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PREWAR ECONOMIC RELATIONSHIPS  
AND THE TRANSITION TO WAR

11 March 1947 *24751*

CONTENTS

Page

SPEAKER -- Mr. William C. Foster, Under Secretary of Commerce .....	1
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THE INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

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PUBLICATION NUMBER I47-91

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PREWAR ECONOMIC RELATIONSHIPS AND THE TRANSITION TO WAR

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GENERAL MCKINLEY:

Gentlemen, this morning we are particularly fortunate in having with us Mr. William C. Foster, who is the Under Secretary of Commerce.

Mr. Foster in World War II, in addition to acting in numerous advisory capacities of an official nature, held several important operating positions in the War Department. He was Director of the Purchase Division, Army Service Forces; Special Representative of the Under Secretary of War on Procurement, Army Air Forces; Assistant Director of Materiel for the Army Service Forces; and so forth. For his services he was awarded the United States Medal of Merit and the War Department Commendation for exceptional civilian service. The subject of his speech this morning is "Prewar Economic Relationships and the Transition to War."

I take great pleasure indeed in introducing Mr. William C. Foster.

MR. FOSTER:

Thank you very much, General McKinley.

This is in a sense a return to old haunts, although in a new place. I did talk on several occasions, as General McKinley knows, to what used to be called the Army Industrial College. Even so, we did have the pleasure at that time of seeing a number of Navy officers. This morning, just to make it a little different, there is my own appearance, and I brought along to act as aides two Navy men.

I am very glad to come back here. As the General knows, I have had a very keen interest in this job you are all engaged in, and therefore it is a real opportunity for me to come back. I hope I can contribute to you-- I won't say education because I can't contribute much to that--but I can perhaps give you some information which we have in the Department and which might interest you in your capacities here. As I look around, I see a great many familiar faces that were with me in the Army, and I am glad to see them here also.

A review of the economic and political foreign policy of the United States during the period between the two world wars, and a study of the series of steps short of war by which we aided the Allied Nations prior to Pearl Harbor, provides us with a number of lessons of great current significance. The importance of the lessons to be learned grows out of the present world situation.

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It is obvious to anyone whose judgment is not obscured by strong personal prejudices that a great contest is now going on all over the world between the Soviet and Western systems of life. The United States stands as the keystone of the Western system today. Her political power is the direct result of her economic power.

Even during this past war, when the capital equipment of most nations of the world suffered heavy damage, we escaped unscarred, and in fact were able to increase our productivity by almost 60 percent. As a result, we are now not only the most productive nation on earth, but we are the major source of relief supplies and credit for reconstruction.

In addition to our economic preeminence we are the champion of the Free Society. We stand for the maximum degree of individual choice in all the affairs of life.

Our individual political and legal freedoms have their economic counterparts. Our industry and agriculture have developed in a political environment of freedom. Throughout our history, we have held to the principle that government should interfere in the private conduct of business only where the public interest clearly required it. Our businesses, like our individual citizens, have not been subservient to the state.

We believe that many of the blessings we now enjoy, as well as our material well being, have grown out of this free society, and we are determined to preserve it.

However, in a world that shows many disturbing signs of moving toward totalitarianism, the ideals and principles to which we hold may be a little dangerous. In some situations they may turn out to be rather costly.

In the short run, totalitarian states have several characteristics which might be called "advantages." Political decisions are speeded up by the simple process of outlawing the opposition. Individuals do not control the State; they are the servants of it.

Business enterprises exist as adjuncts of the State. They are instruments for the execution of State policy. Instead of individual decisions by private organizations, governmental decisions based on national goals determine the course of economic activity. Resources are allocated by decree. The government determines what and how much shall be produced. Private consumers are obliged to accept whatever supplies happen to be available.

The difference between our system and the other is significant. The technology, the industry, and the manpower of the totalitarian state are continuously under governmental control. They are immediately available in the event of war or even the preparation for war.

Democratic countries are not in the habit of running the intimate details of the lives and the businesses of their citizens. Therefore, in war, the job of mobilizing and coordinating their economies takes precious time. The governments are not used to it, and the people are not used to it.

Totalitarian states thus have an initial military advantage. In the light of our recent experience, this initial advantage can be extremely important, and even decisive. Pearl Harbor crippled our striking power in the Pacific for many months. To a less determined and less richly endowed nation, the attack might have been a fatal blow.

With the advent of atomic power, jet propulsion, and super long range bombers, the advantage to the country which lands the first blow has been multiplied.

The problem we are faced with, then, is clear. We have to maintain our principles, and not fall into the trap of abandoning our free society in the course of trying to preserve it. But we must develop defenses for our free society -- so that our peaceful nature and our tolerance cannot be used against us. Our system is the best in the long run; we know that. The problem is to overcome a possible short run disadvantage. One means of attacking the problem is to analyze the pattern of our past actions, to apply historical data to our current difficulties. I shall review our experience for the last thirty years with this purpose in mind.

Following the first World War, the position of this nation in world affairs was fundamentally altered. This change altered the requirements for our effective national defense.

Until the first war, we could rely with some justification on the broad oceans which flanked our continent to protect us against a sudden attack. But after 1920, rapid technological developments shrank the globe and in effect stripped us of some of our insulation against the rest of the world. Inventions in the field of communications and transportation brought us closer to the continents of Europe and Asia than we had ever been before.

As inventions caused the world to grow smaller, other factors caused it to grow more interdependent, politically and economically. Industrial and commercial developments linked the whole world together more closely than ever.

One result of this was to make wars difficult to isolate and control. A spark set loose anywhere was liable to set off a general conflagration.

Another result of the technological change was to place great military superiority in the hands of the proficient, the scientifically competent, and the richly endowed. Industry, civilian workers, homes, factory buildings, and even farms became an integral part of the potential war machine. They therefore became first line targets for attack. The line of distinction

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between soldiers and civilians became blurred. The line between military and non-military production disappeared.

While these developments in technical fields were taking place, other rather sweeping economic and political changes occurred. The interlude from 1919 to 1939 was marked by many restrictive economic practices. The economies of a number of the major trading nations was severely disrupted by the first World War, and they resorted almost universally to defensive economic practices. A variety of new devices for economic protection appeared. These were in many cases devices for economic aggression. Nationalization, quotas, and special arrangements became common. Whole economies passed under the domination of government.

In the same period, various nations, in order to extricate themselves from real or imagined disadvantages in their situations, launched forth on totalitarian enterprises, which in some instances developed into national programs of military conquest. Individual liberties were more and more infringed upon. Theories of racism and Statism became more prominent. The general debasing of the human personality accompanied the subjugation of private business enterprise by the State.

The United States during this time was having difficulties of its own. The economic instability which had been troublesome in previous periods became first acute and then disastrous in the late 1920's. This had its effect on the international economic policies of the country. Restrictive tariffs were raised, and the country made the effort to shut itself off from the markets of the world.

In the political field, revelations of graft and excessive profits in the first World War, plus a general disillusionment with the fruits which had been won with the victory aroused pacifist and isolationist sentiments. These were reflected in our political dealings with other nations. Because of deep divisions in America on questions of international responsibilities, our policies were at times blundering and at others contradictory.

As the interval between the wars drew to a close, however, two most hopeful programs were developed. In 1934 Congress passed the first Reciprocal Trade Agreements Act. By the time the second World War began, we had concluded reciprocal trade agreements with twenty-eight of the major trading nations. The reciprocal trade agreements had for their purpose the lowering of barriers, both tariff and otherwise, to the movement of trade between the United States and each of the twenty-eight nations with which they had been concluded.

The second promising policy launched by the American Government during this period was the Good Neighbor policy toward South America. This was a deliberate effort to foster the friendship and support of those nations. It was a reversal of our alleged "dollar diplomacy" and imperialism for which we were widely criticized in South America after the turn of the century.

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Both these policies were in mid-course when events in Europe had reached a crisis, and the actual outbreak of war occurred.

Between 1939 and December 7, 1941 the pattern of our foreign trade was increasingly changed. As of 1938, our total foreign trade amounted to about 3 billion dollars, of which nearly two billion was in exports, and slightly over a billion was in imports. When the British imposed their blockade on the Continent with the start of hostilities in 1939, we lost virtually our entire market in central Europe and eventually in Occupied Scandinavia. Our exports to the Allied Nations in Europe were predominantly of arms, munitions and other war goods. Our import pattern was changed to a lesser extent, since we traditionally imported chiefly raw materials, and during this time continued to do so in larger quantities. At the time of the Pearl Harbor attack the volume of our foreign trade had grown to more than four billion dollars a year.

As the war in Europe continued, we progressively abandoned our position of absolute neutrality by a series of economic acts which definitely threw at least a part of our weight in on the side of the Allied Nations.

Our first action was to impose controls over our exports, and to prevent the outflow of goods to those nations with whom we were not in a state of war, but toward whom we had adopted what amounted to a state of belligerency. Under the provisions of the National Defense Act of July 2, 1940, the President was authorized to require licenses for the export of commodities from the continental United States. The system of export licenses continually grew until, at the time of our entry into the war, it embraced all commodities shipped from our ports. The export of a sizeable portion of these commodities was permitted to friendly nations under a "general license"; but exports of most goods to Axis belligerents were virtually eliminated under the provisions of the export-control system.

Our next action was the Destroyer Base deal. The German submarine attack on the supply lines to the United Kingdom during the Spring and Summer of 1940 had taken such a toll that the United States was asked to extend emergency aid. On August 20, 1940, the President announced the transfer of fifty over-age destroyers to the United Kingdom in exchange for 99-year leases on eight naval bases situated in British possessions in Newfoundland and the Atlantic Islands. This horse-trading, anticipatory action not only gave Britain sorely needed assistance in staying in the fight, but it made it possible for us to strengthen greatly our defenses of the approaches to the Panama Canal.

In March of 1941, we went one step further in extending our help on a large scale to the Allied Nations. The Lend-Lease Act, approved March 11, 1941, authorized the President to cause any department of government to procure or to repair defense goods for the benefit of any country whose defense the President deemed vital to the United States, and to make such goods available by lease, loan, or otherwise. Under the provisions of this Act, billions of dollars worth of arms, equipment, food, and other

RESTRICTED

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goods necessary to the war effort had already been supplied or were moving to the Allied Nations, including Russia, at the time of our entry into the war.

Between April and August of 1941, we agreed with Canada to cooperate in the production of war goods for Britain. We froze the assets of German and Italian nations in this country. We closed all German Consulates. We forbade American business firms to do business with a proclaimed list of foreign concerns with Axis connections. Then, in August, the President and the British Prime Minister met on the high seas and announced the Agreement in principle which is now called the Atlantic Charter. Among the decisions announced at this meeting was that for continued economic collaboration between the United States and Britain for the prosecution of the war.

The last move was the modification of the Neutrality Act on November 17, 1941. Shortly after the outbreak of war in Europe, the United States had adopted the Neutrality Act, which forbade the entry of American national or ships into the war zone and prohibited the extension of credit to governments in default on their indebtedness to the United States. This Act, which indicated the strong determination of perhaps a majority of Americans to try to stay out of the war in 1940, had seriously hampered our efforts to help the Allies. The modification of the Act, in November of 1941, permitted the extension of credit to governments engaged in armed conflict, abolished the prohibition against the entry of our vessels into war zones, and permitted the arming of United States merchant vessels. Under the provisions of this revised legislation, the United States inaugurated the practice of convoying merchant ships on the high seas.

To borrow a phrase from Mr. Winston Churchill, this for the United States was "the end of the beginning." Within a month the Japanese had bombed Pearl Harbor and we were formally and completely at war.

From our experience in the interwar period and from our efforts to prepare our defenses this last time, we have learned a few things which it will be useful to remember in the future.

The whole structure of our international political arrangements is directly a part of any realistic program of national defense. These political arrangements can help protect us in two ways. In the first place, they can help prevent wars. At the close of the first World War, the United States was unwilling to join the League of Nations. This time, however, we have not only joined, but have taken leadership in the formation of the United Nations. An effective United Nations is our greatest hope for national defense. For in an atomic age, any war is certain to be a catastrophe for the victors as well as the losers.

In the second place, our political agreements can provide us with allies and support in the event that another war does occur.

RESTRICTED

In the same way, the economic foreign policy of the United States is an essential element in our program of national defense--both as a form of preventive medicine and as a basic means of strengthening our ability to fight back in case of an attack.

It is a truism to say that political stability in the world, and hence military security, can exist only in conjunction with economic stability. And at the present time the world is perhaps as unstable economically as it has ever been.

This recent war destroyed a greater proportion of the productive power of Europe and Asia than any catastrophe in history. The physical damage to plant and facilities is past computing.

The same prospect meets the eye everywhere. Even where there was little devastation, as in the Middle East and India, the war nevertheless gave a spur to the social ferment of backward peoples. As a result, we are now a part of One World in which discontent, civil war, and revolution are the order of the day. People are re-ordering their economic systems, and making new or stronger political alliances.

For the United States, the economic and strategic meaning of these developments is reasonably plain.

Those countries need our goods and our capital for reconstruction and development. If we do not offer it, if we turn our backs on them, it will strengthen the hand of political extremists in those countries. Their hostility will be aroused. Their drift into a competitive political sphere will be made more certain. Tensions and instability in the world will grow greater rather than less. Our friends will become fewer. War will not only become more likely, but our chances of winning it if it does happen will grow less.

Therefore, such instruments as the Export-Import Bank, the World Bank, the International Monetary Fund, and the proposed International Trade Organization are instruments of national defense on the preventive level.

In a more direct sense, these international economic arrangements have a strategic importance for us, also.

In the first place, world markets for our exports will provide us with outlets for our greatly expanded productivity. They will contribute to a high level of business activity in the United States, which will have the effect of improving economic conditions and hence political stability throughout the world. In strict strategic terms, a high level of business activity is essential to the maintenance of a skilled labor force and a vigorous, progressive technology capable of providing the nation with superior strength in war. In these terms, economic depressions mean that we have to fight wars with men whose skills are rusty, and with industrial facilities which are obsolescent. Continuous high levels of business

RESTRICTED

activity mean not only diminished probabilities of war, but also greater fighting strength, greater technological proficiency and industrial capacity, in the event of war.

In the second place, international economic arrangements can ensure the United States of dependable sources of basic raw materials which are essential to our whole economy. At the present time, this is of especial importance to us.

For the past hundred years, the United States has been mining the earth of its continent at an unprecedented rate. As a result, our reserves of minerals and ores are dwindling so fast that we have come to a point where we must ask ourselves how long we can hope to maintain the kind of industrial economy we now have. We are becoming dangerously short of lead and zinc, for example, and there is doubt right now that we have enough copper to fight another major war.

A still more urgent problem, from a military standpoint, is the fact that two of our greatest new technological advances depend upon materials in which this country is deficient. Atomic power uses as its basic requirement either uranium or thorium. The supplies of this country are limited to inadequate deposits of carnotite ore in the Far West. To date we have had to depend on ores from Great Bear Lake in Canada, the Shinkolowbe deposits in the Belgian Congo, and on monazite sand from the beaches of Travancore in India.

The jet engine for aircraft requires new alloy steels capable of resisting the terrific internal heats which the jet generates. Although we have plenty of one of the main alloying ores, molybdenum, we are completely lacking in the other, cobalt. Indeed, we are badly short of many of the most essential ferro-alloying and specialized minerals--chromite, antimony, manganese, nickel, tungsten, and vanadium.

It is absolutely vital for our national defense that we have access to supplies of these materials. Therefore, international political and economic arrangements which will make it possible to acquire them from other countries are an integral part of our security system.

All this adds up to the fact that we cannot afford to resort to isolationist practices, either in the economic or political sphere, if we assess our defense needs realistically.

In addition to these lessons about our international relationships which we have learned from our experience in the last thirty years, we have also learned a few things that pertain primarily to our internal economy.

Internally, national security reduces itself to a double edged problem. We have to develop devices which will enable us to retain our essential freedoms for the the individual and for enterprise, and which at the same time will enable us to overcome the initial handicaps which

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our democratic system imposes in the event of an attack. I should like to suggest what I think are some of the more promising of these devices.

Perhaps as never before, the past war has taught us how completely interdependent and specialized our economy is. A breakdown in any part, in the coal mines, in the supply of rubber, in the supply of skilled welders, and the whole machine is affected. The complex system is kept in smooth operation only so long as our transportation and communications systems function perfectly.

The essentiality of transportation and communications is such that they must be adequate at all times to accommodate the severe demands of a national emergency. Our present network of railroads, highways, telephone and telegraph lines, pipelines, inland waterways, coastal and Great Lakes shipping, radio broadcasting facilities, and airlines is the finest in the world. A first requirement of national security is that they must never become obsolescent or inadequate.

I have already mentioned the developing shortages in our raw materials as a factor which places the greatest strategic importance on the character of our international relations. There are, however, some steps which we ourselves can take to minimize our risks on this score. We can put into operation more effective conservation measures to maintain our reserves of natural resources for military purposes. We can draw more extensively on the resources of other nations to meet our needs. By importing a larger part of our raw material needs from others, we will help them and at the same time help ourselves. A program of stockpiling of essential raw materials is necessary to our national defense. It is my opinion that we have tended to think in much too narrow terms in our stockpiling programs to date. The needs of war are so immense, that half-way or inadequate efforts to meet contingencies may prove to be totally inadequate for our own protection.

Industrial strength is the basis of modern military strength. But plant capacity and material resources are only a part of what makes for industrial strength. The vitalizing factors are efficiency and new invention.

Our greatest resource in this connection, I believe, is our free society and our private enterprise system, which by the continuous process of the exercise of individual initiative will affect economies, develop more efficient procedures and processes and achieve a better utilization of resources. In a healthy competitive situation, continuing research for the development of new and better products and processes will be carried on.

However, there are undoubtedly many lines of research in which government assistance is necessary and where, for national security, it will be sensible for us to invest government money. The Manhattan District Project is of course, the outstanding example in which private interest and private funds would have been insufficient to achieve the success which was won except in a much longer period of time. By the encouragement of new invention and research through the intelligent and selective expenditure of government funds, we can maintain our technological superiority and thus strengthen our national defense.

It is not reasonable to expect private companies which are geared to service a peacetime market to maintain sufficient standby facilities in certain lines to accommodate the needs of the nation in a war emergency. We have, in times past, of course protected industries through our tariff system. These might have been unable to compete freely but were essential for national defense. It is also true that government funds have financed many new developments in the aircraft industry, and provided the capital for new plants during the war which were necessary for the production of armaments and war equipment. I believe we should give thought to the areas of our industry which are likely to be underdeveloped in normal peacetime operation, and to provide the means for the maintenance of standby facilities which would be needed in the eventuality of war.

It is generally agreed that enterprise in the United States should not be subject in time of peace to overriding control by the government. For defense purposes, this can mean that precious time must be lost in switching our industrial and agricultural plant over from uncontrolled, undirected production to a situation in which national goals and national needs determine the pattern of production. The first requirement to minimize this danger, I believe, is that we must conceive of the close cooperative relationship between industry and the government not as something to be cultivated only after an emergency develops, but as something to be maintained continuously—not in the form of compulsory control but in the form of cooperative interchange of information about plans and needs. I believe that the relationship which now exists between the Department of Commerce and the various business advisory groups with which it maintains contact can serve as a model for other government agencies. The industrial advisory groups with which the armed forces now deal are a similar and equally promising line of attack.

In summary, then, if we are to preserve and defend our democracy we must follow policies of internationalism, not isolationism, in our foreign economic and political dealings. Here at home we must keep our economy strong and progressing and the relationship between government and industry active. These are the lessons of our experience in the last thirty years. They must not be forgotten.

(17 March 1947--350)E