

4-1941

Price Control In Times Of Emergency (a)The Federal Reserve Bank (b) Taxation

Oliver S. Powell

Rowland Burnstan
Carleton College

Follow this and additional works at: <https://digitalcommons.morris.umn.edu/jmas>



Part of the [Economics Commons](#)

Recommended Citation

Powell, O. S., & Burnstan, R. (1941). Price Control In Times Of Emergency (a)The Federal Reserve Bank (b) Taxation. *Journal of the Minnesota Academy of Science, Vol. 9 No. 1*, 95-100.
Retrieved from <https://digitalcommons.morris.umn.edu/jmas/vol9/iss1/22>

This Article is brought to you for free and open access by the Journals at University of Minnesota Morris Digital Well. It has been accepted for inclusion in Journal of the Minnesota Academy of Science by an authorized editor of University of Minnesota Morris Digital Well. For more information, please contact skulann@morris.umn.edu.

Social Science

PRICE CONTROL IN TIMES OF EMERGENCY

(a) THE FEDERAL RESERVE BANK

OLIVER S. POWELL

Vice President, Federal Reserve Bank

(b) TAXATION

ROWLAND BURNSTAN

Carleton College

The problem of price control and the instruments through which this control shall be exercised is one which, like most economic problems, requires different solutions depending upon various existing conditions encountered at the time that control seems to be necessary. Much talk, but little control, was exercised in connection with this problem during the last war; but in the present defense effort resulting from the war in which we are now participating, at least economically, we are faced with a problem which will require an organized solution. Figures on our national debt, and the rate at which that debt is increasing, may indicate a price problem of greater magnitude than any with which we have previously been faced. Price inflation is a very active issue, and it is only a question of time before it will reach the problem stage unless some counter-acting move is made in the meantime.

In this country, we have as an experimental laboratory, the developments that are taking place in Great Britain today, and although the financial positions of the two countries differ in many respects, there is still enough similarity to permit us to draw some valid conclusions from the efforts at control that have been instituted in England. A study of the financial sheet of any newspapers containing quotations on foreign exchange will indicate that some inflationary influences have been affecting the British economy. Quotations on the pound have shown a marked decline in terms of the American dollar. Up to now this comparison has been regarded as a fairly accurate measure, but complete dependency upon it now is impossible because of the exchange control processes in force. Allowance must be made for this influence and as our own inflationary moves begin to take place in the United States, exchange quotations will be even less reliable measures because domestic conditions will tend to offset some of the decline in the price of foreign currencies. However, there are other measures which can be resorted to, such as indexes of wholesale prices, cost of living, and the level of wages.

These data, gathered from a variety of sources and kept up to date by agencies interested only in the accuracy of their reports furnish the curves that may be observed as at least a partial measure of the effect of defense spending on the entire economy.

In the early periods of an era of great spending, it is usually possible to finance the operation through the established sources of funds but even so, each borrowing procedure tends to change the inflationary picture. Other factors which must be considered along with the amount of the national debt are, the volume of idle funds, the volume of unused capacity, and the volume of unused factors of production available at a given moment. When a necessary braking action is put on price movements this is usually accomplished through exercising some control over our credit structure. Attempts of this sort have been made in the last two decades with varying degrees of success, and furnish us with a background of information that may be utilized to meet our developing problem. From this it will be seen that previous experience is valuable, but only for general comparison, and it can not be used as an infallible guide to present policy. World War borrowing was done by economies at full employment and only economies at full employment can use successfully a credit restricting policy as an inflationary control.

If alterations in credit policy cannot exercise sufficient control by themselves it is possible to attempt further control through taxation. The effects of specific taxes on prices may be traced. These effects are always operating on our price structure to some extent, even though their comparative unimportance under ordinary conditions causes them to be ignored. As matters are now developing it appears that it may be necessary to combine all forces if any effective grip on prices is to be maintained. In dealing with its effects it must be kept in mind that taxation like other controls does not function as a separate entity.

So far as spending is concerned, the United States is faced today with practically the same problems that come before a nation at war. We are producing goods on a vast scale that will be used for destructive purposes, if they are used at all. Assuming that we can expand the civilian factor of our production in such a way that bottlenecks with resulting unemployment can be avoided or minimized and that WPA and relief payments are maintained at or near the present level, the creation of war goods will bring an increase in employment and payrolls. The result is that money earnings as a whole will expand, but there will not be a proportionate increase in the production of goods available for consumer uses.

It appears that with any production control which may be exercised priority will be given in every instance to the defense program so that there will result a certain falling off in consumptive articles wherever the machinery of production must be used for one activity or the other. Such control may be exercised easily in times of

war but up to now it has been difficult to impose with the country not engaged in hostilities.

Evidence of a new attitude that has produced results without compulsion may be found in recent announcements by some of the large motor car manufacturers that no retooling will occur for next year's models. The purpose of this move was the diversion of machine tool facilities to the expansion and acceleration of defense industries. If this policy continues, a condition will increasingly prevail wherein larger amounts of money will eventually be competing for a decreasing amount of consumer goods from which condition it may be assumed that there will be a succession of price increases. As a result, there will take place recurring demands for increases in wages made on the part of laborers who feel that their income must keep pace with the rapid increase in prices. Wage increases, on the other hand, contribute to increasing costs with a subsequent rise in price and thus the whole process continues.

We have usually assumed that there exists a lag between increased prices and the wage level. Within the framework of the business cycle this may be generally true, but it is not always the case, and certainly it does not seem to be so in the present program. This does not mean that prices may not overtake the wage level as the defense effort develops, and the prevention of a movement of this sort is one of the reasons that price controls are being discussed and suggested at the present time.

To turn more specifically to the use of taxation we begin with the income tax as the most important source of revenue for our federal government. Since the question has been discussed many times and at great length, it seems possible to begin by assuming that this levy is recognized as being the closest to the ideal tax of any now utilized in our fiscal structure. Thus it is possible to attack the first problem as that which concerns the expansion of governmental income from this source, until the source has been exhausted. There is another reason for taking this approach and that involves the desire to keep at a minimum the disruption of our peace-time economy so that at the conclusion of hostilities the shock of readjustment will be minimized. If this is to be accomplished the defense effort should be financed so far as possible out of current income. The government should obtain a maximum of funds from taxes and loans derived from income as the source. There is encountered immediately one of the controlling influences which taxation can exert on prices because most of the funds coming to the government from income will of necessity be diverted from the purchase of consumers' goods. The competition in the market is thus decreased, thereby acting as a deterring force against an upward price movement. On the other hand, if loans come as a result of bank credit expansion then the total money available for expenditure is increased in a proportion greater than the increased

supply of goods and services available. This will bring the opposite effect to that referred to above, and would tend to make prices rise.

An examination of the recent changes in the income tax law will reveal that the probabilities of a greatly increased aggregate tax payment may be expected in the future. The new law takes in many persons who were formerly exempt and also decreases the allowance made to tax payers under the old statute. With increased employment and a higher level of wages, great numbers of additional taxpayers may be expected to fall within the law during the next few years. So far as present taxpayers are concerned, the increased business activity will bring an expanded income to this group and the progressive features of the tax will cause increased payments to the government from this group on a rapidly expanding scale. It is certain that such payments will bring to the treasury funds which otherwise would largely have been used in the acquisition of consumers' goods, and it is clear that the collection of these moneys by the government acts as an effective instrument of price control during a period when it appears desirable to resist upward movements of price levels.

Considerable publicity has been given to the sales tax in recent months, and it is assumed that much of this has been put forth by persons who were alarmed by the probable increased payments required under the income tax law. The sales tax will raise funds just as any other tax will, but beyond that, there is little that can be said in its favor except where price control is important. A further analysis of the subsequent effects of a sales tax indicates that it may cause future difficulties which far outweigh its present apparent advantages. Recognizing that our economy has been moving at a slow pace so far as consumers' goods are concerned, it would appear that the sales tax directly cuts down the sale of consumptive goods to a degree far greater than the income tax. This is because the sales tax strikes heaviest at the lowest income groups among the consuming public. These individuals would spend all of their income gained during a year and the sales tax would take a fixed proportion of that money out of circulation. If we are interested in bringing our unemployed back to work, then a sales tax is difficult to justify before our productive machine has reached capacity, and it is necessary to make sacrifices in the consumption of consumers' goods in order that war products may be produced in greater volume. To adopt any other course would mean that the disruption of the post war economy would again be accentuated. We would be retrenching in the consumption of exactly those products which would not help our defense program. There is also the question of the inequities under such a tax, which must be considered. The case of persons receiving aid under social security laws would present the extreme cases. The government would be granting aid to individuals at a level assumed to be the minimum for their existence and then taking a portion of that payment away.

In the case of Great Britain, a plan for war payment has been put forth by Mr. Keynes. It is referred to at this time because it falls upon the same class of people that would be most affected by a general sales tax. It is called a plan of enforced savings, and it differs from a tax on wages only in the respect that the money exacted from the workers is credited to them for future use during the period of post war reconstruction. If it is assumed that a nation's productive plant is operating at or near capacity then the diversion of facilities from the production of consumers' goods can be accomplished through a tax on wages, which will reduce the demand for this class of goods and thus also tend to act as a deterrent to higher prices. This takes in another factor wherein every device is being employed to win a war and any plant capacity utilized in the production of consumers' goods beyond the barest necessities may be looked upon as detracting from the war effort. The Keynes proposal of enforced savings overcomes some of the objections to a sales tax because it means that only the workers who are actually receiving wages are taxed and they are making sacrifices now with the knowledge that the fruits of their effort will be available to them at a future time. Mr. Keynes based his proposal on the same conditions that were referred to earlier, namely, that money earnings as a whole tend to increase sharply in war time whereas the diversion of productive effort causes a decrease in the output of goods available for civilian consumption. He therefore proposes that each worker shall be forced to save by depositing a certain portion of his earnings each week with the government. A minimum ration of necessities is to be prescribed and supplied and, in order that growing families shall not be penalized, a grant is made for each child. At the conclusion of the war the deposited money plus interest would be paid back to the depositors with funds obtained from a capital levy. The only conditions under which earlier withdrawals may be made is for expenditures made because of illness or for payments to insurance funds which in many cases are really savings deposits. Just how the capital levy is to be arranged at the end of the war is not described in detail, but this is assumed not to be an insurmountable problem.

A capital levy solution has been suggested in this country to pay for the prosecution of our defense effort. A bill was recently introduced into the United States senate authorizing the conscription of capital on an ability basis, with a fixed interest rate of 1%. Although the bill was not reported out of committee it received a surprising amount of favorable comment, most of which was based upon the social effects to be expected. An example of a method which might be pursued is found in the plan put in effect when the currency of Germany was rehabilitated after the last war. A capital levy was made against all property and since the government could not take over the property as such, it merely took over title. Then the property was returned to former owners for their use at a fixed

return of rental. In effect, of course, this was a tax, but because of the peculiar reasoning involved it was never known by that name in Germany and was always referred to in official literature and correspondence as a contribution. It is possible that Mr. Keynes contemplates some similar plan for Britain or that something on this order may be resorted to in the future in this country if our own level of expenditures reaches proportions that cannot be controlled by ordinary means of borrowing or taxation. The point of price control was paramount in Mr. Keynes' plan, and if this or some tax having restrictive effects is not adopted along with other controls, the well known inflationary cycle will soon be functioning. The laborer then will have none of the benefits of his higher wages which will be outdistanced by increased prices for the things that he has to buy.

Almost every tax or similar levy can be utilized in some manner as an instrumentality of price control. These controls are more apparent in times of emergency because of the accelerated rate at which they take effect. In the present emergency in this country, it is difficult to outline an equitable plan until the course of the current program of expenditure becomes more clearly defined. It has been suggested that there should be a freezing of price levels at given dates, that price control agencies should be established to make necessary adjustments and to function on a local as well as a national basis, and that equalization accounts be established within industries in order to avoid forcing marginal producers out of business. In addition to any direct controls that may be established, it seems certain that other controls will be attempted through our credit and currency systems and that some tax levies will also be applied for this purpose. The primary aim of the taxes will continue to be the raising of revenue but the careful selection of taxes and the timing of their levy may aid in price control. The different effects will come about through the incidence of each particular tax and the income level in society wherein it strikes. The element of price control will increase as the amount of money collected comes from funds which otherwise would have been used in purchasing consumers' goods.

(c) WORLD WAR EXPERIENCE IN PRICE CONTROL

FORREST A. YOUNG
Macalester College

ABSTRACT

Literature on war economics was quite limited prior to the first world war. European nations gave little thought to economic planning or to the economic organization needed to carry on a major war. The need for planning and control over production, raw mate-