

UNIVERSAL
LIBRARY

OU_154051

UNIVERSAL
LIBRARY

OSMANIA UNIVERSITY LIBRARY

Call No. 330.19355; Accession No. 22232

Author ^{E 35 F} *Singh . P*

Title *Economic problems of
post-war*

This book should be returned on or before the date
last marked below.

ECONOMIC PROBLEMS OF
THE NEXT WAR

ECONOMIC PROBLEMS
OF
THE NEXT WAR

BY
PAUL EINZIG

MACMILLAN AND CO., LIMITED
ST. MARTIN'S STREET. LONDON

1939

COPYRIGHT

**PRINTED IN GREAT BRITAIN
BY R. & R. CLARK, LIMITED, EDINBURGH**

PREFACE

It is a sign of the times that the British public and the Press are at last becoming alive to the necessity for discussing the economic problems that have arisen from the rearmament race and that would be likely to arise from a war. While in Germany the subject has been discussed in great detail for years, until quite recently it was considered taboo in Great Britain. In 1937 I contributed a Preface to a book entitled *The E.s.d. of National Defence*, by Miss P. M. Rae. This book was the first attempt at systematic discussion at some length of all the main economic problems of national defence. For our pains both the authoress and I were accused of war-mongering, almost in so many words, in a review appearing in a weekly paper. In the meantime, however, that paper itself has published some very valuable contributions to the subject of rearmament economy and war economy.

Owing to the change in the British attitude towards the discussion of the subject, it seems almost superfluous to point out that the fact that I have decided to publish a book on the economic aspects of the next war does not in any way mean that I want war, or even that I consider it absolutely inevitable. I condemn war as much as anyone could, and I consider it the supreme duty of statesmanship to try to avoid it if that is possible. The fact that throughout this book I have used the future tense instead of the conditional is merely an attempt at simplification of phrasing, and should not be regarded as an indication that I consider a world war a fore-

gone conclusion. I am convinced, however, that a war, if not absolutely inevitable, is at any rate probable. It is therefore of the utmost importance that Great Britain should enter the war adequately prepared. Some progress has been made during the past year in the sphere of rearmament, and steps have also been taken to increase the degree of economic preparedness with which this country would face the war if it came. A great deal, however, remains to be done with regard to economic rearmament, and also with regard to the systematic study of the difficult problems of war economy. In this respect, as in respect of rearmament, Great Britain is at present at a disadvantage compared with Germany. Although Whitehall is studying these problems, they have not yet received sufficient public attention to enable the experts to pool their knowledge and ideas.

The number of problems likely to arise is immense, and many of them require an entirely specialised knowledge. It is not my ambition to try to produce anything like a comprehensive handbook of war economy. My aim is solely to study some of the broad problems and suggest tentative solutions. If my critics accuse my book of having raised more problems than it has solved, I am prepared to plead guilty in advance. It is necessary that these problems should receive attention, and I feel that if I have proposed wrong solutions they may contribute none the less to the desired end if their elimination by critics clears the path for the right solution.

P. E.

CONTENTS

	PAGE
PREFACE	v

CHAPTER I

LESSONS OF THE LAST WAR	1
-----------------------------------	---

1. Military *v.* Economic Preparedness. 2. A Pre-war Misconception: "War Must End in a Few Months". 3. Modern Credit System removes Financial Limitations of War. 4. Internal Finance presents no Insurmountable Difficulties. 5. Central Powers at a Disadvantage regarding Exchange Resources. 6. Gold instead of Butter. 7. Delay in Planning and Rationing. 8. Inflation Ignored. 9. Hope of Returning to "Normal" Conditions after the War. 10. No Sweeping Flight of Capital. 11. Borrowing instead of Taxation. 12. The Bank Rate Blunder of 1914. 13. War a Bad Business Proposition.

CHAPTER II

HOW THE LESSONS OF THE LAST WAR APPLY TO THE NEXT WAR	15
---	----

1. Need to Prepare for Prolonged War. 2. Lesson of Spanish and Sino-Japanese Wars. 3. Measures to be Completed before the Outbreak of War. 4. Preliminary Study of Problems of War Economy. 5. Arrangements to ensure Speedy Application of War Measures. 6. Initial Advantage of Disciplinarian States. 7. Ample Resources for Internal Financing. 8. Germany's Inferior Gold Resources. 9. Economic Limitations to the Pursuit of War by Germany. 10. How Experience of the Last War will affect the Public. 11. Outbreak of War likely to cause Initial Slump. 12. Inflation-Consciousness. 13. Measures against Inflation.

CHAPTER III

WAR AND PRODUCTIVE CAPACITY	28
---------------------------------------	----

1. "Business as Usual" during the Last War. 2. Need for Reorganising Production on a War Basis. 3. Collection of Statistical Material. 4. Increase of Agricultural Production. 5. "Wait and See" Policy Condemned. 6. Industrial Conscription. 7. Ruthless Rationalisation. 8. Conscription of Labour. 9. Restriction of Luxuries. 10. Effect of Air-raids on Production. 11. Order of Importance of Various Branches of Production.

CHAPTER IV

PAGE

WAR AND CONSUMPTION 40

1. Vital Requirements of the Civilian Population. 2. Danger of Surrender through Starvation. 3. Inventory of Supplies. 4. Privately held Food Reserves. 5. Reserves to be kept Intact. 6. Measures against Hoarding and Waste of Food. 7. Production of Substitutes. 8. Japan's War Restrictions on Consumption. 9. Reduction of Food Imports. 10. Measures against Luxury Consumption.

CHAPTER V

WAR AND FOREIGN TRADE 49

1. Effect of Rearmament on Imports and Exports. 2. Reduction of Luxury Imports. 3. Increase of Food and Raw Material Imports. 4. Increased Export Possibilities, Reduced Exportable Surplus. 5. Demand for Goods by Neutral Countries. 6. War with Golden Bullets. 7. Germany's Bid for Control of Danubian Supplies. 8. Neutral Countries' Attitude towards Blockade. 9. Neutrality likely to be Interpreted in Favour of Great Britain. 10. Germany Unable to Import unless she Exports First.

CHAPTER VI

BUDGETARY PROBLEMS OF WAR 60

1. Taxation *v.* Borrowing. 2. Taxpayers' Resistance. 3. Fight against Tax Evasion. 4. Form *v.* Substance. 5. Absorbing Inflated Purchasing Power. 6. Will Germany be Able to Borrow? 7. The German Public and Inflation. 8. Position of Great Britain and France. 9. Large External Reserves. 10. Germany and Italy at a Disadvantage.

CHAPTER VII

WAR AND MONETARY POLICY 71

1. Fight against Inflationary Tendency. 2. Degree of Initial Inflation. 3. Inflation in Germany Inevitable. 4. Price Control. 5. Deflation of Purchasing Power. 6. Rise in Prices Inevitable. 7. No Credit Restrictions. 8. No High Bank Rate. 9. Treasury's Cheap Borrowing Facilities. 10. Trend of Commodities and Money Rates. 11. How to divert Surplus Purchasing Power into Government Loans.

CHAPTER VIII

WAR AND FOREIGN EXCHANGE PAGE 82

1. Germany's Inadequate Gold Reserve.
2. Large British Overseas Investments.
3. Realisation of U.S. and Latin-American Securities.
4. Realisation of Empire Securities.
5. Repayment of Foreign Loans.
6. French Foreign Assets.
7. Neutrals and "Hot Money".
8. The Disharding of Gold.
9. Credits on Security.
10. Neutral Refugee Money in London.
11. Restriction on British Capital Export.
12. Discrimination in Favour of Foreign Balances.
13. The Case for All-Round Exchange Restrictions.
14. Immunity of Foreign-owned Funds and Gold decided in Advance.
15. Exchange-Pegging.

CHAPTER IX

GERMAN WAR ECONOMY 97

1. *Wehrwirtschaft*.
2. Economic System serving Aim of Victorious War.
3. Prussian Military Efficiency *Über Alles*.
4. Bid for Self-Sufficiency tempered by Labour Shortage.
5. Building Up Commodity Reserves.
6. German Population Underfed.
7. "Bloodless Invasion" of the Danube Basin and the Balkans.
8. Britain to Resist German Economic Penetration.
9. Germany Handicapped by Inflation-consciousness of her Public.

CHAPTER X

FRENCH WAR ECONOMY 107

1. Deterioration of Industrial Discipline.
2. Hopes of Restoring National Unity.
3. Forty-Hour Week must go.
4. Need for Exchange Restrictions.
5. Calling in Foreign Assets.
6. Budgetary Problems.
7. French and German Economic Positions Compared.
8. British Financial Support for France.
9. Advantages of Control of the Seas.

CHAPTER XI

ITALY'S ECONOMIC PROBLEMS 117

1. Will Italy join Germany in a European War?
2. Italy's Economic Structure.
3. Lack of Raw Materials.
4. No Economic Assistance from Germany.
5. Internal Financial Difficulties.
6. What Italy stands to Lose by joining Germany.
7. Advantages of Neutrality.

CHAPTER XII

	PAGE
WAR ECONOMY OF THE SOVIET UNION	124

1. Self-Sufficiency of Soviet Russia. 2. Improved Facilities for Transport of War Material. 3. Increase of War Material Production. 4. Will Red Army's Supplies Break Down? 5. History may Repeat itself? 6. Dangers of Russo-German Alliance.

CHAPTER XIII

WAR ECONOMY OF THE UNITED STATES	131
--	-----

1. How the United States could Save Peace. 2. Decisive Rôle of United States in Next War. 3. Immense Economic Resources. 4. Capacity for producing War Material. 5. Financial Resources Inexhaustible. 6. War Economy during Neutrality. 7. Need for War Debt Settlement. 8. Neutrality Act likely to be Repealed.

CHAPTER XIV

JAPANESE WAR ECONOMY	139
--------------------------------	-----

1. Economic Effects of Sino-Japanese War. 2. How the War is Financed. 3. Advantages of Neutrality in a European War. 4. Disadvantages of joining Germany.

CHAPTER XV

CONCLUSION: WHY BRITAIN WILL WIN	143
--	-----

CHAPTER I

LESSONS OF THE LAST WAR

(1) MILITARY *v.* ECONOMIC PREPAREDNESS

DURING the years which preceded the world war of 1914–18, the General Staffs of the countries which were eventually to become enemies were busily engaged in elaborating plans of campaign. The mobilisation of millions of men, the schedule for the transfer of military masses to the scene of hostilities, their grouping and their subsequent movements, were worked out years ahead, to the minutest detail. On the other hand, most countries made practically no advance arrangements about their economic mobilisation. The Governments plunged their nations into a war of unprecedented dimensions without knowing anything about its economic implications, and without taking any of those economic measures which, in the light of subsequent events, should have been regarded as a matter of common sense.

The contrast between the high standard of military planning and the absence of economic planning before 1914 was very striking indeed. It is true that it was not always possible to carry out the military plans to the letter, but even so the existence of such basic plans helped the Army High Commands to no slight extent in their operations. On the other hand, the absence of economic advance plans increased the difficulties of the Governments of the

belligerent countries, especially during the later stages of the war.

(2) A PRE-WAR MISCONCEPTION: "WAR MUST
END IN A FEW MONTHS"

The ignorance and inexperience of official quarters, experts, and the public regarding the economic aspects of a modern war were due in part to the absence of prolonged wars of first-class magnitude during the decades before 1914. The lack of adequate literature on war economics and war finance during pre-war years, however, was also partly responsible for the lack of adequate economic preparation. Books and articles dealing with the subject were very few and far between. They were virtually unanimous in supporting the erroneous conception that, owing to its heavy financial burden, a modern war was bound to come to an end in a few months. This conception was almost universally accepted, in the years before the war, by those who gave any attention to this subject, including the Governments. It was based on the fact that the cost of modern warfare would be a multiple of that of wars of past centuries. For one thing, as a result of conscription and of the increase in population, most countries could mobilise very large armies from the very outset, so that the number of soldiers to be fed, clothed, and provided with arms and ammunition was likely to be a multiple of the corresponding numbers in the previous comparable war, namely the Napoleonic war. Moreover, during the century that separated Waterloo from the first Battle of the Marne, the adoption of modern equipment increased the *per*

capita cost of armies and navies to a considerable extent. Where Napoleon and his adversaries thought in terms of millions, the generation of 1914 had to think in terms of milliards. Hence the view that no nation could possibly stand the tremendous financial burden for any length of time.

(3) MODERN CREDIT SYSTEM REMOVES FINANCIAL LIMITATIONS OF WAR

Those who held this view overlooked two things. First, they overlooked the general expansion of the volume of currency and credit since the Napoleonic War, as a result of which the size of financial figures underwent a steady and substantial all-round increase. What was even more important, they overlooked the increased elasticity of the currency and credit structure. As a result of a century of economic progress and comparative stability, modern credit conditions developed amidst which Governments were in a position to raise and spend many times the amounts which during the Napoleonic era had been considered the limit of their spending capacity. This was, however, overlooked by the pre-war experts, brought up in the school of financial and monetary orthodoxy, to whom it never occurred that the belligerent Governments might be able or willing to finance a war for several years largely by inflationary methods. Since in pre-war days Government expenditure, whether on arms or for other purposes, was limited by budgetary resources and by the amounts that could be raised by normal methods of borrowing, it was generally assumed that these limitations would continue to operate in time of war.

Owing to the growing tension between rival groups of powers, the outbreak of a world war was a question of time. That it actually began in 1914 instead of at some later date was, perhaps, to some extent, the result of the misconception about the limit of war financing. The assumption that, for financial reasons alone, the war must come to an end in a few months, may have contributed in a negative sense to the decision of the statesmen responsible for the war. Had they been aware that as far as financial factors were concerned there would be nothing to prevent a war from continuing for years, they might possibly have hesitated to embark upon the disastrous adventure. At any rate they might first have completed economic preparations to enable them to face a prolonged war. This in itself would have postponed the date of the outbreak of hostilities, since the economically weaker party, in particular, would have taken a long time to gather strength before making the fateful decision.

(4) INTERNAL FINANCE PRESENTS NO INSURMOUNTABLE DIFFICULTIES

Another theory which became popular during the early stages of the war was that the war would be won by the side whose money lasted the longest. On the basis of the pre-war theory of the limitation of war financing, it was widely believed among the Allies that the Central Powers, being financially weaker, were bound to get the worst of the contest because the Allies would have ample financial resources for the pursuit of war long after the Central Powers had exhausted their resources. The experience of the

war of 1914-18 proved that even the financially weaker side was quite capable of raising funds for the pursuit of war for years.

(5) CENTRAL POWERS AT A DISADVANTAGE
REGARDING EXCHANGE RESOURCES

Nevertheless, in a sense there was some truth in the theory that the group of countries whose financial position was the stronger stood a better chance of winning the war. While internally the weaker party was as much in a position to finance war expenditure as the stronger party, as far as external financing was concerned the Central Powers were obviously at a disadvantage. Their gold and foreign exchange resources and realisable foreign investments were inferior to those of the Allies, even before the United States entered the war. This meant that, apart altogether from the difficulty of buying food and raw materials abroad owing to the Allied blockade, the Central Powers had to husband their gold resources and were unable to take full advantage of the loopholes provided by the possibility of trading with or through neutral countries. Even at the moment of the Armistice, however, both Germany and Austria-Hungary possessed quite considerable gold reserves, so that they could not be said to have exhausted their financial resources.

(6) GOLD INSTEAD OF BUTTER

The necessity for economising with these gold resources must have contributed, however, to the food shortage which eventually played a predominant

part in undermining the morale of the hinterland, and even of the fighting forces of the Central Powers. On more than one occasion the Allied Governments were able to prevent the neutral countries from selling important stocks of food and raw materials to Germany by outbidding her. Had the gold resources of the Central Powers been more plentiful, they would not have been at such a disadvantage.

One of the reasons why Germany and Austria-Hungary were reluctant to spend gold on food, even on occasions when they would have been able to do so, was the necessity for the Central Bank's gold reserve to be kept more or less intact because it served as the backing of the note circulation. Had it not been for this requirement, and for the belief that the war would in any case be over very soon, a large part of the gold reserve of the Central Powers would have been converted into food and raw material reserves during the early stages of the war.

(7) DELAY IN PLANNING AND RATIONING

The generation of 1914 was entirely unaware of the necessity for extensive economic planning in time of war. In each of the belligerent countries it was years before planning and control over production and distribution, the rationing of fuel and transport facilities, control over prices, exchange, etc., were gradually introduced. In a great many instances the stable door was not closed until the horse was gone. During the early stages of the war no attempt was made to prevent the reckless waste of precious food and raw material stocks. It happened over and over again that no steps were taken to ration the con-

sumption of a commodity until an acute shortage developed. Nor were any arrangements made at the beginning of the war to increase the production of "civilian" goods essential for prolonged warfare, or to produce substitutes for commodities the purchase of which abroad was either impossible or would involve an unnecessary loss of gold resources. Until the more advanced stages of the war no comprehensive scheme existed for the allotment of existing raw material among industries according to their relative importance in the general scheme of national defence. Rathenau's plan for rationing raw materials in Germany was ahead of its time and encountered strong resistance.

Nor were any steps taken to prevent wastage of material, fuel, human labour, or transport facilities in the production and distribution of luxury articles. Although war requirements placed an almost unbearable burden upon the railway and shipping facilities of the belligerent countries, most of these countries did not take any steps during the early stages of the war to prevent the use of those transport facilities for unnecessary movements of goods and passengers. If it had been realised that the war was likely to last four years, possibly some of these measures, at any rate, might have been introduced during the early stages. In particular, the rationing of food supplies would have been adopted from the very outset. As it was, it was years before the necessity for such action was adequately realised, as far as most commodities were concerned, and it was some time before the control was made reasonably effective.

(8) INFLATION IGNORED

The monetary policy of the belligerent countries was also characterised by a lack of ability to grasp what was happening. The generation of 1914 was oblivious to the essentially inflationary character of war finance. The authorities could not help noticing the rise in commodity prices which set in after a while, but it was attributed to the shortage of supplies due to war conditions. The monetary side of the rising trend was almost entirely overlooked. The authorities in the various belligerent countries tried to fight the trend by introducing a limited price control. First of all rents were brought under control; then a small number of essential commodities; and finally a large number of commodities. The system was not watertight, however. Until the very end of the war, in each country the price of many commodities and services remained free of control, apart from some vague provisions against profiteering in general.

While the prices of certain goods and services were thus limited, earnings were allowed to soar. In the absence of price regulations, the increase of purchasing power would have led to an all-round rise in commodity prices. Since, however, the price of a number of articles and services was kept down by official measures, there was an inevitable scramble for those goods and services, resulting in an acute shortage. This made the authorities realise the necessity for rationing supplies. Since the owners of the increased purchasing power were thus prevented from increasing materially their spendings on these essential commodities, their surplus purchasing power was diverted

to commodities which were not subject to price control or rationing. The result was a sharp rise in their prices.

(9) HOPE OF RETURNING TO "NORMAL"
CONDITIONS AFTER THE WAR

The rise in the general price level did not occur for some time after the outbreak of the war. The immediate reaction to the outbreak was, in fact, in most countries a slump in both securities and commodity markets, and even as late as 1915 certain commodities, such as wheat, were inclined to fall at times. Evidently the public was blissfully oblivious to the probable effects of inflationary war financing, and was not at that stage inclined to discount its effect. While it could not help noticing the rising tendency in certain commodities, it attributed the rise, as well as many other evil developments, to the war, and left it at that. Most people took it for granted that, once the war was over, the clock could be put back and the world would revert once more to pre-war conditions. Thus it was that, whenever there was talk of peace, the rising trend in commodity prices became reversed. When, during the late summer and early autumn of 1918, the victory of the Allied Powers became more and more assured, the result was a declining trend in commodities not only in the victorious Allied countries but, strangely enough, even in the vanquished countries. Most people were firmly convinced that once the armistice was signed the price level and everything else would simply return to "normal", a term which was used to describe the state of affairs which existed until July 1914.

(10) NO SWEEPING FLIGHT OF CAPITAL

Lack of experience and foresight was manifested particularly clearly regarding the attitude of the belligerent Governments towards the international movement of funds. It was some time, even among the Central Powers, before watertight restrictions could be enforced on the employment of foreign exchange resources for the purchase of unnecessary articles abroad. It took even longer to develop a system of preventing the flight of capital. Even in 1918 the restrictions applied to international capital movements were mostly inadequate. Notwithstanding this, the volume of refugee money during the war was comparatively small. There was a fair amount of French refugee money and continental refugee money in general in London, while New York, Switzerland, and Holland also received their share. There was, however, no wholesale flight of capital in anticipation of a currency depreciation, for the simple reason that very few people had enough foresight to anticipate a lasting and substantial depreciation of their national currency. The object of most of the flight of capital which occurred was mainly to seek refuge against the menace of German invasion.

Had the public realised the lasting monetary consequences of war finance, there would have been a sweeping exodus of capital to neutral countries. All the more so since the exchanges of the belligerent countries were for a long time artificially pegged at a grossly over-valued level, which provided additional inducement for capital to take flight. It was only because of the ignorance of the public that the pegging of the exchanges was possible without the

imposition of an unbearable strain on the gold resources of the Governments through the flight of capital. It was also thanks to the ignorance of the public with regard to the lasting financial consequences of the war that the Governments were able to collect very large amounts of gold from circulation. Had it been expected that after the war the currencies would depreciate far beyond the extent of their depreciation during the war, patriotism would hardly have induced so many holders of gold coins to surrender their holdings at par to their Governments.

(11) BORROWING INSTEAD OF TAXATION

Ignorance regarding the true nature of inflationary financing was largely responsible for the mistaken financial policies adopted in most belligerent countries. Even those quarters which realised the inflationary effect of an expansion of the currency held the view that inflation could be prevented by keeping down the note circulation. Thus the notes spent on the financing of the war were promptly mopped up again through the frequent issue of war loans. What was not adequately realised was that even though the bulk of the money spent found its way back to the Treasury in the form of subscriptions to these war loans, this did not alter the fact of the increase in profit inflation and purchasing power in general. Great Britain was practically the only belligerent country where serious efforts were made to counteract by means of an increase of taxation the undue increase of purchasing power and the inflation of profits. Income tax was increased to a multiple of its pre-war figure ; new types of direct taxation, such

as Corporation Profit Tax and Excess Profit Duty, were introduced. While Germany was content to mop up the increase in the note issue, Great Britain made a valiant effort to mop up the increase in purchasing power. The absence of any serious effort to do so in Germany was all the more remarkable since it was a leading German economist, Professor Liefmann, who during the war put forward with convincing force the theory that war expenditure and currency inflation affected the price level entirely through their effect on the level of incomes. Notwithstanding this, incomes in Germany were allowed to rise to an inflated level without any strong resistance.

(12) THE BANK RATE BLUNDER OF 1914

A curious example of the ignorance of the generation of 1914 about the financial consequences of the war was provided by the decision of the Bank of England to raise the bank rate to 10 per cent in August 1914. Those responsible for this decision, which plunged the London market into a crisis far more severe than that experienced by weaker financial markets at the outbreak of the war, were guided by the "bank-rate worship" which developed among bankers and economists during the nineteenth century. The conception that the fate of Mankind and the course of the Universe could be guided by changes in the bank rate was extremely popular. The beginning and the end of the much-vaunted skill of Central Banks before the war was to raise the bank rate every time something went wrong, and the extent of the increase depended upon the extent of the adverse development against which the rise was

applied. In 1907 there was an international financial crisis. Up went the bank rate to 7 per cent. In 1914, war was declared. Up went the bank rate to 10 per cent. Had the war been lost, the bank rate would probably have been raised to 15 per cent, and actual enemy invasion of the British Isles would have had as a natural consequence an increase of the bank rate to 20 per cent. Internal disorder and civil war would probably have caused it to rise to 25 per cent, and the pundits of Threadneedle Street would probably have attempted to cope with the collapse of the Universe by raising the bank rate to 100 per cent. Their action in August 1914 disclosed a lack of appreciation of the situation which could only be described as astonishing, even allowing for the general ignorance and lack of foresight concerning problems of war finance.

(13) WAR A BAD BUSINESS PROPOSITION

At the beginning of this chapter I pointed out the fallacy of the conception that owing to the exorbitant financial requirements of modern warfare no war could, possibly last more than a few months. Sir Norman Angell, who was partly responsible for the popularisation of this misconception, redeemed his mistake by his brilliant theory that a modern war was bound to be a bad business proposition even for the victor. The comparative ease with which Germany exacted heavy indemnities from France after the Franco-Prussian war of 1870-71 made it appear desirable for a militarist nation to undertake a war as a purely financial transaction for the sake of exacting huge indemnities from the defeated nations.

The experience of 1914–18 showed that any country was bound to spend in a modern war more than it could possibly hope to recover from its defeated adversary. The actual extent of war expenditure exceeded all anticipations and left even the victorious nations with a staggering burden of public debt.

To summarise, it is justifiable to say that the efficient conduct of war was heavily handicapped in every country by the lack of adequate knowledge in official quarters regarding the economic aspects of war. We propose to examine in the next chapter the extent to which the lessons learnt during the last war could be made use of in order to avoid mistakes in the next war.

CHAPTER II

HOW THE LESSONS OF THE LAST WAR APPLY TO THE NEXT WAR

(1) NEED TO PREPARE FOR PROLONGED WAR

THERE is one point which those responsible for organising the economic defences of the country during the next war will undoubtedly bear in mind, and that is the certainty of a prolonged struggle. There may have been some excuse during the last world war for assuming that hostilities would come to an end within a few months. There can be no possible excuse for any statesman or Government official falling into the same error when the next war breaks out. Until a year or two ago it was fashionable among some military experts and pseudo-experts to maintain that, owing to the immense increase in the importance of the air weapon, the mechanisation of the armies, and the invention of new lethal weapons far more destructive than anything used during the last war, it would be possible to achieve victory within a few weeks. On that assumption there would be no need to worry very much about the economic aspects of the next war, since even in the absence of special measures any country could stand the economic burden of war for the space of a few weeks. Nevertheless, no statesman would be prepared to repeat the mistake of 1914 by embarking on a major war without adequate economic preparation and organisation.

After all, the theory that the next war will bring a decision so quickly has not been tested, and even the most reckless gambler with the destinies of his nation would hesitate to stake everything on such an untried assumption.

(2) LESSON OF SPANISH AND SINO-JAPANESE WARS

The quick result of the Abyssinian war appeared to confirm the theory, to some extent at any rate, but owing to the glaring inequality of the opposing forces and their equipment it could hardly be regarded as a convincing test. The experience of the Spanish and Sino-Japanese wars, on the other hand, provided conclusive proof that, notwithstanding the technical changes since 1918, a major war was likely to be a prolonged affair even if the attacking power established its superiority over the defenders from the very outset. At the time of writing the Spanish war has been in progress for more than two years and the Sino-Japanese war for more than a year, and the end is not yet in sight. It would have appeared reasonable to assume that General Franco's trained forces would be able to win a speedy victory over the undisciplined and badly-armed masses that confronted them. It would also have appeared reasonable to suppose that China would be no match for the highly efficient armed forces of Japan for any length of time. Nevertheless, in both instances the war has been dragging on far beyond anticipations. Given closer equality between the armed strength of the opposing camps, it is reasonable to assume therefore that the next world war will last quite as long as the last one did.

(3) MEASURES TO BE COMPLETED BEFORE THE OUTBREAK OF WAR

For this reason it is essential from the point of view of national defence to make preparations for a prolonged war, and to that end it is necessary to consider the economic measures to be taken. To some extent those measures could actually be carried out before the outbreak of war. The accumulation of reserves of food and raw materials, the increase of the home production of certain commodities, the increase of shipping tonnage, etc., are some of the methods. Most of the measures, however, could not be taken until after the beginning of hostilities. It is impossible to disorganise the economic life of a democratic country in time of peace by placing everything on a war footing. This could and should be done if the outbreak of war within a short time were a certainty. It is inconceivable, however, that the economic system of a country should be kept on a war footing year after year on the off-chance that a war might break out shortly.

(4) PRELIMINARY STUDY OF PROBLEMS OF WAR ECONOMY

What is needed is that all the necessary preparations should be made for the conversion of peace economy into war economy at short notice with the least possible delay after the outbreak of the war. The first step in that direction is to study the problems involved. It would be too much to expect harassed Cabinet Ministers and Government officials to take the right decision at a moment's notice in the middle

of an unprecedented emergency. Most of these decisions involve a number of conflicting considerations, the study of which requires time. Admittedly it is possible, and even probable, that when the emergency itself arose it would bring with it a number of unexpected factors. This is no reason, however, why the effect of those factors for which reasonable allowance can be made should not be examined carefully well in advance.

The necessity for such examination has in fact been realised by most countries. In Great Britain various departmental and inter-departmental committees have for some time been engaged in discussing economic and financial problems of war. The Food Defence Department set up under the auspices of the Board of Trade has been studying such problems systematically. In other countries, especially in Germany, the advance study of the economic problems of the next war has reached a much higher stage. Far-reaching economic plans to cope with war conditions are being elaborated everywhere. These plans are not confined to questions of general policy, but go into minute details. To take an example, it is not enough to deal with the problem of timber supply in general; it is essential to go into details such as that of the supply of pit props.

(5) ARRANGEMENTS TO ENSURE SPEEDY APPLICATION OF WAR MEASURES

In itself the elaboration of plans by an economic General Staff would not be sufficient. It is necessary to build up in advance skeleton organisations to enable the Government to apply the plans with the

least possible delay after the outbreak of war. This is being done in connection with air-raid precautions, and there is no reason why it should not be done in connection with economic defences. Even if it means an increase of personnel in Whitehall, the additional cost would be a mere fraction of the amount spent on rearmament, and it would be a very effective way of preparing for emergencies.

The skeleton organisations thus formed could be kept fully occupied with the task of collecting statistical material, about the existing stocks of various products and manufactures, whether produced in this country or imported from abroad ; the rate of normal production or influx of those products, and the rate of consumption ; the normal limits of producing capacity in existing circumstances, etc. In order to be able to obtain this data it would be necessary to have legislation passed to make the declaration of stocks, etc., compulsory. Even in the absence of such legislation, however, it would be possible to accumulate large quantities of useful statistical material. This is proved by the experience of the Bank of England, which since 1931 has been collecting statistical data from the London banks about the various items of their foreign short-term assets and liabilities. Although there is no legislation to make the declaration of these assets and liabilities compulsory, there is no reason to suppose that anything is concealed from the Bank.

(6) INITIAL ADVANTAGE OF DISCIPLINARIAN STATES

So much for the measures that should be taken in order to prevent a repetition of the experience of the

belligerent countries during the last war, when they failed to study in advance the economic requirements of a prolonged war. During the last war all the belligerent countries were more or less equally unprepared from an economic point of view. The Central Powers found themselves at a disadvantage because, owing to the blockade and their smaller financial resources, they were unable to make good their omissions at more advanced phases of the war. In the next war, however, Germany will have the initial advantage of a more efficient economic organisation. In fact, economic planning and the regimentation of production and consumption have now in many ways reached a much more advanced stage in Germany than they did during the last war. On the other hand, in Great Britain and other democratic countries there is a very strong opposition to anything that savours of regimentation. This means that the outbreak of the next war will find Germany with her disciplined economic system fully organised on a war basis, while in Great Britain and other democratic countries it will be necessary to reorganise the economic system in great haste to cope with the emergency.

Needless to say, it would be wiser for the democratic countries to take a leaf out of the book of the totalitarian States and, in face of the approaching danger, to adopt a certain degree of Government control in production and trade. It seems, however, that as things are at the time of writing, opposition to such voluntary suspension of economic freedom is insurmountable. Conceivably, if and when the imminence of German aggression becomes evident to the public, there will be less resistance to measures

aiming at the reorganisation of economic defences. It is possible, however, that the public will not realise the danger until it is too late, and it is therefore necessary to envisage a situation in which the conversion of peace economy into war economy would have to be carried out at a moment's notice. This being so, it is of the greatest possible importance that preparations for such a conversion should be carried as far as possible in spite of the public's dislike for regimentation. Even though industrial conscription is at present impossible, the collection of up-to-date statistical material about the productive capacity and requirements of industries would go some way towards facilitating industrial conscription at the outbreak of the war.

(7) AMPLE RESOURCES FOR INTERNAL FINANCING

In drawing upon the experience of the last war it is necessary to use discrimination. History never repeats itself in an exactly identical form. On the basis of the experience of the last war, it might appear to the superficial observer that the problem of the internal financing of the next war would present practically no difficulties, and that Germany would be in as good a position to face this problem today as the countries with much larger capital resources. This view is as one-sided and exaggerated as the view that Germany could not afford to fight another war owing to her lack of capital resources. The truth lies between the two extremes. The experience of German rearmament financing since 1933 shows that financial resources can be created out of nothing for the purpose of war expenditure. On the other hand,

it would be a mistake to take it for granted that the system would work as smoothly in time of war as it does in time of peace. It should be remembered that the German public is essentially inflation-minded, and that the outbreak of war would lead to the anticipation of extreme inflation. This subject will be dealt with in more detail in Chapter VII, and at the present stage it is merely quoted as an instance of the necessity of allowing for differences in conditions when applying the lessons of the last war to the next war.

However it may be, there is no reason to regard the difficulties of internal financing in Germany as insurmountable, even though they would probably prove to be a grave handicap to the financing of a prolonged war.

Nor is there any reason to suppose that the existence of a large public debt would prevent the British and French Governments from financing the next war. As a result of Government expenditure, the amount available for reinvestment in Government loans would increase, and there is no reason whatever to suppose that there would be any insurmountable difficulty in inducing investors to increase their holdings of Government securities.

(8) GERMANY'S INFERIOR GOLD RESOURCES

Neither Germany nor the democratic countries are likely to come to the end of the resources which are available to them for internal financing. The question is which of the opponents is likely first to come to the end of its resources which are available for external purchases. The answer is not difficult to find. Germany's inferiority regarding gold and foreign

exchange resources is generally known, and, as we propose to show in a later chapter, it will place her at a considerable disadvantage in the next war. Indeed, the absence of adequate gold reserves will be more effective in preventing Germany from replenishing her food and raw material stocks through imports than any naval blockade or military encirclement could possibly be. It will be one of the causes of Germany's economic exhaustion, and will lead to her defeat. While the experience of Germany during the last war showed that financial exhaustion is not likely to be the cause of defeat or victory, it also showed that economic exhaustion is likely to be a factor of major importance in determining the outcome of the war. The financial limitations of the conduct of war are very vague and remote. On the other hand, its economic limitations are very real, even though elastic.

(9) ECONOMIC LIMITATIONS TO THE PURSUIT OF WAR BY GERMANY

It would, of course, be absurd to attempt to reduce the problem to one of simple arithmetic. One often sees in the Press calculations that Germany would be unable to carry on war for more than six months or twelve months, owing to her lack of timber resources, or fats, or certain indispensable metals. The experience of the last war proved that a nation at war is capable of going to considerable lengths in using substitutes for various products, or even in doing without them altogether. Had anybody taken the trouble before the war to calculate how long Germany's nitrate supplies would enable her to con-

tinue the war, the conclusion inferred from that calculation would have been rendered wholly useless by the invention of synthetic nitrate in Germany during the war. The economic limitations of the pursuit of war by Germany could not be estimated with even approximate accuracy. Nevertheless, they existed, and the chances are that in the next war Germany will sooner or later reach the stage of economic exhaustion which she reached in 1918. The chances are also that she will reach that stage in a much shorter time than she did during the last war. This question will be discussed in greater detail in a later chapter.

(10) HOW EXPERIENCE OF THE LAST WAR WILL AFFECT THE PUBLIC

We saw in Chapter I that to a very large extent the ignorance of the public regarding the economic and financial consequences of a prolonged war was a definite advantage from the point of view of all belligerent countries in the last war. The question is, will the public again be as ignorant, in spite of the experience of the last war? And if not, how will the superior knowledge and foresight of the public in the next war affect the economic and financial situation?

Those who, during the ten years that followed the outbreak of the last war, reached an age at which they were able to grasp what was happening and who remember their experience are now for the most part middle-aged. In another twenty years' time, only the members of the older generation will be able to recollect the experiences of 1914 and after. At

present, however, the majority of those who carry weight in the conduct of business, and who possess more or less substantial financial resources, are still in a position to remember the economic and financial results of the last war. This does not necessarily mean, however, that all of them, or even the majority of them, actually remember, or that in any case they will act on the assumption that their experience will be repeated. No one who was in a position to grasp the economic and financial developments of the last war can be unaware that the next war will probably produce inflationary results.

(11) OUTBREAK OF WAR LIKELY TO CAUSE INITIAL SLUMP

Nevertheless it is possible that the majority of the public will fall into the same error as they did at the outbreak of the last war, when the immediate reaction was a slump, even in neutral countries which were not menaced by the destructive consequences of the hostilities. On the basis of the experience of the last war it should be obvious that the result of war must in the long run be a rise in commodity prices and an appreciation of equities. Notwithstanding this, it is conceivable and even probable that the outbreak of the next war will be accompanied by a heavy slump in both. Indeed, the mere threat of war is sufficient to produce such an effect, as we saw during the second half of 1937 and during 1938. Possibly the markets will recover more speedily from the first shock of the outbreak of the war than they did in 1914. Nevertheless, a repetition of the experience of August 1914 would show that the public had not grasped the

lessons of the last war. It would be unwise, however, to bank on the brevity of its memory, or its lack of foresight. The chances are that on the basis of the experience of the last war the public in all belligerent countries would sooner or later become inflation-conscious.

(12) INFLATION-CONSCIOUSNESS

This is true to a much larger degree in countries where inflation reached an advanced stage during or after the last war. In Great Britain the public has never been really inflation-conscious. The idea that "a pound is a pound" survived even the sharp break in sterling that followed the suspension of the gold standard in 1931. It would take a fairly advanced degree of inflation to make the British public realise that the pound was after all not quite a pound in purchasing power. In France the public is more inflation-conscious, not only because of the post-war experience — which was comparatively mild — but also as a result of more recent experience in repeated devaluations. The inflation-consciousness of the French public, however, is likely to be moderate compared with that of the German public. Anyone who lived through the disastrous experience of the collapse of the mark in 1923 is likely to remain under its influence for the rest of his life. A comparatively slight degree of inflation would be sufficient to arouse in Germany the anticipation of advanced inflation and complete collapse.

(13) MEASURES AGAINST INFLATION

This is the reason why after 1931 Dr. Brüning decided to subject Germany to the evil consequences of deflation rather than obtain relief through allowing the mark to depreciate even to a moderate extent. This was the reason why the National Socialist régime avoided a depreciation of the internal value of the reichsmark, and maintained its nominal exchange rate at gold parity, elaborating a complicated and ingenious system by which the country might enjoy the advantages of an apparently stable currency without suffering its disadvantages. It does not follow, however, that, in face of the accelerated pace of war expenditure, any monetary conjuring tricks could prevent an internal depreciation of the reichsmark and its effect upon the mentality of the German public.

However it may be, it is certain that, on the basis of the experience of the last war, efforts will be made in every country to reduce to a minimum the extent of inflation. Steps will be taken to prevent inflation of profits and incomes by means of higher taxation. At the same time efforts will have to be made, in countries which at present have no exchange regulations, to prevent an outflow of the national capital in anticipation of inflation. It would hardly be safe to rely upon the experience gained in the last war in this respect. Similarly, early measures would be necessary to prevent the hoarding of goods by an inflation-conscious public, and to reduce the possibilities of profiteering.

CHAPTER III

WAR AND PRODUCTIVE CAPACITY

(1) "BUSINESS AS USUAL" DURING THE LAST WAR

"BUSINESS as usual" was the slogan adopted at the beginning of the last war in order to stimulate the recovery of the business world from the shock of the outbreak of the war. The idea that, within the inevitable limitations imposed upon economic activity by the special requirements of the war, everything must be carried on as before the war, continued to be the standing rule for the duration of the war, even though after a while the number of exceptions to the rule grew to considerable proportions. To the very last day there was nothing to prevent any manufacturer from using labour and raw material for the production of luxuries. From time to time a shortage in raw material, fuel or labour set a limit to the profitable catering for the requirements of war profiteers, but before that stage was reached much valuable material, labour, foreign exchange and transport facilities were wasted for purposes which did not in the least further the ends of national defence. Producers were at liberty to employ workmen unfit for military service for any purpose they chose. They were at liberty to use up raw materials, which subsequently became scarce partly owing to this wasteful use.

(2) NEED FOR REORGANISING PRODUCTION ON A WAR BASIS

It is essential that the Government, political parties and the public should realise the necessity for an organisation of production in the interests of national defence, if not before the outbreak of war at least immediately after it. It should be remembered that to all intents and purposes production in the totalitarian States is already organised more or less on a war basis, so that from this point of view Germany will have an initial advantage. The extent of that advantage will depend upon the extent to which the democratic countries realise the necessity of following Germany's example. It will be necessary from the very first day of the war to take steps to increase the production of those goods which are required directly or indirectly for the pursuit of national defence, and those which are essential for the maintenance of the civilian population. At the same time it will be equally essential to reduce or stop the production of goods which are not required for either of those purposes, and of which the production tends to interfere with the increase of the production of essential commodities.

(3) COLLECTION OF STATISTICAL MATERIAL

The first step towards organisation of production on a war basis is the compilation of an inventory of supplies, capacity of production, and requirements, both military and civilian. As I pointed out in the last chapter, this could and should be done before the outbreak of the war. To a greater or less extent

this is in fact already being done by the majority of countries. Apart altogether from any considerations of national defence, the statistical services regarding production have greatly improved during the post-war years. Great Britain, like other countries, has initiated the publication of valuable statistical material about the volume of production. Apart from the official data collected and published by the Board of Trade, various organisations representing particular branches of industry have elaborated very valuable statistical systems of their own. There is, needless to say, a great deal left to be done in the way of co-ordinating the existing material from the special point of view of national defence. Nor is the possession of figures concerning the actual production during past periods sufficient. It is necessary to have detailed information about the producing capacity in various branches; their respective requirements of raw material and fuel; the possibility of labour-saving through rationalisation and amalgamation, etc. The Government departments should elaborate detailed plans for the reorganisation, which should be carried out immediately after the outbreak of war to enable national production to replace imports to the greatest possible extent.

(4) INCREASE OF AGRICULTURAL PRODUCTION

The fact that the reorganisation of production is contrary to fundamental principles which are at present considered sacrosanct should not deter the officials in charge from elaborating plans for the day when those principles have to be discarded in the interests of national defence. Thus the fact that the

idea of replacing food imports by an increase of national agricultural production has been rejected by the Government again and again, and that Mr. Neville Chamberlain pronounced himself emphatically against it in a speech at Kettering in July 1938, does not mean that no steps will be taken to grow food at home in the event of war. The moment war breaks out, it will be the Government's duty to do its utmost to secure the best possible utilisation of all the land available for agricultural purposes. Plans are understood to have been prepared already for an increase of agricultural production in case of war. It is undoubtedly deplorable that these plans will not be put into operation before war breaks out, since in any case the country would stand to gain by increasing its agricultural production. The argument that by doing so this country would stand to lose its overseas markets for manufactures, since it would compel its customers to embark upon industrialisation, does not carry any conviction in face of the fact that, whether or not Great Britain increases her agricultural production, most of her customers have already reached an advanced stage of industrialisation. A glance at the figures of the British trade balance is sufficient to indicate this trend, which would amply justify an increase of agricultural production in order to make good the loss of markets suffered by British exporters through the progress of industrialisation in agricultural countries.

(5) "WAIT AND SEE" POLICY CONDEMNED

It would, however, be outside the scope of this book to discuss in detail this highly controversial

question. Deplorable as it is that an increase of agricultural production has not already been put into operation, the next best thing would be for it to be carried out immediately after the outbreak of hostilities. The adoption of a "wait and see" policy, in this or indeed in any economic sphere, would be gross negligence. In any case it would be years before the policy of increasing agricultural production would bear full fruit. To waste additional months or years in postponing the necessary measures in the hope that the war might soon come to an end would be simply unpardonable.

To discuss in detail all the essential measures which should be taken in order to increase the acreage of agricultural production and the yield per acre would require a separate volume. It would also require a great deal more expert knowledge than I can possibly claim to possess. Most experts agree that the possibilities of increasing agricultural production in Great Britain are by no means inconsiderable. In order to secure the maximum result from Government action it would be necessary to go beyond the stage of book planning before the outbreak of hostilities. In compiling the list of commodities of which a reserve supply should be accumulated by the Government in case of war, fertilisers should not be omitted. After the outbreak of war it might not be easy to spare sufficient tonnage for the import of fertilisers, nor to spare chemical works to manufacture them. The accumulation of large stocks of fertilisers beforehand would go a long way towards assisting the efforts of the Government to bring about a sufficient increase of agricultural production within a reasonable time.

(6) INDUSTRIAL CONSCRIPTION

If the question of an organisation of agricultural production for the requirements of national defence is controversial, that of the organisation of industries is even more so. The mere suggestion of industrial conscription is sufficient to arouse the furious indignation of capital and enterprise, in the same way that the suggestion of conscription for military service arouses the protests of pacifists. Yet in the next war, both will be necessary. It is to be hoped that the experience of the last war when conscription in Great Britain was postponed year after year, will not be repeated in the next war, and that the adoption of military conscription will be made more palatable by the simultaneous adoption of industrial conscription. This argument alone would be sufficient to overrule any opposition to industrial conscription, apart altogether from the imperative necessity for increasing production in accordance with the requirements of national defence, and to avoid wasting productive capacity. Industrial conscription, in order to be thoroughly effective, should not be confined to the placing of industrial undertakings under the orders of Whitehall. It should be much more thorough-going. It should virtually amount to the nationalisation of industrial undertakings for the duration of the war. The owners or shareholders should receive a reasonable dividend, and should in no circumstances be allowed to derive additional profit through the increase in the activities of their enterprises. The workers and employees should be placed under military discipline, and should not be allowed to take advantage of the vital role which they would have to play

in providing for the requirements of national defence, by extorting undue increases of wages. Above all, strikes and lock-outs should be outlawed the moment war breaks out. Any attempt at a strike should be dealt with in the same way as mutiny in the army.

(7) RUTHLESS RATIONALISATION

The conversion of industrial undertakings for war requirements should take place with the least possible delay. A Ministry of Supplies should take charge of industrial production and should co-ordinate the various branches and the particular enterprises within each branch. Rationalisation should be carried out ruthlessly. In conditions of peace the rationalisation and amalgamation of industrial undertakings are often frustrated by the individualism of the owners. Considerations of personal interests, or even personal vanity, have caused the shipwreck of many schemes which would have benefited the country as a whole, by increasing the competitive capacity of our export trade. In time of war it would be entirely out of place to pay too much attention to such individualistic considerations. They should be unhesitatingly overruled in the interests of national defence. At a time when the number of unemployed is between one and a half and two million there is much to be said against rationalisation which, while increasing the efficiency of industries, would throw additional thousands of hands out of work. At the outbreak of war, however, the fighting forces would absorb all the superfluous hands and a good many which would be needed to maintain and increase production. In such circumstances rigid economy in the use of human

labour would become one of the vital requirements of national defence. If by means of forced amalgamations and rationalisation in industrial undertakings in the same branch it were possible to save human labour, there would be everything to be said for it, even though it meant the payment of compensation to the owners who stood to lose by the amalgamation.

(8) CONSCRIPTION OF LABOUR

By taking such an uncompromising attitude towards capital and enterprise, the Government would strengthen its hand in dealing with the particularism of Trade Unions. One of the reasons why Mr. Chamberlain met with the utmost opposition from the engineering unions in his efforts to obtain a relaxation of their rules in the interests of the speeding-up of rearmament was that, while expecting sacrifices from the Unions, he refrained from demanding that the proprietors should sacrifice part of their freedom of action. The moment industrial conscription and compulsory rationalisation subordinated the interests of the owners to those of the State, the task of inducing the Trade Unions to submit to Government interference would become incomparably easier. It would become necessary to modify various collective contracts regarding working hours and other rules. Above all, it would become necessary to overcome the resistance of the Unions to the admission of additional workmen, temporary or permanent. The moment war breaks out it will become necessary to double or treble the number of workmen engaged in certain branches of production, and rigid unionism should not be allowed, any more than the individualism

of capitalists and captains of industry, to frustrate the Government's efforts to that end.

The utilisation of labour reserve supplies should be planned and proceeded with. While it would be a mistake to displace skilled labour, unskilled workmen who are suitable for the fighting forces should be replaced as they are required by the forces. There should be conscription of labour, male and female alike, and those unsuitable for service in the fighting forces should be employed for the increase in industrial and agricultural production. It is indeed inconceivable that the experience of the last war, when half the male population had to submit to incredible suffering while the other half was allowed to live more or less as before, should be repeated in the next war. Anyone who is not suitable for the fighting forces or their auxiliary services, or whose work is not essential in the interests of national defence, should be conscripted for labour in accordance with his capacity.

(9) RESTRICTION OF LUXURIES

The restriction of luxury production is essential not only in order to safeguard labour and material for essential purposes but also in order to save the feelings of those who are called upon to make sacrifices. If the men in the trenches have to do without most of the elementary comforts of life, it is not too much to expect that the wealthy classes should use the same limousine for another year instead of buying a new one. So long as war profiteers are at liberty to display their newly-acquired wealth conspicuously, it is difficult, if not impossible, to expect the munition

worker not to demand disproportionate rises in wages. The limitation of the production and consumption of luxuries should be but one of the many measures aiming at preventing social discontent. There should be a series of social measures to that end. While it is impossible to expect the authorities to proceed with ambitious slum-clearance schemes in time of war, everything should be done within the limit of possibility to improve the living conditions of the working classes, or at least to prevent war conditions from affecting their standard of living more than is inevitable. Altogether it is essential that at least for the duration of the war the glaring discrepancies between the standards of living of the various classes should be reduced as far as possible. In a besieged fortress food and drink are rationed out irrespective of rank and social standing, and this should be done to a large extent in a country engaged in a life-and-death struggle. About this aspect of national defence economy more will be said in the chapter dealing with consumption.

(10) EFFECT OF AIR-RAIDS ON PRODUCTION

An important task of the authorities in charge of the wartime organisation of production will be to make provision for the disturbing effect of air-raids, submarine blockades, etc. In this respect it is very difficult to plan ahead beyond the transfer of some of the vital industries to areas less exposed to air-raids. It is especially from this point of view that the Government's reluctance to interfere with the freedom of enterprise in time of peace is to be regretted. The possibility of destructive air attacks has been

becoming increasingly evident for years. The Government realised that it was to the interest of the industries themselves, as well as of the country as a whole, that industrial production should become decentralised, and that as much plant as possible should be erected in the distant regions. Notwithstanding this, nothing whatever has been done to prevent the mushroom growth of factories around London and in South-Eastern England. In some cases there was admittedly economic justification for this choice of a site for new factories. Even in such instances it would have been the Government's duty to overrule these considerations in the interests of national defence. In a large number of cases, however, economic considerations in favour of establishing the plant near London were by no means predominant. The General Manager's wife preferred to be near London; the Directors did not want to have to travel too far on the one or two occasions in the year when they inspected the works; the Proprietor did not want to be too far from his constituency or his favourite club. These are some of the characteristic reasons which resulted in the crowding of industries into the London area. The owners of the industrial undertakings may have to pay a very heavy price in time of war for their lack of foresight, and the Government may one day regret its reluctance to interfere with the individualism of industrialists.

There is little reason to expect that before the outbreak of war drastic action will be taken in order to prevent the undue concentration of industries in the exposed south-eastern area. Once war breaks out, however, it will be essential to make arrangements

for the transfer to more distant areas of at least some of the enterprises vital for national defence. Instead of expanding existing plant in the south-eastern counties, it will be advisable to erect new plant in the north or west.

(II) ORDER OF IMPORTANCE OF VARIOUS BRANCHES OF PRODUCTION

Beyond these measures, very little could be done in the way of planning in advance against the consequences of air-raids. Once the nature and extent of the damage to industrial production through an air-raid has been ascertained, it will be necessary to improvise plans to reorganise production in accordance with the new situation thus created. It is essential that after each air-raid the Ministry of Supplies, or the authority in charge of industrial organisation, should immediately obtain possession of the data enabling them to assess the effect on productive capacity and supply. They would then have to proceed to replace the loss by transferring workmen and material from less essential to more essential branches. The frequency of air-raids may necessitate frequent revision of plans for production, always at a moment's notice. It is essential that those in charge of industrial organisation should make up their minds in advance about the order of importance of various branches of production. Even though the scale established would be liable to alteration, it is important that the authorities should at any given moment have a very definite idea which set of requirements must be subordinated to more important sets of requirements.

CHAPTER IV

WAR AND CONSUMPTION

(1) VITAL REQUIREMENTS OF THE CIVILIAN POPULATION

IN time of war the secondary requirements of the civilian population must be sacrificed in the interests of the requirements of the fighting forces. On the other hand, the primary requirements of the civilian population are, in a long war, fully as important as those of the fighting forces. In a war of short duration it might be possible to expose the civilian population to all but extreme privation; for, if it is a question of a few weeks or a few months, the nation could be expected to put up with much suffering in the interests of victory. If, however, the war is likely to last for years, it would be an extremely short-sighted policy, even from a purely military point of view, to disregard the vital requirements of the civilian population.

Generals may regard civilians as a nuisance in time of war, but even the most extreme militarist among them is bound to admit that the civilian population must be kept more or less alive in the interests of the efficiency of the fighting forces. After all, soldiers and sailors could not be expected to take charge of the whole railway system and the growing of food, to say nothing of the manufacture of arms and ammunition, without which no army could hold

out for any length of time. If the civilian population is not adequately fed, its efficiency in providing all the services necessary for national defence must inevitably decrease.

(2) DANGER OF SURRENDER THROUGH STARVATION

What is more, a half-starved crowd might become dangerous, in that, driven to desperation, it might revolt against the Government, thus jeopardising the achievements of the fighting forces. In any case, what would be the use of winning the war, even if that were possible, if the victorious army returned to find that the civilian population had become virtually extinct as a result of the sufferings inflicted on them by inadequate provision for their primary requirements?

Writers on the subject have frequently quoted, as an example, the fact that Great Britain was reduced by submarine blockade to within sight of starvation. An equally well-known example is that of the revolt of the civilian population in Germany against the Government in 1918, enforcing surrender before the German army was actually defeated. Thus, apart altogether from any humane considerations, the importance of providing adequately for the food and other vital requirements of a civilian population during a war, in the interests of final victory, is self-evident. To that end it is necessary to organise consumption, as well as production, on a war basis.

(3) INVENTORY OF SUPPLIES

The first step towards the organisation of consumption during a war is to make an inventory of the

existing supplies of consumption goods. Food is by far the most important, but by no means the only, category which should be subject to such an inventory. Even in a coal-producing country such as Great Britain, there was an acute shortage of fuel for civilian consumption during the last war. In most countries it became increasingly difficult, as the war went on, to replace the worn-out clothing of the civilian population. Thus while it is the food situation which requires the most urgent attention, it is also essential, even at the earlier stages of the war, that the Government should make an inventory of the stocks of other essential consumption goods, in order to be able to take the necessary measures for safeguarding the vital interests of the civilian population.

In Great Britain the Food Defence Department has presumably compiled statistics about the visible commercial supplies of some essential foodstuffs and other consumption goods. Changes in these supplies are duly registered. Any such statistics, however, must allow for a very wide margin of error, since they are necessarily confined to wholesale stocks, while estimates of supplies in the hands of retailers are hardly more than mere guess-work. The moment war breaks out it will be necessary to elaborate an inventory of all commercial stocks, wholesale or retail.

(4) PRIVATELY HELD FOOD RESERVES

A question to be considered is whether the inventory of consumption goods, and subsequent measures, should be extended also to privately held reserves. During the past twelve months or so there

has been a movement afoot to encourage the accumulation of food and other consumption goods by consumers who could afford it. This private accumulation of food has several obvious advantages over the purchase of war reserves by the Government. In the first place it does not necessitate any expenditure of public funds, a consideration which is of some importance at a time when the resources of the Treasury are in any case under heavy strain owing to rearmament. The accumulation of private food reserves by hundreds of thousands, or even millions, of people, would reduce the necessity for the construction of vast storing accommodation. Above all, it would reduce the risk that the supplies might be destroyed by air attacks. There is thus every reason to encourage the accumulation of private food reserves. While the hoarding of food by individuals after, or even immediately before, the outbreak of war is obviously against the interests of the community, and should be prevented as far as possible, the gradual accumulation of food in time of peace is a different matter. It might be wise to promise that the privately owned food supplies accumulated before the war would be immune from sequestration. It might even be desirable that special credit facilities should be placed at the disposal of those who could not otherwise afford to accumulate food.

(5) RESERVES TO BE KEPT INTACT

The reserves accumulated by the authorities in anticipation of war should not be drawn upon prematurely, but only in case of pressing necessity. On the assumption that the war would be a long one

those reserves should be kept intact as long as possible, or, if they had to be drawn upon, they should be replenished as soon as this could conveniently be done. The possession of substantial reserves should not therefore obviate the necessity for embarking upon an increase of agricultural and industrial production of primary necessities immediately after the outbreak of war. Nor should it obviate the necessity for maintaining, and if possible increasing, the import of such commodities while this was possible.

(6) MEASURES AGAINST HOARDING AND WASTE OF FOOD

The stocktaking to be undertaken immediately after the outbreak of hostilities should be followed by rationing, as far as vital foodstuffs and other essential consumption goods are concerned. Only by means of swift action could the authorities prevent the recurrence of the experience of the last war, when large quantities of valuable consumption goods were wasted during the early stages of the war, or disappeared through selfish individual hoarding. The authorities should not wait for acute shortage, but should prevent such a shortage by timely rationing. By doing so they could give themselves a chance to maintain more adequate rations for the average consumer, and would prevent a minority from securing advantages for themselves at the expense of the community.

Immediate measures should be taken to reduce waste of consumption goods as much as possible. This is already being done in Germany to a remarkable extent. To give an example, household refuse in Germany has to be sorted according to whether it

can be used for the feeding of animals or for other productive purposes. In some English towns there is a voluntary system of collecting waste paper in order to use it as raw material in paper-mills. In Germany this is compulsory. There are innumerable practical details which could and should be worked out in advance in order to facilitate the enforcement of the maximum of economy in consumption goods from the very outset after the outbreak of war.

(7) PRODUCTION OF SUBSTITUTES

Another important measure which should be taken is the production of substitutes for commodities in which a shortage is likely to develop in the course of a prolonged war. As a general rule, substitutes are in most ways inferior to the genuine product, and every time it becomes necessary to fall back on some inferior substitute, this is likely to produce a demoralising effect on the public. It would be a much better plan if the consumers were forced from the very outset to combine the use of substitutes with that of the original articles.

Processes and methods of manufacturing substitutes should not be neglected until the eleventh hour. From this point of view Germany is at an advantage, since the shortage of her gold resources during the last few years, and the policy of economic autarchy which was adopted, have led to a series of valuable inventions. Even though there is no similar inducement at present in Great Britain or France for the use of substitutes, the Government should study the mechanical and chemical processes of their production.

(8) JAPAN'S WAR RESTRICTIONS ON CONSUMPTION

The measures taken in Japan during 1938 provide examples of the kind of interference with consumption that might become necessary after the outbreak of war. The sale of cotton goods for home consumption has been restricted, owing to the difficulty of importing an adequate amount of raw material. Restrictions have been placed on the use of iron in connection with private building activity or for the manufacture of objects, such as lamps, furniture, stoves, various sorts of machinery and equipment, kitchen utensils, etc., which could be made of other materials. The use of leather for various civilian requirements has also been forbidden. The new Economic Dictator, Mr. Ikeda, has taken steps to enforce these restrictions through the organisation of a special police force for the purpose. These examples show that war measures aiming at the regulation of consumption need not by any means be confined to foodstuffs.

(9) REDUCTION OF FOOD IMPORTS

While the main object of the rationing of consumption goods and other measures to regulate consumption is to secure the continuity of adequate supplies, it also serves the purpose of reducing the amount of foreign exchange which has to be spent on civilian requirements. This is essential in a war in which large amounts have to be spent abroad on arms and ammunition. Another advantage of the regulation of civilian consumption is that it tends to relieve pressure on tonnage and transport facilities at a time when such facilities are badly needed for the direct require-

ments of national defence. Timely rationing in food supplies and the prevention of waste might obviate the necessity of diverting too many naval units from actual national defence to the task of convoying food ships at a time when it is essential to maintain the striking power of the navy at maximum strength. Last, but by no means least, the rationing of consumption goods and economy in their use would tend to relieve a large number of hands who could be more usefully employed in connection with the urgent requirements of the fighting forces.

(10) MEASURES AGAINST LUXURY CONSUMPTION

The Government, while doing its utmost to provide for the requirements of civilian consumers, should make an effort to reduce luxury consumption. It is extremely difficult to decide exactly where necessity ends and luxury begins, but there are some obvious instances of luxuries the production of which in time of war would constitute unpardonable waste of labour and material. Those sections of the civilian population which could afford to indulge in luxury during the period of war would have to be made to realise that they were in a besieged fortress where the garrison was fighting for its life and for the lives of the civilian residents. Even if the latter could not collaborate actively in the defence of the fortress, the least they could do would be to reduce their requirements to the indispensable minimum.

The restriction of the production of luxuries at the outbreak of war would in itself not be sufficient, for in a large number of lines wholesale and retail trades are overstocked. It would be essential to reserve

these supplies as far as possible for export trade, which, as we shall see in the next chapter, will in any case work under a handicap owing to shortage of labour and material. The inventory of consumption goods, to be undertaken at the outbreak of the war, should therefore also be extended to luxury articles which could not possibly be of any use for the requirements of national defence.

Needless to say, there are limits beyond which the restriction of luxury consumption would damage the spirit of the civilian population as well as of the fighting forces. This consideration would increase the difficulty of deciding the limit to which luxury consumption should be reduced. The question deserves careful study. While the efficiency of national defence must come first, the human factor should not be left out of account.

CHAPTER V

WAR AND FOREIGN TRADE

(1) EFFECT OF REARMAMENT ON IMPORTS AND EXPORTS

DURING the last few years the trade balance of most countries which have embarked upon an extensive programme of rearmament has changed materially for the worse. This is due in part to the increased imports of raw materials, and even manufactures, in connection with rearmament, and in part to the large decrease in the exporting capacity of the industries engaged in rearmament. The same situation would arise during a war, but on a much larger scale. There would be an increase in raw material imports, especially if the countries were unable to maintain their home production of such materials in war conditions. The import of war material would add to the heavily adverse trade balance. At the same time export trade would find it difficult to hold its own. Many industries would have to be employed exclusively for the requirements of national defence to the limit of their capacity. They would be unable to undertake deliveries for foreign markets. The calling of employees to the colours, and war conditions in general, would tend to reduce also the output of industries not directly concerned with armaments, which would suffer equally from the shortage of raw material and labour.

The net result would be a tendency towards the development of a huge adverse trade balance. It would be the duty of the Government to minimise this evil as far as possible, in order to husband the gold resources of the country, which would be required for the purchase of essential foods abroad during a long war. Even though Great Britain and France possess substantial gold reserves and foreign exchange resources, these are by no means inexhaustible, and during years of war they might easily come to an end unless every effort was made to keep down the amount of the adverse trade balance.

(2) REDUCTION OF LUXURY IMPORTS

In the first place, it is absolutely essential that luxury imports should be reduced to a minimum. This is even more important than the reduction of the domestic production of luxuries. From the moment war breaks out there should be a ruthless embargo on all imports which are not indispensable for the requirements of national defence or for the primary needs of the civilian population. During the last war, the measures taken in this respect by most belligerent countries were in most cases belated and half-hearted. In Great Britain, for instance, the McKenna duties were introduced on certain luxury articles, but even though the imposition of a duty of 33 per cent may have discouraged their import to some extent, that duty was certainly not prohibitive. On the other hand, it is true that lack of transport facilities provided an additional obstacle to luxury imports. Nevertheless, in the next war it will be necessary to proceed more effectively in the task of

limiting luxury imports. Admittedly, in some instances it would be expedient from a political point of view not to stop the purchase of certain goods from certain countries. It would obviously be a mistake to antagonise potential allies by such methods at the beginning of the war. At a later stage, however, the luxury trades of neutral countries would find it increasingly easy to sell their products outside the belligerent countries, owing to the lack of competition from the export trade of those countries.

(3) INCREASE OF FOOD AND RAW MATERIAL IMPORTS

The elimination of luxury imports is all the more essential since it will be necessary to increase certain imports from the very outset far beyond immediate requirements. As I pointed out in Chapter IV, it is essential to increase food and raw material reserves, so long as this is not prevented by blockade, submarine warfare, etc. If it is possible to convert gold and foreign exchange into essential food and raw material reserves, it would be a mistake not to do so.

It is a matter of detail whether the reduction of luxury imports is carried out through the imposition of embargoes, quotas, and prohibitive duties, or through the rationing of transport facilities or foreign exchange allotments to importers. In all probability all these methods will have to be adopted simultaneously, because the imposition of import restrictions, the allotment of tonnage and the allotment of foreign exchange are handled by authorities which are independent of one another. Occasions may arise when there is exchange available for certain

imports, but the authorities engaged in the allotment of tonnage will be too hard pressed for primary requirements to be able to satisfy secondary requirements.

(4) INCREASED EXPORT POSSIBILITIES, REDUCED EXPORTABLE SURPLUS

The export trade of countries which retain the command of the seas will to some extent benefit by the absence of competition from the countries subject to blockade. They will also benefit by the increase of the purchasing power of food- and raw-material-producing countries as a result of the increase of purchases by belligerent countries. It will be for the exporters and their Governments to take advantage of these opportunities. As I pointed out above, in some industries the importance of producing exclusively for national defence will rule out the possibility of maintaining export trade. There is all the more reason to make an effort to make good the deficiency by maintaining and even increasing the exports of industries which are in a position to reserve part of their capacity for such a purpose. In Great Britain the productive capacity of the engineering industry will be earmarked entirely for war requirements. On the other hand the textile industry, for instance, may stand a good chance of maintaining its existing markets and even of recovering some of its lost markets, as a result of the disappearance of the competition of some of its rivals. If it is necessary, the Government should not hesitate to resort to subsidies in order to encourage exports. It is essential that the adverse trend in the trade balance should be

resisted at all costs, and an increase in the budgetary deficit as a result of the subsidies would be a small sacrifice if it led to an increase of exports.

(5) DEMAND FOR GOODS BY NEUTRAL COUNTRIES

While at the beginning of a war the Government's endeavours to increase exports would meet with strong resistance abroad, at a more advanced stage the absorbing capacity of foreign markets would increase. The neutral countries would enjoy a high degree of prosperity, as they did during the last war, and would be able to spend heavily on luxury imports. The wealthier classes which during recent years have become accustomed to wearing suits made of inferior local cloth would once more acquire the habit of insisting on English cloth. Thus the chances are that British exports to neutral countries would expand. On the other hand, it is inevitable that exports to belligerent countries would decrease, while exports to enemy countries would, of course, cease altogether. Thus in spite of the utmost efforts, it is useless to expect to maintain the total volume of exports at its pre-war figure.

It is conceivable that the efforts of the belligerent countries to increase their exports will be facilitated by the insistence of the neutral countries on payment in the form not of gold but of goods. During the last war some of the neutral countries, notably Sweden, Spain, and the United States, grew alarmed by the huge influx of gold, but in the absence of alternative methods of payment they had to continue to put up with it. In the meantime, however, the exchange clearing system has been devised, and its application

would enable neutral countries to deliver goods to belligerents and to obtain payment from them in the form of goods. The chances are that foreign trade between belligerent countries and neutrals would be based to a large extent on the exchange clearing system. This would be to the interest of the belligerent countries, since it would enable them to cover at least a large part of their requirements without having to spend their gold or foreign exchange resources. There would also be frequent compensation or barter agreements. In the last war they constituted an exception, but in the next war they are likely to be of frequent occurrence.

(6) WAR WITH GOLDEN BULLETS

Trading with neutrals will again be a struggle between the opponents in pursuit of their economic warfare. They will compete, as they did in the last war, to secure the food, raw material and war material supplies of neutral countries. In this respect during the last war the fight between Great Britain and Germany was more or less equal during the early phases of the war, because Germany too possessed large gold and foreign exchange resources. The agents of both countries outdid each other in trying to secure the crops of neutral countries such as Roumania and Bulgaria. In several instances Great Britain secured abundant supplies and, owing to the impossibility of transporting them, had to have them destroyed in order to prevent their being captured by Germany.

During the next war, Germany will be heavily handicapped by her lack of gold resources. Assuming

that the Danubian and Balkan States, or some of them, at any rate, will remain neutral, Germany will endeavour to secure as much food, fuel, and raw material as possible in those countries. She will be unable, however, to offer gold in payment. Every one of the Danubian and Balkan countries is thoroughly tired of taking blocked marks in payment for the goods it sells to Germany. They would all therefore eagerly welcome British purchasers, who would have no difficulty in outbidding their German rivals by offering gold or free exchange for their supplies. It would be years before the Danubian and Balkan States, which are at present starved of gold, were saturated with it in the same way that Sweden, Spain, and the United States were during the last war. They would prefer gold to German goods.

Admittedly, the acquisition of stocks at an unduly high price would be onerous, especially as it might be impossible to transport to England the goods bought in some of the countries. Nevertheless, the result would be worth the sacrifice, since it would bring nearer the day of Germany's economic exhaustion.

(7) GERMANY'S BID FOR CONTROL OF DANUBIAN SUPPLIES

Germany is fully aware of this weak link in her system of war economy. It is largely for this reason that she is trying to secure political control over the Danubian countries and the Balkans. Once Nazi puppet Governments are in office in Hungary and Roumania, there will no longer be any need to fear that those countries would sell their goods to Great Britain rather than to Germany. From a German

point of view the establishment of Nazi régimes in the Danubian and Balkan countries would be almost as advantageous as the open conquest of those countries. Since, however, those countries are likely to resist to the utmost either conquest or the establishment of Nazi régimes, Germany is endeavouring to make arrangements by which to secure the continuity of supplies in the case of a war in which those countries would be likely to remain neutral. In some instances industrial and mining undertakings are acquired by German capital. In other instances, long-term contracts are concluded with agricultural producers for the supply of their goods at a relatively high price. Even so, assuming that the Danubian and Balkan countries remain neutral, the odds will be heavily against Germany in her competition with Great Britain for their products.

(8) NEUTRAL COUNTRIES' ATTITUDE TOWARDS BLOCKADE

In the next war, as in the last war, the enforcement of a blockade would raise a series of complicated problems. During the last war, loopholes were provided by various neutral countries, which imported far in excess of their own requirements and resold the surplus to Germany. It is essential that in a future war such abuses should be prevented by the limitation of the volume of goods allowed to pass the blockade to neutral countries. Their average consumption during the preceding years should be made the basis of the legitimate requirements during the next war. On the whole, the chances are that the Governments of most of the neutral countries which are in a position

to act as intermediaries between Germany and overseas raw-material producers will adopt an attitude less favourable to Germany than they did during the last war. The temptation to allow their nationals to benefit by highly profitable intermediary trade is likely to be more than offset by fears of the consequences of a German victory.

During the last war there was a reasonable chance that victorious Germany would respect the neutrality of such countries as Holland, Switzerland, and the Scandinavian States. At present, however, it is the declared intention of the Third Reich to incorporate as soon as possible all territory with a German-speaking population, and to force her political system upon all the Nordic races.

(9) NEUTRALITY LIKELY TO BE INTERPRETED IN
FAVOUR OF GREAT BRITAIN

It is also an open secret that Germany wants an outlet to the Mediterranean and the Persian Gulf, and aims at absorbing, in substance if not in form, all the smaller countries that lie between her borders and the realisation of this goal. This being so, all the potential neutral countries in Northern, Western, Central, and South-Eastern Europe would undoubtedly realise that a German victory would be dangerous to their independence. They would be aware that Great Britain was fighting their battle. While fear of being crushed by the German Colossus might prevent them from openly joining the alliance of democratic countries, their neutrality would certainly be benevolent towards the opponents of Nazi domination. They would therefore observe the spirit of

strict neutrality in their foreign trade policy by scrupulously refraining from lending themselves to the circumvention of the blockade.

During the last war, British diplomacy had a hard task in pacifying the various neutral Governments which wanted to secure overseas imports far in excess of the requirements of their nationals. The chances are that in the next war the neutral Governments will not do more than register formal opposition, for the sake of appearances, to the restriction of overseas imports through British blockade.

(10) GERMANY UNABLE TO IMPORT UNLESS SHE
EXPORTS FIRST

A consideration which is well worth bearing in mind is that in order to break or circumvent the British blockade in the next war, it will not be sufficient, as it was in the last war, for Germany to be able to import goods from overseas. This time it will also be necessary to export goods, in order to be able to pay for the goods imported. During the last war Germany had gold resources at her disposal and was able to pay cash. In the next war she will not be able to import on any substantial scale unless she is also able to export overseas. Thus it will be at least twice as difficult for her to overcome the blockade as it was in the last war, apart altogether from the difficulty of finding buyers for the German products which slip through the vigilance of the British blockade.

Notwithstanding the obvious advantage of the democratic countries in the sphere of foreign trade in the next war, it would be a mistake on their part

to be over-confident and to fail to do their utmost to consolidate these advantages by a policy of restricting imports and stimulating exports. Even the largest gold reserve is not inexhaustible, and it is necessary to allow for a prolonged war.

CHAPTER VI

BUDGETARY PROBLEMS OF WAR

(1) TAXATION *v.* BORROWING

THERE are three ways in which large capital Government expenditure can be financed : taxation, borrowing, and inflation. During the earlier stages of British rearmament, the choice of the method of financing the Government's extensive programme was subject to heated controversy. A number of experts insisted that the additional expenditure ought to be financed by means of a corresponding increase of taxation. At least an equal number of experts contended that this would be impossible, and advocated the financing of rearmament expenditure by means of borrowing. There were no open advocates of the inflationary method of financing rearmament, but most of those in favour of financing by means of borrowing held the view that if the process produced an inflationary effect this should not be resisted.

Undoubtedly, the ideal solution, if it were possible, would be to raise the whole additional expenditure by means of additional taxation. The Government decided, however, that a large part of rearmament should be financed by means of borrowing because a Draconian increase of taxation would be a handicap to trade. Nor is there any reason to hope that in case of war more than a relatively small part of national defence expenditure would be covered by

means of taxation. The Government should do its utmost to raise the largest possible amount by such means, but it should not be too dogmatic about the question. What is more important than anything else is to avoid crippling, by prohibitive taxation, the branches of production which provide for the requirements of the armed forces and for the essential requirements of the civilian population.

(2) TAXPAYERS' RESISTANCE

It is difficult to ascertain the limit beyond which it would cease to be advisable to increase direct taxation. Before the war, income tax at 5s. in the pound would have been considered inconceivable; and yet since the war the standard rate of income tax has not declined below that figure for any length of time. Similarly, we may all be horror-struck at the idea of an income tax of 10s. in the pound, and yet, given an adequate degree of relief for smaller incomes, this would be by no means impossible.

What matters is that any increase of earnings above peace-time level should be subject to ruthless taxation. If war profiteering cannot be prevented altogether, at least it should be subject to heavy excess profit duty. In 1937 Mr. Chamberlain made an attempt to apply the principle of excess profit duty to the profits earned on the armament boom. His attempt was frustrated by the determined opposition of his own followers, against whom he was powerless. He had to abandon his original National Defence Contribution scheme and replace it by a corporation profits tax. There can be no doubt, however, that the moment war breaks out an excess

profit duty will be introduced. From the point of view of the efficiency of war finances, it is to be deplored that Mr. Chamberlain's effort of 1937 was defeated, since it takes some time for a difficult and complicated new tax such as his original National Defence Contribution to become adequately established. Better late than never, however, and those who suffer through the shortcomings of the new tax when it is imposed will have only themselves to blame for having prevented its establishment amidst a more peaceful atmosphere, when the authorities would have had more time to remedy individual grievances than they will have in the upheaval of war.

(3) FIGHT AGAINST TAX EVASION

During the last war Great Britain had the advantage of a well-established system of direct taxation. In the meantime many countries have adopted similar systems, and will be able to cover a higher percentage of their war expenditure by means of taxation than they did during the last war. The experience of the last war made foreign Governments realise the superiority of the British fiscal system, even though it is doubtful whether any of them will be able to catch up in a short time with the advantages of century-old traditions in direct taxation.

It is essential that from the very first day of the war the Government should embark upon a determined effort to fight tax evasion. From this point of view the position in Great Britain to-day is less favourable than it was during the last war. During the term of office of the Labour Government of 1929-1931 many British taxpayers departed from the path

of traditional loyalty and, without violating the letter of the law, devised methods by which to circumvent it. This practice continued on an increasing scale even after the formation of the National Government. Holding companies and trusts have been registered by the thousand in the United States, Canada, and various European States such as Luxembourg, Liechtenstein, and certain Swiss cantons. Various other ingenious methods have been invented to evade taxation, and the total loss of revenue must run into many millions of pounds every year. From time to time the Government has declared its intention of tackling the problem, but on every occasion it has been tackled very half-heartedly indeed. It is by no means an exaggeration to say that under the existing legal system very few people have to pay surtax unless they want to.

(4) FORM *v.* SUBSTANCE

These abuses will have to be brought to an end, if not before at any rate during the next war. The superiority of the British fiscal methods could only be maintained if fiscal evasion were at last tackled with a really firm hand. It has been suggested again and again that the only way in which to fill the technical gaps through which revenue escapes is to induce the Law Courts to take a less legalistic and formalistic view. What should matter is not whether a certain income can technically be regarded as an income subject to taxation, but whether in substance this is the case. The fact that skilful lawyers have devised methods, by which income from capital nominally transferred to fictitious companies registered abroad

serves for the repayment of fictitious indebtedness, should not confer immunity upon the recipient of the income, because the arrangement is evidently devised solely for the purpose of tax evasion. At present the line of demarcation between fiscal fraud and fiscal evasion is too distinct. Morally they both belong to the same category, even though legally the second category escapes penalty. In the next war it will be necessary to introduce strict legislation against every kind of fiscal evasion, and to make examples of some of the evaders so as to deter the rest.

(5) ABSORBING INFLATED PURCHASING POWER

The necessity for finding resources for the financing of the war is by no means the only reason for the supreme fiscal effort through which the largest possible percentage of expenditure is to be covered by means of taxation. High taxation will be necessary also in order to absorb the surplus purchasing power created by war expenditure. Unless it is absorbed, this surplus purchasing power is bound to produce a very strong inflationary effect. We saw in Chapter I that the reason why inflation was less pronounced in Great Britain than in the continental belligerent countries was simply that in Great Britain a large part of the additional purchasing power was absorbed by means of taxation.

While the major part of the fiscal effort in the next war will have to assume the form of direct taxation, it will be equally important not to neglect the fiscal resources provided by indirect taxation. It will be comparatively easy to check profit inflation by means of higher income tax, surtax, and excess profit duty.

It will be much more difficult, but none the less essential, to moderate the inflation of small incomes which will largely escape direct taxation. The ideal solution would be to keep down both profits and wages to their pre-war level by means of direct intervention. In so far as this is impracticable, however, it is necessary to seize by means of taxation as large a part as possible of the surplus incomes. Possibly the wage-earning classes would not be prepared to put up with the limitation of their wages to the pre-war level, but they might be more willing to surrender a large part of their surplus earnings as a result of an increase of taxation.

(6) WILL GERMANY BE ABLE TO BORROW ?

Notwithstanding all fiscal efforts, it will be inevitable to cover a very large percentage of war expenditure by means of borrowing. Once more the leading belligerent countries will have to raise internally milliards in war loans. Until a few years ago there was a popular belief that Germany would be unable to do so owing to lack of capital resources. In the meantime, however, it has become evident that, in time of peace at any rate, the very process of German Government expenditure tends to create those capital resources which the Government is then able to borrow. This experience of German rearmament financing has resulted, however, in the development of a misconception in the opposite sense. It is suggested at times, in all seriousness, that Germany would be in a better position to finance a war than either Great Britain or France, simply because the amount of her public debt is smaller. Apart altogether from the

fact that by the time the rearmament race culminates in war the German public debt may conceivably have caught up with those of Great Britain and France, the amount of public debt in proportion to national wealth is by no means the only factor which has to be taken into consideration when a country's capacity to borrow is being examined.

The success of Government borrowing is largely a question of confidence. The reason why Germany has been able to finance her rearmament internally is that the money has found its way back to the Government largely through the intermediary of the banks. In so far as the money spent has not been reabsorbed in the form of taxation or retained in the form of the limitation of dividends, it has found its way back sooner or later to the banks, and the latter are compelled to subscribe to Government loans. This vicious circle can continue as long as there is confidence in the Government and the banks. The moment confidence in either is undermined, the circle is bound to break as a result of the development of hoarding.

(7) THE GERMAN PUBLIC AND INFLATION

Should doubt arise about the German Government's willingness or capacity to meet its internal debt, it is inevitable that a wave of distrust should develop in the German banks whose assets consist largely of Government securities. The result would be a run of depositors. Even though this could be prevented by means of a moratorium, it would be difficult, if not impossible, to compel the population to put into the banks the new money created by additional Government expenditure.

Another source of danger to the smooth running of German war finance would be the development of an inflationary mentality. As we have already noticed, the German public is highly inflation-minded, owing to the disastrous experience of the post-war generation. At present there is no reason to anticipate inflation in the near future, but if war broke out those Germans who remember the experience of 1923 would inevitably anticipate a recurrence of that disastrous experience. No Government regulation could then prevent sweeping inflation of prices through a growing demand for *Sachwerte* (goods with intrinsic value). If additional purchasing power were created it would be used immediately for the purchase of goods so long as they were obtainable. If goods became scarce, their price would be put up recklessly. The money would not find its way to the banks, but would be spent again and again at the first opportunity. This being so, the banks would no longer be in a position to subscribe to additional Government loans, and the Government would have to resort to crude inflation.

(8) POSITION OF GREAT BRITAIN AND FRANCE

In Great Britain, on the other hand, the public would trust implicitly in the stability of the pound, the integrity of the Government as a debtor, and the soundness of the banking system. It would be comparatively easy, even in the event of a long war, to reabsorb by means of borrowing a very large percentage of the additional resources created through war expenditure. Admittedly by this process purchasing power would not be reabsorbed, but a large part of it would be at any rate neutralised, which is

the next best thing to its reabsorption by means of taxation.

France would not be in the same favourable position as Great Britain from the point of view of internal financing, unless the French budgetary deadlock found a solution long before the outbreak of war. This solution could not be imagined in any other form than that of a wholesale conversion of the French public debt to a lower interest basis. Judging by the low price of French rentes, such a conversion has been largely discounted by the investing public, and would not inflict irreparable harm on the French Government's credit. Nevertheless it would be a good thing to carry out the operation without delay, so that there shall be a fair lapse of time between the forced conversion and the appeal to the public for war loans.

(9) LARGE EXTERNAL RESERVES

In any case, both Great Britain and France have one considerable advantage over Germany in the matter of internal financing. They can draw upon their external reserves for that purpose. The amount of British and French capital held or invested abroad is very large indeed. In a way the flight of British capital from taxation during recent years, and the much more considerable flight of French capital both from taxation and from the depreciation of the franc, may prove to have been a blessing in disguise, since it may enable the two Governments to draw upon these hidden reserves as well as upon the legitimate investments of their nationals abroad. This would be highly beneficial from the point of view of the foreign exchange position, about which more will be

said in Chapter VIII. The calling in of privately owned foreign assets, while increasing the foreign exchange resources, will also tend to increase the basis of credit, at least until these additional foreign exchange assets have been spent during the later phases of the war. Nazi speakers may sneer at the superstitious belief of the democratic countries in the value of gold, but in the next war they may find that the "superstition" which they have denounced with such venom will serve a useful purpose for their opponents, in that it will assist them to maintain confidence in the credit of their Governments. Imagine the effect on the French Government's credit of the increase of the gold stock by, say, 50 per cent as a result of the repatriation, voluntary or otherwise, of privately owned French assets abroad.

(10) GERMANY AND ITALY AT A DISADVANTAGE

From this point of view Germany and Italy are at a disadvantage, for neither of them has any external resources on which to draw, having already collected and spent the foreign assets of their nationals. What German and Italian refugee funds exist abroad are successfully hidden out of reach of the authorities. Thus while the German Government's credit stands to suffer from the very outset by the evidence or assumption that the meagre gold resources are being depleted rapidly, the credit of the democratic countries stands to be strengthened by the evidence of the accumulation of additional gold resources during the early stages of the war, in spite of the necessity of spending vast sums abroad.

The importance of gold assets as a basis for internal

credit is likely to increase considerably in time of war, since it is amidst such conditions that the public is driven by a primitive instinct to seek safety in gold. This primitive instinct may well be denounced as a barbaric survival, fetish-worship, or superstition built on ignorance, but it is a fact which has to be reckoned with.

CHAPTER VII

WAR AND MONETARY POLICY

(1) FIGHT AGAINST INFLATIONARY TENDENCY

I REMARKED at the beginning of the last chapter that war expenditure could be financed by means of taxation, borrowing, or inflation. While it is preferable to cover the largest possible amount by means of taxation, it is inevitable that a very large amount should be covered by means of borrowing. As for inflationary financing, it became a necessity during the last war in each belligerent country. While there are schools of thought in favour of covering war expenditure by means of borrowing, there is no expert who would actually advocate deliberate inflation as a means of war financing. Inflation will come as the inevitable consequence of the gigantic requirements of the war.

The Governments of the belligerent countries are likely to do their utmost to fight against it and keep it down to a minimum. Their ability to do so will depend partly upon the monetary policy they pursue, but partly upon factors which are entirely outside their control. During the last war most continental belligerent countries experienced crude currency inflation from the very outset. The vast amounts spent in connection with mobilisation largely assumed the form of an increase in the note issue.

(2) DEGREE OF INITIAL INFLATION

The degree of initial inflation in Great Britain was kept down partly by the small size of the British army during the early years of the war and partly by the highly developed banking habits of the public. On the continent, on the other hand, the Governments had to spend vast sums in payment for the large purchases of provisions for the mobilised armies, for horses, carts, and other necessities commandeered at the mobilisation. Moreover, since in most continental countries the habit of keeping banking accounts was confined to a relatively small section of the community, these purchases were bound to lead to a high degree of currency inflation. The extent of this inflation was, however, offset by the moratorium which was declared in most belligerent countries on the outbreak of war and which limited the repayment of bank deposits to a moderate amount per head. Even after the gradual removal of the moratorium, the crude currency inflation failed to produce any spectacular effect for a long time, simply because the public was not inflation-minded.

The chances are that the experience of the last war regarding the initial currency inflation will be repeated at the outbreak of the next war. Great Britain will continue to be at an advantage compared with the continental countries with large mechanised armies, even though it seems likely that during the first few months of the war the British army will increase at a much more rapid pace than it did during 1914 and 1915. To some extent the banking habit has been adopted in some of the continental countries,

but even so, Great Britain will be at an advantage in this respect.

(3) INFLATION IN GERMANY INEVITABLE

It is difficult to see how it will be possible in Germany to avoid initial crude inflation as a result of mobilisation. And since the German public is now much more inflation-minded than it was at the beginning of the last war, the evidence of a large increase of the note issue is likely to produce a profound effect. It is doubtful whether the German Government will be able to eradicate this effect, in spite of strenuous efforts against war profiteering and income inflation in general. Even in the absence of an increase of purchasing power among the German public, the evidence of an increase in the note issue will induce millions of people to spend more in anticipation of an inflationary rise in prices.

It is of considerable importance that the British authorities should do their utmost to retain their initial advantage in this respect, by reducing to a minimum the inflationary effects of war financing. Whether there is crude currency inflation or not, an increase of profits and purchasing power in general through war expenditure is bound to produce a pronounced inflationary effect in the long run. To prevent this it will be necessary to resist an artificial increase of purchasing power and profits or, if such an increase is inevitable, to counteract it as far as possible by means of increased taxation. Failing that, the fictitious wealth created through war expenditure must be reabsorbed by means of borrowing, although the experience of the last war in

Germany and elsewhere proved that inflation cannot be prevented by such means.

(4) PRICE CONTROL

On the basis of the experience of the last war, the futility of trying to avoid a rising trend in prices brought about by profit inflation and income inflation is evident. The evil must be tackled at its very root, and not at its surface symptoms. This does not mean, however, that the Government should not try to fix the price of primary necessities, rents, and essential services. Apart altogether from considerations of monetary policy, it is essential to do so from the point of view of avoiding social discontent. All that matters is that the Government should not rely exclusively upon the effects of price control, but should aim at reducing to a minimum the forces which would otherwise be working against the artificial control of prices.

During the last war price control was, to a large extent, circumvented through illicit trafficking at higher prices, or through a reduction in the quantity or a deterioration in the quality of the goods of which the price was subject to control. Even the most drastic regulations are powerless to prevent a large number of people from resorting to such subterfuges if there is a strong inducement to do so. We have seen that the threat of the death penalty was not sufficient to destroy the various Black Markets in Soviet Russia, and however efficient the German police may be, price regulations are likely to be circumvented to a large extent if they run strongly against human instincts, such as the instinct of profit-

making or self-preservation. Nor is it justifiable to expect the adoption of a sufficient degree of discipline in Great Britain to prevent the wholesale circumvention of price regulations unless the inducement to circumvention is reduced to a minimum.

(5) DEFLATION OF PURCHASING POWER

Nothing short of ruthless profit and income deflation, or, rather, measures directed against profit and income inflation, can moderate the inducement to circumvent price regulations. Prices may be kept effectively at an artificially stable level so long as that level is not substantially lower than the natural level. Even in the absence of an inflationary expansion of purchasing power, there would be a tendency for prices to rise above the official level, owing to scarcity of supply or fear of future scarcity. This tendency would, however, increase considerably if the purchasing power of the public were allowed to increase.

Needless to say, monetary measures against a rise in purchasing power and a rise in prices would have to be supplemented by the rationing of the existing commercial supplies. Care would have to be taken, however, that all these various measures were not carried far enough to kill the initiative for production and trading in the communities concerned. Unless a complete industrial conscription were carried out from the very outset, it would be necessary to retain the inducement of private profit as a driving force for production and trading.

(6) RISE IN PRICES INEVITABLE

It would be unduly optimistic to expect that all these measures would be applied efficiently enough to prevent altogether an inflationary rise in prices. That such a rise would take place as a result of war is a foregone conclusion. So long as it is kept within comparatively moderate limits, however, it need not be regarded as an unmitigated evil. The result of a prolonged war would be an increase of the public debt to astronomical figures. The greatest mistake made after the last war was to assume that in spite of that increase the value of the currencies could and should be restored to the pre-war level. The growth of public debt would necessitate a corresponding depreciation of the commodity value of the currencies. It would admittedly be advantageous if this inevitable rise could be postponed until after the war, but the chances are that part of it would take place during the war.

(7) NO CREDIT RESTRICTIONS

If it is essential that the authorities should do their utmost to resist inflation in time of war, it is equally essential that they should apply the right policy for that purpose. Their main efforts should be directed against purchasing power inflation, instead of pursuing the old-fashioned deflationary policy against credit inflation. While it may be open to argument whether in time of peace it is advisable to restrict production in general, in any circumstances, for the sake of preventing monetary inflation, there can be no question about the folly of attempting

to hamper production in time of war by means of credit restriction measures.

During the war production should be regulated solely from the point of view of the requirements of the fighting forces and the essential requirements of the civilian population. If from that point of view the production of certain commodities is superfluous, it should be checked not by means of credit restrictions but simply by means of direct Government intervention. The production of superfluous goods should be prevented, even if the producers have adequate financial resources at their disposal. On the other hand, the production of essential goods should not in any circumstances be hampered by lack of financial resources. If the producers have not enough capital, they will have to be assisted by means of an adequate amount of credit, irrespective of the effect of such expansion upon the monetary situation. In any case, the extent to which credit expansion reacts upon the price level is apt to be overrated. In so far as the credit expansion leads to the creation of purchasing power without a corresponding creation of goods, it tends to cause a rise in commodity prices. If, however, the creation of additional purchasing power is either prevented or offset, then there is no reason why credit expansion in itself should lead to a rise in commodity prices.

(8) NO HIGH BANK RATE

It would be a gross error therefore to seek to fight against inflation by means of all-round credit restrictions. Even in normal conditions such measures are liable to affect not only industries which are over-

expanded but also industries which are in bad need of stimulus. During a war it would certainly be out of place to indulge in orthodox dogmatism. Above all, there could be no question of repeating the incredible folly of August 1914, when ruthless deflation was enforced by the raising of the bank rate to panic level. The bank rate as a powerful and highly efficient means of regulating the supply of credit has in any case been discarded. The authorities are most unlikely to resort to an increase of the bank rate merely because war has been declared unless their hand is forced by a natural rise in money rates.

The question is, should the authorities allow such a natural rise in money rates to take place, or should they pursue a deliberate policy of cheap money? There can be no doubt that the cheap money policy which has been enforced in Great Britain and various other countries for some years will continue during the period of the rearmament race, if only in order to enable the Governments to borrow at low rates for rearmament requirements. Another reason why the authorities are not likely to depart from that policy is their desire to stimulate trade which is in any case under the cloud of frequently recurring war scares. If the rearmament race were not accompanied by an atmosphere of acute political tension and uncertainty, the persistent demand for commodities in connection with rearmament would inevitably lead to a sweeping boom such as tended to develop at the beginning of 1937 before the menace of war was adequately realised by the public. As it is, in spite of the material stimulus to trade provided by rearmament, it is necessary also to provide material and psychological stimulus through a cheap money

policy, or at any rate to prevent the development of a material and psychological handicap through a rise in interest rates.

(9) TREASURY'S CHEAP BORROWING FACILITIES

After the first shock of the outbreak of war, the necessity for such stimulus would cease to exist. On the other hand, the necessity for enabling the Treasury to borrow at low rates would be stronger than ever. The cost of war would be many times higher than that of rearmament, and the amount that would have to be raised by borrowing would be many times as large. In such circumstances it is of considerable importance to maintain a plentiful supply of cheap money for the Government's requirements. This consideration is in apparent contradiction to the necessity for absorbing surplus purchasing power in order to avoid an inflationary rise in commodity prices. In reality the two requirements are by no means irreconcilable. Here again it is necessary to realise that an inflationary rise in prices takes place mainly through an artificial increase of purchasing power, and not through an expansion of credit resources. Money may conceivably be allowed to remain reasonably easy so long as the increase of purchasing power is kept down. If money is pumped into the market through open market operations, it does not in itself add to the purchasing power of the public, but it does add to the market's capacity for absorbing new Government loans.

(10) TREND OF COMMODITIES AND MONEY RATES

From the point of view of being able to maintain cheap money, it is essential to keep down the pace of the inflationary rise in commodities during the war. Once the investing public realises the existence of an upward trend in commodities, it will naturally expect a higher yield on its Government loans in order to obtain compensation for the depreciation of the commodity value of its capital. From this point of view alone it is essential to avoid a rising trend in commodities during the war. As far as possible, the rise should be postponed until after the war, when the same necessity for borrowing on a large scale would no longer exist.

While considerations of monetary policy should not be allowed to interfere with the necessity of borrowing cheaply and easily, it might become necessary to raise long-term interest rates in order to provide an adequate incentive to save. If investors did not consider it worth while to save for the sake of a yield of $3\frac{1}{2}$ per cent, then the interest on war loans would have to be fixed at a level at which it provided sufficient inducement to save.

(11) HOW TO DIVERT SURPLUS PURCHASING POWER INTO GOVERNMENT LOANS

Even from this point of view the prevention of spending on luxuries would go some way towards obviating the necessity for paying higher interest rates. By reducing the temptation to spend more, the Government would induce the public to save more. It would also be necessary to divert savings

into Government loans by the limitation of dividends on shares. The rent restrictions and the additional war risk attached to the ownership of property would at any rate prevent an excessive demand for real estate or mortgages to the detriment of the demand for Government loans.

It is reasonable to expect that Great Britain would be able to avoid excessive inflation during a prolonged war. The position of continental belligerent countries, and particularly of Germany, will be much less favourable in this respect, and the chances are that the German Government would have to cope with all the disadvantageous effects of inflation upon the social situation, the morale of the nation, and the Government's capacity to borrow. The very difficulty of borrowing would accelerate the pace of inflation and would establish a vicious circle, the working of which would be only too familiar to those who remember the experience of the last inflation in Germany.

CHAPTER VIII

WAR AND FOREIGN EXCHANGE

(1) GERMANY'S INADEQUATE GOLD RESERVE

IF there is one sphere in which the advantages of the democratic countries over Germany and her potential allies are overwhelming, it is in the sphere of foreign exchange. The superiority of the gold and foreign exchange resources of Great Britain and France is considerably greater than it was during the last war, when both Germany and Austria-Hungary possessed substantial gold resources. Today the published gold resources of the Reichsbank would barely suffice to cover a few days' war requirements of imports. Even though it is certain that Germany has been accumulating a hidden gold reserve, its amount cannot be very large. A careful examination of the figures of the German balance of payments during recent years fails to reveal any items which would justify the assumption that Germany has succeeded in accumulating a really substantial secret reserve. It is well known that the proceeds of the foreign assets called in from private owners have been spent as they were obtained. The only important addition to the unpublished reserves is the gold stock of the Austrian National Bank, and possibly some foreign assets seized from former Austrian nationals. Even allowing for these items, it is difficult to imagine that the total gold reserve of the Reichsbank can be much

more than £50 million. Against this the British authorities possess at the time of writing about £700,000,000 in gold, while the French authorities, notwithstanding their heavy losses during recent years, also possess about £600,000,000.

(2) LARGE BRITISH OVERSEAS INVESTMENTS

Nor is this the complete picture. Both Great Britain and France possess large secondary reserves in the form of gold and foreign assets owned by their nationals. The figure of British investments abroad has been estimated at about £3000 million. The amount of French capital held abroad is smaller, but by no means inconsiderable. The question is, to what extent can these assets be converted to the use of the Government ?

As far as Great Britain is concerned, there is no likelihood of any difficulty in obtaining the surrender of a very large part of foreign investments. The experience of the last war amply proved this. On that occasion very large amounts of American railroad stocks were surrendered in the early phases of the war, enabling the Government to acquire the dollars necessary for the large purchases of raw materials and munitions. British people are essentially law-abiding, and even though the wealthier classes of taxpayers are keen to take advantage of any legal loopholes that may be available, few of them would actually break the law by refusing to declare and surrender their foreign assets when called upon to do so by the Government.

(3) REALISATION OF U.S. AND LATIN-AMERICAN SECURITIES

Admittedly, Great Britain does not today possess such essentially marketable investments as the large blocks of British-owned American railroad stocks which she held in 1914. Nevertheless, a large percentage of British foreign investments are easily marketable. British holdings of good-class American equities are considerable, and, given skilful handling, they would be marketable without causing a heavy fall in Wall Street. The amount that could thus be raised runs into hundreds of millions of pounds. The next item is British investments in Latin-American industries and public utilities. Admittedly it would be a pity to part with these assets, which are very valuable from the point of view of maintaining the Latin-American markets for British trade. Such peace-time considerations have to fade into the background, however, when the outcome of a life and death struggle is in the balance.

There would be no difficulty whatsoever in realising good-class South American shares. For one thing, the South American countries themselves would be both able and willing to repurchase the control of their industries and public utilities. Since they will all have large favourable balances in relation to Great Britain, from the point of view of their foreign exchange position they would be well able to pay the purchase price. Nor would the internal financing of such repatriations encounter insurmountable difficulties. The gold reserves of the Latin-American countries would expand rapidly during the war, and their authorities would be able to expand credit to

a sufficient extent to enable their local financiers to raise the capital required for the repatriation of British holdings. Alternatively these holdings could be sold in the United States, although from a British point of view this would be a less favourable solution than the repatriation of the control of South American undertakings. If the control reverted to South Americans, there would still be a fair chance that after the war orders for machinery and equipment would be attracted to Great Britain, but if the control were acquired by the United States the chances are that these orders would definitely become diverted eventually to American industries. Even so, it would be worth while to make the sacrifice in the interests of providing the foreign exchange resources required for the eventual victorious termination of the war.

(4) REALISATION OF EMPIRE SECURITIES

Another important item in the inventory of British assets overseas is investments in the British Dominions and colonies. It would be deplorable if, owing to extreme pressure, it became necessary to part with these assets, which constitute a very valuable link between the Motherland and the Empire. Nevertheless, if the worst came to the worst the Dominions at any rate would be in a position to repurchase the control of their undertakings. In an extreme emergency it might even be necessary to sell participations in such undertakings to American interests. Admittedly, such a transfer of interests from British hands would be detrimental to the links between the Motherland and her Dominions and Colonies, but on the other hand it would strengthen

the links between the British Empire as a whole and the United States. Even so, the realisation of Empire assets outside the Empire should be left as the very last emergency measure.

(5) REPAYMENT OF FOREIGN LOANS

While the realisation of good-class industrial and public utility securities in the Empire and Latin America would present no difficulties, it would be less easy to raise foreign exchange resources through the realisation of sterling loans granted to Dominions and foreign countries. Nevertheless, in many instances the debtor countries would be willing to use their war profits for the repayment of their liabilities. Indeed, it is easy to imagine a situation in which they would be only too anxious to do so. Quite conceivably a stage might be reached when some of the neutral countries might experience the same plethora of gold which during the war induced Sweden and Spain to attempt to check the influx. Since producers and exporters of these neutral countries would press the Government to allow them to continue their profitable trade with Great Britain, the only way in which payment for such exports could then be made would be through the liquidation of part of the outstanding indebtedness of those countries to Great Britain. The war might provide an opportunity for a drastic reduction of the international balance of indebtedness, and would thus solve a problem which in existing conditions appears to be impossible to solve. It might enable the Dominions and Latin-American countries to repay or materially reduce their excessive indebtedness to Great Britain.

To that extent the situation would become distinctly sounder, even though the other side of the picture would be represented by a falling-off of the British invisible export item represented by the yield on overseas investment. This change would not, however, begin to produce its effect until after the war, for during the war the liquidation of capital investments would amount to a multiple of the amount represented by the loss of interest and dividend on the capital liquidated.

(6) FRENCH FOREIGN ASSETS

France too would be in a position to liquidate her Latin-American investments. The external financing of war by France, however, depends largely upon the Government's ability to obtain the repatriation of the huge amounts of French refugee funds. To a very large extent repatriations are likely to be voluntary. It is quite certain that in face of a national emergency patriotism would prevail, and a large number of Frenchmen would hasten to surrender their foreign assets to their Government in the interests of national defence. If this were not sufficient, it would be necessary to resort to legislation to seize the refugee money, and to that end it would be desirable to secure the collaboration of the authorities of Great Britain, the United States, Holland, and Switzerland. There can be no doubt that the Governments of these countries would be only too willing to assist the French Government in collecting the assets of its nationals. In time of peace these Governments would be reluctant to resort to measures which would be contrary to the established principles of banking

secrecy, but such considerations are bound to be waived during the war, not only by Governments which are allied to France but also by Governments which, while neutral, would welcome a victory of the democratic countries.

(7) NEUTRALS AND "HOT MONEY"

In the case of the United States the influx of gold would probably become a source of embarrassment during the next war, and for this reason alone the Washington Administration would probably seize the opportunity to drive away some of the unwanted "hot money". Both Holland and Switzerland, if they remain neutral, are likely to suffer from an acute *embarras de richesse* as a result of the accumulation of refugee money for which it would be difficult to find employment. Moreover, both countries would be well aware that a German victory would mean the end of their independence, and while they would not care to risk being overrun by the German army as a result of openly joining the alliance of democratic countries, they would certainly do their utmost to assist France as far as it was possible within the limits of neutrality. One way of assisting her would be to enable the French Government to seize the French-owned assets in those countries. There is every reason to suppose therefore that in time of war the French Government would find no great difficulty in laying hands upon the predominant part of its privately-owned foreign assets.

(8) THE DISHOARDING OF GOLD

Both France and Great Britain are thus in a position to raise vast foreign exchange resources, apart altogether from their very substantial gold reserves. Their immense advantages over Germany in this respect are further increased by the possibility of calling in substantial amounts of hoarded gold from their nationals. Admittedly the secondary gold reserve represented by coins in circulation, which played such an important part during the last war in both France and Great Britain in enabling the Governments to increase their gold stocks, no longer exists. On the other hand, large amounts of coins and bar gold are held hoarded and could be called in through voluntary surrender if possible, or by compulsory measures if necessary. In this respect, too, Germany is at a heavy disadvantage, since virtually all the privately-owned gold which could be located has already been seized and spent.

(9) CREDITS ON SECURITY

Over and above the gold assets which the democratic countries possess or are in a position to mobilise, this country would stand a good chance of raising substantial credits overseas. In the first place she might rely upon being able to buy on a credit basis from her various Dominions and colonies, which in the past have been largely financed by the Motherland but which, as a result of profitable trade in time of war, would be able to repay their indebtedness and even to grant loans to their former bankers. Even though the British Dominions will become belligerents

and will have to raise big armies of their own, nevertheless the chances are that they will be able to continue to export to Great Britain on a large scale. During the last war Great Britain had to grant financial assistance to some of the Dominions, but it is possible that in the next war relations in this respect will become reversed, at least as far as Canada is concerned. During recent years Canada has become a favourite refuge for flight money, and this will place her in a favourable position to grant financial assistance to Great Britain in the form of credits to finance Canadian exports. The same may be true of the Argentine and possibly, to a lesser extent, of other Latin-American countries.

As for the United States, the Neutrality Act confines trade in time of war to a "cash and carry" basis, but in this respect the situation will be no worse than it was during the first three years of the last war, before the United States joined the Allies. There will be nothing to prevent the raising of loans in New York on the security of American, Latin-American or Empire stocks. If the British authorities in charge of the realisation of these assets found the American market saturated, they would always be in a position to take their time by pledging these assets as security against credits or loans.

(10) NEUTRAL REFUGEE MONEY IN LONDON

Great Britain may also rely upon being able to obtain credit in Holland, Switzerland, and the Scandinavian countries. All these countries will be only too well aware that Great Britain is fighting their battle. They will prefer to lend their money to Great

Britain rather than see it seized by Germany in the same way as the Austrian assets were seized after the *Anschluss*. Indeed, the chances are that these countries will transfer to Great Britain a large part of their gold resources either before the war or immediately after its outbreak, in order to reduce the temptation to Germany to violate their neutrality. The ease with which the Reichsbank laid its hands on some £26 million of gold in Vienna might conceivably induce the German Government, hard pressed for foreign exchange resources, to attempt to seize the substantial stocks of gold held in Brussels, Amsterdam, and Berne by means of a swift stroke smashing through the defences of the neutral countries. Indeed, it is hardly fair to place such temptation in Hitler's way by leaving substantial gold stocks within easy reach of his mechanised columns. Belgium, at any rate, has realised this, and has been gradually transferring much of her gold abroad. Although the bulk of such official refugee funds is likely to find its way to New York, some of it at any rate may come to London. Similarly, many nationals of the continental neutral countries may find it safer to rely upon the British navy for the defence of their funds than upon the word of Germany that she will respect their neutrality. The amount of refugee funds in London owned by the nationals of prospective neutral countries is already considerable, and is likely to increase further in the event of war.

(11) RESTRICTION ON BRITISH CAPITAL EXPORT

This brings us to the most controversial part of the chapter, and indeed of the whole book, namely

whether it will be advisable for Great Britain to adopt exchange restrictions during a war, and if so how far these restrictions should go. We have already seen in dealing with the problems of the British trade balance during the war, that it will become necessary to impose restrictions upon imports. This does not in itself necessitate the adoption of exchange restrictions, since it could be applied also in the form of restrictions on the allotment of tonnage or simply import quotas and embargoes.

A much more difficult question is whether or not any capital transfers should be made subject to restrictions for the duration of the war. In this respect it is necessary to discriminate between capital movements on British account and on foreign account. There can be no two opinions about the necessity of imposing restrictions on the export of British capital. For one thing it would be futile to attempt to call in and realise privately-owned assets if at the same time the public is at liberty to export its capital abroad. For France the adoption of exchange restrictions might become necessary before the outbreak of war, and it would become a matter of vital importance during a war. For Great Britain a restriction on the outflow of British capital would be hardly less important. For one thing, the financing of war by means of borrowing would become incomparably more difficult and more costly if investors had the choice of subscribing to war loan or taking a hand in the war boom that would undoubtedly develop in Wall Street. In order to be able to compete with such an attraction the Treasury would have to offer ruinous interest rates, and even so it might be unable to raise all the funds required.

(12) DISCRIMINATION IN FAVOUR OF FOREIGN
BALANCES

To avoid internal inflation and a depletion of foreign exchange resources it might become imperative to stop the outflow of British capital. This was done during a brief period after the suspension of the gold standard in 1931 without any apparent ill-effect upon London's position as the international banking centre. During the next war the restriction will have to be much more drastic than those adopted during 1931-32, which were loose enough to enable anyone who wished to do so to drive a horse and cart through them. The issue at stake will be incomparably more important than it was after the suspension of the gold standard, when the object of the exchange restrictions was merely to prevent an excessive depreciation of sterling. It will be necessary to make provisions too to ensure the repatriation of the proceeds of British exports. The British authorities must learn the lessons taught by the experience of other countries and stop as many loopholes as possible from the very outset.

The chances are that such restrictions on the export of British capital will indeed be introduced on the outbreak of war. On the other hand, it may be regarded as certain that the movements of foreign capital held in London will not be interfered with by the authorities. The reason for this discrimination lies partly in the survival of nineteenth-century traditions, partly in the desire to maintain London's position as the world's banking centre, but mainly in order to secure an influx of foreign balances during the war. It will be remembered that during the last

war the "special" deposit rates paid by the Bank of England enabled London to attract quite considerable amounts of foreign balances. Even in the absence of any statistics it is safe to assume that the influx of foreign funds to London between 1914 and 1918 was well in excess of the efflux of foreign capital from London.

(13) THE CASE FOR ALL-ROUND EXCHANGE RESTRICTIONS

There are, however, strong arguments in favour of the extension of exchange restrictions to the withdrawal of foreign capital. In the event of wholesale withdrawal, the British foreign exchange resources would become considerably depleted, and this should be avoided if possible. Admittedly the blocking of foreign balances for the duration of the war would be a severe blow to London's position as the world's banking centre. Nevertheless, it should be remembered that if this country lost the war, that would certainly be the end of London's rôle as the world's banker. Even though it would be an exaggeration to suggest that the withdrawal or non-withdrawal of a few hundred million pounds of foreign assets would make all the difference between victory and defeat, it is easy to imagine circumstances in which the possession of the few extra hundred millions might prove to be of vital importance. Moreover, after the victorious termination of the war London would in any case resume her rôle as the leading international banking centre, for the simple reason that there is no other centre qualified to fulfil that part adequately. This is amply proved by the experience of the last twenty years, when, in spite of the superiority of

their financial resources, various foreign centres have been unable to capture the lead from London.

(14) IMMUNITY OF FOREIGN-OWNED FUNDS AND
GOLD DECIDED IN ADVANCE

However, while it may be a matter of opinion whether or not the Government should impose restrictions on foreign balances, it is beyond doubt that in fact no such restrictions will be imposed. I have reason to believe that the question has been discussed and that it has been decided not to interfere with foreign balances in time of war. It is safe to assume that, once the Government decided not to interfere with foreign balances in London, foreign gold deposits would also be left undisturbed. Anxiety in this respect is entirely unjustified. Possibly the monetary authorities may avail themselves of their right to call in British-owned gold in excess of £10,000 per holder, but it seems most unlikely that the Government will avail itself of its right to buy at 85s. instead of the current market price. As for foreign-owned gold deposits, they will be left severely alone. It is indeed difficult to see what would be the point in seizing these gold deposits and paying the owners in free sterling. The chances are that most of the owners would resent this action and would transfer the sterling balance thus obtained, thereby increasing the pressure on sterling and compelling the Government, in order to support sterling, to part with the gold thus acquired. The calling-in of foreign gold deposits could only serve a useful purpose if payment were made in blocked sterling, which of course would be out of the question.

(15) EXCHANGE-PEGGING

Another important and controversial problem of foreign exchange is whether or not during the next war sterling should remain pegged. The policy of pegging during the last war was subject to much criticism after the war by economists who condemned the Government for having maintained sterling at an artificially overvalued level instead of allowing it to adjust itself to its natural level. These critics were, however, altogether too dogmatic. They regarded the question from the narrow viewpoint of the technical specialist instead of regarding it as part of the major problem of national defence. It may have been economically unsound to maintain sterling at 4·76 during the last war, but by doing so the British Government reduced the extent of the internal depreciation of the pound, at least for the duration of the war. For the same reason it will be wise to peg sterling during the next war. Thanks to the possession of large gold assets, the realisation of privately-owned foreign assets and the restrictions imposed upon imports and the transfer of capital, the task of maintaining the stability of sterling should not prove too difficult.

CHAPTER IX

GERMAN WAR ECONOMY

(1) "WEHRWIRTSCHAFT"

IN the foregoing chapters we have been dealing mainly with the economic war problems of Great Britain. Although frequent reference has been made to Germany for purposes of comparison, a book dealing with war economy would not be complete without a chapter discussing the specific problems of German war economy.

War economy has developed into a science in Germany during the last few years. Long before the subject had been referred to in the British Press, German financial newspapers had permanent sections headed *Wehrwirtschaft*. This term was coined to suggest "national defence economy", but it could be translated equally well as "war economy". The German literature of *Wehrwirtschaft* is very extensive indeed. The problems that exist in Germany are discussed with great thoroughness, and developments in rearmament economy abroad are followed and commented on regularly. In particular, special attention is paid to the economic measures adopted in countries which at present are at war—Japan, China, and Spain.

(2) ECONOMIC SYSTEM SERVING AIM OF VICTORIOUS WAR

Simultaneously with the development of the German *Wehrwirtschaft* literature, the German economic system has been gradually adapted to war requirements. The object of the Four-Year Plan is to secure economic self-sufficiency for Germany so as to enable her to fight a prolonged war in spite of being cut off from food and raw material supplies from overseas. The whole economic system of the country is being transformed with the object of serving the one supreme end of increasing Germany's chance of winning the next war.

The idea of a military State in which economic interests are merely a means to the end of military efficiency even in time of peace is not new in Germany. Friedrich Liszt, the leading German economist of the nineteenth century, supported his protectionist doctrines with the argument that it was necessary for a country to produce at home everything required for national defence. In those days the requirements were much more moderate, but even then the application of Liszt's doctrine would have meant a very high degree of economic autarchy. In the meantime the increased size of the modern army and its mechanisation has resulted in an increase in the variety and volume of materials required for national defence, so that the application of Liszt's doctrine today would necessitate a much higher degree of self-sufficiency than it did during his lifetime. Moreover, in the meantime the necessity of providing for the requirements of the civilian population during a long war has been amply proved by the experience of 1918.

Thus Field-Marshal Goering's Four-Year Plan aims at a much more ambitious task than anything that could possibly have been envisaged by Friedrich Liszt.

(3) PRUSSIAN MILITARY EFFICIENCY *ÜBER ALLES*

The reason why the idea that the German economic system should be established according to military requirements has been absorbed so easily in Nazi Germany is that the same conception prevailed to a very large extent in pre-war Germany. The military caste was reigning supreme and its members looked down upon leading industrialists and merchants of the type of Krupp and Ballin as inferior beings whose sole object in life was to work for the economic conditions making for the highest possible efficiency of the Prussian Army. While in most other countries the fighting forces were regarded as serving to safeguard the peaceful pursuit of trade, in Germany industry and trade were regarded as the subordinate means of strengthening the striking-power of the Reich.

There was an interval of fifteen years following upon the end of the war, but since 1933 this conception has once more reigned supreme in Germany. The only difference is that the place of the military caste of the Prussian landed gentry has now been taken by the small group of politicians who control the destinies of the Nazi party. For them, both the army and the economic organisation are means to world conquest for the Third Reich and Nazi doctrines. They make full use of economic weapons in their endeavours to secure political control in various countries.¹ At the

¹ The methods employed to that end, and the aims pursued, are discussed in detail in my book *Bloodless Invasion*.

same time they believe that the main object of the German economic system is to prepare for *Der Tag*, and to that end to secure the maximum of efficiency for the fighting forces.

(4) BID FOR SELF-SUFFICIENCY TEMPERED BY LABOUR SHORTAGE

The underlying idea of the Four-Year Plan was that Germany should produce all the essential materials at home irrespective of cost. Even though the production of synthetic petrol in Germany costs more in terms of labour than the production of oil abroad plus the cost of its transport and refining, home production must nevertheless be encouraged in order to secure the self-sufficiency of the Reich in that all-important commodity. The fact that the production of synthetic petrol required an excessive amount of human labour did not in the least worry the German authorities during the early phases of the application of their Four-Year Plan, for at that time there was still much unemployment in Germany and they could draw upon the labour reserve for the purpose of manufacturing synthetic products. For the time being the labour shortage that has developed since the beginning of 1938 has been remedied by the import of labour, mainly from Italy. In case of a war, however, this would no longer be possible. To some extent the mobilised workmen might be replaced by the conscription of women and of men unsuitable for military service. Even so, shortage of labour will be an important problem in the German war economy.

(5) BUILDING UP COMMODITY RESERVES

A question of immense importance is whether Germany has succeeded in accumulating sufficiently large stocks of food and raw material for the pursuit of a prolonged war. If we took the word of German politicians, it would appear that from this point of view Germany is well equipped to embark upon a major war tomorrow. There can be no doubt that, by a sheer stroke of luck, the bumper crop of 1938 has enabled Germany to build up a really substantial wheat reserve. On the assumption that next year's crop will be at least up to the average, Germany's wheat supplies are assured for the next two years or so, even without any additional purchases from abroad. The position regarding other commodities is, however, much less favourable. A comparison between the import figures of 1913 and 1937 fails to disclose sufficient discrepancy—allowing for the increase of the population of the Reich—to justify the assumption that Germany now has a two years' supply of most of the essential commodities. If we envisage a war of four years' duration, then, notwithstanding statements to the contrary by Hitler and his lieutenants, it would be a leap in the dark from an economic point of view to embark upon war, just as it was in 1914. It would take many years for Germany to accumulate sufficiently large stocks to be able to face a war of several years' duration. For one thing, rearmament continues to absorb a large percentage of German imports, while the consumption of food by the population could hardly be reduced further in time of peace. Nor is it likely to be easy to expand exports sufficiently to secure the import of a large

surplus above current requirements. The accumulation of stocks is necessarily a slow process.

The storage of huge quantities of commodities would render Germany more vulnerable to air raids. If commodity stocks were destroyed by air raids in Great Britain, it would only mean that the supply would have to be replenished by drawing upon the gold reserve. If, however, a food depôt were destroyed in Germany, it would mean that the supply that perished could not be replaced for the rest of the war.

(6) GERMAN POPULATION UNDERFED

Nor is the German population likely to submit cheerfully to the sacrifices imposed upon it in the form of a curtailment of its food rations. It must be borne in mind that the German population is already underfed and that its physical resistance to a further curtailment of its food supplies is now much weaker than it was in 1914. The last war broke out at the end of a long period of prosperity. Between 1871 and 1914 Germany had forty-three more or less fat years, and, in spite of that, by the end of four lean years the physical and moral resisting capacity of the nation had become undermined by food shortage. Today Germany looks back upon twenty-four more or less lean years, since the war period was followed by an inflation period of five years, a period of acute capital shortage lasting eight years, a period of acute deflation lasting two years and a period of "guns instead of butter" policy, lasting five years up to the time of writing. The chances are that this latter policy will continue, so that the German nation will enter the war with a much lower capacity for physical

resistance than it had in 1914. Accordingly, a shortage of food will produce a quicker and more devastating effect than it did during the last war.

(7) " BLOODLESS INVASION " OF THE DANUBE BASIN
AND THE BALKANS

The problems of German war-time foreign trade have already been dealt with at some length in Chapter V. We have seen that the import of raw materials from overseas through the circumvention of blockade would encounter almost insurmountable difficulties. The blockade would also prevent Germany from exporting overseas for the purpose of raising the necessary foreign exchange for her import requirements. There is, of course, always the possibility of trading with neutral countries. As far as the potential neutral countries of Western and Northern Europe are concerned, the chances are that they will not lend themselves to an expansion of German trade, owing to the fear that a German victory would place them at the mercy of a ruthless conqueror. The same consideration would doubtless hold good for the Danubian and Balkan States in so far as they remain neutral. Germany is at present engaged in a supreme effort to secure complete economic control of these countries. As I have tried to prove in my book *Bloodless Invasion*, she could not possibly be satisfied with mere economic control, for unless she secured political control the Danubian and Balkan States would always be in a position to close their frontiers to exports of essential commodities to Germany in time of war, or to sell their commodities to Great Britain rather than to Germany.

Whether or not the object of acquiring political control over the Danube basin and the Balkans by means of economic penetration will succeed remains to be seen. If it does, then the Nazi puppet Governments established in that area will place the food and raw material supplies of their countries unconditionally at Germany's disposal. It would be idle to deny that such an addition to Germany's resources would materially increase her strength.

(8) BRITAIN TO RESIST GERMAN ECONOMIC
PENETRATION

For this reason it is of primary importance for Great Britain and the other democratic countries to counteract German economic penetration into South-Eastern Europe before it is too late. It is gratifying to see that Mr Chamberlain has grasped the necessity for adopting a policy of economic assistance to the countries of South-Eastern Europe without trying to block Germany. The pace of the application of that policy has, however, up to the time of writing been very slow, and unless it is adequately accelerated it may be too late to avert the German bloodless conquest of the Danubian and Balkan States.

Should Germany have free disposal of the raw material resources of these countries, it would prolong her resistance, possibly by several years. Apart from the importance of her political control over those countries from a military and naval point of view, German influence might be able to close the straits for Russian traffic through the Black Sea, in which case the war economy of the Soviet Union might suffer to some extent. Nevertheless, it is incon-

ceivable that even the acquisition of complete control over South-Eastern Europe would make any difference to the final outcome of the war. After all, during the last war the economic resources of Central and South-Eastern Europe, and in addition those of Poland and a large part of Russia, were at Germany's disposal, and in spite of that she was unable to secure an adequate supply of food and raw materials.

(9) GERMANY HANDICAPPED BY INFLATION-
CONSCIOUSNESS OF HER PUBLIC

The financial aspects of German war economy have been discussed in some detail in Chapters VI and VII. From a financial point of view, Germany will enter the next war in considerably less favourable conditions than she did the last one. Even though her public debt is smaller than those of Great Britain and France, it is much larger than it was in 1914. Above all, it cannot be emphasised sufficiently that the German public is much more inflation-conscious. Its inflation-consciousness is likely to continue to increase until the outbreak of war, owing to the inevitable necessity for inflationary financing of rearmament. Early in 1938 Dr. Schacht made an effort to check the process of inflation. From April 1938 onwards, the bills received by Government contractors in settlement of their claims ceased to be eligible for rediscount. The result, however, was the contraction of liquid resources, leading to a bourse slump in August 1938. In the existing circumstances it is quite impossible for Germany to embark upon deflation, or even to check inflation for any length of time. She will enter the war with confidence in

her currency and finance thoroughly undermined, and the first evidence of crude currency inflation will produce the maximum of effect upon her population.

Notwithstanding this, it would be idle to expect a collapse of the German war machine as a result of currency depreciation. If necessary the reichsmark will be devalued, or an effort will be made to maintain it at its artificially high level by means of ruthless measures of control and restrictions. It is inevitable, however, that currency difficulties, added to difficulties of food supply, should produce a demoralising effect upon the generation which still has vivid recollections of the currency disaster of 1923.

Admittedly the Nazi economic and financial system has been elaborated with considerable skill and has worked on the whole satisfactorily in time of peace. It is, however, a house of cards, which is hardly likely to remain intact amidst the shocks produced by a war.

CHAPTER X

FRENCH WAR ECONOMY

(1) DETERIORATION OF INDUSTRIAL DISCIPLINE

IT would be idle to deny that in many respects the French economic and financial position would leave much to be desired if war were to break out tomorrow. French economic preparedness for a long war would compare unfavourably in many ways with British economic preparedness. The position is highly unsatisfactory regarding economic discipline, productive capacity, monetary stability, and internal capital resources. Even though it is to be hoped that, by the time war breaks out, all these difficulties will have been eliminated, nevertheless in order to form a realistic view of the situation we must reckon with their existence.

Although it is impossible to contest the merits of the Front Populaire Government in the sphere of social reform, it is also an undeniable fact that the advent of the Blum Government in 1936 was accompanied by a marked deterioration of discipline in the French economic system. Fortunately the epidemic of stay-in strikes came to an end, even though there are occasional isolated relapses. Nevertheless, the various Governments that followed M. Blum's first Front Populaire Government have not succeeded in restoring industrial discipline to a sufficient extent. Progress in the right direction is slow and not con-

tinuous. The ruthless struggle between the working classes and the industrial and barking Upper Ten — known as the “200 Families” — has thoroughly demoralised both sides, and they now place narrow self-interest above the interests of the community.

(2) HOPES OF RESTORING NATIONAL UNITY

In order that France should be able to bear the economic strain of a long war, one of the most important preliminary conditions is that this spirit of selfishness should be overcome. Otherwise France will be in a worse position economically to fight the aggressor than she was in 1914–18, when the split between the two main social classes was not nearly so pronounced as it is today. Fortunately there is every reason to hope that the shock provided by the outbreak of war will work a miracle in this respect. Indeed, even the danger of a non-stop depreciation of the franc, and the menace of a European war after the Austrian *Anschluss*, went some way towards assisting M. Daladier's efforts to restore the right spirit in the French economic system. It is of great importance that France should not wait until the moment of the outbreak of the war. The restoration of a normal degree of economic discipline is essential to the efficiency of her rearmament. As it is, France has already lost much ground. She had to watch Germany capture the lead in the air, and while the French Army is still stronger than the German, its superiority will soon be challenged through the progress of German rearmament.

(3) FORTY-HOUR WEEK MUST GO

France does not stand a chance of keeping her place in the international armament race unless her industrial production can be increased materially. Although the adoption of the 40-hour week has been an achievement from a social point of view, it has certainly placed France at a disadvantage against Germany, where workmen are prepared to work 60 hours and more. The French working classes should be given to understand that in departing from the rigid regulations of the 40-hour week they would be serving, not the hated capitalist classes, but first and foremost France as a whole in her preparation for her life-and-death struggle against a ruthless aggressor. There can be no doubt that once war breaks out the French working classes will fully realise this, but France's chances of resisting the German onslaught would improve materially if a way could be found to increase production through restoring industrial discipline and departing from the 40-hour week long before the actual outbreak of hostilities.

It is to be hoped that M. Reynaud's attempt at a drastic modification of the 40-hour week will meet with success. At the time of writing it is impossible to ascertain what the response will be to the proposals aiming at the economic and financial reconstruction of France, but there is a widespread feeling that it would have been easier to induce the working classes to submit to the sacrifices if M. Reynaud had adopted exchange restrictions simultaneously with the adoption of the measures against the 40-hour week.

(4) NEED FOR EXCHANGE RESTRICTIONS

The major mistake made by M. Blum from his own narrow party point of view and also from the point of view of France as a whole was that, at the time of his advent to office, or at any rate at the time of the first devaluation of the franc, he omitted to introduce stringent exchange restrictions. Conceivably this was politically difficult, since the Right Wing of his supporters in Parliament was against it. It might have been possible, however, to strike a compromise by which, in return for some concessions in the sphere of social legislation, the parties of the Right could have been induced to agree to the imposition of exchange restrictions. As it was, M. Blum resorted to advanced measures without having taken steps to prevent his opponents from retaliating by transferring their capital abroad. The result was a series of monetary crises and a prolonged period of confusion, which considerably reduced the economic strength of France. It is perhaps not too late to make good the omission, and a skilful statesman should be able to negotiate a compromise between capital and labour by which the former submits to discipline for the sake of inducing the latter to relinquish some of the achievements which have proved detrimental to French production. Unfortunately, in addition to the internal political obstacles, the French Government would also have to overcome narrow prejudice against exchange restrictions on the part of the Governments of the Tripartite Agreement. From the point of view of the efficiency of France's economic defences in the event of war, the Tripartite Agreement has been a major misfortune from the very outset.

Between September 1936 and May 1938 the British and United States Governments did their utmost to prevent, or at any rate delay, the downward adjustment of the franc which was necessary if the wasting of the French Government's gold resources was to be avoided. At the same time they were equally opposed to the alternative solution, namely that of exchange restrictions. Their opposition was based on the assumption that exchange restrictions would gradually lead to the development of a totalitarian economic system, and that this again would lead to the alignment of France with the Fascist powers. Their line of reasoning ran as follows :

All Fascist States have exchange restrictions.

France has exchange restrictions.

Therefore France is a Fascist State.

Never have otherwise intelligent statesmen and Government officials become such easy victims to a logical fallacy which any student preparing for matriculation would easily spot.

The fact of the matter is that exchange restrictions, far from converting France into a Fascist State, would have safeguarded her democracy against Right Wing financial pressure in the form of export of capital. In any case, the fact that Portugal, in spite of being a Corporate State, has removed its exchange restrictions, while Denmark, an essentially democratic country, has had to maintain them for years, shows that the adoption of exchange restrictions is not in any way identical with the adoption of Fascism. It is deplorable that as a result of dogmatism in official quarters in London and Washington, France was prevented from working out her own salvation.

(5) CALLING IN FOREIGN ASSETS

One thing is certain. The moment war breaks out, France will have to impose stringent exchange restrictions, even if she does not impose them before. In the case of France the dilemma of whether or not to apply exchange restrictions to foreign funds would not arise, since there are hardly any foreign funds in Paris. Undoubtedly a large number of Frenchmen would in any case refrain from sending their capital abroad in time of national emergency, and would even go so far as to repatriate voluntarily their foreign balances. Nevertheless, there would inevitably be others less public-spirited, and the Government would have to reckon with their attitude.

The question of French foreign assets available in the event of war was dealt with at some length in Chapter VIII. In spite of the unfavourable developments of recent years, France will possess a substantial gold reserve and a by no means inconsiderable secondary reserve in the form of privately owned foreign assets. Thus even if no improvement takes place between now and the outbreak of the war, the foreign exchange position of France will be strong during the war, provided that the drain is stopped by the timely imposition of exchange restrictions and by their efficient enforcement.

(6) BUDGETARY PROBLEMS

The outlook is somewhat less reassuring as far as the state of French public finances is concerned. France would be at a considerable disadvantage if she were to enter a war without bringing about a

drastic improvement in her budgetary position. In itself the existence of a perennial deficit due to rearmament would not place her at a disadvantage. After all, all European budgets are suffering from the same disease. On the other hand, it is absolutely essential that, given the inevitability of huge armament expenditure, France should cut down her expenditure in other directions.

At the time of writing, M. Paul Reynaud has just submitted proposals aiming at the balancing of the ordinary budget through additional taxation and cuts in expenditure. Even though it is open to argument whether such deflationary measures were advisable before reflation had brought about a trade recovery, from a narrow budgetary point of view they constituted a praiseworthy attempt which, if successful, will enable France to enter the war with a considerably improved financial position.

(7) FRENCH AND GERMAN ECONOMIC POSITIONS COMPARED

If France had to fight Germany single-handed, or at any rate without British support, she would be in many ways at a disadvantage from an economic point of view. Even then she would have the advantage of her superior gold and foreign exchange resources, which would enable her to import food and war material in spite of the inevitable decrease of her exports. On the other hand, in the absence of a naval blockade, Germany would be able to continue to export on a fairly substantial scale, and, with the aid of the proceeds of exports, she would be able to maintain a fair volume of imports. From the point

of view of the internal financing of war expenditure, France, left to her own resources, would be gravely handicapped compared with Germany, unless before the outbreak of war she set her house in order. Owing to the difficulty of raising loans, she might have to inflate on an even more rapid scale than Germany. Nevertheless, since the German public is more inflation-conscious than the French, a small degree of inflation might produce a much more pronounced effect in Germany than a larger degree would in France. It is to be hoped that, thanks to M. Reynaud's drastic measures, the French financial situation will improve before the outbreak of war from both a technical and a psychological point of view.

(8) BRITISH FINANCIAL SUPPORT FOR FRANCE

It serves little practical purpose, however, to dwell upon the possibility of France's having to defend herself without British assistance. There can be no doubt that if France were involved in war Great Britain would unhesitatingly go to her assistance. From a financial point of view, British assistance would go a long way towards enabling France to carry on during a long war. This does not mean, of course, that France could afford to rely on British assistance as the mainstay of her war financing. Unless she made a real effort to help herself, the extent to which she could be helped from abroad would be very limited.

British assistance could assume the form of war loans, even though the necessity for supporting France with the aid of external credits is not likely to arise until later stages of the war. Thanks to her

large gold stock and the foreign assets which she could collect from private holders, France would be able to finance her external requirements without assistance for years, assuming, of course, that she succeeded in establishing a reasonably strict system of exchange restrictions. The chances are that Great Britain would still possess substantial amounts of foreign exchange resources long after the resources of France came to an end. Once that stage was reached, it would be essential for Great Britain to give France the benefit of her stronger exchange resources.

There is one way in which Great Britain would be in a position to help France effectively in solving the problem of internal financing. Even assuming that the French Government will succeed in restoring her credit before the outbreak of the war, it might be difficult to raise sufficiently large loans to cover an adequate proportion of the cost of national defence. To overcome this difficulty it might be advisable for the British Government to lend its guarantee to internal French loans. The risk involved in such guarantees is negligible. The French Government will always be in a position to meet the service of the internal debt, if not otherwise then through inflationary means. If conditions in France deteriorated to such an extent as to force the Government to default, the chances are that the franc would by that time have depreciated to such an extent that the sterling equivalent of the guaranteed French loan, which the British Treasury would have to find, would not be unduly heavy. There can be no doubt that the British Government's guarantee would provide a sufficient attraction to induce a large

number of French investors, who would otherwise have kept aloof, to subscribe to the war loan.

(9) ADVANTAGES OF CONTROL OF THE SEAS

The control of the seas would ensure for France the same economic advantages which it would ensure for Great Britain. France would be able to import from her colonies, and for these imports exchange difficulties would not arise. She would be able to export, within the limit of her capacity, to overseas countries, and the proceeds of her exports would enable her to husband her gold and foreign exchange resources. If we remember that France is much more self-sufficient, from the point of view of food production, than either Great Britain or Germany, we may safely conclude that her economic resisting capacity, as distinct from her financial situation, is very strong indeed. If only her industrial workmen would submit to discipline in the interests of increased production, and if her capitalists would submit to exchange restrictions in the interests of safeguarding the currency and increasing the exchange resources, France would be in quite as strong a position as Great Britain to face the economic problems of a prolonged war.

CHAPTER XI

ITALY'S ECONOMIC PROBLEMS

(1) WILL ITALY JOIN GERMANY IN A EUROPEAN WAR ?

ALL friends of Italy in Great Britain hope that there will never be an occasion for the two countries to fight against each other. Nevertheless, the existence of the Berlin-Rome axis cannot be ignored, and it is conceivable that on the "He who is not for us is against us" principle Germany may drag Italy into the war on her side. On the other hand, it is just possible that Signor Mussolini will realise at the eleventh hour that a German victory would endanger Italy's northern provinces and also her position on the Mediterranean. It is also possible that Great Britain and France will secure Italy's support, or at least her neutrality in the coming war, by allocating to her some of the former German colonies or other overseas territories. Moreover, German penetration into South-Eastern Europe may put an unbearable strain on the Berlin-Rome axis, and may drive Italy into the Anglo-French camp. It is therefore necessary to examine Italy's economic position in the next war, both on the assumption that she will join forces with Germany and on the assumption that she will join forces with Great Britain and France.

(2) ITALY'S ECONOMIC STRUCTURE

The economic structure of Italy and the economic system which she has adopted bear much similarity to those of Germany. Italy too is far from self-sufficient in food and raw materials. In fact, from this point of view her position appears to be even weaker than that of Germany. On the other hand, Italy too has the advantage of a disciplinarian economic system, even though the Italian character does not lend itself so well to that system as does the German character. Italy, like Germany, will have the initial advantage of a planned economy, even though, as we saw in Chapter III, that advantage will be offset in the course of time by the adoption of planning and discipline in the economic systems of the democratic countries under the pressure of war requirements.

The Italian industrial organisation is second only to that of Germany regarding the degree of its adjustment to war production. Since in Italy unemployment has not yet been completely absorbed, there is a margin for an increase in the volume of industrial output. This margin may, however, be wiped out as a result of the mobilisation of millions of hands.

(3) LACK OF RAW MATERIALS

A much more difficult problem than that of human labour is, however, that of raw material supplies. In this respect Italy would be at a considerable disadvantage if she decided to join Germany. Her lack of foreign exchange resources and the British-French naval blockade would cut her off from her raw

material resources. Lack of raw material would soon become a grave handicap in the conduct of warfare. This is the reason why Italian politicians and publicists never fail to emphasise that Italy will aim at a swift campaign. Signor Mussolini declared in the Senate in March 1938 that the aim was to prepare men and material for a war of short duration. His mouth-piece, Signor Gayda, writing in the *Giornale d'Italia*, remarked that this conception corresponded to the conditions of Italy, "a country richer in men, intelligence, and bearing than in iron, coal, and petrol". Whether the war is short or long does not altogether depend on Italy, however, and it is safe to take it for granted that there is not the slightest chance that a joint German-Italian onslaught could secure a victory against Britain and France in the course of a few months, or even a few years.

If Italy joins the camp of Great Britain's opponents, she will have to reckon with an acute shortage of raw materials after the exhaustion of her reserve supplies. What I said about Germany in Chapter IX regarding the difficulty of importing food and raw material holds good also for Italy. Her foreign exchange resources are as weak as those of Germany, and for this reason, apart altogether from blockade and encirclement, she would find it difficult to pay for her imports for any length of time.

(4) NO ECONOMIC ASSISTANCE FROM GERMANY

The fact that Italy survived the sanctions during the brief Abyssinian campaign should not mislead Italian opinion in this respect. There is a great difference between sanctions enforced half-heartedly

by a number of countries, and a naval blockade plus shortage of exchange. Even in countries which could not be cut off from Italy by naval blockade, British gold would secure the supplies of commodities, if only to destroy them in order not to allow them to serve the requirements of the enemy.

While France could rely on effective British assistance in the economic sphere, Italy could expect little or nothing from Germany, since the latter herself, although the stronger partner in the Axis, would come under the pressure of growing economic and financial hardship as the war proceeded. Thus in a prolonged war in which Italy fought on the side of Germany, her doom would be inevitable owing to the inadequacy of her economic defences.

(5) INTERNAL FINANCIAL DIFFICULTIES

Nor would Italy's internal defences stand the strain. In this respect, too, Italy is in some ways in an even weaker position than Germany. In fact she combines the weaknesses of France with those of Germany. Her public debt, though not so large as that of France, is large enough for a financially poor country such as Italy. Most investors are saturated with Government loans, and the Government's credit stands low. In Italy, too, the public is inflation-conscious—though not nearly to the same extent as in Germany—and the outbreak of the war would lead to the withdrawal of bank deposits. The vicious circle through which it has been possible to finance rearmament in Italy as in Germany would then break, and it would be necessary at the very outset to fall back on the printing press. In face of a non-stop

inflation, any effort to counteract the rising trend of prices would be bound to break down, all the more so since in Italy the disciplinarian system is only skin-deep. Before very long both Italy and Germany would experience all the adverse effects of advanced inflation.

(6) WHAT ITALY STANDS TO LOSE BY JOINING
GERMANY

It is difficult to imagine that so shrewd a statesman as Signor Mussolini could fail to realise the glaring economic disadvantages of a prolonged war fought on Germany's side. Even more than Germany, Italy would stake everything on the non-existent prospects of being able to enforce a quick decision. Does he really imagine that a few air-raids, however destructive, could intimidate the British nation into surrender? After his experience in Spain he should know better, and it is probable that he does know better. By joining forces with Germany he would expose his country to all the consequences of growing economic pressure. A modern war could not be pursued indefinitely without oil and other materials, and once the attempt to force a quick decision had failed, Italy would have to envisage a gradual decline of her fighting power until her defeat or surrender brought the war to an end. This would be a blessing in disguise for Italy, since a victory over Great Britain and France would establish incontestable German superiority on the continent and around the Mediterranean. Signor Mussolini should know Germany and Hitler too well to imagine that, when it came to the division of the spoils, Italy could rely upon the generosity of

the German nation. Indeed, as a result of the incontestable German hegemony, it would not be long before Italy would be forced to relinquish the Southern Tyrol and Trieste, while Germany would entrench herself in the Danube basin and the Balkans. The dream of Italian world power would vanish, and Italy would become reduced to the position of a secondary vassal state of Germany. If, on the other hand, Italy and Germany were defeated, the victorious powers would not be likely to interfere with Italian territorial integrity or independence.

An Italy victorious on the side of Germany would fare little better in the long run than an Italy defeated on the side of the Western European powers. Her absorption by the German World Reich would be only a question of time in either case. What is more, the chances are overwhelmingly in favour of a victory of the Western European powers, with or without the assistance of Italy. By joining the winning side in return for the concession of some of the former German colonies and other overseas possessions, Italy would expand and consolidate her position as a colonial empire, and she would secure for ever her northern frontier against enemy aggression. Indeed, if it were possible to restore the Stresa front a European war might be averted altogether, since Germany would hardly be likely to risk war against such a formidable alliance.

(7) ADVANTAGES OF NEUTRALITY

Signor Mussolini has a reputation for being a realist. While ideological considerations may draw him towards fighting on the side of Germany, Italy's

economic weakness should deter him from such a suicidal course. If he is not prepared to fight against Germany, the next best course, from the point of view of Italy's fundamental interests, would be for her to remain neutral. As Italy must have learnt in 1914-1915, before she entered the war on the side of the Allies, neutrality is very profitable from an economic point of view. A prolonged war would enable Italy to accumulate a large gold stock and to replenish her capital resources while building up her armed forces and industrial organisations. An Italy thus strengthened could not be regarded as a *quantité négligeable* by the two opposing sides, and she would be able to make herself felt at the peace conference.

CHAPTER XII

WAR ECONOMY OF THE SOVIET UNION

(1) SELF-SUFFICIENCY OF SOVIET RUSSIA

IT is hardly conceivable that Soviet Russia would remain neutral in a European war for any length of time. What remains to be seen is the extent of her intervention, which will depend largely upon the attitude of Poland and Roumania, especially the former. For geographical reasons, Soviet Russia would be debarred from entering a war with all her immense, might and power unless she succeeded in securing a thoroughfare for her armies through Poland, or at least through Roumania. Similarly, Germany, unless she secured the alliance of Poland, would not be likely to embark upon a war of aggression against Russia. If war between Russia and Germany consisted of reciprocal air-raids, it would engage only a small fraction of Soviet Russia's economic resources and no unusual war problems would arise. For the sake of argument we shall assume in this chapter that Russia will be involved in a gigantic struggle with Germany, and will play her full part in the European war.

How would the economic system of the Soviet Union stand the strain of a long major war? In many ways Soviet Russia would be in a much more favourable position than any other European belligerent country. For her, the maintenance of food

and raw material supplies would be entirely a matter of internal organisation. Apart from the United States she is probably the most self-contained industrialised country in the world in this respect. She could not be starved into surrender by prolonged warfare, nor could she be defeated as a result of a deficiency in her raw material resources ; that is, unless the organisation of internal production, transport and distribution broke down so completely as to lead to economic chaos and collapse.

(2) IMPROVED FACILITIES FOR TRANSPORT OF WAR MATERIAL

During the last war, the weak spot in the Russian Empire was her inadequate industrial capacity. It was impossible to make use of more than a fraction of the immense Russian man-power owing to lack of arms and ammunition. In addition to the deficiency of Russian arms industries there were also difficulties in the way of importing materials and equipment which were urgently needed. These deficiencies have now to a large extent been overcome. Since the war the Murmansk railway has been completed and the Siberian railway has now a double track. Assuming that the control of the seas could be maintained in the Far East, it would now be much easier for Russia to obtain essential supplies abroad than it was during the last war. Moreover, owing to the friendly relations between the Soviet Union and the Turkish Republic, there would be no difficulty this time about Russian imports coming through the Black Sea.

Nor would there be any difficulty in the way of paying for the goods required. During the last few

years Soviet Russia has developed her gold production to a spectacular extent. Even though no reliable figures are available, it is reasonable to assume that only part of the increased output has been exported, and that a considerable gold reserve is being accumulated, in addition to the substantial foreign exchange reserves kept in London and New York. If in addition Soviet Russia could export freely through her Black Sea ports, she would find no difficulty in raising the foreign exchange required for essential imports.

(3) INCREASE OF WAR MATERIAL PRODUCTION

What is much more important, Russia's requirements of war imports would be a mere fraction of what they were during the last war. In the meantime she has become industrialised to an amazing degree, and her output of war material is now a multiple of what it was before and during the last war. Indeed, it seems probable that even in that respect Soviet Russia has become more or less self-sufficient. She has equipped the Red Army entirely through the efforts of her own industries, and her only problem is to increase the output of these industries to cover war requirements.

The solution of this problem, and that of the continuity of food and raw material supplies, depends upon the maintenance of a reasonably efficient organisation. The enemies of the Soviet Union build their hopes on the assumption that Russian inefficiency, combined with Communist inefficiency, and internal dissension, will lead to a breakdown of organisation and discipline at the early stages of the war. Germany is well aware of the high degree

of efficiency and fighting power of the Red Army, and the Soviet air force constitutes a nightmare to the population of the German cities. This is the truth, in spite of the fairy-tales recently brought back from Russia by stunt fliers and others. It is hoped, however, in Germany that after the first onslaught the striking power of the Soviet forces would decline materially. The assumption is that they would be formidable while they could use the equipment they possess, but when it came to replacing the munitions used and the arms destroyed, then the inefficiency of production, transport, and general organisation in war time would soon produce its effect.

(4) WILL RED ARMY'S SUPPLIES BREAK DOWN ?

The German assumption, although grossly exaggerated, is undoubtedly correct to some extent. There is no reason to suppose that the maintenance of the supplies of the Russian army would be handled any more efficiently than it was under the Czarist régime. Indeed, the chances are that the organisation behind the front will be, if anything, less efficient. There will be less corruption but much more deliberate sabotage by the enemies of the régime. On the other hand the economic structure of Russia is today much more favourable for the requirements of war economy than it was during the last war. Apart from the increase of industrial production, the exploitation of additional raw material resources and increased import facilities, transport facilities have also improved materially compared with the Czarist days. Nevertheless, it must be admitted that after the first onslaught the Red Army will undoubtedly be gravely

handicapped by the inefficient organisation of its supplies.

Even so, the Soviet Union will be a formidable opponent. Its overwhelming strength during the early months of the war will be of particular importance, since it will tie down a large part of Germany's fighting power and will prevent the latter from dealing a swift blow and achieving a quick victory against the western democratic powers.

(5) HISTORY MAY REPEAT ITSELF

In a way history may repeat itself. In 1914 it was the menacing advance of the Russian steam-roller that induced the German Army High Command to divert some divisions of Kluck's army to the Eastern Front instead of using them to win a decisive victory at the Marne. Whatever may happen during the later stages of the war, the first onslaught of the Red Army would be sufficient to reduce the driving force of the German army towards the west during the most critical phase of the war. Once the first sweeping attack has been repulsed, the belligerent countries will have to settle down to prolonged warfare on the pattern of 1914-18. It will thus be largely thanks to Soviet Russia's initial intervention in the European war that the inexorable pressure of economic difficulties will in the long run defeat Germany as it defeated her in 1918.

Although the efficiency of the Red Army may suffer after the first few months owing to the inadequate organisation of supplies, Soviet Russia is likely to remain a factor of primary importance in the military situation. Nor is discontent with the

existing régime likely to lead to civil war, which besides paralysing the fighting forces would completely disorganise the economic system of the country. In face of the danger of enemy invasion, internal political differences will fade into the background, for a time at any rate. Whether or not history will repeat itself as far as Russia is concerned, in that a Russian collapse will come before a German collapse, remains to be seen. Even so, the repetition of history may even be carried further, in that Russia will probably hold out long enough for the United States to decide to enter the war.

From an economic point of view, the participation of Soviet Russia in the world war on the side of the democratic countries would be of considerable significance, since she is virtually the only European power who would be in a position to supply her allies with raw materials on a large scale. The chances are that she would not even require financial support, owing to the high degree of her self-sufficiency and the possession of gold and exportable raw material resources. Nor would she be a liability from the point of view of her arms and ammunition requirements, at any rate not to such an extent as she was during the last war.

(6) DANGERS OF RUSSO-GERMAN ALLIANCE

Let us for a moment consider the possibility of Soviet Russia's joining forces with Germany instead of with the democratic countries. The suggestion may sound absurd, but taking a long view it cannot be ruled out altogether from the realm of practical politics. If Soviet Russia should enter the war as

the ally of Germany, she would certainly be able to strengthen Germany's economic position to a very considerable extent. Indeed, many of the most difficult problems of German war economy would find their solution as the result of the possibility of obtaining almost unlimited supplies of food and raw materials from Soviet Russia. In that case the chances of Germany's becoming economically exhausted in a long war would be considerably reduced. This, in addition to the military value of Soviet Russia as an ally, would materially reduce the prospects of a victory of the democratic countries.

Fortunately the odds are heavily against an alliance between Nazi Germany and Soviet Russia. Nothing but utterly short-sighted statesmanship on the part of Great Britain and France could possibly bring about such a result. If Mr. Chamberlain should definitely adopt the policy of the Four-Power Pact, of which the world had a foretaste at Munich, and if he should succeed in persuading France to adopt a similar policy, then the way for an alliance between Moscow and Berlin would be well prepared. Finding himself isolated, Stalin would sooner or later yield to the temptation of throwing in his lot with Hitler. It is to be hoped, therefore, that before Mr. Chamberlain decides to adopt the fateful course which would lead to the alliance of Soviet Russia with Germany, he will give due consideration to the importance of that country as a potential ally and as a potential enemy from an economic as well as a military point of view.

CHAPTER XIII

WAR ECONOMY OF THE UNITED STATES

(1) HOW THE UNITED STATES COULD SAVE PEACE

THERE are only two countries which would be in a position to prevent another world war: Germany and the United States. Germany could prevent war simply by abstaining from attacking any other country. There is no other country which could possibly plunge the world into war. Italy, after her quick success in Abyssinia, might have done so, but the Spanish experience has taught her a lesson. Germany alone, under her present régime, is capable of repeating 1914. By deciding to live in peace she could safeguard world peace. The United States, on the other hand, could achieve the same end by totally different means. She could prevent war by declaring herself ready to make war against aggressor States. If the United States were prepared to undertake a definite commitment to support victims of aggression with all her might and power, no country would dare to break the peace. Such is the strength of the United States in man-power and economic resources that no country would risk becoming her adversary.

There can be no doubt that the Washington Administration could bring to an end the series of war scares which at present paralyse trade in most parts of the world, merely by declaring itself prepared

to intervene against the aggressor. Confidence would return and trade would revive.

(2) DECISIVE RÔLE OF UNITED STATES IN NEXT WAR

Unfortunately, there appears to be no hope whatever that the United States Government will commit itself in advance to intervention in a European war. This does not, however, mean that she will be able to keep out of it. Indeed, it is likely that sooner or later she will join the camp of the democratic countries, as she did in 1917.

The moment the United States enters the war the balance of power will turn incontestably in favour of the democratic countries. She will play the same decisive rôle which she played in 1918. It would be some time, however, before the United States could train, equip, and trans-ship to Europe a sufficiently large army to enforce a decision, and thus to bring the war to an end. Meanwhile the economic system of the United States will have to adjust itself to the requirements of war economy.

(3) IMMENSE ECONOMIC RESOURCES

No country would be in such a favourable position as the United States to stand the economic strain of war. She possesses immense resources of food and raw materials, more than sufficient to meet even her own increased war requirements. The potential capacity of her war industries is by far the largest in the world, and they could be most easily expanded at short notice. Her capacity for financing war is immense, and, possessing as she does vast gold

resources, she could easily secure all the raw materials in which she is deficient. Owing to the distance that separates her from her potential opponents there is no danger that her economic organisation will be unsettled by air raids. Except for Soviet Russia, the United States is virtually the only country which could develop her production of war and other essential materials at a safe distance from the air-bases of the enemy. In this latter respect, however, it must be remembered that the advantage enjoyed by the United States is likely to disappear in the course of the next few years. Before very long New York, and even the States of the Middle West, will be within striking distance from Germany's air-bases. Within ten years it will be as easy for bombing squadrons to cross the Atlantic and recross it after discharging their loads as it is now to cross and recross the Channel or the North Sea. This consideration should be borne in mind by American isolationists, who think they could afford to regard with equanimity the destruction of Great Britain owing to the safe distance that separates the United States from Germany. Before many years that distance will cease to be safe.

(4) CAPACITY FOR PRODUCING WAR MATERIAL

Considering that at the time of writing the American steel industry is working to only 60 per cent of its capacity, it is easy to imagine the extent to which the production of war material could be increased at short notice. Moreover, Americans are capable of putting up new plant and transforming existing plant in record time. In possession of an unemployment reserve of more than 10 million souls,

the United States has no problem of labour shortage, nor would she have to put up with any irksome economy in raw material, even though the rationing of supplies and the planning of production in general would be by no means superfluous. Agricultural production could also be considerably expanded once the increase of acreage had come to be regarded as a civic virtue instead of an act unfriendly to the community, as it has been in recent years.

(5) FINANCIAL RESOURCES INEXHAUSTIBLE

The financing of war expenditure by means of internal loans would be an easy matter for the United States Government, in spite of the spectacular increase of the American public debt during recent years. The American public is not at all inflation-conscious. This was amply proved by the experience of President Roosevelt's reflationary efforts, which produced a negligible effect on prices, notwithstanding the considerable extent of the deliberate expansion of the credit structure.

It is in regard to gold resources that the position of the United States is absolutely impregnable. Admittedly, at present a very large part of the American gold stock serves as a counterpart for foreign "hot money" in the United States. Much of that "hot money" would, however, be surrendered to the belligerent Governments, and the latter would spend a very large proportion of it in the United States. Thus as a result of the war the uncomfortably large volume of "hot money" would become materially reduced, and the net amount of the American gold reserve would thus increase, in addi-

tion to its direct increase through shipments by the belligerent Governments in payment for purchases of American goods.

(6) WAR ECONOMY DURING NEUTRALITY

Even if the United States remained neutral during the first part of the war, she would have to convert her economy to a war footing. It is safe to assume that from the very first day of the war the Washington Administration would aim at a rapid increase of the fighting power of the United States. Whether or not the United States enters the war eventually, she will want to be prepared to defend herself if necessary, or to be in a position to enforce the Monroe Doctrine. While during the last war it was not until the United States actually declared war on Germany that she began to make military preparations, at present the United States is already arming fast, and the pace of her rearmament would become accelerated considerably if war broke out. Thus while supplying the belligerent countries which could pay cash, the American industries would be engaged in the task of equipping an American fighting force of a size proportionate to the power and resources of the country.

(7) NEED FOR WAR DEBT SETTLEMENT

The United States during the next war will be in an even better position than she was in the last war to assist economically the countries with which her political sympathies lie. It is to be hoped that legislation such as the Johnson Act and the Neutrality Act will have been repealed by the time the next war

breaks out. As far as the Johnson Act is concerned, it is to the interest of Great Britain and France to see to it that, even if the Act still exists, it is no longer operative as far as they are concerned. To that end the British and French Governments will have to come to an agreement with the United States Government regarding the settlement of war debts. To deal with this problem according to its merits would be outside the scope of this book. Nevertheless it is necessary to lay stress on the urgency of coming to a settlement acceptable to both parties.

Such a settlement might be arrived at on the basis of the repayment of the capital amount, less the annuities paid up to now, without paying any interest. The present actuarial value of the war debt, the repayment of which would be spread over, say, forty years, and which would carry in the meantime no interest, might be low enough to enable both British and French Governments to raise the amount in the form of a loan in New York. The Washington Treasury would thus receive a considerable lump sum, and the whole irksome war debt controversy which for two decades has empoisoned the relations between the two Anglo-Saxon nations would be out of the way.

It is essential that the liquidation of the war debts should take place as soon as possible and not at the eleventh hour when Great Britain might be suspected of settling the old debt merely in order to be able to borrow afresh. Indeed, the necessity for Great Britain to ask for financial assistance from the United States might not arise during the next war. It is possible that Great Britain might be able to borrow all she needed in the United States on a strictly commercial basis, on the security of her

overseas assets. The settlement of the war debt would be very valuable, not as a means of enabling Great Britain to borrow again from the United States Government but as a means of establishing close and cordial relations with the United States. The elimination of the main cause of irritation between the two nations would have considerable political significance, since it would make Germany realise that there was, to say the least, a strong possibility that the United States would enter the war on the side of Great Britain. Thus the settlement of the war debt would go some way towards reducing the chance of another war.

(8) NEUTRALITY ACT LIKELY TO BE REPEALED

While there was some justification for passing the Johnson Act, the Neutrality Act was, to be frank, a reprehensible piece of legislation. The number of Americans who are ashamed of themselves for having passed this Act, which declares neutrality between right and wrong, between the aggressor and his victim, is increasing daily. In fact, the author of the Act himself, Senator Nye, made an attempt to obtain the suspension of the act in the case of Spain. Considering the evidence of strong feeling in the United States against dictators and aggressors, it is difficult to understand how such a piece of legislation, which obviously serves the interests of dictators, and which provides the maximum of encouragement to aggression, has been tolerated for such a length of time. There can be no doubt that before long the Neutrality Act will be scrapped, if only to demonstrate the willingness of the United States to assist the victims

of aggression, and thereby to discourage aggression. It is safe to take it for granted that even if the United States remained neutral during the first part of another war, her immense economic resources would be made available to those countries which were fighting for the cause of freedom and democracy.

CHAPTER XIV

JAPANESE WAR ECONOMY

(1) ECONOMIC EFFECTS OF SINO-JAPANESE WAR

As a result of the Sino-Japanese war, Japan's economic system has gradually been placed on a war footing during 1937 and 1938. A series of measures has been adopted for the strict control of production, consumption, foreign trade, and the foreign exchange market. Japan has one great advantage over Germany, Italy, and Great Britain, in that she is more or less self-sufficient in regard to food, as long as she retains the control of the sea between the Motherland and possessions such as Taiwan, Chosen, and Manchukuo. On the other hand, her deficiency in raw materials is second only to that of Italy. This was the main reason which necessitated the adoption of a large number of measures leading to the regimentation of Japan's economic system in a way which is not dissimilar to the system existing in the totalitarian States.

Unquestionably, Japan has set an example of the restriction of luxury production and consumption in time of war. Her civilian population has to do without a number of articles which, while not luxuries, are not indispensable necessities. Whatever raw material can be imported has to be used for the requirements of national defence, for the indispensable requirements of the civilian population, and, last but

by no means least, for the requirements of Japan's export trade. No effort is spared to keep up exports in order to have sufficient foreign exchange for the purchase of raw materials abroad.

(2) HOW THE WAR IS FINANCED

Even before the outbreak of the Sino-Japanese war, Japan imposed stringent restrictions which were further reinforced as the war became prolonged. At the same time the Japanese authorities maintained the yen at 1s. 2d. They did not hesitate to draw upon their gold reserve for the purpose of supporting the yen, and its maintenance at its present level is now considered a matter of prestige. The internal financing of the war caused no difficulty, since owing to the expansion of financial resources through war expenditure the Government has so far been in a position to reborrow the amount spent, largely through the intermediary of the banks. The extent to which it has had to resort to currency inflation is comparatively small. A large part of the increase of the note issue was due to the use of Japanese banknotes to serve as security for the issue of local currencies in the conquered territory of North China.

In forming a judgment about the effect of the Chinese war upon the Japanese economic system, it should be remembered that the war is far from engaging the full resources of Japan. Although the size of the army that is operating in China is considerable, it does not necessitate anything like general mobilisation. Indeed, the younger classes have been retained in order that they shall be in readiness in the event of war with Soviet Russia. Thus the economic

requirements of the Chinese war, though materially larger than those of the Abyssinian war, are by no means as heavy as would be those of a war with first-class powers.

(3) ADVANTAGES OF NEUTRALITY IN A EUROPEAN WAR

It is to be hoped that Japan will succeed in keeping aloof from a European war. This would obviously be to her interests from both a political and an economic point of view. Politically a European war would enable her to consolidate her gains in China without fear of any intervention on the part of other powers. Economically, neutrality would be highly profitable for her, especially if she succeeded in bringing the Chinese war to an end. In that case she would be in a position to supply the belligerent countries with munitions. At the same time, since the industries of the belligerent countries would be handicapped by war conditions, Japanese exporters would have the chance of a lifetime to create new markets. The country would experience a high degree of prosperity and the wounds caused by the Chinese war would soon be healed. The gold reserve of the Bank of Japan would be replenished and the Government would be able to repay much of its external debt, the elimination of which would considerably increase Japan's prestige as a first-class power.

(4) DISADVANTAGES OF JOINING GERMANY

If, on the other hand, Japan should be ill-advised enough to enter the war on the side of Germany, it is

inevitable that her economic system should undergo a strain compared with which the strain caused by the Chinese war would appear insignificant. Even if Japan could not be subjected to naval blockade, many of her most valuable foreign markets would be closed to her exports, and with her depleted gold reserve she would find it increasingly difficult to purchase the raw material required for the pursuit of the war. All the more so since her military and naval requirements of war material and fuel would rise to a multiple of what they are at present. Her gold stock would soon dwindle to a negligible figure, and after that the efficiency of her fighting forces would be gravely handicapped by raw material shortage. Nor would internal financing proceed smoothly. It would be impossible to maintain the yen at its present level, and its external depreciation would be accompanied by an internal rise in prices. Before very long Japan would be in the throes of non-stop inflation.

There is reason to hope that the Japanese statesmen will bear the above considerations in mind. They will realise that in the economic sphere Japan would have practically nothing to gain and everything to lose if she allies herself to Germany, and that on the other hand if she remained neutral she would have a unique chance to lay the economic foundations of the Japanese Empire while consolidating its political foundations. Bearing this in mind, it is difficult to believe that Japan would decide to throw in her lot with Germany.

CHAPTER XV

CONCLUSION : WHY BRITAIN WILL WIN

THE late Turkish Foreign Minister, Dr. Aras, declared recently that Great Britain might lose battles but she was bound to win a war. This view is held very widely all over the world, not least in Germany. It would require a great knowledge of strategy to explain the reasons why a coalition of democratic countries is bound eventually to overcome the formidable strength of Nazi Germany, even if she is supported by Fascist Italy. On the other hand, as I have tried to make plain in the foregoing chapters, in so far as the outcome of the war is likely to be determined by economic factors, there cannot be the least doubt that Great Britain and her allies will emerge victorious.

I am convinced that if Germany should embark upon a world war the result would be the same as it was in 1918—a complete defeat of Germany and her allies :

1. Because the next war is also bound to be a prolonged struggle.

2. Because in a prolonged struggle the economic factor assumes a growing importance.

3. Because from an economic point of view Great Britain and her allies would be in a better position than Germany and her allies to stand the strain of a long war.

4. Because in a prolonged war the initial advantage possessed by a totalitarian State in the form of a disciplinarian economic system would be bound to disappear after a while through the application of economic discipline and organisation in the democratic countries.

5. Because conditions of production under economic autarchy in Germany would lead to an acute labour shortage and inadequate output in war time.

6. Because Great Britain and her allies would be in a position to draw upon the productive capacity of the whole world outside Germany to cover their war requirements.

7. Because the control of the seas by the British navy would prevent Germany from importing the necessary food and raw materials.

8. Because that control of the seas would prevent Germany from replenishing and maintaining her gold and foreign exchange resources through exports overseas.

9. Because owing to the inferiority of Germany's gold resources she would not be in a position to make large purchases abroad apart altogether from the interference of blockade with her imports.

10. Because shortage of labour and raw materials would handicap Germany's sales overseas, apart altogether from the interference of blockade with her exports.

11. Because the attitude of most neutral countries in the matter of trading with Germany would be much less favourable to her on the next occasion than it was during the last war.

12. Because Great Britain, owing to the superiority

of her gold resources, would be in a position to outbid Germany for the purchase of food and raw materials in the neutral countries of South-Eastern Europe.

13. Because Germany is not likely to be able to build up an adequate food and raw material reserve to face a long war.

14. Because the prolonged period of privation and food shortage which precedes the next war will reduce the physical and moral resistance of the German population when faced with the acute food shortage caused by the war.

15. Because on the other hand Great Britain has vast gold and foreign exchange resources by means of which she could secure the continuity of food and raw material supplies.

16. Because France too, in spite of her financial difficulties, has the advantage of a large gold reserve and foreign assets.

17. Because Great Britain would be in a position to raise credits abroad in addition to her immense cash resources, while Germany would have to pay cash for everything imported.

18. Because in the event of Italy joining Germany, from an economic point of view she would be a liability rather than an asset.

19. Because among the potential allies of Great Britain, Soviet Russia possesses immense economic resources and is more than self-sufficient.

20. Because, even if the United States remained neutral, the democratic countries could safely rely upon a high degree of economic support from her.

21. Because there is a strong chance that sooner or later the United States would enter the war on the side of the other democratic countries, in which

case their economic superiority would become overwhelming.

22. Because lack of confidence would gravely handicap the German Government in its efforts to finance the war without having to resort to non-stop currency inflation.

23. Because the German public is much more inflation-conscious than the British public, and the evidence of crude currency inflation would lead to a wave of distrust in Germany.

24. Because the absence of a gold backing would help to undermine the confidence of the German public in the stability of the currency.

25. Because the chances are that Japan will remain neutral in the next war and, even if she should join Germany, she could contribute no economic assistance.

26. Because, even if Germany succeeded in securing complete political control over the Danube basin and the Balkans, their total economic resources would not be sufficient to make up for the deficiency of her supplies.

27. Because sooner or later the shortage of raw material would reduce the efficiency of the German fighting forces.

28. Because sooner or later a shortage of food would demoralise the German population and the army, as it did in 1918.

29. And because the economic superiority of Great Britain and her allies will enable their armed forces to hold out until the moment arrives to deliver the fatal blow to Germany.

BY PAUL EINZIG

INTERNATIONAL GOLD MOVEMENTS. Second Edition, enlarged. 7s. 6d. net.

“Dr. Einzig combines in a rare degree three separate gifts—he understands the technicalities of what goes on in the City, he can explain it in a language intelligible to the ordinary reader, and he can comment on it in terms which are interesting and enlightening to the academic economist.”—D. H. ROBERTSON in *The Nation*.

THE FIGHT FOR FINANCIAL SUPREMACY. Third Edition. 3s. 6d. net.

“The book can be confidently recommended to all who are anxious to follow the most recent and interesting developments in international financial relations.”—*International Affairs*.

THE WORLD ECONOMIC CRISIS, 1929–1932. Third Edition. 3s. 6d. net.

“The best explanation that has yet been printed of the causes of the existing crisis.”—*The Evening News*.

THE BANK FOR INTERNATIONAL SETTLEMENTS. Third Edition, revised and enlarged. 10s. 6d. net.

“The book makes a double appeal; firstly, as a reasoned analysis and criticism of the international bank scheme, and, secondly, as an extremely useful reference work.”—*The Statist*.

GERMANY'S DEFAULT: The Economics of Hitlerism. 7s. 6d. net.

“The book reveals its author at his best.”—*Bankers' Magazine*.

EXCHANGE CONTROL. 7s. 6d. net.

“This volume . . . may be commended to all who are interested in the subject.”—*The Times Literary Supplement*.

FRANCE'S CRISIS. 7s. 6d. net.

“Dr. Einzig correctly traces the source of France's difficulties to the over-valuation of the franc and to the defensive policies adopted by successive French Governments.”—*The Economist*.

BEHIND THE SCENES OF INTERNATIONAL FINANCE. Third Impression. 7s. 6d. net.

“Dr. Einzig apparently knows most things which went on behind closed doors in Threadneedle Street, in Paris, and in Basle . . . he presents a case which makes a remarkably convincing story.”—*The Morning Post*.

MACMILLAN AND CO. LTD., LONDON

BY PAUL EINZIG

FINANCE AND POLITICS. Being a Sequel to
"Behind the Scenes of International Finance." 7s. 6d. net.

"With his earlier volumes it forms the most balanced, the most accurate, and the most justified by events of all contributions to the literature of the world crisis."—*The Week-End Review*.

THE ECONOMIC FOUNDATIONS OF FASCISM.
Second Edition. 7s. 6d. net.

"It is an interesting thesis put forward with all Dr. Einzig's customary zeal and plausibility . . . it is well worth reading."—*The Oxford Magazine*.

THE FUTURE OF GOLD. 7s. 6d. net.

"It debates a serious question; it has something to say which is worth while; it argues the case clearly and its conclusions provoke discussion. Holders of gold shares should not miss it."—*The New Statesman*.

THE EXCHANGE CLEARING SYSTEM. 8s. 6d. net.

"The description is admirably done. Dr. Einzig has a knack of explaining complicated matters very clearly without appearing to write down to the layman, and anybody who wishes to understand the pathological phenomena of recent currency policy could not be recommended to a more competent guide."—*The Economist*.

BANKERS, STATESMEN AND ECONOMISTS.
8s. 6d. net.

"His style is limpid, his ideas are commonsensical, his conclusions definite and clear."—JOAN ROBINSON in *The Economic Journal*.

THE THEORY OF FORWARD EXCHANGE.
21s. net.

"Dr. Einzig's challenging work will deservedly receive a warm welcome from economic students and business men, who will recognise the book as a very serious contribution to the understanding of a difficult subject. . . . Readers may be assured that they will find the book lucid, stimulating and provocative."—SIR CECIL KISCH in *The Financial News*.

WILL GOLD DEPRECIATE? 7s. 6d. net.

"Should make most interesting and valuable reading for expert and layman alike."—*Financial Times*.

FOREIGN BALANCES. 8s. 6d. net.

"Packed with interesting information on a complicated problem."—*Manchester Guardian Commercial*.

MACMILLAN AND CO. LTD., LONDON

