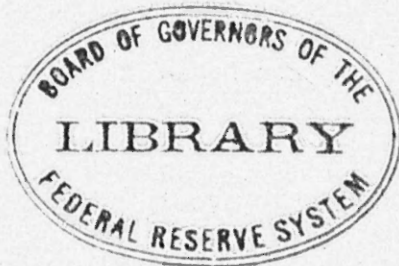


PRODUCTION, DEFENSE AND SMALL BUSINESS

ADDRESS BEFORE THE  
NEW SCHOOL FOR SOCIAL RESEARCH  
NEW YORK CITY, FEBRUARY 18, 1941.

BY

HUGHST C. DRAPER  
MEMBER OF THE BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM



Released for use not earlier than  
8 p.m., February 18, 1941.

PRODUCTION, DEFENSE AND SMALL BUSINESS

By

Ernest G. Draper, Member, Board of  
Governors of the Federal Reserve System

This is a three-point subject which has been assigned to me and I should like to discuss briefly the last point first.

America is a great country and we like to think of its industry in terms of size, of power and of efficiency. And yet the simple facts are that more than 60% of the nation's workers are today earning their living in small concerns. More than 95% of all business concerns in this country have assets of less than one million dollars. Despite our much cherished pride in the bigness of big business we are, essentially, a nation of small businesses.

Strangest of all, small and medium-sized industry is actually more efficient than big business. By "small", I mean small in relation to the size of all concerns in each separate industry. In a recent release by the Federal Trade Commission, in December 1940, we learn that medium-sized concerns lead the way in efficiency in 55% of cases tested, that small concerns are at the top in 34% of the tests and that the giants of industry stand a poor third with peak efficiency in only 11% of the tests. This survey covers 18 major industries representing approximately 25% of the value of all yearly manufacturing production in the United States. Covered by the study were such industries as: cement, blast furnaces, steel,

-2-

farm machinery, petroleum production, petroleum refining, automobiles, beet sugar production, cane sugar production, milk distribution, butter, flour milling, baking, chemicals, fertilizers, rayon, etc.

In the process of erecting the foundations of a gigantic munitions industry for the free democracies of the world - to which the American democracy has dedicated itself - the role of the small business concern assumes increasing importance. For behind every assembly line engaged in turning out bombers, pursuit planes, tanks and anti-aircraft guns, there is at work a veritable army of sub-contractors who supply the materials and parts for those assembly lines. Thus, for example, in the assembly of a Pratt & Whitney airplane motor, 40 percent of the parts are furnished by sub-contractors. In the case of a bomber which the Glenn L. Martin Company turns out, the services of hundreds of sub-contractors are called for, sub-contractors who are located in virtually every State of the Union.

We have at the present time a system which has been described as "the sub-contractor solar system" whereby groups of skilled sub-contractors revolve about certain major prime contractors. In building up an armament industry a heavy responsibility rests upon these sub-contractor orbits, the men and enterprises behind the assembly lines. It is of the utmost importance that all existing sub-contracting facilities be harnessed to the



-3-

national defense effort and that our sub-contractors have access to capital and credit. We can no longer afford the luxury of repeating the mistakes of France and Great Britain in not paying sufficient attention to the needs of the men and enterprises behind the assembly lines. If we are to put production into high gear it means that there can be no breakdown in the continuous flow of parts and supplies along the transmission belts.

Is it any wonder, then, that in marshalling the forces of industry for defense, the National Advisory Defense Commission established a Division for Small Business Activities and appointed Mr. Donald M. Nelson, now Director of Purchases of the new Office of Production Management, as its Director? Recently, this activity was more closely integrated into the Office of Production Management by the appointment of Mr. R. L. Mehornay as Director of what is now called the Defense Contracts Service. This service, under the able leadership of Mr. Mehornay, will be expanded and manned completely with business and engineering experts so as to render decentralized advisory services to all concerns, and particularly to the smaller enterprises. The purpose of this whole program is to enable all establishments, and particularly the smaller ones, the sub-contractors and potential sub-contractors, to mobilize their plant facilities and technical skill behind the defense program as well as to encourage the nation's commercial banks to mobilize their credit reservoirs

-4-

behind the defense effort. To effectuate these ends, the Defense Commission last October requested the cooperation of the Federal Reserve System. At the request of the Board of Governors of the Federal Reserve System, each of the 12 Federal Reserve Banks and 24 branch banks has appointed an officer to provide a point of contact between the smaller business concerns, the commercial banks, and the Office of Production Management.

As an example of how this program functions, consider the case of a manufacturer of clothing here in New York City. He is aware that the Quartermaster Corps must clothe a growing army of two million men. He has never done business with the Army. He has not the remotest idea of how to go about placing his name and facilities before the proper authorities. He is not even familiar with the purchasing methods employed by the Army. He has no representative in Washington who might ascertain this information. The very thought of a personal visit to Washington with the prospect of not knowing what individuals to see after he arrives at the Capital is disturbing - let alone the time and money involved.

Under this program which I have just outlined to you, this manufacturer can go to the Federal Reserve Bank in this city and be informed of the precise method to place his name before the Quartermaster Corps. If he requires credit, he will be directed to the proper sources - preferably his local bank. If he

-5-

should obtain a defense contract and subsequently experience difficulties - production, financial, legal or even plain red tape - he will be aided by a member of the Staff of the Director of the Defense Contracts Service in Washington or a Federal Reserve official located in his district. In short, through the Director of this Defense Contracts Service, and the 36 offices of the Federal Reserve Banks and their branches, a business concern anywhere in the country may obtain information relating to defense contracts as well as engineering, financial and legal guidance in securing and executing such contracts.

Time prevents me from discussing this problem at greater length, particularly as the other two points of my subject - Production and Defense - are so provocative in their implications that I am anxious to say a few words about them without further delay.

You must remember that I speak to you not in any official capacity but rather as one citizen to another, as a citizen who like yourselves is profoundly disturbed by the shattering events of a world as we have heretofore known it and the sinister prospect of the possible shape of things to come.

If I speak to you in a sober vein it is because I am deeply conscious of the gravity of the times and of the urgency of speaking with the utmost candor.

As I look about and endeavor to appraise the gigantic



-6-

effort of the American democracy toward total mobilization of its man power and resources, I am increasingly impressed by one paramount fact: I do not believe that the great mass of Americans have as yet realized the full implications of the meaning of total defense against total war.

For all too many Americans - I have the impression - total defense and total war are matters of turning out vast quantities of guns, tanks, ships and planes; in a word, of arming ourselves to the teeth and saying "Now attack us, if you dare". Yes, total defense does mean building up a vast munitions industry. And to that task, as the President has so eloquently pointed out, this nation has dedicated itself.

But it is at this point that I believe much of our current thinking falls short. I do not believe that there has as yet taken place in any considerable segment of the public consciousness a full enough realization of what lies behind those concepts of "total defense" against "total war".

It is one of the curious attributes of human experience that men will accept the intolerable because they fear still worse catastrophes to come. From roughly about the end of the first World War to the period of time associated with the capitulation at Munich, the West-European world has been immersed in a kind of philosophy of negation. By that I mean to say that men have been tempted to embrace political and social philosophies which have

-7-

destroyed their freedom because either they have feared greater evils to come or have lacked the courage and moral stamina to resist the onslaught of those forces whose avowed purpose was the destruction of the human and spiritual values which are associated with the democratic-capitalistic systems.

We lived during those years in a world beset by a kind of collective neuroticism. And it was out of that kind of world that there emerged the new technique of world revolution which is at the core of Naziism.

I am convinced that the social revolution of Naziism could not have had its present success in the absence of an all-pervading attitude of "putting up with things as they are" in the hope that thereby greater evils might not ensue. We have come to call this attitude of mind "appeasement".

Some of you will recall that in 1931 - two years before the seizure of power in Germany by the revolutionary forces of National Socialism - there appeared in this country a book by an author named Malaparte, on the technique of the seizure of power. That book did not receive very widespread attention; yet it is an important publication of our time in that it revealed (even before the advent to power of Adolf Hitler) the essential basis of Naziism. Malaparte observed how easy it was, granted favorable circumstances, to effect a seizure of power in the modern state. Political opposition could be destroyed - Malaparte pointed out - within its



-8-

own strongholds. However, a seizure of power cannot be successful - and herein lies the basic dogma of Naziism - unless the existing political system and social order have been previously shaken and weakened by revolutionary influences. Thereafter the seizure of power will succeed with almost mathematical precision, Malaparte wrote, when there has been applied to it the essential tactics of revolt.

The application of the technique of the seizure of power has been perfected by the Nazis into a veritable "science of treason". The now classic - and tragic - examples of its use are familiar to all of us.

I have thought it desirable to present this aspect of total war since it is essential that we understand that the military act of blitzkrieg is only the end product of a revolutionary chain of events. A moment's reflection will recall to you that it is only after a victim has been thoroughly shaken and crippled from within, after his moral and social nerve centers, so to speak, have been shattered, that the Nazi armed forces have moved in.

Hitler, with cunning shrewdness, has been enabled to spread his revolutionary doctrine because he has exploited the essential weaknesses of the world's capitalistic democracies. For the issue which he has presented to masses of working men and women is nothing less than the deficiencies of the capitalistic system.

When Hitler boasted recently that he had established an

-9-

economy of work as opposed to an economy of gold, he was not indulging - as some have supposed - in defeatist talk. He was pointing his finger to a dangerous weakness of democracy - its class struggles; its separate worlds of the "haves" and the "have nots"; its "rich" and its "poor"; its mass unemployment in the midst of plenty; its faulty system of production and distribution; its apparent inability to function effectively for the great mass of its people.

So long as Hitler can exploit the economic weaknesses of the democratic states, the new doctrine of total war by means of world revolution has a chance of succeeding. For it constitutes a constant threat to man's will to live freely.

Men will not give their life blood for the preservation of democracy and freedom if those concepts represent only empty stomachs, underfed children and insecurity. Hitler has shrewdly perceived - as too many of us have not - that so long as democracy fails to represent a living, vibrant reality for the common men and women of this world, their will to be free men and women can be broken, through the now familiar techniques of totalitarian propaganda.

Naziism is fully cognizant that a democratic order which is shot through with monopolistic restraints, trade secrets, vested interests, special privileges, rivalries between industries, will endeavor to carry on its preparations for total defense on the basis

-10-

of business as usual.

Naziism is not unaware that the business interests of a democracy are all too prone to think of defense in terms of business profit instead of as a form of economic preparedness.

Naziism is calculating that the democratic effort at total defense will spread further the cleavage between the interests of labor and the interests of capital instead of achieving a genuine partnership, through fair and effective mediation of labor disputes, made necessary by one of the crucial periods of our history.

Since fire is often best fought with fire, the democracies must forge a counter weapon to combat the Nazi instrument of world social revolution. England has perfected its own secret weapon; it is precisely the same type of weapon which Adolf Hitler has employed since his seizure of power in the German Reich; it is nothing less than an entirely new concept of life for all, rather than a few, Englishmen. Great Britain has recognized that Naziism cannot be defeated by force of arms alone. She recognizes that the hold of Naziism on the minds of men can be broken only by a dynamic counter movement directed against ancient abuses of power and responsibility by those who would defeat the legitimate aims of capitalism through an excess of greed and short-sightedness.

Mr. Thomas Bevin, who stands close to Mr. Churchill in influence, recently enunciated the full significance of Great Britain's



-11-

counter weapon. "I want to give you," he said, "a new motive for industry and for life. I suggest that at the end of this war and, indeed, during this war, we accept social security as a main motive of all our national life. That does not mean that all profits or surpluses would be wiped out, but it does mean that the whole of your economy, finance, organization, science, and everything, would be directed together to social security not for a small middle class or for those who may be merely possessors of property but for the community as a whole."

There, indeed, is the answer to the revolutionary forces of the new order or tyranny.

There is plain recognition that in the new world which will emerge from the present holocaust, British men and women are through with exaggerated and unfair class privilege; that as Herbert Morrison has said, "There must be no private monopolies. If monopolies there be, they must serve the state. We must look forward to a society that is rid of the twin pests of extreme riches and extreme poverty."

And on this side of the Atlantic there has been sounded a clear call to democracy, the "marching orders" of our time for the men and women of the democracies in every part of the world. President Roosevelt's historic message to Congress and his profoundly moving Inaugural address contain the ultimate answer to the Nazi social revolutionary force which has been the weapon for

-12-

disunity in the free lands of the world. His is the counter force of freedom: equality of opportunity for youth and for the free men and free women of a free society; security of job; the abolition of special privilege; the full enjoyment by all men and women of our scientific, technological world through a broader and constantly rising standard of living.

In the boldest delineation of the concept of freedom yet presented in our generation, President Roosevelt has laid down for a world in travail the permanent foundations for the new order of affairs to come.

As a result of the American experience itself, President Roosevelt has given the democratic answer to the new order of world tyranny: it is that a world cannot exist half free, half slave.

If that doctrine is now to take on meaning it will require an all-out implementation from every segment of American life. If this conception of freedom as a counter force with which to withstand revolutionary forces of Nazism is to remain in the world, it will require a new understanding on the part of American business men of the meaning of total defense against total war.

It requires, if you please, a realization on the part of business men that production for the defense program is not a matter of merely executing contracts; of filling orders on time and expeditiously. Production for total defense requires that

-13-

business men shall assume a collective responsibility for dedicating the system of private enterprise to the preservation of freedom.

Old ways of thinking will have to be sloughed off. Exclusive preoccupation with the interests of any single business enterprise or industry to the exclusion of the needs of defense production must be abandoned. All of those unfairly competitive techniques of the capitalist economy - monopolistic restraints, price understandings, prestige factors - must be tossed overboard.

At this historic juncture in world history, leaders of American business - big business and little business - face a challenge as profound as any group of men in this country have known since 1776. It is a joint opportunity on the part of all business men to transform a peacetime capitalist order into a dynamic instrument for economic and total defense. It is the opportunity to form effective working arrangements with labor which less momentous times, less critical circumstances would not permit.

In a period of great crisis men are capable of achieving an unselfishness which is otherwise impossible. Today, the men of industry and the men of labor have such an opportunity. For each must dedicate himself to the preservation of this nation and the furtherance of the doctrine of freedom.



-14-

Whether or not our kind of world will survive depends in the final analysis upon whether we as individuals can sink our petty differences and rise to the inherent greatness of ourselves. In a democracy, debate is essential and, if practiced with reasonable restraint, is the very essence of the democratic way of existence. But do not let us have others use this precious heritage of ours to tear us asunder until we all sink in a sea of angry quarrels. There come times when we have to close ranks, to trust those in authority, placed there by ourselves, and to defend our nation, by every legitimate means, against those in this world who, under the guise of being outwardly neutral toward us, would destroy forever the American ideal of democracy.