *movements*. Direct price control, by its very nature, prevents the operation of a basic regulator of our economy.

Changes in prices exercise a regulating function by quickly reflecting scarcities in materials, in types of skilled labor, and in kinds of consumers' goods. Price changes, by affecting the direction in which profits or losses are made, tend to bring automatic adjustments to new conditions. The operation of price reaches into every minute portion of our economic system, and its influence is too vast to be quickly and completely controlled by any agency of government.²⁶

One example will illustrate the nature of the problem. It has been shown that wage rates must be fixed if the price ceilings are to be effective. Ordinarily, relative changes in wage rates directs labor out of employments where workers are needed less into employments where they are needed more. The rise of wages in the shipyards has drawn many laborers into the urgent work of shipbuilding. If the price of labor had been frozen during the past year, this transfer of workmen would not have been as rapid or as great as has actually been the case. Unemployed workers would have found new jobs open in shipbuilding, but it is difficult to understand why any *transfer* of labor would have occurred at all. If wages are now frozen at their present level, future changes in distribution of the country's labor force will not occur automatically. Farmers will soon be short of labor to harvest their crops. The freezing of wages now would prevent the farmer from offering a sufficient increase in wages to attract the labor necessary for the harvest. Crops must be harvested and ships must be built. In the absence of wage control, relative changes of wages in agriculture and shipbuilding would distribute labor among these two employments according to the relative urgency of the tasks to be performed. If any price-control agency arbitrarily fixes the rates of wages in agriculture and

²⁶ This statement does not aim to deny the existence of monopolistic and rigid prices. Rigid prices from *any* cause impair automatic adjustments in our economy.

shipbuilding, it also assumes the task of allocating labor between these two important industries. *Freezing* of wages would prevent the necessary transfer of labor, whereas *arbitrary changes* of wage rates would involve arbitrary decisions as to the distribution of the labor force.

This example involves only two industries. Actually there are thousands of employments among which labor must be distributed. Further, prices are interrelated. The price system is an integrated structure; and, when one price is deliberately fixed, other related prices must be fixed also if serious maladjustments are to be prevented. Indeed, the task imposed upon the price authority seems insuperable.

The freezing of most prices as of March will prevent future automatic adjustments to changing conditions in the industries affected by the price regulation. Whereas some prices, including wages, are exempt and free to move, other prices are rigid. It remains to be seen how well the economic system will work under such conditions.

Certainly inflation could have been more effectively checked by methods less disturbing to our economic system than is the method of direct price control.