not reduce existing demand or narrow the "inflationary gap." If that gap is too large, the successful use of direct controls is undermined. This cannot be reiterated too frequently, lest the public be beguiled into seeking a painless but superficial cure for inflation in the direct controls alone.

A second special consideration is that the distribution of taxes should be such as to promote the maximum cooperation of the public in accepting necessary sacrifices and restraints during the defense period. This means that the public must believe that the tax system spreads the burden fairly. The excess profits tax and the progressive income tax are generally accepted as necessary parts of a fair tax system under current conditions.

A third consideration is that of using taxes to reduce the demand of commodities in particularly short supply. Heavy excise taxes on scarce commodities do this by raising their effective price to the consumer. The resulting price increase goes into the Federal treasury; unlike other price increases it does not add to the profits of businesses or stimulate the demand of wage earners to share in such profits.

Because of the diverse purposes to which taxes must be geared, as well as some differences of opinion regarding the way in which different taxes affect various segments of the economy, there is an understandable variation of viewpoint about just what forms and rates of taxation should be applied. Enough is known about taxation to avoid the clearly harmful and to choose generally among the more desirable approaches. It is far more important to get an effective and sufficient tax program quickly, than to hope for an ideal program at any time. In these times particularly, everyone shares in the responsibility to submerge relatively minor disagreements and to seek agreement on the achievement of broad purposes.

VIII. Price and Wage Policy

The die has now been cast for price and wage controls, which will cover progressively more of the economy as the necessary organization is expanded and as the defense program mounts. It is idle now to speculate how much of this might have been avoided if a far more extensive tax program had been adopted far more quickly, or if certain powerful groups within the economy had shown more restraint. Nor will the Council in this report discuss the details of which controls should be imposed first, in what sequence action should be taken, or what procedural method should be employed. Some of these matters are clearly within the responsibility of operating agencies but outside the purview of the Council. Others will be dealt with in the more programmatic reports transmitted to the Congress by the President in January, including the Economic Report and our Annual Economic Review.

While these controls are now inevitable, the wage and price policies under which these controls will be put into effect are still to be interpreted and applied. It is therefore appropriate for the Council in this report to say something on the general economics of price and wage policy under current conditions. Relatively too much attention has been diverted to the mechanics of price and wage controls, and not enough to the economics of price and wage policy. Too often has it been forgotten that controls are designed to effectuate a policy, and not to substitute for it. In all of the discussion about when, where, and how controls should be applied, there is room for an insistent reiteration of the question: "For what purpose are they to be applied?"

It is not a sufficient answer to say simply that they are to be applied to fight inflation. This does not reveal just what ought to be done, for there are many ways both good and bad of fighting inflation. Nor is the economist completely satisfied with the answer that "the public wants controls." The public will not want them after it gets them, unless they are demonstrably successful. Nor is it sufficient to say simply that all prices and wages should be frozen just where they are. We do not comment here upon whether it would be administratively more practical to begin with a general freeze before adjusting, or to begin first with limited controls and then move on to more extensive ones. In either administrative approach, both economic considerations and the maintenance of public support require the development of policy to implement a set of objectives. The proper sequence is first to define the objectives, and then to develop the implementing policy along with the machinery and procedures which will best effectuate the policy.

In peacetime, the economic function of prices and wages is to promote maximum employment, production, and purchasing power by facilitating the most efficient use of resources. All this has been alluded to earlier in this report. At the start of 1950, before the new international developments, the Council undertook to delineate general price and wage policies for stability in an expanding peacetime economy. On the price side, we advocated in general the maintenance of the then current level of prices. We held that a generally declining price level was likely to retard economic growth, and that a generally rising price level was more or less incompatible with economic stability. We recognized the need for individual variations within this general rule, and that some prices should be reduced where there were extraordinary technological gains or where these prices had already mounted above a sustainable level.

On the wage side, the Council took the position at the start of 1950 that, in the dynamics of the American economy, stability and growth were more likely to be promoted by level prices and rising money incomes than by level incomes and falling prices. Of course, we felt that these increases in money incomes should be consonant with increases in productivity so as not to generate inflation. It was on this basis that we looked with general favor upon the new types of contracts arising in some of our major industries, which inaugurated a stable wage policy for a number of years ahead by relating periodic wage increases to assumed and realizable increases in productivity for the economy as a whole. We did not register objection to the inclusion of "cost of living" adjustments in these formulae, so long as they did not subordinate the general idea that incomes should keep pace with the swelling volume of consumer goods which a peacetime economy at maximum employment and production would be turning out. We recognized, on the wage side no less than on the price side, the need for individual variance in a complex economy, and we advocated that the application of these price and wage policies be left to the processes of managerial decisions and collective bargaining.

The need for reconsideration of the price and wage policies put forward in early 1950 now arises obviously from the fact that the international emergency has changed the economic situation in two vital respects. In the first place, while we must continue to use our resources most efficiently, the pattern of resource-use must be readjusted drastically because new priorities of need have entered into the picture. And secondly, this drastic change, in the interest of national security, must take place much more swiftly than would be possible through the free play of market forces alone.

But it remains true even now that prices and wages will have a bearing on whether we achieve the most efficient use of our resources for the purposes at hand. Even pending the further development of programming and priority guides, it is feasible to formulate some general rules about price and wage policy. In the case of prices, generally speaking, it is even more desirable now than in normal peacetime to hold the average of prices as near as possible to a fixed level. We do not pass here upon the extent to which this should be done by controls or by business decisions. Upward price movements are even more disruptive under current conditions than in normal peacetime. The comment we made a year ago, that almost all important prices were high enough to provide adequate funds and incentives without further increases, is even more valid today. Yet even these general conclusions are subject to some qualifications already hinted in this report. Insistence upon absolute price rigidity should not interfere with some flexibilty where it is needed to get vital production. In rare cases, price increases may be required to induce production, or subsidies may be necessary to hold the line with respect to the cost of living.

Turning to wage policy in the current situation, one may look at wages as the nominal amount received by the wage earner from his employer (which is significant as a factor in business costs). Or one may look at wages as the amount available for expenditure by the wage earner, after the imposition of taxes and other compulsory or voluntary restraints (which is significant from the viewpoint of the inflationary problem of the relationship between consumer demand and the availability of consumer goods, and from the viewpoint of the standard of living).

Looking first at wages as the amount paid by the employer, it is obvious that wage policy cannot countenance increases in wages of a size which would necessitate price increases. There may be a few exceptions to this rule, where the remedying of inequities is more important than the effect upon the defense effort which would result from price increases in particular fields. But these cases should be limited to instances of real hardship.

Looking next at wages as the amount available for spending by the worker after the imposition of taxation and other restraints, the sound economic policy is to adjust these wages as closely as feasible to trends in the availability of goods for consumer use. This is the way to fight inflation, and when wage earners as a whole get more money than this for current spending purposes they really gain nothing.

It is apparent under present and immediately foreseeable conditions that the total amount of wages available for spending after taxes and any other forced restraints cannot, in real terms, rise in accordance with the formulae which we regarded sympathetically in early 1950 under peacetime conditions. For if total wages available for spending rise as fast as productivity increases and are also adjusted upward for changes in the cost of living, while an increasing proportion of the enlarging production is bought by the Government for national defense, then excess of wages over available goods aggravates inflation. If some wage earners benefit by using the early 1950 formulae while others do not, they do so at the expense of other consumers who constitute a majority of the population and most of whom are relatively less fortunately situated.

Although the size of defense outlays has not yet crystallized, it already seems clear that the defense effort will at least be so large that during the next year or two if not for longer the total availability of goods for consumers cannot be increased, and in all likelihood will decline somewhat. Thus, wage and tax policies should aim toward preventing increase in the total amount of wages available for spending, since there is no evidence now of an over-all insufficiency of total wages measured against the proportion of total output which wage earners should buy.

Thus there emerge two standards to be applied in the development of wage policy: first, that the trend of wages paid by employers should not force prices to rise; and second, that the trend of wages available for spending after taxation and other restraints should be kept in line with trends in the availability of consumer goods. The second standard is much tighter than the first one, and probably much more important from the viewpoint of combating inflation.

There are two main ways by which wages available for spending can be kept in line with the availability of consumer goods. The first way would be for the general level of wages paid by employers to workers to be held approximately where they are now until that time in the future when consumer supplies can again be expanded. The second way would be to maintain formulae of wage increases roughly similar to those desirable in peacetime (including in some instances productivity and cost of living adjustments), but to prevent a growth in current spending power by sufficiently higher taxation or through deferred wage payments or some combination of the two.

Each of these alternatives has some points of superiority. The first method is simpler to administer, and does not raise the perplexing question of just what the right formulae for wage increases are or how they may be generally applied in various industries. The second method may have the advantage of providing some mild incentive to the wage earner—which is just as important as incentives to business—and has the further advantage of not seeking to deprive workers of what they believe to be legitimate gains embodied in contracts already signed; but it has a disadvantage insofar as it might be unlikely that taxes would be increased sufficiently or quickly enough to keep the wage gains out of the spending stream so long as civilian supplies cannot be increased. Much the same issues arise in considering the economics of overtime rates of pay for longer working hours.

Perhaps some combination of the two approaches may prove most practical; but any combination should move vigorously toward the objective of holding wages available for spending in line with the supply of goods. This conclusion of general policy bears upon wage trends in general. There are some hardship or exceptional cases, which would need to be treated differently until a larger measure of equity is established.

In the case of wages no less than in the case of prices, the achievement of general stabilization should be reconciled with some individual variations of treatment when necessary to encourage maximum production. There will be a few instances where, because we do not rely upon forced labor, some wage adjustments will be among the tools required to get and hold workers where they are most needed. That is why the word "stabilization", which leaves room for some realistic discretion, is more suitable to our economy even in these times than the word "freeze". Nonetheless, the objective of leaving enough flexibility to enable the system to work should not be allowed to interfere with the rapid achievement of a general situation which holds wages firmly in line with the availability of goods for wage earners to buy.

The problem is made even more difficult because the defense effort will bring millions of additional workers into the active labor force, and also lengthen the hours of many who are already working. Thus, there will be a great increase in the total volume of wages even without pay increases. Manifestly, this increase in the total volume of wages will add to inflationary pressures as long as it is possible to increase the supply of civilian goods; and yet no one would propose that this situation be counteracted by reducing the money wages paid by employers to those who have been working all along. That would be both unfair and impractical. This underscores the importance of taxation as the primary method for draining off excess purchasing power from all types of income recipients, and of greatly increasing personal saving. It also underscores the fact that, because millions of additional workers will cause total wage income to rise while the size of the defense effort will prevent consumer supplies from rising, the bulk of wage earners already employed at high wages should recognize that these wages cannot be allowed to spiral still higher under current conditions. It goes almost without saying that it will be easier to accomplish this objective if the cost of living is stabilized.

It is certainly not too much to ask that wage earners in general forego efforts to increase their living standards, during a time when the economy simply cannot produce more civilian goods and also carry the heavy burden of rapid rearmament. These living standards are already far higher than elsewhere in the world; and they are much higher than they ever were in this country before World War II. Within two or three years, if total production grows as it should—and this is one reason why that growth is so important—it may be feasible to resume some gains in living standards even if the defense program remains very high. But if the size of the defense program should reach the point where large absolute reductions in living standards should become necessary, this too the American people must be prepared to undergo.

It would be unfair to suggest such rigorous wage policies, if it were not stressed at the same time that restraints and sacrifices can be imposed upon one group in a democracy only when there is a sense all around that the total burden is being fairly imposed upon all. In this connection, for example, a freeze of prices and a freeze of wages are not equivalent, because it is profits and not prices that are the reward to management. Thus the treatment of profits through the tax system, and the effect of other national policies upon other types of income, are inseparably connected with the treatment of wage policy and of inflationary pressures. The foregoing discussion has indicated particularly the intimate interaction between wage policy and tax policy.

It follows that none of these policies can proceed successfully in splendid isolation. There must be some top point at which they are all reconciled and synthesized. And whoever is responsible for this reconciliation must be armed with the tool provided by a comprehensive programming and priority system, to enable him to discern basic objectives before he seeks to reach them.