II

Subsidies and War-Time Price Control

ABOUT A YEAR AGO I published a paper, "Fiscal Policy and War-time Price Control," in this JOURNAL,[1] dealing with the problem of war-time inflation and the attempt to hold prices down by administrative decree. Emphasis was placed on the difficulties of preventing price and wage increases while, simultaneously, increasing greatly the circulating medium. If Congress would levy taxes heavy enough to pay for the war—or nearly pay for it—from current tax revenue, such taxes would take spending power away from individuals in proportion as they increased the spending power of the government. Excess money that would otherwise be used in bidding for goods and so promoting price increases would thereby be absorbed for government war-time use. Inflation of the circulating medium would be unnecessary. And to follow this policy would be quite consistent on the financial side with the use of the principle of selective service on the military side. Everyone would be required to contribute what he could. Just as the young man able to meet the physical requirements for military service has been asked to sacrifice his liberty and well-being and to risk his health and his life, those at home with surplus spending power would at least be asked to pay in taxes substantially their entire surplus over reasonable necessary living expenses.

Because taxes have not been anything like as high as they might have been and because tax contributions plus purchases of government bonds from *savings,* taken together, have been inadequate, the government has felt obliged to borrow billions of dollars from banks. *It is this borrowing of new and additional circulating medium* from banks, and

[1] AM. JOUR. ECON. SOCIO., 2 (Oct. 1942), 1–14.

its distribution in paying for goods and for labor, that forms the basis for the current inflation. To attempt to hold down prices, wages and rents under such conditions is like trying to hold back a car by pressing down the brakes, while simultaneously pressing down the gas pedal! Thereby come such various evasions, compromising adjustments by the price-fixing and wage-fixing authorities, quality and label changes and black markets as were described in my paper mentioned above.

But when these inevitable effects of our fiscal policy occurred, the contention was advanced that these difficulties could be avoided by means of subsidies. According to this plan producers receive payments from the government to cover, in part, their costs of production. In consideration of such payments they are supposed to keep down—or even reduce—their prices. The idea seems to be that the rise in the cost of living must be stopped, but not by doing away with its cause, *viz.*, the increase in the circulating medium brought about through borrowing from banks!

From what source are such subsidies paid? The thought of the advocates of this plan appears to be that they will be paid out of increased taxes. That they will actually be so paid does not seem very likely in view of the history of our tax policy in this war. Nevertheless, let us suppose that funds for such subsidies are so raised. How far, then, do we really relieve ourselves from the evils of rising prices by thus paying less in formal purchase prices for goods when at the same time we pay correspondingly more in taxes so as to reimburse the very people from whom we purchase the goods!

It is argued by some, indeed, that the tax method has the advantage of making persons with larger incomes help pay the food and clothing bills of persons with smaller incomes. But if, because government finances this war so largely by borrowing from banks, prices tend progressively upward and we are then urged to impose heavier taxes on the recipients of the larger incomes to protect others—by means of subsidies to producers—from the rising prices, why not instead impose these higher taxes *to meet war expenses?* Thereby we would avoid borrowing from banks and would bring an end to the progressive increase of the circulating medium from which the trouble stems. Is it not ridiculous that we should levy high taxes to get money to pay subsidies in order to secure funds to appear to hold down prices, when the prices are rising just because we *won't* levy high taxes to pay war expenses? Because we insist on paying a large part of these expenses by means of borrowing from banks?

It should be noted, however, that many advocates of subsidies do not wish to have the subsidies paid to all of the producers in a given subsidized line. Instead, they would have subsidies paid only to the "high-cost" producers, assuming that other producers can, and should be compelled to, keep prices down without such help. But in fact, as competent economists know, the question of what is the most expensive part (the "high-cost" part) of the supply of any commodity is much less simple than this. A very considerable proportion of the most expensive part of the supply of any commodity may come from producers who are, on the average of all their production, in the "low-cost" groups. A slightly lower price, therefore, might cause even such a low-cost producing corporation or individual to produce *less* of the commodity than before,—*e.g.,* to stop producing wheat from one of the poorer fields *or* from a field pretty well adapted to another crop, or to stop producing coal from one of the company's poorer veins. Or the lower price of the commodity might mean less demand for labor in that line and lower wages to employees, with the result that *some* of these employees would decide to leave the particular line of work for some other line.

Should subsidies be paid, then, not to "high-cost" producers only but to "low-cost" producers also, at least on part of their output; and, if so, on how much of their output should the subsidies be paid? Should subsidies be paid to workers who, because of their alternatives, may be unwilling to remain in an industry for a wage which many other workers are willing to accept? For, certainly, the product of such unwilling workers is a "high-cost" product. Or shall subsidies be paid to capitalists and land owners but never to wage earners? Should subsidies be paid to all of those who are relatively inefficient in a given industry, so as to keep them in it,—on the theory that their part of the supply is a "high-cost" part? And then, if the subsidies in one industry make it seem relatively profitable, shall subsidies be paid to other industries to keep men from leaving them to go into the originally subsidized ones? How widely, indeed, shall this government favor be spread?

The cost of production of any commodity, in the sense of what must be paid to get the commodity produced, depends on what those engaged in producing it—or who might be induced to produce it—believe they can get in other lines. Cost of production is, therefore, relative. If inflation causes some prices to rise rapidly while other prices are held down, many of those in the regulated lines are likely to leave those lines *unless* prices and incomes are allowed to rise in their lines also. And in like manner subsidies in *some* lines, which are not granted in other lines, definitely tend to draw labor and capital and land away from such other lines. Where, then, shall subsidies stop? And, if they are not given to every one, who shall select the favored individuals and companies to which the payments shall be made, and on what basis and by what detailed research shall the selections be made?

But indeed, since we are not now meeting the expense of carrying on the war out of taxes (or, even, out of taxes *plus* voluntary savings invested in savings bonds) but are borrowing very largely from the banks and thereby expanding greatly our circulating medium, *why* is it so glibly assumed that the subsidies will be paid for out of taxes? What if these subsidies are in fact paid for with funds borrowed from the banks? What if this means *even more* borrowing from the banks by the Federal government than we have had hitherto and, consequently, an *even vaster* increase in purchasing power! Would such a result not resemble, in some sort of fashion, trying to hold back a car by pressing down the brake (price regulation and rationing) while simultaneously not only putting on a full head of gas (borrowing for the meeting of regular war expenses) but also getting the car pushed from behind (more borrowing—to pay for subsidies) by another car or a truck?

To date, in carrying on World War II, we have not prevented prices from rising in considerable degree. If the above considerations apply, how can we conclude that subsidies are the real solution? How can we maintain that, if we now pay subsidies, prices will rise no further but that, instead, we shall successfully "roll back" the price level, improve the economic status of the relatively poor and allay discontent?

TO THE EDITOR OF THE —:

On Friday, November 5th, you printed beneath the daily cartoon an editorial on subsidies from the New York Post, in which it was stated that if the government is prevented from paying 70 million dollars in subsidies "to keep the price of bread where it is now", all of us "will have to pay 350 million dollars more for our bread" and that this also "means pork up more than 13 cents a pound" and "all other meats in proportion."

In the President's November 1st message to Congress he is quoted as saying that, in the case of copper "it has been estimated that every dollar paid by the government to subsidize and increase production has saved the government $28."

Now comes your editorial of Friday, November 19th entitled "All of Us Must Face It", in which you refer to those members of Congress who oppose subsidies as "stubborn, unreasonable, unpatriotic men."

Suppose, Mr. Editor, that you had been in Germany in the very early 1920s when paper money was being printed in vast amounts and prices were rapidly rising. Suppose it had then been proposed to hold down these prices by paying subsidies to producers. Suppose that, knowing the government was constantly spending more than it was taking in through taxation, you recognized that payment of the proposed subsidies would actually be made only through the printing and issuing of even more billions of paper money. WOULD YOU HAVE EXPECTED THIS TO BRING PRICES DOWN?

Right now we in the United States are paying for the war more by borrowing than by taxation and a large part of the borrowing is from banks. Since 1939 bank credit has, through government borrowing, expanded a very great deal. The more and the larger subsidies the government pays, the more it will borrow from the banks. And this increased bank borrowing is equally inflationary whether it takes the form of Federal Reserve notes (paper money)