Notes on the Subsidy Program

There are two distinct types of subsidies which have been
used in the stabilization program. The first of these is the differen-
tial subsidy which is paid to a few high-cost producers in a given
industry to obtain the maximum production of an essential product.
Rather than raise the ceiling price of a product for the whole indus-
try so that the high-cost producers can operate profitably, the price
is kept low and a subsisy covering the difference between cost and
selling price plus a reasonable profit is paid to the high-cost pro-
ducers. This type of subsidy has been most frequently used to maintain
a lower level of prices on basic raw materials, and the copper mining
industry is perhaps the best example. Little issue has been taken with
this type of subsidy since the wisdom of such a policy is clearly evi-
dent.

The second type of subsidy is a general subsidy paid to all
producers in a given industry. Because the anti-inflationary effects
of such subsidies are not so apparent as are those of the differential
type, controversy has been more or less confined to this group. General
subsidies have been used for the most part on food products. On
February 11, 1944, Mr. Bowles estimated that the government was spending
$1,250,000,000 on an annual basis to keep food prices from rising above
their present levels.

Direct savings from general subsidies arise in the following
ways:

1. A subsidy may be paid in connection with only a portion
of the sales, while a price increase would apply to the total volume.

2. A subsidy paid at some stage before the retail stage prevents pyramiding on a larger "mark-up" which would result from a price increase, even though the price increase was equal to the subsidy at the earlier stage.

3. Subsidies may be in fractions of cents, but a price increase in the retail stage would have to be in the next largest whole number.

Estimates are available on the amount of direct savings obtained from subsidies. Mr. Bowles estimated that the $1,250,000,000 food subsidy program was resulting in a direct saving from lower retail prices of $378,000,000 over the cost of the subsidies.

Much more important for the stabilization program, however, are the indirect savings from the use of subsidies, both economic and psychological:

1. If, in lieu of subsidies, price increases are allowed, the relationship between prices and wages is broken. The present pressures for higher wages would be intensified so that the wage stabilization program could not be maintained. Higher labor costs would mean that price ceilings would have to be raised, and the inflationary spiral of higher prices - higher wages - higher costs would be in full swing.

2. Higher prices for goods entering into the parity index for farmers would mean higher prices on those commodities now close to parity. This, in turn, means higher food prices for consumers.

3. A price increase in one agricultural commodity might lead to increases in a number of other products. For example, a higher price

for feeds may force raising the ceilings on meat, poultry and dairy products.

It is impossible to estimate with any degree of precision the amount of _indirect savings_ from the use of subsidies because it is impossible to determine the extent of the price rise which they prevent. The magnitude is indicated, however, by Mr. Bowles' estimate that should a price level increase of 10 per cent take place, it would mean a rise in the cost of war materials of over $6 billion and in the cost of consumer goods and services of another $9 billion. In December 1942, Mr. Bowles stated that the discontinuation of food subsidies would result in an immediate rise of 7 per cent in food prices and of 3 per cent in the cost of living. Richard Gilbert has estimated that savings, both direct and indirect, amount to from $4 to $6 for each dollar of subsidy. (Oct. 1943).

Estimates for Labor Force and Output Data, 1939 and 1947

(All dollar figures are in 1943 prices)

	1939	1947	Increase
Labor force	53 million	60 million [1]	7 million
Employment 1939	44 million	---	---
"Full" employment 1947	---	58 million	14 million
Value of average output per worker	$2,500	$2,925 [2]	$425
Gross national product, 1939	110 billions	---	---
"Full" employment gross national product, 1947	---	170 billions	40 billions

If gross national product in 1947 falls to the 1939 level:

Employment will be about: 41 million [3]

Unemployment will be about: 19 million

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[1] This assumes that 4 million withdraw from the wartime labor force and that 2.5 million stay in the armed forces.

[2] This assumes an increase in man hour productivity from 1939 to 1947 of about 1.5 per cent per year. This is a moderate assumption if compared with the average annual increase of 2.5 per cent estimated for the period from 1929 to 1941.

[3] This unemployment figure assumes the same hours per working day as applied in 1939. If hours are shortened in order to "share the work", the number of fully unemployed will be less. The employment and labor force figures do not include seasonal workers who come into the labor force only during the summer months (family workers on farms, students, etc.)

THE SUBSIDY ISSUE

The major point to be emphasized in this subsidy question is that the alternatives are much worse than subsidies. One can agree that subsidies are bad in principle, but in the present situation, the only real choice is between subsidies and price increases.

Nearly all of those opposed to subsidies argue along these lines:

1. Incomes are high, particularly labor incomes, and consumers can afford to pay higher prices. Therefore, why should government pay part of the food bills of workers who are already better off than ever before.

2. Subsidies increase the cost of government and add to the national debt which will be passed on to the returning soldiers to pay.

3. Subsidies give a political advantage to the party administering them and there is real fear that subsidies will be used to buy votes or otherwise to apply political pressure.

These arguments are appealing, but they make sense only if one does not examine the alternative which is higher prices. Higher prices would tend to break down the delicate balance between wages and prices and between some prices and other prices. If this balance is broken for any reason, there is great danger of a spiral developing. The higher prices and wages will lead to still higher consumer incomes which in turn will be used as an argument that consumers can afford still higher prices. Fundamentally subsidies are not a sop to labor but are of primary benefit to those dependent on fixed incomes, including most of the middle class. Organized labor can probably take

care of itself fairly well in a price-wage race, but unorganized workers and the millions of people living on fixed incomes are the ones who suffer.

With the government buying almost half of the national output, higher prices or higher wages means larger government expenditures and a larger debt. This too may be passed on to the soldiers. The debt will be greater however if prices rise than if subsidies are paid--how much greater depending upon whether the spiral can be stopped after one round or continues for several rounds.

The fear that subsidies may be administered in such a way as to buy votes or to apply political pressure is, of course, a real fear. I think the record shows that there is little basis for this fear. Anything that can be said to minimize this fear should be helpful. It might be pointed out that price increases can also be granted selectively as political favors. While the opportunities for political manipulation are greater in the case of subsidies than in the case of price increases, there is room for politics in either case and some faith must be placed in the honesty and fairness of the people in the agencies administering these programs.

K.B.W.