# Organization of War Economies (USA)

By Erika Cornelius Smith

## Summary

Before the beginning of World War I in Europe, the US enjoyed a sizeable industrial base and one of the largest economies in the world with an economic output that surpassed the UK and doubled that of Germany. In the twenty months of active involvement in the war, however, the US experienced a rapid and substantial transformation of its economy. This article reviews the Great War’s impact on the US economy through evolving business-government relationships; mobilization of the economy; and financing the war effort.

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# Introduction: Historiography

In the immediate post-war period, military and political accounts established an enduring narrative of the American war experience. Although the desire to derive economic and diplomatic lessons from the war ignited an interest in scholarly study of the war during the 1930s, it quickly waned in the wake of World War II. Scholars’ renewed attention to the war’s domestic and diplomatic impact, as well as Wilsonianism’s influence on U.S. foreign policy, came in the midst of another unpopular war during the 1960s and 1970s, and again following the 2003 Iraq War.

In this shifting historiography, economic historians evaluated the efficacy of wartime economic mobilization and assessed the legacy of the federally managed economic mobilization. The firsthand accounts of wartime administrators reinforced the narrative of Americans pulling together voluntarily to win the war, downplaying issues of war profiteering or business inflexibility.[1] Jennifer D. Keene noted that studies in the 1940s and 1950s repeated this narrative of "initial chaos giving way to eventual success," while acknowledging the increased influence of business in governmental affairs.[2] Scholars in the 1960s, including Gabriel Kolko, Melvyn Urofsky, and James Weinstein, offered a different characterization of wartime economic mobilization. They saw business as emerging triumphant from the war effort.[3] William Leuchtenburg encouraged historians to take a longer view in assessing the war's legacy, arguing that methods of economic mobilization during World War I influenced early New Deal approaches to stabilizing prices and wages during the Great Depression.[4] Ellis Hawley went further, arguing that the close relationship between business interests and the federal government cemented the liberal state's role in the American economy.[5] While these historians, particularly Leuchtenburg and Hawley, portrayed World War I as a transitional moment, Robert Cuff and others studied the "gap between the rhetoric and reality," and concluded that administrators in charge of wartime economic agencies sometimes exaggerated their influence over the economy.[6] His work illustrates a network of complex relationships between individuals, industries, and government agencies – some harmonious and others contentious. Historians building on Cuff's work examined top federal administrators' ideological objections to monopolistic business practices, tensions between the War Industries Board and the War Department, and government control of railroads during the war.[7]

Labor historians, such as Joseph McCartin and Robert H. Zieger, focused on the federal government's role in supporting moderate labor unions despite objections from business interests.[8] While offering a more nuanced view of complicated business-government relationships during wartime, both they and the New Left historians agreed on the resurgence of business in American politics. As Keene wrote: "The economic history of the war effort remains mostly focused on fitting the war into the broader battles over regulation, trade unionism, and monopolies occurring during this period."[9] Existent scholarship examines the war's effect on business-government relations and class conflict trends, particularly in urban and industrial areas of the economy, with little attention paid to the war's impact on agriculture.

When the United States officially entered World War I in 1917, it became clear that an unprecedented effort would be required to divert the nation's industrial capacity away from meeting consumer demand and toward fulfilling military needs. By the time Congress declared war, the American economy operated near full capacity, meaning war effort requirements would not be met by simply putting underutilized resources to work. This raised the question of how to finance the war – taxation, borrowing, or printing money?

## War Financing

Throughout the period of neutrality, US government officials kept a close eye on the growing indebtedness of trade partners to private American lenders and the war's economic implications for American prosperity. Ultimately, US cultural connections to the Allied Powers and opposition to Germany's use of unrestricted submarine warfare influenced the US decision to break diplomatic relations with Germany and declare war. Once the United States entered the war, financing their own war effort as opposed to the Allied war effort took precedence.[10]

There was widespread consensus among politicians and business leaders that some portion of the war should be financed by taxation. Secretary of the Treasury William Gibbs McAdoo (1863-1941) professed:

We must be willing to give up something of personal convenience, something of personal comfort, something of our treasure – all, if necessary, and our lives in the bargain, to support our noble sons who go out to die for us.[11]

McAdoo initially pegged that contribution at 50 percent, although he later lowered his expectations to 33 percent.[12] J.P. Morgan, Jr. (1867-1943) suggested 20 percent. There was not any clear theory underlying these figures, rather "an intuition that too much borrowing or too high a level of taxes would be bad for the economy."[13]

World War I had erupted in Europe the same year the US established a Federal Reserve System.[14] During the three years of American "neutrality" in the war, the Federal Reserve completed its organization. The Federal Reserve Act (1913) had, by law, installed the Secretary of the Treasury as chairman of the Federal Reserve Board and the comptroller of the currency as a member of the board. The act also authorized the Treasury secretary to arrange for the board's office.[15] The Treasury and the Federal Reserve, united under a single leader in Secretary McAdoo, worked together in both creating and executing the financial war plan.[16]

Printing money was not part of McAdoo's plan. The experience of issuing "greenbacks" during the Civil War suggested that fiat money would generate inflation, which could not only damage the reputation of the newly issued paper currency, but also hide the costs of war rather than keeping the public engaged and committed. "Any great war must necessarily be a popular movement. It is a kind of crusade."[17] For these reasons, he chose a mix of taxation and the sale of war bonds.

## War Revenue Act of 1917

The War Revenue Act of 1917 created several new sources of revenue for the federal government. Congress had anticipated the need for revenue and passed an initial Revenue Act in 1916, raising the lowest tax rate from 1 percent to 2 percent; those with incomes above $1.5 million were taxed at 15 percent. The act also imposed new taxes on estates and excess business profits. By 1917, largely due to the new income tax rate, the annual federal budget was almost equal to the total budget for all the years between 1791 and 1916. Under the 1917 act, a taxpayer with an income of only $40,000 was subject to a 16 percent tax rate, while one who earned $1.5 million faced a rate of 67 percent.[18] Only 5 percent of the population paid income taxes, yet revenue increased from $809 million in 1917 to $3.6 billion the following year.[19] While President Woodrow Wilson (1856-1924) Underwood Tariff Bill (1913) and prior revenue acts by Congress were an important source of revenue for domestic programs, the War Revenue Act was "designed to raise annually over two and one half billion dollars exclusively for war purposes," above ordinary revenues.[20]

## Liberty Bonds

Secretary McAdoo turned to the record of Samuel Chase (1741-1811), Abraham Lincoln (1809-1865) Secretary of the Treasury, for additional ideas on how to finance the war. Inspired by Chase's marketing of government securities through a private firm, Jay Cooke and Company, McAdoo organized a campaign to market bonds to ordinary citizens across the country. The plan was to keep interest rates competitive with the current return on comparable assets. To many observers at the time, a massive bond sale on these terms was an "imprudent gamble."[21] Bankers and bond dealers feared that many Americans were not familiar with bonds, and that they might not sell without the promise of an attractive return.[22]

Recognizing these concerns, McAdoo developed a "Liberty Loan" program based on three key elements: first, a public education campaign raising awareness about the function of bonds, the war's objectives, and the US' potential financial power; second, an appeal to patriotism calling on all Americans, from children to millionaires, to "do their part"; and third, a volunteer army to promote the bonds and avoid the money market, brokerage commissions, or a salaried sales force.[23] The Federal Reserve Banks would coordinate and manage sales, and bonds could be purchased at any bank in the Federal Reserve System.

McAdoo commissioned posters from leading artists such as Howard Chandler Christy (1873-1952) and Charles Dana Gibson (1867-1944), and enlisted movie stars like Douglas Fairbanks (1883-1939) and Mary Pickford (1892-1979) to extol the virtues of buying bonds.[24] The Boy Scouts participated under the slogan "Every Scout to Save a Soldier." Purchasers received buttons and window stickers advertising their patriotism. In May 1917, supporters donated 11,000 billboards and streetcar ads in 3,200 cities.[25] During the second drive, nearly 60,000 women sold bonds.[26] *The New York Times* reported that the third drive issued more than 9 million posters, 5 million window stickers, and 16 million lapel buttons in one of the government's greatest advertising efforts.[27]

McAdoo also conceived of an installment plan to make the bonds more affordable. Individuals could start by purchasing "War Thrift Stamps" for twenty-five cents. Referred to as "little baby bonds" by the Treasury Department, they earned interest like Liberty Bonds. The program targeted women and children, and enabled shoppers to take their change in Thrift Stamps. Once sixteen were pasted to a card, they could be exchanged for a five-dollar "War Savings Stamp." Ten stamps could be exchanged for a fifty-dollar Liberty Bond.[28]

The program achieved its goals with the first loan oversubscribed by 50 percent, or more than 4 million subscribers. Nationally, this represented about one in every six households. Subscribers for the smallest amounts were given priority and larger subscribers were rationed. *The New York Times* reported that John D. Rockefeller (1839-1937), who pledged $15 million, was allotted only "something over $3 million."[29] 50 percent of the bonds sold for the lowest face value, and approximately one-third sold at the $100 value. By war's end and after four sales drives, 20 million individuals had purchased bonds, raising more than $17 billion.[30] Ultimately, the bulk of the war effort (58 percent) was financed by borrowing from the public, and the remaining funds were evenly split between taxes (22 percent) and money creation (20 percent).[31]

## Mobilization of the Economy

Between 1914 and 1917, American industrial production increased 32 percent and GNP increased by almost 20 percent. For example, Bethlehem Steel, which suffered from the pre-war economic recession (1913-1914), rebounded by producing the steel that Europe needed to build tanks, guns and artillery shells. By the end of the war, Bethlehem Steel had produced 65,000 pounds of forged military products and 70 million pounds of armor plate, 1.1 billion pounds of steel for shells, and 20.1 million rounds of artillery ammunition for Britain and

France.[32] The US' entry into the war in 1917 gave Bethlehem Steel an additional boost. It produced 60 percent of the finished guns ordered by the United States, 65 percent of all American gun forgings, and 40 percent of the nation's artillery shell orders, in addition to steel for the world's largest shipyards and supplies for the British and French armed forces. Between April 1917 and the Armistice in November 1918, Bethlehem produced more than 65 percent of the total number of finished artillery pieces manufactured by all of the Allied nations.[33]

For economic historians, one of the most interesting aspects of the war economy was the federal government's attempts to control the economy through centralized production and price systems. The three most significant agencies were: first, the War Industries Board (WIB), including the autonomous Price Fixing Committee which oversaw industrial production and prices; second, the Fuel Administration, which oversaw fuel production and prices; and third, the Food Administration, which oversaw agricultural production and prices.

The War Industries Board, a regulatory agency set up to manage the economy during World War I, had more powers than any other US government agency to that date. In practice, however, the board was not a centralized regulatory agency rationalizing the economy. Instead, the WIB partnered with businesses to coordinate producing and distributing war materials in the American economy. It matched the demands of war production with the needs of the armed forces, European allies, other war organizations, and consumers. In some cases, the board persuaded corporations to cooperate voluntarily to meet the priorities of war production. The WIB established fifty-seven committees, organized by commodities. The Commodity Committees negotiated for the US government with the War Service Committees, or trade associations, representing suppliers.[34]

Some historians have argued that the macroeconomic impact of these agencies remained small, as many were not created, staffed, or implementing policy until the end of the war. Bernard Baruch (1870-1965) tenure as WIB chair, cited a great success, did not begin until February 1918 – nine months before Armistice.[35] Further, the WIB did not control the allocation of US steel products until June 1918.[36]

In addition to agency creation and departmental reorganization, the American entry into the war in April 1917 also created a wave of federal spending. Rising monthly, spending reached a peak of over $2 billion in January 1919 (roughly 33 percent of annual GDP).[37] This surge produced a rapid shift in production from civilian to military goods, adding nearly 4 million people to the military and more than 500,000 to the civilian government between 1914 and

1918. The non-agriculture private sector, mainly manufacturing, expanded to include nearly 3.5 million workers, an increase of more than 12 percent. Agriculture, on the other hand, lost a relatively small number of workers during the same period, about 1.4 percent of the agricultural labor force.[38]

It is important to contrast, however, the timing of the growth in the public and private sectors. In the non-agricultural private sector, the increase occurred between 1914 and 1916; 2.5 million workers were added during US neutrality. During active US involvement, 790,000 workers joined – less than 3 percent of the 1916 workforce. The public sector, in contrast, saw most of the workforce increase from 1916 to 1918.[39]

Those drawn into the workforce by the availability of employment in manufacturing may have expected wages to rise, but this was offset by increases in the cost of living. During the early phases of mobilization and US neutrality, a 7.61 percent upsurge in manufacturing wages stayed below the 8.34 percent increase in cost of living, resulting in real wages actually falling 0.7 percent. During active US engagement in the war, nominal wages in manufacturing finally outpaced increases in the cost of living 38.8 percent to 32.2 percent.[40]

## Legacies of the War for the US Economy

World War I, by some estimates, cost $208 billion and caused one of the greatest global depressions in the 20th century. Debts accrued by all of the major combatants except the US haunted the global economy. Appraisals for the cost to the US vary widely. The Congressional Research Service, for example, estimated the total military cost of war from 1917 to 1921 at $20 billion (time of conflict) or $383 billion (2017). The study reported that at its peak in 1919, total defense war spending for that year amounted to 14.1 percent of GDP.[41] One of the more comprehensive and detailed efforts to measure the economic costs of the loss of life and war is John Maurice Clark (1884-1963) *The Cost of the World War to the American People* (1931). Clark's calculations included the Treasury's estimated expenditures by the federal government through June 1921 ($27.2 billion), and then adjusted the total to include first, foreign obligations amounting to $7.5 billion; second, an adjustment to the wages of persons in government service versus what they might have earned in a civilian sector in the amount of $0.2 billion; and third miscellaneous additions of another $2 million. Clark then adjusted this amount by subtracting interest on war debt of $2.7 billion on the grounds that it was a "transfer" rather than a use of resources, and part of the deficits of the Federal Railroad Administration of $1.2 billion on the grounds that were also "transfers" from taxpayers to shippers. The net result was $31.2 billion.[42]

Although America’s casualties paled in comparison to those of its European allies, they were still substantial. About 204,000 Americans suffered non-fatal wounds, and about 117,000 died. Of those who died, an estimated 50,000 died in battle and 67,000 from disease. Pneumonia, for example, accounted for approximately 40,000 deaths. Of those, 25,000 were related to the influenza-pneumonia pandemic.[43] These deaths only amounted to about 0.28 percent of the workforce, but the psychological impact was widespread and encouraged strong reservations about future involvement in European wars for many Americans.

Moreover, it is widely recognized that in 1914 the US was a net debtor in international capital markets; World War I permanently altered the US’ international economic position. The foreign capital that the US did receive was typically invested in infrastructure projects, such as building canals, railroads, and mines, or in government securities. Between 1914 and 1919 foreign investments in the US fell dramatically, from $7.2 billion to $3.3 billion respectively.[44] By 1919 US investments abroad had risen to $9.7 billion; Americans were net creditors of nearly $6.4 billion.[45] Americans began investing large amounts abroad, particularly in Latin America, and a significant portion of Germany’s reparations payments levied by the Treaty of Versailles were funded by loans from American banks, and recipients used them to pay off loans from the US Treasury.

## Conclusion

World War I increased the United States’ economic preeminence, amplifying its growing economic strength. At the same time, it accelerated the decline of Europe’s powers, including the “victorious” Great Britain and France, both of which ended the conflict burdened with huge debts and exhausted economies. The US, although a late entrant into the war itself, played a decisive role in shifting the momentum of the conflict against Germany. It became a major creditor of the Allies and spent more on the war than any other power, with the exception of the UK. It could absorb the costs thanks to its larger, more dynamic economy and ability to borrow cheaply. This role of creditor spurred US financial markets and, in the post-war period, shifted the global center of finance from London to New York.

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## Notes

1. See, for example: Baruch, Bernard: American Industry in the War. A Report of the War Industries Board of 1921, New York 1941. ↑
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World War I, in: The Historian 78/3 (2016), pp. 439–468. ↑
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9. Keene, Remembering 2016, p. 448. ↑
10. For more on how much the Allies' war economies were dependent on American financing from 1914 to 1917, see Strachan, Hew: The First World War, volume I, Oxford 2003, chapters 10–11; and Mulder, Nicholas: War Finance, in: 1914-1918-online. International Encyclopedia of the First World War, ed. by Ute Daniel, Peter Gatrell, Oliver Janz, Heather Jones, Jennifer Keene, Alan Kramer, and Bill Nasson, issued by Freie Universität Berlin, Berlin 2018-02-08. DOI: 10.15463/ie1418.11220. (retrieved: February 2018). ↑
11. McAdoo, William Gibbs: The Second Liberty Loan and the American Farmer, Washington, D.C. 1917, p. 8. ↑
12. Rockoff, Hugh: Until It's Over, Over There. The US Economy in World War I. Working Paper no. 10580 (June 2004), issued by National Bureau of Economic Research, online: http://www.nber.org/papers/w10580 (retrieved: 15 May 2018), pp. 9–11. ↑
13. Ibid., p. 10. ↑
14. The Federal Reserve System, often referred to as the Federal Reserve or simply "the Fed," is the central bank of the United States. The Federal Reserve banking system was

created in 1913 in an effort to bring coherence to nationwide banking practices and prevent crises like the financial panic of 1907. Since it began operating in 1914, the Federal Reserve has played a crucial role in determining American financial policy and practice. It is largely an entity unto itself, operating independently, rarely subject to the political machinations of Congress or the presidency. For more information, see Wells, Donald R.: The Federal Reserve System. A History, London 2004. ↑

15. It was not until the Banking Act of 1935 that Congress removed the treasury secretary from the board, and provided the US president the power to designate a chairman from among the seven appointed board members. ↑
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24. Kennedy, David M.: Over Here. The First World War and American Society, Oxford 1980, p. 105. ↑
25. U.S. Committee on Public Information, 21 May 1927. ↑
26. McAdoo/Woodward, Crowded Years 1931, p. 407. ↑
27. The New York Times, 10 March 1918. ↑
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29. The New York Times, 23 June 1917. ↑
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36. Hitchcock, Curtive N.: War Industries Board, in: Journal of Political Economy 26/6 (1918), pp. 545–566. ↑
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38. Kendrick, John W.: Productivity Trends in the United States, Princeton 1961, p. 306, table A-VI. ↑
39. Ibid., p. 312, table A-X. ↑
40. U.S. Bureau of the Census: Historical Statistics of the United States, Colonial Times to 1970, Bicentennial Edition, Washington, D.C. 1975, D727, p. 164 and D740, p. 166. ↑
41. All estimates are of the costs of military operations only and do not reflect costs of veterans' benefits, interest on war-related debt, or assistance to the allies. All estimate are based on US government budget data. Daggett, Stephen: Costs of Major U.S. Wars. No. 7-5700 (June 29, 2010), issued by Congressional Research Service, online: https://fas.org/sgp/crs/natsec/RS22926.pdf (retrieved: 15 May 2018). ↑
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## External Links

- Baruch, Bernard: American Industry in the War, Washington, D.C. 1921 (Internet Archive) (Book)
- Clarkson, Grosvenor B.: Industrial America in the World War. The Strategy behind the Line, 1917-1918, Boston 1923 (Internet Archive) (Book)
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