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THE POST-WAR DEPRESSION
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The Post-War Depression & The Way Out

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K I T A B I S T A N

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PREFACE

Theoretical logic, which seems to be borne out by the experience of the years immediately following the last armistice, would seem to indicate that, failing preventive action on the part of the State, the transition from war to peace would be marked by three distinct phases of change. First we would have the demobilisation crisis- This would be no more than an enlarged edition of the temporary, frictional unemployment which is incidental to the migration of workers as between jobs and trades. The armistice of 1918 released from the services and the munitions industry on the labour market in Great Britain an aggregate of about $4\frac{1}{2}$ million men and women. The very magnitude of the numbers, for whom work had to be found, was bound to produce an unemployment crisis. But the process of re-transfer into civilian occupations very largely solved itself. The numbers who availed of the out-of-work donation provided for them just exceeded the million mark only in two months, March and April

1919. The crisis was mastered before the close of spring. By October the number getting the benefit of the donation had fallen to less than half a million.

Beneath the demobilisation crisis, however, there would be present in the economy a pronounced tendency towards boom conditions. This would seem to explain the automatic resolution of the crisis. The boom, which would follow, would represent the second phase of change. Its impelling force, however, being no more substantial than paper, this phase, though it may be longer than the demobilisation crisis, nevertheless, would be short-lived. In Great Britain it lasted for about a year, from April 1919 to April 1920. As the iboom progresses, the illusion of the war-time paper riches will begin to wear thin and the fact of the physical shortages in the economy would become more and more apparent. The programmes of reconstruction and expansion, embarked upon whilst the spirit of optimism had prevailed, would soon prove to be far too ambitious relatively to the available supplies of the real resources and the boom would be followed by a depression. This would mark the third phase of change. It is only subsequent to the termination of this phase that undisturbed economic progress may be confidently looked forward to.

Some writers in this country would seem to have confused the first phase with the third. The two, however, are distinctly separate phenomena, the boom intervening between them. The first phase is the direct outcome of demobilisation and of the cessation of the governmental demand for war goods. The third would represent the phase of liquidation of the over-development in the capital structure of the economy produced during the boom. It is, therefore, a vastly more painful process. Labour disputes are likely to mark this phase more than the first. It would be the post-war depression proper. How completely these writers have mis-conceived the real character of the armistice- and the post-armistice economics may be seen from the suggestion made by some of them that, as a remedy to the depression, the warring States should continue to maintain for some time after the restoration of peace the fighting services as well as the armament factories in their full strength. If the logic underlying this suggestion were valid, one might as well argue that public good would be served if the war continued for some time longer than it actually may—at least a mock version of it if only to prevent the unemployment which might otherwise emerge!

In Great Britain and other countries, however,

it is generally recognised that the more serious post-war problem would be not one of finding work for the men released from the forces and the munitions industry but one of preventing a mad scramble for goods, rising prices and a false boom. Post-war economic measures are being planned in these countries on the basis of this general assumption, Mr. Herbert Morrison, the Home Secretary, for instance, in a public pronouncement last May set out to show that to attain this end the familiar controls and restraints of war-time will have to be continued for some time after armistice. (See *The Economist*, 15 May 1943, p. 614). The analysis of the following pages would seem to suggest that it is such continuation of the war-time controls, not the deferment of demobilisation, that might produce the desired result.

It would also seem to indicate that the root cause of the post-war economic ills would lie in the orthodox methods of war finance. This would leave behind the fearsome illusion of financial prosperity in the background of a shattered and impoverished economy. It would mislead entrepreneurs into launching over-ambitious schemes of expansion and would thus be responsible for the boom as well as the depression. This discussion has suggested certain preventive measures which

have been briefly examined in the last chapter.

The first two chapters deal with some of the analytical theorems which help to clarify the working of the war and the post-war economics. They do not, however, make any claim to an exhaustive discussion, which, clearly, would require vastly more space.

S. L. D. ARTS COLLEGE

B. R. S.

Ahmedabad, *January* 1944.

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CHAPTER I

WHAT HAPPENS WHEN WE SAVE

Economists before Adam Smith, consistently with their concept of capital, which they regarded as the sum of money invested in a concern¹, would seem to have looked upon the phenomenon of saving more or less on the same lines as, perhaps, the average man has always been doing. They imagined it to consist in an accumulation of money from out of income. When the amount grew into a sufficiently large volume and was, thereupon, exchanged for goods such as boats or nets to be employed in production the savings were said to be "invested."² They did not enquire, any more than the average individual, into the changes which savings produced in the structure of the economy behind the monetary veil. These and the collective or the social aspects of the phenomenon were left severely alone. They were

¹ Edwin Canan, *A Review of Economic Theory*, London, 1929, p. 143;

² *Ibid.*, p. 131.

content with a superficial view of it from an individual angle of vision.

Adam Smith (1723-1790), acutely conscious that money was not the real thing, made a strenuous effort to portray the phenomenon in real terms but without success. The picture he was able to draw was far from the correct one, though it dominated classical economic thought on the subject. He spoke of savings, instead of in terms of money, in terms of consumption goods and tools. Saving was conceived as a process by which these were "saved" from "unproductive" consumption and employment and were diverted into "productive" channels, i.e., employed in maintaining and equipping workers engaged in creating visible and tangible material goods instead of in meeting the immaterial wants of man.

Saving was not believed to involve any reduction in the output of consumption goods. It was thought merely to produce a redistribution of consumption goods, materials and tools from a certain category of consumption trades into instrumental trades in general and such of the consumption trades as produced material goods. We have an example of Adam Smith's view of the saving process when the workers engaged in organising a hunt, which was regarded as an "un-

productive" effort, are drafted on, along with their means of subsistence and the materials and tools they use, into weaving more cloth, digging a canal or making some agricultural implements, all of which were considered to be "productive" efforts. Obsessed with the fatal distinction he drew between "productive" and "unproductive" consumption and effort, he failed to view the phenomenon as simply a case of diverting labour, plant and materials from the consumption into the instrumental trades.

The classicists who came after Adam Smith more or less echoed his views, some with minor alterations or additions. They all moved on the same terrain of thought as he and none of them was able to correct his errors. Even Nassau Senior (1790-1864) and William Stanley Jevons (1835-1882), both of whom defined savings in abstract terms and were otherwise quite acute, failed to grow out of the classical tradition. They were unable to prick the bubble except, perhaps, the latter in his *Fragment* published long after his death.

None of the classical economists, however, imagined savings to be an *accumulation* of consumption goods as some of their modern critics, notably Professors Gustav Cassel and J. B. Clark, would

seem to think they did. So far from this being the case, all of them, Adam Smith not excepted, emphasised that the "saved" consumer's goods were also consumed almost simultaneously with the rest of them which were "unproductively" employed. T. R. Malthus (1766-1834) and Senior doubted the practical possibility of such accumulation, whilst Malthus and John Stuart Mill (1806-1873) would designate such accumulation, even where practicable, not as saving but as hoarding. Also, with the exception of Jevons, none of them spoke of savings exclusively in terms of consumption goods.

Alfred Marshall (1842-1924) does not seem to have paid much thought to the phenomenon of saving. He did no more than substitute the term "waiting" for Senior's term "abstinence" so as to escape the criticism advanced against the latter, especially by the Socialists.

The credit for clearing the classical confusion goes to Leon Walras (1834-1910) of the School of Lausanne. He laid the foundation of the contemporary view of what happens when we save. The Walrasian ideas were further developed, among others, by Eugen von Böhm-Bawerk (1851-1914), Gustav Cassel and Knut Wicksell (1851-1926) on the Continent of Europe, Philip Henry Wick-

steed (1844-1927) in Great Britain and John Bates Clark (1847-1938) in America. Böhm's version of it has been further elaborated by the contemporary Austrian economists notably Professor F. A. von Hayek.

Without entering into the details of the contribution made by the several writers we may briefly review the economic changes which the saving activity may produce.

To begin with we must distinguish between saving from the individual and the collective standpoints. For an individual saving exists when his expenditure during a given period falls short of his disposable income of the period, the magnitude of the difference between the two being the measure of the volume of the savings of that period. Contrariwise when expenditure exceeds disposable income the individual is said to dis-save, the difference being made good by drawing upon past savings or hoards, by borrowing or by liquidating an asset. When, however, expenditure exactly balances disposable income, the individual neither saves nor dis-saves.

When we view the community collectively there may be present in it all the three categories of individuals, the savers, the dis-savers, and those who neither save nor dis-save. The effect

on the economy of the last group of individuals would be neither positive nor negative. It would be neutral. The same would be the case if the aggregate individual savings in the community were to be exactly balanced by the aggregate individual dis-savings. No *net* change of any kind would then be recorded in the structure of the economy. There would take place merely a change in the ownership of assets. The assets put on the market by the dis-savers would be exchanged, directly or indirectly, for the funds made available by the savers. The savings of the latter would, in this manner, get into the possession of the dis-savers and the aggregate expenditure of the community would be equal to its aggregate income. From the collective standpoint there would be neither saving nor dis-saving.

If, however, the volume of the aggregate saving were to exceed the volume of the aggregate dis-saving there would be saving from the collective standpoint, the magnitude of the excess being the measure of it. Here the sum total expenditure on consumption would fall short of the sum total income of all individuals in the economy. In the opposite case of the aggregate savings of the savers falling short of the aggregate dis-savings done by the dis-savers, collective

expenditure would exceed collective income and there would be present dis-savings from the collective standpoint. In an economy where saving existed, on balance, the old assets released on the market by the dis-savers would be insufficient to meet in full the demands of the total body of the savers. For doing this it would be necessary to create *new* assets representing *new* capital goods of the aggregate value of the volume of the collective saving. In the opposite case of social expenditure exceeding social income, i.e., when the economy, on balance, does dis-saving, the demand for assets on the part of the savers would fall short of the supply of the assets released on the market by the dis-savers. The excess assets may be then exchanged for the funds which may be imported from neighbouring economies or the funds set apart against the depreciation of capital. A community such as this would be living on its capital.

That is to say, the question of what happens when we save is intimately bound up with the behaviour of the rest of the individuals in the economy with regard to saving and consumption expenditure. It depends on whether collectively speaking savings are zero, positive or negative. In the first case the saving process would merely

amount to an acquisition, by the general body of savers, of the old assets put on the market by the dis-savers. The economy would remain a stationary one, the capital creating activity in it being limited to the requirements of the repair and replacement of the worn out units of the existing capital equipment of the community. New houses and new factories would merely go to replace those which have been pulled down because they are too old and new machinery would be produced only to take the place of the worn out and discarded units. And these replacement capital goods would be acquired, and their production would be financed, not from out of savings but from out of the depreciation funds set apart for the purpose.

Virtually the same would hold true of the saving process in an economy in which collective savings are negative. The savers in such an economy would merely acquire the old assets of the dis-savers, probably, at a somewhat lesser price than would have been the case if stationary economic conditions had prevailed. For, the supply of the assets would now exceed the demand for them on the part of the savers. The creation of new capital goods would also be merely to maintain intact the existing stock of goods, if we were to

assume that foreign capital had flowed in to finance the surplus expenditure of the community. If, however, it had been financed from out of the depreciation funds and to the extent this had been the case new creations of capital goods would be less than sufficient to maintain the community's capital goods.

When, however, collective savings are positive the saving process would amount to a somewhat different story. The saving activity would then record a change in the structure of the economy. For, only some among the savers would be able to secure old assets in which to invest their savings. In order to meet the demands of the rest of them, the community would have to produce, in addition to replacement capital, *new* capital goods of a value equal to the surplus savings of the community. This would augment the existing stock of such goods. When collective savings are positive the saving-investment process includes, therefore, not merely the acquisition of old assets from the security- or the real estate market but also the creation of *new* capital goods. The activity of such excess capital creation, not merely the creation of replacement capital, is what constitutes the process of saving from the collective standpoint. If no such capital creation were to take place,

socially speaking, no saving would be present, though individual savings may be there. In other words from the social angle of vision, saving exists only in a progressive economy. It is zero in a stationary economy and negative in a regressive economy.

We shall now examine in some detail the phenomenon of saving from the collective standpoint. Surplus social saving would take away from the consumption goods market an equivalent volume of money that might have, otherwise, flowed into it. Prices of consumers' goods would consequently decline or, if the dealers should decide to withhold stocks from the market in order to prevent a fall in prices, reduced sales would take place at the old price level. In either case, either because of reduced profits or because of reduced orders from the dealers, the manufacturers would curtail the output of consumers' goods. This would release from the consumption trades a quantity of labour, plant and materials, hitherto engaged in producing consumers' goods but which are no longer demanded by consumers.

Looking at the same thing from another angle of vision, the first effect of an increase in individual saving (from which net social saving resulted) would be an increase in the unspent

balances of individuals at the banks. Though individually the increase may be small, on the aggregate, the accumulations in the banks may be appreciable almost as soon as the wave of increased saving started. Anxious to maintain the level of their profits, the banks would now seek credit-worthy borrowers for the additional balances and would be willing, if necessary, to relax the rigour of the loan conditions or even slightly to lower the rate of interest they charge.

This signal of an increase in the supply of short-term savings would produce certain reactions. Speculators on the security- and the real estate markets would probably see in it a future increase in the demand for securities and real estate on the part of the savers, which would begin to be effective as soon as individual savings grow in volume sufficiently. The supply of the old assets put on the market by the dis-savers being insufficient to meet the enhanced demand, however, they would bid up their price by a margin which would be commensurate with the fall in the rate of interest or the estimated increase in the volume of savings.

The rise in the price-level of securities and capital goods would induce instrumental entrepreneurs to increase the production of such goods.

They would, therefore, readily take over the labour, plant and materials, no longer wanted in the consumption trades, and, with their help, would organize an increased output of capital goods. And the funds required for doing this they would raise from the banking system, which, as we have seen, would be only too pleased to find a suitable outlet for their increased deposits.

In this manner, as a result of the forethought of the speculators, increased production of capital goods would be taken in hand almost simultaneously with the spread of the sentiment to save more. The savings of the public would be passed on by the banking system to the instrumental entrepreneurs even as they accumulate. On the one hand, therefore, individual savings would grow in volume and, on the other, the goods in process would keep maturing from the raw material stage towards the finished product, namely, capital goods. When individual savings will have grown sufficiently the savers would seek long-term assets in which to invest them and the speculative demand for such assets would then be replaced by the genuine demand of the savers. The entrepreneurs would see in this growing demand an opportunity to embark upon floatations of new enterprises or to enlarge the size of the existing

ones. New securities would, therefore, be put on the market and would be exchanged for the accumulated savings either by the savers directly or by those who may have already sold old assets to them. With the proceeds of these issues the new entrepreneurs would purchase the newly created capital goods. This would enable the instrumental entrepreneurs to repay the loans they had raised from the banks. From which we see that the production of capital goods, which the savers demand, would be financed \ from out of the savings themselves *via* the banking system.

The essence of the saving-investment process, then, lies in the release of labour, plant and materials from the consumption trades and their employment in the instrumental trades. The consumption goods which the savers abstain from consuming would not be produced at all, the means of production hitherto engaged in creating them having been diverted into the instrumental industries. In place of the "saved" consumers' goods, they would now produce capital goods. Savings make available a certain quantity of the means of production and investment brings about their employment in the creation of capital goods. In the language of Professor Edwin Cannan the saving

process begins with saving "on" the means of production and terminates with saving "up" the capital goods.

The capital goods saved up would enable the economy to turn out a larger stream of consumption goods than before the commencement of saving. For, it would now have either a larger number of capital goods of the old type or, if the volume of savings was sufficient for the purpose, new capital goods of a relatively higher productive capacity. Savings, for instance, may bring about a replacement of hand-looms by power-looms, hand-ploughs by tractors, sailing ships by modern liners and so on. That is to say, savings produce an increase in the standard of living of the community. They are the basic essential of economic progress. In the absence of net social saving a rising standard of living for a stationary population or a stationary or rising standard of living for a growing population is inconceivable.

CHAPTER II

WHAT HAPPENS WHEN THE BANKS CREATE EXPANSIONARY CREDIT

The analysis of the preceding chapter rested on the assumption that the banks did not create any expansionary credit. We were there mainly concerned with the consequences of the voluntary or the self-imposed restrictions on consumption on the part of the public. But the initial effects of voluntary saving, namely, a reallocation of men and resources from the consumption into the instrumental industries can be produced also through the device of creating credit in favour of the instrumental entrepreneurs in excess of the volume of voluntary saving.

As a result of the recent developments in the theory of the business cycle, interest in this phenomenon, now widely described as the phenomenon of forced saving, has been considerably enhanced. But as Professor Hayek has pointed out there are many more or less distinct allusions to the subject in the works of the earlier writers. Jeremy

Bentham (1748-1832) was, probably, the first among them. He was followed by Henry Thornton (1760-1815), Malthus, David Ricardo (1772-1823) and Dougald Stewart (1753-1828). It would seem somewhat significant that these references belong to the bank restriction period, when the issue of currency was not subject to the rigours of a gold standard. But interest in the doctrine did not disappear with the restoration of specie payments (1 May 1821). J. S. Mill, whose writings generally represent a restatement of the contemporary position, has given a version of it on Benthamite lines in the closing years of the third decade of the last century and also later in the middle 'sixties.

Their portrayal of the phenomenon, however, was vitiated by the same fallacies as their portrayal of the phenomenon of voluntary saving. They imagined that the inflationary issue of currency notes merely changed the direction of the flow of consumers' goods, from the "unproductive" into the "productive" hands, the volume of the flow itself remaining unaffected. Reduced consumption on the part of the "unproductive" section of the community, which was supposed to make possible increased consumption by the rest, was believed to result from a fall in the pur-

chasing power of money which the inflationary issue of currency produced.

Even as in the case of the phenomenon of voluntary saving it was Walras who redeemed this doctrine from the classical muddle- He pointed out that the expansionary issue of bank notes in favour of entrepreneurs engaged in the production of capital goods enabled them to withdraw labour, plant and materials from the consumption into the instrumental trades. Capital goods were thus produced in substitution of consumption goods, the volume of the latter being reduced as a consequence.

These ideas were restated or further developed by, among others, Wicksell, Professor Ludwig von Mises and Professor Joseph A. Schumpeter and through their influence have become a familiar feature of Continental economic literature. In Great Britain, however, Professors A. C. Pigou and D. H. Robertson have propounded what we may call a neo-Benthamite view of the doctrine. They have argued that expansionary credit only produces a transfer of real) consumption from the general body of consumers to the nominees of the entrepreneur borrowers. Professors Hayek and Lionel Robbins, on the other hand, have built an imposing edifice on the Walrasian version

and regard expansionary credit creation by the banks to be the primary cause of cyclical economic fluctuations.

Without entering into the details of the controversies which surround the phenomenon, we may briefly review what we consider to be its essential characteristics. Let us assume that the willingness of the banks to create expansionary credit occurs in a background of stationary economic equilibrium. To be able to find an outlet for this excess credit the banks would have to lower the rate of interest they charge. This would be interpreted by speculators as an indication of an increase in the volume of savings and they could consequently bid up the prices of securities and real estate. This, in its turn, would induce instrumental entrepreneurs to produce more capital goods. The new funds would, therefore, be acquired by them.

But, unlike under voluntary saving, there would not now be present in the economy labour, plant and materials wanting to be taken over into employment. Instrumental entrepreneurs, therefore, would have to attract them from the consumption trades. This they would proceed to do by offering them higher prices. As nothing will have happened in the meanwhile to indicate

that there would arise an increase in the demand for consumption goods, the consumption entrepreneurs would be unable to resist this encroachment upon them on the part of the instrumental entrepreneurs. They would be compelled to surrender the labour and resources which the latter would demand. With the means of production thus acquired the instrumental entrepreneurs would organize the creation of capital goods.

So far the changes produced would be more or less identical with the reactions which follow an increase in the volume of voluntary savings, except for a rise in the prices of the factors of production. But serious differences between the two phenomena would begin to appear when, as a result of the withdrawal of the means of production from the consumption trades, the magnitude of the flow of consumption goods would begin to shrink. This would happen at the end of the first period of production of consumption goods.

The consuming public, however, would not be prepared for any such diminution. It would come upon them unawares. Owing to short supply, the prices of consumption goods would be moving up and they would find that the same amount of money expenditure now brings them fewer consumption goods. Unwilling to submit

to this back-door encroachment upon their consumption the consuming public would seek to regain their customary level of real consumption. And, for doing so they would draw upon the larger money resources which would now be at their disposal. For, it will be noted that, as a result of the higher prices paid to the factors of production, their incomes would now be at a higher level. In all probability they may also have built up larger bank balances during the first production period of consumption goods when incomes had begun to rise but prices had not yet risen. The price-level of consumption goods, therefore, would tend to rise for the double reason, namely, short supply and higher money expenditure.

The rise in the price-level of consumption goods, it will be noted, is a device for rationing the reduced quantity of them now available. It is the consequence of the means of production being switched over from the consumption into the instrumental trades, which would materialise as soon as the borrowing entrepreneurs make use of the newly created credit for engaging means of production. It is thus wrong to suppose, as many seem to do, that such switching over is made possible through the reduced consumption

which results from a fall in the value of money incomes.

The rise in the price-level of consumers' goods would turn the situation against the instrumental entrepreneurs. It would put into the hands of the consumption entrepreneurs the newly created money and would also raise above its original level the rate of profitableness in the consumption trades. Simultaneously, the prospects in the instrumental trades would become less bright. If we assume that the average period of production in these trades is longer than the average period of production in the consumption trades, the newly initiated production in the former will not as yet have been completed when the consumers may discover the shortage in the supply of consumers' goods and would begin to bid up their price. They would, therefore, still be drawing upon the funds they had borrowed from the banks. Unlike in the case of the consumption entrepreneurs, no new moneys would come into their possession. The consumption entrepreneurs, therefore, would now be in a position to outbid the instrumental entrepreneurs and reclaim into their trades the means of production which had been forcibly taken away from them.

This would create difficulties to the instrumental entrepreneurs. The rise in the prices of the factors of production would increase their costs, and they would be unable to complete the planned creation of capital goods. The balance of the borrowed moneys left in their hands would be insufficient for the purpose. The projected capital goods in the process of production would, therefore, have to be abandoned before their completion. Alternatively they would have to be hastily converted into something less elaborate than had been planned at first, as the labour and other resources engaged on them would now be taken away by the consumption entrepreneurs.

If, however, this must be prevented and the instrumental entrepreneurs must be saved from the losses that would otherwise fall to their lot, the banks would have to create more loans in their favour and in amounts somewhat larger than the higher money receipts of the consumption entrepreneurs. This would then enable them successfully to outbid the latter and to retain in their employ the factors of production they require.

This would not, however, put an end to their difficulties. At best it can only postpone them. For, if we assume that the public would expend on

consumption the full amount of the increase in income which would fall into their hands, the additional credits advanced to the instrumental entrepreneurs would reappear as income almost as soon as the latter begin to draw upon them to pay the higher rates of remuneration to the factors of production. It would, therefore, pass into the hands of the consumption entrepreneurs *via* the consumers' goods market. As soon as this may happen, the difficulty which the instrumental entrepreneurs had sought to overcome would stare them back again in their face. To prevent this it would be necessary for the banking system to go on creating credit repeatedly at an accelerating pace and always faster than the rate at which expenditure on consumption goods may increase.

But, if the banks should agree to do this, incomes also would rise at an accelerating pace, the price-level of consumers' goods would keep soaring high and there would soon appear in the economy nearly all the symptoms of boom conditions. The rising price-level would bring obsolete and discarded methods of production within the range of profitableness, and it would become worthwhile to engage labour and plant of subnormal efficiency and materials which are below the

standard quality. Production would be on the ascendant, employment would be full and the less capitalistic methods of production generally, in which unit costs are relatively higher, would receive more than their due share of importance.

The boom conditions, however, cannot last indefinitely. For, the banks cannot go on creating credit unlimitedly. If not caution born of self-interest, the limitations imposed by the reserve ratio and the gold standard would, sooner or later, compel them to restrict extensions of credit. They would raise the rate of interest they charge and make loan conditions more stringent. When this may happen the instrumental entrepreneurs would be back again in the old predicament. The price-level of securities and of capital goods would fall as a result of the rise in the rate of interest and they would be unable to compete with the consumption entrepreneurs in the price they would offer to the factors of production. These would be snatched away from them by the latter. They would suffer losses and those whose commitments would exceed their capacity would go into liquidation. The output of capital goods would begin to shrink and there would appear unemployment in the instrumental trades.

In due course, this must produce its repercussions in the consumption trades as well. Growing activity in these trades, it will be noted, was the result of the rising expenditure on consumption made possible by the expansionary credit injected into circulation through the instrumental entrepreneurs. With the curtailment in the creation of credit and the emergence of unemployment, the volume of consumption expenditure must soon decline. This must lead to reduced production of consumers' goods and, therefore, unemployment in the consumption trades. Depression conditions would thus spread throughout the economy and as it spreads it would gain momentum, unemployment giving rise to more unemployment.

From the foregoing analysis we see that any attempt at economic expansion through the creation of credit, which does not correspond to an equivalent voluntary abstention from consumption on the part of the public, must necessarily lead to disaster, though at first it might produce all the outward symptoms of boom conditions. But being a paper generated boom it must be short-lived. When viewed with the inevitable reaction, which must follow, the damage done might prove to have more than negated the advantages, if

any, gained during the spurious expansion. In other words, artificially created paper or bank money can be no substitute to the voluntarily generated savings as an agent of lasting economic progress.

CHAPTER III

HOW THE WAR IS FINANCED

The real economic resources possessed by any country comprise the bountifulness of nature in it, its land and mineral deposits, its material capital of factories, machinery, railways, ships, buildings, intermediate products in various stages of production, and its immaterial capital of "organization" of production. To these agents of production we may add the durable consumption goods in the possession of its citizens. The creditor countries and countries which have an empire can also claim, in addition, legal rights of its citizens to payments from the outside world or titles to the productive assets situated abroad. In the case of debtor countries and political dependencies the opposite would be true: some productive resources within their frontiers and a portion of their real income stream would be claimed by foreigners or by the citizens of the ruling power concerned.

In peace-time these several productive resources would be engaged in creating the national dividend, whether in the form of goods or of services not embodied in goods. They may be conceived as being divided between two broad categories of trades, the instrumental trades which produce the required volume of material capital and the consumption trades which employ the material capital, so created, in the production of the national dividend.

In stationary economic conditions the instrumental trades would have to attend only to the repair and renewal of the existing capital equipment in the economy so as to maintain its magnitude intact. And the depreciation funds set apart by entrepreneurs from the sale proceeds of their output would be sufficient for the purpose. Savings being balanced by dis-savings, the aggregate money income or the full amount of the national dividend would be consumed. In progressive economies, however, the instrumental trades would have to augment the stock of capital at a rate commensurate with the rate of economic progression besides maintaining the existing volume of it intact. Otherwise it would not be possible to produce a growing stream of consumers* goods. This is done by adding to the depreciation funds the net

social savings. In such economies the full amount of the social dividend would not be consumed nor would the full amount of the social aggregate of money incomes be spent on consumption. A portion of the dividend would take the form of an addition made to the community's capital equipment and a portion of the money income, the social saving, would be exchanged for it.

We may illustrate this conception of a two-fold division of the productive system by the following diagrams:—

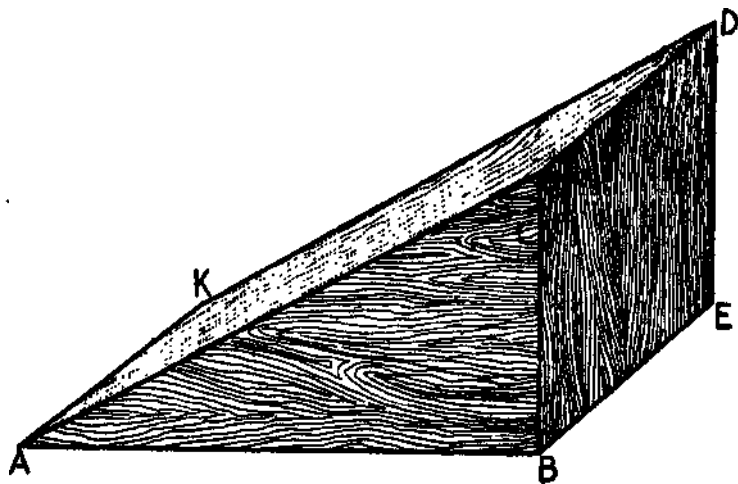


Fig. 1—Instrumental Trades

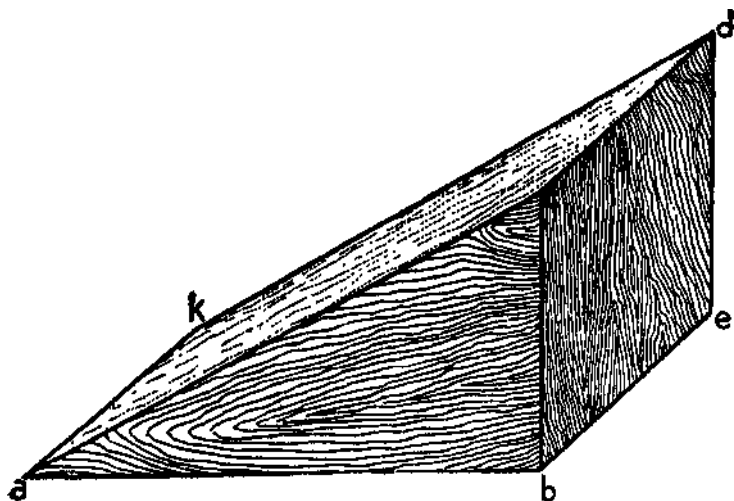


Fig. 2—Consumption Trades

Figures 1 and 2, which are diagonally bisected rectangular blocks, represent the productive processes in the instrumental and the consumption trades respectively. We are assuming that the goods in process increase in value at a uniform rate and that there is not any idle time interval between any stage of production and the next. The sides AB and ab stand for the length of the period of production (or the time interval between the date at which their production is taken in hand and the date at which they reach the hands of the consumption entrepreneurs in the one case

and of the consumers in the other) during which labour and capital are applied to the goods in process as they pass from one stage of production to the next. The sides $A K$ and $a k$ represent the volumes of the raw materials taken up by the productive machinery for fashioning into finished products, in the one case, instrumental goods and, in the other, consumers' goods. And the sides $B C$ and $b c$ indicate the rising values of the goods in process as they pass through the productive machinery.

The volumes of the two figures would, therefore, measure the value of the circulating real capital (goods in the various stages of production) which would have to be always present in the system if the productive organization must yield at a steady rate a continuous stream of the finished goods of both kinds. And the full rectangular blocks over the bases $A E$ and $a e$ would represent the value of their respective output during their respective periods of production. In a stationary economy the magnitude of the two figures would remain unchanged whereas in a progressive economy both would steadily grow and in a regressive economy both would steadily shrink.

In normal times of peace our principal concern with regard to these agents of production would be the amount of the goods and services which

they can produce regularly and efficiently while the people enjoy their normal amount of leisure. In times of war, which, under modern conditions, would demand almost limitless resources, the chief concern of governments, however, would be rather the amount of them which can be squeezed out of purely civilian use, consistently with public morale and national efficiency, for immediate employment in the actual processes of war. As war involves the question of life or death for the pre-war political status of the nation, the immediate requirements of it are of vastly greater concern than questions such as the maintenance intact of the community's material and immaterial capital equipment, which relate to its future economic well being. Also, in the matter of the current satisfaction of wants the needs of the military must have preference and priority over the needs of the civil population.

To simplify our argument we might conceive the army, the navy, the air-force, the munitions works and industries attending to the various requirements of the fighting forces as comprising a third category of trades, the war trades. Comparatively quiescent in normal times of peace, these trades would occupy the centre of the industrial system and would assume domineering importance

in times of war, almost everything else being relegated to the background. As the needs of a modern war would exceed the rate of increase, if any, in the aggregate economic resources of the country, the growth and expansion of the war trades must necessarily involve encroachment upon the consumption and the instrumental industries and the task of governments and the peoples at war must be to facilitate such encroachment.

There are seven principal devices of doing this. These are as follows: (i) taking up the slack or wholly idle resources; (2) direct acquisition of the men and things needed through commandeering or conscription; (3) reducing personal consumption to a minimum so as to maximise the volume of savings; (4) restricting investments in the civilian trades to the minimum amount essential so as to render available for war loans a maximum of savings; (5) allowing the existing capital equipment to be used to exhaustion so as to be able to appropriate for war purposes the agents of production normally engaged in their repair and renewal; (6) inflationary issue of currency notes or the creation of expansionary bank credit in favour of the government; and (7) exchange control. The quantity of the real resources which may be set free in these several ways constitutes the real

national war fund or the war potential of a country and the extent to which they are actually tapped would measure the real sacrifice of its people in the prosecution of the war. We shall examine in some detail these several sources separately, items (1), (2), (5) and (7) in this chapter, items (3) and (4) in the next chapter and item (6) in Chapter V.

We shall take first the industrial slack or wholly idle resources. These are present in most modern economies in a lesser or larger measure. Production under modern conditions being highly specialised and complicated, unemployment, frictional or other, is, in a measure, endemic in most industrialised countries. In Great Britain, for instance, about a million of idle workers had come to be regarded almost as a normal feature of the economy during the inter-war years. The unemployed workers as well as the unemployed resources may be and are taken up by the fighting machine in times of war.¹

¹ In the United Kingdom, for instance, in August 1939 the number of unemployed workers was 1,232,000. This figure steadily declined with the progress of the war. In September 1942 it stood at 128,000 and in April 1943 it was 80,091, See *Memorandum No. 92*, London and Cambridge Economic Service, November 1942, p. 11 and *The Economist*, 15 May 1943, p. 632.

In most countries, especially rich countries, there exist a certain number of people, both men and women, who live on inherited wealth or on other people's earnings and who are accustomed to doing no work at all or only a nominal amount of it and who devote their lives to various kinds of personal amusement. These people may be drawn into one of the war trades or into active service in the forces. They would also help the war effort, indirectly, if they would take the place of their own domestic servants, as thereby they would set the latter free for enlisting in the army or to take up work in a munitions factory.

To the ranks of these may be added such of the elderly people as may decide to remain at their jobs or perform some essential service instead of retiring in the ordinary course or as may return to work from retirement at the country's call. At the other end, boys and girls may be drawn into industry at an age earlier than is usual and somewhat before they may have completed the full period of their training. Workers in the munitions and other factories and in the essential services may be induced to work harder and for longer hours than they do normally. Stoppages of work and the consequent loss of output resulting from strikes or lock-outs, which are apt to arise in normal

times, may be cut down in times of war by public appeals to the patriotic sentiment of the parties concerned or by penalising or prohibitive legislation.¹

It is not possible to say with any accuracy what these various slack factors may amount to statistically. It would vary as between countries and also with the circumstances, such as the state of employment, in which the war had come. In the case of rich countries, generally, other things being equal, the amount of the slack would be greater than in comparatively poorer countries. For, the workers in the former have, in normal times, comparatively fewer hours of work, they enlist for work somewhat later in life and retire from it earlier than in poorer countries. The richer countries can also claim a larger number of leisured people. The order of magnitude of these factors would, therefore, be quite appreciable in the advanced countries of the West. Professor Pigou has conjectured that, for Great Britain, the aggregate increase of productive power which the industrial slack would make possible may amount

¹ By an Order in Council promulgated in July 1940 the Minister of Labour in Great Britain may set up tribunals to settle trade disputes. He may prohibit strikes or lock-outs and may require the fulfilment of specified terms and conditions of employment. *The Economist*, 20 July 1940, p. 69.

to about 20 per cent of the productive power at work in recent times.¹ To the extent of this increase no encroachment need be made upon the peace-time consumption and instrumental trades for building up the war industries.

Let us now turn to the second source from which the real war fund may be built up, namely, commandeering by executive decree. This may be applied equally to manpower, stocks of productive instruments as well as to the annual flow of goods. In the case of manpower for the forces commandeering generally assumes the form of Conscription Acts, by which all fit males of military age are compulsorily enlisted in the fighting services. They may also be applied to females, to persons falling outside the military age and for purposes other than military service, for instance, employment in the munitions factories and other essential occupations of direct military value.

When a government wants for war exactly the same classes of goods as the civil population

¹ A. C. Pigou, *The Political Economy of War*, London, 1940, p. 34. Lord Keynes has estimated these factors to be worth in terms of money roughly between £ 500 millions and £ 1,000 millions or between 8·9 p.c and 17·8 px of the gross national income for 1939 (£ 5,700 millions). See the *Economic Journal*, December, 1939, pp. 627 and 628.

may also use, the device of commandeering the annual flow of them may be employed. The government may take over the whole or a certain percentage of the total output at the source of its production. Thus the Government of India buys up from the mills at an agreed price 90 per cent of their annual output of paper, the public being left to manage as best as it could with the remaining 10 per cent.¹ This method can also be applied to commodities which have already got into the possession of the consumers, as is being done, for instance, in the case of cars of certain makes and models, and air-conditioning sets.

A great part of the war needs of governments, however, differs from the peace needs of the civil population. In such cases productive power has to be transferred from one set of occupations, those which cater to the requirements of the civilians, to another, those which produce the things which the government requires. By this device a part of the annual flow of civilian goods is not allowed to be created at all, war goods being turned out instead. Thus, the car factories and engineering works may be taken over, along with their

¹ In June 1943 the Government decided to reduce its share to 70 per cent of the output with a view to relieving the acute scarcity of paper in the market.

workers and other equipment, for the production of munitions, bombers or tanks.¹

To the same class belong executive decrees by which governments compulsorily take over all the foreign assets and currencies owned by their nationals acquired either in the past or currently through exports, and also gold, which, too, like foreign exchanges, command international purchasing power and are, therefore, of value in acquiring materials of war or other essential imports from neutral countries. They are thereby prevented from being indiscriminately made use of for civilian purposes either by importing against them consumption goods or capital instruments for employment in the non-essential peace-time trades.

Commandeering as a method of building up the war fund has several advantages. It enables the transformation of the peace-time productive machinery on a war basis much more speedily

¹ In the United States, "war requirements have taken 70% of this increased output (of machinery), compared with 43% of the smaller production of a year earlier. The only activity for supplying civilian requirements carried on by the automobile industry is the manufacture of a small volume of replacement parts." See *Memorandum No. 93*, London and Cambridge Economic Service, March 1943, p. 16.

than would be possible if the government were to rely wholly upon financial methods.

For, in the latter case, it would first have to transfer to itself purchasing power from the public through taxes or loans and with the proceeds buy the things required by out-bidding its competitors in the market. Simultaneously, the prices of the things with which the public dispensed in order to provide money for taxes and loan subscriptions would tend to fall. The consequent higher profitableness in the one direction and the reduced profitableness in the other, would cause a change-over of productive resources from the civilian to the war trades. This adjustment to the shifts in demand is, however, a gradual process and is attended with friction and inertia arising out of the general tendency to procrastination, the unwillingness on the part of entrepreneurs to incur the additional outlay for adapting their works and training their workers to the new tasks until they feel sure that the war may last sufficiently long to render the change worth while and so on. The needs of war may ill-afford this slow transition when time is of the essence of victory. The short cut of commandeering, directly puts a stop to all these embarrassing delays.

Commandeering also prevents private parties

from making fabulous profits at national expense, as it gives a chance to the government to fix the prices of the things it may wish to take over. In the case of goods like cars, which have already passed into the hands of the consumers, less drastic devices may not be equally as effective in producing the number of cars required and at the speed at which they may be required. And where manpower for the forces is concerned, conscription may help to reduce to nearly zero the number of people of military age who might otherwise regard their lives more precious than the demands of the fighting machine.

The fifth source of the real national war fund is the volume of the fixed real capital and the circulating real capital in the economy, both of which, like income, may be drawn upon to fight a war. The circulating real capital may be said to be drawn upon when the wheat stocks of the country are allowed to run out without being replaced equally fast from, say, six months' supply to four weeks' supply or when cotton in the process of production, or butter, are employed in turning out instead of into civilian wear, or ghee and sweets, into army clothing and guns.

We have a simple case of drawing upon the country's stock of fixed real capital when the railway

track and the corresponding rolling stock are removed bodily from civilian use for employment in the more important theatres of war.¹ We do something similar when we pull out the railings from the public parks and buildings for conversion into bombs. It is not possible, however, to use most sorts of fixed real capital, for instance, houses, canals, mines, most of the railway equipment, land and machinery in this way. Bits of them cannot be torn and hurled at the enemy or otherwise converted into war goods. But they can be drawn upon indirectly. Capital goods once created do not remain in the same good condition indefinitely and independently of human decisions regarding them. They need repair and upkeep towards which the entrepreneurs set apart a depreciation fund and the economy sets apart a certain amount of the agents of pro-

¹ The following extract from an article in *The Economist* (27 march 1943, p. 397) represents an account of how fixed real capital has been drawn upon in India for the prosecution of the war: "To start with the (Indian) railways handed over, for military purposes, 200 locomotives and 10,000 other vehicles. Some of these transfers have been used outside India. Recently, the opening was reported of a new railway linking Iran with India which will speed up supplies to Russia. It was built at the rate of a mile a day by Indian personnel, and the rails and rolling stock all came from India/'

duction. Through postponing replacement until after the war and doing only the minimum necessary repairs, most of these agents of production may be diverted into the war trades. The existing machinery and plant would then be worked to exhaustion and the war may be said to be financed with capital. In the sphere of agriculture this would take the form of slaughter tapping of rubber plantations and the taking of exhausting crops from land without equivalent restoration of fertility through adequate manuring. The magnitude of the possible contribution to the real national war fund from this source is by no means a mean one. According to an estimate based on the work of Mr. Colin Clark,¹ for instance, in the United Kingdom, during 1938, 420 million pounds² worth of the national effort was employed in keeping the then existing capital intact.

To these methods of drawing upon the nation's capital, which are applicable even to countries completely cut off from the rest of the world through blockade, may be added the indirect methods which become permissible when communication with the outside world remains open. Gold, silver, pre-

¹ C. Clark, *National Income and Outlay*, London, 1937, pp. 86 and 185.

² *Economic Journal*, December

cious stones, jewellery, collections in the museums and rare works of art, all of which represent locked up capital can be shipped abroad in exchange for war material. Foreign investments owned by the citizens of a warring State, which in the case of the leading creditor countries may constitute a considerable amount,¹ may also be employed similarly.

When communication with the outside world is open, it is also possible to draw upon the country's capital by raising loans abroad with which to finance the war. It is immaterial how or through what channels these loans are raised, so long as they are available for the prosecution of the war. They may take the form of direct lend-lease of war goods or other essential articles, goods supplied to individuals by foreigners on credit, subscriptions to war loans by foreigners and the like.

We may now pass on to the seventh main source of the real war fund, namely, exchange control. The primary object of exchange control is to prevent the export of capital abroad and to conserve the exchange resources of the country in

¹ *The Economist* (12 August 1939, p. 347) estimated that just before Great Britain entered the war, British holdings of overseas securities amounted to £ 1,170 millions.

order to help the Empire to pay for essential imports from outside the sterling circle, through restricting the civilian demands made on them. They, therefore, constitute an essential part of the country's war effort.

In order to facilitate exchange control, transactions involving currencies of countries outside the sterling circle are restricted to authorised dealers, usually banks. No individual may purchase such currencies without a permit from the Controller of Exchanges nor can securities, other monetary assets or gold be sent out of the country except under permit. Holdings of foreign currencies must be surrendered to the Control in exchange for local currency at the official rate of exchange. In order to ensure that acquisitions of foreign currencies by residents in the country may not be lost to the Control exchange control regulations decree that no commodities may be exported to countries outside the sterling circle except under the authority of a licence.

And, as foreign exchanges must be conserved for the purchase of the materials of war and other requirements of the fighting services, claims for them on the part of the civilian section of the national economy must be reduced to the smallest magnitude consistent with the efficient running of

the economic life of the country. Imports of all kinds, therefore, are subjected to careful scrutiny and control by regulations and are made subject to the issue of a licence. Purchases from outside the sterling area are restricted to absolute necessities which are not procurable within the circle. A certain category of goods, such as gold, monkeys and certain articles of luxury, which are mainly unnecessary, are altogether prohibited from importation and goods, which are obtainable from within the circle, may not be imported from outside the circle.

The device of licensing imports and exports also makes possible the most advantageous use of shipping space, which, in times of war, needs to be economised, and enables prevention of any attempt at trading with enemy countries. The object of economising on foreign exchanges is also indirectly served by producing at home commodities hitherto imported from abroad. If, for instance, India were to grow less of cotton, for which the Japanese market has been cut off, and with the resources thereby set free were to raise more food crops, not only would the strain on the food front at home be less but the foreign exchanges which would otherwise be required to import food grains and other articles of food from abroad

would be "saved."

These general regulations may be reinforced from time to time with a view to closing the loopholes and leakages in the Control which practical experience might reveal.¹ For instance, the United Kingdom Control introduced in July 1940 more stringent orders with regard to the transfer of sterling balances held by residents outside the sterling area. The "free" sterling markets in neutral countries were getting their supplies of sterling from the United Kingdom bank balances of residents outside the sterling circle. These were sold to foreigners who had sterling payments to make. As such sterling was obtainable at a more advantageous rate than the British official rate, the result of the presence of the "free" markets in sterling was that the British Control lost the amount of the foreign exchanges which in the absence of the "free" markets might have been paid into it. In order to remedy the situation, i.e., to dry up the supply of sterling to the "free" markets, the new orders canalised into separate accounts, which were mutually unconnected and ran parallel to one another, all transfers of sterling as between resi-

¹ See "Completion of Exchange Control," *The Economist*, 17 July 1940, pp. 124-25.

dents and non-residents. Special agreements were entered into with certain countries under which the debits and credits arising out of trade and other transactions were made payable through these accounts. In this manner exchange transactions through the official channel were sought to be increased at the expense of the "free" markets in sterling.

In a modern war, however, the foreign exchange requirements of a country at war may outstrip the current accruals of foreign exchange through the channels of trade. It may be necessary, therefore, to build a nest-egg from out of the long-term investments abroad of its citizens such as securities issued by governments or joint-stock companies. Their sale abroad would produce the necessary foreign exchanges for supplementing the amounts of them acquired through exports.

CHAPTER IV

SAVING AND THE WAR

In this chapter we shall examine the third and the fourth main sources from which the national war fund may be built up, namely, economies in personal consumption on the part of the public and the restriction of civilian investment. In a prolonged war these two sources must necessarily be the chief sustenance of the war effort of a nation. For, the other sources reviewed in the last chapter are more or less in the nature of reservoirs and must, sooner or later, reach the limit of exhaustion as they are drawn upon. Saving, on the other hand, like income from which it emerges, is a continuous stream and cannot easily dry up so long as income is large enough for the exercise of economies in consumption.

We shall take first reduction in personal consumption on the part of the public. It is quite obvious that if people eat less or less costly food, buy cheaper or fewer clothes to wear, consume less electricity or firewood, use petrol sparingly,

travel less, employ fewer servants and so forth, they either make available equivalent food, clothes, petrol, travelling space etc., for use by the military and the essential services or set free labour, plant and materials engaged in producing them for turning out instead goods which may satisfy the war needs of the State. By foregoing the use of cars, for instance, we not only release for use by military personnel on duty the fewer cars that may be there or may be produced but enable the car factories to devote their attention to turning out more bombers or military trucks instead. Similarly, by exacting a large number of shaves from a razor blade we enable the machinery, the army of skilled workers and the materials employed in manufacturing blades to produce instead bomb shells. If we fail to exercise these personal economies, the supply of the agents of production being limited, it is quite clear that the needs of the fighting services may have to be stinted.

An important task before governments at war is, therefore, to induce their citizens to consume less or to impose reduced consumption upon them, with a view to setting free a maximum of the men and things for the war trades. It is important to bear in mind this objective as the contribution to the real war fund resulting from personal eco-

nomies in different directions is apt to differ in magnitude, sometimes greatly, and it is not every item of economy that may necessarily yield some addition to the fund. For instance, economies which set free chauffeurs, able-bodied young men fit for military service and men of mechanical knowledge are of greater help to win a war than economies which may release from employment men learned in the classics, skilled performers at *Kathakali* dancing, poets and philosophers, who may be convinced pacifists, midwives, specialised children's nurses, and young men not possessing any specialised skill and medically unfit for military service. The latter group of persons would be of little or no use to a War Office. There is, therefore, not much point in dislodging them from their jobs. Indeed, in the case of midwives and children's nurses, it may be best to leave them at their jobs, as they would be performing a useful service to the community without taking away anything from the war fund. More or less the same would apply to services rendered by museums and art galleries. Their closing down may, no doubt, release their staff for war service, but the loss in public amusement, which has its advantages in times of war, would be incomparably greater than the gain to the war effort. Economies over a wide range of personal

consumption, however, would set free labour, plant and materials which are more or less well fitted to produce the things that the conduct of a war may require.

Six several forms of action are open to a government for bringing about reduced real consumption on the part of its people. These are: (1) commandeering the producing plants or the annual output of consumers' goods, (2) restricting the imports of consumer's goods or of machinery and other instruments of production employed in the consumption trades, (3) restricting the domestic output of instrumental goods which are meant for use in the civilian trades, (4) appealing to the patriotic sentiment of the people and doing propaganda for abstaining from non-essential consumption, (5) controlling incomes through devices such as putting a "ceiling" on wages, "compulsory" saving, heavy taxation, etc., and (6) rationing.

We have already referred to commandeering as a device of meeting the needs of war in the last chapter. By going straight to the root of the matter it enforces reduced consumption on the public. The supply of consumers' goods is cut short behind the backs as it were of the consumers. It has an additional merit in that, simultaneously, it takes over into the real national war fund the

men and things made available as a result of the reduced real consumption.

In cases where the consumption goods are of foreign origin or depend for their manufacture upon imported raw materials or machinery, the supply of such goods in the local markets could be cut short through regulating the imports of the consumption goods, raw materials or machinery as the case may be. The contribution to the war fund resulting from this would be in the form of foreign exchanges as these would now be "saved" for the purchase of war materials from abroad. When the instrumental goods employed in turning out consumers' goods are locally produced, the output of the latter may be curtailed *via* the reduced creation of instrumental goods. This may be achieved by exercising control over the supplies of essential constructional materials such as iron, steel or cement. They may be rationed out through the issue of priority certificates. The effect of this control on the output of final goods, however, would not be apparent until the existing instrumental goods employed in the trades show signs of wear, suffer loss in efficiency and need to be replaced.¹

¹ Reduced production of consumers' goods may also be realised through outright prohibition of their manufacture or imports by executive decree. Certain selected articles,

There are certain categories of consumption in respect of which appeal to the patriotic sentiment of the people and propaganda produce the best results. The use of the telephone, the telegraph and the railway are cases in point. If the public take advantage of these facilities sparingly, they make room for the traffic of the military and that of the essential services without the necessity of having to increase the number of wires or rolling stock. And, as in these cases the rationing of their use is not easily practicable, recourse must necessarily be had to appeal to the good sense of the public through propaganda.

A direct method of imposing personal economies on consumption is to cut at the very source of expenditure, namely, income. This is achieved by putting a "ceiling" on, or "freezing," wages and salaries, through compulsory saving such as deferred pay or by heavy taxation.

mostly luxuries, are subjected to such decree in many belligerent countries. In Germany where war-time restrictions would seem to have reached an extreme limit, according to a recent report in *The Economist*, the manufacture of furniture and certain household commodities is altogether banned. The report adds that as a result of various restrictive measures production of civilian commodities in the country has practically been at a stand-still for several months. With the same end in view perfume, jewellery and stamp shops are to be closed down. See *The Economist*, 6 March 1943, p. 300.

President Roosevelt's decree of 8 April 1943 is an example of the first. It freezes all wages and salaries at the existing level and also all employees in the jobs they hold. The freezing of wages and salaries solves the problem of having to collect into the treasury any increase in the money incomes of the people by preventing the occurrence of such increase. And the freezing of employment, on the one hand, prevents competition among entrepreneurs to secure labour and, on the other, prevents workers from seeking higher remuneration elsewhere. Essential mobility of labour, however, is provided for by empowering the Director of Economic Stabilization to transfer workets, at his discretion, as between jobs and trades.

Compulsory savings are in the nature of taxes on income. They are realised before the payment is made of income in the form of wages or profits, with this difference, namely, that, whereas in the case of taxes payments made to the government are not recoverable, in the case of compulsory savings they take merely the form of a loan to the government. The party on whom the saving is imposed, in fact, either subscribes to a war loan or makes a deposit at the treasury and would get back the amount of the subscription and the interest thereon at the agreed dates. Under the

Excess Profits Tax Ordinance issued on 17 May 1943, for instance, it is obligatory to deposit with the Government of India $13\frac{3}{4}$ p. c. of the excess profits before the declaration of dividends. These deposits would be repayable after the war with bonuses plus interest at 2 p.c. The device of compulsory saving enables a levy being made on all incomes including the lower grades. For political reasons it may not be expedient so to adapt the income tax system as to reach the latter. Also, as the levy is only a loan but not a tax, the rate of the levy may be, perhaps, higher than would be permissible in the case of a tax.

In times of war taxes generally and taxes on income, in particular, tend to increase heavily, the super tax and the excess profits tax combined falling with especial severity on the higher grades of income.

Rationing of consumption goods, though it limits personal consumption directly, is not, strictly speaking, essential to war finance. For, it is not through rationing that Additions are made to the real war fund of the nation. It is not as if rationing cuts down the actual demand for consumption goods, thereby brings about a reduced production of them and thus sets free some of the agents of production engaged in the consumption

trades for the benefit of the war fund. Though this is quite feasible theoretically, in practice, it is the other way about. For, it is administratively more convenient to cut down civilian supplies through the various devices indicated above, than to work the same thing up through rationing. Rationing would require the setting up of a large, costly and rather combrous machinery which must necessarily take time, whereas the cutting down of supplies at their source may be effected with much greater despatch. Also, if the production of consumers' goods were to be left free, the device of rationing alone being relied upon to restrict their output, the danger of leakages at the expense of the national war fund in the machinery of rationing would be great.

The real justification for rationing, therefore, must be sought not in the immediate and direct needs of war, but elsewhere. It would seem to lie rather in the fear of the social peace being threatened and the possible harmful effects of this on the war effort. For, in the absence of rationing, as a result of the keen struggle to secure a share of the limited supplies, the distribution of the consumers' goods among the mass of the population may become chaotic. Though the proportion of the total supplies of any staple article of food that is consumed by the rich people may

be small, they may indulge in hoarding large stocks of them. Among the masses of the people, some may be able to collect barely their requirements, others little or nothing at all. And the consequences of this may be serious, especially in free countries with democratic constitutions. Such a state of affairs may also seem ironical when the nation is supposed to be engaged in a war which is aimed at rendering the world safe for democracy. Rationing, therefore, is essential to the maintenance of peace and quiet on the home front.

When these considerations do not prevail, the necessity for introducing rationing is correspondingly less. This would seem to provide the broad explanation for the absence of rationing in India on a country-wide scale. The capacity of the people in this country meekly to suffer the difficulties which may come their way is classic and, if isolated disturbances do sometimes arise, experience has shown that they can be effectively overcome with less elaborate, though more drastic, devices than rationing. Also, the existing administrative costs together with the inevitable war-time additions made to them being already disproportionately high, it would be a colossal drain upon the available resources of the country to instal a machinery for nation-wide rationing when the urge for

economy is so great. In the case of large cities, however, in which public opinion is especially vocal and the fear of wide-spread and serious food riots may be very real, the balance of advantages may lie on the side of rationing. But cities to which this description may apply are comparatively few and in some of them rationing is already in the process of being introduced. However, rationing, regional or nation-wide, must not be confused with the economic measures which are essential to finance a war.

We shall now proceed to consider the fourth main device of releasing productive resources for the benefit of the national war fund, namely, restricting *new* investments in the civilian trades. The principal aim here is to make available for the war needs a maximum portion of the aggregate net savings of the community which may result from the voluntary, induced or imposed economies in personal consumption.

The current stream of savings may be held or invested by their owners in one or more of the following ways: (1) hoarded in the form of cash, (2) held on current or fixed deposits in a bank, (3) exchanged for an old asset or security or advanced as a loan against their hypothecation, (4) invested in newly created securities or capital

goods such as an estate, plant, machinery or raw materials employed in the civilian trades, and (5) handed over to the government as war loans.

In so far as alternative (3) is concerned, it is clear that, if the acquisition of the asset or security, through purchase or mortgage, does not represent an act of dis-saving on the part of someone else, the savers would merely pass on the burden of the decision regarding the disposal of their savings on to the shoulders of those who acquire the savings. The same would apply to the savings entrusted to a bank. The bank, however, would have *to invest the savings held on current deposit in short-term assets (i.e., assets representing circulating real capital). The savings held on fixed deposits alone could be safely invested for longer periods.

Virtually the same would be true of the savings held in the form of hoards. For, in times of war governments take care to comander, except for such small amounts as may be needed for industrial use, the gold stocks in the country as well as the current production of the mines as these are useful for the purchase of essential materials from neutral sources. Hoarders, therefore, are not likely to be able easily to get hold of gold in which to keep their savings. If they do succeed in getting hold

of it, chances would seem to be that it would be part of the old stocks of gold and their purchase of it would clearly fall under the category of alternative (3). By acquiring such gold they would only be shifting the decision with regard to the investment of their savings on to someone else. The control over newly mined gold being even more complete than the control over the existing supplies of the metal, it is exceedingly improbable that the hoarders might succeed in acquiring the newly mined gold, in which case alone they would escape the ring which governments at war seek to put around the savings of their citizens.

If not in gold the hoards must be held in currency notes. In this case the savers who hold the notes may be said to be, in effect, transferring the responsibility of investing the savings, which the notes represent, to the banking system. For, it would then be economically quite legitimate for the latter to create for investment purposes either equivalent notes or bank credit or some of the one and some of the other, without inviting the charge of currency or credit inflation. The banking system would then be merely passing on the savings of the hoarders to the investors though it may be without their consent or knowledge.

From which we see that, given war-time res-

trictions, the net social savings of the community must flow, directly or indirectly, into alternatives (4) or (5). In order to put a ring around the current stream of social savings with a view to canalising a maximum portion of them into war loans (alternative 5), it would suffice, therefore, if the government were to take the necessary measures for blocking up to the desired degree, the several openings for *new* investment (alternativ 4).

This is generally secured in three ways. First, the flow of capital to neutral countries is prohibited by executive decree. Any attempt at evading the decree would be effectively foiled by exchange control. Domestic savings would thus be compelled to seek investment at home. If exchange transactions between countries falling within the Empire sterling area are not subjected to any severe control and capital is comparatively free to move as between them, they would only be moving from one ring into another without being able to escape into neutral countries.

Secondly, the creation of capital goods for use in the civilian trades is restricted or wholly blocked up, depending upon the degree of its social importance, through the issue of priority certificates for the purchase of essential constructional

materials such as iron, steel or cement,¹ In a country, like India, where the engineering trades are either non-existent or only poorly developed, the same end may be attained by exercising the general control over imports against the free importation of machinery and machine, tools.²

Thirdly, the raising of capital in the home market is made subject to the issue of a licence by a competent authority. In India, for instance, under the Defence of India Rule 94A, which was announced by the Finance Member at a Press conference on 17 May 1943, no new capital may be issued without a permit obtained from the Examiner of Capital Issues in Delhi. This enables the govern-

¹ The following complaint by a leading businessman, Mr. J. R. D. Tata, gives some idea of the effect of this control on the possibilities for new investment in India: "While it is inevitable in war time that the consumption of steel for private building purposes or ordinary market consumption should be heavily curtailed, the almost complete withdrawal of all structural steel during the last two or three years has had a serious effect on the pace of the country's industrialisation.⁰ Speech at the 37th annual general meeting of the Tata Iron and Steel Co., Ltd., held on 28 July, 1943.

² Under Defence regulations all orders for machines and machine tools, whether abroad or to producers in India must be sent to the Machine Tool Controller, Department of Supply, Calcutta, through the Regional Representative of the department in Bombay, Lahore, Madras and Cawnpore. See *Bombay Chronicle*, 11 July 1943, p. 6.

ment to scrutinise all new issues of capital with a view to protecting the capital market for the issue of war loans. Coupled with the restrictions on the creation or importation of instrumental capital goods, it acts as a double check on the flotation of non-essential new enterprises.¹ It also helps to prevent the springing up of superfluous investment trusts, insurance companies or banks, whose material capital requirements may not be large.

Until the formulation of Defence India Rule 94A there existed only the first two checks to investments in India. But the absence of the third may not be said to have militated against the fundamental aim of drawing into the war fund a maximum of the community's savings. The first two checks did involve more or less complete control over all new flotations which depended for their functioning upon instrumental capital goods. And from the standpoint of the war effort proper there could not be any serious objection to the flotation of enterprises such as investment trusts, insurance companies or banks. For, in view of the blocking up of investments in other directions, they can do little else than act as agents for collecting

¹ See the list of questions to be answered in the application for a permit to the Examiner of Capital Issues. *Commerce*, 21 August 1943, p. 287.

the savings of the public for investment in war loans or treasury bills. On the other hand, there may be certain advantages in allowing the formation of such companies, if there should exist a strong body of opinion among the savers against subscribing to war loans, as might be the case in some discontented political dependencies. They may not have the same objection to taking up the shares of these new companies.

At the same time it may not be conducive to post-war economic stability to allow an indiscriminate growth of new companies. When normal conditions return after the restoration of peace a good many of the new ventures may prove to be superfluous to a healthy functioning of the economy and would, consequently, tend to be eliminated. In the process they may retard the smooth progress of post-war economic reconstruction. Timely prevention of a mushroom growth of companies would, therefore, contribute to the economic well-being of the community after the war. The new Defence of India Rule permits this being done.

Having taken these negative measures designed for blocking up the several channels for new investment, governments at war adopt certain positive steps for gathering in the savings of the commu-

nity. The method and form of loan issues are so adapted as to appeal to a wide range of tastes and requirements. To suit the demands of the banks and the other constituents of the short-term money market, they issue twelve-month treasury bills or short-dated treasury bonds, long-dated war loans are issued for the benefit of trusts, insurance companies and the general investing public, war saving certificates for those with small means and so forth. In addition they also organize, from time to time, (or induce unofficial bodies to do so), tank weeks, battle-ship weeks, "send a plane fund" and such like campaigns for collecting savings.

From the above analysis we see that, if the government were to take the necessary measures for restricting the output of consumption goods, the community would have no alternative but to save. May be that, owing to the abnormally high prices which the scarcity of goods might produce, those with fixed money incomes such as wage-earners and salaried men might now have to devote to consumption a larger proportion of their incomes than before the war. But this is quite immaterial to the volume of social savings available for financing the war. For, it would only lead to a transfer of incomes from those with fixed money incomes to the profiteering dealers and

the latter would be compelled to save. Looking to the community as a whole its aggregate net savings would be necessarily larger than what they might have been prior to, or in the absence of, the curtailment of civilian supplies, and its magnitude would increase with every additional curtailment of them though the savings of certain classes may be less. Under a regime of rationing and price control, however, the mad rush for goods would cease and the savings of all classes may be higher.

Likewise, if the government were to take the necessary measures for restricting the creation of new instrumental goods, the savers would have no alternative but to place their savings, directly or indirectly, at the disposal of the State for the prosecution of the war, whatever may be their personal views regarding the war. They would be unable to send them abroad to a neutral country. If they bought with them some existing property, some of the old stocks of gold, old securities, life insurance policies, or the shares of newly created investment trusts, banks or insurance companies, they would merely be asking someone else to take their savings to the treasury, instead of doing this themselves. The same would be the case if they kept them with the banks. They would be unable to invest them in new machinery or in new

houses. The first they will not be able to import, even if the manufacturers abroad were willing or free to produce them, and, for the second, they may not get the necessary priority certificates in respect of cement, iron or timber. They would be unable to acquire new gold in which to keep their savings underground. If, instead, they were to decide to hold currency notes, the Reserve Bank of India may pass on their savings either to the Government of India or to the Imperial Government through issuing to them equivalent currency notes, to the former against rupee treasury bills or rupee war loans and to the latter against sterling treasury bills or sterling war loans. To this must be added the possibility that, in the event of excessive inflation, the value of the notes hoarded may completely disappear and, again, into the hands of the government for financing the war.

Nor would any attempt at riotous living on the part of the consumers in any way diminish the aggregate volume of savings flowing into the treasury. For, as we have seen, so long as the supplies of consumers' goods remain depleted any competitive outbidding on the part of consumers to acquire them can only drive their prices higher and higher and increase the profits of the consumption entrepreneurs. These latter would then be

compelled to save more and the aggregate net social savings would remain undiminished.

This is not to say that, once civilian supplies are cut down and the output of new instrumental goods is restricted, it is a matter of indifference to the government as to what people do with their incomes and savings. If they spend their incomes freely, prices, profits and wages would keep soaring high and, unless incomes earned in the war industries are also correspondingly high, there is a danger of the real resources being drawn away from the war effort into the civilian trades. To prevent this from happening, the government may be driven into inflationary finance. If savings are not employed in subscribing freely to war loans but are left on deposit with banks or are hoarded in currency notes, as the banks and the currency authority can take only a limited quantity of long-dated securities, an unduly large proportion of government debt may remain in the form of treasury bills or bonds. This might create budgetary difficulties or engender inflation after the termination of the war.

It is, therefore, in the interest of the government to supplement the physical measures, designed to restrict the production of 'consumers' goods, by financial measures such as those aimed at pre-

venting an undue rise in prices and incomes and thereby mop up the surplus purchasing power of the community before it is allowed to work out social harm. The latter are formulated more with an eye to avoiding the social injustice and the social disorders which might otherwise follow the colossal changes which a war must produce in the economy. So far as the immediate requirements of the war are concerned they may be said to be satisfied almost as soon as the civilian supplies are cut down, the output of capital goods is restricted and the men and things are thus released for feeding the fighting machine.

CHAPTER V

INFLATION AND THE WAR

There remains to consider the last important method of war finance, namely, the creation of expansionary currency or bank credit. A government at war may supplement the moneys raised through taxation and war loans by printing currency notes (or getting this done for it by the bank of issue), by inducing the banking system to advance to it moneys which do not represent equivalent savings on the part of the public or by some combination of these two devices. The currency or credit acquired in this manner would serve the same purpose as, and would be indistinguishable from, the proceeds of taxation or of the issue of war loans. Like the latter, they enable a withdrawal of the goods useful for war from civilian consumption or of labour, plant and materials from civilian employment. India provides an example of war finance through the inflationary issue of currency and the United Kingdom provides an ex-

ample of such finance through the expansionary creation of credit.

Expansion of currency by the issuing authority in favour of the government may be done against government securities or treasury bills. It is immaterial whether such issue is made directly to the government or whether the securities or treasury bills are first taken over by the public and then passed on by the latter through the banks to the bank of issue in exchange for new currency. Instead of approaching a bank of issue at all the treasury may also itself exercise the right of issue and directly put into circulation treasury notes, as the British Treasury did during the first world war when it put into circulation, under the Treasury and Bank Notes Act, 1914, £ 1 and 10s. notes.

Both forms of the inflationary issue of currency are at present in process in India and are employed to finance the war expenditure of the Government of India and also of the expenditure in India of the Imperial Government. Inflation for the benefit of the Government of India takes place partly through the direct issue of currency by it but mainly through the issue of notes by the Reserve Bank of India against Government of India securities.

Direct issue of currency takes place in the form of one rupee notes and also rupee coins. The

rupee notes were ushered in by an * Ordinance (Currency Ordinance No, IV of 1940) in July 1940. Like the rupee coins, no reserves need be held against them and there is not any statutory maximum limit for their issue. Also they enjoy the same legal and monetary status as the rupee coin. Indeed, they may be and are held as part of the "rupee coin" reserve on the asset side of the Issue Department of the Reserve Bank of India. The amount of them outstanding do not, however, form part of the note liability of the bank. They are a liability of the general revenues of the State.

The rupee coins are also tokens like the rupee notes and yield inflationary revenue by the amount of the difference between their face and bullion values. Primarily with a view to avoiding the difficulty, experienced during the last world war, which would follow a rise in the bullion value of the coin above its face value, its pure silver content was lowered from eleven-twelfths to one-half of its weight (180 grains) by the Indian coinage (Third Amendment) Ordinance of 23 December, 1940. The possible increase in the profits of coinage, however, has been largely neutralised by the rise in the price of silver. Since March 1943, when the price of silver rose above Rs. 109

per 100 tolas, the "melting point" of the old standard rupees, the possible increase in profits may be said to have been more than neutralised.

No statistics are available of the issue of one-rupee notes by the Government of India under the Ordinance of 24 July, 1940. But the amount is, probably, appreciable. The issue of rupee coins during 1940, 1941 and 1942, however, aggregated Rs. 51.09 crores. But it is difficult to state as to what proportion of this would represent the profits of issue.

The bulk of the inflationary finance, however, would seem to be effected through the issue of the Reserve Bank of India notes against Government of India rupee securities. Legal obstacles on the way of such finance have been cleared by an Ordinance, the Reserve Bank of India (Amendment) Ordinance, issued on 8 February 1941. It removed the upper limit of the amount of these securities which could be held by the Reserve Bank against the note issue, namely, Rs. 50 crores or one-fourth of the total assets in the Issue Department of the Bank, whichever was higher. These securities in the assets of the Reserve Bank as on 25 August, 1939, the week preceding the outbreak of war, were of the value of Rs. 37.39 crores. They rose to Rs. 120.71 crores on 11 June, 1943, or by Rs.

83.32 crores. The table below gives an idea of the pace at which notes have been issued against rupee securities of the Government of India including treasury bills.

TABLE I

Notes in Circulation and Securities in the Issue
Department of the Reserve Bank of India
(Crores of rupees)

Average of Friday Figures	Rupee Securities	Sterling Securities	Notes in Circulation
1938-39	32.18	66.88	182.36
1939-40	37.42	78.32	208.86
1940-41	48.57	129.97	241.62
1941-42	75.56	165.44	308.46
1942-43	138.51	320.60	5[^]3.94
April 1943	¹ 37*39	480.79	667.00

One of the causes for the inflationary issue of currency in India for the British Government would seem to be the phenomenal increase in the expenditure in India of the Imperial Government with the progress of the war. As will be seen from the following table, it outstripped the sterling obligations of the Government of India (Home-Charges) during the second year of the war (1940-41).

TABLE II

Expenditure of the British Government
in India and Home Charges
(Crores of rupees)

	A British Expenditure in India ¹	B Home Charges	A - B
1939-40	4	27	- 23
1940-41	53	30	+ 23
1941-42	185	32	+ 152
1942-43	387	49	+ 338

This meant that the bills payable in India by the Imperial Government could no longer be met wholly by offsetting, as was possible in the first year of the war, against the payments owing to the British citizens by the Government of India. For meeting the bills in full the Imperial Government had to acquire rupees otherwise than by asking for the payment of Home Charges in Indian currency.

There were four several possible ways of doing this, namely, (1) export of goods to India for sale against rupees in the Indian market, (2) commandeering for disposal in India the British owned rupee securities or the sterling securities represent-

¹ *The Economist*, 26 September 1942, p. 393.

ing the sterling debt of the Government of India or the shares of companies operating in India but registered in the United Kingdom with a sterling share capital, e.g., the shares of the jute mills, of the Bihar coal mines, the Imperial Bank of India, the cotton textile mills and of the iron and steel industries, (3) floating a loan in India on behalf of the British Government and (4) directing the Reserve Bank of India to issue to the Indian agents of the Imperial Government currency notes against British Treasury bills, British Government securities or any other *ad hoc* sterling paper.

Of these several ways (1) must be ruled out for the double reason, namely, scarcity of manufactured goods and scarcity of shipping space. The second alternative compares with the commandeering and disposal of the British owned dollar securities to pay for the surplus imports of war goods or essential commodities from America into Great Britain. It would reduce the debtor position of India and might contribute towards a higher standard of living for her people in the post-war period. But for Great Britain the opposite would be the consequences of this policy. It would amount to killing the goose that has been, for generations, laying the golden egg for the British investor. This alternative also must, therefore, be ruled out.

Alternative (3) involves a great financial climb down for a country which has been traditionally filling the role of a supplier of capital not only to India and the rest of the Empire but also to a large part of the outside world. It might cause public opinion in neutral countries to suspect the financial strength of Great Britain and might produce very adverse comments from the enemy broadcasting stations. To these objections must be added the risk, however remote it may be, of the issue proving unsuccessful, which may cause irreparable damage to the Imperial *iqgat* in India as well as abroad.

None of these objections, however, are applicable to alternative (4). It is also the simplest and the most expeditious method of obtaining currency in India, the time taken for doing so being no more than what may be involved in cabling the advice to India that sterling treasury bills of the required value have been deposited with the Bank of England to the credit of the Reserve Bank of India. It does not call for the shipping of British goods for the Indian market nor for the commandeering of the British owned Indian securities. To pay for either the British Treasury would have to find more money by taxation, loans or inflation in Great Britain. Instead, the same end is attained by inflicting inflation on India at a minimum of cost

to the British Treasury, namely, that represented by the nominal interest payable on the treasury bills passed on to the credit of the Reserve Bank of India. Payment of the bills at the due dates need not create any great problem as the maturing bills could be replaced by fresh ones. It does not also involve the delay or the risks of floating loans in India.

Though from the British standpoint this is undoubtedly the best of the four alternatives, it would seem to be the worst of the four from the Indian standpoint. It forces inflation on India, not in order to finance the Indian war effort, but in order to relieve the pressure of war finance on the British Government and it, perhaps, saves the British public from so much more inflation. It imposes "forced saving" on the Indian public in order to enable Great Britain to pay her Indian war bills. It is a subtle device of drawing upon the Indian economy to supplement the British national war fund and yet keep the fact cleverly concealed.¹

Indeed, this method of meeting Imperial expenditure in India would seem to have created a perfect illusion that the burden of the British war finance

¹ See *World Economic Survey*, League of Nations, 1939-41, pp. 130-31.

in India is borne not by the Indian public but by the British Government. How successfully it has screened away the real fact may be seen from the trend of the discussion in India regarding the accumulation of the sterling paper with the Reserve Bank of India: that it is but a measure of the amount of the inflation inflicted upon us for the benefit of the British Treasury and that the cost of this sterling to the British Government is no more than the cost of the paper on which the securities passed on to the Reserve Bank are printed does not seem to have been very clearly perceived by some of the Indian publicists who have written on the subject at considerable length.

The effort of the British Press to spread the illusion is, however, understandable. The London *Economist* for instance, has observed that "Every bullet of Indian manufacture discharged by Indian soldiers in the Burmese campaign is paid for on the mail in sterling/" It would be economically far more correct to say, that we have been made to pay for it through the nose by the reduced consumption imposed upon us through inflation. After reviewing the amount of sterling accumulated with the Reserve Bank the same paper, with a sense

¹ 6 March 1943, p. 302.

of elevated moral triumph, adds: "There is little here of 'imperialist exploitation' it should be widely noted." One feels tempted to retort that if this is not imperialist exploitation it is inflationary exploitation. But it is nothing other than exploitation.

It is somewhat amusing, however, to note the same journal's description of an identically similar act by Germany. In an article entitled "Scientific Looting," referring to the finance of German purchases of war materials and other goods in German occupied territories, it has observed:

"This does not mean, of course, that the owners of goods requisitioned or bought by Germans are not paid for them. The Germans are too clever to resort to the crude form of looting, except in remote countries such as Poland. As a general rule, they pay for everything and pay generously—with the conquered nation's own money. That is the point: no matter what form the payment takes, it is in fact always the monetary authorities of the conquered countries who provide the cash. Germany, in addition to inflating her own currency, is in a position to inflate the currencies of other nations.

The methods of payment in occupied territories can be summarised under the following

headings: (1) payment in Reichsmark notes; (2) payment in Reichskredit-Kassenscheine; (3) acceptance of bills drawn on German Government departments; (4) issue of bank notes by occupation authorities; (5) settlement through exchange clearing; and (6) payment with the aid of advances from central banks. *In each case the net result of the transaction is that Germany obtains something for nothing, and the financing of the purchase entails an expansion of currency or credit in the conquered countries.*¹ Even when payment is made in Reichsmarks, it does not mean that the recipients are enabled thereby to buy German goods, for, imports from Germany are strictly controlled."²

One wonders why, when exactly the same thing is done by another power in respect of its Eastern dependency, it should cease to be "scientific looting" or "imperialistic exploitation." Indeed, it takes away our breath when we are told that it becomes, instead, an act of unexampled generosity. And that is what the British propaganda machine would want us to believe. Further commenting upon this technique, *The Economist* adds:

¹ *Italics mine.*

² *The Economist*, 24 August, 1940, p. 249,

"By inflating the currencies of her victims, Germany aims at killing two birds with one stone. She is able to exploit the conquered nations to the limit of their capacity; and she is able to do so without unduly antagonising them. If the Nazis were to resort to bare-faced plunder, the bitter hatred against them would become intensified and increase the difficulty of ruling the conquered peoples. As it is, large sections of the conquered communities are placed under the delusion that they are being paid generously for the goods they have to sell to the Germans. This deception cannot last for ever. Sooner or later, the victims will realise that Germany has depleted them of their supplies of goods and has left them with an inflated currency whose holders are unable to spend it. It is only then that the population of the conquered countries will realise the true character of Nazi exploitation/'¹

It is not at all clear why this way of thinking should not apply to the inflation which is at present in process in India.

If we were a sovereign power, importation of goods not being open, we should, perhaps, insist

¹ Ibid., p. 249.

that we be paid in rupee securities held by the British public very much in the same way as the British purchases in America were paid for in dollars acquired through the sale, in the United States, of the British owned dollar securities. This was the course best calculated to meet our interests. But so long as Great Britain remains the trustee of our finances we can have little or no choice in the matter and all discussions, regarding it can have no more than purely academic value.

The actual magnitude of the inflation thus effected, however, can be known only to the parties concerned until they may agree to reveal to us the amount of the British Treasury sterling bills, British Government bonds or other sterling or rupee paper representing a liability of the British Government (e.g. bills drawn on British Government departments or Government firms such as the United Kingdom Commercial Corporation) presented to or held by the Reserve Bank of India, which is apart from, and is in excess of, sterling acquired from private parties in the course of trade. But that such inflation exists or that its volume is appreciable need not be doubted as the table below would seem to make clear:—

TABLE III

Sterling Securities in the Issue Department of the
Reserve Bank of India and the Balance of Trade
(Crores of rupees)

	A Balance of Trade in merchandise	B Sterling Securities	C Notes in Circulation
1938—39	43.03	66.88	182.36
1939—40	78.02	78.32	208.86
1940—41	68.38	129.97	241.62
1941—42	77.84	165.44	308.46
1942—43	84.21	320.66	513.94

The increase in the sterling paper held by the Reserve Bank during 1940-41, 1941-42 and 1942-43 is striking. It coincides with the increase in the Indian expenditure of the British Government during the period, especially the latter two years. It is out of all proportion to the rise in the merchandise balance of trade.

It is exceedingly difficult, however, to conjecture what part of sterling in the possession of the Reserve Bank may represent *ad hoc* sterling paper held as a basis for the inflationary issue of currency* For, the merchandise balance of trade is not the relevant figure of the amount of sterling which may be

presented to the Reserve Bank in return for notes to be issued in India. A part of the trade balance may be employed, before it may reach the Reserve Bank, for liquidating bills arising out of the invisible imports into the country. And the magnitude of this is known to be considerable. It would seem probable, therefore, that the volume of the inflationary sterling in the vaults of the Reserve Bank may be more than the difference between the figures in columns A and B in the table above. Also part of this difference may represent payments for the purchase of gold exported from India to Great Britain which, under Defence regulations, is acquired by the British Treasury.

Another part may represent American and other allied war expenditure in India against which Great Britain would receive dollars and other foreign exchanges and India a corresponding amount of *ad hoc* sterling and equivalent inflation. In other words we have no means of knowing the actual amount of the inflation imposed upon the country on British account, what part of it is for financing Imperial expenditure in India, what part for the purchase of Indian gold and what part for acquiring dollars and other foreign exchanges, which, in the ordinary course, would have found their way into the Reserve

Bank of India, It is not possible to make good bricks without straw.

In a country with a well developed credit system such as Great Britain direct recourse to the printing press as a method of inflationary finance is both unnecessary and unlikely. The same result may be produced through securing the creation of bank credits in favour of the government, currency expansion being only induced as a result of credit expansion. The main steps of procedure would be somewhat as follows. The starting point of the process would be an extension of credit by the Bank of England on Ways and Means to the Treasury. If in a given week the Government require £ 10 millions over and above the receipts from taxation and loans, this amount would be credited to the Public deposits in the books of the Bank. When the Treasury would draw cheques on this amount to pay its contractors and other creditors the amount of the advances would pass from the Public to the "Other" deposits through the clearing, i.e., to the credit of the joint stock banks which would get these cheques from their constituents. In other words, the cash reserves of these banks would increase by £ 10 millions. This would considerably improve their ratio of cash to liabilities. If we assume this ratio to be normally

10 p. c, as the deposit liabilities of the banks would have risen only by 10 millions, they would now be in a position to advance credits to the extent of £ 90 millions- And, if the rate of interest they charge be less than the earnings on war loans and treasury bills, the public might feel tempted to act as the link between bank credits on the one hand and war loans and treasury bills¹ on the other. That is to say, a Ways and Means advance of £ 10 millions might be expected to bring to the Government a public subscription as of much as £ 90 millions out of artificially created bank credit towards their loan issues.²

¹ Though the discount market in London continues to act as a link between the banks and the Treasury in respect of the latter's programmes of deficit financing by holding large quantities of treasury bills on borrowed funds, after the outbreak of war the clearing banks have begun to acquire treasury bills directly from the Bank of England, instead of from the discount market. This war-time innovation, which violates a deep-rooted principle of British banking practice and which was considered to be vital to the British central banking technique, arose out of the phenomenal increase in the floating debt borrowings of the Treasury after the outbreak of war. See *The Economist* 25 July, 1942, p. 113.

² When "The first issue of War Loan" was made in Great Britain "the banks undertook with a unanimity which could not be fortuitous to provide special short-term facilities to enable their clients to apply for the stock and spread their instalments over a lengthier period than that

Credit expansion, however, cannot continue by itself without entailing an expansion of currency. For, the newly created credit, through governmental expenditure, would pass into circulation and would produce an increase in income and expenditure, which, in turn, would give rise to a greater need for currency. Indeed, in the absence of an additional issue of currency the pyramid of credit might stand in danger of withering away through a drain of cash from the banks. Use of the printing press must, therefore, follow the progress of credit expansion. During the first world war this was done by the Treasury. It exchanged currency notes for the banks' deposits with the Bank of England and the banks passed on the notes to their customers in payment of the latter's deposits with them.

Some idea of the inflationary expansion of money in the United Kingdom during the present war may be gained from the following table:—

provided in the prospectus." This account from *The Economist* (*Banking Supplement*, 18 May, 1940, p. 4) shows that credit creation to finance the war has been in process from the very start.

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TABLE IV

Note Circulation, Bank Deposits and Prices
in the United Kingdom¹ (July 1939 = 100)

	Notes in Circulation	Bank Deposits	Wholesale Prices
1939 III	103	101	102
IV	105	108	119
	104	no	130
1940 I I	no	112	136
III	119	122	143
IV	118	138	152
	123	146	154
1941 I I	130	156	156
III	141	173	158
IV	147	164	161
	157	166	163
1942 I I	162	175	163
III	162	175	163
IV	^x 73	187	163 ²
1943 I	180	189 ¹	~

On the basis of these and other figures Professor Pigou has estimated that in August 1941 or after nearly two years of war there took place in the United Kingdom an "unwarranted" or inflationary expansion of money and income of

¹ Figures taken from the *Report on Currency and Finance for the year 1942-43*, Reserve Bank of India, p. 6.

² For two months of the quarter only.

about 20 px.¹ It would seem significant that the pace of currency expansion has lagged behind the pace of credit expansion. The opposite holds true in the case of India. The rate of currency expansion in this country is appreciably greater than the rate of credit expansion. That is to say, the credit creating capacity of the banks in India being limited, the Government has placed greater faith upon the former method of putting itself in funds than upon the latter. Also, currency, credit as well as prices have all increased by a greater ratio in India than in the United Kingdom. This is clearly brought out by the table below:—

TABLE V

Note Circulation, Bank Deposits and Prices in India² (July 1939 = 100)

	Notes in Circulation	Bank Deposits	Wholesale Prices
1939 III	102	101	105
IV	122	103	129
I	132	105	125

¹ See A. C. Pigou, "War Finance and Inflation," *Economic Journal*, December 1940, p. 468, and "Types of War Inflation", *Economic Journal*, December 1941, p. 447.

² Figures taken from the *Report on Currency and Finances*, op. cit. p. 6.

	Notes in Circulation	Bank Deposite	Wholesale Prices
1940 I I	135	106	117 •
III	13 ¹	" 5	116
IV	129	125	121
I	136	129	120
1941 I I	148	135	131
III	f J ²	149	150
IV	167	165	i J4
I	204	167	154
1942 I I	246	185	169
ra	273	224	185
IV	311	253	218
1943 I	360	*73	258

It is immaterial, however, whether it is currency or credit that is expanded for meeting the war bills of the State. Both do the work equally well. Only under the method of a straightforward issue of currency, either by the government directly or against government securities, in order to raise a given volume of funds the volume of the currency issue would have to be larger than under the British method of induced credit expansion.¹

But the full amount of the newly created credit or currency cannot be strictly termed inflationary.

¹ A. C. Pigou, *The Political Economy of War*, London, 1940, pp. 103-05.

For, if the public should decide to hoard in times of war more currency than it does normally,¹ the government would merely be getting hold of the savings, which the hoarded currency represents, if equivalent currency or credit were to be created in its favour by the banking system. It would be, in effect, simply a case of creating in favour of the government substitute monetary tickets to real savings which had got mislaid somewhere in the process of circulation. Similarly, the taking up of the industrial slack, the magnitude of which, as we have seen, may be quite appreciable, would require more money. If the currency or credit created in favour of the government was no more than what was necessary for doing this, the process cannot be termed inflationary.

Inflationary finance may be said to begin only when the limit of these two factors has passed. It is only thereafter that the governmental disbursements of the newly created money would be in addition to, not merely in substitution of, private expenditure and the men and things which the government would require would then be drawn away from their civilian occupations behind the backs,

¹ This would seem to be the case in Great Britain. See *The Economist*, "Bank credit and Inflation," 21 June 1941, p. 818.

and without the approval, of the consuming public. The output of consumers' goods would shrink as a consequence and their price-level would rise. The incidence of this would fall with greater severity on the smaller income groups. Inflation thus acts as a concealed, regressive tax.

But the amount of the productive power which it may be possible to secure through a given volume of the inflationary creation of money must necessarily diminish with the progress of inflation. For, assuming that the war has got into its stride and unemployment has practically disappeared, every creation of expansionary currency or credit must raise the prices of the war goods and of the agents of production which the war industries may require. This would materialise as a result of the government or their contractors bidding for the war goods or the agents of production as the case may be against the civilian consumers or the entrepreneurs running the civilian trades. The new money, through the governmental disbursements of today, would become the consumers' incomes of tomorrow and would then produce a further rise in the prices of consumers' goods. Thereafter, it would get into the possession of the civilian entrepreneurs, and would strengthen their position *vis-a-vis* the government contractors in

bidding for labour, plant and materials which they would require. Competition between the government and the entrepreneurs would drive the prices of the agents of production higher still. So as to enable the government to obtain a given quantity of men and things for the war industries the volume of the inflationary funds which would have to be placed at its disposal must, therefore, be higher each time. In other words, to get control, and to maintain control continuously, over some defined fraction of the productive resources of the country, inflation must take place at an accelerating pace the rate of acceleration being determined by reference to the rise in the commodity and factor prices.

But this is not the whole story. When inflationary finance has been carried to a certain distance, it is apt to generate a rise in prices and wages not merely in proportion to the rate of inflation, but at a rapidly accelerating pace. Money would then begin to pass from income to income at a progressively increasing velocity. It is exceedingly dangerous to carry inflation beyond the point at which this may happen. Simple inflation would then pass into galloping inflation, confidence in the country's currency would be shaken, prices would go up soaring and the value of a unit of currency would tend to dwindle towards nothing. The

"flight from currency" or the preference of the people for durable goods would gain momentum. In other words the monetary system would begin to collapse.

But in a modern war, the demands of which can never be said to be fully met, it would be exceedingly difficult to escape inflation altogether, especially in a poor country, such as India, where other sources of raising funds are meagre. There is no other equally efficacious device of making the starving man pay for the war by eating less in order that some of the agents of production engaged in producing his starvation rations may be diverted into manufacturing guns and tanks. Even as in times of peace indirect taxation, such as customs duties, though regressive and inequitable, must form an important source of revenue in such countries, they cannot hope wholly to escape inflation in times of war. But it would be desperately dangerous to indulge in it on a large scale and to pass beyond the limits of simple inflation.

CHAPTER VI

THE POST-WAR BOOM

An idea of the enormous scale on which it is possible to divert real resources from their civilian occupations, through the seven principal devices reviewed in the preceding chapters, for employment in the production of war services, may be gained from the figures of the increase in governmental expenditure of the countries at war.

In the United Kingdom, for instance, the expenditure of the Central Government, which in 1938 was £ 1,015 millions, rose to over three times this figure (£ 3,333 millions) in 1940, the first complete year of war, to somewhat under five times (£ 4*663 millions) in 1941, and the budget forecast for 1942-43 was well over five times (£ 5,286 millions)¹ the amount. Of the aggregate expenditure for 1941, *The Economist* has estimated that roughly

¹ *Economic Journal*, June-September, 1942, p. 207. The actual expenditure for 1942-43 was £ 5637*8 millions. See *The Economist*, 10th April, 1943, p. 456.

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£ 1,135 millions represent non-war expenditure.¹ On the basis of this estimate the war expenditure of the year represents 51.8 per cent of the gross national income (£ 6,813 millions) at factor cost (i.e., excluding indirect taxes) and 47.4 per cent of the net national income (£ 7, 441 millions)² at market price (i.e., including indirect taxes but excluding payments to depreciation funds) both of the same year. The same journal also estimated⁸ that the war expenditure during 1918 was almost one half of the then national income. Since then, as the community's income producing power per. head has considerably risen, it should be possible to devote to war service a larger proportion of the national resources before trenching upon the minimum requirements of non-war service.

The withdrawal of labour, plant and materials from their peace-time occupations into war service on so large a scale as these figures suggest must render the organization and working of the war economy essentially different from their peace-time version.⁴ We shall briefly review the

¹ *The Economist*, 18 April 1942, p. 530.

*Ibid., p. 530.

⁸ 30 September 1939, p. 590.

⁴ For an idea of how the several groups of industries may be affected see H. Makower and H. W. Robinson,

broad character of these changes.

In order to be able to absorb the slack factors in the war trades, the banking system would be called upon to produce more currency or create more credit. It is a mere matter of detail whether this is done in favour of the government or in favour of their contractors. In either case the new money would be employed in paying the slack factors for the war services rendered by them. This need not, however, affect the consumption price-level, if we assume that the resulting increase in the social income would be taken back into the treasury through either an equivalent increase in taxation or an issue of war loans. It need not also affect the *rate* of remuneration of the factors of production as no attractions would be sought to be offered to the factors which are already employed to capacity. The new currency or credit, having taken up the slack into the war effort, would return, from the pockets of the public, *via* tax payments or loan contributions, back into the banking system. If the new credit was created in favour of the government contractors, tax receipts or proceeds of the loan issue would return into the banks *via*

the contractors who would receive these amounts from the government in payment of the war goods produced by them. This process would be repeated until the whole of the slack will have been absorbed. It would add to the war effort without taking away anything from the rest of the economy and would leave wages and prices unchanged.

But, as we have seen, a world war does vastly more than taking up the industrial slack. The economic controls, which it introduces, drastically cut down the output of goods for civilian consumption. This releases from the consumption trades large amounts of productive resources. These are then switched over into the war trades. The demand for war goods being assured entrepreneurs may do this voluntarily. It may also be brought about through an executive order directing the entrepreneurs to change over from their peace-time occupations into producing the requirements of war. Alternatively the government themselves may employ the resources set free and run their own ordnance and munitions factories.

The liquid funds, made up of the short-term savings of the public and the liquid capital of the firms themselves, hitherto engaged in financing the production of consumers' goods, i.e., in the creation of the circulating real capital which would emerge

as consumers' goods, would now be engaged in financing instead the production of war goods.¹ In the first two cases the short-term savings of the public would be acquired *via* the banks in the form of advances and in the third case mainly by the issue of treasury bills or bonds.

A similar transformation would take place in the instrumental trades as well. Civilian investments being drastically curtailed, the instrumental entrepreneurs would, either voluntarily or under executive direction, divert their labour, plant and materials into war production, or they would be taken over by the ordnance factories or munitions establishments. The production of the circulating real capital which would mature into war goods of all kinds would be financed by the liquid moneys which in peace-time had been financing production in the instrumental trades, namely* the liquid funds of firms themselves, the short-term savings of the public and the accumulating depreciation funds. These would be acquired from the banks partly by the entrepreneurs and partly by the treasury,

¹ For an account of the broad nature of this change and for the manner of how it was brought about in Great Britain See *The Economist, Banking Supplement*, 18 May 1940, pp. 4j •

When the production of the war goods would be completed, they would be acquired by the government through the moneys raised by taxation and war loans of all kinds- These moneys, it will be noted, would be made up of three main elements. They would represent partly moneys which, normally, would have been expended on consumption, but which it has not been possible to do owing to the non-availability of consumption goods. Partly they would comprise the normal savings of the community, which, ordinarily, would have been invested in the civilian trades. The rest would represent the depreciation funds, which, in normal times, would have been directed towards the cost of repair and renewal of the existing capital equipment of the economy but which, owing to the restrictions on the production of instrumental goods, it has been possible to do only to a limited extent.

In respect of imports a somewhat similar transformation would be taking place. In place of the articles of consumption for the civil population and machinery for use in the civilian trades, the importation of which would be severely restricted, there would now be imported materials of war or machines and materials to be employed in the war trades. The owners of currently acquired foreign exchanges would be paid in domestic

currency by the exchange control authorities. This they would employ, after paying for their rationed supplies of consumption goods and meeting their tax obligations, in subscribing to war loans. In effect, therefore, those whose income receipts are in foreign exchanges would get in return for them, apart from their rations, paper documents representing tax receipts and government bonds, very much in the same way as the rest of the citizens who receive their incomes in domestic currency.

When the needs of war exceed the available supplies of the currently earned foreign exchanges, foreign securities held by the citizens would be commandeered and sold abroad to pay for the essential excess imports. In exchange for these foreign investments, their owners would get local currency which, like the savings of the rest of the population, they would have no option but to convert into war bonds either directly or indirectly. Thereafter they would get their income from investments, in local, instead of in, foreign currency.

To bring about these changes, apart from the creations of money which may be necessary to finance the taking up of the slack factors and for salvaging for war use, the community's savings held in the form of money hoards, there need not

take place any *expansionary* issue of currency or credit. Also, if the depleted civilian supplies of consumers' goods are properly rationed out there need, not ensue any rise in the price-level of consumers' goods. But unless all transactions in old securities and assets are subjected to rigorous control, which would be both difficult and without any real value from the standpoint of the *immediate* needs of war finance, it would not be possible to prevent a rise in their prices. And the price-level of assets such as land may be driven up to absurdly high levels. But, as we have seen, so long as *new* investment is under strict control this would not really matter. For, the owners of the old assets would have to pass on the savings they have received in exchange for the assets to the government as subscription for war loans.

Speaking in terms of the flow of money the changes which the war may bring about would be briefly these. The money incomes of the community plus its depreciation funds, instead of being allocated as between the consumption and the instrumental trades, as would be the case in normal times of peace, would now be allocated, in consonance with the new distribution of man-power, machines and materials, as between these two trades plus the war trades. The war trades would be,

naturally, getting the lion's share and the civilian part of the instrumental trades would, probably, be getting the least of the three.

When the resources acquired through the physical and the financial devices prove insufficient to meet the exigent needs of war, recourse would be had to the monetary device. The men and things required for war would be, in this case, forced out of their civilian occupations by offering them higher remuneration. The change-over of the economy to a war basis would be produced through inflicting "forced saving" upon the consuming public.

That is to say, during a war, allowance being made to the expansion which the slack factors may render possible, the war trades have to grow at the expense of the consumption and the instrumental trades. A combination of the physical, financial and monetary devices, on the one hand, would transfer productive resources into the war trades and man-power into the fighting services and, on the other, would transfer to the government funds with which to pay for them. Such of these funds as had been raised by taxation would leave no visible legacy behind them, whilst the funds which had been collected through the issue of government securities or through inflation would leave behind

the bonds of governmental indebtedness which would be in the possession of the subscribers to war loans or their legal successors or in the possession of the banking system which had created currency or credit in favour of the government.

The changes produced in the economy by the war may be roughly indicated by the diagrams below. Figure 3 may be said to represent the war trades, figures 1 and 2 the consumption and the instrumental trades, respectively, catering to the needs of the civil population and the dotted lines, in these two figures, the immediate pre-war position of the consumption and the instrumental trades.

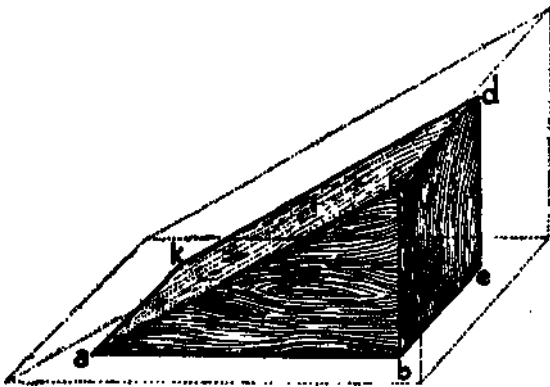


Fig. 1—Consumption Trades

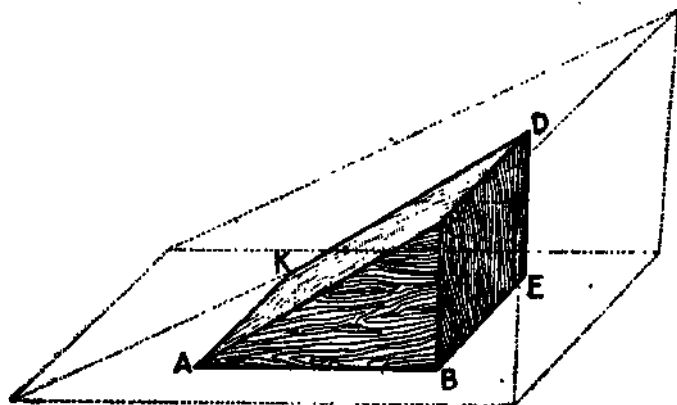


Fig. 2—Instrumental Trades

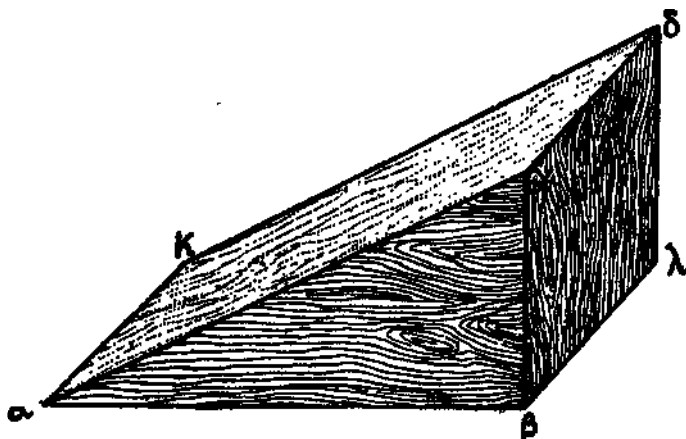


Fig. 3—Wax Trades

As the war progresses the volume of figure 3 would grow and the volumes of figures 1 and 2 would diminish. There is, however, a limit beyond which it would not be possible for the one to grow or for the others to fall. In the case of countries which will have already reached an advanced stage of mechanisation and rationalisation of industry on the outbreak of war, this limit would depend upon the extent to which its citizens would be capable of tightening their belts and yet maintain the necessary standards of efficiency in war production as well as in fighting. In the case of industrially backward countries it would depend, in addition, upon the amount of the resources which could be released from the rest of the economy for speeding up industrialisation whilst the war was on. To the extent progress may be made in this direction the war potential of the country would then be a rising war potential.

It is no doubt possible to put in a spurt of effort in excess of this limit on empty stomachs or on starvation rations, or by drawing upon the capital too heavily, but this can not only not last for any considerable length of time but is most likely to be followed by an adverse reaction and it may take some time before the original standards of effort and efficiency may be regained. Any attempt

to exceed the economic limit of the war potential must, therefore, prove detrimental to the maintenance of a sustained maximum of war production.

On the termination of the war and the restoration of peace, the demand for war goods of all kinds would abruptly fall. The citizen army would be disbanded and the men would seek to, return to their civilian occupations. The ordnance factories and the munitions establishments would go into voluntary liquidation, the workers in them would be released from employment, and their machinery and materials would be disposed of. Private industries which had been catering for war needs would also similarly close down their war-time lines of production. In other words figure 3 above, which had grown fat at the cost of figures 1 and 2, would begin to wither away.

The War Office would no longer be interested in continuing the systems of economic controls enforced during the war. If, therefore, the government were to release the economy from these controls simultaneously with the cessation of the demand for war goods, the peace-time trades represented by figures 1 and 2 above would seek to recover their lost volume. For, it will be noted that, to a considerable extent, the growth of the

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war trades was made possible not so much by voluntary choice on the part of the public as through the authoritarian and monetary encroachments upon private consumption and private investment. As soon as these external shackles would be removed from them, both trades would seek to regain their liberty of self-expression.

Meanwhile, there will have accumulated in the course of the war an enormous volume of funds which would be awaiting the termination of the war for investment in instrumental goods. They may be classed under four main heads: (1) the depreciation funds for the repair and renewal of the existing plants and machinery, (2) savings, individual as well as corporate, (3) reserves, other than depreciation funds, built up from out of war profits and set apart for post-war reconstruction and expansion and (4) monetary compensation received from private insurance firms or under the compulsory governmental schemes of insurance for properties destroyed by enemy action. With the removal of the war-time controls there would, therefore, arise a rush of demand for instrumental goods, for the repair or renewal of the existing plants and machinery, which would now be in a badly worn condition, for the reconstruction of the buildings, railways, factories, ship-yards and other properties

destroyed by enemy bombing or under the "scorched earth" policy and also for implementing many essential projects which were held in abeyance because of the war-time restrictions. The vastly reduced rate of output of the instrumental goods, however, would be unable to meet this sudden rush of demand for them and their prices would consequently jump up. Eager to take advantage of this demand the instrumental entrepreneurs would welcome back in their trades labour, plant and materials released from the war trades. There would appear greedy stimulated activity in the instrumental trades.

Simultaneously, there would be increased activity in the consumption trades as well. This is obvious in the case of countries which had been subjected to strict rationing and price control during the war. For, starved of their wants during the war years, there would be a general rush of desire on the part of the people at least to regain the old level of their real consumption. Millions of men and women will heave a sigh of relief that the necessity for stinting and saving has passed and they will sally forth in their masses to purchase more food, new clothes, new furniture, new cars and new stocks of almost everything that comes to hand. And for doing so nearly all would have to their credit an accumulated reserve of balances which, as

a result of rationing, had remained behind unspent. As the prospects of the continuance of full employment would now seem to be bright, expenditure from out of current income may also be at a high level. The money stream of expenditure on consumption would, therefore, swell above its war-time level subsequent to the removal of the war-time restrictions. To this pressure of demand would be added the demand arising out of the eagerness of the dealers at every stage of the wholesale and retail trade to build up their peace-time norm of the stock of goods. But the current output of consumption goods would be quite insufficient to cope with this rush of demand for them and their price-level would consequently shoot up much above their war-time "ceilings". This would correspondingly increase the profitability in the consumption trades.

In the non-rationing and non-price-control countries, however, the situation may be somewhat different. In their case the cessation of the war may not make any appreciable difference in the money demand for goods. This may continue more or less at the war-time level. The consumption price-level, therefore, may not jump up as in the former group of countries. It may on the contrary even indicate a downward tendency be-

cause of the prospects of increased production or increased imports. This may be the case, for instance, in India where, the war having introduced no restrictions on individuals' freedom of expenditure on consumption, prices would have already reached their peak levels during the war. An increase in the supply of consumption goods in such cases might, therefore, produce a downward movement in their price-level. Nevertheless in this group of countries also the consumption trades may experience greatly stimulated activity. For, the prevailing consumption price-level itself would permit a large profit margin and consumption entrepreneurs, therefore, would be only too willing to embark upon programmes of increased production when the physical barriers to production would be removed. But, perhaps, unlike in the case of the rationing and price control countries, where the accumulated balances would be more evenly distributed, goods consumed by the general body of entrepreneurs, who will have made large profits during the war at the expense of the rest of the community, would be more in demand and would consequently receive relatively greater attention from the producers.

That is to, say, in the rationing as well as in the non-rationing economies the consumption entrepre-

neurs would eagerly welcome back the men, machines and materials disengaged from the war trades.

Almost as soon as the economy may be released from the artificial pressure of war-time controls, boom conditions would thug begin to set in in the instrumental as well as in the consumption trades. Labour, fixed real capital and also circulating real capital, (except for the portion which will have already reached too advanced a stage of production as war goods and would, consequently, be incapable of being transformed into anything else), no longer needed in the war trades, would be taken over by the civilian entrepreneurs. The demobilisation crisis, if any, would be wholly transitory. Employment would continue to be full, production would be on the ascendant and incomes generally would remain high.

In the field of money and finance the termination of the war would produce a corresponding change-over. The government and the war trades would demand no more the short- and the long-term investment funds of the community. The outstanding volume of treasury bills and war bonds would consequently begin to decline rather than the opposite. The accumulating depreciation funds and the short-term savings plus the payments received by the holders of the maturing treasury bills,

the treasury deposit receipts and other floating debt would, therefore, begin to seek investment elsewhere. And they would find a ready demand for them in the now reviving consumption and instrumental trades. They would easily get absorbed in financing the creation of the circulating real capital in the two trades. The long-term investment funds, too, would be similarly diverted by their owners into civilian trade and industry.

The boom conditions, however, as we shall see in the next chapter, would be short-lived.

CHAPTER VII

THE POST-WAR DEPRESSION

On the termination of the war, speaking in terms of real resources, the economy would be in a state of, utter exhaustion, especially if the war had been a prolonged one. Most of its stock of machines and fixed real capital generally, whether in civilian use or transferred into war industries, would be in a badly worn condition, as, during the war, they would have received only the most essential repairs. The normal rate of renewals not having been possible, the number of machines in working condition would also be smaller than before the war, the rest of them having been discarded as scrap or melted down for their iron, an article of great scarcity in war-time. To this depletion of capital must be added the destruction of capital goods such as ships, docks, railways, factories, mines, oil-wells, buildings and other property by enemy action or under the "scorched earth" policy.

Except, perhaps, in some of the war trades it is very unlikely that improved techniques would

have been employed, during the war, in civilian production. So far from this being the case it would seem likely, as is happening around us today, that obsolete and less effective techniques of production would have been brought into service by the entrepreneurs. For, in view of the prevailing insufficiency of capital, the presence of a large margin of unsatisfied demand for consumers' goods and the high prices ruling, in the black markets under the regime of rationing and in the open markets elsewhere, these methods would have come well within the range of profitableness. For instance, the spinning wheel, the hand-loom and the cottage industries generally, the bullock cart, the sailing ship¹ and the like would have been receiving more than their ordinary measure of attention. In other words, on the termination of the war, production, on the average, would be less round about and, as a consequence, less efficient than before the war.

The savings of the community, notwithstanding their having been produced on a vastly larger scale than in peace-time, will have left no

¹ An idea of the encouragement which is being given in India, as part of the war effort, to the bullock cart and the sailing ship may be had from *The Economist* of 27 March 1943, P- 396.

positive mark on the community's capital equipment. They will have instead taken the form of goods such as munitions, tanks, tommy-guns, underground air-raid shelters, trenches, submarines and so forth, which, whether destroyed in action or not, would be incapable of adding to the community's productive power and must be reckoned as permanently lost to the economy. Some creations such as aerodromes, bombers and ships can be, no doubt, absorbed in peace-time trades, with or without alterations, but this would be poor compensation for the enormous drain of capital which will have resulted during the war. In other words the productive capacity of the aggregate fixed real capital equipments of the belligerent countries at the close of the war would be appreciably below their respective capacities at the commencement of it.

The magnitude of the circulating real capital, i.e., the goods in process and the finished goods in stock at the factory head or with the dealers, present in the economy at the close of the war would be vastly less than what it was before the war. For, in the first place, during the war, as we have seen in Chapter III above, the circulating real capital of the country will have been drawn upon for the prosecution of the war. This would

have been effected by cutting down the normal waiting period at each intermediate stage of production within a factory as well as by increased concentration of industry or closer co-operation of production as between the several productive units. This process, which we see happening today in the belligerent countries,¹ would have advanced considerably with the progress of the war, so that, on the termination of it, the aggregate volume of the circulating real capital existing in the economy will have suffered great depletion.

Secondly, the rate of the output of raw materials will have suffered appreciable diminution as the plantations, farms and the agricultural and allied industries generally will have been worked on the principle of "slaughter tapping" during the war. The same would also hold true of the output of forests and, owing to the deterioration of their capital equipment, also of the mines and other extractive industries. The factories, too, would be turning out less of finished and half-finished goods in consequence of the loss in efficiency of machinery and other fixed real capital. The same

¹ In Great Britain governmental control of industry has led to increased concentration or co-ordination of production. This has been the policy of all the war-time Presidents of the Board of Trade. See *The Economist*, 18 April 1942, p. 535 and 15 May 1943, p. 632.

would apply to the circulating real capital in trades in which specialised production had to be abandoned owing to the loss of foreign markets and in which recourse had, therefore, to be taken to producing goods of a lower degree of economic advantage. For, the volume of the goods in process when labour and capital are applied to less effective spheres, i.e., to spheres in which the length of the average period of production is less, must decline.

In the third place, some of the circulating real capital in the war trades, which will have already reached an advanced stage of production as war goods, e.g., shells of bombs, half-dug trenches, gun-powder, tanks and guns in process, would be more or less incapable of being turned over to the civilian trades and would, therefore, have to be largely abandoned.

The same would apply to the country's manpower. It will have suffered in quality as well as in numbers. During the war, the birth-rate would have been less than maintained and the death rate would have been higher than usual as a result of the normal death rate having been reinforced by the deaths in the front and through enemy bombing of the cities. Certain numbers will have been permanently disabled through dis-memberment in fighting. The ratio of the

able-bodied men to the total population will have been, therefore, greatly depleted on the termination of the war. The general standard of efficiency of the nation, too, would be at a low ebb owing to a combination of factors. When the men return from the forces to their peace-time occupations, they will have generally suffered in efficiency through loss of familiarity and contact with their old jobs. It would be only in a minority of cases that the opposite may hold true as a result of the training received while in the army. For, while military service may contribute to the general discipline and smartness of an individual, it cannot make him as good a carpenter or as good a farmer as he might have been had he continued in these vocations or apprenticed for them for the period he was in the forces. Boys and girls will have been called out of Schools and Universities before the completion of the full period of their training. Some may have lost opportunities of any training at all and the workers in the factories will have suffered in vigour through over-work. Under-feeding owing to the shortage of food might have generally affected the health of the population. It would be some time, therefore, before the nation may return to the pre-war standards of numbers, age distribution and efficiency.

The general efficiency of the factors of production as well as the productive capacity of the post-war economy in the aggregate would, therefore, be considerably less than before the commencement of the war. If so, the programme for a return to the pre-war standards of production and equipment, and also for an expansion beyond that level, which the consumption and the instrumental entrepreneurs might embark upon with the removal of the war time restrictions would prove to be, as we have indicated above, far too ambitious. The available supply of the real resources would be soon found to fall short of the required quantity for the successful completion of this programme and the economy would get caught when it is somewhere half-way through it.

The insufficiency of the real resources, however, is not likely to be realised by the savers, the individual firms or the entrepreneurs who work for them. For, in the sphere of finance there would seem to prevail affluence all round and hardly any evidence of scarcity.¹ To the individual saver his savings would seem to be intact, whatever may be the havoc which had been wrought by the war. They would be there as bank deposits, post office cash certi-

¹ See "The Torrent of Liquidity," *The Economist*, 19 April 1941, p. 529.

ificates, war savings certificates, tax reserve certificates, treasury bills or as war bonds of various kinds with perhaps the accumulated interest payments revived on them if these latter had not been expended on consumption. He would have no doubts at all that his bank would be able to pay to him his deposits on demand. Indeed, he may find its position more liquid than ever thanks to the treasury deposit receipts and treasury bills it may have acquired. Nor would he have any doubts in the ability of the government to honour their bonds of indebtedness at the due dates and he would see that he would be able to realise his investments on them almost at a moment's notice by disposing them of on the stock exchange or in the money market. The same sense of security would prevail in the minds of the management of corporations in respect of their depreciation funds and reserves. It may, therefore, seem to the parties concerned that the available funds would be ample not only for a return to the pre-war level of capital equipment—the depreciation funds alone might perhaps be considered sufficient for this—but also for taking the economy beyond this standard.

The instrumental entrepreneurs, too, would be misled by the low rates of interest prevailing, the plentiful supply of the funds available in the

money market, and the high and rising prices of the securities and of new capital goods, in the general sense of optimism, which would prevail, neither the savers nor the entrepreneurs may pause to think that, though the bank balances, the treasury bills and the government bonds may be there to "draw upon," the real resources would be present only in a greatly depleted strength. They may not see that the paper documents in their possession are but in the nature of the ghosts of the dead and that it would be futile to try to revive them. For, considerable quantities of real savings behind these documents would have, in fact, vanished in smoke, gone to the bottom of the sea or would have taken the shape of the various implements of war which would be mostly useless for furthering any scheme of economic expansion or reconstruction.

Instead of putting a break upon these developments the banking system may, indeed, facilitate their progress. The scale of deficit financing by the governments at war being too large to be raised by public subscriptions to medium- and long-dated government loans, recourse would have been taken to an increasing extent, as is happening to-day in many belligerent countries, to the more easy method of direct short-term borrowing from the banks. The long-established

independence of currencies from rigid gold parities would have removed some of the inhibitions which might have deterred governments and their advisers from this course. It would also have a better appeal to the investors as the uncertainties of the prevailing outlook might have created in them a preference for liquidity. The war, therefore, would have been waged to a considerable extent on cheap and abundant money. This would have left its mark in the high and rising liquidity ratio of the banks, and, eager to remedy the oppressing pressure of it, they may welcome credit-worthy borrowers. Rather than make loan conditions more rigorous, the tendency on the part of the banks is, therefore, likely to be in the opposite direction.

Thus the chief actors in the drama, may not realise that the immediate post-war position would not permit a return of the economy at one stride,* so to speak, to the pre-war level of real consumption as well as to the pre-war standard of capital equipment. Blinded by the financial integrity of their resources they may not see that for attaining the latter objective the level of real consumption, so far from being increased,* would have to be curtailed considerably below its pre-war level. And yet, on the one hand, instxu-

mental entrepreneurs would launch schemes of capital creation designed to take the economy beyond the pre-war standards and, on the other, consumption entrepreneurs would begin to expand their output in order to meet the growing demand for it on the part of the consumers who would now want to recover the lost magnitude of their real consumption.

For some time, however, [while yet the machines, materials and man-power, disengaged from the war occupations, would be available for employment, i.e., during the period of withering away of figure 3 on p. 119 above, the inherent unsoundness of the programme of reconstruction and expansion may not become apparent. On the contrary, the transition from the war to the peace economy might seem to be progressing marvellously well. Peace-time production would rapidly increase, incomes would be high and rising and both the consumption and instrumental trades would seem to show every sign of prosperity.

It is not possible, however, to forecast how long these boom conditions might continue. But once the agents of production made available from the war trades will have been wholly re-sorbed in the civilian occupations, serious difficulties would arise. Any expansion of either

the instrumental or the consumption trades beyond the level reached at the moment this may happen would be possible only by withdrawing real resources from the other trades. And obviously neither of the trades would by now have completed their planned programme of expansion. There would, therefore, ensue a tussle between the two categories of entrepreneurs for gaining hold of labour and materials, the instrumental entrepreneurs for completing the half-finished projects and the consumption entrepreneurs in order to maintain or increase the output of consumption goods. The wages of labour and the price-level of materials would consequently rise.

Simultaneously, the rate of interest also might tend to stiffen. For, subsequent to the cessation of hostilities, serious breaches will have occurred in the fund of social savings. The stream of current savings would no longer remain at the artificially inflated levels at which it may have been maintained during the war by the various measures which we have reviewed above. Owing to the general orgy of spending, it might even fall below the level which might be deemed to be normal. The accumulated individual balances, too, might be drawn upon by their owners to swell the volume of consumption expenditure. As the boom

progresses the fund of resources at the banks would, therefore, suffer rapid depletion and the banks would soon find it difficult to accommodate prospective borrowers as freely as they may have been doing in the early stages of it. They would make loan conditions more stringent and also raise the rate of interest.

The rise in the rate of interest, for the reasons we have examined above, would lower the price-level of securities and of instrumental goods. This would reduce the profitableness of the productive undertakings taken in hand by the instrumental entrepreneurs. They would, therefore, find the new wages of labour and the prices of materials too high and uneconomic.

The consumption entrepreneurs, however, would be somewhat differently placed. Throughout the boom period the demand for Consumption goods would continue to be high or even increase, as what would be a loss to the fund of savings would be a gain to the volume of consumption expenditure. The price-level of consumption goods, therefore, would remain at a high level or even keep moving upwards. It would be largely unaffected by the rise in the rate of interest. If> therefore, the banking system did not intervene and create expansionary credit in favour of the

instrumental entrepreneurs, the consumption entrepreneurs would be able to acquire the limited supplies of savings by paying for them the higher rates of interest which the banks would demand. And, with the help of these savings, they would attract the labour and materials employed in the capital goods industries.

Deprived of the essential factors of production the instrumental entrepreneurs would be now faced with the prospects of having to abandon the projects which they had embarked upon and which would now be only half-way through. But this would involve considerable loss of capital. In order to escape the loss or to minimise it the more favourably placed among the entrepreneurs would, therefore, somehow try to raise the necessary funds and either complete the remaining processes of production or adjust the goods in process to a lower order of round-aboutness of production than had been planned at first. In doing this they would, perhaps, attempt to recapture, by "sale or mortgage, some of their past savings held in the form of government and other securities. But, so far from remedying the situation, this can only render the struggle for short-term funds more keen, drive the prices of the essential factors of production higher, hasten the fall in se-

curity prices and further intensify the difficulties in general. It cannot relieve the shortage of funds or the insufficiency of the real resources. It can do no more than shift the incidence of both on weaker shoulders. And, there being no other way of escape, further production in instrumental trades would be adjusted to a lower order of magnitude or to a lower scale of round-aboutness. This would give rise to unemployment in these trades.

It would be no remedy to this turn of events for the banks to create credit in favour of the instrumental entrepreneurs. On the contrary, as indicated in Chapter II above, such action on their part would merely postpone the evil and in doing so intensify its character. In actual fact, however, before the crash would come some expansionary credit might have been already created by the banks in favour of these entrepreneurs. For, the banks may have felt satisfied about the general soundness of the projects, the integrity of the borrowers and the quality of the security offered. And, under the existing banking tradition, so long as there was sufficient room for the creation of credit, the commercial banks need not take into consideration any other factor before deciding to advance loans. Questions such as general econo-

mic stability do not come within the purview of individual banks.

The setback in the instrumental trades would soon spread to the consumption trades as well, though for some little time high prices and increased activity might continue in the latter. As a result of unemployment in the instrumental trades, aggregate social income would fall and, therefore, the volume of consumption expenditure. Prices of consumption goods would thereupon tend to decline, the scale of their output would diminish and unemployment would appear in the consumption trades also. The depression would thus spread throughout the economy and would gather cumulative force as it progresses. It would act as an instrument for liquidating the incongruities in the economic structure developed in the course of the boom. In the sphere of finance it would tend to eliminate, through its deflationary effects, the surplus currency and credit in the economy, which was the original cause of the trouble, and equilibrium conditions would thereby tend to be restored.

CHAPTER VIII

THE WAY OUT

If the analysis of the preceding chapters be broadly correct, it would seem that the root cause of the post-war depression lies in the orthodox method of war finance. For, we have seen that it is such finance that would leave behind the fearsome legacy of long-dated war bonds, treasury bills and other floating debt, and a plentiful supply of inflationary funds in the money market. And, our analysis has shown that this would be responsible for all the trouble that would follow. It would create an illusion in the minds of the savers and corporations that their savings, depreciation funds and reserves are intact. It would be responsible for raising the price-level of instrumental goods to artificially high levels, and would keep the market rate of interest at below the natural rate. These developments would give wrong signals to the instrumental entrepreneurs and would lead them into launching far too ambitious schemes of capital construction.

The much depleted supply of the real resources, however, would be insufficient, as we have noted above, to satisfy simultaneously the demands of capital construction as well as of the increased output of consumption goods. The situation would be somewhat like the blue-print of a building being too large and complicated and the materials available for its construction being too short. If construction on the lines of the blue print were taken in hand and the fact of the shortage were to be discovered only too late, there could be no way out but somehow to adjust hastily the part of the structure already erected to a new blue-print less elaborate than the old one, though in the process some of the materials already employed in the construction of it might have to go to waste. It would be something like this that would happen in the course of the post-war depression. No amount of tinkering with the currency or credit system would be of any avail. For, there is no device by which a quart could be got out of a pint pot. That is to say, once the over-development of the instrumental trades was allowed to take place there would be no way of escape but through nature's remedy of the depression. If so, the best method of avoiding the post-war depression would seem to be to prevent the post-war boom from raising its head.

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If we accept the view that the origin of the whole trouble lies in the orthodox method of war finance this could be done in one or more of three ways: (1) by preventing the creation of the documents of governmental indebtedness and the inflationary supply of funds; (2) by removing from the picture these documents and funds on the termination of the war; and (3) by continuing for a planned period of post-war economic reconstruction the war-time economic controls. We shall briefly examine these several remedies separately.

The first remedy would require that the war must be financed wholly from the proceeds of taxation and not at all by the issue of war bonds or by currency or credit inflation. This would mean that the rate of taxation would have to be very much higher than normally and, as depreciation funds, reserves and investments also would have to be trenched upon, the war budget would have to include, in addition, annual capital levies. In the United Kingdom, for instance, during 1941, under such a system, the Treasury would have had to collect, through taxation and capital levy, £ 4,663 millions as against an actual taxation and miscellaneous revenue collections of £ 1,875 millions.¹

**The Economic Journal*, June-September 1942, p. 207.

Such war finance, however, might seem far too rigorous and also unorthodox. The burden of it might seem to weigh too heavily upon the *minds* of the people though in point of the sacrifice of real resources, there can be no difference between this method of finance and the actual one under which the people get in exchange for their savings, depreciation funds, reserves and investments, government bonds, treasury bills or other bits of paper. In comparison, the orthodox method of appropriating the savings and the capital of the people might seem to produce less squealing. It has also certain political advantages, more especially, when the loan contributions come from the masses of the people in the form of deferred pay, war saving stamps or war saving certificates. It may increase their sense of security and they may then feel that they have a personal stake in the war and may consequently be willing to bear the strain of it a little longer than under the taxation *cum* capital levy system. For the individual citizen the latter system of war finance may seem all on the debit side with nothing to show on the credit side* Also, in the case of poor countries, as noted elsewhere, finance through inflation may prove to be the only device of making the people in the lower income groups

pay for the war. In other words administrative and political considerations may render it exceedingly difficult to finance a world war wholly by taxation and capital levies and avoid altogether war loans and inflation.

If we ruled out repudiation of all government debt as too revolutionary or too crude, the second remedy would imply the imposition of a stiff capital levy on the termination of the war and the redemption in full of all the governmental indebtedness incurred during it from the proceeds of the levy. Though not as a measure for avoiding post-war depressions, proposals have been made in the past for a capital levy as a means of wiping out war debt. Ricardo had strongly advocated it after the Napoleonic Wars¹ and it had led, in several countries, to one of the major political controversies in the years following the last world war. The debate mainly centred round the questions of the burden imposed upon the national budget by the service on war bonds and of the injustice of permanently enslaving the tax-payer to the bond-holder.

Expert opinion on the subject, however, has never doubted that from the practical view the levy

¹ Works, p. 149.

is perfectly feasible.¹ There would be wide agreement also on the social justice of the measure. In addition, if our analysis be correct, it would remove from the body economy one of the root causes of trouble and would enable the progress of post-war economic reconstruction without the tears of a depression, 'But it is a major surgical operation. It would seem, however, that the greatest good of the whole would be promoted if vested interests, namely, the small and the large capitalists who would have to be called upon to pay the levy, could be induced, or compelled, to submit to it.'

The adoption of either of these two remedies would produce an equivalence between the financial resources in the possession of individuals on the aggregate and the real resources present in the economy. Under the system of war finance through taxation plus capital levy, this equivalence would be maintained even as the war was being fought. The individual citizens would then realize their growing poverty in the exact ratio in which their incomes and capital would be drawn upon and used up in the act of war.

Under the second method the equivalence would only follow the post-war capital levy. Till

¹ See Keynes, *A Tract on Monetary Reform*, London, 1923, p. 69; Hugh Dalton, *Principles of Public Finance*, London, 1936, p. 271.

then the financial resources of the people would be in excess of the real resources in the economy by the amount of the war loans and treasury bills, assuming that the proceeds of their issue, or, to be more precise, the real resources acquired with the proceeds, were all used up in the war. The capital levy would take away from the possession of the public the surplus financial resources to which no real resources correspond.

In doing this, it may be noted that, there may not result any great transference of wealth of a regressive nature as between the major income groups in the economy. The only noteworthy transference would be from the wealthier classes to the workers to the extent of the voluntary war contributions made by the latter. But this transference would be of a non-regressive character.

For, the general body of contributors to the capital levy are likely to be more or less the same body of individuals as the holders of war bonds or the actual beneficiaries of the transference of wealth produced by inflation. If so, all that would happen would be a reciprocal payment and repayment of certain sums of money as between these classes of people on the one hand and the government, on the other: the amount of the capital levy received by the government would be repaid to the

assesseees of the levy in liquidation of the bonds of governmental indebtedness held by them. Only this body of people would now feel themselves poorer by the value of the government bonds they would thereby lose. In respect of the profits produced by inflation something similar would materialise. These profits or sums equivalent to these profits would be taken away from their recipients and would be paid into the bank of issue or the commercial banks in redemption of the government securities held by them as cover against the inflationary moneys they had created.

Thus, the capital levy may be said to deal out some rough and ready justice by the community in general. The net result of it would be more or less the same as if the war had been financed wholly by taxation plus capital levies from the very start. To produce the desired result, however, it must be collected before the instrumental entrepreneurs may commence work on the impossible schemes of reconstruction and expansion.

If either of these two policies could be pursued and if the banks do not create any credit to which voluntary savings, depreciation funds or reserves held in liquid form do not correspond, there need be Utde or no fear of a false boom breaking out after the close of the war. For, though the capital equip-

ment of the economy would be, no doubt, badly in need of repair, renewal or reconstruction, the instrumental entrepreneurs would be unable to move faster than the funds accumulating under these several heads plus the funds released from the war trades may permit. That is to say, the sudden removal of the war-time economic controls may not then engender a more capitalistic development of the economy than the prevailing situation might justify.

This would be ensured by the rate of interest on bank advances, which, inflationary funds being assumed to be non-existent in the economy, would be identical with the natural rate of interest. It would not permit any attempt at an immediate return of the economy to the pre-war standards of capital equipment. That would become practicable only as savings reach the pre-war level. If the consumers, having been starved of their wants during the war years, should decide to spend a larger proportion of their incomes on consumption than they do normally, the recovery to the pre-war rate of savings and, therefore, to the pre-war standard of capital equipment must be a slow process. Until then only so much of instrumental goods would be created as would be worthwhile under the existing interest rate, or, which is the

same thing, as would be permissible under the current flow of savings, depreciation funds or reserves. The more important creations of capital would be taken in hand first, the rest of them being left to be attended to as and when more savings accumulated.

The cue to the third remedy is provided by the fact that the war bonds, the treasury bills and the inflationary funds could induce no structural maladjustments in the economy while the war lasted. The physical and the financial restrictions on the entrepreneurial and consumption activities, which had then obtained, had rendered these financial resources innocuous. They could set about producing such maladjustment only subsequent to the removal of these restrictions.

If, therefore, the war-time economic controls are continued for a planned period of time after the war, these remnants of war finance may be effectively prevented from disturbing the orderly progress of the economy. The post-war reconstruction may then become possible without our having to pass through a depression. The Ministry of Supply, the Ministry of Labour and the Treasury, therefore, in place of being occupied in diverting labour, machines and materials from the instrumental and the consumption trades into the war trades, as they had been doing during the war,

should now be engaged in furthering a planned programme of capital creation.

To begin with, in order to prevent the depleted real resources from being frittered away in the consumption trades, the output of consumption goods must be subjected to restrictions through the same devices as had been employed for this purpose during the war. The programme of reconstruction could be put through speedily, if real consumption could be kept down at its war-time level. This would release for employment in the instrumental trades the entire army of resources hitherto engaged in the war trades and capital goods could then be produced at the same fast pace as war goods.

In the second place, investment must be restricted to the volume of the real resources forthcoming. That is to say, the creation of the instrumental goods must not be allowed to be launched on a scale which is more than commensurate with the supply of the agents of production available for the purpose. Speaking in terms of finance, the programme of capital construction must be so planned that the stream of liquid moneys comprising savings, depreciation funds and reserves would be sufficient, at current prices, to complete them.

It would seem necessary, therefore, to continue the war-time machinery of the physical and financial restrictions on investment. Only, the object of these restrictions should now be prevention of any tendency towards an over-development of the instrumental trades. In the light of this objective the use of the essential constructional materials and of the transport facilities may be subjected to the issue of priority certificates and the flotation of all capital issues may be made conditional on the taking out of a licence from a properly accredited authority.

In the third place, simultaneously with these measures, steps must be taken progressively to redeem all governmental indebtedness. This would be facilitated if the war-time rate of taxation was continued during the post-war reconstruction period, the proceeds of it being utilised to redeem government bonds. These paper balloons of financial resources may thus be exploded and put out of action by instalments. The continuation of the war-time rate of taxation need not, it will be noted, in any way diminish the volume of social savings directed into the reconstruction trades. For, the moneys, which in the absence of heavy taxation might have been saved by the tax payers and employed in capital construction, would now be

so employed by the erstwhile government bond holders. So long as the output of consumers' goods is cut down the savings cannot disappear into the consumption trades.

The success of these measures in preventing a post-war boom from breaking out, however, would largely depend upon the co-operation of the banking system. It must desist from creating any expansionary credit. Self control in this respect may be necessary because amidst the general feeling of optimism the temptation for creating credit may be great. It may be helpful, therefore, to "freeze" all war bonds with their then holders or allow transfers of them only under certain specified circumstances, and to forbid banks from creating credit against them.

The economic controls may be gradually relaxed as the planned programme of reconstruction was being fulfilled. But it may not be safe to abandon the controls wholly until the full completion of the programme as well as the complete redemption of the war debt. If the war debt was not redeemed in full at the time of the removal of the controls the economy might still have to suffer the consequences of such over-development in the constructional trades as the unredeemed bonds might be instrumental in producing. If, on the other

hand, the controls were removed before the completion of the projected plans, the instrumental trades might be faced with the problem of an insufficiency of savings for the completion of the remaining processes of production, as expenditure on consumption might then attempt suddenly to jump up. When both objectives would be wholly realised, however, there will have been removed from the economy the two major elements of instability which had emanated from the conventional methods of war finance and the economy may then hope to reach, and also maintain, a position of stable equilibrium.

To summarise. The origin of the cyclical fluctuations of the post-war economy lies in the finance of war through loans and inflation. If, however, war finance was wholly raised from taxation and capital levies and not at all through loans or inflation, we need experience neither a boom nor a depression. The economy may then steadily expand towards the pre-war standards of capital equipment and real consumption, provided that, after the termination of the war, the bank rate was not permitted to fall below the natural rate, i.e., provided that the banks did not create any expansionary credit.

If this method of war-finance, which is theoretically the best, should be discarded on grounds of political expediency or administrative convenience, the boom and the depression may be still avoided if, immediately following the restoration of peace, a drastic capital levy was imposed upon the people and the paper wealth of war loans was wholly wiped out with the proceeds of the levy. In this case also it would be necessary to keep a strict watch over the credit policy of the banks with a view to preventing overlending.

If this, too, should prove to be too bitter a pill to swallow, the only way of escape would be to continue, for the duration of a planned period of reconstruction, the system of economic regimentation which had been applied and developed during the war. It would not be before the completion of the planned programme and the complete redemption of the war debt that the freedom of consumption may be safely restored in its entirety.

If, however, there should be wanting the necessary courage and wisdom for the adoption of one or the other of these two measures, or a suitable combination of them, we would be condemned to an inflationary boom which would be followed by a depression. It is the price we would be called upon to pay for the sins of inability and unwilling-

ness to face facts on the part of the government. It is, so to speak, nature's remedy which comes into ruthless operation when the body politic has shrunk from curing itself by throwing out the foreign matter of the artificially created paper riches.

