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ARM *and* FOOD POLICY

Pamphlet No. **8** *in the Series*

OOD MANAGEMENT AND INFLATION

by

MARY JEAN BOWMAN and
ALBERT GAILORD HART

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WARTIME FARM AND FOOD POLICY SERIES

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To mobilize our nation's giant strength for war necessarily means a drastic readjustment in our ways of producing, distributing, and consuming everything we make. A few laggards, and people working at cross purposes, can slow down the whole nation if government authority is not used to bring them into line. But authority is not a substitute for public understanding and acceptance. As a matter of democratic principle and of efficiency, the citizens must know what has to be done in economic mobilization—and why and how. This series of pamphlets, prepared by members of the Department of Economics and Sociology at Iowa State College, deals with the what, why, and how of agricultural policy and food management.

Previous pamphlets have outlined the broad relations of food to the war effort and sketched techniques of dividing food supplies and getting maximum production. The use of farm prices and commodity loans to guide production, the efficient use of farm labor and soil resources, and the effect of food rationing on morale have been considered in some detail.

This pamphlet, "Food Management and Inflation," deals with a side of the food problem which is often under-rated. It takes up not only the effect of food management in stimulating or checking inflationary rises in the money incomes of farmers, food distributors, and laborers, but also the handicaps imposed on food management by leaving consumers with a huge excess of spending power over supplies of consumption goods.

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Ames, Iowa, April 14, 1943

FOOD MANAGEMENT AND INFLATION

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THE FINDINGS*

Excess consumer spending power—resulting from rising incomes in the face of unchanged or diminishing supplies of consumers' goods—creates grave problems in getting the food production needed and in managing the flow of food supplies. This excess creates "inflationary pressures" that tend to break through into actual inflation; and the existence of the pressure causes serious trouble, even though price rises are checked. Unless fiscal measures are greatly strengthened, and soon, many difficulties ahead in the management of food will be very much aggravated.

Inflation and inflationary pressure handicap the farm production program. Consumers seek to buy relatively expensive foods, and often production of these foods requires much labor. Such demand increases the difficulty of shifting production to foods giving maximum nutrients per man and per acre. Moreover, the exaggerated uncertainties of future prices interfere with the timing of farm marketings.

Inflation and inflationary pressure impose even more serious handicaps on the management of food supplies. In response to eager consumer buying, food stocks in processors' and wholesalers' hands tend to be taken up too rapidly. It is difficult to control the flow of supplies when consumers in

* This pamphlet is based on research carried on under Project 818 of the Iowa Agricultural Experiment Station, Iowa State College, Ames, Iowa. The study also was aided by a grant from the division of the Social Sciences of the Rockefeller Foundation, New York.

both rural and urban areas will pay high prices to get additional foods. Supplies for army and lend-lease are therefore threatened. Civilians in war industry centers and in our port cities have greater difficulty in getting food. Markets are disrupted. The need for consumer rationing is increased, and it becomes harder to institute and more difficult to administer once we have it. Price ceilings are necessary, and the greater the inflationary pressure the more difficult their enforcement. Small breaks in price ceilings and in supply controls are likely to lead to big ones. Breaks are already occurring, and the strain on the system in the future will be even more serious.

Wise food management is needed to check further growth of excess spending power and an upward spiralling of prices. It can do this in part by holding retail food prices in check and by supporting price control by rationing. It can do it in part by an intelligent farm price policy that limits any price increases to special foods for which prices are used to get increased production. The parity formula generally applied leads to cumulative inflation. Other means should be found to reward farmers for their effort and to give them a fair share in national income.

Even if food controls are well designed and carefully administered, they will break down unless much more spending power is withdrawn. A tax program designed to facilitate managing food production and supplies in the war economy would have to absorb a large part of the excess spending power that threatens not only the food economy but other parts of our economic life as well. The main feature of such a tax plan must be a heavier income tax with lower exemptions. A general sales tax, *with personal exemptions* to prevent unbearable burdens on the poor, could be a useful supplement. A progressive "spendings tax" in line with the Treasury's proposal in 1942 could well play a minor part; it would deter consumer spending, yet leave individuals free to spend more and pay a heavier tax or to save more and avoid paying a large "spendings tax." Besides checking inflation and inflationary pressure on prices, a powerful income tax, with or without a supplementary sales tax or spendings tax, would help divert consumer demands from luxury to less expensive foods—a shift facilitating the most efficient use of agricultural resources.

THE ANALYSIS

The main purpose of this pamphlet is to explore the relations between food management and fiscal policy. The exploration demonstrates that the stake of food administrators in fiscal policy is tremendous. Food administrators should act in ways that will reduce rather than increase inflationary problems—in fact, such action is clearly in their own interests as managers of the nation's food programs. But even more striking is the need for strong fiscal measures to support food policies.

The discussion is divided into five main parts. The first outlines briefly the nature and scale of the inflation problem facing us today. Inflation and inflationary pressure that has not yet found expression in actual inflation are both a part of the "inflation problem." Both are therefore considered. The second and third parts of the pamphlet describe the handicaps to food management that are caused by inflationary conditions; first in agricultural policy, second in the management of food supplies. The role of national food management policies in their relation to the inflation spiral is then outlined. Finally, three kinds of fiscal measures that can absorb excess spending power and help in food management are briefly described and evaluated.

NATURE AND SCALE OF THE INFLATION PROBLEM

Inflationary tendencies accompany all important wars in modern societies. War activity raises money incomes, and at the same time it reduces the supply of civilian goods for incomes to buy. More money can be spent in buying less goods only by bidding up prices—that is, by inflation. To keep inflation within bounds, ceilings are put on prices and products are rationed; and a larger part of money incomes is diverted into tax payments and savings.

Inflationary Pressure and Actual Inflation

Excess spending power exists whenever consumers are able and willing to spend more than supplies of goods can absorb at constant prices. If there are efforts to hold prices down, the excess spending power will create "inflationary pressure"—an upward pressure on prices. If prices in general rise, there is "inflation."

Whether inflationary pressure will break into actual inflation will depend on many things. If the pressure is moderate, price rises may be blocked directly by skillful and painstaking use of price ceilings. Incentives to save more than normally (induced by patriotic appeals to buy war bonds) will diminish the pressure. But even if it is possible to hold the line against actual inflation, inflationary pressure will by itself greatly aggravate existing food problems.

During 1941, the excess of spending power was allowed to work almost unchecked, with only limited attempts to control the prices of selected goods. By the end of the year the prices making up the "cost of living" were 11 per cent higher than the 1940 average. During 1942, price control was extended, and at the same time more and more goods were "short"—from automobiles and refrigerators, sales of which were restricted, to commodities like meat and butter. More and more spending power became "excess" as people received larger incomes, there were fewer goods to buy, and the prices of many goods were held down by price ceilings.

Whenever excess spending power is dammed up in this way, there is trouble. There is perpetual temptation for somebody to get more than his share of supplies by paying more than the official price. As more people yield to this temptation, irregular dealings spread, and inflationary pressure breaks out in actual inflation even in the face of maximum price ceilings.

Incomes, Civilian Supplies, and Excess Spending Power for 1939–42

Despite larger taxes, the excess of spending power over and above the supplies of goods available has increased steadily since before the war. This is due to the rapid increase in consumer incomes unmatched by expansion in the production of goods for consumers to buy, and to the lack of large enough taxes to take up the slack.

The extent to which the growth in incomes has outpaced the growth in supplies of consumption goods and in taxes is shown in Table 1. In 1939 all but $11.1 billion of consumer income went into buying consumption goods; and $5.1 billion of this remainder went into taxes, leaving $6.0 billion of unspent income. In 1942 there was approximately $37 billion of consumer incomes not absorbed in the buying of consumption goods, and $27 billion of this remained unspent after taxes were paid. This increase in unspent income—from $6 to $27 billion in four years—went far beyond what was necessary to carry out people's customary savings plans. Nearly half the $27 billion remaining unspent in 1942 went into increased holdings of paper money and bank deposits subject to check, and thus remained on tap for spending whenever its owners saw occasion.

Prospects for Excess Spending Power in 1943–44

Present forecasts are for a sharp increase in excess spending power and thus in inflationary pressure. The United States Department of Commerce expects national income to rise from $119 billion in 1942 to $140 billion in 1943, and the rise is likely to continue well into 1944. On the other hand, the quantity of consumer supplies is on the downgrade: in line 2 of Table 1, 1942 supplies appear to exceed those in 1941 only because the 1942 supplies were sold at higher prices. If supplies in these two years had been valued at the same

TABLE 1

CONSUMERS INCOMES AND SUPPLIES OF CONSUMPTION GOODS, 1939–42
(billions of dollars at current prices)

	Annual Totals				1941–42 by Half-years			
					1941		1942	
	1939	1940	1941	1942	Jan.–June	July–Dec.	Jan.–June	July–Dec.
1. Income received by consumers[a]	72.8	78.6	94.8	118¾	43.5	51.3	54½	64¼
2. Consumer goods supplies[a]	*61.7*	*65.7*	*74.6*	*87¾*	*35.2*	*39.4*	*38½*	*43¼*
3. Excess of income over supplies[a]	11.1	12.9	20.2	37	8.3	11.9	16	21
4. Personal taxes paid[a]	*5.1*	*5.4*	*6.6*	*10*	*3.5*	*3.1*	*5¾*	*4¼*
5. Unspent income[a]	6.0	7.5	13.7	27	4.9	8.8	10¼	16¾
6. B.L.S. cost-of-living index 1935–39 = 100[b]	99.4	100.2	105.2	116.5	102.1	108.4	114.5	118.6
7. B.L.S. index of retail food prices 1935–39 = 100[b]	95.2	96.6	105.5	123.9	100.5	110.5	119.3	128.5

[a] *Survey of Current Business*, March, 1943, p. 21.
[b] As published in Federal Reserve Bulletin.

prices, 1942 supplies would be seen to have been 3 per cent lower than those in 1941. Official estimates put civilian supplies for the twelve months from July 1, 1943 through June 30, 1944 at a fifth less than those available in 1942—they will amount to barely $70 billion worth valued at December, 1942 prices. For this twelve-month period we must anticipate consumer incomes of about $145 billion. Of this amount, consumers' goods will absorb only $70 billion (unless prices rise sharply), and taxes already on the books will take less than $20 billion. This leaves an excess spending power of $55 billion unless taxes are increased further.

WHERE IS THE BREAKING POINT?

No one can tell exactly the point at which excess spending power will break down our control of supplies and of prices;

but it is perfectly clear that the $55 billion of unspent income in sight for 1943–44 is more than can be safely handled. With a much lower excess of spending power and a much more comfortable level of consumer supplies, "black markets" developed during the winter of 1942–43. There is danger that these black-market beginnings may greatly expand. Increased consumer rationing can help; but it cannot do the whole job. By our slowness in setting up machinery to check the growth of spending power and tie down the excess, we have left the way open to the development of a serious inflationary crisis.

INFLATIONARY HANDICAPS TO AGRICULTURAL POLICY

Inflation and inflationary pressure increase the difficulties of adjusting agricultural production in line with the needs of the war economy. Many consumers' wants run counter to the requirements of the wartime adjustments, and limit the usefulness of consumer demands as a guide to efficient use of farm resources. In addition, uncertainties of future prices have led to poor timing of feed use and of sales of livestock. Inflationary pressures may break into inflation; and if this inflation is concentrated in the agricultural sector of the economy—as is highly probable—the post-war problems of agriculture are aggravated.

Handicaps to Farm Production Programs

Consumers' Wants Run Counter to Needed Wartime Adjustments

When money incomes rise, consumers naturally try to shift their consumption toward a "prosperity standard." For example, they seek to buy more of the expensive grades of meats, fancy vegetables, and butter; they lose interest in potatoes, bread, cabbages, and margarine. Unfortunately, this "prosperity standard" means increased demands for foods that require manpower and acreage high in proportion to the nutrients provided.

The most efficient use of agricultural resources calls for using labor to provide those foods that are high in nutrients per acre and per man. Examples are potatoes, cereals, dried beans, peanuts, and soybean products. It calls for limitations on the use of labor to produce expensive and fancy foods—as choice beef, butter, and cauliflower. From the standpoint of our war needs, increased spending power on the whole shifts consumer demands in just the wrong direction.

Increased consumer demand for meat brings with it increased opportunity for profit in producing and selling meat. This provides an incentive to expand livestock in general and in addition to feed for luxury quality; whereas there is no such increased incentive to produce cereals and potatoes. Restrictions on sales of meat in civilian markets exist; but the greater the inflationary pressure the more difficult are such restrictions to enforce. Because of inflationary pressure it may be impossible to secure an adequate supply of meat for military and lend-lease needs except by setting livestock production goals higher than would otherwise be necessary.

Difficulties are illustrated in dairy production as well. Greater consumer demand for butter increases the tendency to remove the cream from whole milk and divert the skim milk to hogs. From a given dairy output, consumers then get more butter and pork, but less whole milk. This is exactly contrary to the most efficient use of our dairy resources under present circumstances. Butter production should be curtailed, and people should get more of the valuable nutrients in skimmed milk that now go to hogs. But the difficulties of getting greater human consumption of milk solids (whether as fresh whole milk or in processed form) are increased when consumer demands for both butter and pork have risen more than their demand for whole milk.

Consumer Rationing Can Partially Neutralize Detrimental Demand Shifts

Rationing of consumers sets legal limits on the quantities of rationed foods they are permitted to buy. No matter how much money a consumer may have, and how much beef or butter he may wish to buy, he cannot legally get more than his ration allotment. Now that a large proportion of foods are rationed, the consumer demands of a "prosperity standard" can have much less effect on production. Point rationing makes possible a directing of consumer purchases away from certain items by setting their point values high, yet avoids the necessity of dictating consumption of individuals in detail. It would be dangerous, however, to place too much reliance on consumer rationing when large amounts of unspent money fill consumers' pockets and threaten to break over into purchases of foods sold outside of controls. The relations between excess spending power and consumer rationing are discussed fully on pages 14–17. Experience with operation of consumer rationing in this country is still largely in the future.

OPA Price Ceilings Are Inadequate in the Face of Strong Pressure

Thus far OPA price ceilings have played an important part in preventing the demands for a "prosperity standard" from becoming widely expressed in higher prices and in shifts to luxury food production. Had it not been for OPA ceilings at the retail level, there is little doubt that the prices of most animal products would have skyrocketed far above the high levels they have in fact reached—many animal products would have risen 25 per cent or more above their present prices.

Price ceilings have not, however, always been adjusted to bring a more efficient wartime agricultural program. For various reasons certain products were exempt from the original ceiling controls; and occasional upward adjustments have been made in ceiling prices. In some cases these upward adjustments have been on the "prosperity standard" foods—thus giving partial expression to inflationary demand shifts. In general, price administrators have sought to prevent the breakdown of ceiling controls that might follow numerous "exceptions" permitting upward ceiling adjustments. Firm control, unwillingness to yield to group pressures for higher prices, is a prime qualification of a good price administration. But policy should be selective. Unfortunately, in some instances there has been a rigid holding down of just those prices that should have been increased to get the expanded production needed—some of the vegetable oils, for instance.

As control of consumer markets becomes increasingly difficult in the face of inflationary pressure, the strain on production goals increases. Opportunities for irregular and illegal dealings in expensive foods become more enticing. The likelihood that price controls will break becomes greater and may lead to production adjustments to luxury foods in anticipation of marked increases in their prices. And if inflationary pressure finally culminates in widespread upward pricing of "prosperity standard" foods, production controls may get out of hand completely.

Poor Timing of Use and Sales of Farm Products

Not only have inflationary conditions interfered in decisions to produce more of some farm products and less of others. They have also aggravated uncertainties that have distorted the rate at which stored feeds are utilized and livestock is sold. Farmers have been uncertain of future prices because, on the one hand, there has been an inflationary impetus to rising price levels while on the other there has been an expectation that government might clamp down on livestock prices.

Anticipations of new price controls may bring livestock to market too rapidly. In the fall of 1942, for example, hogs came onto the markets too soon and were not fed to as heavy weights as was desirable from the standpoint of the most efficient utilization of feed to make food. Farmers apparently anticipated that in the face of inflationary pressures government would put ceilings on hogs that would make continued feeding unprofitable. Recent guaranteed price floors under hogs have helped to alleviate this situation.

Anticipations of higher future prices may sometimes lead to the withholding of farm products needed currently. The withholding of feeds that probably reflected such anticipations was in part responsible for the excess of livestock marketings last fall. Currently there is much concern over the withholding of feed corn. Thus far, however, most nonperishable farm crops used directly for human food have been so abundant that the flow to market has been adequate; and the relation between feed and livestock prices has encouraged early sales rather than holding back of live animals.

Aggravation of Post-war Problems

Wartime inflation breeds many troubles for agriculture in the post-war period. Higher farm prices are a spearhead of general inflation likely to have far-reaching effects. This pamphlet is not the place to go into a detailed discussion of the after-effects for agriculture of wartime inflationary developments. Two main points deserve mention however.

First, if inflationary pressures are strong, and if they are permitted to find expression in farm prices, it will become increasingly difficult to prevent large increases in land prices. This means a disruption of farm financial and owner-tenant relations in the post-war economy that many farmers fear. This aspect of the problem is discussed in a later pamphlet.

Second, if farm prices are permitted to rise in response to inflationary pressures at a rate far ahead of other prices—as has been the case thus far—agriculture will find its prices seriously out of line with post-war markets. This leads to painful post-war readjustments.

INFLATIONARY HANDICAPS TO MANAGEMENT OF FOOD SUPPLIES

Major problems in wartime management of food supplies are: (1) getting needed foods for military and lend-lease purposes, and doing this without seriously disorganizing civilian markets, (2) ensuring reasonable inter-regional and rural-urban distribution of foods for civilians, and (3) getting equitable and orderly division of foods among individual civilians at any given time and place. All of these problems would be big ones even if there were little excess spending power in consumers' hands. Direct controls of many kinds are necessary: for example, the "reserving" for government use of part of the supplies of foods moving through the hands of processors and wholesalers, orders of various kinds limiting the quantities to be sold by dealers at one stage in marketing to those at another, and the rationing of consumers.

But excess spending power aggravates the difficulties of managing food supplies. In the face of inflated consumer demands, maintenance of stocks and the building of stockpiles requires much more extensive and elaborate government orders and regulations. The competition of civilians for the foods that government must buy is far more intense. Big consumer incomes soak up foods in surplus producing areas despite efforts to move them elsewhere. The "gray markets" of the midwest prior to rationing of meat were in part a reflection of this situation; and consumer rationing cannot eliminate it. Especially is this true of products such as eggs that are not easily controlled. High incomes in metropolitan centers similarly provide incentives and outlets to food bootleggers operating outside government regulations of all kinds—price ceilings, sales quotas, rationing, etc. The fact that the inflationary threat makes it necessary to use quite general retail and wholesale price ceilings in order to prevent marked price rises makes all these matters worse. Moreover, price manipulations intended to help regulate the flows of food supplies run into conflict with maintenance of price ceilings to prevent inflation.

As a result of inflationary conditions, we are moving into the present period in food management with less adequate stockpiles than we might otherwise have accumulated, with very uneven division of hoarded foods among consumers, with some unnecessarily bad experiences in interregional food distribution scored up against administrators, and with some husky infant blackmarket organizations (especially in meats) threatening supply management.

Since the primary impact of excess spending power on food supply management centers in the need for and operation of direct price controls and consumer rationing, the remainder of the present discussion will be oriented to these two things.[1]

Inflationary Pressure and Consumer Rationing

Inflationary Pressure Increases the Need for Consumer Rationing

Consumer rationing on a coupon basis is needed to check the depletion of stocks, to get supplies distributed reasonably over the country, to bring order into retail markets disrupted because of shortages of all kinds. Limiting the amount each individual can buy to his fair share helps to check excess consumption and to push supplies back into channels where the government can buy more readily, onto regional markets that have experienced extreme scarcity, and into the hands of consumers who have been unable to shop around or to get to markets at hours when the things they wanted to buy were still available. By blocking off consumer spending, rationing can help in the enforcement of price ceilings. Since excess spending power increases all these difficulties—of over-all shortages, of interregional maldistribution, of stock depletion—it increases the need for rationing.

[1]A much more complete analysis of the problems of food supply management and some of the available techniques for controlling supply flows is to be presented in a later pamphlet in this series.

The Heavier the Inflationary Pressure, the Worse the "Pre-rationing" Difficulties

Rationing of each commodity or group of commodities takes time to organize, and each extension of rationing involves an increased burden on the Office of Price Administration and on local rationing boards. Consequently, there is much reluctance to embark on rationing—and inevitably there is considerable delay in getting it into operation. A situation in which clear need for rationing exists, but in which rationing has not been introduced, is loosely called "pre-rationing."

The greater the inflationary pressure, the more serious are the disturbances of food distribution prior to the introduction of rationing. The more money consumers have to spend, the more goods they try to buy. A supply that would be ample at ceiling prices if consumers had only \$80 or \$90 billion per annum after paying taxes becomes an acutely short supply when they have \$110 or \$120 billion. This means that heavy excess spending power brings foods into the "pre-rationing" stage sooner, and shortages develop for more foods.

The effectiveness of the improvised remedies of "pre-rationing" is related to the volume of excess spending power. The greater the excess, the less effective are these remedies. If meat packers (for instance) can fill all demands for beef plus 90 per cent of the demand for pork, a very informal system will work: whenever a housewife comes into the store undecided whether to buy pork or beef and the butcher sells her beef, the pork shortage is smoothed over. But if beef is also seriously short, customers will come away from the store with a smaller package of meat than they intended, or even empty-handed. Early comers and especially favored customers get the lion's share of the supply under such conditions. Customers have to spend more and more time in shopping and get more and more irritated. Stocks of staples disappear faster and faster, and hoarding increases. Government faces increasing difficulties in getting needed supplies, and some regions experience extreme shortages of certain foods even though other areas are still adequately supplied.

The Heavier the Inflationary Pressure, the Greater the Difficulty of Enforcing Rationing

Formal consumer rationing under a coupon system can help smooth out some of the "pre-rationing" difficulties, provided the rules can be enforced. But rationing is effectively enforced only when most of the civilian supply moves through the hands of dealers conforming to regulations. Inflationary pressure makes such control even more difficult than it would be otherwise.

The greater the excess of spending power the greater are the incentives to the irregular dealings discussed above. These threaten to break down the rationing mechanism as well as other supply controls. With plenty of money on hand, people will offer high prices to get extra foods. Especially important is increased buying of restaurant meals, and restaurants tend to become a major black market outlet. This has been the experience of the Food Ministry in Great Britain, even though there existed no widespread bootleg organizations ready to handle illegally acquired foods as well as liquor, and even though excess spending power there is less than here. But illegal rural buying of rationed foods directly from farmers is also intensified by inflated consumer incomes. Moreover, excess spending power is likely to bring illegal sale of ration coupons; and extreme care must be taken to see that coupons are not used more than once.

The adverse effect of excess spending power on the "pre-rationing" situation carries over into rationing as well. The "grab-psychology" that frequently develops in disorganized consumer markets is not easily dissipated when rationing is introduced; and such attitudes interfere with the rationing system. Rationing commonly starts with much less adequate stocks, which makes it hard to assure a regular flow of goods. If consumers in certain areas are unable to buy the amounts permitted in their ration books, they lose faith in rationing itself. Depleted stocks necessitate the beginning of rationing with lower ration allowances than would otherwise be available; and the lower the ration level the greater are the incentives to find goods outside regular channels. The uneven hoarding of foods purchased in the pre-rationing period creates public resentments. The persistence of injustices of the "pre-rationing" period thus sets the stage for innumerable irritations and difficulties after rationing is introduced.

Inflationary Pressure and Price Ceilings

Excess Spending Power Makes Price Ceilings Necessary

A large proportion of commodities and services, including most foods, is now under "price ceilings."

Two principal reasons lay behind our government's decision to issue orders that retail prices should not rise above the levels reached in March, 1942. One was to protect low income consumers, and those whose incomes were not rising, against sharp increases in the cost of living. The other was to avoid starting an inflationary spiral by increases in retail prices that would lead to increases in wages and incomes of food dealers and farmers, that lead in turn to further increases in retail prices, and so forth.[2]

These needs for price fixing arose because consumers' pocketbooks were swollen with money in excess of the available supplies of goods, and taxes had not absorbed enough of this excess spending power. Direct controls over some retail prices would doubtless have been introduced gradually even if taxes had been sufficient to mop up most of the excess spending power; but such cases could have been fewer, and limited to particular commodities and special situations. The large amount of excess spending power is responsible for the large

[2] See pages 24–29.

number of foods that were placed under price ceilings early in the war. The piling up of inflationary pressure and the problems it creates have been a principal result.

Price Ceilings Retreat in the Face of Strong Inflationary Pressures

In the face of heavy excess spending power, price control may be likened to a rear-guard action. Gradually but inevitably prices advance; and the adjustments are by no means those that would be most appropriate for guiding production or consumption.

Examples of the gradual upward movement of controlled prices are already well known to the American public. Ceilings were first set for each retailer according to the top price he charged during March. As a consequence, each store tended to concentrate on those foods on which its ceilings were relatively high, dropping others; consumers, therefore, lost the benefit of buying at the lower price and found that they had to spend somewhat more money to get the same foods. There was a tendency to claim that low or medium quality foods were high quality—the process of "upgrading"; in this way a grade A price could be obtained for what was really a grade B product. This is just a disguised price increase. For some weeks this practice was common in the marketing of meats, though OPA's enforcement program probably did much to bring grades back in line with officially approved standards. In some instances the eagerness of consumers to buy has tempted retailers to give short weights and to tie together sales of scarce, price-controlled items with sales of those items which were most profitable to handle. As shortages spread, the policing of retail prices through consumer shopping from store to store becomes less effective, and open selling at above-ceiling prices more frequently appears.

In imposing price ceilings, various kinds of maladjustments occurred that called for later price revisions. In spite of wishful thinking most of these revisions have been upward.

When wholesale and retail prices are frozen as of a given date, the margin between wholesale and retail prices is likely to be frozen at less than its customary amount. This puts a "squeeze" on many retailers, its extent varying with the rates at which supplies flow through different channels of marketing and through different retail stores. Price ceilings as we first introduced them tended to squeeze those retailers with slow turnover of stock, since they commonly had not yet marked up their sales prices in line with the higher prices they would have to pay at wholesale for replacements. It was hoped that this "squeeze" on retailers would be "rolled back" onto the wholesalers who would then lower their prices; but this was perhaps too much to expect.

Gradually the methods of setting both retail and wholesale price ceilings have been changing—commodity by commodity. Some time ago there were provisions that retailers of certain goods could choose either their March, 1942 prices or certain percentage markups over wholesale prices in determining their ceilings. The effect on retail prices was to push them upward slightly, since when left free to choose the grocer would naturally take the higher ceiling. These modifications relieved some of the "squeezes" under the previous setup. But even when legally fixed markups are used in setting the retail ceiling price—or margins are fixed by flat price controls at both wholesale and retail levels[3]—some firms are penalized relative to others, and requests for further adjustments continue. Some requests are for downward adjustments in the prices the retailer or wholesaler must pay to get supplies; but rarely are such adjustments made. Instead there are usually upward adjustments in the permitted selling prices of the "squeezed" dealers.

The stronger the inflationary pressure the greater are the incentives to economic interest groups to get upward revisions of the price ceilings of the foods they sell or to prevent the

[3] This is the method now being generally introduced.

imposing of ceilings on their products.[4] And each increase in one price becomes a precedent cited by sellers of other goods in favor of increases in their prices.

Finally, the greater the inflationary pressure the greater the incentives to blackmarket dealings. And there is then a tendency to permit the prices to rise legally in order to minimize these illegal actions.

Price Ceilings Have Prevented Sharp Increases in the Prices of Controlled Foods; but Ceilings Have Also Caused Trouble

Opinions differ concerning the degree of success attained in the price control program, and the future hazards with which it is faced.

OPA has been successful in one thing. It has "held the line" against major increases in listed prices for those foods on which ceiling prices were placed. This success must be conceded even though prices under a ceiling have edged upward. The upward movement of the food price index has been largely caused by the increase in prices not under ceilings. Comparisons are given in Table 2.

As shown in official statistics, prices of foods under ceiling controls rose 1.2 per cent between May and December, 1942. Uncontrolled prices rose much more sharply—those still uncontrolled by December 15 had risen 29.8 per cent above their May levels.

In appraising the success of price ceilings, one must, however, look beyond changes in listed prices. Prices have risen more than is indicated by price indexes; prices of foods sold in black markets are not included in the index of food prices, and various forms of disguised price increases have occurred. Furthermore, price ceilings have been an important factor in the development of black markets, in stock depletions, and in regional maladjustment of supplies. They have in some

[4] One pressure group recently asserted in a newspaper release that the existence of excess spending power obviously justified a price increase in order to "absorb" it!

TABLE 2

INCREASES IN FOOD PRICES, MAY TO DECEMBER, 1942 *

	Percentage Increase	Weight in Total Food Index
All foods	9.1	100
Controlled by general maximum price regulation	1.2	58
Controlled since maximum price regulation (but prior to Dec. 15)	17.5	31
Not under control Dec. 15	29.8	11

* United States Department of Commerce; *Survey of Current Business*, February, 1943, p. 24.

cases interfered with needed production adjustments. They have been the cause of many inequities and hardships among food dealers at all stages in marketing. When all these disturbances are taken into account, we must chalk up some black marks against the effect of price control in foods.

Though major price increases have been largely prevented thus far, inflationary pressure has meanwhile grown very strong. The increasingly elaborate machinery of enforcement necessary to maintain ceilings and prevent further price advances is costly; it requires a large personnel, and this is a drain on skilled manpower.

The greater the excess of spending power remaining loose, the more must we rely on price ceilings, and the more difficult are they to enforce.

DANGER OF BREAKDOWN IN CONTROLS OVER FOOD SUPPLIES

The difficulties which inflationary pressure throws in the way of management of food supplies have been rather fully surveyed. When we consider their combined effect, it becomes plain that these difficulties may even go so far as to break down control over supplies of critical foods.

The heart of the trouble is the tendency of excess spending power to deplete food stocks and to divert food into irregular channels—whether legal or illegal. Price ceilings actually accentuate this tendency; and consumer rationing, while it lessens the difficulties, is not a complete answer. The danger that troubles may pile up springs from these facts:

1. The more supplies are diverted the less is available on the regular markets. These conditions increase the hardships of those consumers who abide loyally by regulations, and they increase the incentives to buy foods outside legitimate channels.
2. The more stringent the civilian supply restrictions (and the price controls), the harder it is for dealers and processors to survive within the regulations, and the stronger their temptations to draw on "black markets" and offer their customers foods outside their own permitted sales quotas or the consumers' ration allowances.
3. The bigger and more conspicuous the black markets (and the "gray markets"), the more both consumers and dealers come to feel that obedience to regulations is only for "suckers."

An attitude of willingness to evade and break the rules is infectious; and once it spreads to even a quarter of the population, the entire structure of supply controls is likely to break down. Among the consequences would be great difficulty in getting food for our own troops, allied armies, and many war workers. To repair the damage by rebuilding the control system after a major collapse would be exceedingly costly in time and effort.

FOOD MANAGEMENT AND THE INFLATION SPIRAL

An increase in prices at one point in the economy is likely to become a center of contagion for price increases elsewhere—starting a disastrous "inflationary spiral." An important focus of price control is in the food economy. The responsibility of those involved to see the problem as a whole cannot be ignored without unfortunate consequences. Price-making and subsidies at all levels of food marketing, from farmer to retailer, must be viewed in relation to the total economy—partly in the interests of the general public, but also in the interests of food producers and marketers themselves.

Retail Food Price Ceilings and Wage Rates

Food Prices Are of Prime Importance in the Cost-of-living of Wage Workers

Ceilings on retail food prices are an important part of a program to check inflation—especially in the absence of adequate tax measures. Food is the most important factor in the index of living costs. Roughly speaking, a 10 per cent rise in retail food prices will raise the cost-of-living index about 4 per cent. Increases in retail food prices account for practically all the 2.6 per cent increase in the cost-of-living index between May and October, 1942. The fact that retail price increases have centered on foods is shown by the data of Table 3.

TABLE 3

Percentage Changes in Bureau of Labor Statistics Cost-of-Living Indexes*

	May, 1941 to October, 1941	May, 1942 to October, 1942
All items	+ 6.2	+2.6
Food	+ 9.3	+6.5
Clothing	+ 9.6	− .2
Rent	+ 1.8	−1.8
House furnishings	+10.8	+1.2
Fuel, ice and electricity	+ 2.9	+1.2
Miscellaneous	+ 4.3	+ .7

* United States Department of Commerce; *Survey of Current Business*, February, 1943, p. 14.

Approximately 40 per cent of the workers' food budget was exempted from the original retail price ceilings imposed by the General Maximum Price Regulation of May, 1942. There were two reasons for these exemptions: (1) farm provisions in the original Price Control Act prevented the placing of retail ceilings on certain foods because their farm prices had not yet risen to 110 per cent of parity,[5] and (2) the administrative difficulty of setting and controlling prices of perishable foods—for example, leafy vegetables—is very great. In October many more foods were brought under ceiling regulations, and further additions to the controlled list have been made since. Foods exempted from the original General Maximum Price Regulation rose 16 per cent between May and October last year—accounting in large measure for the increase in food prices as a whole and hence for most of the increase in the general index of cost-of-living[6] of American wage workers.

Increases in Food Prices Lead to Increases in Wages

It is generally recognized that one of the key points in inflation control is wage rates. The "Little Steel Formula" followed by the War Labor Board since the wage freeze of September 1942 is the basic policy with regard to wage increases. Workers are permitted increases in wages over what they received in January, 1941 equal to the 15 per cent increase in the cost-of-living that occurred between January, 1941 and May, 1942. If by September, 1942, they had received wage increases equal to or greater than that allowance, no further raises are permitted. Exceptions are made when wages are still below what is regarded as a "minimum standard." If the "Little Steel Formula" were strictly adhered to, recent and future increases in living costs could not be made the basis for further widespread wage increases. But at the present time the "Little Steel Formula" is under severe attack;

[5] Among the items exempted from control for this reason were such important foods as oranges, eggs, butter, cattle, and lamb.

[6] For a comparison between controlled and uncontrolled food prices, see Table 2, page 21.

and there can be no doubt that if retail prices—especially food prices— are permitted to rise, the pressures to adjust wages upward will grow in intensity and scope. Even the expectation that price controls *will* break can set off a series of labor demands for wage increases in anticipation of the coming higher costs of living. The strong and clear-cut position taken recently by Price Administrator Prentiss Brown against those who are urging him to ease up on prices is an essential part of a program designed to check pressure for wage increases.

Fiscal Measures Are Needed to Prevent Food Price and Hence Wage Increases

As has been shown in previous sections of this pamphlet, the job of holding retail prices down in the face of strong inflationary pressure is not an easy one. Despite a surprising measure of success in maintaining ceilings, some increases in controlled prices have taken place. And the growing pressures are likely to make these increases much greater in the future unless fiscal measures absorb the swelling excess of consumer spending power. For some foods administration of price ceilings is so unpractical that it should not even be attempted; and prices of these foods climb steeply. Fiscal measures to absorb the excess spending power that boosts food prices will become increasingly important in the weeks and months ahead. Direct price controls cannot hold the fort alone.

"Parity" Prices and the Inflation Spiral

Parity Pricing Discourages Production of Some Foods

Any price program that discourages production of foods that would be consumed by the civilian population has an inflationary effect. The gap between consumer incomes and the supplies of consumption goods is increased when supplies are curtailed, quite as much as when incomes are permitted to rise. "Parity" pricing of some products increases farmers' incomes and limits farm production. Such pricing is clearly inflationary on both counts.

In pamphlet No. 2 of this series, it was pointed out that some existing farm prices which are tied to the parity formula are interfering with full use of farm resources, thus curtailing total food supply. Examples are many. Let us take the case of cotton. High prices on short-staple cotton do two things: they encourage continued production of cotton that merely goes into storage, and they discourage shifts to production of more meat, milk, and eggs in the Cotton Belt. Another example is the high price of wheat, which prevents its use as a feed and hence diminishes production of meat. If more meat and milk and eggs were available, the shortage of these foods would be less acute, and there would be less tendency for retail prices to rise.

If the present parity formula is maintained, satisfactory price relationships can only be secured by pushing up sharply the prices of some foods that are already well above "parity."[7] This would add billions of dollars to farm marketings without doing much more than maintain the supplies of foods that would be forthcoming anyway if some farm prices were reduced while others were raised. Billions of dollars added to farm incomes without corresponding additions to supplies of foods contribute to inflation.

Higher Farm Prices Lead to Price and Income Increases Elsewhere

It is highly unlikely that farm prices in general can advance much without increasing retail prices,[8] which leads to higher

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[7] If basic feeds rose to 100 per cent of parity, a feeding ratio sufficient to reach livestock production goals could only be achieved by raising livestock products in proportion (roughly from the present 125 per cent or more of parity to 140 per cent or more).

[8] Some comments of Mr. Humphrey in an article in the February, 1943 issue of *Survey of Current Business* emphasize this point (p. 13): "An additional need for granting relief from ceiling prices based on March 1942 has arisen in the case of those foods uncontrolled at the farm level. The rise of these farm prices since the base date has created a squeeze on processors or distributors.

wages, which in turn will increase the costs of non-agricultural industries and their prices.

Some farmers are of the opinion that farm prices could rise without affecting retail prices. They hold that the margins of middlemen might be narrowed. Opportunities to squeeze middlemen are less than some people have assumed; in fact, in meat products the squeeze has gone so far already as to have created serious difficulties. Unless farmers are willing to support elaborate programs of subsidies to food middlemen, they must recognize that widespread farm price increases will create an impossible situation—leading either to the breakdown of the system of food distribution or to the breaking through of retail ceilings, or both. If subsidies to middlemen are widely used in order to make possible simultaneously the increase of farm prices and the maintenance of low retail prices, then more money enters the income flow in these subsidy payments to middlemen. So far as inflationary effects are concerned, there is clearly a presumption against increases in farm prices with or without subsidies. It is thus important that farm price increases be used sparingly.

"Parity" Prices Keep Moving Up

Parity is an elusive thing. It won't stay put. Parity is essentially a scheme for keeping the prices farmers get, for what they sell, in the same relation to the prices they pay, for what they buy, as prevailed in a "base period" (1909–14 for most products involved). An increase in the prices of things farmers buy therefore necessitates an increase in the prices of what they sell if the parity ratios are to be maintained. But when prices farmers get for their products move up to or toward parity, they in fact *cause* the prices farmers pay to rise also; "parity" must then be revised upward. The process becomes a little like a dog chasing its tail. Rising farm prices means rising prices for things farmers buy—and thus a higher "parity" standard—for three reasons:

1. *Farm products are among the things farmers buy.* Especially important are feed prices. Increases in feed prices up to or toward parity (most of them are currently below parity) mean increases in the prices paid by farmers buying feeds. Thus when farmers selling feed get higher prices, the result is also an increase in the index of "prices farmers pay," and "parity" must be revised upward. Feed prices alone make up 12 per cent of the index of prices farmers pay; and there are several other less-important farm products that go into that index.
2. *Farm products are materials for industrial products farmers buy.* Clothing and processed foods are a large part of what farmers buy; and the cost of the raw material is a large fraction of the price. Clothing and processed foods have to be allowed to rise in price to cover higher costs created by rising farm prices.
3. *Wage rates echo rising farm prices*, for reasons examined above. This again means rising costs and rising prices for industrial products; and many of these products are among the things that farmers buy.

The "Parity Principle Is a Formula for Cumulative Inflation

The essence of the "parity principle" is that farmers' selling prices should go up when their buying prices go up. But this idea is not patented by farmers. Factory workers, coal miners, railway workers, truck drivers, grocery clerks, storekeepers will also insist that it is only fair to increase their money incomes as the goods they buy come to cost more. Extension of this principle to other parts of the economy would mean upward revision of industrial prices to allow for increases in industrial costs.

When we take all the interrelations into account, it becomes evident that the "parity principle" applied in an inflationary situation operates to create more and more inflation. Pushing all farm prices up to parity would necessitate pushing some farm prices even further above parity than their present levels if needed agricultural production were to be maintained. Higher farm prices lead to higher prices of food and clothing in retail markets (or to subsidies to middlemen). Higher retail prices increase labor's demand for higher wages and business men's demands for upward price adjustments to take care of their higher costs. Higher feed prices and food prices and industrial prices in turn mean higher prices on goods farmers buy. Higher prices on goods farmers buy mean higher parity levels. The top is out of sight.

This "spiral" mechanism should be seriously considered along with the other arguments against continuing to base farm price policy upon "parity." The principle of giving people more money because prices are rising guarantees that inflation will get worse and worse.

Farm Subsidies and Inflation

For some reason many farmers seem to consider that it is highly desirable to increase their incomes by getting higher prices for what they produce—even when higher price is only possible if the government purchases large quantities of the product or crop acreage is restricted. Yet these same farmers object to being "helped" by something that is labeled "subsidy." Farm leaders at times maintain that subsidies to farmers would be more inflationary than higher farm prices. There are many good reasons for avoiding new farm subsidies and for removing some of the old AAA type of subsidy payments[9]; nevertheless, misconceptions about subsidies must be avoided. Farm subsidies that fail to increase consumers' supplies are somewhat inflationary; but the belief that they would be more inflationary than rising farm prices is mistaken.

To increase farm prices without inducing greater production is inflationary because it increases farm incomes and spending *and in addition* tends to push up retail food prices

[9] See pamphlet No. 2.

and thus set in motion wage increases and a spiral of inflation. Subsidies to agriculture that fail to increase production are inflationary because they too increase farm incomes; *but they do not* push up food prices at retail and they do not exert the pressure on wages and other non-agricultural incomes that result from increases in the prices of farm products. Thus both increases in prices of farm products and subsidies to farmers are likely to be inflationary in effect; but subsidies are less so than are higher farm prices. The case against farm subsidies rests far more on the difficulty and cost of administering a subsidy program than on the inflationary damage that would ensue.

FISCAL POLICY AND EXCESS SPENDING POWER

The major burden of controlling excess spending power—to prevent both inflationary pressure and inflation—must rest with fiscal policy.[10] Three kinds of taxes are most deserving of attention as means to do this job. They are: (1) a "Spendings Tax," (2) a general sales tax, and (3) increased levies on personal incomes.[11] Any of these taxes may be either plain taxes or refundable taxes, which are in fact compulsory loans.[12]

The "Spendings Tax"

In the summer of 1942 the Treasury brought forward a scheme for a tax on consumer expenditures. Its two most important features[13] were:

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[10] See Appendix 1 for the impracticability of relying on extended consumer rationing as a method.

[11] The much discussed corporation levies can do little in this respect. See Appendix 2.

[12] The refundable part of a tax may be returned to the taxpayer currently instead of at some future date—the current refund being conditional on his claims of credits for certain forms of saving. Such a scheme is sometimes called "compulsory savings" as distinct from "compulsory loans."

[13] It is also of some interest that the Treasury proposed to call for statements from taxpayers once every three months, and that a large part of the money to be paid in would be subject to post-war refund; but these suggestions could be altered without changing the principle of the scheme.

1. Putting a tax on each family's spending, the rate of tax becoming higher the greater the spending.
2. Determining "spending" by having each family report its total cash receipts—income plus receipts from sales of property, drafts on bank accounts, borrowing, etc.—and treating as spent all money not reported as used to pay taxes and life insurance, buy assets, or repay debts.

The progressive feature of the tax is secured by allowing each family an exemption, taxing the first few hundred dollars of spending above the exemption at one rate, and applying a higher rate to the next few hundred, a still higher rate to the next, etc.

The Treasury's 1942 proposal for a spendings tax was aimed to bring in about $6.5 billion of revenue, which would make a sizeable dent in the so-called "inflationary gap." But the probable effectiveness of such a tax should not be measured by its revenue yield; for its primary object is to discourage spending, and it would yield revenue only as it failed to reach this primary objective. If effectively administered, a tax of this sort would increase consumers' voluntary savings as well as bring in tax revenue, whereas all other proposed taxes would decrease voluntary savings.

By reducing the amount of spending exempt from the tax, and by setting higher rates at each spending level, a spendings tax could be made much heavier than the one proposed by the Treasury.[14] To get the *revenue* far above $6.5 billion might be impossible, since the deterrent on spending would take hold strongly; but if it could be enforced, the tax could be made heavy enough to reduce spending to the $70 billion level.[15]

There are two main arguments against trying to use this tax as a major part of an anti-inflation fiscal program. In the

[14] For the Treasury's specific proposal, see Appendix 3.

[15] See the discussion of the scale of the inflation problem in the first part of this pamphlet.

first place, putting too much reliance on a new tax would create a very difficult and risky administrative situation. It would be hard to peruade taxpayers to file promptly and to teach them to file correctly, and a heavy tax of this character (particularly if imperfectly understood and hence resented by many taxpayers) would offer strong temptations to evasion.

In the second place, to adopt a device which leads to a maximum of saving and a minimum of taxpaying implies maximum growth of public debt; and if consumers are permitted and even encouraged to put their savings into bank balances, there will be great danger of an explosion of spending at or even before the end of hostilities.

As an auxiliary tax, the spendings tax has much to recommend it; as a main reliance for disposing of excess spending power, it is not very promising.

General Sales Tax

Sales taxation is clearly rising in favor with the public, with politicians, and with many tax experts. This change reflects partly the desire to penalize spending as such, partly despair of getting adequate revenue otherwise, and partly new ideas of ways in which the differential burden of sales taxes on the poor can be eased.

If a general sales tax is to perform the function of preventing price increases, it is important that it be stated separately from the price of each commodity sold—as is characteristic of sales taxes now in force in various states. It is equally important that both labor and farm groups refrain from using the tax as an argument for revising the indexes of cost-of-living or farm price parity; otherwise, the spending power absorbed in taxes would tend to be replaced in consumers' pockets by increases in wages and farm prices, with no net gain in controlling inflation.

The basic objection to sales taxation has always been its unfairness to the poor, since even to buy bare necessities they have to spend the bulk of their incomes on taxable goods. C. O. Hardy and others have pointed out that this objection could be overcome by giving a *personal exemption* to taxpayers (perhaps in the form of a book of coupons good for payment of taxes up to a certain amount). It has also been suggested that foods might be exempted; but from the standpoint of food management this suggestion must be rejected. Omitting food would greatly weaken the power of the tax to absorb spending power; and making other commodities (tax included) more expensive relative to food might push spending power over into the food field.[16]

The spendings tax and the general sales tax with personal exemptions have much in common. They are both levies on spending and start only after spending reaches a certain level.[17] The primary difference is in the method of collection. The spendings tax is based on consumers' reports of their incomes, with deductions for exempt uses of funds (primarily government bonds, insurance premiums, and bank savings accounts). The sales tax is collected from retail dealers.[18] Until there has been some experience with the spendings tax, and the Treasury has had time to perfect the system, it will present more difficulties of administration than a general sales tax—particularly since frequent reports from taxpayers would be required to keep tax payments in line with current spending.

Another difference between a spendings tax and a general sales tax lies in the extent to which spending is discouraged

[16]Another possibility would be to give wage increases to cover increases in living costs caused by the tax, but increases not proportional to income. The Canadian system which adds 25 cents a week to everybody's pay check for each 1 point rise in the cost of living index would serve. Since many low-income consumers are not wage-earners, however, the personal exemption suggested by Hardy would work better.

[17] See Appendix 4.

[18] This administrative difference gives rise to an important difference in the practical coverage of the two types of tax. Under a sales tax it is generally considered impractical to tax rent, spending on domestic service, etc., because the number of landlords and domestic workers is too great to permit getting good reports. Under a spending tax it would probably be impractical *not* to tax these expenditures, because the basis of the tax is reported receipts less amounts used in specified ways and spendings of these types would be hard to verify.

and saving encouraged. The progressive feature of the expenditure tax makes it increasingly costly to the individual as his expenditures rise, and this deters spending and encourages voluntary saving. In the absence of progressive rates the sales tax, however, would probably not increase savings; it would usually be regarded as a factor which raised living costs and thus discouraged savings.

Levies on Personal Incomes

The tax that is most promising as the bulwark of anti-inflationary fiscal policy is the tax on personal incomes. The potential contribution of this tax to inflation control is still only partially realized. The income tax is an established part of our government machinery; the tradition of compliance is well established; and the structure of the tax makes it relatively easy to allow for the chief variables in "ability to pay"—size of income, expenses involved in earning the income, and size of family. The defect of the past, that the tax was collected a year after the taxpayer received and spent the taxable income, is now being cured. The chief reason that we have not to date put the personal income tax on a genuine war footing is simply unwillingness in Washington and in the country to face the facts of the tax issue.

The untapped tax capacity which personal income taxes can reach is enormous. As was shown at the outset of this pamphlet, consumers will have about $145 billion of money income in the year beginning July 1, 1943 ("fiscal 1944"); of this they will need $70 billion to buy consumption goods and at most $20 billion for saving. An ideally designed income tax could therefore take up to $55 billion without adding anything to the war hardships beyond what is implicit in the supply situation.

To take up all or even a large part of this $55 billion would require reducing exemption from the tax to a minimum level of living and increasing the tax rates applying to the first few hundred dollars of taxable income. These changes would have the effect of taking much larger amounts in taxes from the middle income groups as well as something from many persons not now paying income taxes. In view of differences in living costs, new kinds of allowances would have to be made—especially exemptions of limited amounts to take into account differences in housing expenses, and some of the extra domestic expenses incurred by families in which the wife takes a job.

If these things were done, the major part of the job of absorbing excess spending power could be accomplished by a personal income tax collected on a "pay-as-you-go" basis.

A Tax Program for Food Managers

A tax program made to order for food managers would do two kinds of things: it would absorb excess spending power, preventing the many difficulties arising out of inflationary conditions; and it would shift demands for particular commodities in harmony with the needs of the wartime economy.

Expenditure, General Sales, and Personal Income Taxes Shift Demands Favorably

Any of the three taxes we have just discussed would tend to shift consumer demands away from the "prosperity standard" engendered by excess spending power. When people's spendable incomes are cut by heavy personal income taxes they revise their spending to a lower level of living. A heavy general sales tax indirectly lowers incomes in that each individual's income is used up more quickly on the purchase of any given amount of goods; it is therefore necessary to spend more carefully. A progressive expenditure tax makes it more and more costly in taxes for the individual to spend larger and larger amounts of money; he will therefore try to get the most for what he does spend—to buy less expensive goods and to cut down on luxury items.

When consumer demands shift away from a "prosperity standard" in response to personal income, sales, or expenditure taxes (or a combination of these taxes), we should expect curtailment of expenditures to be more severe in non-food than in food items. But this is too broad a statement. More important is what would tend to happen within each category of expenditures, and especially within the block of expenditures on food. We would expect a shifting away from expensive cuts of meats—away from butter and from like luxury foods. We would expect a shifting toward the potatoes and bread and cabbage and margarine that are the most efficient sources of nutrients for civilian consumption in view of present war needs and labor shortage. The more severe the combined impact of these taxes, the greater is this shift likely to be, and the greater the tax contribution to facilitating management of agricultural production and food supplies.

Increased Personal Income Taxes Are the Key to Inflation Control

The preceding pages have analyzed the spendings, sales, and personal income taxes as means of taking up excess spending power. Each of these taxes can help in doing this job. Greatest reliance, however, must be placed on the personal income tax; this tax is well established in our federal system and can be adjusted to make those allowances for ability to pay that become increasingly important as the total tax burden becomes increasingly heavy. A general sales tax *with personal exemptions* might be used to supplement the income tax, and would be favored by many groups unwilling to put the full burden of increased taxation in the income tax form. An expenditure tax might occupy a minor place in such a program; it provides a way of deterring consumers from spending large amounts of money, and yet it leaves them a larger measure of choice to spend or not to spend than would remain if sole reliance were placed on the personal income and general sales taxes.[19]

[19] The continuance of other taxes already on the books is assumed.

Fiscal policy based on these principles can absorb excess spending and prevent an inflationary crisis. The stake of food managers—and hence of the American people—in such a program is clearly a great one.

APPENDIX

SOME NOTES ON CONTROLLING EXCESS SPENDING POWER

1. *Extended Rationing Schemes Are Not Practical as the Major Reliance in An Inflation Control Program*

When most items of food, clothing, furniture, etc. are either rationed or unavailable, as in Great Britain, Germany, and other European countries, considerable saving becomes automatic since opportunities to spend are few. This might suggest extending rationing control all over the map in order to make people save instead of spending. But this involves a costly and burdensome administrative load and elaborate controls over hundreds of details of economic activity. The sheer complication of the system coupled with inevitable delays in extending it creates opportunities to spend either by jumping in before the market is fully controlled or by infringing regulations that are not adequately enforced. The notion of throwing the whole job of combating excess spending power onto the consumer rationing machinery springs from defeatism about other measures. It involves risking the total collapse of rationing and price control; and at best it means extra burdens which interfere with doing the primary jobs for which food managers and others concerned with rationing and price control are responsible.

Proposals for general purchasing power rationing (a number of variants of the "Kalecki Plan" and related schemes) seem at first sight to provide a simplified method for using rationing to check inflation. They are essentially schemes for including all goods in one rationing system, to be bought with one set of coupons that apply to everything. But these plans fail to eliminate the difficulties involved in extending particular ration schemes to more and more groups of commodities: the problem of supply controls remains. Moreover, adjustment of consumption by commodity groups is an important part of managing a war economy and this is much more readily done by separating goods into different ration groups. (See the pamphlet in this series on "Improving Nutrition in Wartime," to be printed later). General Purchasing Power rationing would not eliminate the necessity for rationing particular groups of foods, for example, under special ration schemes.

2. *Levies on Corporations Can Do Little to Check Consumer Spending*

In view of the widespread discussion that has been devoted to corporation taxes a brief explanation of why they are omitted here is called for. From the standpoint of eliminating excess spending power, levies on corporations are not very powerful. They affect consumption through a rather lengthy chain: by reducing disposable income of the corporation they force corporations to borrow or reduce cash resources or cut dividends; insofar as they reduce dividends they force stockholders to reduce savings or else curtail expenditures. Neither the cut in dividends nor the curtailment of stockholders' expenditures is automatic. On the whole it is likely that dividends will be cut by somewhat less than the government takes from the corporation, and that stockholders will respond to the dividend cut more by reducing savings than by reducing expenditures. Profits of corporations, net of present taxes, have recently been at about the 1941 level (while all other forms of income have been higher); and they are not likely to get as high as $10 billion a year during the war.

3. *Ten Per Cent Spendings Tax Proposed*

The Treasury proposed a 10 per cent flat rate tax on all spendings without exemption—but waiving tax on single persons spending less than $500, childless couples spending less than $1,000, couples with two children spending less than $1,500, etc. This was to be refundable after the war without interest; its revenue yield is estimated at 4.5 billion dollars a year at 1942 income levels.

In addition, the Treasury proposed a spendings surtax, levied on spending *per capita*, counting a child as half a person. (Thus a couple with one child would be 2.5 persons.) The first $1,000 of spending per capita was to be exempt.

On spending per capita in excess of $1,000, the first $1,000 was to be taxed at 10 per cent, the second $1,000 at 20 per cent, the third at 30 per cent, the fourth and fifth at 40 per cent, the next $5,000 at 50 per cent, and the excess over $10,000 at 75 per cent.

4. *A General Sales Tax Could Be Made Progressive*

Progressive rates could even be introduced under the sales-tax system, distributing the burden in a manner quite similar to the possibilities under the spendings tax. The basic sales tax rate might be set, for example, at 25 per cent, and every consumer would get two coupon books. The first might be good for the full 25 per cent tax on, say, $400 of expenditure; the second might cover 10 per cent of purchase value on the next $600 (thus cutting the tax rate on purchases in this bracket to 15 per cent). Thus consumers would in fact pay no tax on the first $400 of expenditure, a tax of 15 per cent on the next $600, and a tax of 25 per cent on all expenditures over $1,000. The chief argument against such a scheme is its administrative complexity, including the difficulty of preventing illegal transfers of tax coupons from one person to another.

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Dividing Food Among Civilians
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