THE ECONOMY AND FINANCE OF THE WAR

The war has had the effect of resuscitating quite a number of economic delusions—from Protection to the proposal to finance the war by the issue of thousands of millions of bank notes—some of which, such as the virtues of economy in the purchase of luxuries, have been advocated by persons of distinction. It is refreshing, therefore, to discover a book by a well-known economist which deals with the economic problems arising out of the war in a straightforward and reasonable fashion, and in some respects in an amazingly radical fashion. Such is Professor Pigou's essay on THE ECONOMY AND FINANCE OF THE WAR.*

The money costs of the war were for the year 1915-16 1,300 million pounds over and above the normal revenue requirements of the nation, and if the war continues for another year they will be even larger. This sum represents the value of the real things absorbed in the war, the value of the goods and services that the Government has required. But, says Professor Pigou, the things absorbed for use in the war and the real costs of the war to the nation are not exactly identical.

> If there had been no war, the great bulk of the things that are absorbed in it would not have come into being at all. The particular sorts of service which soldiers and munition makers render would not have been rendered. The real costs of the war to the nation, then, consist, not in the things that are actually absorbed in the war, but in the things—including the leisure of some of its workpeople—*which the community has to do without in order that these things may be provided.*

Professor Pigou then proceeds to discuss some fallacies connected with the real costs of the war. The first of these is one that must have caused difficulty to every reflective person. The costs of the war are represented by 1,300 million pounds, and yet the income of the people of this country as it stood before the war was estimated at only 2,300 millions. It would appear at first sight, then, that the cost of the war amounted to thirteen twenty-thirds of the national income. "This estimate is incorrect, because it ignores the fact that, since the outbreak of war, general prices in England have risen till they are now some 40 per cent. higher than they were in the previous peace." To allow for this we must either estimate the costs on a lower basis or estimate the national income on a basis some 40 per cent. higher in order that the comparison may be just. The cost will then work out at, say, thirteen thirtieths of the income of the British people.

A second fallacy is to assume that "not only do we have to provide goods and services to the tune of 1,300 million pounds, but we have to provide them out of a real income enormously diminished." Professor Pigou illustrates the point thus: "If a man with an income of £2,000 spends £1,000 on a motor car, we can say *either* that he has devoted £1,000 of his income to this purchase, *or* that his income has been reduced by £1,000 through this purchase. But it would be a ridiculous blunder to say that he has *both* devoted £1,000 of his income to buying a car and has also reduced his income by £1,000." This fallacy arises in part from assuming that we, the nation, do not include those persons who are soldiers or engaged on other military service. This will be clearly seen in the case of another fallacy—"that, when the size of the Army is given, the costs of the war to the nation may be made greater or less according as the rate of pay to the soldiers is high or low, and according as a large or small amount of money has to be paid in respect of their dependants." As Professor Pigou says, probably 90 per cent. of the people of this country believe that Germany can carry on the war with less expense to the nation than we can because the pay of her conscripts is merely nominal, and that it is cheaper for the British nation to have single men in the Army than married men. But to argue thus is to forget the fundamental proposition with which our author commences his inquiry, that the real cost of the war consists in "the productive services which these soldiers would have been rendering in industry if they had not been mobilised." To pay them or their dependants at a high rate does not cost the community any more; it merely transfers a certain amount of wealth from one portion of the community, the non-combatants, to another portion, the combatants and their dependants. Professor Pigou is one of the very few writers who, in discussing questions of this kind, has not been guilty of fallacies, such as have more than once been pointed out in this journal, arising from carelessness in the use of the terms "we" and "nation."

Such fallacies have been particularly common in the discussion of the influence of personal economy on the cost of the war. To abstain from the purchase of luxuries is not necessarily advantageous, to save on common necessaries is much more likely to be so; and in any case to make the personal economy effective the amount saved must be handed over to the Government by investing in the War Loan. To take an illustration of Professor Pigou's. If a man has been accustomed to buy a 1,000 pounds' worth of shells and explode them for his own amusement, and if he abstains from so doing and invests £1,000 in the War Loan, the saving has full value to the Government which thereby gets the shells it needs. But if he has been employing a person who can do nothing else to make 1,000 pounds' worth of lace, to save on that has no value; he loses 1,000 pounds' worth of lace, but the rest of the community gains nothing. It is advantageous, therefore, to lessen one's expenditure on commodities or services that the Government can utilise. For instance, to economise in the purchase of woollen goods will either enable the Government to obtain more khaki or to purchase khaki more cheaply.

Many other points discussed by Professor Pigou are well worthy of attention, but space forbids. The question of the foreign exchanges, for instance, he deals with very well, though not in a fashion that will please those who imagine that the rate of exchange between Germany and the neutrals has fallen to a point that will seriously incommode the German people. This subject we hope to return to in a later issue; and we shall now consider the method of raising money to pay for the war.

There are two ways in which the Government may meet the cost of the war in the first instance, by taxes and by loans, though ultimately there is only one, by taxation. "In a community where everybody was in the same position and of exactly similar wealth, the effect of a State loan of 1,000 millions and of State taxes

* THE ECONOMY AND FINANCE OF THE WAR. By Professor A. C. Pigou. J. M. Dent & Sons, Ltd. 1s. net.

to that amount would (except in respect of cost of collection) be practically identical. No doubt, under the loan method interest would be paid in the future, and under the tax method it would not. But the interest itself would have to be raised by new taxes; so that, if all members of the community were in the same position, the interest that each of them got would be, in effect, paid out of a new tax of equivalent amount levied on himself." Unfortunately we have not a community in that happy position, and Professor Pigou foresees the danger which has already been pointed out in LAND VALUES that the rich will bear the immediate burden, but that the poor will have to shoulder it in the long run. He says :—

> Under the tax method the rich and the moderately rich really shoulder the whole burden of the charge that is laid upon them. Under the loan method they do not do this; because they are compensated afterwards through taxes laid for that purpose partly on themselves, but partly also on other and poorer sections of the community. Under the tax method a great deal of money is obtained from the very rich and the rich of this generation without compensation. Under the loan method the same amount of money is obtained from them, but a contract is appended to the effect that the poorer classes in future generations shall pay money to their descendants as a reward for their present patriotic conduct. That is the vital difference between the two methods.

Professor Pigou proceeds to point out that this line of argument is strengthened by a number of other considerations. The position of the poorer classes will be relatively worse compared with that of the richer classes after the war than it was before. The Government is now paying a nominal rate of interest on the last War Loan of 4½ per cent., but the capital or commodities that it is so securing are raised some 30 or 40 per cent. above their normal price. After the war general prices will be much lower again, but the interest now stipulated for must continue to be paid. "That is to say, though the nominal rate of interest in terms of money is only 4½ per cent., the real rate in terms of things is probably something more like 6 per cent. Thus, the rich stand to gain largely as an indirect result of the war. On the other hand, the poor stand to lose." And further, the normal accumulation of capital for use in industry is not now taking place, and the production of wealth after the war will be to that extent hindered, capital will be scarce and obtain a greater share of the earnings of industry, and labour will obtain so much less. Professor Pigou continues :—

> This, however, is not all. As a matter of practice it is almost certain that, when very large levies are required from the rich, these will not be provided without considerable resort on their part to the device of borrowing from banks. If, as is probable in the case of very large levies, their borrowings for war loans and war taxes, coupled with the war loan subscriptions of the banks themselves, exceed their normal borrowings in times of peace, there is likely to occur a certain amount of currency inflation. This means that the bank money handed over to the Government and expended by them has reached such a large amount that it causes prices to rise. The result is that the money income held by the poor, since wages are not likely to rise as rapidly as prices, buys them less commodities than it bought before. This means that, in effect, a part of what the rich hand over to the State in their War Loan subscriptions is really exacted without interest from the poor. For inflation acts like a proportionate tax upon the expenditure of all classes, and such a tax, of course, hits poor people more severely than rich people.

Could any more damning indictment of our financial system be imagined?

Let us turn now to what is likely to happen after the war, and of this Professor Pigou gives us merely a hint. The national debt will, of course, be enormous, but this would in itself be no hardship to the country as a whole if it does not involve taxation which will impede industry and hinder the production of wealth. What the national debt involves, says our author, is "only a remodelling of distribution." "It threatens, not national penury, but only a struggle between people of different grades of wealth as to how much those in one grade shall pay over to those in another." The productive capacity of the nation will to some extent have been impaired, because the creation of new capital has been smaller during the war than it would have been normally. "The full measure of this loss is not to be found by a study of production alone . . . a necessary result of the shortage of capital is to increase the rate of reward which the providers of capital can claim for their services and to diminish the rate which the providers of labour can claim; this involves a worsening of the way in which the nation's real income is distributed."

When peace breaks out, there will be a period of "difficulty and waste and confusion while industry is readjusting itself to peace conditions," but Professor Pigou anticipates that "after the first few mouths of transition, the very destruction and check to new creation of capital, for which the war has been responsible, will be sure to have left open immense fields for profitable enterprise. It is practically certain that, to make good the havoc and the waste of war, there will be a strong industrial boom. This boom, if history is any guide, will generate in many minds an unreasoning sense of optimism leading to much wild investment. The result, some years afterwards, will be failures, crisis and depression." At this point Professor Pigou's inquiry breaks off. Let us pursue the investigation for ourselves. What species of speculation will this temporary boom engender? Surely, speculation in the one article that is the basis of all industry, that supplies the materials it uses and the sites on which it is carried on, the land. It is speculation in that alone which can lead to any serious crisis, for speculative increase in the value of land clogs industry at its source. It was this that happened after the Franco-Prussian War. As another political economist, Professor Adolf Wagner of Berlin University, has pointed out the price of land in Germany rose by leaps and bounds. The soldier who returned from the war found his rent raised enormously, employment scarce, and wages low. That is the danger that faces us in this country at the close of the war, a danger that can only be averted by prompt and vigorous action.

Grave as the prospect is, the solution of it is not too difficult for a people that realises the danger. There is in existence a valuation of land, a valuation staff, and a tax-collecting staff that, without much difficulty, can be turned at once to the task of collecting a general tax on land values. The imposition of such a tax will prevent the land speculation and the consequent distress and unemployment that will arise after the war, and it will solve the other difficulty which has been referred to—the danger that the cost of the war will be shifted on to the poorer classes of the community, and that the rich will escape and perhaps even profit by this disastrous conflict.

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