

THE SECRETARY OF THE TREASURY

WASHINGTON

November 27, 1942

My dear Mr. Byrnes:

On November 10, in response to your request, I sent you a letter dealing with measures to control inflation through the restriction of consumer spending. I now supplement that letter with some comments on the use of subsidies to stabilize the cost of living and to prevent inflation.

Because of their large possible cost and the dangers of abuse, subsidies have a limited role. However under special circumstances, they can help accomplish three objectives: (a) they can be useful in preventing an undue increase in the cost of living, (b) they can help assure an adequate supply of consumers' goods necessary to health and efficiency, and (c) they can facilitate an equitable distribution of essential goods among all consumers. The proper use of subsidies in special circumstances to attain these objectives would help to prevent the further development of inflationary forces.

A rise in the price of goods or services that are significant in the budgets of the low income groups, such as breadstuffs, dairy products, and essential transportation, may make it impossible for such people to purchase these products in amounts necessary to maintain health and efficiency.

If a rise in the prices of such important goods or services cannot be prevented in any other way, it may be desirable to maintain price stability through a subsidy. In fact, unless the prices of commodities that bulk large in the budgets of the low income groups are kept relatively stable, it will be difficult to avoid compensating increases in wages with their tendency to produce an inflationary spiral.

Subsidies may also be necessary to assure an adequate output of important products needed for civilian consumption, for our armed forces, and for the United Nations. There are already some instances in which the supply of products vital to the health of the nation is in danger of declining because of the greater attractiveness of alternative types of employment or production. We are apparently now faced with this situation for some of our more important food products. Under such circumstances, a subsidy may be necessary to assure the maintenance of the present level of production without an undesirable rise in prices.

The case in favor of subsidies is particularly clear where production of an adequate supply of essential goods requires the utilization of a relatively small additional amount of resources involving higher costs of production. Where such conditions prevail, subsidies can be used to

stimulate production from marginal resources without giving a windfall profit to the bulk of the producers through a uniformly higher price.

Especially in wartime it is of the utmost importance that the low income groups receive adequate supplies of commodities vital for health and efficiency. Wherever subsidies are proposed, careful consideration should be given to the possibilities of rationing. In cases where even rationing will not assure that these groups will be able to purchase an adequate portion of the existing stocks at present market prices, it will be desirable to assure through subsidies that a satisfactory portion of the available supply goes to these groups. There may, however, be instances in which the supply of an essential commodity would be adequate for health and efficiency if its consumption were equitably distributed. The rationing of such a commodity may entirely eliminate the need for a subsidy. Even where a subsidy is needed to maintain or to increase production, the aggregate cost of a subsidy can be minimized through rationing.

There are important limitations to the beneficial use of subsidies even with respect to cost-of-living items:

- (1) The total amount of subsidies granted should be kept small since the granting of subsidies may increase the amount

of consumers' spending power that must be withdrawn through fiscal or other devices. (2) Subsidies are liable to abuse. Pressure groups are likely to secure or maintain subsidies not in the public interest. (3) Subsidies should not be used to remove the barrier to cost inflation which is normally provided by consumer resistance to price rises. Consumer dissatisfaction with rising living costs constitutes a wholesome check on the unnecessary inflation of production costs.

Where subsidies are granted, the selective principle should be followed as far as practicable. Subsidies should be restricted as far as possible to producers who need them to produce the additional output. They should also be limited to commodities required for the maintenance of health and efficiency. Wherever possible, rises in the prices of cost-of-living items should be prevented through economies in production and distribution rather than through subsidies. Any stage of production which has an adequate profit margin should be compelled to absorb increases in costs. Where subsidies are granted, they should be strictly limited to the minimum amounts requisite to attain the desired objectives.

The above comments are not intended to cover the use of subsidies for other purposes, such as increasing the output of war goods. Moreover, they are intended to be only a

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general indication of the Treasury Department's views on the use of subsidies for the purpose of stabilizing the cost of living and preventing inflation. We shall be glad to examine any specific subsidy proposal which you might wish to submit to us.

Sincerely yours,



Acting Secretary of the Treasury.

Mr. James F. Byrnes,
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Stabilization,
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Washington, D. C.