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War Economics

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## WAR ECONOMICS

THE ordinary business man sees most economic events through the medium of money. Production, consumption, foreign trade, capital and wealth have little meaning for him except when expressed in terms of pounds, shillings, and pence. This is all right so long as he is dealing with the affairs of a few individuals and prices are fairly stable, but when his attention is transferred to the affairs of a nation and at the same time prices are rapidly changing, his deductions are likely to be all at fault. Consequently he is quite unable to answer such questions as "How best can the cost of the war be met?" "Can payment be postponed to the future?" "Can war be financed out of accumulated wealth?" These and similar questions are only to be answered by going back from finance to the economic facts which are behind finance.

One of the difficulties of the subject is the ambiguity of terms in general use. Thus the word "national" applied to income or expenditure sometimes refers to all the people in the country taken collectively and sometimes to the administration of the country by the Government. In the following article the words "the country as a whole" will be used to designate all the individuals taken collectively, while the Government administration will be referred to as "the State." In civilised countries material wealth consists of two more or less distinct parts: (1) "capital," sometimes called "fixed capital," consisting of such things as factories, machinery, etc., not directly convertible to consumption, and (2) stock, *i.e.*, commodities ready, or on their way to become ready, for consumption. The term "total productive output" will be used to include both "material production" and "services," and the former will be subdivided into "production of capital" and "production of commodities."

It is not necessary to be an economist to appreciate the fundamental fact that consumption must inevitably be confined to commodities already in existence and to services concurrently rendered, and that there can be no consumption to-day of com-

modities to be produced or of services to be rendered in the future. Thus there is no financial device which can enable us in the year 1915 to consume clothes, food, shells, munitions, or motor cars to be made in 1916. From this truism results a proposition the importance of which is often overlooked, particularly when a nation is at war. It may be stated as follows :—

*I. A country without foreign trade is dependent on its past production and its concurrent services; it cannot anticipate future production or services. Therefore the idea that such a country as a whole can throw any part of the burden of a war on to the future has no counterpart in fact.*

This does not mean that such a country as a whole may not be poorer after a war than it was before, nor does it mean that some of the people in a country may not be able to throw their share of the burden on to the shoulders of others. It means simply that so far as commodities and services are concerned, all those that are required for the war must be found before or at the time and not afterwards.

Proceeding to consider consumption over a period of time, the following identity regarding a country without foreign trade is self-evident : “Consumption during a period consists of the stock at the beginning of the period, together with the material production of commodities and the services rendered during the period less the stock at the end of the period.”

It must be remembered that this is not merely an equation, but an identity ; both sides consist of so many motor cars, loaves of bread, shells, suits of clothes, etc., and the services of lawyers, policemen, domestic servants, and the like.

Over short periods of time the difference between the amount of the stock at the beginning and at the end may be important, but when the period is a year or a multiple of years, the two amounts will be nearly identical in peace time, and even in war time the difference is not likely to be very great compared with the other terms of the identity. Remembering, therefore, that in war time total consumption is of two parts—consumption for war purposes and civil consumption—we reach the following proposition :—

*II. Except for a possible small difference in the stock of commodities at the beginning and end of the year, the year's consumption for war purposes in a country without foreign trade consists of the year's produce of commodities and the year's services less the year's civil consumption of commodities and services. The capital wealth of the country, as differentiated*

*from its stock of commodities, cannot be drawn upon for the purposes of the war.*

It must be remembered that the production of commodities is not total production, which includes also production of capital. In so far as less productive effort is spent on the latter, there will, of course, be more available for the former.

In a country without foreign trade it is also possible to establish an identity for the "fixed" capital over a period of time: "The capital at the end of the period consists of the capital at the beginning of the period, deteriorated by use or disuse, together with the capital produced during the period."

This statement of fact cannot be changed by financial operations or by the existence of a war, and accordingly:—

III. *In an uninvaded country without foreign trade the total loss of "fixed" capital during a war cannot exceed the deterioration from use or disuse during the period; and it will be less than this by all the productive effort devoted to repairing and replacing old capital and providing new capital.*

It should be noted that the deterioration of capital from disuse may be exceptionally heavy in war time, as a man may go so far as to scrap some of his normal machinery entirely to make room for war plant.

### *Countries with Foreign Trade.*

The introduction of the idea of foreign trade theoretically alters the problem completely. Theoretically a country might devote the whole energies of its adult population to soldiering, while it imported the whole of its food, clothing, and munitions of war from abroad, paying for them either by the actual export of its capital, by external loans contracted by the State, by the sale of foreign securities held by its citizens, or by the sale or mortgage to foreigners of citizens' property remaining within the country.

If a small rich country were at war and there were large trading nations remaining neutral such a theory might have some counterpart in reality. But when the belligerent nations form a considerable part of the whole civilised world and the neutral trading nations are few and only one of them is large, the facts are altogether different. The neutral nations are only in a position to increase their normal supply to a belligerent country in so far as they themselves (1) produce more, (2) reduce production of capital for themselves, (3) consume less, (4) decrease their supplies to other countries. Any failure in supplies

from belligerent countries will diminish their means of sending supplies to the belligerents. From this analysis it will be seen that in such a war as the present the neutral countries will be able to contribute a proportion, but not a great proportion, of the commodities required by one or more of the belligerents. It is possible to establish an identity of production and consumption for a country with foreign trade. On the left side there will be (1) the year's consumption, (2) the year's exports,<sup>1</sup> (3) the stock at the end of the year, and (4) the year's repair of old capital or production of new capital for internal use; on the right side (1) the year's total productive output, (2) the year's imports exclusive of the import of capital, (3) the stock at the beginning of the year. From this may be deduced the next proposition:—

IV. *There are only six ways that military consumption can be increased: (1) By increasing imports, (2) by decreasing exports,<sup>1</sup> (3) by increasing total productive output, (4) by decreasing internal capital repairs and additions<sup>2</sup> to capital, (5) by depleting the stock, (6) by curtailing civil consumption.*

An interesting statistical investigation could be devoted to the discussion of the proportions in which these six terms have contributed to the military budgets of each of the present belligerents during the past year. For this there is no room here, but it is worth while noting that most economists assume that the "total productive output," whether measured in (a) pre-war prices or (b) current prices, will be less than that for the year before the war. I venture to think that the assumption is often made on insufficient grounds. In such a country as Great Britain, where (1) the services of soldiering, being counted as war expenditure at soldiers' wages plus separation allowances, must also be counted at the same figure in total productive output, (2) there is little unemployment, (3) much overtime, (4) not much capital idle, I am inclined to think that the total productive output, if measured in fixed pre-war prices, will be little if at all below the figure for the year before the war, and if measured in present prices considerably above that figure.

Whatever view be taken of this question it must be clear that each term has a maximum value. Imports cannot be increased and exports decreased beyond a point dependent on the conditions of foreign countries; the total productive output admits of a limited amount of advance in actual quantity; capital repairs and

<sup>1</sup> To be strictly accurate we should say "exports exclusive of the export of any capital not made during the year inside the country."

<sup>2</sup> Including both capital produced inside the country and that imported.

new creation cannot go below zero; depletion of stock is at all times dangerous, and is only possible to a small extent; civil consumption cannot fall below starvation level. Accordingly:—

*V. There is a theoretical limit to the possible military consumption of any country and a practical limit far short of this. Any idea that a country can neglect to take this limit into careful consideration and can enlarge its military output indefinitely, on military grounds alone, must, if put into practice, be fraught with grievous economic result.*

The phenomenon expressed by the identity given on the last page may be conceived of as a stream consisting of the total imports and the total internal productive output of the country taken together, being carried off in four channels: (1) Exports, (2) internal capital repairs and additions to capital, (3) civil consumption, (4) military consumption. If the stock is to be taken into account, it may be conceived of as a lake through which the stream flows, which as time goes on may be slightly raised or lowered.

In peace, the major part of the stream called civil consumption goes to individuals, while a small part of it, and the whole of military consumption, is controlled by the entity called the State. When war breaks out the State requires an immensely increased military consumption. It wants specific services and commodities. It has, firstly, to alter the nature and, as far as possible, to increase the volume of the total stream, and, secondly, to divert to itself what it requires for the war from the private individuals to whom it would normally go. It can do these things in various ways.

Firstly, by commandeering. It can divert to itself, without compensation, a stream of services, and it can compel capital and labour to produce without compensation a stream of commodities for military use. Such a proceeding is now generally recognised to be grossly unjust, because it places burdens arbitrarily upon certain individuals and exempts others. It is therefore not resorted to except in one case, namely, that of those conscripts who are not paid the full economic equivalent of their services (if, indeed, services such as theirs can ever be said to have a limited economic value).

Secondly, by taxation. It can tax all the individuals in the country according to determined proportions, and with the proceeds it can compete in the open market with other purchasers for the services and commodities which it requires for the war. By this process the taxpayers are deprived of effective demand

for commodities and services to the exact extent and at the same time that the State becomes possessed of additional effective demand. Except for secondary causes, such as dislocation, there will be no unemployment; and except for the operation of other results of the war there will be no general rise in the level of prices. (Of course, in so far as the taxation is "indirect," the price of the taxed articles will be increased by the amount of the tax.) Accordingly :—

VI. *Taxation during war spreads the economic burden of the war over the population in a predetermined proportion.*

Thirdly, by foreign loans. These will stimulate imports and relieve the necessity of sending exports to pay for them. We have already seen that there is a maximum limit to the excess of the value of imports over that of exports in a given period. This sum, allowing for the interest on past debts, fixes the maximum effective amount of a foreign loan. Accordingly :—

VII. *A foreign loan enables the country as a whole to postpone till afterwards that part of the economic burden of war which is represented by the maximum balance of the value of imports over exports.*

It should be noted that when individual citizens of a country possess foreign paper, the sale of this to foreigners is equivalent to a foreign loan.

Fourthly, by genuine internal loans. A genuine loan is the voluntary relinquishment by individuals of their hold on capital, commodities, or services. Remembering that the existing "fixed" capital is not what the State wants to buy, and that, taking the country as a whole, sales of capital from one individual to another cancel out, we see that what the State really needs to have lent to it is the command over the capital and labour which would have produced a stream of services and commodities for the individual. Accordingly :—

VIII. *A genuine internal loan is extracted from the same sources as taxation, and involves to the country as a whole the same immediate amount of deprivation. As between individuals it falls upon those ultimate<sup>1</sup> lenders who elect to stint themselves.*

Fifthly, by depreciating the currency. The State issues additional paper money and with it competes with other purchasers for commodities and services. Prices rise, particularly of

<sup>1</sup> If *A* lends £1,000 to the Government and in order to pay for it sells existing capital to *B*, and *B* finds the money out of his savings, *B* is the "ultimate" lender in the sense used in the text.

necessaries which cannot be dispensed with. Any slight advantage this may have in stimulating production is far more than counterbalanced by the disadvantages. The war cost in money itself rises. Private consumption is cut down, particularly of the poorest people, whose budgets consist chiefly of necessities. Moreover, the effects of each new issue are superimposed on the one before. Accordingly :—

IX. *Depreciation of the currency is, during the war, a form of taxation graduated inversely according to wealth. It is cumulative in effect, and increases the money cost of the war. It leaves acute problems behind after the war is over.*

Lastly, by inflation loans. These take many forms. The commonest is the following : A man has a balance of £1,000 in his bank and requires £900 for the prosecution of his business. Instead of investing £100 in war loan and keeping the £900, he invests the whole £1,000 and receives war loan certificates for it. These he takes to his bank and borrows £900 on them. This £900 is placed to his credit at the bank, and against it he draws cheques which set capital and labour in motion. The Government also draw cheques on the £1,000 which he has lent them, and set capital and labour in motion with it. The recipients of all these cheques pay them into their banks, and, accordingly, taking the banking system as a whole, bankers' balances are not depleted, and further, since many thousand similar transactions go through, each particular bank will on the average retain the same balance. We have, therefore, without apparent loss to anyone, an original £1,000 setting to work capital and labour to the amount of £1,900. But we know that a mere financial transaction cannot make two blades of grass grow where one grew before. What, then, has happened? The answer is, *inflation of credit*. The £900 lent by the bank to the man is simply additional credit, and neither he nor the bank have cut down in any way the expenditure they would have effected if the loan of £1,000 had not been forthcoming. Accordingly we see that :—

X. *Inflation loans do not represent any sacrifice or stinting on the part of the ultimate lenders.*

Nevertheless, the ultimate lenders, the bank, make an additional annual profit of the interest on the £900, while the man who receives interest from the Government on his £1,000 and pays interest on the £900 is roughly in the same position as if he had not invested in the war loan.

In opposition to this view of inflation it will very probably be contended that the transaction is exactly similar to many in



civil life—as, for instance, when a man invests £1,000 in municipal tramway stock and borrows on the strength of his stock. But there is this essential difference: that in such a case the stock represents material reproductive capital, whereas in the case of the war loan the money has been spent in destruction, or at least in consumed commodities, and the certificates do not represent wealth in existence, but only a mortgage on the income of the future.

Apart from the payment of interest the immediate effect of the inflation loan is precisely similar to that caused by the issue of paper money, in raising prices, in increasing the money cost of the war, and in reducing the consumption of the whole population, particularly of the poorest section of it.

In distinguishing between a genuine loan and an inflation loan it is important to realise that a State when it floats a loan has no means of insisting that the whole or even any part shall be of the genuine character. Moreover, even that part of a war loan which was at first genuine may at any time lose its genuine character by the lender taking his certificates to his bank and borrowing for expenditure on them. The following proposition is in fact true:—

*XI. Inflation is inherent in the flotation of a loan for purposes other than the construction of material reproductive capital.*

It only remains to discuss the rival merits of the various methods which Governments may adopt. Commandeering and depreciation of the currency are clearly unjust and injurious, and though still used to some extent are recognised as discreditable. A foreign loan may be advantageous up to the amount of the balance of imports over exports (allowance being made for interest on past debts). Whatever is not met in these ways will have to be met either by taxation or by internal loans.

In comparing these two latter it is essential to realise that the total amount of stinting to be done at the time by the country as a whole is the same in both. In taxation it falls on individuals in proportions determined by the State; in genuine loans it falls on the persons who voluntarily stint themselves; in inflation loans it falls haphazard upon all individuals, the poorest suffering most. It is clear, therefore, that the whole could undoubtedly, if desired, be taken at the time in taxation. If the State could be certain that a loan were to be wholly genuine, the question whether such a loan would be preferable to taxation might be a matter of opinion. It would depend on the answer to the following ethical question: Ought the weight to fall on the population

in proportion as they are able to bear it at the time—in which case the bulk of it will necessarily fall on the well-to-do classes—or ought the latter be able to recoup themselves for part of the greater share that they must bear at the time by taking toll from the country as a whole in the days to come?

But the question is not between a genuine loan and taxation, for, as we have seen, there is no guarantee that the whole or any part of a loan will be genuine; and for inflation loans there is not one good word to be said. They are the worst of all methods of paying for the war, because they enrich one class and make the bulk of the people pay twice over. They are only comparable to the famous transaction in “Sylvie and Bruno” in which “noble” Peter extracts from “poor” Paul interest and principal of a loan which he has never lent him. To sum up:—

XII. *In floating an internal loan to pay for a war the State makes a thoroughly bad bargain. It does not prevent the full economic burden from falling at the time on the country as a whole, nor a large part of it from falling on the poorer classes. Yet it allows the richer classes to secure a lien on the future prosperity of the country out of all proportion to the sacrifices they have made during the war.*

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