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POST-DEFENSE FULL EMPLOYMENT

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1. War and Postwar Aims

The immediate war aim is to defeat Hitler and 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 another international conflagration.

A positive program of postwar economic expansion and full employment, boldly conceived and set forth in a vigorous manifesto, is the only thing that can touch off any spark of mass enthusiasm at all comparable to Wilson's "Fourteen Points". Such a manifesto would awaken a tremendous popular response in this country, in England, and in the conquered countries.

2. Structural Gains from the Defense Program

Three important gains will be won from the defense program in the struggle to achieve and to maintain full employment. But it will require vigilance to hold these gains.

First, we shall get the national income up to say, $100 billions. It is far easier to resist a decline from a high income level than it is to muster support 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 100 to 90, 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.

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Second, we shall achieve from the defense program a large Federal budget -- about double that of recent years. A Federal budget of around $18 billions is a basic prerequisite, under modern conditions, for full employment.

Third, we shall gain from the defense program steeply progressive corporate and individual income taxes and estate taxes. If we hold this gain and drastically reduce consumption taxes when the defense program is over, a major structural shift in the tax structure will have been achieved. This is the second necessary condition for full employment under modern conditions.

3. Our Output Potential

Basically, our output potential is a function of our labor potential. What is important is not the number unemployed -- actively seeking work -- when the Census was taken in March 1940. What is important is the labor potential which we can muster.

I shall use two bench marks from which to measure our labor potential: (1) the employment reached at the peak of the 1929 boom, and (2) the employment reached at the peak of the 1918 war effort.

In the third quarter of 1929, 49.7 millions were employed, or 56.7 per cent of the population, 14 years of age and over. Applying this per cent to the 1940 population in this age group, we get a labor potential, based on our first bench mark, of 57 million workers. A correction is, however, necessary. The age of entrance for youths to the labor market is now higher; the age of retirement for aged persons is lower; while, on the other side, the proportion of women in the labor market is now greater. Adjusting for

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these changes, as revealed in the Census data, our labor potential is reduced to 56 millions for 1940. Half a million will be added annually to the number through natural growth. Thus the labor potential by 1947 will be 57 millions and by 1944, 58 millions -- 10 to 11 millions in excess of the averaged employment of 1940.

In 1918, 44 millions were employed in economic pursuits or in the military force, or 61 per cent of the population, aged 14 and over. Applying this ratio to the 1940 population, we get a labor potential of 61.5 millions. When adjusted for the factors enumerated above, we get a corrected labor potential, based on the 1918 war effort bench mark, of 59 millions for 1940, or 12 millions in excess of the averaged employment in that year. By 1944, through natural growth, this would become 61 millions, or 14 millions in excess of the 1940 employment.

We may thus conclude that we shall have as a minimum a labor potential by 1943-4 of 10 to 12 millions to absorb into industry. This is true even though 2 to 4 millions are added to our military forces. Over and above the labor potential we can divert from current agricultural employment 2 to 3 millions without encroaching upon agricultural output. In addition, it is estimated that about one million, now engaged in more or less useless self-employment jobs, would gladly turn to more remunerative jobs in industry as employment opportunities develop.

This labor potential of 10 to 12 millions cannot suddenly be put to work. Experience, both in Germany and the United States, shows that the task of retraining and fitting large masses of labor into the productive process is a slow and difficult one. In no single year, in the rapid expansion from 1933 to 1939, was Germany able to absorb more than 1.8 million

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workers. With a population half the size of ours, this would mean, in terms of our population, 3.6 millions. And the average for the 4 best years was only 1.4 millions, or 2.8 millions in terms of our population. In the best year of the boom in the Twenties, we absorbed only 3 million workers, and the average for the 4 best years was only 2.2 millions. In the best year of the recovery of the Thirties, we absorbed only 2.9 millions, and averaged in the 4 best years only 2.6 millions. We may thus conclude that an average absorption of 2.5 to 3 millions and a maximum absorption of 4 millions in a peak year is probably all that can humanly be achieved, especially when account is taken of the possibilities of transfer from agriculture and self-employment. On this basis we shall not reach our labor potential of 58 to 60 millions employed until 1943 or 1944.

Past experience, both in Germany and America, indicates that output increases proportionally more rapidly than employment. This is true for the following reasons: (1) the secular rise in labor productivity tends continually to raise output relative to employment, (2) plant, equipment and other overhead factors are more fully utilized as total employment increases, (3) in many fields, especially trade and the service industries, those already employed are occupied more continuously throughout the working day as the national income rises, and (4) the expanding industries, which absorb much of the additional labor, are "high productivity" industries. Actual experience in the United States in the boom of the Twenties, the recovery of the Thirties, and in the German expansion strongly support this theoretical analysis. In Germany output increased more rapidly than employment straight through until full employment was reached before the

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outbreak of war. According to the American experience, the absorption of 10 to 12 million workers should enable us to increase our real income by $25 to $35 billions in terms of 1940 prices. Thus we could expect the income to rise from $75 billions in 1940 to $100 to $110 billions in 1943-4, assuming no increase in prices.

Miracles cannot be achieved overnight. The process of labor absorption and expansion of output takes time. In no year was Germany able to raise her real income by more than 10 per cent, and the average was 9 per cent. Similarly in the recovery years of the Thirties, the average increase in real income in the United States was 9 per cent. Applying a ten per cent increase per annum, we get the following interesting figures for national income at 1940 prices:

1940	-	$75 billions
1941	-	82.5 "
1942	-	90.7 "
1943	-	100 "
1944	-	110 "

It is not improbable that the movement may be somewhat more rapid in the early years and somewhat retarded in the later years. We may set the limit of real income (1940 prices) at $100 to $110 billions when our full labor potential has been realized.

4. The Post-Defense Gap

In calendar 1940, our national income was $75 billions. Of this, $64 billions was expended on consumption, $8 billions on net capital formation (over and above replacement capital expenditures), on plant, equipment, housing, inventory accumulation, public works, and net foreign balance, and $3 billions on defense. Our output potential by 1943-4 is probably around

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$100 to $110 billions at 1940 prices. Let us adopt for our model the $100 billions as our minimum realizable goal. Assume that the 1940 per capita consumption level is maintained. (It will be higher in 1941, but 1942 will doubtless see a sharp curtailment in automobile purchases and also in the purchase of electrical equipment and other consumers' durables which encroach upon defense output.) Let us suppose that consumption as a whole by 1943-4 will not fall below the 1940 per capita level. $65 billions of the $100 billions would then be spent on consumption. Considerably less than $8 billions per annum would be adequate for net capital formation. Of the $8 billions so spent in 1940, $2 billions was for inventory accumulation, $1 billion was for net foreign balance, while the net for housing and public works (over and above replacement) was about $3 billions. We shall not want to continue to accumulate inventories; the foreign balance will henceforth be financed (under Lend-Lease) mainly from the defense budget; while housing and public works will certainly be considerably curtailed by 1943-4. $5 billions may thus be set down as adequate for net capital formation, exclusive of the plant and equipment financed from the Federal defense budget. (In passing, it may be noted that only $3.8 billions per annum was expended on plant and equipment (net) in 1927-29). Thus $30 billions would be available for defense without encroaching on the consumption standard achieved in 1940 -- the highest level reached in our history. The national income would thus be apportioned as follows:

Components 1943-4 Income (billions)	
Consumption	$65
Net capital formation	5
Defense	30
Total national income	$100

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When the defense is over and the $30 billions for defense drops out, we shall be confronted with a gap that has to be filled by consumption and net capital formation if we are to maintain full employment.

In order to analyze how this gap may be filled, it will be necessary to make specific assumptions with respect to the Federal budget and the tax structure in 1943-4. It will be assumed that, at $100 billions income, corporate profits prior to taxes are $15 billions. (In 1929 corporate profits were 14 per cent of national income.) It is assumed that we shall by then have imposed, besides a corporate income tax of 30 per cent, a stiffly progressive excess profits tax. It is assumed that these two taxes together will capture two-thirds of the corporate profits, thus netting $10 billions per annum. It is assumed that the individual income tax will be broadened and rates increased to yield $5 billions, with $1 billion from estate and gift taxes. Thus $16 billions would be raised from progressive taxes. It is further assumed that during the defense program liquor and tobacco and manufacturers' excises, especially on consumers' durables, will be sharply increased to yield $6 billions per annum. Thus the Federal budget for 1943-4 may be set down as follows:

Expenditures:	
Administration and interest	$3
Public works (including skeleton relief agencies)	1
Social welfare	2
Defense	30
Total	$36
Taxes:	
Corporate - income and excess profits	10
Individual income and estate	6
Consumption (including pay roll, less appropriation to old-age reserve)	6
Total	$22

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In the post-defense period, the problem now is how to fill the gap left when defense expenditures are curtailed. Let us suppose the following components of the post-defense national income:

Post-Defense Income Components
(Billions)

Consumption	$80
Net capital formation (including public works and housing)	10
Defense (including international RFC)	10
Total	$100

This model presupposes that consumption is lifted from $65 billions to $80 billions, that net capital formation is increased from $5 billions to $10 billions, while defense outlays decline from $30 to $10 billions. The latter figure includes post-defense international loans (of, say, $3 to $4 billions) by a federally financed international RFC, rehabilitation and reconstruction of England and the Continent, and investment in Latin America and China.

We have assumed that consumption would be held down to $65 billions during the defense effort. It is not likely that this could be achieved without (1) the imposition of heavy consumption taxes during the defense effort, (2) part payment of increased wage and salary bill in defense bonds (Keynes' plan), and (3) large voluntary purchases of defense bonds. If these ends can be achieved during the defense period, the post-defense release of funds thus diverted would help greatly to raise post-defense consumption and so fill part of the gap from curtailment of defense expenditures.

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Let us suppose that post-defense consumption is raised by $15 billions through the following measures:

1. Cash payment of wages and salaries in lieu of part previously paid in defense bonds	$5
2. Reduction in consumption taxes (from $6 billions revenue to $2 billions)	4
3. Consumer credit, and spending part of accumulated defense savings	2
4. Shift (in middle and upper income classes) from purchase of defense bonds to consumption expenditures	2
5. Increased Federal expenditures on social welfare projects	2
Total increase in consumption	$15

Net capital formation, we assume, would increase by $5 billions, to a total of $10 billions per annum. This would include not only net investment in private plant and equipment, but also an enlarged housing program, public and private, and a greatly expanded public works program.

On this basis, the Federal budget might look as follows:

Federal Budget in Transitional Post-Defense Period

Expenditures:	
Defense (including international RFC)	$10
Administration and interest on debt	3
Public works (including public housing program)	5
Public welfare	4
Total	$22
Taxes:	
Corporation (income and excess profits)	10
Individual income and estate	6
Consumption taxes	2
Total	$18

It is assumed that the steeply progressive corporate and individual income taxes will be maintained, while consumption taxes are sharply cut —

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from $6 to $2 billions. Corporate profits (at $100 billion income level) are assumed in the transitional period to remain at $15 billions.

The problem of corporate profits in a society continually operating at full employment level is of special interest. Full-prosperity profits have never in the past been achieved for any considerable period of time. In a highly fluctuating society, such as that we have known, normal profits are some sort of average over good times and bad. In a society operating continuously at full employment, it is not likely that peak-prosperity profits could indefinitely be maintained. They are likely to be eaten into, partly by competitive price decreases benefiting consumers, and partly by pressure for higher wages. Either development would tend to raise consumption expenditures. But it is not likely that either wage increases or price decreases can reduce profits by as large a slice as is possible through taxation. Corporate income and excess profits take profits where they actually emerge. Wage increases and price reduction cut across all firms, whether they make profits or not, and if carried too far disrupt cost-price relationships.

We shall, nevertheless, assume that corporate profits will gradually be eaten into by wage and price adjustments. If a full employment income were continuously maintained, it is reasonable to suppose that wage increases and price decreases might cut corporate profits to perhaps 10 per cent of national income. (In 1925-29, corporate profits averaged 13 per cent of national income.) Such a shift, gradually evolving, could add several billions more to consumption. In addition, increasing labor productivity would make possible wage increases without encroaching on profits.

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In a later post-defense period (say, 1947), we may assume the following allocation of the national income. It is assumed that the national income has risen to $110 billions by reason of (a) secular increase in productivity and (b) population growth.

Components of National Income, 1947	
Consumption	$95
Net capital formation	12
Defense (including international RFC)	3
Total	$110

The Federal budget, corresponding to this income level, may be set down in our working model as follows:

Expenditures:	
Defense (including international RFC)	$3
Administration and interest	4
Public works	5
Public welfare	6
Total	$18
Taxes:	
Corporation	6
Individual and estate	7
Consumption	2
Total	$15

5. Conclusions with Respect to Policy

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

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

(a) Sharply progressive corporate income and excess profits taxes, leaving only about $5 billions of corporate net profits after taxes.

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(b) Sharply progressive individual and estate taxes, netting about $6 billions revenue at $100 billion income level.

(c) Sharp increase in defense consumption taxes, designed to hold down consumption and thus permit expanded output to go into defense.

(d) Part payment of wages and salaries in defense bonds.

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

(a) Full retention of progressive tax structure.

(b) Sharp reduction in defense consumption taxes.

(c) Adequate shelf of public improvement projects, including a nation-wide development of TVA program, express highways, urban transportation development, and a reorganized public housing program, involving the setting up, under a Federal Housing Agency (coordinate with the three existing Federal agencies), of four Government corporations as follows: (1) Slum Clearance Authority, (2) Public Housing Authority (USHA), (3) Housing Insurance Authority (FHA), and (4) Housing Research Authority -- the whole setup being designed to greatly enlarge the scope both of private and public housing. [A separate memo on housing will be submitted later.]

(d) Expansion of public welfare expenditures -- Federal aid to education, public health, and old-age pensions. This involves partly an expanded program, and partly a means of reducing State and local property and consumption taxes, thereby stimulating private consumption expenditures.

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