

productive superiority, and in setting out to do so we will be choosing the weapon which we know best how to use.

## VI. Uses and Limits of Controls

The argument thus far has been that the first task of economic mobilization is to define and reconcile competing requirements, to match these requirements against available supply, and to service these requirements in accord with priority of need.

It has also been pointed out that the most fundamental approach to the satisfaction of necessarily enormous requirements is by accenting production. Goods must be made before they can be used.

But there are various compelling reasons why, in addition to promoting production, it is necessary to restrain demand. The output of some items cannot possibly be expanded rapidly enough to meet the needs of the primary military build-up without cutbacks elsewhere. Reliance upon the competitive bidding up of prices, to determine the allocation of goods which are in short supply relative to the total need, does not service competing needs on the basis of the priorities of national interest. Such hectic price movements create grave inequities which undermine public morale and contribute to the inflationary spiral. In brief, the traditional mechanisms of the free market, which in peacetime are relied upon to balance supply and demand and to respond to the relative wants of a free people as determined by themselves, must be supplemented in a period of economic mobilization.

While the expansion of production may ultimately reduce the specific inflationary impulses which arise from shortages of specific commodities, it takes allocations and other controls, in many instances, to make scarce manpower and materials available for the most needed production lines. Besides, the expansion of production does not and cannot remove the general inflationary problem in a period of very high and constantly rising defense spending. The reason for this is that the volume of income received by producers and consumers (and thus available for spending) is generated by the totality of production, and increases as the total increases. The only goods available for these buyers, however, are total production minus the large amount purchased by the Government for the defense program and for other programs. Thus, the "inflationary gap" is not filled simply by expanding production. It is accordingly necessary to reduce consumer and business demand below levels they would otherwise reach.

Controls—both indirect and direct—are needed to deal with this inflationary danger. There are several different methods which may be employed for restraining demand. First and foremost, incomes may

be absorbed through taxation, thus cutting down the amount which consumers and businesses have to spend. Heavy excise taxes may also be used to reduce demand for goods in short supply. Second, demand may be restrained through restricting the expansion of credit. Limitations may be placed on credit used specifically for purchasing durable consumers' goods and housing, and on credit expansion generally. Third, allocations of supply operate to restrict the demands of producers, thus reducing pressures on the prices of scarce raw materials. At the consumer level, rationing may be used to restrict demand for particular goods which are in short supply, although it does not reduce total inflationary pressures. Fourth, demand may be prevented from increasing by keeping incomes from rising. This is the way in which price controls and wage controls help restrain demand. A rise in the prices of goods or services which a person sells results in an increase in income available for spending.

Finally, demand may be reduced by promoting net saving, that is, by decreasing the spending of current disposable income and previously saved assets. Strong emphasis will need to be placed on the enlargement of saving, as it will be extremely difficult to prevent the amount of disposable income after taxes, which people would normally want to spend on consumption, from exceeding the available supply of consumer goods. To enlarge saving sufficiently, however, will not be an easy task. Several of the control methods listed above operate to encourage net saving, namely, heavy excise taxes, specific credit controls, and rationing. The central effort to increase saving will undoubtedly be through vigorous patriotic campaigns to buy government bonds. No method for increasing saving should be left unconsidered.

The different kinds of controls—priorities and allocations, price and wage controls, credit controls, and taxation, both general and special—differ in their operation and effects. In general, controls, when wisely used, supplement the price system in achieving the purposes of the defense program in three ways: First, controls can promote production by channeling resources into the most desirable uses; second, controls can promote economic stability by restraining excessive demand; and third, controls can promote equity in the distribution of goods and services.

But while controls are useful in promoting these results in a defense program, they may in some degree interfere with them. The outcome depends on how wisely they are used. Thus, it is clear that if the goals are to be achieved, the controls must be geared to the programming of requirements and supply. This will help to indicate clearly the new pattern of resource use which the defense emergency dictates. The nation will then be able to shape the controls more accurately to fulfill their appropriate tasks.

In particular, controls may interfere with production if they are not

applied with great care. It is important to reconcile the imposition of controls with rapid acceleration of some lines of production and with the maintenance and expansion of total production. Actually, controls should be regarded as the handmaiden of production, because even cut-backs of some kinds of goods are ordered to facilitate the production of more of other kinds of goods which are in greater need.

In the long-drawn-out effort now confronting us, there will be many cases where programs to expedite production and programs to impose restraints complement one another effectively. But there will be other cases—and these will be the hard ones—where to achieve maximum production it is necessary to relax controls at particular points and thereby run the risk of price increases. There is no one rule which will reveal the more desirable of these two alternatives in all cases. Each situation must be handled pragmatically. But it may be safer to run the risk of a minor effect on specific prices than to err on the side of smothering or handicapping our productive genius. In the final analysis, our security depends more on how rapidly we expand our armed strength and productive power than on whether all inflationary forces are rigidly contained over a given period of time.

This report is not the medium for discussing the details and effectiveness of various controls. That effort is held in abeyance until the January reports transmitted to the Congress by the President.

But the foregoing discussion points up to this conclusion now: In the worthy desire to be vigorous, we should look where we are going. And we should not too rapidly sacrifice on the altar of automatic conformity the dynamic qualities which thus far have made our industrial system almost as productive as those of all the rest of the world.

## VII. Taxation in the Defense Program

No discussion of the economics of defense would be complete without some special reference to taxation. The major combination of methods by which resources are redirected by Government consists of expenditures through which the requirements of Government are exerted, and taxes through which other demands for resources are reduced. In peacetime, this combination of expenditures and taxes is ordinarily sufficient to divert resources without resort to other control measures. The fact that in the defense period other measures also are found necessary to redirect resources for the most efficient promotion of defense purposes, does not alter the prime importance of taxation and Government expenditures.

The diversion of resources to the defense program must be made for