

AMERICAN ECONOMIC SYSTEM TODAY

1 September 1950

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

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COLONEL BARNES: Today's lecture had to be placed slightly out of sequence, ahead of the spot where it really belongs from a continuity standpoint. It should be considered as the lead-off lecture in your short course in economics which starts a week from Monday.

You will have noted that the scope set forth in your curriculum book for this lecture defines it as an explanation of relationships; relationships which make our American economy "the most powerful and productive tool for peace or for war ever created." Note the use of the word "tool."

It is how we make use of this tool that is important; how we use our dominant and productive position; how we use our tremendous economic resources; how we employ our political system. International relationships today are extremely sensitive to American action. The way we make use of this tool will determine its influence toward peace or war, or its bearing on our relative strength vis-a-vis other nations in peace or war.

Dr. Rolfe Allen of our college staff has prepared a thought-provoking analysis of this subject. I am sure when he has finished his talk you will understand why he was selected for this assignment. It is with great pleasure that I introduce Dr. Allen.

DR. ALLEN: General Holman, gentlemen: The American economy is as many things as the number of people attempting to explain it. To the political scientist it is the expression of working relations among a democratic people under law. To the statistician it is a series of tables, a thing in black and white, a pattern of figures and graphic lines. To the academic economist it is the proof or disproof of theorems and rules which have been developed by classical economists. To the politician it is a division of votes, of pressure groups, of those whose interests must be served or opposed. To the sociologist it is a complex of tensions, of successes and failures, an instrument capable of infinite human good or of infinite human destruction and waste. And, unfortunately all too often, to the military man as to the average citizen, the economy is a strange, incomprehensible machine which somehow, by some mysterious alchemy, produces or fails to produce the goods that are needed and the money that makes those goods available.

It seems entirely clear that the American economy, together with our armed forces, must guarantee the survival of this Nation. However, the economy will be of value only to the extent that it is intelligently used, and it will continue to serve only so long as it remains in a healthy condition. It is therefore the duty of those charged with the

defense of the United States to understand the economic tool that is placed at their disposal, its nature, its characteristics, its uses, and, perhaps most important of all, its limitations.

Should world war again come, the graduates of the Industrial College of the Armed Forces will have a major responsibility in determining whether the American economy will be used intelligently and effectively, or whether our strongest weapon will be destroyed through inexpert handling.

Just what, then, is the American economy of today?

We like to refer to our economy as "the American free-enterprise system." This is a nice, mouth-filling phrase. However, just what does it mean? Voltaire's famous saying to the effect that the Holy Roman Empire was neither holy, Roman, nor an empire, might be paraphrased to apply to the American economy, to read that it is neither "American," "free enterprise," nor a "system." While this is perhaps an extreme view, there is considerable basis for its utterance.

Actually, the economic practices typical of modern America had their origins in England and the nations of western Europe during the period of the Industrial Revolution, and this economy was, prior to World War I, typical of most of the advanced nations of the Western World.

In any literal sense, the phrase "free enterprise" is hardly applicable to the American economy. From the days of the Founding Fathers, the Federal and State Governments of the United States have, to at least some extent, regulated economic enterprise in this country. At the present time many conservative economists would state bluntly that free enterprise no longer exists in our Nation.

The final word of the phrase, "system," would imply an orderliness, an element of planning, a continuity of development which hardly relates to the American economy. As a matter of fact, it is probably a useless academic exercise to concern ourselves over the validity of the phrase "American free-enterprise system." What is much more important is to have an understanding of how our economy came into being, what factors conditioned its development and growth, and what are the essential characteristics which have emerged to make it outstanding among the economies of the community of nations.

The economy of the United States had its origin in the British Colonies of North America. As you know, these colonies depended almost entirely upon agriculture, supported by a moderate volume of ocean commerce and a very small amount of domestic industry. At the time of the Revolutionary War, over 90 percent of gainfully employed Americans were engaged in agriculture. Of these, the great majority were small freeholders, operating at virtually the subsistence level. Most of their

agricultural products were consumed on the producing farms or in nearby towns. Some, however, formed a surplus which entered foreign trade and brought specie to the colonies.

These agricultural beginnings have left an indelible stamp upon American economic, political, and social thinking. Since land was the basis of the agricultural economy, property was highly regarded by the leaders of early America, and our legal institutions reflect this fact. The traditional personal independence of farmers expressed itself in strong emphasis on the freedom of the individual as a primary concept of our political order.

As the United States developed and grew more populous, manufacturing industry appeared on the eastern seaboard and gradually increased in importance. The rate of this increase was slow down to the War Between the States, but the military needs of that period led to a tremendous growth in industry, particularly in the Northern States. The individualistic tradition of the agricultural economy remained as a part of our legal background and, consequently, the Governments, both Federal and State, were slow to act in economic matters.

However, the entrepreneurs of the new industries, seeing the opportunities available should American markets be closed to foreign competition, were able to persuade the Federal Government to provide tariff protection to virtually all products manufactured in the United States. It was only natural that other major economic groups in America sought and received government assistance. Thus, the farmers, under various state land laws, and under the Federal Homestead Act of 1863, were able to secure land at low prices or at no cost at all. The railroads, which tied the Nation together, were heavily subsidized by both Federal and State Governments. The first intercity telegraph line was constructed under a Federal appropriation. State funds were granted for the construction of canals and for the subsidization of such ventures as steamboats and cotton mills.

The years between the Civil War and World War I saw the United States steadily developing into the leading industrial nation of the world. As this trend continued the proportionate number of persons employed in agriculture dropped steadily, while those employed in industry increased rapidly. Having a virtual monopoly of the vast American market, industry was in a unique position to profit. The demands of the growing country were virtually inexhaustible, and in an effort to meet these demands industry developed the processes of mass production which have become the symbol of the American economy. Actually, mass production was first devised in Europe, but in the United States the process was carried to successively greater heights.

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However, in spite of its ability to earn profits and to supply the Nation with great volumes of relatively low cost goods, mass production techniques brought new problems to America. The great cost of the specialized machines and huge plants necessary to carry on the mass production process led to a tendency for industrial units to increase steadily in size. Thus the business of the Nation tended to become concentrated in the hands of a relatively small number of entrepreneurs.

At the same time, these large-scale industrial enterprises demanded huge labor forces. Since virtually all manufacturing processes are cyclical in nature, interrupted employment for industrial workers became characteristic of the newly developing economy. This seasonal unemployment led to fluctuations in the national economic cycle which became progressively more severe as time passed. Labor, finding itself subjected to periods of economic loss and to continuing uncertainty as to its economic future, began to follow the pattern set by European workers and organized trade-unions for its own protection. These trade-unions became increasingly powerful and played a progressively larger part in the economic life of America.

The United States Government found itself gradually participating more and more in the economic life of the Nation. However, America lagged far behind the western European nations in this field.

We are all familiar--all too familiar--with the great depression of the thirties. The steps taken by the "New Deal" Administration in attempting to solve the economic problems of that era are fresh in our minds. Thus, it is sufficient to say that the New Deal introduced a new concept of the role of the Government in relation to the national economy. Prior to the thirties, most Americans had believed that the Government should interfere as little as possible in the workings of the national market and financial community. It was felt that the economic system could best regulate itself, and that the duty of the Government should be confined to acting as a sort of policeman to prevent unfair activities by any individual or group competing in the market. Protection to the public was to be limited to the prevention of fraud, of dangerous practices, of unfair competition, and the elimination of monopoly.

Shortly after the Civil War, Americans had become convinced that monopoly was a danger to the Nation. Accordingly, beginning in 1890 with the Sherman Act, a series of statutes outlawed monopolies. However, this antimonopoly action of the Government represented virtually its only activity in the field of corporate regulation.

The New Deal brought a complete change to this situation. Under this philosophy it was held that the Government had the duty of maintaining the national economy at a high and satisfactory level, and, in

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the event of a depression, should use its authority and credit to maintain or restore that level. Accordingly, the Federal Government instituted an extensive series of measures designed to bring economic stability and prosperity to the United States.

It is not our purpose this morning to argue the merits or demerits of this philosophy of government. The fact remains that the United States appears to be quite firmly committed to the belief that the Government must use its powers to secure the economic as well as the political and social welfare of the citizens.

Thus, by an evolutionary process, there has developed the economy of the United States as we know it today. It will be well to examine its outstanding characteristics.

First and perhaps the most visible characteristic of the American economy is that of size. The Nation is big; industry is big; labor is big; agriculture is big; the Government is big. This matter of size is most significant in appraising our economy. The vast area and population of America made possible its mass production industries. In turn, the ability of these industries to produce great volumes of low-cost goods has led to a high economic level, a unique level of consumer income, and has, in turn, created a market which is unequalled.

The size of the individual industrial unit has permitted the maximum exploitation of the principles of mass production, employing complicated automatic machine tools, and reducing the requirement for skilled labor to a minimum. The size of the labor forces of these industrial establishments has made possible the creation of very strong union organizations, increasing the bargaining power of the workers enormously. The increasing size and mechanization of farm units has greatly reduced the manpower requirements of American agriculture and has made it possible for a progressively smaller percentage of the gainfully employed to feed the Nation. This in turn has released manpower for industry, accelerating the development of the manufacturing phase of our economy.

In the period since World War I a further development in the economic character of America has taken place. For many years the shift of workers from agriculture to the manufacturing industries was typical of our economy. Recently, however, there has been an increasing trend for workers to leave both agriculture and manufacturing to enter the service industries, such as government (including the armed forces), the professions, entertainment, etc. This is most significant since this change is characteristic of the most highly developed economies known today. Many scholars consider this trend to be an evidence of a maturing economy. By the outbreak of World War II, persons employed in the service industries represented the largest single group of wage earners in the United States. Since World War II this trend appears to be continuing at an accelerating rate.

Another significant characteristic of the American economy of today is the rigidity of the market. The free-enterprise system is supposed to be based upon the give and take of the market; that is, if a good in the economic sense is desired, purchasers will bid up the price. This demand will lead to increased production of the good, and then, when this production passes the point beyond which prospective purchasers are satisfied or lose interest, the decreasing demand that follows will force down the price. Conversely, if the price of a good is so great that purchasers are unwilling to buy it, the inability to sell the product will lead to a reduction in its price and a restoring of economic equilibrium.

However, in the United States of today, the presence of a relatively limited number of large-scale producers in many categories of industry, the enormous economic strength of leading corporate enterprises, the reduction in the number of competing lines of merchandise, and the trend toward standardization of items all tend to make the market less responsive to the whims of the purchasers or the necessities of the sellers. Many economists hold that the present American market is less susceptible to the working of the supply and demand factors than any free market known to history. These men feel that we can no longer rely upon the market place as an economic stabilizer for the Nation.

The subject of monopoly has been mentioned before. While the present body of statutes makes it possible for the Government to inhibit the classical type of monopoly in which a single enterprise or a small combination controls the entire supply of an economic good, it is an observable fact that today effective monopoly, with a majority of its detrimental economic effects, can exist where a product or service is dominated not by one, but by a relatively limited number of major producers. It is not necessary that an actual combination be formed to achieve virtual restraint of trade. This condition of monopoly, approaching the European concept of the cartel, is far more difficult to control by legal means than the older monopoly.

Another significant characteristic of the American economy of the last few years is the relative decline in importance of the entrepreneur--the owner--and the corresponding rise of management. There is no agreement among economists on this phenomenon, but the fact is noted as being closely connected with the changing fiscal structure of American business, particularly the tendency toward retrenchment in the application of risk-seeking or venture capital for the creation of new economic enterprise. This is, in itself, a most important development.

Traditionally, the economic enterprises of the United States have been primarily financed by venture capital, that is, the money contributed by individuals from their personal surpluses and their savings. At the present time, the combination of high taxes, low interest rates, fears for the future, and a variety of other causes, have led to a very

significant decline in the relative volume of venture capital offered for investment in business enterprise. Under the classic theories of economics, this decline in venture capital should lead to a sharp recession in business activity. However, this has not been the case. This situation results, to a considerable extent, from the increasing incidence of corporate self-financing. The subject deserves brief consideration.

In recent years, many American corporations have tended to depend more and more upon the ability of management to use corporate funds available after payment of taxes and before payment of dividends for the expenditures in the fields of plant, inventory, equipment, material supply, and other requirements which would normally be met through the obtaining of venture capital from the stockholders of the corporation or from outside sources. The effect of this action is to strengthen greatly the power of management in the operation of industry, to reduce the area in which venture capital may be risked, and, as a serious corollary, also to reduce the area for the successful investment of funds held by fiduciary and other credit-type corporations, such as insurance companies, banks, and credit houses. Many economists are alarmed at this trend, since banking and other fiscal institutions are being progressively forced into new fields of financing which, to these economists, appear to be less desirable than the traditional areas of corporate finance.

In a way, the question of corporate self-financing would appear to give the corporate personages, created by law, an individual existence, divorced from those who created them. Perhaps, like Mary Shelley's Frankenstein monster, our corporate beings are taking on, economically speaking at least, a life of their own. At least some economists accept this theory and consider the trend a threat to the national economy.

One of the most important characteristics of the American economy today is the great and apparently growing power of organized labor. For many years the trade-union movement of the United States developed slowly; but in the years since the depression of the thirties, the major labor organizations of the Nation have made tremendous strides. Some political scientists and economists hold that organized labor is today the most powerful single factor in American economic and political life.

A distinctive phenomenon of the American labor movement is that, up to the present time, it has virtually abstained from direct political action. Of course, we all know that labor groups have worked to secure the election of certain candidates and the defeat of other candidates. However, labor has devoted its political strength to the support of the established parties on the basis of their assumed friendliness toward its interests. Throughout the rest of the world, labor has organized itself into political parties which, in many countries, are able to control the government.

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Last, and perhaps the most important of all the characteristics of the American economy today, is the rise to a dominant position of the public interest as represented by the Government.

While the United States remains the nation of the world most devoted to the principles of free enterprise, it is clear that the powers of government will be used today and in the future to meet economic as well as social or other hazards. Party differences in this field relate primarily to the measures by which the goals of economic stability and the highest possible standard of living may be obtained, not to the goals themselves.

Under this concept, the Federal Government participates in the national economy in a number of ways. The most direct participation takes the form of outright economic activity by the Government. Such enterprises as the great hydroelectric developments represent government entrance into competition with private industry--for better or worse.

The Government also participates directly in the national economy through its financial assistance to entrepreneurs. Literally a score of Federal agencies utilize Federal as well as federally insured private credit for the support of a tremendous variety of industrial and commercial enterprises. In addition, the Government also supports such individual activities as home ownership.

A major area of government impact upon the economy of the Nation lies in the field of control. Although this was the first activity of government in relation to economic enterprise, its recent growth has been most spectacular and its effects most far-reaching. It is in this area of control that the change of America from a pattern almost approximating a free-enterprise economy to one of a controlled economy approaching those of the nations of western Europe is most evident. It can be fairly stated that today there is virtually no field of economic enterprise in which operation without reference to the power of government is possible.

Industry is controlled by a wide series of enactments covering the fields from monopoly through the quality of products, to the regulation of hours and wages in the public interest. Under the Taft-Hartley Act, Federal control has been extended into the field of organized labor in a manner unknown prior to this legislation. Farm price supports, acreage regulation, and the purchase of surplus farm commodities have long been a part of the American economic scene.

An outstanding example of direct government control of what would normally be considered a field open to individual enterprise is to be found in the wide and explicit authority provided in the field of atomic energy and its utilization. Although this new economic area has been

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subjected to almost total government control, there has been virtually no popular criticism of this action. As a matter of fact, those Americans most conservative in their political views have often tended to denounce existing controls as too weak, and to demand even more stringent government regulation in this field.

The Federal Government has, in recent years, been most active in the field of management-labor relations. In carrying out its duty to support the economy, and to provide necessary goods and services, the Government has intervened in management-labor relations to the point where, in extreme situations in essential industries, the power of injunction is used to compel the maintenance of production or operations.

Finally and most significant of the economic activities of the Government are those calculated to advance the social and economic welfare of the people through direct action.

Beginning with the Social Security Act of 1935, the Federal Government has established a broad system of unemployment insurance, old age retirement, and survivors' insurance benefits.

At the present time, many leaders in the Federal Government believe that its power should be used to afford to all Americans acceptable standards of education and medical and dental protection. These matters are, of course, subject to controversy and, although bills have been introduced in the present Congress to provide Federal aid to education in the States and a Federal medical service plan, it is doubtful that there will be action in this field--particularly in view of the world situation now prevailing.

This last phrase--the reference to the current war--is particularly significant since it points up what is unquestionably the most important factor relating to the economy of the United States today, that is, the inescapable fact that our economy is an economy of conflict--conflict forced upon us through the Communist attempt to achieve world domination.

Our consideration of the American economy must, therefore, deal with this condition, since any other approach would be not only unrealistic but would fail to explain many of the most significant economic pressures which condition American life today.

It has been said by many leaders of the Western World that the struggle between communism and democracy is a struggle for the minds of men; for the allegiances of men. This is undoubtedly a true statement--but it is only a partial truth. The mind of a man is not an effective mechanism for intelligent thought when that man's stomach is empty. When a man's family is starving and dispossessed, his allegiance is far more apt to turn to the system which offers at least the promise of economic betterment than to any other system, no matter how well supported it may be by the arguments of political science and law, which does not promise immediate economic aid.

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For many years, as the Communist movement spread and increased its strength, the friends of democracy attempted to answer its propaganda with learned but often rather academic discussions on the rights of man, the privileges of the individual, and the ultimate blessings of the free-enterprise system.

The period since the conclusion of World War II has brought grim disillusionment to those who believed that the contest between democracy and communism would proceed in the atmosphere of a parliament in which the opposing theories would be presented as logical expressions of political, social, and economic thinking.

From the very beginning, the Communists missed no opportunity. No lie has been too great, no method too cynical, no attack too brutal, as long as it served the ends of world communism.

Gradually, it became clear that the struggle with communism, where it was not a military struggle, was essentially a contest between economies. The peoples of a war-torn world were ready to listen to arguments that appealed to their own immediate physical welfare. They were inclined to reject arguments based on political theory, high ideals, and abstract right.

When this lesson was thoroughly learned by the western powers, the tide began to change. The first effective use of the economic power of America in offsetting the attacks of communism is to be found in the Marshall Plan. Under this program the United States has established a system of economic aid which has brought one country after another back from the brink of Communist insurrection into stable government and orderly economic life.

In some cases, however, the need was too urgent to be met simply by economic assistance. This was particularly true in the case of Greece and Turkey, where internal revolution or external pressure made necessary extraordinary measures of support. Under the Truman doctrine, the United States provided funds and materiel by means of which both Greece and Turkey were able to provide themselves with the nucleus of an effective national defense and deny two pivotal areas to world communism.

Since many of the nations of the world were in too backward a condition to be benefited by economic assistance of the type promised by the Marshall Plan, it was necessary that the United States initiate a program specially suited to their needs. The Point Four Program, established by President Truman, under which the United States proposes to render economic and technical assistance to such nations, appears to offer very real promise for the future in turning these vulnerable areas away from the Communist ideology.

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Thus, through the operation of the Marshall Plan, the Truman doctrine, and the Point Four Program, the United States has done much to raise an economic barrier to communism.

Unfortunately, the very success of the American economic counter-offensive against communism has driven its masters to new extremes. By 1948 it was clear that the Communist movement, checked by the economic strength of America, might turn to armed attack to achieve its ends. Realizing that the only effective offset to the massed strength of the Communist forces lay in union for defense, the nations of western Europe, together with the United States, formed the North Atlantic Alliance. This agreement provided the framework of military strength for the forces of democracy, as the Marshall Plan, the Truman doctrine, and the Point Four Program had provided economic strength. While the North Atlantic Alliance is military in character, its implementation to a very large extent depends upon the economic strength of the United States. Thus, once again the economy of America checked the advance of communism.

In June of this year, the Communist leaders, halted by the American economic assistance programs and the North Atlantic military agreement, turned to open military aggression. As was to be expected, this action took place through a satellite. The North Korean aggression upon the Korean Republic is of double significance. In one sense this assault is encouraging to the friends of democracy, in that the Communists have been obliged to resort to armed force where their normal methods of intrigue, subversion and propaganda have failed. On the other hand, the Communists' use of open force, in the face of American military resistance, has brought the world to its greatest crisis since the conclusion of World War II.

In Korea, as in every other area where communism has struck against democracy, there is an economic lesson for those who will read it. The initial weakness of the armed forces of the Korean Republic rose not from lack of courage, lack of patriotism, or lack of training. It resulted almost entirely from the lack of adequate equipment, the lack of the planes, the tanks, the guns with which to meet their Communist attackers. The retreats of the South Korean and American forces have underlined once again the necessity that democracy be prepared to defend itself at any time and at any place where it is threatened. The economy of war, the material, the flow of supplies, today, as never before, determine the outcome of action in the field.

Should a general war again be forced upon the United States, the American economy will experience the greatest strain ever placed upon the economy of any nation. Under these circumstances it will be necessary for the American productive machine to supply not only our armed forces and our civilians, but also our allies and associated powers to a degree undreamed of even in World War II. The cost of military

materiel, which mounts in geometric progression today, means that the measures which proved adequate in World War II may very well not prove adequate in the future.

In the event of war, not only must the American economy stand the shock of conflict, but perhaps even more important to the ultimate survival of the democratic world, it must be able to meet the problems of reconstructing itself and the economies of virtually the entire community of nations throughout the world after we have gained victory. Two world wars have made the American people well aware of the terrors and destructiveness of war--the Flaming Horsemen of the Apocalyptic vision. We should be equally aware of the perils that lie in the economic ruin and dislocation which follow war. It would perhaps be the final and greatest tragedy of our times if the Pale Horseman of Want and Destitution should succeed in communizing the world after the Fiery Horseman of War has been defeated.

One final possibility remains in the struggle between democracy and communism. Many thinking Americans believe that the struggle may never assume the proportions of a world war. Rather, the forces of communism may content themselves with a series of outbreaks in sensitive areas throughout the world, hoping thus to wear down and weaken the United States to the point where it will fall victim of its own economic and military commitments. It is a basic tenet of Leninist communism that the capitalist world--particularly the United States--will collapse as the result of a great economic depression ending in disorder, revolution, and the triumph of the dictatorship of the proletariat. The true doctrinaire Communist tends to reject war as an instrument of policy unless necessary, since he is convinced that the economic collapse of capitalist America is correctly foretold in his dogma.

Up to this time our discussion has devoted itself to two general areas. First, we have summarized the most significant characteristics of the American economy as it is today, looking in turn at the chief factors within the economy, and the groups comprising our economic community. Second, we have considered the impact of Communist aggression upon America in immediate reference to our economic commitments and liabilities.

Properly approached, there is no more fascinating subject than the economy of the United States. However, our economy, interesting as it may be, is significant to us here at the Industrial College primarily as it relates to the ability of this Nation to conduct a prompt and efficient economic mobilization, and to support the military operations of the United States. Thus, the end purpose of this discussion will be to set up a sort of balance sheet listing the good and the bad characteristics of our economy as they relate to economic mobilization--and the mission of the college.

Let us consider the credit side of the ledger.

First, it is clear that the United States possesses the largest and most efficient productive system in the world today. As a matter of fact, our country has the economic ability to produce goods at a rate virtually equal to the other nations of the world combined.

Second, the American working force represents the most effective combination of numbers, levels of skills, and individual and group efficiency in the world. The American workman is unbeatable in intelligence, capacity for hard work, and ingenuity. Americans are used to working under pressure; they accept changes in occupation more readily than most other workers; and their long experience with the mechanisms of mass production enable them to turn quickly to the most complicated manufacturing processes.

Third, in the matter of materials, the United States is fortunate in possessing resources at least equal to those possessed by any other nation. In addition, vast supplies of essential industrial raw materials are readily obtainable from neighboring and friendly countries. Our large and well-developed transportation system makes possible the effective utilization of these resources and guards against interruptions in production.

Fourth, American achievements in industrial, agricultural, and distributive technology are outstanding in the world. No nation has equaled the ability of the United States to maximize its production and, at the same time, to minimize its human effort.

Fifth, the scientific accomplishments of the United States, after years of lagging behind those of western Europe, have risen steadily in the last generation so that today we are able to match the achievements of any other nation.

Sixth, in the matter of food supply, America is uniquely fortunate in that American agriculture has shown the capacity to meet the requirements of even extreme emergencies without any serious change in the food levels of this country.

Seventh, the wealth--the financial strength--of the United States enables its government and people to look confidently forward to the successful accomplishment of any remotely reasonable economic goal.

Finally, our productive capacity, our wealth, and our sincere desire to support those nations dedicated to the democratic way of life have drawn to us a group of allies which is daily proving its great value in combatting communism and which, in the event of another world war, might be the difference between victory and defeat.

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All of this is a most impressive and pleasing picture. However, there is no real reason for complacency. The other side of the balance sheet--the debit side--also contains a formidable list of entries.

First, the American mass production system is admittedly efficient, but it is also rigid and not easily adapted to other than its normal pattern. American industry obtains volume and low cost at the expense of variety of goods, adaptability, and, in some instances, quality. Industrial conversion to military needs is a slow and costly process in the United States--costly in time, manpower, managerial and technical skills, and materials. World War II experience proved that many of the vast industrial facilities which had been considered to be invaluable resources in the event of war actually offered little more than enclosed and heated space when the conversion was attempted.

Second, the economy of the United States, based on the traditions of free enterprise, lacks the singleness of purpose that may be achieved in an economy under authoritarian control. The fact that America produces four times as much steel as a potential enemy is of little significance unless part of that vast output is devoted to the production of materiel. It is a well-known fact that the Communist powers have, in recent years, far surpassed the United States in the production of many of the most important military items, and as a result we find ourselves seriously overmatched in many fields.

Third, the American economy is extremely complex. The concentration of our industry, the extent to which the production of vital items is concentrated in one or a limited number of plants, the reliance of one industrial unit upon others for essential components, the tendency to break down industrial operations into highly specialized centers of production all make America particularly vulnerable to enemy attack. In many industries damage to a single plant would seriously interrupt the production of the entire industry. Less highly organized economies generally tend to combine virtually all operations in the production of a single item in integrated plants, thus making their output far less vulnerable.

The fourth entry on the debit side is the basic economic problem of cyclical variations in the economic level. In spite of its wealth and economic strength, the United States has been subject to extreme variations in levels of consumer income and demand.

In this discussion we have emphasized the essential importance of the economic strength of America in maintaining a free world against the attacks of communism. There can be little doubt that an economic collapse in the United States, similar to that of the depression of the thirties, would provide, to the enemies of democracy, a long-hoped-for chance for victory. Today, as never before, the democratic world

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rests its opportunity for survival upon the economic strength of this Nation. Failure of our economy would destroy our allies as surely as ourselves, and would convince the economically underprivileged peoples of the world that only communism offers a solution of their problems. In thinking and planning in the field of economic mobilization the fact must always be borne in mind that any action which seriously weakens the economy of the United States will be as much of a defeat for our country as a military failure in the field.

A year ago I discussed this topic, and I should like to quote a statement I made at that time. "A factor besetting our political and economic status is to be found in the difficulties attendant upon the defensive position. All over the world communism is maintaining a continuing offensive. Gains in some areas are offset by losses in others, but the pressure is never relaxed. On the other hand, the United States and those nations associated with it are cast in the position of defenders of the status quo--a status quo which to many peoples is not particularly acceptable." I do not believe that the events of the past year have done anything to change that statement.

Many experts believe that the present plan of world communism is to so harass the United States by peripheral assaults, such as that now taking place in Korea, that we will gradually lose the ability to defend ourselves. The position of America, as leader of world democracy, is a difficult one. Since we cannot engage in aggressive warfare, we must wait, ever on the defensive, and attempt to checkmate the moves of the Communists as they occur. Our victories are not particularly evident in world thinking since they simply affirm the existence of a situation already in being. On the other hand, the victories of the Communists, since they represent a change in the status of the world community, attract great attention. Every setback received by the United States increases the psychological disadvantage of our defensive position, and weakens the prestige of this country in the minds of peoples all over the world.

There appears to be one point arising out of the present war in Korea, and the possible projection of similar actions into other troubled areas of the world, which has, so far as I know, received little comment.

It has long been an article of faith with most Americans, including most American military men, that the chief reliance of potential aggressors is the military unpreparedness of the United States. There can be no question that military preparedness is absolutely essential to the continued survival of this Nation. However, as students of economic mobilization, it is your duty to consider the circumstances of today as they are, not in the light of preconceptions or beliefs, but objectively.

The fact today is that world communism has, for nearly five years, continually emphasized its hostility toward, its hatred of, and its ultimate determination to destroy the United States. No effort has been made to conceal this hatred and this ambition. Subversion and propaganda have been succeeded by political action, by the operations of pressure groups, by revolution, as in Czechoslovakia, and now, by armed invasion in the North Korean attack upon the Korean Republic. In the light of this pattern and these facts, it is becoming increasingly difficult to rationalize the belief that the Communists most fear American military preparedness in their drive to world hegemony.

If this had been the case, their logical action would surely have been quiet, concealed preparation of their military forces, followed by a sudden attack upon the most vital element of the democratic world, the United States itself. Actually, the long series of insults, provocations, and now armed attack has forced America to take positive steps toward military preparation. There can be no doubt that our country is rapidly improving its position of military readiness. The present Korean war is, inevitably, creating military power for the United States which could be achieved in no other way. Actual combat, with the consequent production of military items, the mobilizing of manpower, its training programs, and its actual experience in field operations can only advance our military readiness.

Thus, the Communists appear to be acting directly against the traditional view of Americans that our military unpreparedness is the greatest encouragement to potential aggressors. Honest analysis must dictate the belief that the Communists regard military preparedness in the United States as of secondary importance to economic strength. While such actions as the Korean war can only strengthen the military forces of the United States, they inevitably strike with destructive effect at the economic bases of American power. The precipitation of several similar incidents would lead to virtual full mobilization of the United States Armed Forces.

Thus, the Communists would find themselves faced by a nation practically on a war footing. However, the cost in money, materials, in plant expansion, and in impact upon the normal civilian economy of such action would be enormous. It would thus appear that the enemies of America believe that our economic strength is a more important objective than our military strength--at this time; that it is desirable to weaken the economy of the United States even at the cost of strengthening our military arms. In your studies at the Industrial College I suggest that you consider these facts and this theory, and while I do not say that this interpretation of the Communist strategy is correct, it must not be assumed that the leaders of world communism are stupid men. Rather, it must be assumed that they realize the effects of their

present actions upon the United States, and in the light of these assumptions at least serious attention should be given to the belief that the masters of communism consider the economic defenses of America even more important than our military defenses.

We are well aware that this is not a particularly comforting viewpoint. The acceptance of time-honored beliefs, the passage along well-worn roads, the study of established doctrine, are all easier and more gratifying than pioneering.

However, this Nation is at war. A failure in basic intelligence-- a failure to understand the enemy--is as important as a military failure and, in fact, may very probably lead to military failure. Gentlemen, it is your duty to study the American economic system and all aspects of economic mobilization realistically and without bias, against the background of facts and acceptable assumptions as they exist today. You have no right to rely on beliefs passed down to you from earlier years. The time when your knowledge and your thinking may be called upon to preserve or lose our American heritage could be much closer than any of us think.

Thank you very much.

QUESTION: In your discussion you emphasized the fact that our economic system underwent considerable modification during the depression period; that there was an increase in government participation in the economy.

I am wondering, assuming that a total war should come and we had, say, total economic control even to the extent of a national service act, if you think that the American economic system has the resiliency to bounce back from those controls?

DR. ALLEN: The trend in the control pattern of government and the economic structure, if it could be charted, would be a curve expressing a geometric ratio. Control brings on control; authority rises out of authority. The emergence of a control calls for subsidiary controls. That has been the pattern of government not only in the United States but in all the industrially advanced countries for the last 150 years.

An abrupt change in the path of control which modifies this line we are trying to talk about creates a node, a high point in your graph, and very seldom, very seldom indeed, does the recession of the line carry you back to the true curve. In other words, there is a residuum, a remaining element of control, which goes on.

The history of the United States in the past 30 years has shown that after each period of crisis, be it military or be it economic, there has been a tendency not to recede back to the projected normal control line; a tendency not to pick up from the high point of control established during a crisis, but from a point somewhere between that point and the normal, established by the curve, and go on from there. I see no reason to believe that this will not continue to be true. The fact is that there may be a resumption of the higher level of control in case of economic dislocation. We may swing back to a more simple economy. However, I believe the degree of government participation in the economy will continue to go up.

QUESTION: Dr. Allen, you advance the theory that the recent Communist actions may have been made with the thought that they can weaken our economic position even at the risk that our military position will be improved. It appears to me--and I would like to have your opinion--that the result of these recent actions, particularly the Korean incident, has strengthened our economic position rather than weakened it. What is your opinion?

DR. ALLEN: The point is well taken. However, are you thinking in terms of the immediate reaction, or are you thinking in terms of the long-run performance? I merely gave that as a rhetorical question.

QUESTIONER: I am thinking of the long run.

Now, outside the fact that it may, to some extent, reduce our natural resources and perhaps increase our national debt, it would appear to me that it has a tendency to get our national economy at least directed toward mobilization.

DR. ALLEN: Precisely; it would direct our national economy toward mobilization.

Mobilization is an unnatural state. Mobilization is a strained economy. An economy of transition from peace to war is an economy under stress. We know that from our personal experience. If the United States could be mobilized at the present time, with reasonable speed, to the point where we would be in a sound, defensive position, that would be remarkably satisfying to all of us here at the college. There is no doubt about that, gentlemen. However, if it were necessary to maintain that mobilized position for a year, or two years, or three years, without the incidence of war, the strain would almost certainly result in a severe dislocation of our economy.

Now I think the lesson of history is pretty clear in that respect. No modern world power has mobilized and stayed mobilized for a period as long as a year without participating in actual war. The German

mobilization of 1912, for example, was over in a matter of a month. The strain of a full mobilization is about the heaviest strain an economy can bear. Without the psychological impact of war upon the people, without the action of war, the sheer mechanics of full mobilization would bear down on the economy with an overwhelming weight.

I am merely making the assumption because it has never been tried. No country has ever tried to mobilize and stay mobilized.

QUESTIONER: Isn't it true that the Russians have been mobilized for quite a long time? How does that affect their economy as compared to how our mobilization would affect our economy?

DR. ALLEN: I assumed the question when I made the point. That is perfectly correct. However, an authoritarian government does not mobilize in the sense that a normal economy does. In other words, should the United States economy have been designed on the basis of maintaining a larger military establishment, somewhat along the lines of the Russian pattern, we should have worked out an economy that would have continued for year to year on that basis. You have only to turn back to the frontier communities of America where that was the case; where the manpower in the community was virtually on a mobilized basis. That was typical of the communities throughout Kentucky, Ohio, and West Virginia.

The same applies to the Russian economy. They have X dollars, or X rubles, if you will. That pie can be cut up any way you wish. You can put your young men in the armed forces; you can reduce the standard of living existing in the community. Assuming the willingness of the people to go along with it, you can maintain that kind of an economy.

The very word "mobilization" implies change in status; movement, literally. A mobilized economy is one which turns from a peacetime footing to a wartime footing. It is not so much the level of the division between military and civilian activity that is significant. It is the interruption in and change of the flow of economic life; the changing pattern of economic life. In other words, Americans would have to forego, give up, their normal economic pattern of existence and accept a new one.

We think of our economy as a going concern. Thus we maintain our police and fire departments at levels capable of meeting normal situations, not great emergencies. For example, you remember the big fire in the City of Baltimore. In this fire the entire resources of the city were mobilized and put to relieving the distress caused by the fire. And yet, though it lasted a relatively short time, it completely disrupted the economy. There was no economic activity worth mentioning in Baltimore at that time, or in San Francisco a little bit later.

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QUESTION: Isn't it true that both the First and Second World Wars actually strengthened the economy in an absolute way?

DR. ALLEN: Well, here we approach the pitfalls of political opinion. Yes, I'll say--perhaps it is heresy. By and large, it is perfectly true that the United States economy has absorbed the shock of several wars with an upturned economic curve. However--and I speak here for the ghosts of some distinguished professors--it is held that the economic strain that has accompanied these shocks has tended to create a fiscal structure which is not acceptable to many Americans. World War I brought an up-lift to American industry at the expense of dislocating the farming economy; at the expense of the uneconomic growth of many urban communities; at the expense of a 26 or 27 billion dollar national indebtedness; at the expense of new government controls; at many, many costs. World War II brought a further dislocation in the form of a 252 billion dollar debt, and so on.

In other words, what do you consider a gain? It is an honest question and a matter of opinion. If you should borrow \$10,000 and get a college education, you have made a gain educationally, but you have at the same time compromised your economic freedom and your future. It is a matter of choice.

COMMENT: I am interested in your analysis of Russian mobilization. I might say, too, that I pretty much agree with Colonel Browning's point on the economic gains as opposed to the economic losses. But I will come back to that in a moment.

As I understand your explanation or theory of the Korean situation, it is that the Russians might be more interested in weakening our economic structure than in strengthening our military potential. It seems to me that you have to make certain assumptions in that connection.

Now, the first assumption you have to make is that the Russians anticipated we would react in precisely the way we did. I submit that all of the evidence we have--and we have some evidence--would seem to indicate that the Russians were not prepared for our military participation in the Korean war. I think that can be documented by the unpreparedness of the Soviet delegation in the United Nations and a lot of other things.

I am inclined to believe that the Russian policy in Korea was based not on the intention of involving us in the Korean war, but was rather based on their analysis--and their correct analysis--in the few weeks up to the time of President Truman's decision to support the defense of South Korea by the United Nations that we had no intention of participating in the Korean war. Certainly there were enough statements by our military and political spokesmen, and certainly our actions in Korea up to the time of the Korean invasion would justify that analysis.

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The next statement I should like to make is in connection with this controversial question you have touched upon--whether the Korean war strengthened or weakened our economic structure. I submit that economic strength is a relative and not an absolute fact. Just as it is true that our participation in the Korean war will bring about the strengthening of our military organization, so it will at the same time put into operation certain economic forces in this country which relatively, not absolutely, tend to strengthen our economic system and economic ability to conduct war.

I think we have to answer the question in terms of whether the Korean war will result in a partial or a total mobilization. I agree 100 percent if we get total mobilization, are forced to maintain total mobilization over an unlimited period of time, that it will create certain economic problems, and the cost of that economic change may be greater than our system can, or should, afford to bear. But if the Korean war is not the first of a series of incidents but is merely a mistake on the part of Russian strategy, as I believe it is, then we will get a partial mobilization. I think there are valid arguments for maintaining that our economic system can stand partial mobilization, can stand the expenditure of 10 or 20 percent of our national income for military preparation without weakening our economic system in a relative form.

DR. ALLEN: Taking your statement and questions in order as best I can--and please refresh my memory if I slip--I did not, I believe, suggest that the Korean war and our reaction to it was necessary for the Soviet goal to be obtained; that we entered into the war in a military way was a fortuitous gain for those Communists who would have torn us and divided our resources by a series of peripheral actions.

However, if it is to be assumed that the Communists were interested in weakening our economy, it would not in any way have been necessary for the United States to have met the North Korean armed forces with American armed forces. The result would have been all that could have been desired because, as one person who has lived in Washington for a good many years and has seen how the Congress has reacted, it is almost inconceivable that there would not have been at least a strong reaction for increased military preparedness.

You can draw a chart of the whole situation. The incidents in Czechoslovakia, the incidents in Poland, the incidents in Iran, Iraq, and the Middle East area in general have all been followed by a moving up in the amount of our expenditures for defense. That has been true for many years. We do not have to take just the present time. Whether the bull lunges immediately when you wave a red flag at him, or whether he jumps up and down, snorts and churns up the earth, sooner or later he will charge. You may have to make a hundred different gestures, but the time will come when he will charge. That is the Communist pattern.

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Perhaps this pinprick or this waving of the red flag won't cause us to charge, but possibly the next one would, or the next one, or the one after that. In other words, if the United States fails to act, the Communists pick plums while we stand back. They make political and social propaganda while we sit back and bite our fingernails. If, on the other hand, the bull charges, as it did in this case, and as a result the United States is forced to use some 10 billion dollars, or 6.7 or 9.8 percent; whatever figure you want to use, of the national income for defense, the bull will bleed itself white. We all know, of course, that it is a big bull; nevertheless, it is bleeding. If the first thrust by the matador does not kill the bull, another thrust will. They have us running in circles at the present time. That is perhaps what they have been hoping for.

Had we not used armed force, we would still--assuming the pattern of history and of recent events to be valid--be pouring out money for defense, calling up the boys, building tanks, taking the "moth-balling" off the old planes, ships, and all the things we are now doing. It would have been on a smaller scale, but we would have been doing it.

So much for the first assumption.

COLONEL BARNES: We will assume that you have answered both assumptions.

DR. ALLEN (to student): I will be glad to discuss it further, if you will come to my office.

COMMENT: I am not an economist. I realize I am sticking my neck out, but I am willing to do it.

It seems to me that you are overlooking one of the fundamental principles of economics, namely, that one of the basic sources of wealth is the land. The resources of the land are exhaustible. We can build up our economy in terms of productive capacity; we can stand enlarged expenditures in terms of dollars. In the meantime, however, we are throwing into the stockpile a lot of raw material which we cannot replace.

There is another aspect to that, too. As a nation grows old, it inevitably uses up its raw materials, item by item. Historically, when that happens the government itself takes over control of that commodity, as happened in the case of the mercury industry. The United States, regardless of the fact that in most of our raw materials we are pretty well off, is approaching that state with one or two commodities. An outstanding example of this would be manganese. There has been proposed, although it has not yet reached the Congress, and probably will not, a bill authorizing the United States Government to buy the manganese deposits of this country and to build the plants and operate them.

That brings us close to those items you mentioned. Government control feeds upon itself. We either accept that situation or try to devise some pathway whereby that control becomes--I don't know how to phrase this--minimized. We--that is, the Government--can either buy American manganese mines, run and operate them, or we can contrive some system whereby industry may do that. While officials say, "We don't care who owns those deposits, or who operates them, whether it is the Government or industry so long as we get manganese in the stockpile," manganese in the stockpile today may be nothing in the stockpile tomorrow if we have increased control.

I would like to finish this with one sentence: Neither the United States nor the world at large can produce as much raw materials as the people of the world want to have. The materials just aren't there.

DR. ALLEN: There is very little argument there. Mr. Lasky is modest. He speaks with authority. His first assumption is correct. Economics has a law of gravity as does the terrestrial earth. Lifting oneself by one's bootstraps is possible by illusion, but it is not possible in the long run. Of course, in the long run we could have, at the expense of depleting our resources and manpower, a fiscal buffer against depression. In the realm of material there can be no doubt that Mr. Lasky is speaking authoritatively. We have a material base that is so large, it is easy to see that it can be expanded indefinitely. As a result of our technology we can use taconite instead of the ore from our Mesabi Range, but we pay the price for it. We will deplete our resources if we go on. There will be an increase in the price we pay as our resources are depleted and this curve of depletion is apt to be geometric; that is, as you get down to the last, say, 20 percent, you will find that the cost of recovery will go up in ratio by leaps and bounds. In fact, it is virtually impossible to recover the last small percentage. That is our story. We are not able to re-establish mineral resources by sound planning or by wishing for it. We just cannot do it.

COLONEL BARNES: Dr. Allen, you certainly have given a very well conceived and executed discussion. We certainly do appreciate it. It was very stimulating.

Thank you very much.

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