

LESSON 2: DOMESTIC ECONOMIC POLICIES DURING WORLD WAR I

Student Handout 2

OUTCOMES

PROBLEM 1—GOVERNMENT AND BUSINESS

The government chose both B and C. As in choice B, President Wilson and Congress established a government agency called the War Industries Board (WIB). The WIB helped businesses to focus production on the war effort, and it increased efficiency and conserved resources by promoting standardization. However, the WIB didn't have the personnel or knowledge to make independent decisions, and its policies were heavily influenced by businesses. One reason for this was that the U.S. government at that time was small and, excluding the Post Office, had fewer employees (as few as 50,000) than many large businesses. Businesses had much more information about their own industries than the WIB could ever hope to learn on its own. So the War Industries Board relied on business for information (production levels, wages, costs, prices, etc.), which led to several **unintended consequences**:

- Businesses controlled much of the agency and used it for their own benefit. Several thousand businesses made over 50% profit during the war, and 20,000 more made over 20% profit. Two thousand corporations made over 100% profit. The four largest meatpacking companies increased their profits by an average of more than 600%.
- The largest businesses dominated the WIB, so the agency made decisions that favored big business over small businesses. Many smaller businesses felt cheated.
- In order to entice businesses to cooperate, the government offered contracts that guaranteed a profit (choice C—offer favorable contracts). These “cost-plus-fee” contracts reimbursed a business for the cost of making a product and added a fee for making it. The government continued to use cost-plus-fee contracts for decades. Eventually taxpayers complained about the excessive payments of these contracts.
- The government also enticed businesses by introducing subsidies, relaxing antitrust laws to allow businesses to cooperate with each other (resulting in higher prices), and restricting market entry (keeping the number of businesses down so prices would be higher). As a result, a small number of huge corporations (called oligopolies) wielded a great deal of control over the market and prices. This undid many of the reforms of the progressive movement, which sought to limit the size and regulate the power of big business.
- The increased power of large businesses was compounded by the expansion of well-organized special-interest lobbying groups. After all, the WIB was helping to organize each industry. It was a small step to use the organization for lobbying to get what they wanted (for businesses, farmers, etc.) from government. Later,

- President Eisenhower would call the increased cooperation between government and business for military goods the “military-industrial complex.”
- The government grew, relative to the economy as a whole. War spending was less than 1% of the GNP in 1915; it rose to 23% of the GNP in 1918. The government was heavily involved in many areas of the economy.
- By establishing large programs to oversee businesses, the government also created a larger bureaucracy. World War I drew more people to Washington DC for employment and created jobs for economists.
- The WIB’s push for increased standardization led to much greater industrial efficiency, and that efficiency continued after the war. Consequently, more goods were produced at lower costs, and the American standard of living increased.
- Businesses learned to use planning to produce sufficient goods. After the war, businesses continued to incorporate more planning, and their efficiency increased.
- Government controls over production led to a black market. The government told businesses not to produce certain products in order to focus on goods necessary for the war effort. Soon shortages of non-essential goods appeared, and when the prices of those goods rose, some people began producing them illegally, “under the table.” All of the countries involved in World War I experienced significant black-market activity, including the U.S.

A free-market approach (choice A) might have been more efficient in the long run, but production might not have increased quickly enough to meet the needs of the war effort. If a significant shortage had appeared and the demand had not been met quickly, the U.S. could have lost the war before the market corrected itself to meet the demand. Whatever the imperfections of choices B and C, they worked: businesses supplied enough goods for the U.S. to fight and win the war.

Choice D describes socialism. Perhaps it would have worked in wartime, but what would have happened when the war ended? The track record of government-run businesses in the 20th century was not very good, as the collapse of the Soviet Union and poorly run countries in Eastern Europe demonstrated. Private businesses seem more efficient and productive over the long term.

PROBLEM 2—GOVERNMENT AND FINANCING

The government did both A and B. It increased taxes (doubling the income tax from 1% to 2%, raising the surcharge on incomes over \$20,000 to 13%, increasing taxes on alcohol and tobacco, imposing more taxes on corporations, and increasing the inheritance tax to 10% on amounts over \$50,000). At the outset of the war, the Secretary of the Treasury stated that the government would raise taxes enough to pay for 50% of the cost of the war. But the war became so expensive (from an initial estimate of \$3.5 billion to \$15 billion) that the government realized the cost would place an undue burden on taxpayers. Instead, the government would need to borrow heavily to pay most of the costs. Appealing to the patriotism of the American public, the government asked people to loan it money by purchasing war bonds. After the war, the government would pay back these loans, with interest. These decisions had several **unintended consequences**:

- The deficit that the government was running (by spending more than it was taking in through taxes) rose to about \$1 billion per month, an amount greater than the yearly federal budget before the war.
- The federal debt was 20 times greater after the war. The government had to rely on either future taxes or spending cuts on other programs (or both) to pay back the debt.
- Prices almost doubled during the war as result of shortages of goods and expansion of the money supply due to all this borrowing.
- The bond drives especially helped the rich, who benefited from a tax exemption on the interest on the bonds. (Since the rich are taxed at a higher rate, the exemption helps them more.)
- During the war, the burden of taxation shifted to wealthier people, who paid more income, luxury and estate taxes. On the other hand, the rich benefited greatly from lending money to the government, and many rich people made tremendous profits during the war.



The final choice, choice C, would have prevented the U.S. from fighting the war effectively. The war proved to be very expensive, and if the government had not come up with new strategies to raise money, the U.S. and its allies may have lost the war.

PROBLEM 3—GOVERNMENT AND LABOR

The government formed an agency (Choice D) called the National War Labor Board (NWLB), which included five members each from business and labor. The NWLB gave workers the right to organize unions and bargain collectively with owners. In exchange, the government wanted workers to pledge not to strike. Union leaders, especially Samuel Gompers, encouraged unions to avoid strikes, but there



Striking miners on parade in Pennsylvania

were thousands of strikes nevertheless. If unions refused to work after consulting the NWLB, the government often took strong action against them, arresting workers and threatening to send them into the army. These labor policies had several **unintended consequences**:

- Despite the efforts of the NWLB, strikes increased greatly during the war, from 979 in 1914, to 4233 in 1917. Some historians believe the increased number of strikes during the war was inevitable. With a smaller supply of workers and increased demand for goods, workers were bound to demand higher pay and strike if they didn't get it.
- Union membership increased almost 50% during the war
- Wages almost doubled, but real wage rates (correcting for inflation, which nearly doubled also) only increased 4%. This 4% was much less than the tremendous profits made by many businesses, but it was still an increase.
- Moderate unionists became more influential and numerous than radicals, since workers' wages and working conditions were somewhat improved. Whether the move toward moderation helped or hurt workers is a matter of interpretation.