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ECONOMICS IN WAR

Lecture

by

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ADDRESS OF DR H G MOULTON
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It is always a pleasure to me to come down and meet this group and I particularly enjoy the time devoted to discussion I have not prepared any formal talk and in one hour I am afraid I cannot do very much for you gentlemen

I want to start with the problem of what I call economic organization in time of peace - how we get things done, what is the motive force for the running of what we call the economic machine. The starting point of all economic activity is with land and natural resources (Referring to diagram) Without these, of course, we can do nothing That is a truism Land and natural resources are the beginning of economic activity, and then we have population, or more specifically, the labor supply I do not mean merely unskilled or dirty collar labor, but all classes of working individuals - working to get a means of subsistence out of these natural resources Then we have the third division of our economic set-up which we will call Capital Goods (Organization). By that I do not mean money I mean factories, railroads, stores, and the material concrete instruments which society has built up to aid in extracting from the land the means for subsistence We, the people, with the aid of our natural resources and capital goods, produce Consumption Goods of various types First, food, second, clothing, shelter and other necessities, (I use that term fairly broadly) and, third, luxuries There, in brief, is the layout. These are the things that we, the people, want and we get them through what has come to be regarded as an economic machine or organization.

Consider the 120 million people in the U. S. Somehow or other, week by week, month by month, the food necessary for the subsistence of the American people gets placed before them. The clothing which we need somehow or other is nearly always available for us at the time we need to use it, and in the same way - necessities and luxuries This economic system does get its wants supplied with a high degree of regularity. What makes the wheels of this machine go around? What is the motive force that turns out in the quantities desired the various things we want? What determines how much of our labor supply, capital goods, etc , are devoted to the turning out of food? How much to clothing, shelter, etc? This (see diagram) may be regarded as a great pool of energy What determines the energy that goes into the production of food? What determines the direction of this energy?

Let us examine the price and profit mechanism. These people here (Organizers) are those in business for profit to the end that they may themselves use their profits to supply their wants.

But what these people will produce is determined by considerations of money making and profits, not by service directly They probably make profits to the extent that they render service, but the amount of this total that goes into the production of food as against the production of luxuries is dependent upon considerations as to which will pay them better - to produce more clothing or shift to other things. It depends on how much and how rapidly they can shift. The textile industries, because of certain developments, are hard put - they cannot shift at once Some of them get cleaned out. In any given industry you have a number of concerns producing at different costs I want to discuss the marginal principle. Here we have four different business establishments producing goods of a certain type - the first costing 1.00, the second, $.90, - $.80, etc , etc. Let us assume that the demand for that particular commodity falls off Let us say it is shoe leather When people begin to ride in automobiles they do not wear out so many shoes The demand goes down Prices go down. Unless the $1.00 man can reduce his costs, he is one of the many business failures we hear about. Then the $ 90 fellow is crowded out The $ 80 fellow just gets by, etc The change on the part of the desires of the people makes this price change and produces industrial readjustment Now that manufacturer may decide to get into another line, or he may retire, but the workers are thrown out and the problem arises as to how to shift these laborers to some other activity That is going on all the time in business, - shifting of labor, shifting of capital equipment It is not easy to make this shift There are losses to individuals - but the price has fallen.

Now we turn to the economic problems of war time Let me make one thing clear, to begin with. You hear figures about the cost of a war being 20 billion dollars, or 50 billion dollars The cost of a war as expressed on those figures is exaggerated. Suppose we shift a million men from peace pursuits to war pursuits Those men have to have clothing furnished them while they are in the army, they have to have food. That is not figured in the nation's cost because those people were not naked before. They would have worn civilian clothes and they would have eaten They would have had shelter. Looking at it from the standpoint of the national treasury, the cost is increased, but additional money passes through the Treasury without necessarily being lost to the nation The people in the army have consumed roughly the same amount of food, etc , that they would have consumed in private life

Now the big problem in time of war is to shift a portion of the energy that goes into ordinary peace-time necessities and luxuries to war goods. You cut off a part of this ordinary consumption and put it down here (War Requirements - See Diagram) You do not have to make a complete diversion. This machine is never

working at 100% in ordinary times. In fact, they only work about 60% or 80% of their maximum capacity. There is always a great deal of unemployment In war, women are being brought in and older men supplement the working supply.

What is the mechanism by which we get this diversion to war requirements? I have said already that we might purchase less shoes, and less food of a certain kind, more of some things - and that would affect prices and gradually force readjustment, the motivating power and directing force being prices and profits The big question that all nations face in time of war particularly is, "Can we rely wholly upon this price and profit mechanism to effect the shifting from these ordinary consumptive goods to the supply of the necessary war goods?" That is the big question Can you rely upon a price and profit mechanism? We have, in fact, relied upon that mechanism too much in time of war. Wars generally, however, have been waged on the assumption that you do not have any fundamental change in mechanism (In the great World War, we modified it profoundly)

I am going to introduce money now. I have talked about land, raw materials, people, capital goods, and I have talked about consumptive goods. Money is the mechanism by means of which the whole machine is operated

National Monetary Income

This (square on diagram) I will call the National Monetary Income Wages of all people flow into this national reservoir Also, rent derived from the use of land, buildings, etc , which is monetary income to certain people. Also interest received on capital invested and profits. There are 120 million American people who receive in the course of each year - let us say, 300 billion dollars That actually comes to us in the form of liquid resources,- monetary purchasing power which can be used in purchasing things. Now what do we do with the money we have received? We do three things with it

There is a certain amount of monetary income which we spend through distributive channels The retailer and wholesaler pass it on to the manufacturer and producer The spending of this money sets up a chain of demands. Another portion of it is saved. That goes into banks of various kinds, savings banks, insurance companies, etc The banking institutions do two things with it. Part goes as additions to plants, equipment, etc. It gets into the hands of existing manufacturers and they hire labor and use raw materials to build additions to these plants and equipment One of our problems is to make sure that we expand our plants, equipment, etc., so we will have more capital to do it with That is worked out by the

division on the part of the people between what they save and what they spend. The third part is taxes which the Government extracts from us. The Government, by virtue of its authority derived from the people, can take a portion of this total from us and put it in the U S. Treasury, state treasuries, etc. What does the Treasury do? In ordinary peace times the Treasury does a variety of things. There is the problem of running the Government itself, but in addition to that they are expanding the Navy - and they ought to be expanding the Army - they are building postoffices, improving rivers and harbors, and various kinds of public works. When they do that, to some extent they add to society's capital equipment in the form of Navies, military roads, public works, etc You see that this income which we, the people, have, is really laid out in three different avenues. The amount going through the Treasury depends upon Governmental policy The division between saving and spending depends upon both the total of income available and the habits of the people.

When we come to war time, what happens is this The first thing we have to do is to increase the flow of funds into the Treasury What does the Treasury do? The Treasury sends the manufacturer of iron and steel an order. Let us say this manufacturer has been turning out iron and steel at $1.00. The Government says "We would like to place an order with you at $1.10 for certain iron and steel products " But at the same time, this producer has his regular customers He is selling iron and steel at a profit and if the next fellow wants the goods very badly he buys it at $1.10 The Government has got to have it so they pay $1 20 That is exactly what happened in the war, - the competition between private and Government needs. We also had competition between different departments of the Government. It was up to the Army to get its needs supplied and it was up to the Navy. They both wanted to render the maximum of service Iron and steel prices were skyrocketed as a result of competitive bidding. The same was true of food. If you are going to rely on this price and profit mechanism to get you what you want, the Government has got to bid high enough to attract labor and capital into the production of goods needed by the Government. The price has to go up and industry will adjust itself to where the profits are largest That is what happens first of all, but it has its weaknesses In the first place, they could make good profits in producing iron and steel and a miscellany of goods for ordinary distribution, particularly when a lot of slack is taken up in the labor market More members of the family work and the purchasing power of the family is increased. There is a tendency for the demand for luxuries to be increased in time of war.

One of our war slogans was "Business as usual." Now is it wise to have business as usual? This competition between ordinary necessities and luxuries means that we do not get into production as fast as we ought This raises the question as to whether we should not have

conscription of industry. Suppose the Government, instead of bidding against private producers and trying to get those engaged in turning out some kind of dispensable commodity to shift their plants to the production of war supplies, compels them to shift. Suppose the Government, by an official pronouncement in time of war, said that Company A shall cease producing its regular commodities and turn its attention to something else? We might force them to shift and give them a reasonable profit.

Now comes labor Labor has the alternative of working in the production of a dispensable commodity or shifting to war supplies. Labor wants to work where the wages are highest and wages might be highest in this dispersable line. It has been suggested that we conscript labor If you look at this from the standpoint of efficiency, there cannot be any question that the wise thing to do in time of war would be to say that such and such factories must turn out war supplies and such and such laborers must be shifted to war work There are, however, reasons why you cannot go to that extreme Take labor first. The laborer is a human being who has rights as an American citizen. We did compel men to go into the Army but it is a question as to whether we could get them to agree to be conscripted for industrial purposes A great many individuals would be perfectly willing. However, the American Federation of Labor as an organization would oppose it and then perhaps the people would feel that there was a restriction of the rights of the individual which even a war would not justify We have to face that, as a fact, and make the most of it.

You may not agree with this, but in my judgment you would not have much difficulty in getting a large number of industries to agree to do the Government's bidding in shifting. It probably is not necessary, however, to go as far as to compel them to do it. We have developed other means of doing it - the Priority system While we do not compel a certain manufacturer to shift from peace time production to war time production, we tell them they will have difficulty in getting coal and raw materials, etc You will have to take what is left, etc That was a kind way of getting the same result We fooled them into believing they were doing as they pleased We did not have enough coal and we had to give it to the most important industries first.

Now what is being undertaken by the War Department is preplanning in this whole field We did not have any plans in the last war. Germany did not either, with all her efficiency, she did not make any real plan in advance for industrial mobilization. She believed it would be over at the end of six weeks, or three months, and she had enough supplies for that time. But once Germany was through the first few months and had used up that accumulated stock and settled down to a long war, she had the problem of getting into war production She began fairly early to work out methods for this readjustment In England, they had "business as usual" for a year or two on the theory that if you keep everybody at work on the same things and allow women and the unemployed to give the necessary expansion, you would be all right It took them a year to find out. We got

into it later and had the advantage of European experience, but even then we did not understand the necessity for shifting. "Money will win the war", we said. They asked us to subscribe to Liberty Bonds and we did and when they could not get all the money they wanted from the people they got it from the banks. When they got it that way all they did was to expand the total amount of money available and run up prices. Money did not win the war. Money was only the means by which we got war supplies Shells were what was needed and ships, and we were just on the surface of things when we talked about money It was a necessary instrument but it was not the basic thing.

At present we are trying to find out by industrial surveys what industrial establishments can do in the event of war to expand their production, and unless we should get into a war under conditions similar to what we had in the last war where there were tremendous requirements and imperative necessity for speed, I should be inclined to believe that with the knowledge as to where there was possibility of expansion, with arrangements partly completed in advance, we could very quickly get great augmentation of supply of war requirements. We would not do it merely through price mechanism. The Treasury would have to have more money, but instead of our former method, now we are going to have worked up means by which we know where we are going to get it and how quickly, and first of all what we would do would be to speed up industrial mobilization tremendously We would prevent enormous skyrocketing of prices The great costs of war are often manifested in the post-war purchases - the readjustments made necessary by the fact that the war was naturally expensive.

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Q. Why is it not possible to increase the assessment of taxes and then as you fight the war, to pay for it and then at the time of the armistice you will not have that period of readjustment? You can reduce the production of non-essentials and when it is all over it is paid for.

A. You would find among economists complete assent to that principle Namely, increase taxes sufficiently to pay for the war as you go Economists have, however, sometimes lost sight of practical difficulties It takes time to get this tax machinery to work and you have got to have money very quickly and you may have to borrow some of it from the banks. You should pay for as much of it out of taxes as it is possible to do Just one other point. You really have to pay for a war as you go, anyway in the fundamental sense of the word, assuming that you cannot borrow from other countries We paid for it as we went in that it was the labor that produced the shells, etc. These 120 million American people produced the food, supplies, ships, etc. that were necessary as we went. However, while this is true in

the terms of the basic supply, the methods used for financing it built up a huge Government debt to the American people and complicated its fiscal problem for years to come It took us several years to get over it. The European countries are not over it yet. You have to pay for a war anyway in the sense that you have to produce shoes, food, shelter, etc If you do it with taxes you do not have any aftermath comparable with what you do if you borrow from the Government. That will be followed by a period of readjustment.

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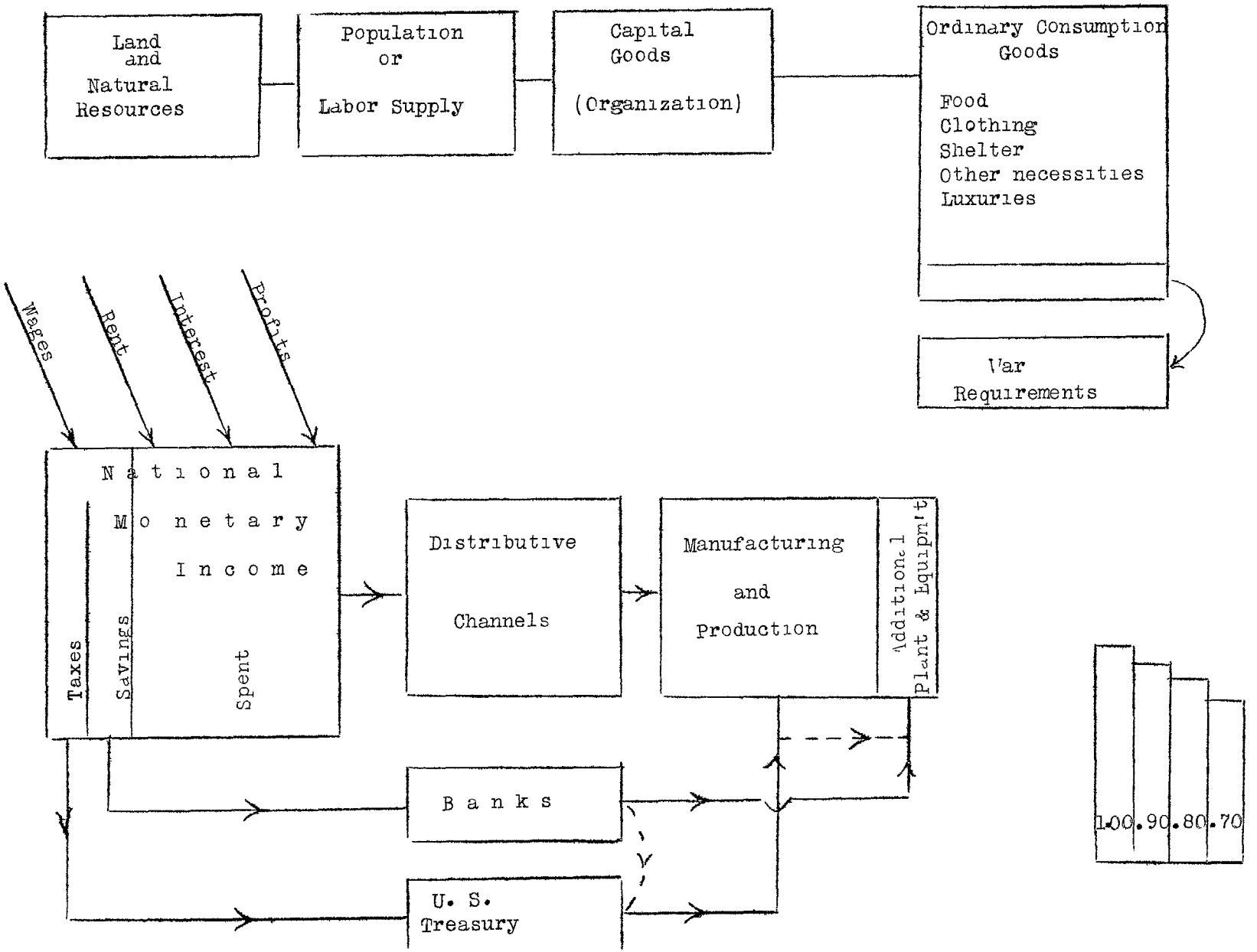
Land and Natural Resources
Population or Labor Supply
Capital Goods (Organization)
Ordinary Consumption Goods
Food
Clothing
Shelter
Other necessities
Luxuries
War Requirements
Wages
Rent
Interest
Profits
National Monetary Income
Taxes
Savings
Spent
Distributive Channels
Manufacturing and Production
Additional Plant & Equipm't
Banks
U. S. Treasury
100
90
80
70