

Policies for Full Post-War Employment

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Source: *The American Journal of Economics and Sociology*, Vol. 3, No. 2 (Jan., 1944), pp. 141-154

Published by: American Journal of Economics and Sociology, Inc.

Stable URL: <https://www.jstor.org/stable/3483637>

Accessed: 20-01-2022 16:48 UTC

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# *The* AMERICAN JOURNAL *of* ECONOMICS *and* SOCIOLOGY

Published QUARTERLY under grant from the Robert Schalkenbach  
Foundation in the interest of constructive synthesis in the social sciences.

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VOL. 3

JANUARY, 1944

No. 2

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## Policies for Full Post-War Employment

By HARRY GUNNISON BROWN

### I

THE QUESTION IS sometimes asked: "If we can have prosperity when there is a war on, why can we not have prosperity during the years of peace?" And yet, at the same time, there appears to be a widespread idea that war must be followed by business depression or, at least, that to prevent such an aftermath, there must be careful and detailed "planning" for after-war production and jobs.

No solution of this problem is possible without a careful analysis of the forces that tend to prosperity and to depression. In such analysis it will appear that especial attention must be devoted to monetary influences or, more broadly, to the effects which may be produced on prices and on business activity by fluctuations in money and in the checking accounts of commercial banks. And it may appear that without intelligent monetary policy no amount of "planning," whether by government administrators or business "leaders," can save us from recurring depressions.

An increase of spending means an increased demand for goods and for labor. This is what we have had during World War II and what we had in World War I. Indeed, we seem to have it in every war.

In war time a much larger proportion of the spending than at other times is by government. But there does not appear to be the slightest reason to believe that \$1,000 spent for goods or for labor by government will have any greater stimulating effect than \$1,000 similarly spent by private corporations or by individuals. If the spending of money is what we need for prosperity, it would seem that we ought to be able to do as well with individual spending as with government spending.

The total volume of spending during any period, such as a year, depends on *how much* circulating medium there is to spend and on the *rapidity* with which it is spent, i.e., on its "velocity" of circulation.

A given number of dollars would make possible a much greater amount of total spending if only each person would *immediately* spend for goods, for labor or for the use of land or capital the money he receives in his own business or for his own work. But hardly anybody wants to spend instantly all the money he receives. He prefers, rather, to have some on hand for emergencies. Household gadgets that are now, apparently, all right, may break or unexpectedly wear out and need to be replaced. Clothes may become badly torn. There may be unexpected occasion to go to a distant city by airplane, bus or train. Exceptionally good shows may come to town before the next salary check is received. And even apart from such considerations as these, the average person likes to have time to decide at his leisure between the various things for which he may spend his money. He likes to have time to "shop around."

It is not desirable that people should be put under great pressure to spend their money more rapidly than their own convenience dictates. For such pressure would appreciably limit their freedom of choice in the purchase of goods and services and in investment. But when, because of monetary

inflation, prices are rising rapidly, there is such pressure. Recipients of money, whether as wages or otherwise, feel obliged to spend it at the earliest possible moment, even though they have not the time to decide carefully and wisely for what to spend it, because the money will buy so much less if it is kept for some time unspent.

But if, on the other hand, prices in general are falling at a noticeable rate and further decline is expected, there will be some tendency for recipients of money to delay purchases, because of their anticipation that their money will purchase more at a later date than at or near the date of receiving it. Likewise a merchant, if he anticipates either declining prices or generally dull business, will be more likely to hold his money or bank deposit account unused for a relatively long period than if his anticipation were otherwise. And a manufacturer will be more hesitant to spend current funds buying raw material and hiring labor if he believes *either* that the prices of finished goods will greatly decline *or* that he is likely to find difficulty in selling them. These two contingencies come to the same thing. For there is almost always *some* price at which goods can be sold; and to say that they may have to be sold at a low price amounts to saying that they may not be salable at all at a higher price.

Despite the possible importance of velocity of circulation as a *derivative* factor, I believe we shall do well not to assume that it has any especial importance in initiating either rising prices or falling prices. And I believe we ought not to expect to find in velocity of circulation of money and bank credit an important influence in the initiation of business depression.

The greater velocity with which money is spent when prices are rising is, as has been indicated above, a *consequence* of the fact that the money will buy less—or is expected to buy less—if spending is deferred. It is true that this in-

creased velocity of spending still further increases the demand for goods and tends to accentuate the rapidity with which the prices of goods and services are rising. But unless some other cause—presumably an increase of the *volume* of circulating medium—gives the initial push to prices, it is altogether unlikely that the increase of velocity of circulation will occur at all.

And likewise when prices fall and velocity declines. The decrease of the velocity of spending of money does not come arbitrarily. It is *because of* the expectation of falling prices—or of unsalableness of goods *except* at lower prices—that men spend their money more reluctantly, i.e., at a slower rate. And we cannot reasonably assume this expectation to be self-causing or to be the consequence of dire predictions made without basis in existing economic fact and yet so widely believed as to bring about a fall in prices that would not otherwise have occurred! On the contrary, it is much more likely that any great decrease in velocity of spending will manifest itself only when and as some other influence—presumably a decrease of circulating medium which might be brought about through restriction of commercial bank credit—decreases the demand for goods and makes prices tend downward.

This does not mean, of course, that velocity of circulation may not change for other reasons. As specialization increases, as more people—or less—live in cities, as credit institutions develop, as habits of other kinds change, the velocity of circulation of money may gradually change, entirely apart from the influence of rising and falling prices. But that such changes would be rapid enough to make the general price level rise or fall greatly and quickly does not seem very likely.

When, therefore, the demand for goods in general increases or decreases, the initiatory influence would appear to be an

increase or a decrease of the total volume of circulating medium. The question may still arise, of course, why the volume of circulating medium changes. But, in most countries, this is either directly controlled or is obviously subject to control by government. Velocity of circulation, on the other hand, is a matter of individual choice. Government can influence it only by giving its citizens a motive to spend money more or less rapidly. In general, government influences velocity of circulation only as it determines the volume of money and so causes prices, on the average, to rise or fall.

## II

WHAT, THEN, is the reason for war prosperity and why can we not have as great prosperity continuously?

We do have very active business—"prosperity"—at times when we are not at war. The year 1919 was a year of very active business. The year 1926 has been regarded as a year of high prosperity. And so of various years and periods of years. Yet there are recurring depressions and some of them are severe and protracted. What is the explanation?

There have been many and complicated explanations of the alternation of prosperity and depression. But the one fundamental influence—the influence that must be especially emphasized in any explanation that is even approximately correct—is to be found in changes in the volume of circulating medium.

In general, increase of circulating medium (money, and bank deposits subject to check) tends to increase prices. Here we are using the word "prices" in a broad sense, in which it includes rentals and wages. But if business is dull, an increase of circulating medium may show its effect partly in stimulus of business activity. When more is being spent, there must obviously be *either* more transactions (more goods sold, labor hired, etc.) *or*, if there are no more transactions,

the fact of more being spent can mean only that prices (including wages and rentals) are higher. When there is full employment and the annual output of goods cannot be appreciably increased, any greatly increased volume of circulating medium and correspondingly increased spending *must bid up prices*. But an increase of spending when there is *not* full employment may aid in putting the unemployed to work. May it not be that the business activity of war-time is to be explained in terms of greater spending and, mostly, in terms of their being *a larger volume of circulating medium to spend?*

An increase of spending promotes business activity *because* prices, including wages, rentals, etc., do not ordinarily increase as rapidly as spending increases. If, with the volume of circulating medium doubled and the number of dollars annually spent also doubled, prices, including wages, rentals and other payments, instantly doubled, the doubled spending would then be barely sufficient to take care of the same total of transactions. There would be required, for example, a doubled spending for wages to employ the same number of workers as before. Such increased spending could then have no stimulating effect on business activity or on employment. If the consequent rise of prices and possible anticipation of still further rise stimulated a still greater spending, nevertheless even this still greater spending could have no stimulating effect on business and employment if prices, including wages, etc., instantly increased again in like proportion.

Are we not likely to find war-time a period when spending is greatly increased and when, though wages, rentals and prices in general rise, nevertheless this rise *fails to keep pace with the increase of spending?* Indeed, is it not a fact that during war there is often or usually an effort to hold down prices, including rentals and even wages, by administrative

regulation, to a lower level than they would almost certainly reach if the greatly increased spending were allowed to reach its full unregulated effect? Under such circumstances, it could scarcely be anticipated that business would be dull. High activity is by all means to be expected.

Whence come the means for increased war-time spending? Government takes the initiative. The increase of demand for goods and services, the increased demand for labor, come first from government. And this increase of demand from government becomes effective on business activity and on prices through an increase of circulating medium. Many times this has meant a large issue by government of paper money. The Continental currency of the American Revolutionary War and the Greenbacks issued by the Union in the Civil War are familiar examples.

But at other times, and more especially in the twentieth century, the increase of circulating medium has been chiefly in the form of bank deposits subject to check and has resulted mainly because of government borrowing from banks.

In this connection we must note that the borrowing which tends particularly to increase demand is borrowing from banks. If government borrows from an individual, his means of purchasing goods or labor are reduced by the amount he lends to his government. The government has more to spend. The citizen in his individual capacity has less to spend. *Unless* the money borrowed from the citizen *would have been hoarded* longer by him than by the government, there is here no increase of spending at all, no special stimulus to business activity and no tendency to bid up the general average of prices.

But *if* the government borrows from the banks and *if* the banks, having sufficiently large reserves, thus *lend more* to government without correspondingly reducing their loans to individuals, then there is a clear and definite increase of cir-



culating medium and of spending. At the beginning of World War I and again at the beginning of World War II the reserves of the banking system of the United States and, especially, of the Federal Reserve banks were such as to permit a great increase of checking accounts. And these deposits subject to check soon became substantially larger than they had been previously.

Business activity rather than business depression is certainly to be desired. General and widespread employment of wage earners is, obviously, vastly preferable to unemployment. And, therefore, an increase of circulating medium and consequent increase of spending is clearly beneficial if and in so far as it promotes employment and business activity. Especially in the midst of desperate war when every effort must be made to produce sufficient guns, planes, tanks and ships, is it undesirable that we should suffer the waste of widespread unemployment.

But this does not mean that we want to go on increasing the circulating medium rapidly and indefinitely. Indeed, even during the progress of war such an increase is a frequent cause of trouble. As soon as any lingering dullness of business has been overcome, further increase of money and checking accounts operates definitely and solely in the direction of price increases. And a general increase of prices, if it does occur, involves unfairness to holders of money, since they find it buys less and less the longer it is held. It involves unfairness to lenders, since the money owed to them decreases in purchasing power from month to month and from year to year. It involves unfairness to—and deception of—investors in government bonds. For the money paid them when the bonds are due will buy a smaller amount—unless the upward trend of prices is reversed—than when the bonds were purchased. The incomes of many workers, too, change but slowly in adjustment to changes in the cost of living. Yet

to reverse the upward trend of prices by decreasing the volume of circulating medium, e.g., by sharp restriction of bank credit, may bring business depression.

On the other hand, the attempt to hold prices down by law while simultaneously increasing the volume of circulating medium is also likely to be attended with serious difficulties. There is rationing with all its complications and its nuisance to the public. There are "black markets." There are evasions through deteriorations in quality. There are the demands of various blocs, such as the "farm bloc," that the prices of what they have to sell shall not be regulated on the same basis as prices of other commodities. There are demands that wages shall be raised for this and that group of workers. And experience shows that, in fact, the average of prices does rise and may rise considerably.

Although, all things considered, a stable general level of commodity prices is probably desirable, it is also probably true that, with it, business activity is not quite as great as it sometimes is during a period of rising prices. For our economic system, even though in large degree competitive, is by no means completely so and, indeed, is definitely less fully competitive than it ought to be in the interest of the general well-being. And each monopolistic group has a tendency to push its prices to the most profitable height, thereby somewhat decreasing sales. Labor groups endeavor to put wage scales as high as possible even though employment is thus somewhat diminished,—trying, of course, to keep what employment there is for their own members. Spokesmen for farmers may attempt to secure legislation limiting the output of various agricultural products, thereby tending to decrease the opportunities for employment in agriculture. Producers in other lines may attempt, through agreements or combinations, to raise the prices of the goods they have to sell. In these and other ways, we may be prevented from

enjoying the possible maximum of production and employment.

But when the volume of circulating medium is being greatly and rapidly increased, the chances are that, for a time, these various groups or interests will not raise their prices, wages and rentals in proportion. The increase of circulating medium "steals a march" on them. They do not at once realize that, compared to the new economic possibilities, they are receiving smaller gains than they have been receiving. And so their ordinarily more or less chronic retardation of business activity and employment is temporarily somewhat in abeyance!

But it is doubtful whether even continuous inflation with its otherwise objectionable features, would remedy this evil for very long. For if such inflation came to be thought of by the various monopolistic and quasi-monopolistic groups as normal and as to be expected continuously, they would be likely to begin pushing up their own prices rapidly enough to prevent the fullest possible business activity. The increase of circulating medium would then not be "stealing a march" on them.

Furthermore, even if it were possible, by means of continuous and progressive increase of money and bank credit, to keep always one jump ahead of the monopolistic groups, this *would not be the logical or the right solution*. The right solution would be to carry out a consistently anti-monopoly policy and thereby to be able to maintain both steadily active business and a stable general level of prices.

### III

IT HAS BECOME the custom in certain quarters to hold war responsible for depressions that come in later days of peace. Indeed, in the political campaign of 1932, in the United States, it was argued, on one side, that the depression of 1929 and following years was really due to the war of 1914-1918!

The year 1919, following directly after the war, was a year of continued and rapid increase of circulating medium. Bank credit and Federal Reserve notes in circulation expanded greatly. Business was at a peak of activity. In 1920 Federal Reserve policy was one of bank credit restriction and the crisis of late 1920 was followed by a two-year depression. Business was active again in 1923 and remained generally active, though with a mild recession in 1927, until the latter part of 1929. But in 1929, again, Federal Reserve policy was one of bank credit restriction and in 1929, as in 1920, we experienced the beginning of business depression.

If war, besides being debited with its own obvious evils, is to be the scapegoat for business depressions occurring ten or twelve years after peace is restored, one wonders whether it may be made the scapegoat for depressions occurring twenty and thirty years after. Perhaps the Civil War was responsible not only for the depression of 1873–1879 but even for that of 1893–1897! Perhaps World War II will be blamed for all the depressions of the next hundred years!

The truth is that sharp and persistent restriction of circulating medium brings business depression equally after wars or before them and would presumably bring depression—were there any serious likelihood of monetary restriction at such a time—in the very midst of war. If there is anything in the idea that depression is to be looked for as an aftermath of war, this can be only because and to the extent that sharp and persistent restriction of circulating medium is more likely to occur after a war than at other times. We have just seen that, during war, there is likely to be great and rapid expansion of currency as a means (but not a desirable means) of financing the war. And after such expansion there is likely to be—has frequently been—some attempt to get back, through restriction, to the pre-war basis. In the United States, for example, the boom of 1919–1920, following al

most at once after the cessation of hostilities, involved further expansion of bank credit beyond that of the war years and, finally, a greatly reduced per cent of reserves of the Federal Reserve banks to deposits and outstanding Federal Reserve notes. This may very well have been a principal reason why the Federal Reserve Board adopted its policy of sharply restricting credit in 1920 and a reason, therefore, why we experienced the depression of 1921–1922. But to say this is far from saying that the war of 1914–1918 *caused* the depression of 1921–1922. And to say that the war of 1914–1918 caused the depression of 1929 and the years following is still more far fetched.

In Great Britain, steps were taken, in the years following World War I, to decrease the circulating medium and bring the price level down to something like its former level—to get back to the former relation of the currency to gold—with a like consequence of business depression. It was not the war, as such, but monetary restriction, that should be held responsible for the succeeding dull business.

What, therefore, can we reasonably expect if, shortly after the end of World War II, there should be sharp and persistent restriction of bank credit (and so of the volume of circulating medium) both in Great Britain and the United States? Should this occur, no amount of preliminary “planning” by business men’s committees, of new and old lines of production and of new construction, would suffice to prevent widespread unemployment.

#### IV

**BUT WHY SHOULD DECREASE of circulating medium bring business depression?**

Clearly, if restriction of bank credit—or decrease of the circulating medium through direct government action—involves any substantial decrease of spending, it must involve *either* lower prices in at least the same proportion as spending

is reduced *or* decreased business. And prices are not likely to decrease both as far and as fast as does spending. As I have expressed the matter in my "Basic Principles of Economics":<sup>1</sup>

Producers and dealers will not see why they should accept greatly reduced prices for their output and for the goods which they have bought to sell. They will lower their prices only with reluctance. Artisans and laborers will not easily be convinced that there is any adequate reason why they should take lower wages. Persons who have land and buildings to rent or to sell will not readily understand why they should accept lower rents or prices than those which they have come to look upon as reasonable. Speculative holders of vacant land will, in many or most cases, continue to ask the prices they have been asking. But with less money and credit being spent, unless prices in general fall in proportion, the volume of business must decline. Continued lack of demand for goods and labor, with unsalability of the goods and diminished employment for laborers, will force a readjusting reduction in prices and wages. The will to maintain prosperity prices and wages is broken by the compulsion of circumstances.

And further, from the same book:<sup>2</sup>

Curtailement of credit certainly must make for business depression if prices fall, unless and until production expenses such as wages and rentals also fall. But credit restriction must bring business depression no less surely if prices do not fall. For the resulting decrease of circulating medium must certainly decrease the demand for goods and, unless prices do fall proportionately, sales and, therefore, production and employment, must obviously decline.<sup>3</sup>

It may be said that this slowness of adjustment of prices and wages means lack of competition,—that there is, in it, a certain element of monopoly. But this does not mean that most prices and wages were, prior to the decrease of circulating medium, above a normal competitive level, although

<sup>1</sup> Columbia, Mo., Lucas Brothers, 1942, pp. 108–9.

<sup>2</sup> *Ib.*, p. 111.

<sup>3</sup> It would lead away from the main thesis of this paper to discuss here all the phenomena that mark the downward path from prosperity to the bottom of depression. This downward path may manifest itself as a "vicious spiral of decreased circulating medium, dull business, falling prices, bank failures and further decrease of circulating medium" (*ib.*, p. 112), including a derivative psychology that affects both the amount of borrowing and the rapidity (velocity) of spending.

some of them probably were so. What it means is that there is a certain inertia in readjustment; some of the prices and wages are "sticky." There is an economic "friction" not quickly overcome. And indeed, where there is clear monopoly and a more or less deliberate monopolistic resistance to reduction of specific prices or incomes, the depression is likely to be worse. For if demand for the monopolized goods does not appreciably decline, so causing decrease of employment in the monopolized line, the decrease of total spending must involve a more than proportionate decrease of demand for the products of other industries.

In any case, we may properly insist that depressions are not caused by war as such and that, granting intelligent and careful monetary policy they are not at all an inevitable aftermath of war. War may and does involve vast destruction of manpower and of capital. It may, therefore, appreciably reduce the productive efficiency of our economic society. But this does not mean that it must or will cause decrease of productive *activity* among the workers who survive it or decreased use of whatever capital is still available.

And as regards the extreme industrial activity or "prosperity" of war time, we have seen that this, too, is largely a monetary phenomenon. We have seen that such activity manifests itself in periods of peace. We have seen that, however, rapid and continuous inflation as a means of producing and maintaining such activity is hardly to be desired even if there were assurance that such inflation would indefinitely succeed in its purpose. A monetary policy calculated to maintain a substantially stable price level, and a general governmental policy of maintaining competition and preventing all kinds of monopolistic extortion, offer the best prospect of worth-while and abiding productive activity and employment.