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**THE
ECONOMICS OF REARMAMENT**

Also by
PAUL EINZIG

**MONTAGU NORMAN : A STUDY
IN FINANCIAL STATESMANSHIP
THE COMEDY OF THE POUND
THE TRAGEDY OF THE POUND
THE STERLING - DOLLAR - FRANC
TANGLE**

THE ECONOMICS OF REARMAMENT

BY
PAUL EINZIG



LONDON

KEGAN PAUL, TRENCH, TRUBNER & CO., LTD.
BROADWAY HOUSE : 68-74 CARTER LANE, E.C.

1934

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PREFACE

THE author feels he owes his readers a confession. When he decided to write a book on the highly controversial questions raised by the economic aspects of rearmament and disarmament, he had not the faintest idea what his attitude would be towards the subject. For sentimental considerations he would naturally have preferred to present as strong a case as possible in favour of disarmament and against rearmament. As his work proceeded, however, he felt compelled to realize that, from an economic point of view, there is no clear case either for the one or the other. Like most things in this imperfect world of ours, both rearmament and disarmament have a number of economic advantages as well as a number of economic disadvantages on their side.

The question is on which side the advantages outweigh the disadvantages. When the author settled down to write this book he had no preconceived answer to this question. Chapter by chapter, he was trying to weigh the arguments

for and against each side, concluding now in favour of the one and then in favour of the other. The result is that probably both pacifists and the opponents of disarmament will be dissatisfied with his conclusions. The book is not meant to be propaganda either for or against disarmament. If it has any tendency at all, it is in favour of economic planning. For it is owing to the absence of planning that in our present system mankind is unable to benefit economically by a reduction of wasteful armament expenditure. So long as, amidst the economic anarchy caused by *laissez-faire*, a large section of mankind cannot be permanently employed in productive activity, the contention of the opponents of disarmament, that it is better to employ them in the manufacture of war material than leave them unemployed, is difficult to answer. While pacifists have a very strong case on political and moral grounds, their economic arguments remain weak so long as prosperity can be increased by rearmament.

Part I of the book examines the economics of armament in the light of the actual experience of recent history. It gives an account of the economic results of the pre-war armament race ; it attempts to isolate the economic effects of armament expenditure during the war from the other

economic effects of the war ; it analyses the economic balance sheet of the war, discriminating between temporary and permanent results ; it attempts to explain why disarmament in certain countries after the war failed to produce the economic advantages expected of it, and to answer the question whether the fact, that countries which remained highly armed after the war retained a relatively high degree of prosperity, was sheer coincidence, or whether rearmament was really responsible for better trade conditions. Part II of the book gives a forecast of the probable economic effect of future rearmament on an extensive scale. It deals with the budgetary aspects of rearmament ; with its effects on trade and employment ; with the inter-relation between rearmament and monetary policy ; with the effect of rearmament on economic depression ; and with the fundamental economic aspects of rearmament.

The appendices contain some relevant material extracted from the League of Nations reports on the proceedings of the Disarmament Conference.

P. E.

LONDON,

February 1934.

THE ECONOMICS OF REARMAMENT

PART I

THE PAST

CHAPTER I

INTRODUCTORY

DURING the last four years, the world's nerves have been strained to the uttermost by the shocks administered by the economic crisis and by the constant uncertainty as to the future outlook. Economic and financial problems have come to occupy a prominent place in the mind of the general public, such as they have never done at any time in the past. And yet, in the last few months, these problems have been overshadowed by developments far more menacing than the economic crisis when at its worst. The threat of another war cast a gloom over the world com-

pared with which the darkest days of the financial chaos appear to us to have been cheerful. For, after all, even if the most pessimistic forecasts of complete economic collapse were to materialize, it would only affect the wealth and welfare of the human race. If, however, the threat of another war became a reality, it would endanger the very life of millions of human beings.

It is therefore no wonder that, in face of the graver danger, the world has been inclined to forget about the lesser one during the last few months. Possibly this has been partly the result of the moderate but world-wide economic recovery experienced during 1933. On the other hand, it is equally possible that the recovery itself was partly due to the fact that the attention of the public was diverted from its economic troubles. Doctors usually advise their patients to think as little as possible about their illnesses, as by brooding over their ailments they can only aggravate their condition. Undoubtedly, the pessimism of the public was largely responsible for the aggravation of the world crisis. The moment it ceases to worry over the possibility of a further slump, financial crashes and economic collapse, the economic situation is bound to benefit by the change. To apply a more appropriate comparison, it is said

to be the habit of seamstresses, when they hurt their finger with the needle, to apply boiling hot water to it, since the pain of the latter neutralizes the pain of the former. Confronted with a graver danger and more harassing worries, the world has to a great extent forgotten the lesser trouble.

On the other hand, there can be no doubt that to some extent the threat of another war must have neutralized this factor. The uncertainty of the international situation is bound to produce an unfavourable effect on enterprise. Its discouraging effect is not, however, general. It is confined to the branches of production and to the geographical districts which are likely to be affected adversely through a war. Generally speaking, the war menace may even act to some extent as a stimulus for the investment of capital in industrial equities in preference to fixed interest bearing bonds. For, as the experience of the last war has shown, the depreciation of currencies which inevitably accompanies a war tends to inflict greater losses upon bondholders than upon holders of shares. The threat of war tends, therefore, to increase the flow of capital into productive channels. At the same time, it tends to discourage the expanding trend of consumption. During periods of uncertainty retrenchment is the watchword of

consumers. Thus, on balance, the economic effect of periodic war "scares" must be decidedly harmful.

However it may be, the economic depression has gradually disappeared from the front pages of the Press during the last few months. Its place has been taken by headlines on the menace of war, on the failure of disarmament attempts, and on the likelihood of rearmament. This latter question has received immense publicity lately. It has been discussed extensively from the political, military, technical and moral point of view. Its economic aspects have, however, been comparatively neglected. This is only natural, for, after all, rearmament is in the first place a problem that concerns politicians and military experts. Those who urge the necessity for rearmament and those who fight the forlorn battle of disarmament, invoke political, strategical and humanitarian arguments, and only very occasionally economic arguments. There can be no doubt that rearmament depends largely upon political considerations, and that its economic considerations are in the background. It is none the less true that those in favour of rearmament argue, in support of their case, that rearmament would mean more employment and an all-round improvement of trade. The number of those who changed their

minds in favour of rearmament consciously on this ground must be relatively small. In the majority of cases it is the question of national security, the fear of an enemy attack, that induces people to abandon their "let us disarm at all costs" attitude.

Ardent pacifists, in order to reinforce their case against rearmament, warn the world that, as it is, we are on the verge of financial ruin, and additional wasteful expenditure would just provide the last straw and would complete the work of economic destruction. If, however, their appeal on moral and humane grounds fails to win over public opinion, their economic argument is not likely in itself to save them from being defeated by their opponents. At the same time there must be a large number of people in whose minds the political and moral arguments for and against disarmament more or less offset each other; in such cases economic considerations, less important as they may be than political or moral considerations, may turn the balance of opinion in one direction or the other. Subconsciously, economic considerations play probably a much more important part than most of us would care to admit. While, consciously, most people would reject the idea that economic considerations would influence

their attitude on the vital question of disarmament and rearmament, in our subconscious selves we are all subject to the influence of our economic interests. However emphatically we may protest against the suggestion that our opposition to rearmament is weakened by any economic advantages of that policy, we cannot escape the influence of that argument even though we may not care to admit it.

For this reason the economic problems connected with rearmament deserve more attention than they have been given in the course of the controversy. Even amidst the disquietude caused by the menace of war mankind has to carry on its routine existence. Even though many of us may be destroyed one fine day by high explosives and poison gas, we do not know how far off that day is, and meanwhile we have to live and carry on as usual. Given the probability—we may almost call it certainty—of general rearmament, our task is to examine how far, and in which sense, it will affect the economic and financial situation. On close examination we find that rearmament raises a surprising number of economic questions which require to be answered. The most obvious of them is the question of how rearmament will be financed in various countries.

With the exception of Great Britain and a small number of other countries, the budgetary situation throughout the five continents is anything but favourable. The Governments of most countries intending to rearm are confronted with the problem of finding the additional financial resources required for rearmament. In the case of Great Britain the problem is comparatively simple thanks to the budgetary surplus available for the purpose. In other countries, such as France and Germany, however, the Governments find it difficult to make both ends meet even without the additional expenditure of rearmament, and the task of finding additional milliards in the ordinary way is bordering on the impossible.

This brings us to the question whether rearmament will be financed by orthodox or unorthodox methods. The strictly orthodox method would be to obtain the funds required either by additional taxation or by cutting down expenditure in some other direction. This again raises the question of how either of these solutions would affect the prospects of the countries concerned recovering from their economic depression. In the case of Great Britain and the small number of countries in a somewhat similar position, the same question arises in the form of how far the

employment of budgetary surplus on military expenditure, instead of being used for the reduction of taxation or for the increase of other expenditure, will interfere with the chances of those countries accelerating their recovery.

The less orthodox way of financing armament expenditure (which was, however, widely adopted before the war) is to raise the funds by means of loans. Undoubtedly a number of countries will have to resort to this method. The question is whether they are capable of raising loans internally, and whether there are any chances for the resumption of borrowing abroad for the purposes of rearmament. In cases where both these questions are answered in the negative sense, the only remaining alternative will be to finance rearmament by unorthodox methods, in other words, by some form of inflation.

This brings us to another set of problems raised by the prospects of rearmament. Insofar as it will have to be financed by unorthodox methods, it is bound to interfere with the monetary situation of the countries concerned. In order to be able to rearm certain countries will have to modify their monetary policy, for too rigid adherence to orthodox monetary principles would deprive them of the only means of financing their rearmament.

The effect of rearmament on trade also raises important questions. Its immediate effect is undoubtedly to provide additional direct and indirect employment. The question is how far this additional employment in the armament and allied industries is obtained at the cost of reducing employment elsewhere. In theory, if rearmament is financed by strictly orthodox methods it would divert expenditure in other directions and is likely to produce no material change in employment. Will things work out in the same way in practice? Assuming that it is financed by unorthodox methods, will rearmament not divert funds which might otherwise have been used for productive public works? According to one favourite argument often used in the cause of rearmament, "as so many millions of hands are doomed to permanent unemployment under present conditions, they may as well wear uniforms or be engaged in manufacturing such useless objects as machine-guns or gas-masks". Does this contention hold good in every circumstance? Or only during extreme depression? Will the subsidy to trade provided by rearmament, which is useful during a depression, not become an inconvenience when such subsidy is no longer required during a boom?

Lastly, there is the fundamental question whether the fact that economic life can benefit at all by such utterly unproductive expenditure as is necessitated by rearmament, is not due to the lack of planning in our economic system. Was it not due to lack of planning that countries which attempted to disarm to some extent failed to derive some economic benefit from it? Was it not due to the same cause that countries which have remained armed to the teeth after the war were affected by the crisis to a relatively moderate extent?

The following chapters will attempt to answer these questions. In doing so, political considerations will be entirely disregarded. For the sake of argument it is taken for granted that worldwide rearmament on an extensive scale is a foregone conclusion; otherwise the author, as well as a large section of his critics and his readers, might be tempted to lay too much stress on the economic disadvantages of rearmament, and underestimate its economic advantages so as to support the case against rearmament. It is only by taking it for granted that rearmament will take place whether we like it or not that its economic consequences can be examined with a reasonable degree of impartiality. Possibly this assumption might be

criticized as being far too pessimistic. Possibly events in the near future might appear to prove it to be so. It is conceivable that, by the time this book has reached its readers, some sort of compromise will have been concluded for partial disarmament. Notwithstanding the possibility of such an agreement, the author considers it safe to assume that, in the long run, the world is more likely to rearm during the present generation than to disarm. The revival of nationalism in various continental countries points in that direction. During the coming years Europe is likely to become increasingly conscious of the German menace and will seek security in rearmament. Even Great Britain, the most pacific of all big countries, is likely to begin to rearm in the near future, especially "as far as air defence is concerned. The Government is not likely to be able to resist very long the increasing pressure from the Press and from public opinion for an increase in the Air Force, and an armament race in the air will most probably follow. Japan's ambitions to obtain naval equality with Great Britain and the United States will also most probably lead to a naval armament race. While it is possible that certain types of armaments, such as heavy tanks and heavy guns, might be ruled out, human ingenuity

will find other channels into which national defence expenditure can be diverted.

Although this book confines itself to examining the economic aspects of rearmament, this does not mean that the author has overlooked, or underestimated, its other aspects. He is well aware of the immense importance of the question whether rearmament accelerates the advent of an armed conflict by increasing the tension between the nations engaged in an armament race ; or whether, on the contrary, it is the disarmed state of certain nations that tempt others, less scrupulous in observing the rules of the game, to attack those who place themselves at a disadvantage. These, and many other important questions, are outside the scope of this book. Nor is the author concerned with the moral aspects of disarmament and rearmament ; not because he does not feel strongly about them, but because they have been adequately dealt with in the existing literature on the subject. It is easy to work up an emotional appeal either by denouncing those who make money by manufacturing and selling lethal weapons and all the diabolical creations of modern scientific warfare. It is equally easy to appeal to the nationalistic sentiments of the public by drawing a vivid picture of the danger of an inadequate

system of defence, and by denouncing pacifists as the allies of our potential enemies. All this, however, has nothing to do with the economic aspects of armament. In order to be able to examine these aspects without prejudice, we have to try as far as possible to rule out sentimental, patriotic and humanitarian considerations.

In order to be able to form an opinion regarding future developments, the first step is to acquire a knowledge of past history. The economic aspects of armament before, during, and after the war are well worth studying, as they have some lessons to teach.

CHAPTER II

ARMAMENT RACE BEFORE THE WAR

MANY of those who hold responsible positions in politics, finance and the Press, are of the generation which was a witness of the armament race that preceded the Great War. A new generation is, however, growing up which has only the vaguest recollection of pre-war experience. Before many years it is this generation which will control political life and public opinion. Taking this into consideration, it is perhaps not superfluous to give a brief summary of pre-war experience, especially as even among the older generation the number of those who have given much thought to the economic aspects of armament before 1914 must be relatively small.

During the two or three decades that preceded 1914, all European nations, big and small, rich and poor, were engaged in the task of strengthening their organizations of national defence and equipping them in accordance with modern re-

quirements. It was taken for granted that the outbreak of a world war was only a question of time. On more than one occasion since the beginning of the century, such a conflict was narrowly averted at the eleventh hour. The annexation of Bosnia-Herzegovina by the Austro-Hungarian monarchy, the Moroccan incident, the Italo-Turkish war, and the two Balkan wars, provided strong reminders that a conflict on a much larger scale was approaching. As a result, the leading continental powers were competing with each other feverishly to strengthen their armies, while at the same time Great Britain and Germany were engaged in a fierce competition in naval armaments.

In the case of rich countries such as Great Britain and France this armament race was financed out of budgetary resources. In the case of countries such as Germany, Austria-Hungary and Italy, it was partly financed by internal borrowing, though Austria-Hungary raised some of the funds required by external loans. In the case of Russia, Turkey and the Balkan States, the armament race was financed mainly with the aid of external loans.

Owing to our contemporary habit of thinking in milliards, acquired through the experience of

the last twenty years, we are inclined to regard the pre-war expenditure on armaments, and pre-war borrowing to meet such expenditure, as insignificant. And yet they presented in those days grave budgetary problems. We must not forget that, as a result of the fantastic increase of "fictitious" wealth since the war, our scale of reckoning has changed considerably, and so has our mentality. The greater part of the civilized world before 1914 lived in the rigid atmosphere of financial orthodoxy. Had the Governments, Parliaments and public opinion of various countries in pre-war days possessed our to-day's scale of reckoning, and our more elastic mentality, pre-war expenditure on armaments would have been a multiple of what it actually was. It was not for lack of pressure on the part of War Ministries, Admiralties and General Staffs that pre-war expenditure on armaments was kept down to what we now regard as comparatively moderate figures. Finance Ministers and heads of Governments in every country had to resist the pressure for larger and still larger armament budgets, because the resources at their disposal were limited and because in those days it was considered unthinkable to increase either taxation or borrowing beyond certain points.

Notwithstanding all this, the burden of the armament race continued to increase, both in absolute figures and in proportion to national incomes. In most countries it resulted in a gradual increase in the public debt. It is of course impossible, in most cases, to establish definitely the connection between new issues of Government loans and the increase of expenditure on armaments. It may be argued that the increase of expenditure on social legislation, or on education, also had a share in the increase of public indebtedness before the war. The tendency of modern progress was to increase the duties of the State towards its citizens, so that possibly, even without the costly armament race, budgets and public debts would have increased to something like the same extent. It appears much more probable, however, that Finance Ministers would have had a much easier task in restricting civil expenditure than they had in restricting military expenditure. In countries where the power of the Executive was greater than that of Parliament, such as Germany, Russia and, to some extent, Austria-Hungary, the demand in military quarters for larger expenditure received the support of the rulers of the States, which support would not have been given so freely for social or educa-

tional expenditure, nor even in the interest of the better utilization of the economic resources of the country. It may be safely affirmed, therefore, that the choice was not between spending on armaments or on other matters, but, to a great extent, between spending on armaments or not spending on anything at all.

Insofar as expenditure on armaments was financed out of current budgetary resources, the result of military expenditure was to transfer purchasing power from one section of the community to another. Insofar, however, as the requirements were met by borrowing, there was an actual increase in the total purchasing power of communities. The theoretical aspects of this question will be discussed in more detail in a later chapter. At this stage let it be sufficient to register the conclusion that the relatively large expenditure on armaments before the war resulted in an increase of purchasing power. It is safe to assume that the rising trend of prices during the pre-war years was the result of this increase.

One aspect of the financing of the pre-war armament race deserves particular attention. It is its effect on international lending. Throughout the nineteenth century the greater part of the capital outflow from Great Britain pursued essen-

tially constructive aims. It was thanks to the outflow of British capital that the greater part of the railway systems in other countries was able to be constructed. It was thanks to this outflow that the natural resources of other continents were made available for the benefit of mankind. Other lending countries may to some extent have contributed towards the funds raised for such purposes, but by far the greater part of the capital was supplied by British investors.

During the decades that preceded the Great War, the general tendency of international lending became less constructive. With the increase of the tension between the two groups of powers, foreign lending became more political in character. In this respect France took a prominent place, but she was by no means the only country which granted loans for political purposes. She had, of course, the lion's share in financing Russia's preparation for the Great War. A large part of the French capital lent to Russia was spent either directly on payment for armaments exported from France, or on financing the construction of the strategical railway systems without which the Russian colossus would have been utterly helpless against her Western neighbours. Undoubtedly the construction of railways in Russia was necessary

and useful from a purely economic point of view, but it is highly probable that, but for political and military considerations, foreign capital would not have been forthcoming for that purpose in anything like such generous amounts, and that the Russian railway system would have remained in a much more backward state.

This is an example to show that expenditure undertaken for military purposes is not always necessarily destructive, or even unproductive from an economic point of view. Such cases are, however, exceptional. If we take foreign pre-war lending for armament purposes as a whole, we must conclude that it exhausted the external credit of a number of countries, thus making it more difficult for them to obtain foreign loans for constructive purposes.

There is a fundamental difference between granting a foreign loan for constructive purposes and for the financing of armament. The capital invested in an undeveloped country for the improvement of its means of communication, or for the exploiting of its natural resources, is largely self-liquidating. The chances are that through the increase of its productive capacity the borrower will be able to meet the interest service of the loan and provide for its redemption. If, however,

foreign funds are lent for the purchase of war material, they do not contribute in the least towards increasing the productive capacity of the borrowing country. The chances are that the interest and sinking fund of such loans can only be met with the aid of fresh foreign borrowing, and this process inevitably leads to a deterioration of the standing of the borrowing country in international financial markets.

Let us now examine the effects of pre-war armament upon industry. There can be no doubt that the requirements of modern armies gave rise to a number of new branches of production and stimulated the development of existing ones. This result is not necessarily an item on the credit side of the economic balance sheet of the pre-war armament race, for the development was not always in the right direction.

The manufacture of most kinds of modern destructive weapons, warships, etc., developed as the monopoly of a comparatively small number of countries. The majority of countries depended for their supply of armaments on import. There was no serious effort made by any of the agricultural countries to make themselves to some extent independent of other countries for the supply of their armaments and ammunition. Look-

ing back with the experience of the war behind us, this omission appears to us of great importance. Even though each agricultural country had potential allies among the countries manufacturing armaments, it was an amazing lack of foresight not to reckon with the possibility of their sources of supply being cut off. We have seen that during the war the immense human resources of the Russian Empire, which would have been amply sufficient to enforce a decisive victory within a few months, were reduced to partial inactivity owing to the lack of means for the production of armaments. If only a fraction of the milliards spent by Russia between the Russo-Japanese War and the World War had been spent upon developing an armament industry of her own, history might have taken a totally different course.

From a purely economic point of view the one-sided development of the production of armaments contributed to no slight extent to the general one-sided development of the world's economic system brought about by free trade. While politically the world was becoming increasingly nationalistic throughout the nineteenth century and at the beginning of the twentieth century, economically the international division of labour continued to develop until the outbreak of the war. Admittedly

the international economic system created on such a basis appeared to be profitable to the world in general and to Great Britain in particular. It undoubtedly contributed to pre-war progress and prosperity. It was inevitable, however, that sooner or later the world would have to pay a heavy price for the inconsistency between its political system and its economic system. Great Britain, in particular, having based her welfare on conditions created by this inconsistent development, was bound to suffer when the inevitable readjustment to realities took place. The sudden and violent adjustment of the world's economic structure to its political structure, which took place after the war, was largely responsible for the world crisis of 1931-4.

It is doubtful whether, even if the pre-war statesmen had foreseen the consequences, both military and economic, of the one-sided development of the armament industry, they could have done much to avoid it. The Governments of the countries which had to import armaments would have found it difficult to borrow from those countries which found it beneficial to supply them with armaments. Had they been willing to depart from orthodox principles of finance, they might have been able to erect factories for the manu-

facture of war material, even without the financial assistance of the lending countries. Such a course was, however, unthinkable before the war. No European country, big or small, would have dreamt of debasing its currency in time of peace for the sake of strengthening its system of national defence. Rather than raise the millions required by unorthodox methods, the industrially undeveloped countries were prepared to pay those millions over and over again for imported war material.

Thus, while pre-war armament stimulated the excessive development of industries in a small number of countries, it drained the resources and delayed the development of the majority. To some extent, certainly, the requirements of the army were produced locally before the war. Such industries as existed in agricultural countries received a welcome stimulus through army contracts. On the whole, however, it may be said that the production of backward countries derived very little economic benefit from the pre-war armament race. On the other hand, this armament race gave rise in the industrial countries to the spectacular development of the powerful branches of industry specializing in military and naval requirements. The economic advantages derived from armament

work even by those countries, were, however, to a great extent apparent rather than real. The greater part of the loans issued for the financing of armament exports before the war were defaulted on or repudiated during and after the war. Of the vast amount lent to Russia for building up her modern army, not a penny has been, or is ever likely to be, repaid to the investors. Those who subscribed to loans granted to Turkey, Bulgaria, Yugoslavia, Roumania, Austria and Hungary, received back only a fraction of what they lent, and it is doubtful whether they will receive much more. It seems, therefore, that the armaments exported to those countries were paid for, not by the purchasers, but by the holders of their external loans. This may be a matter of indifference from the point of view of the armament firms, who may not worry where the money has come from so long as they are paid. In the long run, however, even those firms lost the benefit of their work, as their history after the war seems to indicate.

On balance it may be said that the economic benefits of the pre-war armament race were more than neutralized by its disadvantages. The extreme view that this armament race was slowly ruining the world, which was widely held before

the war, appears to us utterly untenable in the light of subsequent developments. From a financial and economic point of view the pre-war armament race could have continued for decades, as its expenses were but a fraction of those caused by the war. It is true that in 1913 taxpayers on the Continent, and to some extent even in Great Britain, were grumbling against the excessive burden of public expenditure almost to the same extent as twenty years later. Those who talk about the happy pre-war days would do well to look up pre-war files of newspapers to derive comfort from the fact that even then people considered themselves anything but happy. On the other hand, it is now evident that things were not nearly as bad as they believed at the time. To some extent the armament race undoubtedly contributed to industrial progress before the war, even though the price paid for it afterwards was a heavy one.

CHAPTER III

ECONOMICS OF WAR EXPENDITURE

THE economic aspects of the war have an immense literature, and it would be difficult to try to add anything to what has already been published on the subject. Our task here is to single out the one particular aspect of war economics with which we are concerned, namely, the economic effects of armament during the war. There are many other aspects of war economics with which this particular aspect is hopelessly intermingled. The economic developments between 1914 and 1918 were largely, but by no means exclusively, the result of the extraordinary expenditure on armament by all the belligerent countries. Any book aiming at giving an exhaustive survey of war economics would have to deal also with the decline of productive forces through the conscription of a large percentage of the male population in belligerent countries; with Government intervention in production, transport, distribution, prices, and

consumption, necessitated by abnormal conditions ; with the intricacies of the necessary financial operations, and with many other problems. Most of these have something to do directly or indirectly with the economic effects of armament, but we must try as far as possible to isolate that subject from the other aspects of war economics.

The supreme effort of both groups of belligerent nations was only made possible by an expansion of armament financing, between 1914 and 1918, beyond all anticipations. Nobody would ever have dreamt in 1913 that it would be practicable to spend such huge amounts on armaments. For the generation of 1914 grew up in an atmosphere of strict financial orthodoxy. It was taken for granted that budgets must be more or less balanced, or that, if there was any deficit, it was to be financed by loans in such a way as not to interfere with currency stability. Although history taught that wars often result in inflation and are financed by inflationary means, the pre-war generation had no such experience and took it for granted, on the outbreak of war in 1914, that this war would be financed on orthodox lines. Knowing as they did that the financial resources of the various countries were limited, they assumed that, once those resources were exhausted, the war would have to come to an end.

Hence the prophecies in August 1914, by experts whose opinion carried weight, that, owing to the limitations of the financial resources of all countries, the war could not last more than two months. Hence the optimistic forecast on the part of the Allied experts that, as the war was bound to be won by the party which had the last shilling in his pocket, an Allied victory was a certainty. The Allies did win the war, but the superiority of their financial resources, and their access to the financial resources of the United States, had relatively little to do with it. Before many months it became evident that, somehow or other, it was possible to finance the war ; although each one of the belligerent countries had already spent many times the amount which in August 1914 was estimated to be the limit of his resources, they were none the less able to carry on. It was discovered that, strictly speaking, there was no such thing as a limit to the financial resources available for financing the war. The modern system of currency and credit has done away with the limitations which were imposed upon statesmen before the advent of the modern era.

Even in mediæval days, when armaments had to be paid for in hard cash in the strictest sense of the term, wars could drag on for thirty years

and for a hundred years, notwithstanding the limitation of cash resources and the absence of the printing-press. In modern times, when payments can be made, internally at any rate, by printing more and more notes, the financial limitations of a war are practically non-existent. It is true that currency depreciation has its limits. We have seen that in 1923 a stage was reached in Germany when inflationary methods ceased to assist the Government in covering its public expenditure for the simple reason that the mark notes printed ceased to have any value. It took, however, five years after the cessation of hostilities to reach that stage. But for reparations payments, internal political troubles, and the desperate policy adopted at the time of the Ruhr invasion, that stage of utter demonetization of the currency might never have been reached, or at any rate it would have taken a much longer time to reach it. It is reasonable to assume that, so far as purely financial considerations were concerned, Germany would have been able to continue the war for at least another four years, and possibly a good deal longer, before financing armament by inflationary means had reduced itself *ad absurdum*.

The defeat of the Central Powers was not caused by the inferiority of their financial resources. They

suffered, it is true, through lack of raw material and food, but this was due to their encirclement by the Allies, and especially to the naval blockade, rather than to any lack of financial resources.

While before the war General Staffs and War Ministries had to struggle for every additional penny of armament expenditure, during the war the sky was the limit for the amount placed at their disposal. The whole economic conception of the world seems to have changed in 1914. Admittedly, before the war there was a slow but steady expansion of fictitious financial resources. In spite of this, it may be said that at any given moment the limit of those resources was comparatively rigid, so that any additional expenditure on armament had to result in a corresponding curtailment of expenditure in other directions. During the war these formerly rigid limits suddenly became elastic in the extreme. There was no longer any question of trying to make up for additional armament expenditure by curtailing public spendings elsewhere. Indeed, to do so would have been impossible, since in most countries the cost of the war was a multiple of the entire remainder of the budget.

In the circumstances the inevitable result of

financing armament expenditure was an expansion of fictitious wealth and the creation of fictitious purchasing power. Before the war the increase of real wealth through the improved exploitation of natural resources, the construction of capital goods and consumption goods, kept reasonable pace with the expansion of fictitious wealth. During the war, however, the enormous increase of fictitious wealth created by excessive expenditure on armaments, together with other factors such as the limitation of production or the destruction of real wealth, was not accompanied by an increase of real wealth. On the contrary, while between 1914 and 1918 the fictitious wealth of the world as represented by holdings of notes, Government bonds, banking deposits, shares, etc., became multiplied, the real wealth actually declined.

How far was expenditure on armaments responsible for this state of affairs? For every pound spent on armament, goods were actually created. We need not examine whether it was the case that, through extravagance or incompetence, the various Governments spent a good deal more than they ought to have on the equipment of their armed forces. What matters from the point of view of our argument is that, by increasing fictitious wealth, it was possible to produce guns and ammu-

dition, uniforms and all the innumerable other articles required by the armies, which could not possibly have been produced if the limit of expenditure had been kept as rigid as it was before the war. It is true that all those products had no economic value. They were used up and destroyed in the struggle between the nations. This does not, however, alter the fact that it is possible to increase the production of goods by creating fictitious purchasing power.

Just let us try to visualize for a moment what would have happened if, instead of spending untold milliards on armaments during the war, all the countries involved had spent an identical amount on productive expenditure. What immense real and permanent values could have been added to the wealth of mankind! All nature's resources could have been made available for the consumers, whose standard of living could have been raised to the highest level imaginable. All nature's resources of energy could have been harnessed and placed at our disposal, making it possible to reduce working hours to a figure which is beyond the dreams of the most optimistic Utopianist. If all the money and human labour spent on the construction of trenches and other fortifications had been employed for constructive purposes, the whole

population could be housed in palaces instead of slums.

It is tempting to indulge in such futile speculation of what might have happened. In reality such a situation could not possibly have arisen. But for the war, the mentality of the world would have remained strictly orthodox, no Government would have departed from sound financial principles for any other purposes than for the defence of the nation against enemy aggression. What is more, it might not even have been desirable to launch into public expenditure, however productive, on such a gigantic scale. Paradoxical as it may sound, it would have destroyed prosperity instead of increasing it. It ought to be borne in mind that *laissez-faire* reigned supreme before 1914. This means that the sudden increase in the utilization of natural resources and productive forces would merely have resulted in overproduction on an unprecedented scale, and unemployment through the replacement of human labour by hydro-electric and other natural forces would have run into fantastic figures. In the end, instead of enjoying ideal prosperity the world would have witnessed a terrific economic collapse compared with which the economic crisis of 1931-34 disappears into insignificance. In the complete ab-

sence of economic planning it was perhaps as well that orthodox financial principles prevented such an orgy of expenditure for productive purposes.

From a purely economic point of view it may seem most deplorable that, when the world did depart from those orthodox principles, its expenditure was confined to armament instead of serving productive purposes. And yet, as it were, the creation of fictitious wealth did not disorganize the economic system to anything like the extent it would have done had the milliards been spent on productive expenditure. The additional purchasing power was not allowed to result in overproduction in any direction or to disturb equilibrium between various branches of production or between production and consumption. It was made use of according to plan and the whole economic system in the belligerent countries was subject to Government regulation to an exceptional extent.

The consequences of heavy war expenditure, and the shortcomings of economic planning during the war, are usually quoted by liberal economists in support of their crusade against unorthodox finance and against planned economy. Without going into the details of the controversy, which is outside the scope of this book, let it be sufficient to point out that both unorthodox spending and a limited

degree of economic planning were put into practice between 1914 and 1918 in the most unfavourable circumstances imaginable, in the absence of any experience and in the form of emergency measures elaborated and executed in great haste. Whatever the merits or demerits of unorthodox spending and economic planning may be, the experience gained during the war is entirely unsuitable for serving as a basis for our judgment.

The economic situation during the war presented a most remarkable picture of contrasts. As a result of the expenditure on armament, fictitious wealth and purchasing power increased. From this point of view there were remarkable symptoms of economic prosperity amidst the world-wide slaughter and destruction. At the same time, however, the extent to which the population of the belligerent countries was in a position to make use of its increased purchasing power was limited owing to rationing and other circumstances. Owing to the price regulations adopted in most countries, together with rationing, the increase of purchasing power and the limitation of supplies were unable to produce their full effect upon prices. There was in most countries an increase in the real wages of the workmen, not only their nominal wages. Notwithstanding this they were unable to satisfy

some of their most urgent requirements. This situation, however, was not a necessary consequence of armament expenditure. Had an identical amount been spent on armament in time of peace it would unquestionably have resulted in an immediate and all-round increase of business activity during the period of spending. It is only when the bill would have become payable in the form of currency depreciation and taxation that the other side of the picture would have revealed itself.

Even though the object of the abnormal expenditure during the war was destructive, a small fraction of it had decidedly constructive results. In every country a certain number of useful industrial plants had been constructed. Means had been found for the better utilization of agricultural resources. Roads and railways had been constructed and even if they primarily served strategical purposes many of them were beneficial also from an economic point of view. Needless to say, this does not mean that the economic balance sheet of the war closed with a favourable balance. Far from it. Apart altogether from the immense wealth destroyed on the battlefields, there was an all-round deterioration in most countries of every form of real wealth, from office buildings to rolling

stock. On the day of the Armistice the real wealth of Europe was considerably lower than in 1914.

It was only the neutral countries which obtained the full benefit of armament expenditure by belligerents. Above all the United States benefited by it to an amazingly great extent. In four years she made more progress in the utilization of her wealth than during the four decades that preceded the war. Before the war she lacked the adequate financial resources to make use of her immense natural wealth, and her development proceeded in a slow pace. Thanks to the spendings of the belligerents she was able to acquire those resources. The national wealth of the United States rose on an unprecedented scale during the war. Even if a large part of the loans contracted by the purchasers of war material were never repaid, the increase of the country's productive capacity constituted a permanent addition to its national wealth.

How far were the economic results of war expenditure permanent? The war left most belligerent countries with dilapidated plant but with an increased productive capacity. By far the predominant part of the objects produced through war expenditure were destroyed. A very great part of what remained was useless in the changed con-

ditions. The increased productive capacity of armament works was not an asset but a liability from the point of view of peace economy. The immense fictitious wealth created all over the world had no counterpart in the form of increased real wealth. It inevitably became, therefore, an unqualified burden on the shoulders of the post-war generation. Some countries got rid of the burden by depreciating their currency ; in doing so, however, they destroyed not only their liabilities but also their assets, represented by the savings of generations. Other countries sought to pay for the war expenditure by orthodox methods through a permanent increase of taxation. They are still paying for it and it remains to be seen whether, eventually, they will not have to follow in some degree the example of those who took the line of least resistance from the very outset.

CHAPTER IV

DISARMAMENT AFTER THE WAR

THE question of disarmament has never been regarded as a primarily economic problem. It is, indeed, much more important to know whether disarmament can lead to permanent peace than whether its economic results are favourable or otherwise. The latter aspect of the problem should not, however, be altogether lost sight of. After all, while in the first place we want to live in peace, our desire to live in comparative comfort and prosperity comes a good second in our desiderata. Moreover, while the question whether disarmament can bring peace and security leads us into the realms of metaphysics, we have comparatively tangible material for the examination of the question whether disarmament means prosperity. The latter depends upon economic forces which can be ascertained, while the former depends upon human nature, the most uncertain of all factors in the Universe.

We said above that we have comparatively tangible material, in the form of ascertainable economic factors, at our disposal for the examination of the relation between disarmament and prosperity. This does not, however, mean that it is very easy to arrive at a definite conclusion. For the economic influences set at work by disarmament are affected by a number of other factors. If we come to the conclusion that in releasing productive forces, disarmament tends to increase prosperity, we should have to add the customary reserve clause "other things being equal". In practice, however, those other things never are equal. In the case of our post-war experience of disarmament they certainly were not. The disturbing factors vitiated the results, which would otherwise have been valuable as a concrete basis for our conclusions.

Which were the countries which disarmed to a very great extent after the war? Germany and her late allies—with the exception of Turkey—were compelled to disarm almost to the utmost limit compatible with the maintenance of internal order and security. A few other countries, Denmark in the first place, followed their example of their own free will. To a relatively less extent, a few other countries—amongst them Great Britain

—voluntarily reduced their armaments. The degree to which Germany has actually disarmed has been subject to heated debate ever since the conclusion of peace. It has been suggested innumerable times from the French side that Germany has, in a large number of instances, violated the disarmament clauses of the Peace Treaty ; that the actual numbers of her effective military force are in reality well above those agreed upon at Versailles ; that a large amount of war materials, amongst them those expressly forbidden by the Treaty, have been retained or accumulated. The famous *dossier* of the French General Staff is supposed to contain a wealth of statistical material to substantiate these charges. Similar accusations have been made from time to time also against Hungary by the countries of the Little Entente, and, to a lesser extent, against Bulgaria. Austria is the only country whose sincerity in the matter of disarmament has not been called into question.

It is not for us to express any opinion as to how far the charges of camouflaged armament are well-founded. Even if we assume that the extent of actual disarmament in Germany, Hungary and elsewhere, was much less than the official figures would have liked the world to believe, the fact remains that, comparatively speaking, these coun-

tries have disarmed. The extent to which armament can be disguised is by no means unlimited, and, if it were possible to compare the real extent of the armaments of post-war Germany with that of either post-war France or pre-war Germany, the conclusion would undoubtedly be that, from the point of view with which we are concerned, the Central Powers have in fact disarmed.

From an economic point of view the situation of these countries appeared, indeed, enviable. Whatever other problems their Finance Ministers had to cope with, excessive armament expenditure was certainly not one of them. Even if we allow for the higher cost of a professional army compared with a conscript army, and for amounts to be found for disguised armament, their relative burden under this head was small compared with that of other countries. It is conceivable that one of the reasons why it was comparatively easy for Germany, Austria, Hungary and Bulgaria to balance their budgets after the stabilization of their currencies, was the absence of unduly heavy military expenditure. This was, however, by no means the only factor, nor even the most important. In all these countries internal indebtedness had been practically wiped out, and the Austrian, Hungarian and Bulgarian Governments concluded favourable

agreements with their foreign creditors, considerably reducing their external indebtedness. This factor was by far the more important among those enabling them to balance their budgets.

The budgetary aspect of disarmament is not the only aspect that has to be taken into consideration when dealing with the economics of disarmament. There is also the release of a large number of men from the unproductive occupations of military service or the manufacturing of armaments. In all countries with large standing armies hundreds of thousands of young men are prevented, for a certain period, from carrying on productive work. They are fed on the production of the rest of the population. It stands to reason that if their number is reduced the ratio between the productive and unproductive sections of the community will change in favour of the former. The same holds good in the case of workmen who are engaged in producing goods required for the army. It was to be expected, therefore, that the consequence of the disarmament of the Central Powers would be not only a relative improvement of their budgetary situation, but also an improvement in their standard of living.

Unfortunately, in reality nothing of the kind occurred. While the budgets of the countries concerned have probably benefited by disarmament

to no slight extent, the same cannot be said of their general economic situation. Notwithstanding the reduction of her military expenditure, the German currency collapsed between 1919 and 1923 and this inflicted untold suffering upon the population. Owing to excessive reparations demands Germany was unable, between 1919 and 1931, to enjoy the benefits of the budgetary economies which she obtained through disarmament. As for the increase of prosperity through the reduction of unproductive population, there was no trace of such a thing. While during the feverish activity caused by inflation it was possible to absorb most of the hands available, unemployment began to manifest itself to an alarming degree during the years of stability. Even before the beginning of the world economic crisis, Germany suffered from unemployment to a considerable extent. This was partly due to the same changes in the international situation which inflicted upon Great Britain a permanent unemployment figure of over a million before the crisis. For the most part, however, the increase of unemployment in Germany during the boom years was the result of extensive rationalization in industries, carried out without any preconceived plan and without regard to its effects upon labour conditions. As a result,

hundreds of thousands of workmen were thrown out of employment. Instead of absorbing those who became available for productive purposes thanks to disarmament—their number may be estimated at well over a million—the German economic system was unable to provide employment even for the number which was formerly productively employed. Thus, disarmament in Germany failed completely to reduce its proportion of unproductive elements to the total population.

Nor was Austria, the most completely and genuinely disarmed of all countries, happy and prosperous after the war. The dismemberment of the Austro-Hungarian monarchy left her with an excessive proportion of unproductive town population. Her economic system lacked vitality, and it was only thanks to the various foreign loans and credits obtained from time to time that she was able to carry on. In such circumstances any theoretical economic benefit she might have obtained through disarmament was lost in practice. Nor was Hungary much more fortunate. Although as an economic unit she has more *raison d'être* than Austria, the impossibility of surmounting the customs barriers of the neighbouring countries has weighed heavily upon her also ever since the war. As for Bulgaria, any advantages of disarmament

were offset by the reparations payments she had to undertake, which continued even after the other Central Powers ceased to pay reparations.

It may well be argued that, but for their disarmament, these countries would have been in an even worse economic position, for in addition to all their other troubles they would have had to support the expenses of big armies. Such arguments, however, carry but little weight in a world which judges by results. Had the Central Powers experienced a period of prosperity after the war, pacifists would be in a position to point out triumphantly that disarmament, even if compulsory, is a blessing in disguise. Their example would have been more effective than any propaganda to convert public opinion both at home and abroad in favour of disarmament. Had the economic benefits of disarmament made the German population happy and prosperous, it might gradually have come to regard it as a blessing and not as an intolerable grievance. It is only because nobody saw any benefit in it that National-Socialist propaganda against the disarmament clauses of the Peace Treaty was so effective. Nor would the political effect of the economic advantages of disarmament have confined itself to the disarmed countries. The victors would have viewed the

prosperity of the vanquished with increasingly envious eyes, and pressure of public opinion would have worked in favour of voluntarily following their example. All the more so as prosperity in Germany would have consolidated the pacific Republican régime and, in the long run, this would have allayed French suspicions, which were mainly responsible for the maintenance of large armies in France and elsewhere. Had disarmament in Germany resulted in prosperity, the experiment would have continued for a sufficiently long time for it to undergo a fair test of whether or not it can work. As it is, the desperate economic conditions that prevail in Germany in spite of her disarmament, have made it impossible to give the system a fair chance.

Nor has the example of those countries which disarmed to a great extent of their own free will been such as to lend itself to quotation as an argument in favour of disarmament. Here again, as in the case of the countries which were forced to disarm, any beneficial economic effects that might have arisen through disarmament were counteracted by other factors. Let us take Great Britain in the first place. Unquestionably none of the victorious powers have imposed upon themselves such a degree of disarmament as Great Britain.

The reasons for which this country disarmed to such an extent were mainly financial. It would sound much better if we were in a position to say that the only reason why Great Britain disarmed after the war was her desire to inspire other victorious nations with her example, and thus to induce them to act in a like manner. This was not, however, the case. Unquestionably, in deciding to reduce the strength of the navy, and to refrain from developing an adequate air force, the British Government must have been influenced to some extent by the desire and hope to see other countries following her example. The immediate cause, however, was financial pressure. With the public debt over seven milliard pounds, and with income tax fluctuating between four shillings and five shillings in the pound during the post-war period, Great Britain could indeed ill afford to keep pace with other nations in the sphere of armament. As a result of the restoration of the pound to its pre-war parity, and of the subsequent fall in world prices, the real burden of public debt and income tax further increased. For considerations of internal policy it was impossible to cut social expenditure, so that the only direction in which the successive Governments were able to economize was that of armament expenditure.

As there appeared to be no likelihood of another war, the successive Governments thought they could afford to yield to financial pressure and reduce armaments. In any case, handicapped by the terrific burden of public debt and taxation, the country could not possibly have afforded to take part in another war while it was on the gold standard. In order to enable the pound "to look the dollar in the face," the British Government was prepared to make considerable sacrifices, not only in the economic sphere, where the chances of our vital export trade recovering its lost markets were jeopardized for the sake of monetary policy, but also in the political sphere. War weariness in itself would not have been sufficient to induce Great Britain practically to abandon Southern Ireland. But for financial considerations a supreme effort would have been made to retain it as part of the United Kingdom. It was because none of the post-war Governments would have cared to risk an additional shilling income tax to cover the cost of restoring and maintaining British rule in Ireland, that the Irish Free State was allowed gradually to drift apart from the Empire until it has become an independent republic in all but name.

Even the suspension of the gold standard made

relatively little difference from the point of view of the British attitude towards the financial aspects of armament. As it is unthinkable to add further milliards to the public debt, or to raise income tax above five shillings in the pound, the only way a new war could possibly be financed would be through inflation according to the methods which were witnessed on the Continent during the last war. Such methods would not be resorted to by Great Britain except in the extreme emergency of a defensive war forced upon the nation by actual foreign aggression. Ruling out such a contingency, the country would rather put up with a great deal of disadvantages than allow sterling to depreciate considerably as a result of a war. As between 1918 and 1933 the question of a possible foreign attack on Great Britain itself did not arise, the armed forces were regarded as a luxury providing ample scope for economy.

Unquestionably, the budget benefited by this partial disarmament to no slight extent. But for the cuts in the services it would have been impossible to attain budgetary equilibrium on the basis of the existing level of sterling. It may well be asked, however, whether it would not have been better, from a purely economic point of view, to allow sterling to find the level where the budget

could be balanced without having to keep down armament expenditure or any other necessary expenditure to any great extent. By 1931 it was evident that sterling was overvalued. It collapsed in spite of the sacrifices made in order to maintain it at its old parity. And it may well be asked whether, after all, those sacrifices were not wasted.

From an economic point of view the release of a number of men formerly in the Army or the Navy, or engaged in manufacturing armaments, was worth less than nothing. Ever since the war there has been unemployment in Great Britain on an extensive scale, and this has to some extent been due to disarmament. Economic conditions have been such as to make it impossible to absorb the men released by disarmament, and they (or an equivalent number of men they may have displaced if they succeeded in finding employment) have had to be supported by the community. Partial disarmament in Great Britain has evidently failed to reduce the unproductive section of the community.

Had the lead given by Great Britain been followed, the moral and political advantages of her policy would have amply compensated her, and the rest of the world, for its disappointing economic results. The moral and political benefits of universal disarmament could not be sufficiently appre-

ciated. In face of any such benefits, economic considerations would vanish into insignificance. It would not matter in the least if disarmament did not result in economic advantages so long as it resulted in an improvement of political relations between various countries. Unfortunately, in the case of partial disarmament by Great Britain the political result was just as negative as the economic result. Neither France nor Poland nor the Little Entente showed the least inclination to follow her lead. Italy, Soviet Russia and Japan remained armed to the teeth, and the United States developed the new ambition of being second to none in naval power. From a political point of view partial disarmament by Great Britain had done, indeed, more harm than good, for it weakened her importance as a mediator between the conflicting interests. Had she remained armed, her word would have carried more weight in international conferences, and her pacifist policy might have triumphed before Germany, driven to despair by the uncompromising attitude of France, had fallen into the hands of extreme nationalists.

In face of the complete failure of Great Britain's disarmament in the political field, its failure in the economic field assumes some significance. It confirms the conclusions reached by public opinion on

the basis of the economic effects of disarmament in the vanquished countries. It does not by any means prove that it is impossible to obtain any economic advantages through disarmament. Given favourable circumstances, disarmament is bound to produce beneficial effects by increasing prosperity. During a period when the entire population of the country is fully employed, the diversion of a number of hands from armament trades to constructive production is bound to raise the standard of living of the community. It is to be deplored that the post-war attempts at disarmament were not made under such favourable conditions. Had these attempts coincided with a trade boom, when for a short time everybody was employed in productive occupation, public opinion would have been favourably impressed by the economic advantages of disarmament. It would have been, however, just as wrong to welcome disarmament for the sake of its economic advantages during a boom as it was wrong to arrive at the opposite conclusion because disarmament happened to coincide with a period of economic depression. For, even if during a boom period the workmen released through disarmament could be absorbed by trade, reaction would inevitably occur when slump inevitably follows boom. The hands

released through disarmament, which would at first be absorbed thanks to prosperous conditions during the upward swing of the trade cycle, would then be thrown out of employment and the situation would become substantially as unfavourable as in the case of disarmament coinciding with a trade slump.

The public which judges by results would not, however, necessarily realize the truth of this. Once the men released through disarmament are absorbed, and are kept in employment for a reasonable length of time, disarmament would be declared a success from an economic point of view. Its economic results would then be freely used for propaganda in favour of disarmament. Post-war experience in disarmament failed to provide even such arguments of doubtful value in support of the cause.

CHAPTER V

REARMAMENT AFTER THE WAR

WHILE one group of countries, dealt with in the previous chapter, reduced their armaments after the war in varying degrees, another group of countries maintained, and more than maintained, their armaments at their pre-war level. Having demobilized their armies after the cessation of hostilities, they began to develop the peace strength of their armed forces in various directions. The mechanization of the army, the increased importance of the air force, the new technique of defensive fortifications, and innumerable new devices of mechanical, chemical, electrical, etc., inventions, opened new channels for armament expenditure. It is true that, on the other hand, expenditure was reduced in some directions but, on balance, the tendency in a number of countries was one of rearmament rather than disarmament.

We do not propose to deal with the moral and political aspects of this post-war tendency of re-

armament. Many other people have adequately dealt with those aspects ; they have lectured the countries concerned severely, telling them that rearmament was morally wrong and politically short-sighted. What they were not in a position to tell the offenders with any force of conviction was that rearmament was economically disadvantageous.

Let us examine how post-war rearmament affected the economic situation of the principal countries concerned. In this respect it is necessary to discriminate between those countries which are in a position to manufacture their own armaments, or at least a large part of them, and those whose supply of armaments depends on imports. The former group includes France, Belgium, Czechoslovakia, Italy, Japan, etc. The latter group includes Poland, Yugoslavia, Roumania, the Baltic States, etc. Some of the countries, such as Soviet Russia, have developed since the war from mainly importing countries into mainly producing countries.

Since the war France has been affected by unemployment to a much slighter extent than almost any other highly developed country. During the first five or six years that followed the Armistice the absence of unemployment was largely the

result of the additional work provided by the reconstruction of devastated areas. In anticipation of payments to be received from Germany, the French Government provided for the financing of reconstruction on a very generous scale. By rejecting the German offer to reconstruct the devastated areas in kind, practically the whole of the benefit of the additional work was retained for French industries. For years the north of France witnessed feverish activities in connection with the rebuilding and repairing of the damage caused during the hostilities.

Industries were employed to the full extent of their capacity, and hundreds of thousands of foreign workmen had to be imported to cope with the additional requirements. This meant, of course, an increase in the number of consumers, so that the benefit of additional work was spread over a larger number of participants. In consequence, the beneficial effect upon the standard of living was less than it would have been without the increase in the number of consumers. This end would have been attained if, instead of importing workmen from abroad, a corresponding number had been released from the army or armament industry, and made available for constructive employment. The benefit would, however, have

been temporary, for the additional work provided by reconstruction came to an end by about 1926. While until then disarmament would have produced favourable economic results, afterwards it would have produced the same result as in Germany or Great Britain, namely, an increase in the number of unemployed.

Far from disarming, the French Government increased its armament in various directions. Many milliards have been spent upon the construction of a unique system of fortification along the eastern frontiers of France. Although the period of compulsory military service has been reduced and thereby the number of effectives in time of peace has been lowered, this reduction was more than made good by the increased efficiency of the army through mechanization. This, together with the building up of a unique air force and the increase of naval armament in competition with Italy, assumed sufficiently large proportions to justify talking about rearmament in connection with France. Thanks to this expenditure by the Government, boom conditions in French trade continued even after stabilization. In most other countries stabilization was followed by a period of depression, but in France there was no sign of any decline in business activity

until about 1932. This was due to a large extent to the undervaluation of the franc, but rearmament must have also contributed towards it. Thanks to it a large proportion of the workmen, who would otherwise have become unemployed after the conclusion of the reconstruction of devastated areas, have remained in employment.

It is true that for several years after stabilization of the franc budget revenue in France exceeded expenditure, and the Treasury succeeded in accumulating a substantial surplus which, so far as trade was concerned, became sterilized. Had France disarmed, instead of rearming, this sterilized surplus would have been even greater. Conceivably part of the economies would have been passed on to the public through a reduction of taxation and through an increase of other expenditure. In theory the reduction of taxation would have resulted in an increase in purchasing power and would have affected production in the same way as Government expenditure on armament. In practice, however, owing to the thrifty nature of the French public, the result would have been far less satisfactory from an economic point of view. The reduction of taxation would not have led to an increase of demand for goods but to an increase in savings and hoarding.

It is, therefore, impossible to avoid the conclusion that rearmament in France after the war was, on the whole, beneficial for French trade and employment. Had the amount actually spent on armament been spent by the Government on public works, the benefit would of course have been much greater. In practice, however, pressure for the employment of a great part of the economies on taxation relief would have been too great for any Government to resist. It may be said that armament expenditure provided a subsidy which kept French industries busy at a time when they would otherwise have begun to feel the effect of the world depression.

In Italy, the Government adopted a bold and ambitious policy of public works after the stabilization of the lira. This, in addition to armament expenditure, provided employment on a large scale and unemployment was kept down to a comparatively low figure even during the world crisis. Had it been possible for Italy to disarm, instead of rearming, public works could have been carried out on an even more extensive scale, to the benefit of the nation. While in France the existence of a parliamentary democratic régime would have made it inevitable that the economies should be passed on to the various classes of tax-

payers which party politicians were desirous of bribing, in Italy the existence of a dictatorship would have made it possible to dispose of the surplus to the best advantage of the country. Moreover, the existence of a certain degree of economic planning in Italy would have made it possible to make use of the economies on armament expenditure in a way that would have secured the maximum advantage.

Another country which produces its own armaments is Czechoslovakia. Here post-war armament served the special purpose of strengthening the Czech industrial interests to the detriment of German industrial interests in the country. As is well known, a large section of the industries in Czechoslovakia was, at the time of the establishment of the republic, in Austro-German hands. This, together with the German and Hungarian ownership of landed property, placed the new régime at a disadvantage against the national minorities whose economic strength was a source of political strength. While the landowners could be weakened by land reform, there was no way of expropriating the industries. The Government resorted to an ingenious method by which it was able to secure the passage of the control of industries into Czech hands. The Czechoslovakian

crowns was stabilized in 1922 at a very high level, and the country was suffering during the following years through economic depression caused by deflation. The Government thereupon transferred all orders for armament purposes, as well as for other official requirements, to Czech firms, which therefore suffered through the depression to a relatively small degree only. On the other hand, the German-owned industrial enterprises had to bear the full burden of the depression, and their plight was accentuated by the withdrawal of Government orders. They were thus "starved" into surrender. Most of them were compelled to relinquish the control in favour of Czechs. This is an interesting example of the result that can be produced by the combined effect of monetary policy and armament expenditure.

France, Italy and Czechoslovakia, as well as Great Britain and Belgium, have a considerable export trade in armaments. As a result of heavy purchases by relatively undeveloped countries such as Russia, Poland, the Baltic States, the Little Entente, Greece, Turkey, China, Japan and the Latin-American states, the armament industries of those countries benefited by post-war rearmament to no slight extent.

A great deal has been said about the moral

aspect of traffic in armaments. Manufacturers of armaments are often denounced as unscrupulous and inherently wicked individuals, not merely because they make money out of the misery of the victims of a war, but also on the ground that, in their keenness to sell their manufactures, they are alleged to be capable of committing any crime. They are accused of being guilty of stirring up war between countries in order to sell their goods to both opponents. Bribery, espionage, the stirring up of revolutions and the hiring of assassins are mentioned as some of the means they employ to attain their end. In pacifist circles their trade is regarded to be on the same moral level as white slave traffic or dope smuggling.

Unquestionably, in many instances these charges, even though exaggerated, are not without foundation. The recent disclosures about the activities of the Bucharest representative of one of the leading armament firms show that in some cases, at any rate, armament interests go to considerable lengths in order to attain their end. Nevertheless, it may well be asked how far it is possible to generalize from such cases. Conceivably in many instances ambitious and greedy salesmen exceed the instructions of their firms in order to secure a coveted order. It is perhaps fair to assume that

the average armament manufacturer would never stoop so low as to take an active hand in stirring up war. Possibly he welcomes the outbreak of hostilities—provided that they are not too near home—in the same way that doctors welcome the outbreak of a disease, or undertakers welcome the increase of the death-rate. Doctors do not deliberately cause their patients to be ill, however, although admittedly they would be disconsolate if all their patients enjoyed permanent good health. The inventor of an elixir securing eternal life would run the risk of being lynched by infuriated undertakers, and the advocates of eternal peace and complete disarmament are for the same reason highly unpopular among armament manufacturers.

It is a long way, however, from wanting to see a brisk demand for armaments to actually engineering such demands by criminal methods. Possibly, in the majority of cases, the fact that it is obviously to the interest of armament manufacturers that there should be war, gives rise to the assumption that they are capable of anything to attain that end. While the author holds no brief for them, he believes that it is perhaps fair to assume that unscrupulous intrigues are not the rule but the exception in the armament trade.

So long as the Governments are prepared to

spend on armament there will always be people willing and anxious to undertake to provide the goods required. If there is anything that is at fault it is the system as a whole and not individuals. There is a great deal to be said in favour of converting the manufacture of arms into a Government monopoly. It is doubtful, however, whether such a solution would render a real service to the cause of pacifism, for indignation about immoral profits made by armament firms must have driven many thousands of people to swell the ranks of pacifists.

All this is, however, beside the point, and the author must apologize to the reader for this diversion from the main subject. Whether international traffic in armaments is considered immoral or otherwise it is certainly beneficial to the exporting countries, and provides employment for many thousands of workmen. It is, of course, possible to argue that, from the point of view of the exporting countries as a whole, the economic benefits of armament exports are open to question. But for spending on armaments purchased abroad, the important countries would be in a position to purchase from the exporting countries other kinds of goods, and this would create the same amount of employment as the manufacture of armaments for export.

In reality, it is, to say the least, open to doubt whether the countries concerned would have raised credits in the armament manufacturing countries to the same extent for any other purposes than what they rightly or wrongly considered to be the vital requirements of national defence. As in the case of budgetary resources, so in the case of borrowing abroad, armament expenditure is regarded totally differently from any other kind of expenditure. For this reason it is perhaps safe to assume that, but for the rearmament of a number of countries which are not self-sufficient in the manufacture of war material, there would have been less employment in the armament exporting countries as a whole. This does not, however, necessarily mean that rearmament was from that point of view an advantage. Excessive international borrowing after the war was an evident evil, and was largely responsible for the economic crisis.

The purchase of armaments on a credit basis aggravated the budgetary situation and the balance of international indebtedness of the purchasing countries. From their point of view the economic results of rearmament were therefore unquestionably harmful. So long as they paid the loans contracted for the import of war material, the

exporting countries had no reason to be dissatisfied with the economic result. As, however, most of them defaulted to a greater or less extent on their external debt, the exporting countries discovered the fact that they themselves had to pay for at least a large part of the armaments they sold to the importing countries.

The economic disadvantages of rearmament for the importing countries were, however, counteracted to a greater or less extent by certain advantages. Every one of them endeavoured to make themselves as self-sufficient as possible for their requirements of war material, and this gave rise to the development of industries which proved to be useful to the country. After all, the requirements of a well-equipped army are not confined to weapons and ammunition. As the list published in Appendix II indicates, they include an immense variety of manufactures, such as textiles, leather goods, conserved food, etc. In many cases the requirements of the civilian population for such goods are in themselves incapable of giving rise to the creation of corresponding industries. Owing to the Governments' desire to produce these goods for the army at home, factories have been erected which, in addition to satisfying the demand of the army, can also provide for the requirements

of the civilian population. The partial industrialization of Poland and Roumania, for instance, after the war, was largely due to this factor.

Whether or not the increasing economic independence of particular countries is an advantage from the point of view of mankind as a whole, is a highly controversial question. To answer it adequately would require volumes and is beyond the scope of the present book. There can be no doubt, however, that during the crisis agricultural countries had every reason to be thankful for their post-war industrial development, brought about partly by rearmament. When they began to find it increasingly difficult either to export their agricultural products or to obtain credit for the import of manufactures, the industries established under the stimulus of military requirements proved unquestionably of great service to their population.

PART II

THE FUTURE

CHAPTER VI

REARMAMENT FINANCE

THE budgetary aspects of the problems of disarmament and rearmament have assumed considerable importance since the war. In most countries the relative burden of public debt has risen to a multiple of its pre-war figure, while other items of public expenditure have also expanded considerably. Social expenditure, such as unemployment relief, old age pensions, etc., have risen to high figures in the budgets of most countries, and few Governments could afford to eliminate it, or even reduce it materially. During the past twenty years the world has made progress in many directions, and the tasks of modern government tend to become more and more numerous and expensive. As a result, public expenditure in every country has approached the limits beyond which

it could not possibly be covered out of normal resources, unless a corresponding economic expansion took place.

Before the war taxation was very low everywhere, although most people did not think so at the time. Most countries were in a position to increase their expenditure with the aid of an increase in taxation which, economically speaking, was well within the limits of capacity. To-day, however, few Governments would venture to increase taxation further for the sake of rearmament. Even in countries which are more exposed to armed aggression than Great Britain, the danger of such aggression is not sufficiently realized to induce taxpayers to tolerate any further immediate sacrifices.

On the other hand, there are few countries in which the possibility of a reduction in taxation would in itself induce the Government, Parliament and public opinion to disarm. Tempting as it is to obtain financial relief through disarmament, this consideration plays but a subordinate part in the armament policy of most nations. It is only if disarmament becomes an alternative to a further increase of taxation burden, such as it was in the case of Great Britain, that it may to some extent influence the attitude of some countries towards the problem.

The budgetary aspects of disarmament gained particular prominence in connection with the controversy over war debts. Official and unofficial spokesmen of the United States declared on innumerable occasions during the past ten years that Europe was not justified in demanding a revision of war debt agreements so long as her Governments could afford to spend many milliards on armament. More particularly, in its efforts to bring about disarmament, the United States Administration missed no opportunity of giving it to be understood that, so long as there was rearmament and no disarmament, there could be no question of war debt reduction. Unfortunately its attitude in this respect remained purely negative ; it threatened but did not promise. While threatening to refuse any application for reduction if Europe was unwilling to disarm, the United States never officially held out any definite promise of war debt reduction if the European Governments were to decide to follow its advice regarding disarmament. It is true it was often vaguely hinted that this might be the case, but the promise was never made in a sufficiently positive and binding form to serve as a real inducement for Europe to disarm. Possibly, if the Administration and Congress had been prepared definitely to bind them-

selves to a policy of cancelling a large part of the war debts if Europe were prepared to disarm, the history of the Disarmament Conference might have taken a totally different turn. As it was, vague hints of what might happen if Europe agrees to disarm failed to inspire much enthusiasm in Europe. Fears were entertained, and not altogether unreasonably, that even if the European nations were to agree to disarm it would not in itself have brought cancellation of war debts much nearer. The European Governments and public opinion suspected that the moment the question of disarmament was settled the United States would produce a number of other excuses for declining to revise the debt agreements.

Until comparatively recently Washington might have been able to induce Europe to disarm if she had been willing to connect the question of war debt officially with that of disarmament. The Administration alone was not, however, in a position to do so even if it had wanted to, because Congress had the last word on war debts and its attitude was anything but encouraging to Europe. Conceivably, an agreement based on the principle of linking disarmament with the reduction of war debts would have been repudiated by Congress. However it may be, from the moment of the

Hoover Moratorium the hold of the United States over Europe has relaxed. Until June 1931 the European Governments would have been willing to go out of their way considerably to obtain the revision of the war debt agreements with the United States. The Hoover Moratorium aroused hopes, however, in Europe that a substantial reduction might, after all, be obtained without their having to pay the price for it in the form of an unwanted disarmament agreement. After the Hoover Moratorium expired only a few of the debtor Governments resumed payment, and in 1933 practically all European debtors defaulted on the war debt to the United States, though in some cases the President agreed not to consider it as a default. As a result of this wholesale discontinuation of war debt payments Washington has lost the hold on Europe which she did not use in the interest of disarmament while she had the chance.

In any case, the atmosphere in Europe has completely changed during the past twelve months ; and financial considerations carry less weight than ever when real or imaginary national security is at stake. Until a year or two ago there was no real danger of a German aggression ; and France, as well as other countries, might have been pre-

pared to meet the American demand for disarmament if it was made worth their while. To-day this is no longer the case. Being convinced that their security is threatened, the European nations are no longer prepared to bargain about disarmament on the basis of a compensation of a financial nature. They are not particularly tempted by any willingness shown by the United States to cancel war debts in return for disarmament, first because they do not pay war debts in any case, and secondly because their security is regarded as more important than the settlement of the war debt question.

The insistence displayed by France until 1932 on exacting heavy reparations payments from Germany was to some extent connected with the budgetary aspects of rearmament. Having got rid of practically the whole of her pre-war and war debt through depreciation of the mark, Germany was well in a position to spend considerable amounts on secret rearmament, but for the heavy burdens of reparations imposed upon her. On the other hand, so long as France continued to receive a large net surplus of reparations year after year, she was in a position to rearm in spite of the heavy burden of her public debt. From this point of view the cancellation of reparations at Lausanne

unquestionably placed Germany at an advantage and France at a disadvantage. Notwithstanding this, France is still in an incomparably more advantageous position than Germany from the point of view of financing rearmament. While it is true that post-war inflation wiped out Germany's indebtedness, at the same time it also wiped out her savings. France is in a position, in spite of her huge public debt, to finance rearmament with the aid of internal loans, at any rate up to a certain point. In Germany, however, the financing of rearmament by borrowing is practically impossible, for there is no adequate capital available for that purpose. Again, France is in a position to increase her capacity for financing rearmament by depreciating the franc. In the case of Germany the extent to which this method can be applied is very limited and, in any case, involves immense risks. About this, however, more will be said in a later chapter.

One of the most important psychological consequences of the war was the breakdown of the rigidly orthodox mentality in the sphere of finance. It is true that the memory of the disastrous consequences of reckless war and post-war finance tends to act as a deterrent to unorthodox expenditure. The equally disastrous consequences of attempts

at sound finance between 1925 and 1931 have, however, made the public forget the sufferings of earlier years. That is why the idea of unbalancing the budget is nowadays not nearly as unpopular as it was before the war. In fact, even in Great Britain, the home of financial orthodoxy, the deliberate unbalancing of the budget has been advocated by a considerable section of economic opinion. Those in favour of this solution regard it as a means of bringing about economic recovery. They have, of course, constructive expenditure in mind in the form of useful public works. In the United States, however, the object of unbalancing the budget is being achieved in part by carrying out an ambitious programme of naval construction. Even in Great Britain it is probably easier to arouse enthusiasm for expenditure on improving our air defence than for expenditure on irrigation schemes or even on slum clearance.

The favourite argument against rearmament is that, as most countries have reached the extreme limit of the taxable capacity of their populations, an increase in public expenditure would prove ruinous to both state and taxpayers. It is pointed out that the economic crisis has utterly depleted the resources of taxpayers, and that additional burdens would be simply unbearable. This argu-

ment is undoubtedly correct if we assume that armament expenditure can only be financed by strictly orthodox methods. It carries much weight even if we assume that the less orthodox method of financing rearmament, by borrowing, is resorted to. After all, new loans constitute an immediate additional burden to the taxpayer through the increase in the requirements of the debt service. Additional borrowing for rearmament would tend to increase the burden of public debt more than in proportion to the actual amount of its interest and sinking fund service. It would remove the possibility of converting the existing debt on to a lower interest basis. Provided that it is possible to balance the budget for a number of years, all Governments would be able to obtain considerable economies by taking advantage of the improvement in their credit, and converting the high interest-bearing loans issued during and after the war. A deficit brought about by rearmament rules out such possibilities. Having to issue fresh loans, the Governments are not in a position to reduce the interest rate on the existing debt.

Even admitting all this, it would be a mistake to assume that financial considerations in themselves would effectively check rearmament. If a country assumes that its security is in danger it will rearm

by hook or by crook. If necessary, desperate cuts will be enforced in other directions, even to the detriment of the efficiency of public administration. If that is not sufficient, loans will be issued to the uttermost limits of capacity, without worrying too much about the increase in the interest burden.

Should the Governments reach the limit of their borrowing capacity they are confronted with the alternatives of either defaulting on the existing debt or financing rearmament by inflationary borrowing. Both solutions are double-edged weapons. They involve the risk of killing the hen that lays the golden eggs. Putting moral considerations aside, however, and taking a comparatively short view, it may appear profitable to reduce the burden of public debt by inflation or default. After all, experience has shown that the memory of the public is remarkably short. Two years after having stabilized the franc at an unnecessarily low level, thereby deliberately inflicting heavy losses upon its creditors, the French Government enjoyed excellent credit, and the yield on French loans was lower than that on British loans. Had Monsieur Poincaré stabilized the franc at 100 or 80 to the pound, instead of undervaluing it at 124, it might have been difficult, if not impossible, to find the milliards required for the completion of fortifica-

tions and other rearmament expenditure, notwithstanding the fact that from a moral point of view such a solution would have been preferable. Economic and financial difficulties caused by the overvaluation of the franc would have more than outweighed the advantages of a moral nature.

Unquestionably the general financial viewpoint of our generation has become much less orthodox than was that of the pre-war generation. Also, the general standard of financial morality has declined. Before the war it was unthinkable that the Government of a first-class power would even consider the idea of sacrificing its financial standing for the sake of financing ambitious armament schemes. To-day the attitude of statesmen is no longer so rigid. That is why budgetary considerations do not constitute an insuperable obstacle to rearmament.

CHAPTER VII

ARMAMENT AND TRADE

THE industries which supply the armed forces of a country with all their requirements undoubtedly represent a substantial section of the productive capacity of that country. Even in the case of countries which do not themselves manufacture heavy armaments, the more primitive requirements of the armies—clothing, housing and feeding—keep many thousand workmen employed. The immediate effect of disarmament would inevitably be a considerable reduction in the volume of orders placed by the Governments for their army requirements, while rearmament would produce the opposite effect. On the other hand, the effect of disarmament or rearmament upon the spending power of the civilian population would tend to offset to some degree its direct effect upon trade.

Thus, industry as a whole would to some extent be compensated for the loss of army orders by the increased purchasing power of the taxpayers, or

by constructive expenditure undertaken by the Government with the funds thus released. The additional benefit obtained by trade through rearmament is to some extent offset by the reduction of the purchasing power of the civilian population or the reduction of Government expenditure in other directions. This, of course, assumes that the armament expenditure is covered out of current receipts. The effect of both disarmament and rearmament upon trade is modified by the degree to which armament is financed by borrowing which would not otherwise take place.

It is hardly necessary to point out that the trade of countries exporting armaments stands to gain more through rearmament than the trade of countries importing armaments. In the case of the former, disarmament on an international scale would most probably reduce employment to a great extent, and the increase of the spending power of the population would only provide a relatively moderate compensation. On the other hand, armament-importing countries would enjoy the full benefit of the increase in the purchasing power of the population, and would only bear part of the losses caused by the reduction of armament expenditure. Conversely, rearmament would affect the trade of armament exporting countries more

favourably than that of armament importing countries.

Apart from their general effect upon the trade of a country as a whole, both disarmament and rearmament tend to bring about a dislocation within the various branches of trade. A large part of armament expenditure is for special requirements, and an increase or decrease in it affects the trades engaged in supplying these requirements. At the same time, the increase or decrease in civilian expenditure, caused by disarmament or rearmament, affects the other branches of trade in varying degrees. The industries which are concerned the most directly are those engaged in manufacturing armaments in the narrower sense of the term. It is those industries which are usually referred to under the term "armament industries". Although the textile trade may suffer through the decline of Government orders for uniforms, it would be largely compensated by increased civilian requirements for clothing. On the other hand, industries engaged in the manufacture of guns, warships and explosives, derive no compensation whatsoever for their loss from an increase in civilian expenditure.

In practice, of course, in the great majority of cases the same firms or groups of firms are engaged

in producing not only war material but also a large variety of articles required for productive purposes. Thus, the firms which manufacture tanks usually also manufacture tractors. Poison gas is usually but a sideline of chemical works engaged in the manufacture of various other chemical products. Moreover, armament industries are in a position to convert their plant for the production of machinery, etc., should the demand for war material decline. It is true that such a conversion usually involves heavy expenditure. As, however, there is usually a considerable margin of profit in the armament trade, conservative firms can and must write down their machinery in the course of a relatively small number of years, so that, when they have to discard it, the loss should not be unbearable.

This is what actually happened in Germany after the war, and also, to a less extent, in all other countries which had increased the productive capacity of their armament industries during the war. In Germany, the famous Krupp works have taken up the manufacture of agricultural machinery and other engineering products since the war. In Great Britain the leading armament firms have to a large extent converted their works to meet the requirements of peace. Fortunately for them,

new developments such as aviation and the increased use of motors enabled them to compensate themselves substantially for the reduction in their activities.

Insofar as the conversion of armament works may meet new market requirements, their economic utility is beyond question. If, however, the result is merely an increase in competition with existing firms on an inelastic market, the advantages are open to doubt. Overlapping with existing industries merely brings about an increase of productive capacity without any corresponding increase of marketing possibilities. The outcome is cut-throat competition and "the survival of the fittest". If it is the newly converted works that survive, they reduce employment in other works less fortunately placed, and the result is a dead loss. It is possible that international over-production in the mechanical industries after the war was in part due to the conversion of armament works for peace requirements.

Thus, in given circumstances disarmament may lead to over-production. Strangely enough, rearmament may produce exactly the same effect. We have seen in Chapters II and V, that armament both before and after the war gave rise to new industries in the relatively undeveloped countries.

Although those industries had to thank armament for their existence they did not confine their activities to catering for the armed forces. Having once come into existence, they captured a more or less important part of the market for goods required by the civilian population. This progress in the industrialization of relatively undeveloped countries may have been beneficial from the point of view of the countries concerned, but their gain was largely at the expense of other countries. Even from the narrow nationalistic point of view of the countries concerned, the advantages of their industrialization proved to be short-lived. As the industrial countries lost part of their former markets they could not afford to buy the same amount of agricultural products as before, and had to endeavour to increase their own agricultural products at the expense of the recently industrialized agricultural countries.

An argument which is sometimes used in defence of armament is that it encourages industrial progress and gives rise to new industries which could not otherwise be established or whose progress would otherwise be much slower. Unquestionably the systematic expenditure of Governments on armament is a valuable subsidy for industry. In particular instances this subsidy plays a vital part

in modern development. Let us take, for instance, air transport. But for the desire of Governments to have at their disposal, against the contingency of war, a large number of civil aeroplanes which could be converted for military purposes at short notice, civil aviation would not have received anything like the official support it actually obtained. Although the advantages of developing civil aviation, from the point of view of commerce and communications, are obvious, it would have been much more difficult to obtain official support in most countries had not the Governments regarded the development of civil aviation as a convenient form of disguised rearmament. It is conceivable that the armament race in the air which we may witness in the near future, will largely assume the form of increasing subsidies to commercial aviation. It is impossible to deny that trade would benefit by such methods to no slight extent. It might lower the cost of passenger transport by air, air mail and, to some extent, even of goods transport by air, to a level at which it ceases to be a luxury. The other side of the picture is, of course, that, whatever air transport would gain, transport by land and sea would necessarily lose. On balance, the benefit for trade as a whole would not therefore be as great as it would appear at first sight.

Armament undoubtedly encourages scientific research in the sphere of chemistry and engineering. Although the direct object of such research is the invention of new destructive methods, it may lead to inventions of a constructive nature. Admittedly, if only part of the funds available for such research could be used for non-military research purposes, industry would benefit to a far greater extent. Here again, however, the question arises whether the money would be available at all for any purpose other than military research.

Until comparatively recently it was considered the supreme task of mankind, in the sphere of economics, to produce more so as to be able to improve the standard of living of consumers. Any raw material and labour spent on armament was considered a dead loss because it reduced the volume of goods available for consumption. At present, however, thanks to scientific inventions and the application of more efficient methods of production, the problem is no longer the same. It is no longer production that has to make desperate efforts to keep up with consumption, it is consumption that is lagging far behind productive capacity, and even behind actual production. In such circumstances disarmament means the reduction of the world's capacity and willingness to

consume, while rearmament means an increase of that capacity. All rearmament does is to absorb part of the surplus products which would otherwise be unsaleable in our present economic system. So long as the problem of adjusting the world's capacity of consumption and the world's capacity of production to each other is left unsolved, any demand for goods, however artificial and unproductive, is calculated, on balance, to benefit trade.

The question is whether there are no better ways of stimulating the demand for goods than through rearmament. Evidently there are many ; in fact, it is difficult to imagine worse ways of stimulating demand. Anything is better than creating an artificial demand for goods which at best are useless and at worst are destructive. There are innumerable tasks before every Government which are at present left unfulfilled merely on account of timidity as regards raising the requisite funds. To carry out the schemes which at present are considered to be beyond the bounds of practical politics would produce a demand infinitely more beneficial to trade than rearmament. Unfortunately, the money which is made available, by fair means or by foul, for armament expenditure, is not forthcoming for such productive purposes. Until the mentality of Governments, Parlia-

ments and public opinion in most countries undergoes a radical change in favour of productive public works, the choice will not lie between such public works and rearmament expenditure, but between rearmament expenditure and no expenditure at all.

CHAPTER VIII

ARMAMENT AND CURRENCY

STRANGE as it may sound, there is a close connection between armament policy and monetary policy. These two apparently independent functions of public administration are to a great extent interrelated; they tend to affect each other reciprocally.

Before the war the monetary policy of most civilized countries aimed at maintaining the stability of the national currency. By pursuing this policy the Governments imposed upon themselves a natural limit to their armaments. The wars which occurred during the second half of the nineteenth century and the beginning of the twentieth century were not, in most cases, allowed to interfere with the stability of the currency. Neither the Crimean War nor the South African War affected sterling, nor did the franc or the rouble suffer any permanent depreciation through the Franco-Prussian War or the Russo-Japanese War.

Military expenditure during the World War of 1914-18 assumed, however, such dimensions as to make it impossible for the belligerent countries to maintain their currencies at their old parities. The policy of monetary stability had to be sacrificed for the sake of armament requirements. It is true that the principal allied powers succeeded in maintaining the stability of their currencies artificially at a level which was relatively close to their old parities.

It was not until 1919, when the pegging of the allied exchanges was abandoned, that the full monetary consequences of excessive armament expenditure began to make themselves felt. Rapid demobilization and partial disarmament were unable to prevent sterling, the franc and other currencies, from paying the price for earlier excesses, through a depreciation the extent of which varied according to the nature and degree of the departure of various countries from sound finance.

Had France disarmed immediately after the war instead of maintaining a large standing army and fortifying her Eastern frontiers, it might have been possible to stabilize the franc at a considerably higher level. After all, military expenditure, together with the occupation of the Ruhr, was largely responsible for the budgetary deficit which,

in turn, was the direct cause of the depreciation of the franc. It is doubtful whether any substantial section of public opinion in France realized the connection between the militarist policy pursued by her Government and the depreciation of the exchange. Even if they had realized it, it is doubtful whether the attitude of the French electorate would have been any different from what it was. When security is at stake—whether the danger to that security is real or imagined—the principles of monetary policy are sacrificed for the sake of armament. In France, where the *rentier* class has more political influence than in any other country, the depreciation of the currency was fatal for the many Governments that succeeded each other between 1924 and 1926. But none of these Governments fell because of any unwillingness to adjust their armament policy to the requirements of their monetary policy. Indeed, the French public wanted to eat its cake and have it. It wanted security in the form of a high degree of rearmament, but at the same time it also wanted to avoid a depreciation of the currency. Had they realized that the choice was between the one and the other, and that they could not possibly have it both ways, their decision would unquestionably have been in favour of

security. If there is one country where a policy of currency stability is really popular, it is France. But in spite of this no Government would have dreamt of favouring disarmament for considerations of monetary policy.

In Great Britain, on the other hand, considerations of monetary policy influenced armament to no slight extent. In order to be able to restore sterling to its old parity, and to maintain it there, the Governments that followed each other since the war were prepared to cut down expenditure on the fighting forces. This is an example of how monetary policy can influence the extent of armament. Even after September 1931, when sterling was swept off the gold standard, considerations of monetary policy remained predominant. Further severe cuts were made in war expenditure. Although it was unable to save the pound from abandoning its parity, this policy contributed towards the balancing of the budget and had its share in preventing a heavy slump in the pound.

The difference between the British and French attitudes in the conflict between considerations of monetary policy and armament is due in part undoubtedly to the fundamental difference between Anglo-Saxon and Latin mentality. In Great Britain political policy has, throughout the ages, been

subordinated to economic policy. In France, on the other hand, political policy has always been the supreme end, and economic policy has very often been only a means to that end. This difference, again, has been due, however, to the favourable geographical position of Great Britain which, until the advent of the age of aerial warfare, gave the nation a comparatively high degree of security against enemy aggression. While for a continental country, which is exposed to enemy invasion, security was bound to be of supreme importance, a country protected from invasion by its geographical position could afford to attach more importance to the economic prosperity of its population.

The realization that Great Britain is no longer safe has resulted in a change of considerable importance in the British attitude towards the respective importance of political and economic policies. From the Armistice until 1933 the British public did not consider itself to be exposed to the remotest danger of being attacked. Possibly, now that the likelihood of a German attack has become a frequent topic of discussion, even in this country those favouring a certain degree of rearmament will have their way at the expense of the adherents of a sound monetary policy.

Admittedly, with its considerable budgetary surplus, the British Government would be at the moment in a position to rearm without having to change its monetary policy for that purpose. The question is whether, in the long run, it will be possible to keep pace with other leading powers in an armament race without a drastic change in its monetary policy. So long as income tax is between four shillings and five shillings in the pound there is but little scope for an increase of expenditure in any direction. The only possible way of permanently reducing the burden of taxation would be an increase in the price level, which would leave the burden of public debt and other fixed charges unchanged while it would automatically increase taxation revenue. The present attitude of the Government is vaguely favourable towards a rise in prices, but it is unwilling to do anything in order to attain that end. Possibly, if Press and public opinion bring pressure to bear upon the Government in favour of an increase in our air defences and other armament expenditure items, the Government may realize the necessity for taking active steps in favour of raising the price level.

In France, the official monetary policy since 1928 has aimed at maintaining the franc at its

new parity at all costs. Until comparatively recently this policy did not come into conflict with the Government's armament policy. The budgetary situation between 1928 and 1931 was comfortable, especially as there was a substantial Treasury balance to draw upon. By 1932, however, this surplus was exhausted, and the Government had to struggle with a budgetary deficit. By 1933 it has been realized that the franc stands or falls with the possibility of maintaining budgetary equilibrium or, at any rate, keeping the deficit at a reasonable figure. The situation at the time of writing is that the possibilities of further increasing revenue have been exhausted, and the only direction in which further economies on a large scale are possible, is expenditure on the fighting services. The deficit is still at least 4 milliard francs, and, unless it is covered somehow, the franc must become vulnerable.

It remains to be seen whether France, when confronted with the dilemma of sacrificing either the franc or the real or imaginary security against German aggression provided by armaments, will continue to pursue a policy of stable money at all costs. That depends on whether her fear of German aggression is stronger than her fear of a depreciation of the franc. In France and Great

Britain a rise in the price level would go a long way towards relieving the burden of public debt and thus leaving a comfortable margin for armament expenditure. The deflationary policy of the French Government, on the other hand, reduces the possibility of maintaining the armed forces at a level necessitated by the security of France. The chances are that the insistence of French public opinion upon maintaining a strong army will defeat the policy of deflation. A stage will soon be reached when the only possible way of balancing the budget will be through a substantial reduction in armament expenditure. Rather than sacrifice what the French nation, rightly or wrongly, regards as the indispensable condition of her security against German aggression, the budget will be allowed to remain unbalanced. A series of deficits will make it increasingly difficult to raise the missing amount by normal borrowing, and eventually the Government will have to fall back upon the Bank of France. The deflationary monetary policy is doomed to failure because drastic disarmament would be the preliminary condition to deflation. Should the world embark upon an armament race upon a large scale, France could only keep pace with other powers by adopting an inflationary monetary policy. As and when the

danger of a German aggression increases, the control of France's monetary policy will eventually pass from the hands of the Bank of France into those of the General Staff and the Ministry of National Defence.

At first sight it may appear paradoxical to maintain that a higher price level would facilitate the task of rearmament and a lower price level would make it more difficult. After all, the chances are that a great part of the expenditure items connected with armament must rise and fall with the general price level, so that a rise in prices would increase the budgetary requirements for armament purposes. On the other hand a rise in prices also tends to increase budgetary revenue, whether from direct or indirect taxation. It is true that the increase of revenue may not take place to its full extent immediately, while the effect of higher prices on some items of armament expenditure is practically instantaneous. Taking a long view, however, it is safe to assume that a rise in prices tends to affect budgetary revenue at least to the same extent as armament expenditure. As we pointed out before, there is one very important expenditure item which remains virtually unaffected by changes in prices, and that is the service of the public debt. While total revenue tends to

adjust itself in full to the rise in prices, the increase in total expenditure tends to lag behind the rise in total revenue. Thus, the amount available for armaments tends to expand. This is why an inflationary monetary policy is in accordance with the requirements of rearmament in countries whose public debt is heavy.

While armament expenditure keeps pace to some extent with a rise in prices, its decline is bound to lag far behind a fall in prices. On the other hand a fall in prices is always accompanied by a fall in budgetary revenue, especially as it is usually accompanied by economic depression. Thus the relative burden of armament tends to increase considerably as a result of deflation, even though its absolute figure may slightly decline.

In the case of Germany the public debt factor is not nearly as important as in the case of France or Great Britain. Notwithstanding this, it is conceivable that rearmament will be accompanied by a certain degree of inflation, especially if the Government is anxious to catch up the other leading powers within a short time. Default on foreign liabilities goes a long way towards providing the funds required for that purpose. If, however, the Government wants to raise the armed strength of Germany to the level of that of France

within a few years, the only possible way of financing such a rapid increase of expenditure would be through inflation. It would not be a question of inflating deliberately in order to raise the price level and thereby to reduce the burden of public debt. That burden is not heavy enough to make such a policy worth while from the point of view of rearmament. Inflation would be simply a consequence of excessive expenditure which could not be fully covered by normal revenue or by borrowing. The authorities would presumably do their utmost to maintain control over the process, because the disastrous experience of uncontrolled inflation in 1923 is still fresh in their minds. For this reason it is probable that the pace at which rearmament in Germany will proceed will be moderated by the determination of the financial authorities to prevent at all costs the recurrence of the disaster of 1923. It is, therefore, probable that, while during the next few years France will provide an example of how armament policy affects monetary policy, Germany will provide an example of how monetary policy affects armament policy.

The case of Japan is particularly interesting from the point of view of the relation between armament and currency. As a result of the war-

fare conducted in China and Manchukuo, Japan has had a huge armament expenditure during the last two years. The result of this has been a sharp depreciation of the yen. It is absurd to suggest that the depreciation was a deliberate act of monetary policy aiming at stimulating the export trade. At the same time it is beyond question that a depreciation was not merely a necessary evil from the point of view of the armament policy of Japan, but was decidedly advantageous. The relatively moderate rise in prices that followed the depreciation of the yen created an atmosphere of prosperity and stimulated industrial activity. This, again, provided moral and material support for the policy of armament.

The Disarmament Conference duly realized the connection between currency and armament. In its attempt to control and limit armament expenditure, it took due account of the influence of price fluctuations upon armament expenditure. The report of the sub-committee appointed to investigate this problem, extracts of which are published in Appendix I, is an interesting piece of evidence that, when discussing questions of armament, economic considerations cannot be altogether disregarded. The economic problems connected with the budgetary limitation of armaments are dealt

with in Chapter XI. Here let it be sufficient to point out that the Disarmament Conference had to avail itself of the services of economic and monetary experts, which fact is a proof of the close association between economics and armament problems.

CHAPTER IX

REARMAMENT AND RECOVERY

IN a recent speech Stalin is reported to have stated that the economic recovery that took place during 1933 in most capitalist countries was exclusively the result of rearmament, and that an armament race leading to war was the only imaginable way out of the economic deadlock of capitalism. Stalin's views are, of course, guided by the irreconcilable hatred of Communism towards capitalism. There is, nevertheless, a grain of truth in the first part of his statement. It is beyond question that, as far as Germany is concerned, the economic improvement since the advent of the National-Socialist régime was largely the result of feverish rearmament. The spectacular reduction in German unemployment during 1933 was due in a high degree to the increase in the Government's armament expenditure. It is an open secret that the Krupp Works have been employing thousands of additional workmen in spite

of the fact that the plants which work for the export trade are at an almost complete standstill. In addition to the direct increase in purchases of war material, rearmament in Germany has also contributed towards reducing unemployment in many indirect ways. One of these ways is the increase in the capacity of German industries producing aeroplanes and war material. For the time being, the German authorities consider it inexpedient openly to defy the disarmament clauses of the Treaty of Versailles. They rearm only insofar as it is possible to do so without making it too evident. There are, however, limits beyond which secret rearmament is impossible; and for the present it is considered advisable not to overstep these limits. On the other hand, there is nothing to prevent the German armament industries from installing new plants and extending the existing ones in anticipation of a future increase in the demand for war material. Nor is there anything in the Treaty of Versailles to prevent Germany from increasing the production of certain raw materials, even if they are at present practically unsaleable and even if their production at the existing prices is not commercially profitable. The accumulation of raw material stocks will be useful for future rearmament requirements, and

meanwhile their production provides additional employment. The construction of extensive bomb-proof and gas-proof shelters, which is being carried out on a large scale in Germany, also provides employment for many thousands of workmen. While no statistics are available, it is safe to assume that the number of German workmen re-employed during 1933 through rearmament must run well into hundreds of thousands. Rearmament played, therefore, a very important part in bringing about a certain degree of economic recovery in Germany.

As we said in Chapter VIII, economic recovery in Japan was also connected with increased armament expenditure and with the rise in prices caused thereby. Apart from these two examples, however, few, if any, of the capitalist countries actually increased their armaments in 1933. Several of them have every intention of doing so. President Roosevelt's programme of public expenditure for providing employment includes the construction of a number of new battleships which, in the ordinary course of events, would not have been constructed, or at any rate not in the immediate future. There is also every likelihood of an increase in air defence expenditure in Great Britain. Should the disarmament negotiations definitely fail, France will most certainly increase

her military expenditure and other countries will follow her lead. All this is bound to provide a certain amount of employment, and it is therefore conceivable that what was true in 1933 only in the isolated cases of Japan and Germany, may become true in 1934 concerning a larger number of countries.

Notwithstanding this, it is exaggeration to attribute the trade revival of 1933 exclusively to rearmament. There were many other factors which contributed towards the reduction of unemployment even in Germany and Japan and, to a much greater extent, in other countries. Stalin is even more prejudiced and exaggerated in his statement that an armament race leading to war is the only possible way out of the deadlock of the capitalist economic system.

It is true that rearmament expenditure tends to improve trade, but so does every kind of additional public expenditure. If the Governments of capitalist countries were to decide to spend the same number of milliards on constructive public works as they spend on armament, the effect would be, from an economic point of view, decidedly more favourable. Thanks to the psychological factor, the extent to which this expenditure would stimulate recovery would be much greater. The only

trouble is that most capitalist Governments are utterly reluctant to embark upon a really ambitious scheme of public works, while they may be forced, by a real or imaginary menace of aggression, into an armament race against their wishes. But the suggestion that they will deliberately embark upon a policy of rearmament as a solution of the crisis is absurd, and the statement that they would not hesitate to adopt a policy leading to war in order to end the crisis, is too fantastic to be considered seriously.

In this connection, it is interesting to recall a suggestion made recently by Commander Stephen King-Hall. In the half-joking and half-serious tone that characterizes his writings exposing the anomalies of our economic system, he proposed that all the Governments should agree to stage a war in the Sahara. According to his scheme the various Governments would despatch expeditionary forces to invade the Sahara from various directions. Such an undertaking would involve exactly the same kind of expenditure as is necessary for a real war, and would therefore produce a similar effect upon industrial activity. The military requirements thus created would absorb all the surplus products which cannot find a market at present, and after a while, long before the object of the

expedition had been achieved, industry and agriculture all over the world would be fully employed.

Although the scheme is not free from snags, it illustrates the truth that in our absurd economic system, a war, real or artificial, is capable of bringing an economic depression to an end. In spite of this, is it possible to imagine that anybody with a vestige of common sense would seriously suggest real war as a solution of the economic deadlock? The idea is simply monstrous. The suffering inflicted upon the world by the prolonged depression disappears into insignificance compared with the sufferings caused by a war. If the choice were to lie between the perpetuation of the present economic depression and its termination through another world war, nobody outside a lunatic asylum would for a moment choose the second alternative. After all, what is the misery of the millions of unemployed compared with the sufferings of those same millions if employed in killing each other with all the cruel weapons of modern warfare? Life in the slums of the big cities, or in the villages at the deserted coalfields and factories, may be dreadful, but few of these innocent victims of the economic crisis would choose an alternative which might mean for them destruction by air attacks.

Even from the narrow point of view of saving the capitalist economic system, no statesman would think of choosing war as the way out. Indeed, it would be much more dangerous for capitalism to embark upon another war than to continue in a state of perpetual economic depression. The capitalist system has successfully withstood the test of the present crisis, which has obviously already passed its climax. For the moment capitalism is safe. This does not necessarily mean that the system would be equally able to withstand the test of another and more severe crisis which might succeed the present trend towards recovery. For the moment, however, those who believe in capitalism can afford to breathe freely. Conditions are unquestionably improving slowly, and the chances are that, in spite of a few possible setbacks that may occur, the economic situation will be somewhat better within the next few years. There is therefore no need for applying any desperate and highly dangerous remedies. And, of all the remedies imaginable, war would be the most dangerous. Indeed, the chances are that it would be suicidal to capitalism. To choose war in order to escape an economic crisis is like jumping from the frying-pan, not merely into the fire, but into a volcano.

It would not occur to any responsible statesman or economist to suggest rearmament seriously as a way out of the economic deadlock. Such a suggestion may come from quarters especially interested in the prosperity of the armament trade, but it is not likely to influence the attitude of Governments towards the question. The major issue involved in armament or disarmament is incomparably more important than a mere question of a greater or lesser degree of depression or prosperity. Even if the political and moral arguments for and against disarmament or rearmament approximately balanced each other, the economic argument in favour of rearmament and against disarmament would not decide the issue. If on the merits of the political and moral case for disarmament the Governments should decide to disarm, the warnings of those who believe that in doing so they might, on balance, damage trade, would certainly not deter them from their course. Again, if the Governments make up their mind that it is to the interest of their countries to rearm, no pacifist arguments threatening economic ruin and bankruptcy will alter their decision.

Should a Government ever be as short-sighted as to rearm for the sake of the effect of rearmament on trade, it would sooner or later realize

that it had made a mistake even from an economic point of view. Sooner or later the debts contracted would have to be paid, just as the debts contracted during the War are now being paid. Whether the payment assumes the form of increased taxation and reduced expenditure, or whether it assumes the form of wiping out savings through currency depreciation, the population is bound to suffer. Rearmament provides a stimulus to trade only so long as it is going on. The moment it reaches the stage beyond which it cannot continue, the country begins to pay the cost of its temporary prosperity. If the Government is sufficiently unorthodox to decide to subsidize a trade revival at all costs, it should choose public works of a self-liquidating nature in preference to rearmament. If it is difficult to elaborate an adequate programme of constructive public works which are financially self-liquidating, the next best thing is to spend on public works which, though not directly productive and self-liquidating, nevertheless improve the standard of living. Slum clearance is the most characteristic example of such expenditure. Even if the taxpayers' money spent on such purposes is never fully recovered in the form of rents or the sale price of the property, the loss is not like that involved in armament expenditure. It is not a

dead loss, and, even if sooner or later the nation has to pay the cost, it will be well worth paying.

Rearmament expenditure undertaken for considerations of security may, it is true, provide a temporary relief to trade. Its great drawback from an economic point of view is that, having been brought about by non-economic considerations, the ebb and flow of armament expenditure cannot be made dependent upon the requirements of economic stability. In times of depression the stimulus provided by armament expenditure may be welcome for economic reasons. If, however, the expenditure continues when the trade cycle is well on its upward swing, then it is likely to do more harm than good, even from a strictly economic point of view. It would stimulate the boom and would therefore cut shorter the period of prosperity by accelerating the advent of the inevitable slump that follows every boom. Having decided to rearm for considerations of security, the Governments are likely to persist in this policy so long as its primary motive remains in existence. They are not likely to cease to rearm, and even less likely to disarm, when business activity requires checking rather than stimulating. Assuming that rearmament continues during the upward movement of the business cycle, it is likely to do, on

balance, more harm than good, and taking the long view it is likely to diminish prosperity rather than increase it. The difference between economic public works undertaken for economic considerations, and armament expenditure undertaken for political considerations, is that the former can be adjusted to the requirements of economic stability while the latter cannot. It is therefore a mistake to regard rearmament as the way out of the economic depression.

Notwithstanding this, it is possible that the desire to end the crisis might subconsciously influence statesmen, Parliaments and public opinion in favour of rearmament and against disarmament. As the view is widely held that a rise in prices is the essential condition of economic recovery, and that this can only be attained by unbalancing the budget, the idea of increasing expenditure through rearmament would not meet with such determined opposition as it would in times of prosperity. This subconscious influence may, however, be neutralized, and more than neutralized, by the conscious and deliberate endeavour to stimulate trade recovery through the favourable psychological effect of an agreement upon disarmament. There can be no doubt that a disarmament agreement which inspired confidence

would go a long way towards stimulating trade recovery.

In order to obtain such a result, it would be necessary, however, that the disarmament effected should be drastic and that it should not be accompanied by a wave of mutual fear and suspicion. For disarmament would assist economic recovery only insofar as it encouraged optimism as regards international political relations. An agreement arrived at as a result of hard bargaining, and entered into with evident reluctance and with much mental reservation by all parties, would be utterly worthless from the point of view of its economic effect. The experience the world had with the cancellation of reparations would repeat itself. In 1931 it was a commonplace of newspaper articles that reparations were the root of all evil, and yet the Hoover Moratorium made but little difference to the international economic situation simply because, owing to the circumstances in which it was reluctantly agreed upon after lengthy haggling, it was doomed to fall hopelessly flat. Again, the world failed to appreciate adequately the virtue of wiping out reparations by the Lausanne Agreement a year later because it was hedged around with various reservation clauses and was made conditional upon various

supplementary agreements. After Lausanne it was said that war debts were now the principal obstacle to economic recovery. Presumably, if the United States had decided to make a magnanimous gesture by wiping out claims which, in any case, she was unable to collect, it would have produced a very favourable psychological effect and would have resulted in an economic recovery. As it was, the stubborn attitude of Congress drove most debtors into default. This form of cessation of war debt payments, like the cessation of reparations payments, failed to inspire confidence and was useless from the point of view of economic recovery.

The same will be true of any half-hearted and face-saving disarmament agreement. Unless it is entered into in a true spirit of conciliation, its psychological effect upon the economic situation will be worth less than nothing. This fact is not adequately realized by those who believe that any disarmament agreement is better than no disarmament agreement. They seem to imagine that the moment the statesmen can produce a document with the signatures of the interested powers, the world will be swept by a wave of confidence and the feeling of security from enemy attack will stimulate brisk economic activity.

Those who believe this underestimate the intelligence of the general public, which cannot, in these days, easily be led to believe in the salutary effect of an obviously inadequate agreement. However it may be, the possibility of bringing about trade recovery through disarmament exists in the minds of most people more definitely, and with more consciousness, than the belief that rearmament might improve trade.

CHAPTER X

ARMAMENT AND ECONOMIC PLANNING

THE task of the economic historian of future generations in explaining the anomalies of our period will not be an easy one. Living as he will in a system of planned economy, he will be puzzled by the absurd situations that arose in our period of economic anarchy based on *laissez-faire*. That at one time it was possible to improve the standard of living, even temporarily, by an increase of expenditure on armament, will sound incredible to the ears of a generation unacquainted with the queer paradoxical situations of our present system. "Surely," they will say, "it is a matter of common sense that if part of the raw material, organizing energy and human labour is employed for the production of entirely useless objects, the volume of the useful and necessary objects that can be produced becomes unavoidably smaller. It is a matter of simple arithmetics." To the student of the twenty-first century, and possibly

even of the second half of the twentieth century, it will appear absurd that at one time in history it was considered possible to increase prosperity by the production of destructive weapons and other objects which no human being wanted for the satisfaction of any of his requirements.

To demonstrate the absurdity of our system, we need not even look as far ahead as the second half of this century. There is one country which provides a tangible example, even in our days, that in a planned economy the wasteful nature of armament expenditure becomes obvious. This country is Soviet Russia. To avoid misunderstanding, the author hastens to emphasize that he does not believe in Communism as the means of attaining the goal of planned economy. In his opinion, the Corporate State is a much more suitable means to that end, even if it takes a longer time to carry out the transformation required. If, in spite of his preference for economic Fascism on the Italian pattern, the author thinks that Soviet Russia is at present a more suitable example than the Fascist State of Italy for illustrating his point, it is because planning has reached in Soviet Russia a much more advanced stage. Undoubtedly, an advanced stage can be reached also without the suppression of private property and individual

initiative, but it is a longer process. Meanwhile, Soviet Russia has to be regarded as practically the only existing example of a planned economic system.

The Five Year Plan of the Soviet Union has been the most advanced form of economic planning ever undertaken. Although far from ideal either in theory or in practice, it certainly indicates the trend of evolution in our economic system. Even if we do not take the facts and figures supplied by the Soviet authorities at their face value, it is beyond question that the working of the Plan resulted in a gradual improvement in the productive capacity of the nation, and that this improvement, again, resulted in an improvement in the standard of living. During 1932 and 1933 there was, however, a setback which upset the calculations of the State Planning Department. There were, of course, minor and major disappointments before, but this time the departure of practice from plan was on a gigantic scale. The reason for it was that, confronted by an acute menace of war in the Far East with Japan, and by an imaginary menace of attack by some European nations, the Soviet Government decided to rearm in great haste. Factories which according to the Five Year Plan were meant to produce

tractors, had to produce tanks. The plants engaged in the production of motors had to devote their output for military aeroplanes. A considerable section of industrial activity was diverted to the manufacture of war material instead of producing goods which would increase either the productive capacity or the actual consumption of the nation.

This is not the place to discuss the wisdom or unwisdom of this change of policy. It is evident that, when a Government, rightly or wrongly, considers that the security of its country is in danger it disregards economic considerations and makes an effort, irrespective of cost, to improve its system of defence. From this point of view there is no difference between the Governments of capitalist countries and the Soviet Government. Where the difference lies is that, while in capitalist countries the economic effects of rearmament may temporarily be favourable, in a Communist country its economic disadvantages become immediately evident.

In a system of planned economy all the productive forces of the country are supposed to be employed, and therefore, if part of their activities are diverted from the production of useful and necessary goods, the community is bound to suffer

immediately. Under the system of *laissez-faire*, however, it is practically impossible to employ at any time all productive forces to the extent of 100 per cent for any length of time. In the absence of scientific planning it is absolutely impossible to raise purchasing power in accordance with the increase in the production of goods. It is inevitable that, while part of the products would be unplaceable, a large section of mankind would suffer from want. Any attempt to employ the productive powers of a nation in full would lead to over-production and would inevitably be followed by a disastrous slump. It is only under a system of planned economy that it is possible to pass the benefit of an increase of production on to the community without running such risks, and it is only under a system of planned economy that a diversion of productive forces from the production of useful commodities to the production of useless commodities results in an immediate obvious decline in prosperity.

Owing to its deficient method of production and distribution, the economic system of *laissez-faire* is unable to secure the consumption of the goods that can be produced. For this reason, under that system any demand for goods, however artificial, fulfils a useful task. From an economic

point of view it is better to engage the millions of unemployed in useless activity rather than keep them unemployed. Even if the goods they produce have no economic value whatever, the demand for machinery, raw materials, semi-products, fuel, etc., in connection with their activity, and their increased consuming power, tends to be beneficial to the community. If China is unable to sell her tea because our unemployed are unable to pay for it, it is economically justifiable—however unjustifiable it may be from other viewpoints—to sell war material to China ; for, in doing so, those employed in the manufacture of war material can increase their purchases of China tea, and the producers of China tea are, in turn, in a position to increase their purchases of other commodities. This effect of armament expenditure is even more evident within the boundaries of one country. If, owing to unemployment on a large scale in the iron, steel and engineering industries, our textile industries are unable to sell sufficient goods, rearmament, by providing employment in the iron and steel industries, is economically beneficial because in addition to this direct employment it will tend to increase the demand for textiles by those who obtain employment. We have seen in previous chapters that the beneficial economic

effects of rearmament are by no means an unmixed blessing, even from a narrow economic point of view. We have also seen that the adverse economic effects of disarmament are to a great extent compensated by its economic advantages. It is, nevertheless, a fact that, on balance, in our economic system disarmament is harmful to trade while rearmament is beneficial to trade.

If, however, production is planned in order to meet genuine economic requirements, and distribution is planned in order to enable the consumers to buy the goods produced for their benefit, this anomalous state of affairs will cease. The community will not be any richer merely because a section of it is engaged in the production of useless objects. On the contrary, it will be deprived of useful goods to an extent equivalent to the production of war material. This is what has actually taken place in Soviet Russia during the last two years. Under the system of planned economy adopted in that country, everything that is produced is consumed and the limit of the amount of goods is determined by the pace at which production can be increased. If rearmament diverts part of the productive factors from producing goods for consumption, the consumers immediately suffer a disadvantage through it.

The result is that public opinion in a country with planned economy is likely to be opposed to rearmament, unless rearmament is plainly necessary for considerations of security. It is reasonable to assume that in a State with planned economy, economic considerations play a more important part in determining the Government's armament policy than in countries whose economic system is based on *laissez-faire*. As the example of Soviet Russia shows, economic considerations are in themselves unable to prevent rearmament even in a country with planned economy. The chances are, however, that consciously or subconsciously, those responsible for governing and those responsible for influencing public opinion will allow themselves to be influenced to some extent by the obvious and immediate economic disadvantages of rearmament and by the equally obvious and immediate advantages of disarmament.

It is only after the adoption of economic planning that mankind could enjoy the full economic advantages of disarmament without having to bear the full burden of its disadvantages. Doubtless, even under planned economy, the industrial changes brought about by disarmament would be costly and the community would have to pay for it. Perfectly good machinery would have to be dis-

carded and the specialized knowledge and experience of those engaged in that branch of production would be wasted. These losses, however, are small compared with the losses under the system of *laissez-faire*, when the workmen who became superfluous through disarmament cannot be easily absorbed by other branches of production. Under the system of planned economy the productive forces released through disarmament would be engaged immediately for the production of goods tending to improve the standard of living of the community. There would be no losses and no suffering even during the transition period, beyond those caused by the scrapping of machinery and loss of specialized experience.

It has been suggested that, in order to counteract the adverse economic effect of disarmament, and thus to weaken the opposition to the movement, the Governments should undertake to re-employ the workmen who become unemployed through disarmament. This suggestion met with opposition from various points of view. Liberal economists rejected the idea because it would mean additional Government interference with economic life. Socialists are against the suggestion because it discriminates in favour of one particular group of unemployed. Conservative critics dislike the idea because it

would imply the recognition of the principle that it is the duty of the State to provide employment to those who lose it by legislative changes. Even if it were possible to overcome political opposition, the scheme would be far from ideal. Unless it is connected with the execution of additional public works financed by unorthodox means, the result would be merely to transfer employment from one group of workmen to another. Such palliatives would not alter the fact that in the absence of economic planning disarmament is disadvantageous from an economic point of view.

The economic arguments against rearmament and in favour of disarmament lack convincing force so long as production and distribution remain in their present haphazard state. Pacifism would find more fertile soil under a system of planned economy, when the consumers would have to bear the full burden of preparation for war, and when increased armament expenditure does not increase but reduce prosperity. The way towards true pacifism lies, therefore, through economic planning.

CHAPTER XI

FINANCIAL LIMITATION OF ARMAMENTS

ACCORDING to a saying attributed to Prince Eugène of Savoy, the successful conduct of warfare requires three things : money, money and money. The importance of the money factor in war has indeed been fully realized at all times and ages. In our days it is a commonplace of articles dealing with war finance to refer to the financial resources of the belligerents, or potential belligerents, as the sinews of war. We have seen, however, in previous chapters that in modern times the elasticity of the monetary and credit system enables the Governments in an extreme emergency to carry on warfare even if they do not possess an adequate amount of money in the form of hard cash. But this does not mean that in present-day conditions the time-honoured rule has ceased to hold good. It only means that, in our changed conditions, the ways and means by which Governments raise the money required for conducting war have changed.

In the olden days the kings imposed levies on their population, and more particularly on the population of the conquered territories. They also resorted to the debasement of the coinage as a means of raising funds. In our days the debasement of money has become the chief means of financing war, but it assumes a totally different form from what it assumed in centuries gone by. The existence of a highly developed system of credit successfully conceals for a long time the debasement of the currency through war expenditure. Governments have incomparably better facilities for borrowing than they had until comparatively recently. In fact, insofar as the war is financed internally, the limit to their borrowing capacity is very distant. They can borrow, spend, re-borrow the amount spent, re-spend it, and so on *ad infinitum*. It is only inasmuch as part of the war material has to be imported that financial considerations may put a limit to war. In given circumstances these considerations may compel the belligerents to substitute domestic products for imported war material, as an alternative to doing without them and thereby placing themselves at a disadvantage.

In extreme cases, lack of financial resources for the purchase abroad of material or food might

compel one of the belligerent parties to suspend hostilities, or even to surrender unconditionally. Such cases are, however, exceptional. During the last war it was not the lack of financial resources that prevented the Central Powers from purchasing abroad the food and raw material that was essential for continuing the war. It was the Allied blockade which, independently of any financial considerations, produced that effect. But for that blockade Germany and Austria-Hungary would have been able to make use of their considerable gold resources in 1914, and history might have taken a totally different turn. It would be a mistake, therefore, to believe that the Central Powers lost the war because of the inferiority of their financial resources.

It is safe to assume that in modern times the limitation of financial resources does not, as a rule, constitute an insurmountable obstacle to the continuation of warfare. Nor does it constitute an absolute barrier to rearmament in time of peace, if rearmament is regarded, rightly or wrongly, as a matter of vital importance from the point of view of national defence.

Notwithstanding this, financial considerations played a very important part in the work of the Disarmament Conference. It was realized that,

while financial limitations do not nowadays provide an automatic limit to war expenditure, it can be used by agreement as a means to secure the voluntary limitation of armaments. By undertaking not to spend more than a certain amount on national defence expenditure, the nations would voluntarily limit the extent to which they could rearm. If they fix the amount below its present figure, they may go further and undertake to disarm to some extent.

The limitation of armaments through the limitation of national defence expenditure is not, of course, absolute. Even assuming that the Governments honour their undertaking and do not overstep, directly or indirectly, the limits they agree to observe in war expenditure, there are many ways in which, within those limits, rearmament can be carried out. It is always possible, especially in countries with compulsory conscription, considerably to reduce expenditure on the personnel, and use the surplus in other directions. It is also possible to obtain marked reductions in the purchase price of various war materials without the quality deteriorating thereby. All these and many other loopholes can, of course, be guarded against to some extent by agreeing upon a detailed control of armament expenditure. Even such a system is, how-

ever, hardly foolproof. Parallel with the financial limitations there would have to be other measures to control and limit the size of standing armies and the quantity and quality of their weapons. Nevertheless, if the nations will ever agree genuinely to disarm, or to limit their armaments, financial limitations should play a useful part in the system elaborated for the enforcement and supervision of the agreement.

The Disarmament Conference duly realized this, and appointed a National Defence Expenditure Commission to deal with this important aspect of the problem. To a very great extent the questions this commission were called upon to examine were technical questions of armament accountancy, which are outside the scope of this book. There is, however, one set of problems dealt with by the report of this Commission which cannot be overlooked in a book dealing with the economic aspects of armament.

One of the great difficulties of limiting armaments through the limitation of expenditure is the fluctuation of the purchasing power of the currencies. Owing to this fluctuation it would be impossible to obtain satisfactory results by fixing the limits in absolute figures without providing the machinery for revising the totals and adjusting

them to changes in the purchasing power of currencies. Otherwise a substantial fall in prices, such as we have witnessed during the last five years, would automatically increase the scope for rearmament in spite of the limitation of national defence expenditure. Conversely, a substantial rise in prices might render the limits originally accepted incompatible with the requirements of security. Worst of all, as the purchasing power of currencies does not always change in the same direction and to the same extent in every country, a rise in the prices of one and a simultaneous fall in the prices of the other country might considerably change the armament ratio agreed upon between the nations.

The Committee of Experts set up by the Disarmament Conference in 1931 considered the possibility of elaborating an automatic system for the readjustment of the financial limits of armament. It is to their credit that they did not take the line of least resistance by leaving it to the index numbers to perform this task. In a period in which economic literature is characterized by the cult of index number-worshipping, they might easily have decided to propose the regulation of the limits of armament in accordance with the fluctuation of index numbers. They realized, however, that the

existing index numbers in the different countries are compiled according to different systems. They also realized the difficulties of finding any appropriate index number for measuring variations in the cost of armaments. They also rejected the idea of specially compiling an index number based on the national defence expenditure, on personnel, transport, buildings and war material. They arrived at the conclusion that such an index number would not be able to measure changes in quality. For this reason the attempt at elaborating an automatic system for dealing with the fluctuation of the purchasing power of the currencies had to be abandoned. The Committee arrived at the conclusion that only a living organization would be in a position to readjust limits in the case of fluctuations of purchasing power. Details as to the scope of such an organization are given in the official report reprinted in Appendix I.

The fundamental principle of using budgetary limitations as a means of reducing armaments did not meet with unanimous approval. Some of the participants in the Disarmament Conference were not in favour of it mainly because of the facility with which such limitations could be circumvented. There are innumerable ways in which the Government could allocate funds for armament without

showing them in its official armament budget. The system might act as a penalty on those who loyally observed the letter and spirit of the agreement, and an encouragement to those who disregarded it. This, however, is equally true of any other method by which armaments could be limited by agreement. The difference is that financial limitation of armaments would place at a grave disadvantage countries where the Government is under strict parliamentary control. It is much easier to manipulate the budget in countries under a dictatorship than in those under a democratic system. It is, nevertheless, desirable that any genuine disarmament agreement should include financial limitations.

CHAPTER XII

CONCLUSION

THOSE who expected this book to be a warning against the disastrous economic consequences of rearmament must have been disappointed by the author's attitude towards the subject. While realizing the unfavourable economic effect of the failure of the attempts at the limitation of armaments, he is not inclined to regard these consequences as disastrous from a purely economic point of view. Possibly this is the result of the author's general attitude towards the present economic situation. As he made it plain in his book *The Sterling-Dollar-Franc Tangle*, he regards inflation as the inevitable solution of the economic deadlock. It is only through a considerable depreciation of currencies that the intolerable burden of public and private indebtedness contracted during and after the war can be substantially reduced without thereby causing the hardships that are associated with wholesale defaults. The quickest and most effective way

of attaining this end is through the unbalancing of budgets.

It would be, of course, infinitely preferable to have budgets unbalanced through public works, but, unfortunately, in most countries the orthodox mentality of Governments and Parliaments rules out that solution. Expenditure on war material, wasteful as it is, produces the same inflationary effect. Whatever its disadvantages may be in various other spheres, it certainly has the advantage of contributing to the necessary and inevitable process of currency depreciation. Thus the very same reason which makes orthodox economists and statesmen regard rearmament as an economic disaster, has prompted the author to regard it without undue pessimism. If he were a deflationist, or at least an anti-inflationist, he would probably agree with those who paint the economic consequences of rearmament in at least as dark colours as its political consequences. As it is, he cannot agree with the gloomy views taken by those who argue against rearmament on economic grounds.

If pacifists find this book disappointing they may derive comfort from the fact that their opponents have probably found it equally disappointing. The author emphatically dissociates himself from

those who regard rearmament as an ideal solution of the economic crisis. He does not regard an increase in armament expenditure as an unqualified blessing to trade, and realizes that there is another side to the picture. While recognizing that certain temporary economic advantages are obtainable through an increase of expenditure on armament, he does not fail to point out that in the long run these advantages are likely to disappear. He lays much stress upon the point that the only reason why rearmament can produce even temporary economic advantages is that owing to lack of economic planning a large section of the population cannot at present be employed in productive activity. Either public works or economic planning would, in the author's opinion, provide a much more advantageous solution than rearmament could possibly provide.

The author condemns rearmament also from the point of view of the waste of material it entails. The waste of human labour engaged in producing war material cannot be regarded as absolute, for the reason that, under a system of *laissez-faire*, that labour could not in any case have been employed for productive purposes. On the other hand, any raw material consumed in the manufacture of armaments has to be written off as a dead loss for

mankind. In many cases the supply of metals, minerals and other material is by no means inexhaustible, and the quantities wasted for war material are irreplaceable. At present the loss may not be felt, but within a hundred years, or possibly less, our descendants will condemn the memory of their ancestors for having recklessly wasted some of the most precious and indispensable treasures of mankind. It is by no means certain that, in the meantime, the progress of science will compensate the world for its losses by the substitution of synthetic products for the material used up for armament purposes. Quite conceivably later generations will have to pay a heavy price for the lack of foresight of our age.

Above all, the author repeatedly emphasizes that, even if rearmament may have some temporary economic advantages, the attitude of the world towards the problem will be, and should be, determined by political and moral, rather than economic considerations. Even if we were to endorse the most exaggerated opinion of the economic advantages of rearmament, this does not mean that we would decide in its favour. No economic advantage can be great enough to make it worth while to run the risk of another war. The question is whether rearmament increases or reduces

the likelihood of another war. It is on that question that the fate of the struggle between the adherents of disarmament and those of rearmament will depend.

APPENDIX I

LIMITATION OF ARMAMENT EXPENDITURE

THE following text is extracted from Chapter 12 of Volume I of the Report of the Technical Committee set up by the National Defence Expenditure Commission of the Conference for the Reduction and Limitation of Armaments. It deals with the influence of the fluctuations in the purchasing power of the various currencies on the proposed expenditure limits.

At its meeting on May 26, 1932, the National Defence Expenditure Commission decided to refer to its Technical Committee the question of the *fluctuations in the purchasing power of the various currencies.*

This question is undoubtedly of great importance from the point of view of the limitation of national defence expenditure. If the value of currency changes, the limit fixed for the national defence

expenditure of the respective States will cease to have the same meaning. An increase in the purchasing power of the currency of a given country might enable it to increase its armed strength without any addition to its national defence expenditure. On the other hand, a decrease in purchasing power might make it impossible for the country concerned to keep its armaments at the level to which it will be entitled under the Convention. It thus becomes necessary to devise a practical means of guaranteeing that the limit assigned to each country will continue to represent the same level of armaments.

STUDIES OF PREVIOUS PROPOSALS

The influence of variations in the purchasing power of currencies upon contractual limits was dealt with in comparatively full detail in Chapter 18 of the report by the Committee of Budgetary Experts.

During the general discussions at the beginning of the Conference, certain delegations emphasized the importance of the question of fluctuations in the purchasing power of the various currencies from the point of view of the regular working of any system of budgetary limitation. In this connection, it may be appropriate to mention a pro-

posal by the Swedish delegation stressing the need for continuing the examination of the budgetary method, more especially with a view to its application in the case of fluctuations in purchasing power. Reference must also be made to the German delegation's general estimate of the efficacy of the budgetary method in the event of fluctuations in purchasing power.

The National Defence Expenditure Commission also received certain suggestions from the French delegation, which laid particular emphasis upon the desirability of considering the question of variations in the cost of armaments under two different aspects: (1) the economic, and (2) the administrative. The Swedish delegation, on the other hand, suggested that the percentage proposed by the Experts as a means of ensuring greater elasticity in the average four years' limit might also serve to counteract fluctuations in purchasing power. The same delegation further suggested that it would be desirable to entrust the Permanent Disarmament Commission with the task of operating the mechanism outlined by the Experts for the readjustment of contractual limits.

It should be stated at the outset that, like its predecessors, the Experts of 1931, the Technical

Committee has recognized that both publicity figures and the limits assigned to the various States must be expressed in units of their respective national currencies. It would, indeed, be impossible to fix limits stated in terms of a single monetary unit taken as a common measure. In this connection, it need only be pointed out that the rates of exchange of the various national currencies may vary to a very considerable extent without any corresponding variation in the internal purchasing power of the currencies in question.

If limitation figures are to be stated in units of the national currency of each country, account must be taken of the fact that the purchasing power of such currencies may vary. The Committee does not, however, think fit to give an exact definition of what is to be understood by "purchasing power". It considers, indeed, that, for the practical ends which it set itself, it is sufficient to state that by "a change in purchasing power" is to be understood in principle a change in the general level of prices in a given country. It is clear that, in order to gauge the general level of prices, all their various indices must be used, more especially the wholesale price and cost-of-living indices.

ANALYSIS OF THE FACTS

In order to place on a firm basis the inquiry into methods of permitting readjustments of limitation figures in the event of variations in purchasing power, it appeared necessary to ascertain the extent of the fluctuations which have occurred in the course of recent years both in exchange rates and in internal prices.

To this end, the Committee has had drawn up a series of diagrams and tables showing rates of exchange, wholesale prices and the cost of living in various countries in the period 1929-32.

The first essential fact brought to light by this statistical material is the considerable fall in prices which occurred in all countries during the period 1929-September 1931. Wholesale prices, and to a lesser extent the cost of living, fell during these years in a majority of countries. This increase in purchasing power, however, was not uniform in all countries, though in spite of this the general tendency—viz. the general fall in prices—was universal in character.

SCOPE OF THE COMMITTEE'S ACTIVITIES

After this brief summary of the facts of the position, the Committee attempted to evolve some

form of practical machinery for the adjustment of limits in the case of fluctuations of purchasing power.

It at once recognized that it was not necessary to contemplate any procedure to deal with fluctuations of a violent and rapid character. The Committee was agreed that, in cases of this kind, the budgetary method would no longer operate. No machinery is conceivable which would make the adjustments required by a collapse in the internal value of a currency such as the fall of the Reichsmark in 1923 or the devalorization of the Austrian and Soviet currencies after the war.

The exact purpose of the Committee's studies was to measure the influence of variations in purchasing power on the cost of armaments themselves. But it is possible that the cost of armaments will vary for reasons which have nothing to do with fluctuations of purchasing power. It may be affected by organic changes, or administrative reforms, or alterations in the methods of production of the material, or improvement in the quality of armaments. All these factors in the increase of the cost of armaments are independent of the question under discussion in this chapter. Only changes in the cost of armaments due to fluctua-

tions in purchasing power are to be considered in the present instance.

The question arises whether provision should be made for readjustment of limits in the case of any variation in purchasing power, however small. A mathematical solution by which the figures of the limits would have to be adapted to any fluctuation in purchasing power would involve very frequent readjustments. The Committee considers that it is not necessary from the practical point of view to proceed to adjustment of the limits whenever there is a variation in the purchasing power. The Budgetary Experts of 1931 took the view that fluctuations in purchasing power should only be taken into account where they have had the effect of seriously increasing the cost of armaments; and they also considered that it was not necessary to readjust the limits in cases where increase in the cost of certain armaments was counterbalanced by simultaneous decrease in the cost of other categories of armaments.

The Technical Committee on this point approves of the conclusions of the Budgetary Experts; but it desires to define the consequences of their conclusions. The readjustment of limits should only be contemplated in cases where the cost of armaments is affected by variations in purchasing

power, and not by any other factor. There should be no question of readjustment unless the fluctuations of purchasing power are appreciable. The circumstances under which a readjustment of limits would be necessary are defined in the following formula :

“Whenever a High Contracting Party proves that *appreciable* fluctuations in the purchasing power of currency have *seriously increased* the cost of its armaments, and that in fact changes in the cost of certain items have not been compensated by changes in the opposite direction in the cost of other items, that High Contracting Party may ask for a readjustment of these limits.”

MACHINERY FOR THE ADJUSTMENT OF LIMITS

After defining the conditions to be realized as a preliminary to readjustment of limits, it is desirable to indicate a machinery under which such readjustment can be effected.

The Experts in 1931 considered the possibility of evolving an automatic system for the purpose. They began by considering whether automatic readjustments of the limits could be effected on the basis of existing indices in the different countries, or a combination of these indices. Owing

mainly to the difference in the manner of compiling existing indices in the different countries, and the impossibility of finding any appropriate index for measuring variations in the cost of armaments, the Committee of Experts came to the conclusion that no existing index or combination of existing indices could constitute a suitable basis for the automatic readjustment of the limits fixed by the Convention. The Technical Committee entirely endorsed this conclusion.

The Experts then inquired whether it would be possible to draw up a special index showing the fluctuations in the cost of the national defence services. Such an index would have to be based on the data relating to the four main categories of expenditure in the Model Statement—viz. personnel, transport, buildings and war material.

The Experts' studies led them to the conclusion that the establishment of a special index would meet with serious difficulties, the chief difficulty being the fact that such an index would not be able to measure changes in quality occurring chiefly in the case of material in process of technical development, especially air material. A special index would never be able to serve as a measure for a change of a general character in purchasing power. The Technical Committee accordingly,

like its predecessors, has been unable to prepare a sufficiently satisfactory index to allow of automatic readjustment of the limits fixed by the Convention.

It has been observed that the initial period of the duration of the Convention will probably have the character of a period of transition. In order to avoid the inconveniences resulting from excessively numerous demands for readjustment during this first period, it is possible to imagine some kind of lump-sum system allowing each State to increase its limit by a given amount to take into account fluctuations in purchasing power. The Committee wishes to communicate this solution to the Conference as a mere suggestion. If countries wish to avail themselves of this latitude, their rights should be defined in precise terms when the Convention is signed. It would be necessary to indicate in the Convention up to what percentage of the limit fixed excesses over that limit will be permitted in case of fluctuations in purchasing power.

The increases thus authorized might be effected without the States having to supply previous explanations. But they would have to notify the extent to which variations in purchasing power have led them to take advantage of the excess

percentage, so as to make it possible to see whether other causes have also led to the excess.

This method would give States an opportunity of judging in advance the possible risk of changes in purchasing power. The arrangement would no doubt prevent numerous demands for adjustment in the initial period of the execution of the Convention.

After this mention of a lump-sum system, it is necessary to study the principal method under which States might ask the Permanent Commission for adjustments of limits which might have been rendered necessary by fluctuations in purchasing power.

The idea of an automatic system based either on existing indices or on a special index having been rejected, the Technical Committee confirmed the conclusion of the budgetary experts that only a *living organization* would be in a position to readjust limits in the case of fluctuations of purchasing power.

Before stating the reasons for this conclusion, it is desirable to point out that two articles of the draft Convention might be of some importance in connection with the solution of the question of the readjustment of limits by a "living organization".

Under Article 59, the limits fixed in the Convention and the methods for which the Convention provides may be the subject of periodical revisions in the course of the execution of the Convention in the event of the conditions under which the obligations for which the Convention stipulates were contracted undergoing (in virtue of technical changes or special circumstances) modifications justifying such revision. In its general tenor, Article 59 may be regarded as covering universal fluctuations of purchasing power also. In view, however, of the fact that the revisions for which it provides can only be effected after a certain interval, they cannot be regarded as a sufficiently rapid and elastic means of settling by themselves the problems arising out of fluctuations in purchasing power. The Committee wishes, however, to state that, from the technical point of view, the provisions of Article 59 might be applicable in the case of fluctuations which are gradual and universal in scope.

The Committee has also considered whether recourse might possibly be had to the provisions of Article 50 of the draft Convention with regard to derogations. After a study of these stipulations, the Committee is of opinion that this article can hardly be interpreted as covering changes in the

cost of armaments due to fluctuations in purchasing power.

The Committee is anxious at the outset to define what it means by *adjustments*.

An adjustment is not a revision ; it does not touch the contractual bases of the Convention and cannot involve or imply the slightest change in the scale of armaments themselves (effectives or material). Its only aim is to express in currency of changing value the same total sum of armaments.

If, in addition to a limitation of the total expenditure on national defence, the Conference considers limits for the expenditure on each force, it will be necessary, after adjusting the general limit, to assign to the special limits the same coefficient of adjustment as to the aggregate limit.

As regards the duties of the body which will be called upon to apply the system of adjustments, the Committee's discussions were singularly facilitated by the indications contained in the report of the Bureau of the Conference on the constitution of a Permanent Disarmament Commission consisting of representatives of every country and entrusted, in general, with the supervision of the execution of the Convention.

In the Committee's opinion, it should be left to this Commission to decide as to the adjustments

resulting from fluctuations in purchasing power. No other body would be better suited to carry out this difficult task. The Committee would nevertheless feel that it was failing in its duty if it did not emphasize here and now that questions of adjustment are of an exclusively statistical nature and that consequently all political elements of whatever nature should be excluded when taking decisions. Setting out from this premise, it ventures to make the following suggestion :

It would seem, as stated in another chapter of this report, that the Permanent Commission might usefully set up a sub-committee whose sole duty would be to study the problems relating to the limitation and publicity of expenditure, and which at the same time would examine applications for an adjustment of limits and lay concrete proposals before the Permanent Commission with regard to these applications. The Commission should not reject these proposals without hearing the said sub-committee.

The sub-committee should, in the Technical Committee's opinion, be composed, not of representatives of Governments, but of experts in public accountancy and general and military administration ; it should also be able to count on the assistance of special statistical experts.

The Technical Committee has thus not thought fit to return to the suggestion put forward in 1931 by the Committee of Experts for entrusting to the Financial Committee of the League of Nations the investigation of requests for readjustment of limits. The Committee did not consider it desirable to ask the Financial Committee, which is already overloaded with problems of a somewhat different nature, to co-operate regularly in the work of the Permanent Commission. Thus, while discarding the idea of constituting the Financial Committee a body regularly entrusted with these special studies, the Technical Committee was at the same time anxious to emphasize that it would be very desirable for the Permanent Commission to be able in case of need to refer to the Financial Committee for advice. The Committee has therefore been glad to receive from the competent services the assurance that the Financial Committee would always be ready to act in an advisory capacity.

PROCEDURE

In the matter of procedure, the first question arising is to determine who is to have the right to ask for adjustment of limits. It is clear that the right to submit a demand for adjustment of

the limit allowed it by the Convention rests in the first place with the State concerned. But the Experts in 1931 had proposed that, in the event of an increase in the purchasing power of a country, the other States should be entitled to ask for a readjustment of the limits of that country. The Technical Committee approves of this attitude. Referring once again to the general rule stated above that any change, if it is to be considered, must be of a certain magnitude, the Committee desires to point out that this rule must apply *a fortiori* in the case of applications for readjustment put forward by a State on the basis of an increase of purchasing power in another State. The supervising body will itself estimate as a matter of equity the admissibility of such an application.

In submitting an application for readjustment to the Permanent Commission, a State must submit all evidence in support of its request.

The Technical Committee discussed whether it would not be desirable to lay down certain rules to ensure that the readjustment procedure would not be set in operation by applications with little or no foundation. If, for example, a demand for readjustment is not justified insofar as concerns the primary conditions—i.e. changes in purchasing

power—it would be useless to set the whole machinery in operation in order to examine whether or not there had been an increase in the cost of armaments. To make allowance for the possibility of such demands, the Committee has suggested a procedure by which they would be “*taken into consideration*”, to which it wishes to draw the Conference’s attention simply as a practical suggestion.

The sub-committee of the Permanent Commission entrusted with questions of expenditure would form a “small committee” to make a preliminary study of every demand for readjustment with a view to pronouncing on the question whether or not the readjustment procedure should be initiated, and to submitting its recommendation on this subject to the sub-committee for decision. This “small committee” should have power not only to consider demands for readjustment in order to pronounce on the question whether there is reasonable ground for a detailed inquiry, but also to study carefully the nature of the evidence and documentary material supplied, and to ask, if need be, for further particulars. Applications for readjustment would be communicated to the other countries only after being approved by the small committee.

The Committee expressed the opinion above that only appreciable fluctuations in purchasing power which have seriously increased the cost of armaments should be taken into consideration. This essential rule also guided the Committee when it approached the problem of the operation of the system.

To establish the facts, price indices will, of course, have to be utilized. At the same time, for the reasons already noted, it is impossible to recommend the use of any particular combination of such indices. It was felt that the system should be as elastic as possible. Accordingly it seems hardly possible to fix definite rules in advance—for example, for the application of the various types of existing indices. It must be laid down as an essential principle that changes should be reflected to an appreciable extent in the different series of indices, including the index in which changes occur most slowly—i.e. cost-of-living index. As a general rule, changes must clearly be more considerable in wholesale prices than in cost-of-living indices. This rule cannot, however, be definitely fixed by indicating, for example, the mathematical ratio in the variation in the different series of indices which would be required to support a request for adjustment (by saying, for example,

that before there can be a readjustment a change of x per cent must have taken place in the cost of living and of y per cent in wholesale prices). Such rules would not be sound, since the conditions for the establishment of the indices certainly vary a great deal.

The Committee fully realizes that, in laying down the rule that a fluctuation in purchasing power in order to be taken into consideration with a view to a readjustment must be reflected both in the wholesale price index and in the cost-of-living index, certain fluctuations are excluded which, even if they are not reflected in these indices, may nevertheless in special cases possess a certain importance. Thus it was pointed out that, during the year 1931-2, a certain increase in purchasing power permitted the British Army to make economies amounting to about £500,000 sterling, or 1 per cent of its total expenditure. This increase in purchasing power, however, was not clearly reflected in the wholesale and cost-of-living indices. The Technical Committee nevertheless thought it useful to maintain the rule that a fluctuation must be appreciable and must thus be reflected in the cost-of-living index in order to be taken into account with a view to a readjustment. It would be unreasonable to endeavour to take into account

every fluctuation ; and very strong practical reasons militate in favour of the establishment of a somewhat restrictive rule in this respect.

It will now have to be ascertained whether the change in purchasing power has had repercussions on the cost of armaments. This examination will have to refer to all the categories of armaments and to take into account, as the Experts proposed, any possible compensations. In each case, it will be necessary to consider the special conditions in the country concerned. Even if certain definite considerations may be mentioned (and the Committee has made a point of reproducing here the enumeration framed by the Experts) no list of circumstances to be taken into consideration in examining applications can be regarded as exhaustive.

After endeavouring to lay down rules for the working of the system which it recommends, the Committee discussed the question of who should be responsible for supplying proof and what the nature of such proof would be.

In the case of a diminution of purchasing power producing an increase in the cost of armaments, it will be for the State asking for a readjustment to furnish proof. It will thus be for it to prove that the increase in the cost of certain armaments

has not been set off by a drop in the cost of other categories of armaments.

On the other hand, in the case of an increase in purchasing power, it will be for the State asking for the readjustment of the limits of another State to supply proof; the last-named State would have the right to refute the evidence and the supervisory body will be free to ask for any information and to take the necessary decisions.

If it may be presumed from the budget figures that the limit assigned to a State will be exceeded, that State must, at the moment when the Model Statement of estimated expenditure is produced, explain whether the increase is caused by the possibility of a rise in prices. If such rise in prices takes place during the execution of the budget, the State must in due time apply for the readjustment of its limits before sending in the Model Statement based on payments.

It is clear from the foregoing survey that the proof to be adduced before the Permanent Commission will concern a large number of circumstances and facts. There must be proof (*a*) that fluctuations in purchasing power have occurred, and (*b*) that such fluctuations have involved a change in the cost of armaments.

In order to show that the purchasing power has

varied, it will be necessary to employ indices, in the first place, wholesale price indices and cost-of-living indices. Such indices must cover the whole period which has elapsed since the last fixing of the limits. It follows that each State would do well, after the conclusion of a Convention, to supplement its statistical data so as to be able to supply, if need be, the necessary evidence to show clearly the fluctuations in purchasing power.

As regards ascertaining that a change has occurred in the cost of armaments, it is even more difficult to indicate beforehand the nature of the proof to be adduced. The Committee has therefore not thought it advisable to draw up an exhaustive list of evidence to be given by States. Generally speaking, States must be ready to support applications for readjustment by all the necessary explanations.

The particulars must relate to the date of the application for readjustment and to the date of fixing of the limits subject to readjustment and also to the whole of the intermediate period.

The Committee, considering the putting into operation of the procedure for readjustment of limits in the case of fluctuations in the purchasing power of currency, wondered whether the strict

verification of proofs and evidence supplied by States would not mean that they must produce certain information, such as contracts or statistics, which States themselves do not generally make public.

Although this is a general problem relating to the exercise by the Permanent Disarmament Commission of supervision over all contractual obligations arising out of the Convention, the final settlement of which rests with the Conference itself, the Technical Committee feels that it is not exceeding its powers in expressing the opinion that, in such cases, the Permanent Disarmament Commission might, for practical purposes, rest content with the explanations given by the Governments and that the latter should not be required to produce unpublished documents.

In view of the complexity of fluctuations in the purchasing power, the Committee thinks it would be advisable to give the Permanent Commission the greatest possible liberty in examining applications.

The Committee believes, moreover, that such liberty would be in conformity with the provisions laid down in the report submitted to the Bureau on December 7, 1932. The report states :

“ Article 7. The Commission shall receive all

the information which the High Contracting Parties are bound to communicate to the Secretary-General of the League of Nations in pursuance of their international obligations in this respect. The Commission may request the High Contracting Parties to supply, in writing or verbally, any supplementary particulars or explanations in regard to the said information which it may consider necessary."

The Technical Committee has noted that the report of the Bureau provides for local investigations as follows :

"Article 10. Any High Contracting Party whose attitude may have been the subject of criticism shall be entitled to request the Commission to conduct in his territory such investigations as may be necessary in order to verify the execution of the obligations of the said Party under the present Convention.

"On receipt of such a request, the Commission shall meet at once in order to give effect to it, to determine the scope of the investigation within the limits of the criticism which has been made, and to lay down the conditions in which the investigation is to take place."

With regard to this provision, the Technical Committee would merely point out that, in order

to form an opinion on requests for readjustment, it would appear sufficient to conduct an inquiry by means of documents and oral questions, and that it will not be necessary to make investigations in armament factories, Treasury archives or ministries of defence. It should be added that, as regards distant countries, local investigations would certainly not, in the Committee's opinion, constitute a practical means of supervision.

The question has been raised whether, as a result of a readjustment of the limits of one State, the limits of other States must also be readjusted and what procedure should be followed in that case. As, however, the Permanent Commission will consist of representatives of all countries, and consequently the States will be in a position to raise any questions concerning themselves in that Commission, it does not appear necessary to provide for other measures in this respect beyond merely providing that the Permanent Commission should have the power to consider whether, as a result of a revision of limits for one State, a readjustment of the limits of the other contracting parties would also be justified.

This possibility of extending the procedure would certainly be of great value in the case of universal fluctuations in the purchasing power.

CONCLUSIONS

In conclusion, the Technical Committee considers that, if violent and at the same time very rapid changes affect the purchasing power of currencies, and if these changes are not universal and occur at different times and in a different measure for various countries, the system of limiting expenditure could no longer function.

But if price fluctuations are not too violent, the Committee is of opinion that the "living system" which it recommends will allow of a readjustment of the limits that will enable the latter to retain their full contractual value.

APPENDIX II

ITEMS OF ARMAMENT EXPENDITURE

IN order to give an idea of the great variety of expenditure items included under the heading of National Defence Expenditure, we propose to reprint below the Conventional List of those items contained in Volume I of the Report of the Technical Committee appointed by the National Defence Expenditure Commission of the Conference for the Reduction and Limitation of Armaments.

National Defence Expenditure is expenditure in respect of military, naval and air formations, services and establishments in the home country and colonies, in particular :

Central administrations ;

Missions ;

Military, naval and air attachés ;

Headquarters staffs and staffs of commands ;

Various arms and branches of the armed forces :

Infantry, cavalry, artillery, engineers and signal

family allowances, travelling and mission allowances, contributions by the State to pension and social insurance funds, in respect of military or civilian personnel whether normally forming or not forming an effective part of military, naval and air formations, services and establishments (personnel with the Colours, unattached or on leave, persons undergoing preparatory military training, territorials, reservists during periods of training or not).

2. Expenditure on maintenance, viz. :

(a) Expenditure for meeting the immediate requirements of the effectives normally forming part of formations, services and establishments, and of personnel called up for periods of training, more especially expenditure on subsistence, clothing, equipment, bedding, furniture, heating, light, washing of linen, sanitation and medical attention, religious services, office work, military physical and athletic training and education and amusements, together with expenditure in respect of compensation for losses and damage caused by military formations, services and establishments ;

(b) Expenditure in respect of the creation and maintenance for military purposes of reserves of goods, foodstuffs, raw materials or

products relating to the aforementioned requirements ;

(c) Subsidies paid to private associations and institutions with a view to meeting these same requirements (Red Cross, pigeon fanciers' societies, etc.) together with expenditure relative to shooting clubs and physical culture societies so constituted as to be of military importance, fees and allowances granted to individuals for services rendered (doctors, dentists, pharmacists, nurses, barristers, etc.).

B. In respect of expenditure on transport :

Expenditure relating to horses and other animals, the purchase of raw materials, hand tools, finished articles and their repair by private industry irrespective of whether such materials and products (forage, shoeing material, harness, bicycles, motor and horse-drawn vehicles, liquid fuel and lubricants, etc., spare parts and accessories) are intended for current use, together with expenditure relating to workmen or to transport and communication services (post, telegraph, telephone, radio) rendered by non-military, non-naval or non-air force organizations and to all other services rendered by private individuals (veterinary surgeons, civilians, etc.).

Subsidies of a military nature for horse-breeding, subsidies to the owners of horse-drawn and motor vehicles, subsidies relating to the organization of communications of a military character and, generally speaking, all other expenditure in respect of liquid fuel, transport and communications.

C. *In respect of expenditure on buildings :*

1. Expenditure relating to the construction, repair and upkeep of fortifications and defensive works.

2. Expenditure relating to the purchase and hire of land and buildings, building operations, water supply, gas, electricity, the improvement, extension, upkeep and repair of all kinds of buildings, including expenditure on fixed machinery and heavy plant (barracks, accommodation, schools, hospitals, stud farms, State establishments for meeting the material needs of military, naval and air units, storehouses and depots, hangars, aerodromes, training and musketry camps, sheds for stores, etc., marine works in naval ports and naval bases including repair docks, landing stages and floating docks and all other works for the land, sea and air forces and formations).

3. Expenditure relating to the construction, modification or upkeep for specifically military purposes of roads, bridges, railways, landing stages, jetties,

platforms, semaphore signal apparatus, canals, together with drainage or forestry works.

4. Subsidies granted for military purposes with a view to the purchase, hire, improvement, extension, upkeep and repair of the buildings, objects and articles mentioned in paragraphs 2 and 3 above, or any similar expenditure.

D. In respect of expenditure on war material :

This expenditure comprises for all categories of war material specified below :

(a) Expenses of upkeep and repair, purchases from private traders or manufacturers and manufactures in State factories of ships, goods, materials and ammunition, whether complete or in parts, intended either for purposes of training in time of peace or for the equipment, armament or endowment of forces on a war footing with material of all kinds, and replacements for these forces, and also the expenses relating to the creation or maintenance (in State or private hands) of stocks and plant useful only for the construction of warlike stores.

(b) Cost of scientific research and experiment, inspection of material delivered and preparation of plans for material, manufacturers' subsidies or other similar expenditure, such as that relating to

the preparation of industrial mobilization (subsidies granted to undertakings which do not normally manufacture material in peace-time in the event of these subsidies being intended to equip them in peace-time for producing war material as soon as mobilization begins), subsidies to the mercantile marine and all other expenditure for the construction and maintenance of vessels held at the disposal of the State for use for military purposes in time of war, or for strengthening the decks of merchant ships.

The categories of material are as follows :

1. Arms, ammunition and fighting material, engineering material and other armaments of war ; small arms and automatic fire-arms ; rifles, muskets, carbines, revolvers and pistols, quick-firing rifles and pistols, machine-guns, apparatus and appliances for throwing projectiles, including vehicles for transport.

Long and short guns, howitzers, mortars, infantry guns, anti-aircraft guns.

Ammunition for small arms, automatic weapons and guns, bombs, grenades, torpedoes and other kinds of projectiles, explosives, mines, paravanes, including the electric apparatus connected with all this material, ammunition wagons, carriages, boxes, etc., for their transport.

Cutting weapons, such as swords, sabres, lances, bayonets and daggers.

Tanks, armoured cars, armoured trains.

All other arms, ammunition, apparatus and appliances for throwing projectiles, accessory equipment and spare parts.

Tractors.

Railway material, searchlight equipment, pioneer equipment, bridging equipment, signalling and radio stores, boats, acoustic and optical instruments, anti-gas stores, mining stores, accessories and spare parts, vehicles connected therewith and all other categories of material.

2. Warships of all kinds, aircraft carriers, victualling craft, fuelling craft, naval armament vessels, repair ships, tugs, barges and lighters, floating docks, including material of all kinds connected with these vessels, and all other craft intended for naval use.

3. Aeroplanes and airships, free and captive balloons, instruments, engines, and stores—wireless, electrical, photographic—oxygen, material for heating purposes, parachutes, ground electrical equipment, hydrogen and helium, accessories and spare parts.

Note.—1. The enumeration contained in this list is not exhaustive.

2. The various categories of expenditure included in this list and relating to formations organized on a military basis must also be considered as national defence expenditure insofar as the formations are designated as such by the Conference.

APPENDIX III

THE WORLD'S ARMAMENT EXPENDITURE

THE following table gives the amounts of annual national expenditures of the leading countries in terms of their respective national currencies. It is extracted from Volume I of the Report of the Technical Committee set up by the National Defence Expenditure Commission of the Conference for the Reduction and Limitation of Armaments. It has been compiled on the basis of the Model Statements submitted by Governments to the Committee.

Germany	R.M.	707,722,624
Belgium	Frs.	1,444,133,103
United Kingdom	£	112,556,666
Denmark	Cour.	45,265,127
U.S.A.	\$	700,237,191
France	Frs.	13,423,056,818
India	Rp.	54.80.74.304
Irish Free State	£	1,266,650
Italy	Lire	6,220,818,167
Japan	Yen	467,299,840
Norway	Cour.	38,491,187
Netherlands	Fl.	191,715,278
Poland	Zloty	880,104,387
Roumania	Lei	9,059,019,484
Sweden	Cour.	137,696,009
Switzerland	Frs.	113,586,207
Czechoslovakia	Kc.	1,813,260,121
U.S.S.R.	Roubles	1,095,947,326
Yugoslavia	Dinars	2,699,508,683

