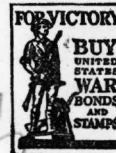


OFFICE OF THE STABILIZATION ADMINISTRATOR
OFFICE OF WAR MOBILIZATION AND RECONVERSION
WASHINGTON, D. C.



*Mr. Evans
returns
Tansam*

January 8, 1946.

TO MEMBERS OF THE ECONOMIC STABILIZATION BOARD:

Attached is the memorandum referred to in Judge Collet's letter to you of January 7 intended to provide background information concerning the problem to be discussed at the Board meeting on Wednesday, January 9, at 11:00 o'clock. The memorandum was prepared by the Staff and Judge Collet has not had an opportunity to review it.

REVIEW OF THE FOOD SUBSIDY REMOVAL PROGRAM

A. Assumptions Underlying the Original Program

1. The program for terminating food subsidies announced on November 9 was formulated after studies carried out by an Interagency Staff Committee during the summer of 1945. It was believed that if the removal were entirely reflected in increased consumer prices its effect on the cost of living would not exceed 3 to 4 percent but the Staff Committee estimated that the subsidies could be removed, under the program they proposed, without raising the cost of living by more than 1.93 percent, even if no offsetting declines occurred in non-subsidized items. It seemed possible - in the light of estimated requirements for agricultural products - to remove the following subsidies with no effect on the cost of living:

Grapefruit juice
Canned & frozen vegetables
Raisins and prunes
Dry edible beans
Cottonseed
Feeder cattle

The subsidies whose removal was expected to affect the cost of living (along with the estimated percentage increase involved) were the following:

Peanut butter	.03
Sugar beets & sugar cane	.10
Sheep and lambs	.05*
Hogs	.35*
Cattle and calves	.50*
Butter	.19
Cheddar cheese	.09
Regional fluid milk	.06
Dairy production payments	.40*
Flour production payments	.16*
	1.93

(For the items marked by an asterisk, only a portion of the removed subsidy is assumed to be passed on to consumers.)

2. The second basic assumption was that items other than subsidized foods, primarily other foods, could be expected to decline in price to an extent at least sufficient to offset the increases just

mentioned. In other words, it was expected that neither the cost of living index as a whole nor the food index would rise as the subsidies were removed.

The movements in the food component of the cost of living index from the July 1945 level that were forecast by OPA and Agriculture members of the Inter-Agency Staff Committee, together with actual changes for October and November, were approximately the following:

(Percentage Change from July 1945)

Forecast with subsidies in effect:

	<u>OPA Estimate</u>	<u>Agriculture Estimate</u>	<u>Actual Change</u>	<u>Effect of Subsidy Removal</u> ^{b/}
<u>1945</u>				
October	- 3.1	} - 2.6	- 1.7	.95
November	-4.0		- 1.2 ^{a/}	.95
December	- 3.7			1.64
<u>1946</u>				
January	- 4.7	} - 5.1		1.89
February	- 5.0			1.89
March	- 5.6			1.89
April	- 5.8	} - 6.0		3.13
May	- 5.9			3.13
June	- 6.2			3.13
July	- 7.4	} - 7.5		4.80
August	- 8.5			4.80
September	-			4.80

^{a/} This figure reflects the removal of subsidies on butter and peanut butter at the end of October, which raised the food index by about 0.5 percent of its July value. If these had remained in effect, the index would have remained unchanged between October and November and the decrease from July to November would have been 1.7 percent.

^{b/} Based on the schedule recommended by the Interagency Staff Committee. This schedule has already been modified to some extent. It called for the removal of the subsidy on hogs by the first of October, which was not done. On the other hand, the butter subsidy was removed at the end of October, although it was scheduled for December 1 by the Staff Committee.

B. Present Outlook and Changes in Assumptions

1. Developments since September.

The Over-all cost of living index declined by 0.1 percent between mid-July and mid-August and by a further 0.3 percent by September. It remained at the September level during October and increased by about 0.2 percent in November.

The food component of the index increased about 0.5 percent between September and November, largely as a result of the termination of subsidies on butter and peanut butter. Increases in citrus fruit prices following the suspension of ceilings on November 19 have not yet affected the index but will be reflected in the December figure.

No important non-food item appears to have declined in November. The prices of textile products have been rising steadily and may rise somewhat further as a result of recent OPA price actions. The wholesale price index increased consistently from mid-September to December 29 with the exception of one week. Some of these increases at wholesale probably have not been fully reflected in the cost of living index to date.

2. The Outlook.

It is very unlikely that the cost of living will show any marked decrease below the autumn levels during this winter, even if existing subsidies remain in effect. After the winter, some decline is possible; but it is improbable that existing inflationary tendencies will reverse themselves quickly enough to fulfill the expectations implicit in the November 9 program. Employment, income payments, and consumer income have all declined less than was anticipated and consumer demand has actually risen. Moreover, a general inflationary psychology has developed in the country, leading to forward buying and speculative holding of stocks. The reduction in clothing prices that was expected under the low-cost clothing pre-ticketing program will probably fail to occur, as a result of recent revisions in MAP regulations. Prices for reconversion products are higher than expected. The Secretary of Agriculture has announced that a further increase of 6 or 7 cents a pound in the price of butter may be required.

At the same time, the views of top staff members of the Department of Agriculture regarding the necessary level of producer returns for some of the commodities now subsidized have been revised upward since November as a result of increased production goals for 1946. Anticipated

recommendations for ceiling price increases for dairy products*, vegetables for processing, and dry edible beans are beyond those contemplated in the original program and would increase the estimated effect of subsidy removal on the total cost of living index to 2.61 percent and on the food index to 6.45 percent, according to both OPA and Department of Agriculture experts. Some additional increases for other commodities may also be proposed.

C. Compatibility of Removing Food Subsidies with Maintaining Cost of Living

It is clear from the above analysis that adherence to the announced subsidy removal schedule may be incompatible with maintaining a stable cost of living. There are no downward pressures now apparent that would serve to offset a 2.61 percent rise in the index resulting from subsidy removals by June 30.

A question may be raised as to whether some other government action might be taken concurrently with subsidy termination that would minimize the resulting increase in cost of living. Apart from reducing ceilings on some other commodities, which is probably impracticable, two possibilities suggest themselves: (a) more rapid release of military stocks might be brought about; and (b) excise taxes might be reduced or repealed. With regard to the first, military purchases appear to have fallen off more rapidly than was expected in September and further releases from military stocks are not likely to have appreciable effect on the cost of living. As for the second, Treasury Department estimates indicate that elimination of the excise taxes under the Revenue Act of 1943 that automatically terminate six months after the close of hostilities would reduce the cost of living index by 0.30 percent from the July level. A further reduction of at least 1.38 percent in the index could be obtained by repealing other existing excise taxes. ^{a/}

^{a/} The main component of the 1.38 percent is the tax on cigarettes (0.80 percent). The 1.38 percent leaves out of account taxes on items that were not priced for the July index because of their unavailability - e.g., automobiles, tires and tubes, refrigerators, and radios. It also omits certain minor items that are not priced separately for inclusion in the index - e.g., handbags, jewelry, and musical instruments - as well as taxes that enter into business costs and therefore might have an indirect effect on the cost of living.

* The price increase necessary for milk had not been decided when the original program was issued. The figure of 1.93 percent cited above as the increase in cost of living resulting from subsidy removal, however, was based on the assumption that milk prices would advance $\frac{1}{2}$ cent a quart. It is now proposed to raise the price of milk an average of 1.3 cents a quart.

D. Some Questions Raised by Probable Inconsistency
of the Two Objectives

If removal of the food subsidies and maintenance of present cost of living levels are inconsistent, as seems highly probable, the general issue arises as to which objective should be permitted to give way to the other, or whether some compromise is best. The following appear to be some of the main questions relevant to this broad policy issue.

1. What would be the effect on wage rates, and thus the indirect effects on prices and the cost of living, of permitting the cost of living to rise as a result of subsidy removal?

2. What would be the direct effects on parity prices for farm products and the consequent indirect effects on prices of permitting cost of living items (which enter into determination of parity prices) to rise as a result of subsidy removal?

3. How would the effort to have price control legislation be affected (a) by permitting the cost of living to rise? (b) By attempting to secure authorization and funds for some continuation of the food subsidy program? (c) By attempting to maintain present cost of living levels without continuing food subsidies if this would involve reducing returns to producers?

4. Under existing law which of the two objectives, if either, overrides the other?

WHOLESALE PRICES SINCE V-J DAY

(1926 = 100)

<u>Average for Week Ending</u>	<u>All Commodities</u>	<u>Farm Products</u>	<u>Foods</u>
August 18	105.5	127.0	106.3
August 25	105.5	126.7	106.6
September 1	105.2	125.1	105.5
September 8	105.0	124.3	105.1
September 15	104.7	123.6	104.6
September 22	104.9	124.5	105.1
September 29	105.0	124.7	104.7
October 6	105.2	125.7	105.3
October 13	105.3	126.3	105.2
October 20	105.5	126.9	105.8
October 27	105.7	127.7	106.0
November 3	105.9	129.1	106.6
November 10	106.1	129.5	107.0
November 17	106.3	130.3	107.2
November 24	106.7	132.1	108.7
December 1	106.8	132.0	108.5
December 8	106.5	130.3	108.1
December 15	106.7	131.3	108.3
December 22	106.8	131.5	108.6
December 29	107.0	132.7	109.5

Source: Bureau of Labor Statistics

CONSUMER PRICE INDEX, BLS

(1935 - 39 = 100)

	<u>All items</u>	<u>Food</u>	<u>Clothing</u>	<u>Rent</u>	<u>Fuel, elec- tricity & Ice</u>	<u>House Furnishings</u>	<u>Miscellaneous</u>
January	127.1	137.3	143.0	*	109.7	143.6	123.1
February	126.9	136.5	143.3	*	110.0	144.0	123.4
March	126.8	135.9	143.7	108.3	110.0	144.5	123.6
April	127.1	136.6	144.0	*	109.8	144.7	123.7
May	128.1	138.8	144.6	*	110.0	145.4	123.9
June	129.0	141.1	145.4	108.3	110.0	145.8	124.0
July	129.4	141.7	145.9	*	111.2	145.6	124.3
August	129.3	140.9	146.2	*	111.4	146.0	124.5
September	128.9	139.4	148.2	108.3	110.7	146.8	124.6
October	128.9	139.3	148.3	*	110.6	146.6	124.5
November	129.2	140.1	148.4	*	110.5	147.1	124.4

Source: Bureau of Labor Statistics