HARRY GUNNISON BROWN

I

Fiscal Policy and War-time Price Control

IN A SYSTEM OF FREE enterprise and free markets, the fundamental forces determining the relation of the price of one commodity to that of another are the forces of demand and cost. The average of all prices—what we often speak of as the general level of prices—is largely a function of the volume of the circulating medium and the readiness of the people to spend it. A large increase in the circulating medium in proportion to available goods usually and, indeed, almost inevitably, raises the average of commodity and other prices, while a great proportionate decrease—e.g., from a sharp restriction of bank credit—brings the average of prices down.

The circulating medium includes, as its largest element, bank deposits on which checks are written. These deposits subject to check are increased when banks lend freely and also when banks purchase commercial drafts, mortgages or government bonds. When banks make such purchases, of course, they give checks and, therefore, bank deposit accounts for the paper or securities involved. So, when a government finances its war expenditures largely by borrowing from the banks, selling to the banks its own bonds or short term promissory notes and thereby obtaining checking accounts to use for paying for material for its military and naval needs, there is, ordinarily, an increase of the circulating medium, increased spending by the government and by those from whom the government purchases its supplies and by the workers they hire. Almost inevitably there is a bidding for goods and services all along the line and, in consequence, a general rise of prices.

It is true that increased bank credit extended to government might go along with decreased credit extended to private individuals and corporations. Such price-level increases would not then result. It is also quite possible—indeed, this has often happened—for credit extended to private business to increase so greatly in peace-time as to bring about a very considerable rise of prices. The recent policy of the United States of buying at $35 an ounce any gold, offered from any part of the world, has meant vast increases of bank reserves and so of the lending power of the American banking system. For this policy has tended to swell American exports which could be paid for with this gold; and the banks, in bringing in the gold and disposing of it to the United States Treasury, have received larger reserves. In our present inquiry the details of bank credit expansion and its relation to reserves are not important. Suffice it to say that, when World War II began, the banks were in such a position that a very considerable expansion of credit, given the demand for it, was easily possible.

But, then, it is argued (even by some of those who realize that increase of bank loans to government and to others is inflationary, and who would perhaps like to see limitations put on such increase of bank loans) that much can be done through direct price-fixing. It is thought that the government need not limit quite so rigidly the volume of money and bank credit, particularly of the latter. It is noted that the sale to individuals of savings bonds, on which bank loans cannot be made, does not provide all the war revenue that is needed. Taxes are increased, but there is legislative hesitation in increasing them *enough* to meet pressing military requirements. And so government borrowing from the banks—

which tends strongly toward inflated prices and a grossly unfair distribution of war's burdens—is resorted to as a means of obtaining the remainder of the needed funds. Then the advocates of direct government price-fixing—like the man who would have his cake and eat it too—come forth with the proposal that this borrowing from the banks and the great increase in the circulating medium and so of the spending power resulting from it, shall be prevented by price-raising prohibitions from having its normal effect. The government will thus get its desired funds from the banks but prices will not—shall not—rise. What are the chances that such regulation would be successful?

Wherever price-fixing has been attempted with prices fixed much below their normal market level, there seems to have developed a "black market." In other words, there is extensive evasion of the price-fixing law. Goods are smuggled out of warehouses and sold, more or less secretly, to persons willing to pay prices that are above the legal ones. Sometimes purchasers who pay, formally, only the legally-fixed price, have been required first to lease the article to be purchased and have thus actually paid a rental in addition to the formal purchase price.[1] Often, too, it is easy to take advantage of consumers who do not know or perhaps cannot remember what the maximum legal prices are on the numerous articles they must buy. Effective enforcement may then require numerous investigators and great expense. In some cases, even, goods are stolen and then sold by the thieves, of course usually at prices above those supposedly—and, perhaps, generally—adhered to by legitimate dealers. The variety of particular circumstances may be numerous. But in all of the special cases there is the one underlying influence,

[1] *Bread and Butter*, published by Consumers Union, New York, July 24th, 1942.

viz., that a low price is fixed by law or administrative regulation on a scarce commodity so desired that many persons would far rather pay a higher price than go without. When that is so, it is almost certain that at least *some* would-be buyers will take part consciously in a conspiracy to violate the law, while not a few others will pay illegal prices through ignorance.[2]

Again, even if "ceiling prices" are otherwise hard to evade, much can perhaps be done to thwart regulation by lowering quality. The price set for a commodity that has been pretty much standardized is applied to an article that looks a good deal the same but is actually of inferior quality and cheaper to make. Or perhaps, in the case of various mechanical gadgets, old models may be discontinued and new models, for which a higher charge is made, substituted. Such practices certainly complicate the problem of enforcement and make for relatively frequent evasion.

But no study limited to direct evasions or violations of price-fixing regulations will begin to give the picture of how an increase of the circulating medium brings about price rises despite the activities of a price-fixing agency. For in fact a large part, or most, of the increases that occur are allowed—not to say encouraged—by the regulating legislation or the regulating administrative agency or both.

The first barrier to successful regulation of prices in the United States during the present war emergency was the provision by Congress that no price "ceilings" should be fixed on farm products lower than 110 percent of "parity." Farm prices are regarded as being at "parity" when they are as high, compared to other prices, as in the years 1909–1914. They were then relatively higher than they have usually been since

[2] Mr. Leon Henderson, OPA Administrator, has pointed out that "to forbid a thing does not prevent it," recalling American experience with the Prohibition Amendment. *Cf.* his address, Norfolk, Va., Aug. 20, 1942.

or than they had been for some time before. Recent Federal legislation and crop restricting regulations provided for in such legislation have been designed to maintain this 1909–1914 favorable relation. But to say that farm prices are not to be held to less than 110 percent of parity was to say, right at the start of price regulation, that for these goods, at least, price regulation would amount to comparatively little. And if these prices are allowed to rise by this amount, prices of goods made from them may have to rise. If wheat is higher, can the price of flour be kept down? If corn is higher, will men feed the corn to hogs unless their price is also higher? If hogs, too, are higher, will butchers—especially when other work is available at high wages—butcher and sell the pork for a low price?

Then there is the matter of wages. Wage increases have recently been allowed by the War Labor Board on the ground that such increases are justified by the higher cost of living. But if certain raw materials, e.g., from the farms, are permitted to rise in price and if, then, wages and, perhaps, other business expenses are also permitted to rise, will not finished products rise in price also? How shall this be prevented? Consider the manufacturer who has to pay more for raw material than before—e.g., for cotton—*and* to pay higher wages and, possibly, higher interest on capital or more rent for a valuable site (the prohibition of increases in residential rents does not of itself prevent business rents from rising). Will the Office of Price Administration require him to keep down the price of his finished products even if he thereby loses money? In that case he will certainly quit and the public will not get the finished products at all. And even if he could be forbidden to quit, by the threat of a jail sentence, he could be forced to continue production only until he became bankrupt. After that he simply *could not* continue production, other than by cheating his creditors or by doles from his friends; he would have to endure the jail sentence if so required.

The above comments are not intended as a criticism of the War Labor Board for ordering certain wage increases. And they are not intended to convey an impression that executives and employing companies are being discriminated against. A recent report of Consumers Union[3] contends that the greater part of the current increase in purchasing power has gone to persons whose incomes were already $5,000 or more a year and that, in fact, considerably more than half has gone to persons already receiving as much as $10,000 a year. While the fight which finally brought up money incomes for workers in "Little Steel" by 15 percent was under way, Consumers Union remarks, twenty-five large companies increased their executives' salaries by "anywhere from $20,000 to $100,000 a year." Obviously, regardless of whether wages of ordinary workers are or are not going up faster than—or as fast as—other and initially higher incomes, it must be noted that interest on borrowed funds, rentals and executives' salaries are part of the expenses of business as truly as are wages of artisans and day laborers. Where and if all of these go up and the prices of raw materials go up, it is hardly to be expected that the prices of finished products will be kept down.

It is of interest to note that the Office of Price Administration in the summer of 1942 permitted fruit and vegetable canners to raise the price of the 1942 pack by 15 to 25 percent above the March "ceiling" because of "increased costs."[4] How many of these price increases can take place without the problem arising of further wage increases to offset "increased living costs" and, eventually, of further increases in the prices

[3] *Bread and Butter*, July 31, 1942.
[4] *Loc. cit.*

of agricultural products to allow them to be at 110 percent of "parity"?

At the same time the War Labor Board defined its wage policy as one of not permitting further wage increases except for "adjustments" in the case of such wages as are "out of line" with the general wage level. But if wages which are thus "out of line" are permitted to rise and if, then, the Office of Price Administration permits increases of the prices of goods produced by the workers whose wages have been thus "adjusted," there is a new increase in the average "cost of living." Then there is a new argument for allowing a further increase in the wages first permitted to be raised. And, of course, since the prices so raised are presumably not farm prices, the latter must be permitted a further increase in order that they be not held down to less than 110 percent of "parity." And then further increase in prices of goods made from farm products become "reasonable" and further increase of wages to compensate for the further increase of living costs, and so on.

As this paper is in press there comes news of the President's message to Congress of September 7th, in which he demands legislation authorizing him to fix farm commodity prices at lower levels than 110 per cent of parity and in which he threatens to take action himself under war-time powers if Congress refuses such legislation. But even this demand, although granted, would permit considerable price increases and would leave open the possibility of large and long continued increases of the general price level. For the President states that the "purpose should be to hold farm prices at parity, or at levels of a recent date, whichever is higher." Thus, if any farm products have been at "a recent date" above parity, they would not be forced down to parity; while if, as is the case, some farm products have been selling below parity, these would be permitted to rise to parity. Even with the proposed new arrangement, therefore, we should have reason to expect further increases in the *average* of farm commodity prices, no matter how effectively the formally set prices were maintained. If, thus, food prices continue to rise *on the average*, are we not still faced with the same problem of the relation of permitted price rises and permitted wage increases above adverted to?

There is a sharp contrast to be noted between the operation of the process of stabilizing the general price level through control of the volume of the circulating medium and attempted stabilization through such price "fixing" as has been described above. If the total volume of the circulating medium is so controlled as substantially to stabilize the volume of spending, individual prices will still fluctuate according to changing conditions of demand and cost of production. With such stabilization, however, all prices will not rise. If some prices rise, others will fall. With the total volume of purchasing power rigidly controlled, any great increase in the demand for and the prices of any one kind of goods would leave less purchasing power for the purchase of other goods. The demand for these other goods must then perforce fall and their prices tend downward.

But if the circulating medium is permitted to increase greatly—as by government borrowing from the banks to meet war expenditures, coupled with extensive private borrowing on the part of defense industries—and the attempt is made to keep prices from rising by fixing price "ceilings," no such balance is likely to be realized. When one price or group of prices is permitted to rise, for such special reasons as have been commented on above, there is not likely to be an offsetting *decrease* of prices of other commodities. Price regulation in war-time is not thought of as a means of forcing price *reductions* nor is it often—if ever—so used. And thus when, as in the policy of the Office of Price Administration, numerous increases are permitted, the enforcement of corresponding decreases in other lines is not to be expected. Indeed, the enforcement of numerous decreases to offset increases would probably be looked upon as unreasonable and as not a necessary part of the business of controlling "inflation." Such rulings would probably meet with a special resentment. To prohibit an increase beyond—or much beyond—a price that has long been regarded as usual or customary seems reasonable to consumers and may not be too much resented by producers and dealers. To force a price down to a level *below* what has been usual or customary seems less reasonable and is far more likely to stir opposition.

When, with the circulating medium stabilized, the rise of some prices is balanced by a fall of others, because the public demand for the other goods has declined, the fall of prices of these other goods appears as the result of the operation of impersonal forces and not as the personal act of members of a regulatory board. But when the circulating medium is permitted to increase very greatly, so that, unless prices greatly rise, increased demand and higher prices for some goods does not automatically decrease the demand for other goods, an order that these other goods be appreciably reduced in price is likely to look like an unjustified discrimination. And so it is much more likely that any regulatory agency will actually permit an *increase* of prices of these other goods, so that their prices will not be "out of line" with those that have risen, than that they will enforce a decrease.

In regard to the considerations that have been advanced herein, the objection may be raised that increased costs need not be accepted as a justification for increased prices to consumers; but that, if prices to consumers were rigidly held down, dealers and manufacturers simply *could not* meet the higher costs, and so wages, interest, rentals and raw material prices would *have to* stay down. It may well be a fact that *if* all retail prices were rigidly and effectively controlled, *if* manufacturers and wholesalers were effectively prevented from disposing of their goods except through these effectively regulated retailers and *if* there were no "adjustments," now here and now there, to sabotage the system, then wholesalers and manufacturers and raw material producers would have to accept low prices and workers would have to accept low wages. The only alternative for wholesalers and manufacturers would be to refuse to sell; and the only alternative for workers would be to cease working—or to produce goods for their own use and nothing else! But obviously, unless such regulation were both rigid and general, it would be utterly ineffective. To regulate retail prices of some goods and not of others in that fashion would divert labor into the manufacture of the goods not regulated. And to regulate retail prices in some localities and not in others in that way would be to prevent goods from going, for sale, into the localities where the regulations applied. Also, confidence would be lacking that prices of goods to retailers would actually be kept down through the operation of the influence of decreased retailer demand. Retailers would be fearful and, probably, resentful of the apparent injustice of the system to them. No one, it seems, seriously proposes any such system and there is little likelihood of its introduction.

Under the war production program, a very large part of industrial activity—including the activity of farmers—is for the production of materials and supplies for the armed forces. These goods do not go through the ordinary retail channels. The government itself, in its various departments, including the military and naval supply services, purchases them, at prices that tend upward as the circulating medium increases. Any attempt to hold down *all* prices, including wholesale and raw material prices and interest, wages and rent, which should depend on regulation *at the retail point,* would be obviously incomplete if it did not involve also a rigid holding down of all prices paid by the government for all goods purchased by it and for all labor, capital and land directly hired,—unless, of course, the definite attempt were being made, not so much to hold down the whole level of prices, but to *force* men into production for the government and out of production for civilians, by forcing wages and returns generally in the latter to a relatively very low level.

But the same result could be reached much more simply, with probably far less evasion and probably with no greater if as great resentment, by directly drafting labor—and capital and land—for the work needed to carry on the war to a successful conclusion.

We might, indeed, attempt a completely regimented economic society in which scarcely a trace of the voluntary price system remained. We might tell each person what he must do: thus there would be no bidding for his services by producers in different lines or, ultimately, by consumers of different goods. We might ration all goods: in that case, if prices were kept down so that most persons could earn more than enough to buy all they were allowed to buy, few would probably care to earn the added money they were not allowed to spend. But the added work, if needed by government, could nevertheless be had by requiring from each person, in taxes, so much of his income that he would be eager to earn the remainder in order to be able to buy his permitted allowance of the various goods he desired.

The mode of operation of the voluntary price system, the system of free enterprise, is different. Yet through it, if legislators have the courage to use it and are supported by public opinion, they can accomplish most—perhaps not quite all—of what is essential to the waging of successful modern war. If taxes are made so heavy as to take nearly all current income beyond that necessary to maintain efficiency, citizens cannot bid high enough to induce production of unimportant or unneeded consumers' goods, because the purchasing power left to them will not be enough to permit it. The labor which would have been devoted to making such goods will then be devoted to producing the goods needed by the government for its war purposes.

This is not to endorse such taxation as a long-run peacetime policy. For to take nearly all the earnings of the efficient above enough to purchase current necessities is likely to weaken the desire for efficiency and dissipate the motive for spending long years in training for efficient service. But to take these excess earnings temporarily during a desperate war, when millions of men are required to risk their lives at the fighting front, is not so likely to have this unhappy consequence and may be necessary in order that the earnings of this very efficiency may be secure in the ensuing years. Believing as I do, that the common welfare is best promoted if we use for public needs the geologically-produced and community-produced annual rent of land before drawing on incomes earned by labor and thrift, I nevertheless realize that in "total war" the earnings of labor and thrift should also be drawn upon for nearly all they will yield.

If we adopt such a policy at the moment when war begins, the demand for non-essential consumers' goods inevitably suffers a sharp decline. Few can longer make a living producing such goods. All who would work for a living and are not in the armed forces will eagerly seek jobs making guns, tanks, bombers, aircraft carriers, transport ships and planes, helmets, uniforms and the other things that must be made in quantity and at the fastest rate possible.

Because circumstances and essential expenditures differ in different districts and among different persons in ways no uniform tax system can take adequate account of, and because of the delays and discrepancies almost inevitable in introducing new tax legislation and in arranging for the necessary administrative set-up, other measures may indeed be desirable. The requirement, for example, that automobile companies cease immediately their manufacture of passenger cars, in order that their plants may be turned at once to war work, may be most important. Even if legislative and administrative delays in revamping the tax system could possibly be avoided, manufacturers might still *hope* for more sales than actually could be realized and so might postpone the complete transformation of plant that the circumstances desperately require. For similar reasons, a priorities system and some rationing may be desirable. That the few remaining cars, when automobile manufacture ceases, should be reserved for doctors, defense workers and the like, rather than that they should go to the highest bidders regardless of national needs, certainly seems altogether reasonable. But if large incomes are left for private expenditure, these incomes may be spent in other ways and for other non-essential goods and so with little less retardation of the war effort.

Finally, as regards price regulation, the comments herein on the evasions of it and on the compromises and "adjustments" which so largely characterize it in practice, need not lead to the conclusion that absolutely no good purposes are ever accomplished by it. Conceivably, for example, the outbreak of war, by arousing the anticipation of increased prices of certain commodities—e.g., sugar—in the minds of consumers and of manufacturers and dealers, might conduce to widespread buying for hoarding by consumers and to speculative buying and holding by dealers, thus bringing about sharp increases in price. Under such circumstances both price limitation and rationing might be advantageous. Yet we must remember that the speculative and the excess consumer buying against which such measures are taken may be, in large part, the result of anticipation of a rise of prices which is itself caused by war-time government borrowing from banks and the consequent increase of the circulating medium.

In ordinary times speculation in commodities performs, often, a social function. For example, there is the purchase of wheat by speculators in the early fall, when it is plentiful, to be sold out gradually during the year. Also, eggs are bought in the spring when hens usually lay most plentifully, and kept in cold storage for sale in other seasons when they are scarcer and, except for such holding, would be much more expensive. And so with various other commodities. But it may be contended that speculative hoarding in war-time is likely to increase greatly the price of necessities to the many whose incomes are relatively small, that excess buying and hoarding by some consumers, inspired by the panic fear of scarcity, tends still further in the same direction, and that price regulation coupled with rationing has definite advantages.

In any case it remains true that price regulation is often subject to considerable evasion; that it is full of difficulties; that, for example, if the prices of some goods are held down a little too much in relation to the prices of others, the production of the too-strictly regulated goods may be disturbingly decreased; and that those whose duty it is to administer the price-fixing legislation seem driven to make compromising adjustments through which average prices rise greatly even aside from "black market" evasions.