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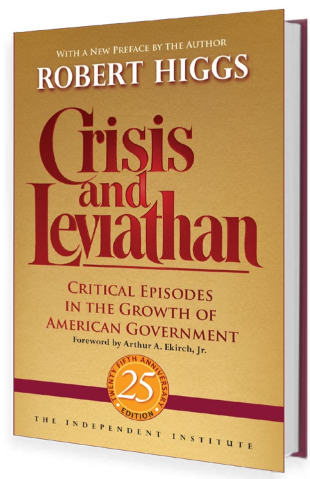

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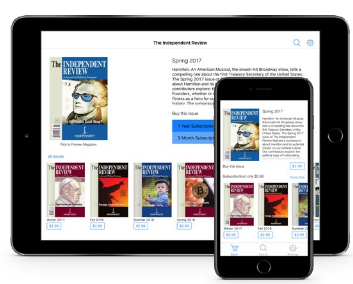

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The Origins of the Permanent War Economy

Thomas K. Duncan
and Christopher J. Coyne

The military-industrial complex that Dwight D. Eisenhower (1961) warned of has become a vast network of expanded political power, enlarged profits, and increased state authority. Indeed, national security, in terms of dollars, mentality, and interests, has bled into nearly every aspect of American life (Turse 2008), into nearly every federal department (Mueller and Stewart 2011), into domestic and international humanitarian efforts (Coyne 2008, 2013), and even into domestic policing (Hall and Coyne 2013). The result has been a lasting impact on the evolution and structure of private industry (Duncan and Coyne forthcoming). Defense funding not only goes to giants such as Lockheed Martin and Northrop Grumman but also filters through subcontractors and supportive nonmilitary firms and organizations to influence "professional and business services, financial, information and administrative services, retail trade, leisure and hospitality services, education and health services, construction, and other manufacturing" (Fuller 2011, 1). How did this permanent war economy emerge?

This paper answers this important question. Our analysis emphasizes the combined efforts of three key interest groups (unions, industry, military) that arose in the context of the dual crises of the Great Depression and World War II. In any good crisis, multiple parties are ready to take advantage of the state of emergency (Higgs 1987, 2004, 2005b, 2006, 2012). During the Depression and the war that

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followed, a partnership between industry, the military, and politicians emerged. The Great Depression and World War II resulted in increased spending by government, and a variety of interests groups took advantage of the opportunity to advance their interests: unions with jobs, industry with profits, military branches with budgets, and politicians with votes and lobbying stemming from the support of these interests. These crises, combined with the state's monopoly over the military, created the opportunity for these interests to influence the trajectory of economic activity in a lasting and self-serving manner.

This paper contributes to two interrelated strands of literature. First, we contribute to the literature on the origins of the permanent war economy (Oakes 1944; Vance 1951a, 1951b, 1951c, 1951d, 1951e, 1951f; Baran and Sweezy 1966; Vatter 1985). This literature emphasizes how the origin of the permanent war economy was a solution to the unemployment problem that plagued capitalism. Our explanation, in contrast, emphasizes the central role of government's monopoly on the military and the desire of powerful special interests to secure the rents of that monopoly in the context of the crises of the Great Depression and World War II.

Second, we extend the literature on the distortionary effects of the permanent war economy (Melman 1970, 1971, 1985; Russet 1971; Rothbard 1989; Higgs 2006; Duncan and Coyne forthcoming) by linking its origin and perpetuation to special interests. Those who argue for the necessity of a constant state of military readiness tend to overlook, or at least to underestimate, the negative effects of military spending in terms of rent-seeking behaviors by private interests. While the permanent war economy generates a mutual benefit for government and private interests, it also generates a significant negative externality by diverting resources from other, private uses.

The Military Keynesian Zeitgeist

The Great Depression was a bitter and long-lasting event, and it shook the core beliefs about the way the U.S. economy worked. The United States spent a decade in economic crisis, far longer than the recessions that had come previously. Citizens, intellectuals, and policymakers began to think that capitalism had failed them and that the only means of recourse to a failing market was the increase of state intervention, which itself was viewed only as a short-term solution to the inherent ills of capitalism. The severity of the Depression "greatly strengthened the belief that similar catastrophic economic breakdowns were inevitable in the future," and "the need for government to play a larger role suddenly became acute" (Baran and Sweezy 1966, 3, 159). Yet even Franklin D. Roosevelt's New Deal programs, extensive though they were, did not appear to be lifting the economy from its slump. Therefore, when perceived prosperity returned with the war effort during World War II, the narrative arose that war-related work could solve the problem of unemployment on an ongoing basis (Oakes 1944; Baran and Sweezy 1966, 161; Melman 1985, 15–16; Vatter 1985, 14; Kennedy 1999; J. Smith 2007, xiii).

As Seymour Melman argues, “War work made business boom and brought economic opportunity, better living and money in the bank to almost all who participated in it,” showing Americans at the time that “the economy could produce guns and butter, that military spending could boost the economy and that war work could be used to create full employment” (1985, 16). In order to explain the recovery, economic arguments of the time combined strands of Keynesianism and Marxism to create the narrative that ongoing prosperity could be generated by using defense funds to shore up flagging economic capacity, creating a system that would be referred to as “state capitalism.”

The Marxist interpretation of the Great Depression was that capitalism had “reached a new impasse. All the methods previously employed to halt, at least temporarily, the abysmal decline in the rate of profit [had] outlived their usefulness” (Niebyl 1940, 234). With the onset of war and the seemingly rising prosperity,[1] the narrative emerged that it might be possible to postpone the complete collapse of capitalism through the dual strategies of smoothing business cycles by employing the Keynesian framework of government deficit spending and stimulus (Kalecki 1937, 1943, 1945; Carter, Kazakevich, and Lamont 1939, 519; Howenstein 1945; Millet 1947, 29–30; Rosen 2005, 176) and by opening foreign markets through U.S. imperialism (Strachey 1938, 101–5; Lamont 1939, 253; Pierson 1942, 234–35; Vance 1951a; Hossein-Zadeh 2006, 41–44). Blending strands of Marxism and Keynesianism, this narrative held that full employment required significant government intervention (Pierson 1942, 229; Howenstein 1946) because “private capitalism is no longer capable of providing full employment” (Williams 1941, 58).[2]

Defense spending was viewed as a convenient solution for increasing state spending because of the popular acceptance of defense as opposed to other forms of deficit expenditures. As early as 1933, John Maynard Keynes acknowledged the power of military spending, advising Roosevelt that “stimulation of output by increasing aggregate purchasing power is the right way to get prices up” and that “in a slump governmental Loan expenditure is the only sure means of securing quickly a rising output at rising prices. That is why a war has always caused intense industrial activity. In the past orthodox finance has regarded a *war as the only legitimate*

1. The idea of wartime prosperity has been challenged. In response to Seymour Melman’s claim that the war allowed for the U.S. to produce more of both “guns and butter” (1985, 15), Robert Higgs argues that this claim “fails to take sufficiently into account the understatement of actual wartime inflation by the official price indexes, the deterioration of quality and disappearance from the market of many consumer goods, the full effect of the nonprice rationing of many widely consumed items, and the additional transaction costs borne and other sacrifices made by consumers to get the goods that were available.” If one calculates the actual consumption data, the truncated production for goods meant for the war effort, “real consumer well-being during the war . . . declined” (2006, 89; see also M. Friedman 1976, Vedder and Gallaway 1991, Higgs 1992, Horwitz and McPhillips 2013).

2. Both Marxism and Keynesianism emphasized the failure of laissez-faire. The policies tried through the 1930s, especially the late 1930s, were stated in Keynes’s language, but the Keynesian models overlapped with those of the Marxists. Both held the idea that capitalism required government spending to be sustainable (see Fan-Hung 1939).

excuse for creating employment by governmental expenditure" (Keynes 1933, 1, emphasis added). And in 1939, as World War II loomed, Keynes gave his famous BBC radio address "Will Re-armament Cure Unemployment?" in which he predicted the permanent war economy as a silver lining to war when he announced that "the grand experiment has begun. If it works, if expenditure on armaments really does cure unemployment, I predict that we shall never go back all the way to the old state of affairs. . . . Good may come out of evil. We may learn a trick or two, which will come in useful when the day of peace comes" ([1939] 2010, 193).

In the midst of the war effort, concerns began to emerge that the removal of the military funds at the war's end would result in economic collapse (Hirsch 1944, 122; Rosen 2005, 211). During the hostilities, the "problem of whether or not there existed a 'lack of investment outlets' as the ultimate reason for our inability to attain 'full employment of resources' in times of peace" had disappeared in the "course of the war economy" (Feiler 1942, 145). Arguments were made that war spending should continue after war concluded in order to smooth the transition from war to peace (Slichter 1945, 161; Rosen 2005, 211).[3] Even after the brief period of demobilization, during which the economy had not returned to depression, the fear of economic collapse absent defense spending did not disappear (Hoover 1948, 399; Daugherty 1951, 46; Brady 1952, 43). As Calvin Hoover argued, "[If] all the danger of war with Soviet Russia were permanently to disappear" and "deficit in the international payments of the rest of the world with the United States were like-wise to disappear," then "the possibilities of a depression's being thus engendered would be tremendous" (1948, 399). Overlooked in these arguments were the negative consequences of government spending on the military in terms of lobbying and rent seeking as special interests vied to secure a share of the government-provided profits.

The Central Role of Special Interests

Though the economic mobilization for World War II would see a rapid increase in federal spending, the Roosevelt administration was not inactive before 1939. In his first one hundred days in office, FDR pushed through a record number of bills, citing the emergency and the need to respond to depressed wages and joblessness (Higgs 1987, 172–80; Smith 2007, 305–32). As biographer Jean Smith notes, within the first one hundred days "Roosevelt had sent fifteen messages to the Hill, and Congress had responded with fifteen historic pieces of legislation" (2007, 332). These legislative actions and those that would continue throughout the 1930s became the

3. Sumner Slichter argues against the idea of continuing employment in war production but notes the trend in the literature (1945, 161). Elliot Rosen notes that "[w]ith the depression following the Great War a cautionary experience, John Kenneth Galbraith and Alvin H. Hansen envisaged a second postwar surge of demand followed by a severe downturn brought on by a decline in expenditure for consumption and investment" and argued that "the government should supplement private spending and investment by deployment of a shelf of public investment projects planned ahead at a minimum of six years" (2005, 211).

foundations for the New Deal. They also became the foundations for the increasing role of government in the U.S. economy.[4]

The legislative outpouring and political arbitrage spawned programs such as the Agricultural Adjustment Act, the National Industrial Recovery Act, the Tennessee Valley Authority Act, and the establishment of the Civilian Conservation Corps. With each of these pieces of legislation came a wave of new government agencies and programs meant to battle economic depression. Support from key interest groups was needed, and political rents were the currency used to purchase this support. The resulting programs generated what Milton Friedman and Rose Friedman refer to as an "iron triangle" of special interests, legislative backing, and bureaucratic administration that have a vested interest in seeing self-benefiting initiatives emerge, sustain, and grow over time (1984, 42). It is this logic that explains the origins of the permanent war economy.

Military

The connection between New Deal employment programs and the military is not a difficult one to make. The level of employment that can be produced via the military branches has a direct effect on the budget that each branch is allotted. Prior to World War II, the budgets of the service branches rose during mobilization and war and fell during demobilization and peace. Although defense spending still exhibits a similar pattern today, the fall is not nearly as severe as that of the demobilizations prior to World War II.[5] This decline in the severity of budget reduction during demobilizations has its foundations in the policy changes of the early New Deal, when the "necessity" of the military budget for employment was realized.[6]

One of Roosevelt's first attempts to raise the general employment level was the establishment of the Civilian Conservation Corps (CCC) in 1933 (Kennedy 1999, 144; Maher 2002, 436; J. Smith 2007, 319–20; Pfaff 2010, 1). The CCC would have a profound impact on the way the military viewed the unemployment problem. With the dual goal of increasing employment and reclaiming the nation's forests, the program was one of the largest and most popular make-work programs of the New Deal. Between 1933 and 1943, 2.5 million men participated in the CCC. Its structure was such that "men, ages eighteen to twenty-five, would live in government-built camps,

4. Higgs shows that the New Deal did not actually end the Great Depression, noting that, "[d]uring the 1930s, private investment remained at depths never plumbed in any other decade for which data exist" (1997, 566). He further argues that the New Deal kept the economy depressed due to the regime uncertainty created from the number of programs Roosevelt enacted.

5. See White House 2013, table 15.4.

6. In response to the army's participation in the CCC, Robert Fechner in 1935 wrote to General Douglas MacArthur upon the general's retirement as chief of staff, stating, "I have repeatedly paid public tribute to the part that the War Department has played in this great undertaking, and I am convinced we could have never made a success of it had it not been for the wholehearted enthusiasm of the Army to do the best possible job in carrying out every part of the program" (qtd. in James 1970, 425).

food and clothing would be provided, and the pay would be a dollar a day. Enlistment would be for six months, with possible renewals up to two years. The Labor Department would recruit the men, the Army would run the camps, and the Forestry Service would supervise the work" (J. Smith 2007, 320). With its role of running the camps, the "U.S. Department of War (Army) had the enormous responsibility for enrollee administration, transportation, housing, food, clothing, supplies, medical care, education, discipline, physical conditioning, and recreational activities" (Pfaff 2010, 6). In terms of participation, the program boomed. Congress voted the CCC into existence on March 31, and by April 6 an initial 25,000 workers had already been enrolled for the conservation project to begin at Camp Roosevelt in the George Washington National Forest. Within a three-month period, "an astonishing 300,000 men from all over the country had been enrolled, transported, and settled in almost 1,500 camps" (Pfaff 2010, 7).

The army benefited greatly from its role in the program. Upon taking office as president, Roosevelt had pushed a deficit-reduction plan through Congress (J. Smith 2007, 314–16). In an attempt to secure the federal government's credit, the bill supported cuts to a number of items on the federal budget, including cuts to the army budget. The army cuts, though budgeted, would never emerge because it found protection through involvement in the employment program. As Jean Smith notes, "After the economy measure was passed in March 1933, FDR and the Bureau of the Budget zeroed in on the Army to absorb a significant portion of the cuts. The 1934 military budget was to be slashed by $80 million, roughly 51 percent. But the necessity to get the CCC up and running placed a premium on military experience. Not only was the Army budget spared, but many reserve officers were recalled to active duty to manage the camps" (2007, 322).[7]

One of the ways the army was able to increase its active budget was to push for the construction of more permanent housing structures made of wood for the CCC instead of relying on the tent camps initially proposed. Harold Ickes, director of the Public Works Administration, kept a tight rein on the public-works funds allocated to the military, and "[s]ince the funds were set up for relief purposes, Ickes largely determined how they would be used and gave priority to projects employing large numbers of workers" (James 1970, 431). The army, supported by the American Forest Products, Inc., an industry group, argued for the addition of these constructed living spaces, convincing Roosevelt of the policy change when "[b]oth entities advocated that the use of frame buildings would create jobs in the lumber and construction fields" (Pfaff 2010, 7). With the additional construction, by "November 1933 the CCC boasted that more than 40,000 carpenters utilizing 300 million board feet of lumber would be building CCC camps in 46 states. The potential benefit to the lumber industry was obvious; however, related manufacturing and construction

7. Budget reduction quoted in fiscal year (FY) 1933 dollars. In FY 2010 dollars, this amount would equal approximately $1 billion.

businesses would share in the profits as well" (Otis et al. 1986). The army also took steps to ensure local support of the project, contracting "with local labor to construct camp buildings in order to promote good public relations with the camps' surrounding communities" (Pfaff 2010, 7; see also, Maher 2009, 116).

Although salvaging the army budget was one immediate outcome of the military's role in the CCC, it was not the only benefit of the program. War veterans also exercised their political power to secure employment in the CCC. In May 1933, a "bonus Army" of veterans from World War I approached the Roosevelt administration in an attempt to secure their pensions for wartime service. The pensions were not scheduled for payment until 1945, but, having suffered in the Depression, veterans increasingly demanded the payment in advance. To address the situation, Roosevelt turned Fort Hunt, Virginia, into a short-term veterans' camp, providing the bonus army with "[f]ood, tents, medical care, and transportation to and from the Capitol so the veterans could lobby" (Patton 2005, 163).

In order to appease the veterans, Roosevelt agreed to a compromise proposal offered by the U.S. Veterans Bureau administrator General Frank T. Hines, who suggested that rather than paying the full bonus, the Roosevelt administration could select veterans and place them in special CCC camps with the promise of a dollar a day (Salmond 1967, chap. 2; Patton 2005, 163). Although there was some initial disagreement, the veteran bonus army eventually agreed to the compromise once it became clear that Roosevelt intended to close the temporary camp at Fort Hunt (Patton 2005, 163–64). On May 11, 1933, Roosevelt issued Executive Order No. 6129, which "authorized the enrollment of 25,000 war veterans into the Corps, with no age or marital limitations imposed" (Salmond 1967).

The veterans working with the CCC again utilized their political influence when it came to the term limits on CCC service. With an initial limit of six months, the veterans faced discharge by the fall of 1933, and "it was clear that separation from the Corps almost always meant unemployment. . . . Faced with the possibility that discharged and then unemployed CCC veterans would bivouac in Washington for a third time . . . the Administration extended the veterans' time limit for service in the CCC. Late in 1933 the service limit was extended to nine months and in March 1934 when an 'April exodus' was expected, the Administration extended service to a year" (Patton 2005, 164). When the year employment limit was slated to expire, the veterans again threatened to march the bonus army on Washington. In return for their not marching, Roosevelt indefinitely suspended the time limit on June 27, 1934 (Patton 2005, 164–65).

The size of the CCC did come under threat once in the interwar period, when, with the coming of the 1936 election year, Roosevelt "intended to reduce the number of participants in hopes of reining in Government spending and presenting a more balanced Federal budget. The President wanted a cutback to 450,000 enrollees by June 1, 1936, and a corresponding closure of about 950 camps" (Pfaff 2010, 12). However, the camps pumped \$5,000 to \$7,000 per month into local economies, making the politicians of each district resistant to closures (Maher 2009, 136–37). Rather than meeting with success in reducing the scale of the program, Roosevelt met resistance from even his own party members, who argued for the CCC's "continuation at the increased levels. On March 14, 1936, two Tennessee Democrats, Speaker of the House Joseph Byrns and Representative Samuel McReynolds, presented a petition to Roosevelt with the signatures of 233 House members requesting that he discontinue the proposed massive closure of the camps" (Pfaff 2010, 12).[8] The administration yielded to these political pressures, ensuring that "all existing camps were to be maintained and closed only when work projects were completed" (Pfaff 2010, 12).

With the forestry-supply industry's and local workers' support of the army, the veterans' increased political power via the continuous threat of marching on D.C., and the support from the politicians who wanted to ensure a steady stream of income into their districts, the CCC had enough leverage to survive into the war period, when the army would no longer need the CCC to ensure its budget (Pfaff 2010, 15).[9] More important, the broader link between the military, government-sponsored programs, and employment had been established as a key part of the foundation of the permanent war economy.

Labor

One of the struggles Roosevelt faced in enacting his war policies in the late 1930s was the necessity of maintaining the support of the American labor movement. Throughout the 1930s, two opposing and competing forces were at work in the labor movement: strong isolationism and pro-foreign interventionism. The former consisted largely of isolationist manufacturing and trade unions throughout the Midwest and Great Plains that feared that their members would incur the costs of a draft and wage controls should the United States enter into an economic strategy of foreign intervention (Roberts 1995, 29–30, 151). The latter consisted largely of the industrial unions that had existing ties to military production.

As early as 1932, well in advance of the economic mobilization of the 1940s, sections of the labor movement favored a policy of rearmament, even though they

8. Neil Maher notes that the Society of American Foresters "hired a professional lobbyist, Charles Dunwoody, to coordinate efforts to defeat the proposal. Such actions helped bring farmers and ranchers into this 'Forest Service lobby'" (2009, 205–6).

9. Clayton James captures the ties underpinning the iron triangle when he writes, "It had been politically expedient for the War Department to cooperate fully in the President's pet project, and the Army's efficiency in handling the C.C.C. had brought the military establishment more favorable publicity than any of its activities since the World War. Both MacArthur and the New Dealers found themselves in anomalous positions regarding the C.C.C. The President and the coterie of liberal advisers around him were indebted to the Army and its conservative generals for the organization and administration of the first and probably the most successful relief program of the New Deal. MacArthur and his military advisers, on the other hand, found in the C.C.C. a lever for prying funds for the Army from the President and Congress" (1970, 225–26).

remained strongly opposed to actual participation in foreign wars. Pro-mobilization advocates did not want union members to be sent to fight on foreign soil, but they did see the economic benefits of military preparedness. During the 1932 American Federation of Labor (AFL) convention, the International Association of Machinists advocated a resolution whereby the "United States naval strength be built up to the maximum levels permitted under the 1930 London Treaty" (Roberts 1995, 34). In making his case before the gathered convention, Machinists' delegate N. P. Alifas cited the importance of military spending on the unemployment grounds, arguing, "What we need in this country now is work, and it seems to us that pursuing a building program of this kind is the logical thing to do in a period of depression. . . . This matter affects practically every industry in the country. We are informed that the materials which go into the building of vessels for the navy come from practically every state in the union. It involves the production of steel, copper, tin, wood, and even cotton cloth, and the people who earn wages where these things are being produced, will purchase commodities which involve every conceivable line" (AFL 1932, 394). Despite the apparent gains for the Machinists Association, the economic gains to other unions were not yet enough to overcome the isolationists' resistance. The resolution did not pass at the convention.

Despite the initial defeat at the convention, the pro-mobilization agenda soon won the day. Only a few months after the convention, the AFL's Executive Council "came out in favor of a $300 million naval appropriation that would bring United States naval strength up to levels authorized by the 1930 London Treaty" (Roberts 1995, 35). Even though the convention had recently ruled the argument inadequate, the "Executive Council cited the justification that it would save existing jobs and create new ones," and the AFL would "portray future military construction programs as victories for organized labor" (Roberts 1995, 35). This episode serves to highlight the competing agendas within the labor movement. Given these tensions, the challenge that Roosevelt faced was how to balance the isolationist resistance to ensure the labor movement would support his armament policies.

Early in the New Deal, Roosevelt knew he would have to appeal to the unions for support, and labor would ultimately come to be an integral part of the New Deal coalition. In the initial maneuvering to get the CCC established, Roosevelt encountered resistance from the labor movement, where the unions began to politicize the idea that the CCC was the administration's attempt to create fascism in the United States (Maher 2009, 107–8). One of labor's main concerns was that the CCC would be used to train skilled nonunionized workers, who would later compete with union members for work (Maher 2002, 438, and 2009, 79). In order to gain the support of labor for his project, Roosevelt appointed Robert Fechner, who at the time was vice president of the AFL's Machinists Association, as director of the CCC program (Stiles 1954, 267; Salmond 1967, chap. 2; J. Smith 2007, 321; Pfaff 2010, 6).

Fechner's appointment managed to satisfy two political needs for Roosevelt. First, Fechner, being a labor man, assuaged the unions' outcries by ostensibly giving them a position of power to oversee the camps and ensure that the unions' interests were being taken into account.[10] Second, in choosing Fechner, Roosevelt had appointed a director with labor backing that would, in fact, defer to both the army leadership and Roosevelt personally (Salmond 1967, chap. 2). The attachment to the CCC was one of the ways in which the military and labor became entwined, but the true gains of military spending would come later as economic mobilization began. Labor's continued gains from the New Deal ensured that the unions were in position to benefit during wartime.[11]

The first of the unions to be swayed toward supporting defense spending were those that operated in the heavy industries, such as coal, iron, steel, and shipbuilding, where the benefit from defense funding would be the greatest (Roberts 1995, 151). In the late 1930s, the pro-mobilization sentiment spread from the Northeast and the South, with strong support coming from the Los Angeles unions (Roberts 1995, 191–92), which benefitted from the connections between southern California's aviation industry and government military funding (Markusen et al. 1991, 84–91). Despite these changes, tensions in the labor movement persisted, with the resistance to armament led by the Chicago and Cincinnati unions (Roberts 1995, 150, 166) until 1940, when Hitler's Nazi Germany overran a significant portion of Europe.

Roosevelt was able to capitalize on the fear caused by the fall of France to enact restrictions on trade with Japan and to institute a peacetime national draft (Rutherford 1939, 9; Higgs 1987, 199–201). The boycott of Japan and Germany had been longtime AFL goals as it sought promotion of its "Buy American" campaign (Roberts 1995, 108–9), so in this regard the interests of labor and the president aligned.

Regarding the draft, until the attack on Pearl Harbor union political power and the isolationists in Congress were able to influence Roosevelt to adopt the position that troops would be kept in the Western Hemisphere and that deferments would be granted for men employed in "essential jobs" (Rutherford 1939, 9; Higgs 1987, 199–201). Even as Roosevelt gave his famous "Arsenal of Democracy" speech, in which he promised armament support for Britain, he was careful to balance union interests to avoid strikes, as illustrated by his declarations that "[i]f our capacity to produce is limited by machines, it must ever be remembered that these machines are operated by the skill and the stamina of the workers," and that "[g]overnment is determined to protect the rights of the workers" because "workers provide the human power that turns out the destroyer, and the planes and the tanks" (Roosevelt 1940). In return for a promise to forgo striking, the union leadership secured promises of federal protection for workers (Roberts 1995, 267).

10. The AFL would join with the Forest Service lobby when the CCC was threatened by Roosevelt's reorganization plan (Maher 2009, 206).

11. With union entrenchment in Roosevelt's New Deal coalition, labor benefited greatly from the National Industrial Recovery Act of 1933, the National Labor Relations Act of 1935, and the Fair Labor Standards Act of 1938. The combination increased membership helped to turn organized labor into a stronger political force (AFL 1933, 8; Higgs 1987, 178, and 2005a, 10; J. Smith 2007, 358).

Fear of continued German expansion abroad and expansions in Roosevelt's power at home contributed to an increased capacity for federal spending. The flood-gates of federal money were once again opened by the crisis of war in Europe that Americans were increasingly unsure they could avoid. By the summer of 1941, unions everywhere were realizing the gains to be had from ties to the growing defense efforts. The increased spending led to opportunities the unions could not ignore, and "[l]abor groups that had discounted the prospect of a job boom early in the war started clamoring for defense contracts. Munitions factories, construction of army camps, and ancillary endeavors from highways to housing to mining for strategic minerals offered employment. Moreover, job-creating civil projects, such as airport improvements, suddenly could be justified and funded in the name of national defense" (Roberts 1995, 201). Unions that had formerly been anti-intervention began to turn on their isolationist political representatives for their failure to secure defense contracts that would benefit union members.

Of course, as great a draw as the new contracts were, it was not just spending that benefited the unions. When U.S. involvement in World War II began in earnest, the unions realized their growing power and explicitly moved to use it to their advantage. In their view, "[t]he war effort needed labor's support. In return for that support, and to make that support effective, labor needed morale-building guarantees: that living standards would be protected; that unions would be able to grow; that an equitable tax system would be developed; that profiteering would be checked; that social security would be broadened; that unemployment would be cushioned; and, above all, that labor would take its rightful place in policymaking bodies" (Roberts 1995, 265). Although the labor movement would not achieve all of its goals, it did make significant strides. For example, using the crisis of war and unions' federally backed right to organize granted by the National Labor Relations Act of 1935, labor was able to force unionization into high-profile corporations, such as Bethlehem Steel, Republic Steel, and Ford Motors, where it had previously been thwarted (Roberts 1995, 281). Pursuant to the National Labor Relations Act, "the government enforced a 'maintenance of membership' rule, which helped the unions to add some four million new members to their ranks—an increase of approximately 40 percent—during the war years" (Higgs 2005a, 10).[12]

Labor unions' political clout also ensured significant involvement and influence in government programs that were created throughout the war. Leading union members were placed in positions on the National Defense Mediation Board, a tripartite agency designed to settle disputes between labor and industry during the war, and on

12. Higgs describes the "maintenance of member" program, supported by the National War Labor Board, as follows: "Where an open shop had existed and the union was demanding a union shop, the board provided that during a fifteen-day 'escape period' any worker could resign from the union and retain his job. After the escape period, union members had to remain members and pay dues for the life of the contract, and the union remained the exclusive collective bargaining agent at the workplace no matter how many nonunion workers subsequently became employed there. Employers did not like this; they considered it a union shop in disguise" (1987, 216).

the National War Labor Board, which had goals similar to the Mediation Board's (Roberts 1995, 280). As price controls were enacted, unionist Sydney Hillman was able to secure a place in both the National Defense Advisory Commission and the Office of Production Management (Higgs 1987, 203; Roberts 1995, 280), which enabled him to instigate the withdrawal of defense contracts from companies that violated the National Labor Relations Act (Roberts 1995, 281). The AFL's Joseph Keenan and the Congress of Industrial Organization's Philip Clowes were appointed to the War Production Board (Roberts 1995, 280).

Union inclusion on these agencies and war boards allowed labor to find exemptions for its own wages even as price controls were enforced elsewhere in the economy. Labor leadership "finagled constantly to push wages and other compensation above the limits the government had set in an effort to restrain the wage–price spiral that its inflationary monetary policy was causing" (Higgs 2005a, 10), and "[b]etween the end of 1940 and the end of 1944, average hourly straight-time earnings increased about 40 percent while weekly earnings went up about 80 percent" (Higgs 1987, 215). Not only did labor ensure that its wages were higher, its also found that with its new position of influence "small businessmen approached labor executives as supplicants, appealing for their support in obtaining defense contracts and raw materials" (Roberts 1995, 280). As the war proceeded, union leaders, not wishing to give up their influence, ensured that "[t]ripartitism—the equal representation of business, government, and labor—became the guiding principle underlying the numerous agencies that the federal government established to handle defense-related matters" (Roberts 1995, 280). Further, due to the political inroads made by labor leaders, "when World War II ended in 1945, organized labor held a far more secure and stable position in the United States than it had held before the war" (Roberts 1995, 281). This secure position ensured that labor would play a key role in the permanent war economy well after the end of the war.

Industry

Though industry would eventually become a central player in the tripartitism during World War II, business leaders, much like the labor leaders, were a vested interest that Roosevelt had to bring on board with his rearmament program. Also like labor, industry did not project a unified stance toward rearmament. A few businesses before 1940 were willing to let the War Department test their munitions capabilities (Rutherford 1939, 4). The aviation industry, with its success at gaining contracts during World War I and in continuing those contracts afterward, welcomed government funding. Businesses in this industry, unlike other munitions manufacturers, could use government contracts to produce the same output as they did for private customers, without having to reconvert factories for military production. Further, the aviation industry was one of the first to lobby for government assistance on the grounds of solving the unemployment problem. For example, when Lockheed

Aircraft Corporation's profits declined in 1934, Robert Gross, who had invested heavily in Lockheed, approached the "Roosevelt-created Reconstruction Finance Corporation for a revolving loan of $150,000" and "debuted the arguments that were to figure so prominently in later debates over government aid to the company—creating jobs and preserving the industrial base" (Hartung 2011, 39–40).

Outside of aviation, industry's role in the permanent war economy began with the actual mobilization rather than with the New Deal. The New Deal had not been favorable toward business, as it had been toward labor (White 1949, 159; see Higgs 1987, 179, and 2006, 47–48; Kennedy 1999, 275–80), and industry therefore did not have the same willingness to work with Roosevelt. The public also had a special aversion to military-oriented industries during the interwar period.

At the end of World War I, a strong sentiment arose throughout the United States that the profits of private business had been the main reason for American entry into the war.[13] According to this view, the profit from armed conflict accrued mainly to those who used the war to protect their foreign economic interests and those who sold arms and equipment to the government. A deeply antibusiness streak entered into American thinking and politics, with the military-industry leaders being labeled "merchants of death" (Higgs 2005a, 7, and 2006, 41). This sentiment was captured by Major General Smedley Butler, twice a Medal of Honor recipient, who wrote that "[w]ar is a racket. It always has been. It is possibly the oldest, easily the most profitable, surely the most vicious. . . . Out of war a few people make huge fortunes. In the World War a mere handful garnered the profits of the conflict. At least 21,000 new millionaires and billionaires were made in the United States during the World War. That many admitted their huge blood gains in their income tax returns. How many other war millionaires falsified their tax returns no one knows" (1935, 1).

The public sentiment that World War I had been fought for businessmen's profits was pervasive enough that Congressmen found it politically advantageous to pass legislation against war profiteering.[14] The Vinson–Trammel Act of 1934 and the Merchant Marine Act of 1934 specified restrictions on the level of profits that a manufacturer could receive for military production in wartime (White 1949, 165; Higgs 2006, 52). Another governmental response was the formation of a Senate

13. The general sentiment is reflected in H. C. Engelbrecht and F. C. Hanighen's book *Merchants of Death* (1934), a study of World War I war profiteering, which became a best-seller the year it was published. Engelbrecht and Hanighen argued that "the profits reported were simply colossal. Du Pont paid a dividend of 100 per cent on its common stock in 1916. The earnings of the United States Steel Corporation for 1917 exceeded by many millions the face value of its common stock, which was largely water. In 1916 this same company reported earnings greater by $70,000,000 than the combined earnings of 1911, 1912, and 1913. Bethlehem Steel paid a stock dividend of 200 per cent in 1917. U. S. Treasury figures show that during the war period 69,000 men made more than $3,000,000,000 over and above their normal income. Almost immediately the cry of profiteering went up" (178).

14. Higgs comments that in calculating the risk of rearmament, industry feared that government might, "as it had after World War I, file suits after the war for recovery of funds advanced to stimulate investment in war facilities" (2006, 46).

committee, led by Gerald Nye, that was charged with investigating whether World War I had been fought in the name of defense or in the name of profits.[15] As the investigation progressed, the committee pushed for price controls, high industrial taxes, and the removal of navy shipyards from private hands (Roberts 1995, 28). Although the Nye Committee's attempts to discover war profiteering were largely unsuccessful, the general climate was one of increased risk for businesses that were considering defense manufacturing.

The risks were already substantial. Industry leaders feared not just the political backlash of rearmament, but also the economic damage to their own companies that could result from the conversion process. With the war buildup for World War I, many industries had developed excess production capacity, which was no longer usable after war's end and especially throughout the Depression, so they were loath to repeat the process for a second war buildup (Yntema 1941, 375–77; Higgs 2006, 45–46). War products were not easily convertible to consumer goods, and idle factories were a drain on the industry. Not only would resources for the war effort have to be pulled from the production of consumer goods, but the resources would also need to be the "cream of the industry" to provide the highest-quality war materials (Rutherford 1939, 8). When the administration's shift in focus from New Deal to war buildup came in 1940,[16] "[p]rivate capital . . . was yet understandably timid at the prospect of investment in defense industries because of the risk involved. The sense of risk may well have been heightened by the long period of friction between the New Deal and the financial community. Only if this risk could be offset by substantial inducements was private capital likely to be available for defense financing in sums approaching the large amounts believed necessary" (White 1949, 159). The substantial inducements were forthcoming, though, because no modern great war could be fought without substantial industrial capacity.

Two of the initial concessions the Roosevelt administration made to industry were the legislative acts of June 28 and July 2, 1940, that authorized the military branches to negotiate their own cost-plus-fixed-fee contracts with their chosen industries (Higgs 2006, 49). These acts had two major effects on the procurement process. First, they removed the existing process of open advertisement and competitive bidding for defense contracts and replaced it with contract negotiation with firms.[17] Second, they gave the military branches sweeping authority to negotiate contracts with the firms with which they had the closest connections.

15. See U.S. Senate accessed March 11, 2013. The Nye Committee would conduct ninety-three hearings involving more than two hundred witnesses. The committee's efforts led to the institution of the Neutrality Acts of the 1930s.

16. Higgs cites a *Fortune* poll as late as October 1940 in which 59 percent of businessmen said they were still hesitant to enter the defense industry (2006, 47).

17. Higgs notes the dramatic shift in procurement: "In the fiscal year ending in June 30, 1940, the War Department had made 87 percent of its purchases through advertising and invitations to bid. During the following eight months, the department spent ten times as much and placed 74 percent of the contracts, by value, through negotiation" (2006, 49).

Industry responded positively to the benefits of the cost-plus-fixed-fee program. These contracts gave government assurance that all costs would be covered with an additional 7 percent fee, ensuring there would always be a profit for production. The negotiation system led to a procurement process whereby "deals came to turn not on price, but on technical and scientific capabilities, size, experience, and established reputations as a military supplier—vaguer attributes that are easier to fudge for one's friends" (Higgs 2007, 308; see also R. Smith [1959] 1991, 311). Once the price became determined by the military branches' administrative decision, the nature of competition shifted as firms came to rely on "political clout . . . rather than [on] the price-quantity contest that is more characteristic of civilian firms" (Melman 1985, 35).

Cost-assured contracts were not the only concession the Roosevelt administration made in order to attract business support for war production. Industry leaders were still concerned with the problem of excess capacity. Building specialized plants to increase production of war materials was costly, and there was little assurance of the plants' viability in the postwar period. In order to incentivize plant production, the Advisory Commission to the Council of National Defense—headed by U.S. Steel's chairman Edward Stettinius, General Motor's president William Knudsen, and Sears's executive Donald Nelson—instituted a program of Emergency Plant Facility contracts, whereby a contractor financed the acquisition of a plant with the government promise to reimburse the contractor fully within a sixty-month time period (White 1949, 171–73; Higgs 2006, 57).[18]

A second strategy employed to promote industrial plant acquisition was enacted through the Defense Plant Corporation (DPC), a subsidiary of the Reconstruction Finance Corporation. Under this strategy, the DPC bought the industrial plants and leased the productive capacities to private industry for production purposes. It allowed for two types of lease agreements. Under one scenario, the DPC acquired plants and then leased them to the contractor outright. An alternative lease agreement involved the contractor's holding a rental agreement based on sales volume, with the contractor paying rent at a rate of 80 percent of estimated sales capacity over a five-year period. This meant that the DPC was assuming partial nonrepayment risk if the plant was not able to work at capacity, a risk subsidized by the War Department, which would reimburse the DPC for the gap between actual sales and estimated capacity (White 1949, 175–76; see also Yntema 1941, 373–74, and Higgs 2006, 58–59).

Through its influence on the Council of National Defense Advisory Committee and the DPC, industry ensured that the federal government assumed the lion's share of the risk for industrial plant acquisition, allowing the profits of the actual product to accrue to business with tax payers holding the downside. Not only did industry

18. The contract also came with a promise by government officials that the plant would not be used for "business or commercial purposes," which ensured that the government-owned facilities would not become competitors in industry after the end of the war (White 1949, 173; Higgs 2006, 57).

negotiate for more risk-free profits, but business leaders were also successful at legally gaining a greater profit margin. The Second Revenue Act of 1940 removed the Vinson–Trammel Act and the Merchant Marine Act. Although the Second Revenue Act did raise corporate taxes and impose an excess-profits tax, it held enough loopholes that "[e]ighteen leading aircraft companies . . . managed to earn profits of almost 26 percent on their net worth in 1940; and despite booming business, only five of twelve integrated steel companies had to pay excess-profits taxes for that year" (Higgs 2006, 53). In this and other similar ways, industrial interests were rewarded for their support of Roosevelt's policies. The broader implication is that private industry became increasingly entangled with military preparation and war efforts, a partnership that continues to thrive to this day.

Conclusion

By war's end, all three interest groups—the military, organized labor, and war-related private industry—had experienced the monetary and political gains offered by the dual crises of depression and war. The iron triangle was complete, with the vested interests of "[b]ig business, including its powerful friends and representatives . . . , and the newly but vastly empowered military establishment together," which "formed a potent political faction" (Higgs 2006, 73). And because "[u]nions could not afford endlessly to neglect their immediate self-interest," organized labor also remained "a junior partner in the postwar complex" (Koistinen 1973, 477). Despite popular sentiment for a respite from the war effort, demobilization was short-lived because American military planners were already looking at the Soviet Union as the source of the next crisis with which to exert their influence (Biddle 2007, 141). The military-industrial complex, with only a short pause to gather its strength, found itself attempting to influence policy against a potential threat that would last for more than four decades (see, for instance, Lazarowitz 2005). And since the events of September 11, 2001, the military-industrial complex has again shifted focus to the transnational "war on terror," which has further extended and sustained the permanent war economy. Indeed, as John Mueller (2006) shows, an entire "terrorism industry" consisting of consultants, counterterrorism experts, and pundits has emerged in the wake of the 9/11 attacks.

In addition to providing insight into the origins of the permanent war economy, our analysis has broader implications regarding the relationship between capitalism and foreign military imperialism.[19] Some critics of capitalism view foreign intervention as a logical outgrowth of this type of economic system (see Oakes 1944; Vance 1951a, 1951b, 1951c, 1951d, 1951e, 1951f; Baran and Sweezy 1966;

19. We are grateful to Mike Munger for bringing this implication and the logic that follows to our attention.

Vatter 1985; Hossein-Zadeh 2006). From this perspective, foreign exploits provide a means for politically connected capitalists to earn significant profits. These critics are right, at least to a degree. What they are really highlighting is a flaw in capitalism whereby investors and entrepreneurs are indifferent, at the margin, between additional rents earned by seducing government and additional profits earned by creating new and less expensive products that benefit the general public (see Buchanan 1980).

In the context of foreign military interventions, this flaw implies that, given the chance, self-interested capitalists will gladly engage in a mutually beneficial exchange with the state-monopoly provider of military services. Private companies offer campaign contributions and political support, and politicians and state bureaucrats offer rents in return. Although both parties are privately made better off, the significant negative externality of allowing this exchange is that the permanent war economy diverts productive resources away from other uses that would improve the general standard of living (see Duncan and Coyne forthcoming).

How is this dilemma to be resolved? One solution is to adopt a completely planned economic system for military and defense production that removes capitalists from the process altogether. The flaw in this alternative, however, is that it assumes that government, absent crony capitalists, will have less of an incentive to build and use weapons for imperialistic purposes. The field of public choice, which demands the symmetry of assumptions between private and public actors, calls this assumption into question. Further, historical evidence also provides countless instances of government abuse of its monopoly on military force.

Yet another alternative is to establish a constitutionally limited system that constrains government while allowing productive capitalism to flourish within a limited domain of action. In principle, this solution would limit the type of cronyism that gave rise to the permanent war economy. The main problem with this alternative is that binding constraints have historically been fleeting in the face of constant pressures by politicians, bureaucrats, and capitalists pursuing their own narrow, self-interested agendas. Further intensifying these pressures are real and perceived crises that create openings for expansions in government, resulting in increased rents available to well-positioned special interests (see Higgs 1987, 2004, 2005b, 2006, 2012).

A third solution is to reconsider the state's role as a monopoly provider of defense services. Recognizing the monopoly rents associated with the state as the sole provider of military services, this alternative entails engaging in comparative institutional analysis to explore the feasibility of different means of providing protection and defense in the absence of a state monopoly (see, for example, D. Friedman 1989; Stringham 2007; Powell and Stringham 2009). Although this alternative may at first appear radical, it is no more so than the first two solutions, which ultimately rely on centralizing control of the military with the hope that it will not be abused by those in power. History, however, shows that avoiding such abuse is the exception rather than the norm.

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