How Did WWII Pull the United States Out of Economic Stagnation?

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By

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Part A – Plan of the Investigation

This investigation will evaluate how U.S. involvement in WWII stimulated the economy allowing America to climb out of economic stagnation and decline. To assess the extent to which the war stimulated the U.S. economy, this investigation will focus on parts of the economy specifically effected by the war, and the U.S. economy as a whole from 1939-1945. To understand the drastic change in economic growth, Depression era statistic will be referenced for comparison. The investigation will cover macroeconomic topics specifically government spending and the multiplier effect and their effects on GDP. This investigation does not extend to Roosevelt’s New Deal though it will be referenced. Relevant economic theories will be used to support and analyze the evidence.

The two sources being evaluated for origins, purpose, limitations, and values are: The Crucial Era by Gerald Nash and The Great Depression and WWII by Thomas Cochran.

Part B – Summary of Evidence

By 1939 the depression was considered to be over but America was nowhere near as prosperous as it had been before the collapse. Though Roosevelt’s New Deal had helped soften the more severe effects of the depression, “on the eve of America’s entry into World War II, between 9.5 and 14.6 percent of the labor force was out of work, depending on how unemployment is measured” (Margo 42).

After a decade America’s Real Gross Domestic Product was only 95.8 Billions of Chained (2005) dollars higher than it had been in 1929 (BEA 1.17.6). To put this in perspective, in 1929 America’s GDP was 976.1 Billion (2005) dollars. In 1939 it was 1,071.9. But by 1945 America’s GDP had increased nearly 100% and was 2,010.7 (BEA 1.17.6.). To understand how things increased so quickly after the Depression it has to be understood how Keynesian economics came to prominence.

The most striking thing to come out of the Great Depression and the most important thing to be implemented during the war was the gross increase in government intervention and regulation. “Many Americans now believed that governments, rather than individuals, had the prime responsibility for coping with the major problems that arose in an industrial society” (Nash 2). Keynesian economics rested on 4 principles. “(1) That increasing the income of the majority of the people increases demand for goods. (2) That increased demand... leads to new business investment. (3) That, in the long run, national income can increase only when there has been increased capital investment. (4) That if the operation of demand in the market does not stimulate sufficient capital outlays for business, government should adopt policies to increase demand and thereby the incentive for investment”
(Cochran 11). This belief was institutionalized when Congress passed the Employments Act of 1946, “which declared that it was the prime duty of the government to maintain economic stability...and ensure employment for individuals” (Nash 2).

The war gave the U.S. Government the best possible opportunity to put this new modified capitalistic state to work. The American people “entrusted the direction of most wartime activities to a vastly expanded federal bureaucracy; they gave whole hearted support to centralization in the American economy to achieve maximum production” (Cochran 142). From 1939 to 1945 Government Consumption Expenditures and Gross Investment increased 265.6% (BEA 3.9.1). “The great increase in GNP from 1940 on resulted from government spending. Two factors contributed to the miraculous rise in production: there were untold numbers of unemployed... who could be drawn into the labor force; and the war required mechanical equipment that the United States was particularly well equipped to supply” (Cochran 171). “Altogether, the Treasury pumped $320 billion into the economy, thus lifting the nation out of the Depression and into a new era of prosperity and full employment (Nash 150). “Although the war consumed about half of the national income of 1944, the remaining half provided the lower class at home with a better living than they had had in 1932” (Cochran 171). This further strengthened the belief in Keynesian economics. “Americans realized that full employment and prosperity were due largely to extensive federal expenditures related to the war effort (Nash 150).

The War put the American people back to work. In 1940 the unemployment rate was at 14.6%. In 1941 the employment rate had dropped to 9.9% and by 1944 had dropped to 1.2% (Hing 1). “War expenditures soon revived the economy. In 1941 the gross national product grew more than twice as much as the amount added by military production alone. In dollars of constant value the GNP rose 67% from 1940 to 1945, allowing the nation to meet the expenses of war and still have more dollars left for civilians to spend than during the depression” (Cochran 170).

**Part C – Evaluation of Sources**

*The Crucial Era* written by Gerald Nash provides a comprehensive account and analysis of the U.S. from The Great Depression up until the end of WWII. The purpose of the source is to help students understand the lasting impact of these events and to analyze how they shaped the current political, social and economic realities of today. The source is valuable because it gives an economic timeline of crucial events and gives statistics to back up analysis. Most importantly this source delves into U.S. war production and government spending which are two crucial topics. This source is limited because it is not solely about the economic impact of the era and thus it is not a comprehensive economic history.

*The Great Depression and WWII* by Thomas Cochran provides a general overview of U.S. history between 1929 and 1945. The value of this source is that it takes a look at the economic aspects of the war and the depression supplying statistics and measurements of spending and production. These statistics are invaluable in differentiating between Depression level spending and war time spending. This source is limited because it is not solely about the economics of the period and is thus only specific chapter are relevant.
Part D – Analysis of Evidence

Growth is a universally held economic goal. The expansion of total output relative to population results in rising wages and incomes and thus a higher standard of living. Growth lessens the burdens of economic inequality. Though the causes of the Great Depression are still argued today its effects are clear. The Great Depression greatly increased unemployment, destroyed productivity, and brought capital investment to a standstill as seen in graph 1.17.6. Over the course of that decade there was little to no growth. In economic terms, the Aggregate Demand (real output that buyers collectively desire to purchase) plummeted because the lower and middle class had no money to spend. Now yes it is true that Roosevelt’s New Deal stopped the Depression from spiraling further down into the abyss but to create real change, and an increase in real output and income, two thing would be required.

First the United States needed to increase its inputs to the economy (inputs referring to land, labor, capital, and entrepreneurial resources). The War provided companies with the solution. Before the War there was no investment because there was no security that companies would make their money back. With the certainty of war, companies had reassurance from the government that what they produced would be purchased. When they expanded to produce more and thus hire more; the goods they produced would be sold. The second way to increase real output and income is productivity. As stated by Nash, with the advent of war the government took control of production and pumped billions into new factories thus increasing productivity. With 14.6% of the nation unemployed, the economy had all the inputs they needed to grow. They just required an outlet. The War was that outlet.

The biggest step taken by the United States to solve the economic crisis was to increase government spending. Government spending creates a rightward shift in the aggregate demand curve increasing GDP. By increasing government expenditures by 265.6% over the course of the war, the U.S. government succeeded in creating jobs and stimulating investment. Investment spending also moves the Aggregate Demand curve to the right further increasing investment. To understand how spending alone can stimulate an economy to the point of prosperity, an economic term called the multiplier effect must be explained. The multiplier effect states that a change in a component of aggregate expenditure, in this case an increase in spending, leads to a larger change in GDP. By increasing Government spending due to the war, the U.S. raised their GDP significantly and in doing so raised the average income of Americans. Simply put, a plunge in consumer aggregate demand (consumer spending specifically) caused the Depression and government spending or expenditures was the catalyst that stimulated spending and brought the U.S. out of stagnation and into economic prosperity.

Part E – Conclusion

It is impossible to say that one act or policy brought the United States out of economic depression. It is true that Roosevelt’s New Deal did what no other policy could, it stopped the descent. But it was not until WWII that real economic growth occurred. It took a war and a single minded, government run economy to get people spending again. Government investment in capital and labor put the American people back to work. Without the advent of war, the U.S. government would have had no reason to take so much control of the economy and pump so much money into it. It took a war like
none that had come before to show the world that Keynesian economics worked. Government expenditures could be used to grow out of a depression and that is exactly what happened. Even with wartime spending, Americans had more money to spend then at any period during the Depression. By the end of the war the United States’ GDP was the highest it had been in history and double what it had been at the end of the Depression. WWII gave the government a reason to invest money back into the country and led to one of the greatest economic booms in U.S. history.

**Part F - Sources**


Word Count: 1693