

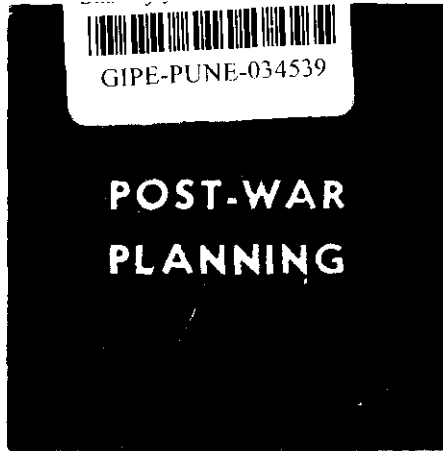
NATIONAL RESOURCES PLANNING
BOARD.
AFTER THE WAR—
FULL EMPLOYMENT.

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FEBRUARY 1943.

NATIONAL RESOURCES PLANNING BOARD

AFTER THE WAR— FULL EMPLOYMENT



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This pamphlet is the second in a series issued by the National Resources Planning Board on problems and planning in the Post-War Period. The first pamphlet was, *After Defense—What?* This statement on full employment was prepared for the Board by Dr. Alvin H. Hansen, Littauer Professor of Economics, Harvard University, and Special Economic Adviser to the Board of Governors of the Federal Reserve System.

Prior to final printing, a pre-print edition was circulated to members of the Federal Reserve Banks and to a group of businessmen, economists, and labor leaders for criticism and suggestions. Dr. Hansen has made numerous revisions in the text as a result of the many helpful comments which were received. The National Resources Planning Board gratefully acknowledges the assistance of these critics.

This pamphlet has been revised at the request of the Board to take into account the progress of the war program to February 1943.

AFTER THE WAR—FULL EMPLOYMENT

By Alvin H. Hansen

WAR AND POST-WAR AIMS

The immediate aim of the American people is to preserve and safeguard political freedom. But a military victory for the democracies is not enough. If the victorious democracies muddle through another decade of economic frustration and mass unemployment, we may expect social disintegration and, sooner or later, another international conflagration.

A positive program of post-war economic expansion and full employment, boldly conceived and vigorously pursued, is imperative. Democracies, if they are going to lead the world out of chaos and insecurity, must first and foremost offer their people opportunity, employment, and a rising standard of living.

THE EXPECTED POST-WAR SLUMP

The fact is that many people dread to think of what is coming. Businessmen, wage-earners, white-collar employees, professional people, farmers—all alike expect and fear a post-war collapse. Demobilization of armies, shut-downs in defense industries, unemployment, deflation, bankruptcy, hard times. Some are hoping for a post-war boom. We got that after the first World War. Not improbably we may get it again. If the war lasts several years, we may have at the end of the war sufficient accumulated shortages in residential housing, in durable consumers' goods such as automobiles, and in the plant and equipment required to supply peacetime consumption demands, to give us a vigorous private

investment boom. Indeed, we need to be on the alert to prevent a possible post-war inflation. If in fact we do experience a strong post-war boom, there is, however, the gravest danger that it will lull us to sleep. Sooner or later such a boom will end in a depression, unless we are prepared. If appropriate action is taken, there is no necessity for a post-war collapse.

Everywhere one hears it said that, when this war is over, all countries, including our own, will be impoverished. This view is, however, not sustained by past experience. No country need be impoverished if its productive resources (both capital and human) are intact. The productive resources of this country will be on a considerably higher plane when this war is over than ever before. A larger proportion of our population will be trained to perform skilled and semi-skilled jobs. We shall have enormous productive capacities in all the machine industries. And in special consumers' durable industries, where plant and equipment may have become deficient by reason of the war, we shall be able very quickly, with our large basic machine-producing industries, to expand to meet the peace-time requirements. We shall have, when the war is over, the technical equipment, the trained and efficient labor, and the natural resources required to produce a substantially higher real income for civilian needs than any ever achieved before in our history. Whether or not we shall, in fact, achieve that level of income will depend upon our intelligence and capacity for cooperative action.

We have to make up our minds as a Nation that we will not permit a post-war depression to overwhelm us. We do not have to take economic defeat after the military victory is won. We can, if we will, maintain business prosperity. We can sustain a continuing demand for goods. We can keep industry going at high levels. We can maintain substantially full employment. We can achieve a society in which everyone capable of and willing to work can find an opportunity to earn a living, to

make his contribution, to play his part as a citizen of a progressive, democratic country.

An important gain will, we may hope, be won from the war program in the struggle to achieve and to maintain full employment.¹ We have every reason to expect the national income to rise to around \$135 billions,

¹ The term "full employment" is often misunderstood and requires brief explanation. A little reflection will make it clear that in a highly dynamic society in which new industries are developing and some old ones are declining we must retain a high degree of labor mobility. In like manner, regional population shifts will occur in an expanding, developing economy. In addition, in a democratic society with freedom of occupational choice, some considerable labor turnover is not only inevitable but, indeed, beneficial. Without this, personal freedom could not be maintained. Thus, a dynamic and mobile society requires some considerable shifting of jobs. Accordingly there will always be, in a society such as ours, a large amount of transitional unemployment. In addition, there will inevitably remain, even under the best planning by business and industry, a considerable amount of seasonal unemployment. For these reasons, in an economy as large as that of the United States, it is probable that at "full employment" there would be at any one time between 2 to 3 million temporarily unemployed.

It must, moreover, be recognized that the concept of full employment can acquire a definiteness only when it is conceived within the pattern of social customs and institutional arrangements which determine the size of the labor force and the customary hours of work. Thus, the labor force will be affected by the customary age of retirement and also by established practices with respect to minimum years of schooling and prevailing practices with respect to the age of entrance into industry. With respect to the hours of work, "full employment" obviously does not mean that the population will work at the maximum possible hours that human endurance makes feasible. On the contrary, the prevailing hours of work will be determined by legislation, collective bargaining, and customary practices. The concept of "full employment" presupposes that the normal labor force is working at the customary and prevailing work week.

Finally, the concept of full employment relates only to those members of the community who are "employable." Unemployables, whether by reason of physical or mental defects, are not a part, properly speaking, of the labor force. The problem of what to do with these elements of our population is certainly an important one to which a democratic society must seriously address itself, but it is not part of the problem of achieving "full employment." It is, however, emphatically true that if we achieve a "full employment" economy, the relative scarcity of labor thereby created will force our society to tackle more vigorously the problem of training and educating some portion of the "so-called" unemployables, making them sufficiently efficient to be added to the employable labor force. This we have never done in the past because there has typically been available a reservoir of unemployed to draw upon. A full employment society, continuously maintained, will discover that it is quite possible through education and training to reduce very substantially the proportion of the population which has in the past been regarded as unemployable.

in the calendar year 1943. It will be much easier to muster support for a program to resist a decline from a high income level than it has been in recent years to win approval for an adequate program to *raise* income to full employment from a low level. But we must be vigilant lest this gain slip from our grasp. If we let the income slide from 135 to 100, 80, 70 billion dollars, we will have to make the old uphill fight all over again. We must deliberately set out to hold the new income level and to push it higher as rapidly as increasing productivity will permit.

DEMOCRATIC PLANNING FOR FULL EMPLOYMENT

We do not want the Government to run the whole show. We do not want a totalitarian state. We want freedom of enterprise. We want freedom for collective bargaining between employers and employees. We want freedom for cooperative action. We want freedom of choice of occupation.

If purchasing power is maintained at a high level, we need have no fears that private manufacturers, retailers, wholesalers, and farmers will not come forward and supply the market with the goods demanded by the public—a rich variety of goods at reasonable prices. Private business can and will do the job of production. It is the responsibility of Government to do its part to insure a sustained demand. We know from past experience that private enterprise has done this for limited periods only. It has not been able to insure a continuous and sustained demand. The ever-increasing gigantic powers of production of the modern industrial system, far exceeding that of any earlier experience in history, means that an enormous output has to be reached before full employment is approached. Private industry and Government together must act to maintain and increase output and income sufficiently to provide substantially full employment.

When the war is over the Government cannot just disband the army, close down munition factories, and stop building ships. We want an orderly program of demobilization and reconstruction. We must retain such economic controls as are necessary during the reconversion period, until industry is prepared to match supply with demand. Once industry has caught up with the backlog of deferred demand, the controls can and should be removed. To fulfill our responsibility as a Nation it is necessary to achieve the cooperation of business, labor, farmers, and the Government in the reconversion period and then to go on to the great task of developing a vigorous, expanding and prosperous society.

A positive governmental program looking toward full employment would greatly vitalize and invigorate private enterprise. An expansionist program would permit private enterprise to operate at high output levels. There is plenty of work to do. We need improved manufacturing equipment to produce more and better goods at lower prices. We need to carry on extensive research in the laboratories of our great private corporations, in our universities, and in Government bureaus to create new products and develop new processes. We need to rehabilitate and modernize our transportation system—by land, water, and air. We need continued advance in the techniques of production, distribution, and transportation; in short in all those elements that enter into a higher standard of living. We need to rebuild America—urban redevelopment projects, rural rehabilitation, low-cost housing, express highways, terminal facilities, electrification, flood control, reforestation. Many public developmental projects open fresh outlets for private investment. We need a public health program including expansion of hospital facilities. We need a nutrition program. We need more adequate provision for old age. We need higher educational standards in large sections of our country. We need a program to improve and extend our

cultural and recreational facilities. We need an enrichment of the material and spiritual resources of our American way of life. We have seen how it is possible to mobilize the productive capacities of the country for war. We can also mobilize them for peace. Under a program of full employment new enterprises would grow up; old enterprises would expand. Youth would find opportunity and employment.

The notion that we cannot finance our own production is quite without foundation. Every cent expended, private and public becomes income for members of our own society. Costs and income are just opposite sides of the same shield. We can afford as high a standard of living as we are able to produce. We cannot afford to waste our resources of men and material. We cannot afford to use them inefficiently. But we cannot afford idleness. The idleness of the decade of the thirties was responsible for the loss of \$200 billions of income, judged by 1929 standards. We know that this is an understatement. We know now that our national income could have grown from \$80 billions in 1929 to \$120 billions by 1940. By these standards we lost \$400 billions of income in the decade of the Thirties. The public expenditures required to rebuild America, to provide needed social services, and to maintain full employment can be provided for out of the enormous income which the full utilization of our rich productive resources (material and human) makes possible. The costs of producing this income are merely payments to ourselves for the work done. There is not—there cannot be—any financing problem which is not manageable under a full employment income. From a \$125 billion income we can raise large tax revenues—large enough to service any level of debt likely to be reached and to cover all other Government outlays—and still retain for private expenditures far more than we had left in former years under a \$70 billion income with lower taxes. Taxes are merely one way of paying for social

services and public-improvement projects which we need. But it is not necessary or desirable *under all circumstances* to finance all public expenditures from taxes. Whether taxes should equal, fall short of, or exceed expenditures must be decided according to economic conditions.

Everywhere it is said, and constantly reiterated, that we must tighten our belts and reduce our Government debt when peace returns. When is it desirable to pay off part of the debt? Certainly not when there is danger of an impending depression. Under certain conditions it would be desirable to do so. Under other conditions it would be quite unsound policy to retire the debt. Financial responsibility requires a fiscal policy (including governmental expenditures, loans, and taxes) designed to promote economic stability. It would be quite irresponsible to cut expenditures, increase taxes, and reduce the public debt in a period when the effect of such a policy would be to cause a drastic fall in the national income. Equally, it would be financially irresponsible to raise expenditures, lower taxes, and increase the public debt when there is a tendency toward an inflationary boom.

Assume that after the war tax money is available for repayment of the public debt. Some holders of bonds receiving the repayment may wish to spend the proceeds, but most will want to reinvest. If new private investment in housing, factories, and other projects are adequate to absorb these funds together with the amount normally saved from income, the process of debt retirement will operate in a quite satisfactory fashion. But if there are not enough houses, factories, and other projects being built, the Government has no recourse (if unemployment and fall in national income is to be avoided) except to borrow the money back again and devote it to public improvement or other useful public projects.

About 70 percent of the federal debt, direct and guaranteed, is held by institutions performing useful and necessary services which cannot be performed without ade-

quate income. The institutions referred to include the social security trust funds, savings institutions, educational and charitable institutions, life insurance companies, and commercial banks. Another 20 percent is held in the form of nonmarketable bonds, mostly war savings bonds. For the rest—marketable securities held by individuals and business firms—we should not forget that financial stability is frequently encouraged by investment in gilt-edged Government bonds. This aspect was stressed by the famous Colwyn Committee in England in its report issued in 1927. Stated broadly, we should keep clearly in mind the fact that balanced against the taxes required to cover interest charges are the interest receipts of institutions and individuals who own the bonds. Thus the fact is that our public debt, owned as it is mainly by institutions performing useful and necessary services, is no such burden on the community as is commonly supposed. The tax funds collected to meet interest charges are not lost. They are paid right back again, largely to institutions that benefit the community as a whole. At the worst, the taxes are collected from one group of citizens and paid out to another group—the bondholders.

The public debt is something very different from the private debt of an individual. An individual will always improve his asset position if he is able to pay off a part of his debt. But a nation may make itself poor by reducing public debt. This is true because such reduction tends to cause deflation, depression, and unemployment. It is a good thing to retire a part of the public debt if you want to check an excessive boom. It would be ruinous to retire the public debt in a post-war period when unemployment was spreading.²

A public debt internally held has none of the essential earmarks of the private debt of an individual. A public debt is an instrument of public policy. It is a means to

² It is understood, of course, that whenever a bond held by an individual or institution falls due, the Government will pay it off in full, in cash. If the Government at that time did not wish to reduce its total debt, it would replace the old bond by a new one which would be sold to investors or to banks.

control the magnitude of the national income and, in conjunction with the tax structure, to affect income distribution.

OUR OUTPUT POTENTIAL

The war has demonstrated the amazing vitality and productive power of American industry. In 1941, the Federal Reserve Index of Production was 156 or nearly 45 percent higher than in 1929, the peak year of the Twenties. In 1942, the Federal Reserve Index averaged 180 or about 65 percent higher than in 1929. And by the end of the year it reached 196.

In this output record there is conclusive evidence that American industry was achieving, despite the hard times of the decade of the Thirties, increased productive capacity. Our business units, it is now demonstrated, did avail themselves of cost reducing improvements; new machines, new techniques, and new processes. We know now that our well-established industries at the end of the decade (1931-40) were well equipped with up-to-date machinery and facilities. Were this not so, how would it have been possible for our economy to produce the prodigious volume of goods which in fact it did produce in 1941 and 1942?

In the decade of the Thirties, there was expended on private plant and equipment nearly \$60 billions. It is true that this volume of investment in plant and equipment was far below the volume of the Twenties. There was not in the Thirties, as there was in the Twenties, the rise of gigantic new industries such as the automobile and the numerous accessory industries related to it, for which new plant and equipment had to be built. But our great established industries were keeping abreast of a rapidly improving technique. Extensive researches into the character of these new techniques indicate that, while enormously productive, they have been relatively inexpensive in terms of capital outlays. Thus, the \$60 billions of new plant and equipment proved sufficient to

thoroughly modernize American industry and put it in a position to produce the enormous output of 1941 and 1942. But while nearly \$60 billions were spent on capital outlays by American business in the Thirties, the outstanding fact, as brought out by Kuznet's recent volume, *National Income and Capital Formation*, is that for American industry as a whole there was little or no *net new* investment over and above replacement capital outlays (which, however, represented modernizations and improvements). Thus, little if any *net* savings were invested in American industry as a whole—the situation of course varying in different industries—in the entire decade. But the \$60 billions of depreciation and replacement funds were expended on such highly efficient equipment, facilities, machines, and techniques that the productive capacity of American industry was very much greater at the end of the decade than it had been in 1929.

As an illustration, the investment in the steel industry in the late twenties was \$3.8 billions while in 1937 it was only \$3 billions, yet the capacity in the late Twenties was only 58 million tons while in 1937 it had risen to 70 million tons. Similarly in the railroads, the capacity to handle a larger volume of traffic has been clearly demonstrated in the record of the last 2 years. Faster trains, better organization, and improved techniques is the answer. In the decade of the Thirties we were making rapid increases in per man-hour productivity, and we were installing better and better machines at relatively low capital outlays. The dynamic quality of American business and its productive potential has now at last had an opportunity to demonstrate what it can do in the war effort.

The increase in output and in the national income has resulted from a fuller utilization of plant and equipment and increased employment, yet the employment figures have increased less than might have been supposed from the enormous increase in output and in income. In the

table below is given, in the first column, the net national income ³ at market prices; in the second column the net national income at 1940 prices (in other words the net national income, as in column one, deflated for price increases—an average of (a) the wholesale price index and (b) the cost of living price index being used to correct for price increases; the result gives an estimate of the national income for each year after 1940 had there been no increase in prices); column 3, gross national product at market prices; column 4, gross national product deflated to 1940 prices; column 5, the employment not including the military force; and column 6, the total employment including the military force.

	Net national income (paid out) (market prices)	Net national income (paid out) (1940 prices)	Gross national product (market prices)	Gross national product (1940 prices)	Employment (not including military force)	Employment (including military force)
	<i>In billions of dollars</i>				<i>In millions</i>	
1940.....	76	76	97	97	46	47
1941.....	92	85	120	111	49	52
1942.....	115	95	152	126	51	58
1943.....	135	106	180	142	53	63

³ The terms "gross national product" and "net national income" (income receipts of individuals) may require brief explanation. The income receipts of individuals includes all of the money payments received by individuals in the form of wages, salaries, dividends, interest, rents, and entrepreneurial profits. The concept refers exclusively to the income receipts of individual persons. This, of course, includes the income receipts of employees, officers and stockholders of corporations, but does not include the retained profits of corporations.

The gross national product includes the total money value at market prices of all goods and services produced in any given year. The total value of all goods and services produced must, of course, cover considerably more than the income payments made to individuals. Thus, if we assume for the sake of simplicity that the entire enterprise in a society were operated by a single private corporation, it will be clear that the total value of the goods and services which it sold would have to cover not only the income payments which it made to individuals but also: (1) all business taxes, and (2) gross corporate savings, the latter including: (a) depreciation and replacement funds (used to finance renewals and replacements), and (b) net savings (used to finance net additions to plant equipment, etc.). Thus, gross national product equals: (a) the income receipts of individuals plus (b) all business taxes plus (c) gross corporate savings.

While the price increases have in this war been relatively moderate, it is nevertheless true that they are large enough to exaggerate substantially the increase in income that has occurred. The figures given above for income and gross national product at 1940 prices serve as a corrective and enable us to get a realistic picture of the true expansion. That expansion, after making corrections for price changes, has, however, been, as indicated above, prodigious and far beyond the expectation of anyone. It represents a remarkable achievement of American industry of which we are entitled to be proud and which gives us hope and assurance for the future. The increase in *real* income has proceeded at the rate of about \$10 billions per year at 1940 prices, while employment has increased by about 2.5 millions per annum.

The growth in expenditures for war purposes has been made possible mainly by reason of the fact that we started from a level of income far below the capacity of the American economy. We were accordingly able substantially to increase consumption expenditures above that of 1940 and yet at the same time produce an enormous volume for war purposes. While consumption expenditures reached a peak in 1941, even in 1942 we were able approximately to maintain the high level of consumption reached (partly through drawing down stocks) at the same time increasing prodigiously the war output. In 1943 consumption expenditures will, by means of rationing and other controls, be reduced substantially below the levels reached in 1941 and 1942—levels higher than any ever before achieved in our history. Our capacity to produce \$90 billions for war purposes in calendar year 1943, and at the same time maintain so high a level of consumption, is an amazing demonstration of the extent to which we failed to use our resources prior to the war. Nothing could more forcefully underscore the stupendous folly of allowing our vast productive resources to remain idle in the decade of the Thirties,

causing us to suffer a loss in national income from \$200 to \$400 billions.

In calendar 1943, the gross national product at market prices will amount to about \$180 billions. Of this, about \$90 billions will be spent on the war, leaving \$90 billions for total consumption, of which about \$13 billions will represent the ordinary civilian governmental services (Federal, State, and local), and about \$77 billions privately produced civilian goods and services.

During the calendar year 1943, goods and services for private use will consist almost exclusively of consumption goods since during this year there will be little private capital formation. It is true that there is likely to be some \$4 billions spent on private plant and equipment, but offsetting this will be a disinvestment of some \$3 or \$4 billions in inventories and in foreign account. Thus, the \$18 to \$20 billions, which in recent years has gone into private capital formation will all be diverted to the war program.

The components of the 1943 gross national product are:

Components of Gross National Product at Market Prices in Calendar 1943
(In billions of dollars)

War production	90
Gross private capital formation	0
Nonmilitary Government services—Federal, State, and local (corrected for transfer payments, etc.)	13
Private consumption goods and services	77
	<hr/>
Total	180
Deduct business taxes and gross corporate savings	45
	<hr/>
Net national income (paid out to individuals)	135

The above table indicates clearly the enormous gap between private consumption expenditures as of 1943 and our total capacity to produce. In calendar year 1940, the income receipts of individuals (national income paid out) were \$76 billions, while the gross national product at market prices (income payments plus (a) business taxes and (b) gross corporate savings) was \$97

billions. Of this total of \$97 billions, \$66 billions were for private consumption, \$13 billions for nonmilitary government services (Federal, State, and local), \$15 billions for private gross capital formation, and \$3 billions for defense. This was the picture of our economy before we embarked extensively upon the war program. In 1943 we shall have moved out to a full war effort. The national income (income receipts of individuals) in 1943 will be nearly \$135 billions (\$107 billions, at 1940 prices) while the gross national product will be about \$180 billions. Of this vast total, one-half will go for war output, and one-half for nonmilitary government services and for civilian consumption. As we have seen, disinvestment in inventories (retail, wholesale, and industrial) is likely to offset approximately private capital formation in plant and equipment.

POST-WAR CONSUMPTION AND INCOME

When the war is over, we shall be confronted with a gap that has to be filled when the \$90 billions for war (for fiscal 1944, \$100 billions) are curtailed. The problem of the post-war period is to fill this gap largely by an increase in private consumption expenditures and in private capital formation.

We have assumed that consumption would be held down to about \$75 billions during the war effort (about \$60 billions at 1940 prices). It is not likely that this could be achieved without (1) the imposition of still heavier income and consumption taxes during the war effort, (2) partial refund of tax in the form of special war bonds (compulsory savings), and (3) much larger voluntary purchases of war bonds. If these ends can be achieved *during* the war period, the post-war release of funds diverted from war savings and tax reduction would help greatly to raise post-war consumption and fill part of the gap from curtailment of war expenditures. In the post-war period, the problem is how to accomplish

the latter. Let us suppose the following components of the post-war gross national product:

<i>Post-War Income Components</i>	
(In billions; and at current prices)	
Private consumption	\$100
Private gross capital formation	20
Government purchases of goods and services (including the ordinary expenditures of Federal, State, and local governments, military expenditures, public works, etc.)	35
Total gross national product	155
Less business taxes and gross corporate savings	30
Net national income (paid out to individuals)	125

This model presupposes that consumption will have been lifted from about \$75 billions during the war period to \$100 billions in the transitional post-war period. In the immediate post-war transition, the increase in consumption might come (1) partly from the elimination of compulsory saving (the refundable tax) effective during the peak of the war effort; (2) partly through the conversion of the accumulated war savings into cash by selling the war bonds to banks or to individuals desiring to save, and the expenditure of such sums on durable consumers' goods with respect to which, in all probability, a large backlog of deficiencies will have accumulated during the war period; (3) partly through an expansion of consumers' credit which we may assume will have been reduced to small proportions during the war period; (4) partly through a sharp reduction of wartime taxes on consumption, including raising somewhat the personal exemptions and reducing the rates on lower incomes; (5) partly through a shift (especially in the middle and upper income classes) from the voluntary purchase of war bonds to enlarged consumption expenditures, especially on durable goods; and (6) partly through an enlarged program of Federal expenditures on social welfare, including family allowances; food-stamp plan and other food subsidies designed to improve nutrition, including school lunches; greatly

enlarged public health program; revised and expanded program for old-age assistance and old-age pensions; and Federal aid to education to bring up the standards in backward areas.

The model further assumes a large increase in private gross capital formation from \$0 to \$20 billions per annum. This includes replacement expenditures on plant and equipment, net investment (over and above replacement expenditures) in plant and equipment and in residential buildings, and inventory accumulations. All these areas may have been starved during the defense and war period, and, accordingly, large shortages may have accumulated requiring greatly increased capital outlays. Capital expenditures might well, for a year or two, rise to a level above the figure indicated. After the last war a tremendous spurt occurred, lasting from the spring of 1919 to the middle of 1920, in investment in manufacturing plant and equipment.

The model further presupposes a figure of \$35 billions for Federal, State, and local expenditures. This includes military outlays, an enlarged social security program, post-war international loans financed by the Reconstruction Finance Corporation as an integral part of some sort of international set-up to engage in international lending and designed to facilitate (1) the rehabilitation and reconstruction of countries devastated by the war, and (2) expansion of investment in industrially backward countries, including South America and China.

Altogether the various factors enumerated above indicate the great possibilities for the expansion both of consumption and of private investment during the transitional period. Indeed, the potentialities for expansion of consumption and private investment in the immediate post-defense period are sufficient to indicate the possibility of a genuine and fairly prolonged post-war boom. The Federal Government should be prepared to play a

balancing role, checking any temporary tendency toward an excessive boom, and, on the other hand, prepared to go forward with large Federal expenditures on public improvement projects to compensate for any strong tendency toward deflation and depression.

SHIFT TOWARD A HIGH CONSUMPTION ECONOMY

From the long-run standpoint, a persistently pursued policy to maintain full employment raises interesting questions with respect to the effect of such a policy on (1) the distribution of income, and (2) the proportion of a full employment income which, it may be expected, would be expended on consumption. In brief, it is reasonable to suppose that the ratio of consumption to income in a full employment economy would automatically tend to be higher than the ratio of consumption to income at the peak of a boom in a violently fluctuating economy. A full employment economy would tend automatically toward a distribution of income favorable to high consumption. This affords ground for optimism with respect to the feasibility of a positive program designed to maintain full employment. Such a policy, if successfully pursued, tends to develop repercussions upon the distribution of income which reinforce the program to maintain full employment.

That this is true can best be seen if we analyze the problem of corporate profits in a society continually operating at a full employment level. Peak prosperity profits have never in the past been realized for any considerable period of time. In a highly fluctuating society such as we have known, normal profits are some sort of average of good times and bad times. Thus, for example, in the period 1925-1940, the net income of corporations fluctuated very violently in relation to the total national income. In periods of high prosperity, the ratio of net income of corporations to the total

national income was high, while in periods of depression, despite a fall in the national income, the ratio of the net corporate income to the total national income was low. Over the entire 16-year period from 1925-40, inclusive, the corporate net income averaged only 4.6 percent of the national income. It should be remembered, moreover, that this 16-year period included many years of serious depression, so that the average national income was relatively low. In other words, corporate profits constituted only a low percent of a small national income—small in comparison with the income potentially realizable.

In a highly fluctuating society, corporate profits are high in good times and extremely low in bad times, but the average must be adequate to motivate a profit economy and insure its workability. If, however, it were possible to maintain continuously a full-employment national income, it is obvious that corporate profits, representing the same percentage of national income as that averaged over the cycle in the past, would yield an absolute profit figure far above the experience of 1925-40. Yet such a percentage continuously maintained would be much lower than the high ratio of profits to national income reached in a fluctuating society in a few peak boom years.

In a society operating at continuously full employment, it is not probable that peak-prosperity profits (in 1925-29 approximately twice the average for the entire period 1925-40) could indefinitely be maintained. In a fluctuating society such high profits are necessary to offset the losses of the depression years, but it is unreasonable to suppose that profits of the magnitude of boom periods would be realized indefinitely in a full employment system. They would almost certainly be eaten into, partly by competitive price decreases benefiting consumers and partly by the pressure for higher wages which invariably occurs in industries making

large profits. Either development would tend toward a more equal distribution of income than has prevailed in the past *in boom periods* when full employment was reached. This is true because of the relative decline in the ratio of business profits to the national income *at full employment levels*. Yet, if a full employment income were continuously maintained, the ratio of business profits to national income over the whole cycle might be greater than that experienced in the past, while the *magnitude* of business profits *would* be considerably greater (even though the average ratio of profit to income were no higher) since the average national income for the whole period would be very much higher if we succeed in achieving substantially full employment.

It must be recognized, however, that there are certain limitations on how far profits can be encroached upon, either through wage increases or price decreases, without encountering unfavorable economic repercussions with respect to the cost-price structure. Wage increases and price reduction are likely to cut across all firms in an industry, whether they make profits or not; and wage increases are likely to spread even to industries which are not making abnormally large profits. Thus, the process of encroachment upon boom-time profits through wage increases and price reduction, if carried too far, may disrupt the appropriate balance in the cost-price system.

Redistribution of income through progressive individual and corporate income taxes is less disruptive of these relations for the reason that such taxes apply only where the profits and income actually emerge. They do not affect the high-cost industries which make no profit. As already indicated, there are limitations upon the process of redistribution of income through the methods of wage increases and price reduction. These methods are feasible up to a certain point, but the point is fixed by the requirements of cost-price balance.

Consumption can, nevertheless, be very materially

raised through wage and price adjustments in a society continuously maintaining full employment. There would still remain, by reason of continuous capacity output, adequate profits to sustain and motivate private enterprise—indeed, better profits than those experienced on the average in a highly fluctuating society.

Such a shift evolving gradually could add several billions of dollars per annum to consumption expenditures at full employment levels. In addition, continuing improvement in labor productivity as a result of technical progress would make possible progressive wage increases without encroaching on the necessary profits required to motivate a private enterprise economy.

In a later post-war period, following the transitional readjustment, we may assume a gradually increasing national income. In terms of current prices, \$135 billion of national income by 1943 now appears to be certain. Accordingly, it should not be unreasonable to suppose that by reason of (1) increased productivity, and (2) population growth, the national income might rise to around \$150 or \$160 billion by 1950.

The components of such a national income, for illustrative purposes, might be set down as follows:

Components of National Income, 1950

	<i>Billions</i>
Private consumption	\$125
Private gross capital formation	25
Government (Federal, State, and local) purchases of goods and services— including public developmental projects, military expenditures, social welfare expenditures, and ordinary public services	40
Gross national product	190
Less business taxes and gross corporate savings	35
Net national income (paid out to individuals)	155

CONCLUSIONS WITH RESPECT TO POLICY

Obviously, the income models set down above can have no validity as statistical forecasts. They are useful, if at all, only as aids to analysis and formulation of policy. They suggest certain conclusions.

First, with respect to the war period, the following policies are indicated:

- (1) High corporate-income and excess-profits taxes.
- (2) Sharply progressive estate taxes.
- (3) Broadening of individual income-tax base together with steeply graduated surtax rates.
- (4) Sharp increase in excise taxes on commodities competing with the war program and other war consumption taxes.
- (5) Compulsory saving (part of tax refundable in special war bonds).
- (6) Qualitative shift in components of consumption.

Second, with respect to the post-war period, the following policies are suggested:

- (1) Retention of progressive (graduated) tax structure and broadened tax base, with major emphasis on individual and less reliance on corporate income taxes.
- (2) Sharp reduction in war taxes on consumption including raising somewhat the personal exemptions and reducing the rates on lower incomes.
- (3) Adequate plans by private enterprise for private-investment projects in manufacturing plant and equipment, in railroads, public utilities, and housing.
- (4) Adequate program of public-improvement projects including a nation-wide development of national resources, express highways, urban redevelopment (involving among other things outlays in terminal facilities and reorganization of urban transportation), and a reorganized public housing program (including the setting up of a Housing Research Laboratory designed to reduce construction costs and thus enlarge the scope of private housing construction).
- (5) Expansion of public-welfare expenditures—Federal aid to education, public health, old-age pensions and family allowances. This involves partly an expanded program, and partly a means of reducing State and local property and consumption taxes, thereby stimulating private consumption expenditures.

(6) International collaboration to pursue internal policies designed to promote active employment; to explore developmental projects in backward countries; and to implement ways and means to open outlets for foreign investment, promote world trade and the effective world-wide use of productive resources.

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