DIRECT TAXATION BEST WAY OF FINANCING THE WAR

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portunity of subscribing to loans during the war, even if they are lucky enough to avoid serious business losses owing to their absence at the front.

In the meantime their rivals in business or in the labour market who are not fit to go to the front, or are retained at home for other reasons, are enabled to earn high war profits and high war charges and to make big subscriptions to war loans. Then, when the war is over and the whole body of the taxpayers has to provide for the war debt charge, those who have been fighting for us, and so have gone back in the industrial and commercial race, will be expected to contribute their share to the taxation involved by the war debt charge.

Under the heading of "Real Borrowing" I included only money borrowed by the Government direct from the citizens who save it and so restrict their own buying power. There are, however, other financial devices by which the Government can get money without involving a transfer of buying power from anybody, but by actually increasing the amount of buying power in the country. By this means, since no one's consumption is reduced, we get the unfortunate result that more buying power, i.e., demand for goods, is created without any increase in the volume of goods being produced, and a consequent rise in prices.

This is the process which produces a rise in prices due to what is technically called "inflation," concerning which so much discussion has raged during the war. Without going into the mysteries of this subject at present I will merely remark that it depends on what seems to me to be a common sense arithmetical truism, that, if you multiply the amount of money of all kinds without increasing the amount of goods to be bought by it, the price of goods will inevitably go up, and, on the other hand, that there cannot be a general advance in the price of goods unless an increase in the amount of available buying power has been carried out.

Goods only rise in price if there is a greater effective demand for them, that is to say, if more people who want them are able to pay money for them. This can only happen if the volume of money is increased relatively to the amount of goods coming forward.

This process takes place, for example, when a Government borrows, not from citizens who save, but from banks. If a government borrows from a bank, none of those who have money in a bank have any less money at their command. The bank simply gives the government a credit in its books, enabling the government to draw checks upon it, and these checks are, in their effect upon prices, just as good money as coins or bank notes which are legal tender, i.e., have to be accepted in payment without any choice on the part of the seller of the goods. The checks that the Government draws on the banks are paid over by it to contractors and others to whom it owes money, and are paid in by them to the banks, and so the amount of banking money in the country is actually increased by the process. Consequently there is an increase in buying power and a rise in prices.

The same process arises when the Government increases the currency of the country by printing notes, as has been done so rapidly by our own Government during the war, and still more rapidly by Germany and most of the other countries now involved in the struggle.

It also arises when the Government borrows directly from the citizens, not money that they have saved but money which they themselves have borrowed from their banks in order to subscribe to war loans. In this case there is no transfer of buying power, but the creation on new buying power. The bank has given the customer a credit, and this credit is added to the total available buying power of the country, and this increase in effective demand remains as long as the advance is outstanding.

There are other ways by which governments can raise the wind for war finance. They can, for example, induce the banks to increase credits for the purchase of goods coming from abroad. This is usually done by the banks and financial houses accepting bills of exchange against the shipment of goods. These bills of exchange are discounted, as it is called, in the money market; that is to say, they are turned into fresh buying power.

The latest example of this kind of financing is an arrangement by which certain English banks have promised to draw bills on one another against the shipment of goods from Switzerland. These bills will be discounted in the Swiss money market, which, in effect, will be making an advance to the London money market, which will have to be paid off when the war is over by the shipment of goods or other valuables from England to Switzerland.

By this means, and also whenever a Government raises a loan by the more usual methods in a foreign country, we induce the citizens of other countries to pay for part of our war cost during the course of the war, promising that we will pay them interest in the meantime and pay back the money at some more or less remote date when the war is over.

The objections to his process of war finance are sufficiently obvious. It involves a much more serious problem to the borrowing country when the war is over than the existence of a war debt which is held at home. Debt held at home will involve, when peace comes, merely a transfer from the citizens as a whole to those of them who hold the war debt in the form of interest and repayment. It will not directly affect the nation's power to produce and consume goods as a whole, but will merely warp the distribution of those goods owing to the command that the holders of war debt will have over it.

This warning of distribution may have important political and social effects if the charge involved by the war debt is too heavy. But the existence of a foreign-held debt is much more serious because it will mean that out of our after-war production of goods we shall have to ship abroad a certain amount every year to meet interest and sinking fund on our foreign-held debt without receiving any goods in exchange for them.

The broad conclusion at which we thus arrive is that the country will come most successfully out of the war in the matter of finance which raises the largest possible proportion of the war cost by taxation, and apart from taxation, relies as much as possible on genuine borrowing of saved money from the citizens and as little as possible on loans from foreigners.

—*New York Journal*