

HOW TO PAY
FOR THE
WAR

By
JOHN MAYNARD KEYNES

PRICE 1/- NET

MACMILLAN AND CO., LIMITED
ST. MARTIN'S STREET, LONDON
1940

HOW TO PAY
FOR THE
WAR

A RADICAL PLAN FOR THE
CHANCELLOR OF THE
EXCHEQUER

By

JOHN MAYNARD KEYNES

MACMILLAN AND CO., LIMITED
ST. MARTIN'S STREET, LONDON
1940

Brethren, Friends, Countrymen and Fellow Subjects,

What I intend now to say to you, is, next to your Duty to God, and the Care of your Salvation, of the greatest Concern to your selves, and your Children; your *Bread* and *Cloathing*, and every common Necessary of Life entirely depend upon it. Therefore I do most earnestly exhort you as *Men*, as *Christians*, as *Parents*, and as *Lovers of your Country*, to read this Paper with the utmost Attention, or get it read to you by others; which that you may do at the less Expence, I have ordered the Printer to sell it at the lowest Rate.

It is a great Fault among you, that when a Person writes with no other Intention than to *do you good*, you will not be at the Pains to read his *Advices*: One Copy of this Paper may serve a Dozen of you, which will be less than a Farthing a-piece. It is your Folly that you have no common or general Interest in your View, not even the Wisest among you, neither do you know or enquire, or care who are your Friends, or who are your Enemies.

(From the Drapier's First Letter—1724)

PRINTED IN GREAT BRITAIN

PREFACE

THIS is a discussion of how best to reconcile the demands of War and the claims of private consumption.

In three articles published in *The Times* last November I put forward a first draft of proposals under the description of "Compulsory Savings". It was not to be expected that a new plan of this character would be received with enthusiasm. But it was not rejected either by experts or by the public. No-one has suggested anything better. That public opinion was, as yet, not ready for such ideas, was the usual criticism. And this was obviously true. Nevertheless a time must come when the necessities of a war economy are realised; and there is much evidence for the belief that the public are not so behind-hand.

Amongst the manifold comments provoked there were some valuable suggestions. In the revised draft here set forth in ampler detail I have taken advantage of these. In the first version I was mainly concerned with questions of financial technique and did not secure the full gain in social justice for which this technique opened the way. In this revision, therefore, I have endeavoured to snatch from the exigency of war positive social improvements. The complete scheme now proposed, including universal family allowances in cash, the accumulation of working-class wealth under working-class control, a cheap ration of necessaries, and a capital levy (or tax) after the war, embodies an advance towards

economic equality greater than any which we have made in recent times. There should be no paradox in this. The sacrifices required by war direct more urgent attention than before to sparing them where they can be least afforded.

A plan like this cannot be fairly judged except against an alternative. But so far we have had no hint what alternative is in view. The Chancellor of the Exchequer has recently explained to the House of Commons that he is seeking to prevent a rise of wages by subsidising the cost of living. As an ingredient in a comprehensive plan, this is a wise move; something of the kind is recommended in what follows. As a stop-gap arrangement to gain time it is prudent. But taken by itself it is the opposite of a solution. In making money go further it aggravates the problem of reaching equilibrium between the spending power in people's pockets and what can be released for their consumption.

The Chancellor has expressed agreement with this conclusion. I hope, therefore, that he will look with sympathy on an attempt to work his policy into a consistent whole. I have canvassed these proposals in many quarters and comment has reached me from all shades of opinion. I confidently believe that, put forward with authority, they would not be unpopular. No one is expecting to get off scot-free. The fault of my plan is that it asks, not too much, but too little; and it may look, a year hence, too feeble a beginning for a heavy task.

Since one cannot rule out the possibility that we shall drift or adopt half-measures, I will

venture on a prediction of the result of this. I discuss below the mechanism of inflation; and that, I suppose, is what most people are expecting if we shirk. But except at a slow rate and as the second stage of deterioration, this is not my immediate expectation. There is a passage in the "Golden Bough" where the proneness of primitive man to generalise on the basis of a very few experiences is amusingly illustrated. Men like dogs are only too easily "conditioned" and always expect that, when the bell rings, they will have the same experience as last time. But the psychology which provoked previous price-inflations is not present to-day. So far from there being a natural tendency to raise prices in response to an unsatisfied demand, manufacturers and retailers are as reluctant to charge higher prices except in response to an actual rise in cost as the public are to pay them. They have no desire to flout public opinion and what appears to be the intention of the authorities. They are doubtful how they stand under the Anti-Profiteering Act. With the Excess Profits Tax they have less inducement than usual to maximise profits. In short, it eases their consciences, saves them trouble, and does not even cost them much, to clear their shelves and leave the next customer unsatisfied rather than raise their prices to the level which would equate supply and demand.

Thus the first stage, I suggest, will be a shortage of supplies rather than a runaway price level. This will be a singularly unfair, inefficient and irritating method of restricting consumption.

And if it provokes, as it probably will, more widespread rationing, the waste and inefficiency will be aggravated for reasons, explained below, due to the diversity of men's needs and tastes. The right plan is to restrict spending power to the suitable figure and then allow as much consumer's choice as possible how it shall be spent. Moreover, gradually the pressure of spending power will bring in the tide of inflation, which is nature's remedy and the only genuine alternative.

But a further, and even less satisfactory, consequence is also probable. A shortage of supplies relatively to consumers' spending power will exert an unfavourable pressure on our balance of trade. For it will divert goods from export and give a stimulus to the use for current consumption of imports, and home production too, which might otherwise have been employed for war purposes. Thus we shall be prevented from putting forth our full war effort and we shall run down our foreign reserves faster than is prudent.

A reluctance to face the full magnitude of our task and overcome it is a coward's part. Yet the nation is not in this mood and only asks to be told what is necessary. It is a fool's part too. For victory may depend on our making it evident, that we can so organize our economic strength as to maintain indefinitely the excommunication of an unrepentant enemy from the commerce and society of the world.

J. M. KEYNES

King's College, Cambridge
February, 1940

CONTENTS

CHAPTER	PAGE
I. THE CHARACTER OF THE PROBLEM	1
II. THE CHARACTER OF THE SOLUTION	8
III. OUR OUTPUT CAPACITY AND THE NATIONAL INCOME	13
IV. CAN THE RICH PAY FOR THE WAR?	20
V. A PLAN FOR DEFERRED PAY, FAMILY ALLOWANCES AND A CHEAP RATION	27
VI. DETAILS	34
VII. THE RELEASE OF DEFERRED PAY AND A CAPITAL LEVY	44
VIII. RATIONING, PRICE CONTROL AND WAGE CONTROL	51
IX. VOLUNTARY SAVING AND THE MECHANISM OF INFLATION	57
X. THE SYSTEM ADOPTED IN FRANCE.	74

APPENDICES

I. THE NATIONAL INCOME.	79
II. THE EXTENT OF OUR RESOURCES ABROAD	82
III. THE COST OF FAMILY ALLOWANCES	86
IV. THE FORMULA FOR DEFERRED PAY	87
ACKNOWLEDGMENTS	88

HOW TO PAY FOR THE WAR

CHAPTER I

THE CHARACTER OF THE PROBLEM

It is not easy for a free community to organise for war. We are not accustomed to listen to experts or prophets. Our strength lies in an ability to improvise. Yet an open mind to untried ideas is also necessary. No-one can say when the end will come. In the war services it is recognised that the best security for an early conclusion is a plan for long endurance. It is ludicrous to proceed on a different assumption in the economic services;—which is what we are doing at present. On the economic front we lack—to borrow a phrase of M. Reynaud—not material resources but lucidity and courage.

Courage will be forthcoming if the leaders of opinion in all parties will summon out of the fatigue and confusion of war enough lucidity of mind to understand for themselves and to explain to the public what is required; and then propose a plan conceived in a spirit of social justice, a plan which uses a time of general sacrifice, not as an excuse for postponing desirable reforms, but as an opportunity for moving further than we have moved hitherto towards reducing inequalities.

More lucidity, therefore, is our first need. This is not easy. For all aspects of the economic problem are interconnected. Nothing can be settled in isolation. Every use of our resources is at the expense of an alternative use. And when we have decided how much can be made available for civilian consumption, we have still to settle the thorniest question of all, how to distribute it most wisely.

We shall, I assume, raise our output to the highest figure which our resources and our organisation permit. We shall export all we can spare. We shall import all we can afford, having regard to the shipping tonnage available and the maximum rate at which it is prudent to use up our reserves of foreign assets. From the sum of our own output and our imports we have to take away our exports and the requirements of war. Civilian consumption at home will be equal to what is left. Clearly its amount will depend on our policy in the other respects. It can only be increased if we diminish our war effort, or if we use up our foreign reserves.

It is extraordinarily difficult to secure the right outcome for this resultant of many separate policies. It depends on weighing one advantage against another. There is hardly a conceivable decision within the range of the supply services which does not affect it. Is it better that the War Office should have a large reserve of uniforms in stock or that the cloth should be exported to increase the Treasury's reserve of foreign currency? Is it better to employ our shipyards to build war

ships or merchant-men? Is it better that a 20-year-old agricultural worker should be left on the farm or taken into the army? How great an expansion of the Army should we contemplate? What reduction in working hours and efficiency is justified in the interests of A.R.P.? One could ask a hundred thousand such questions, and the answer to each would have a significant bearing on the amount left over for civilian consumption.

We can start out either by fixing the standard of life of the civilian and discover what is left over for the service departments and for export; or by adding up the demands of the latter and discover what is left over for the civilians. The actual result will be a compromise between the two methods. At present it is hard to say who, if anyone, settles such matters. In the final outcome there seems to be a larger element of chance than of design. It is a case of pull devil, pull baker—with the devil so far on top.

But it makes no great difference to the problem we are now discussing whether the final result is arrived at wisely or foolishly, by chance or by design. On the assumption that our total output is as large as we know how to organise, a definite residual will be left over which is available for civilian consumption. The amount of this residue will certainly be influenced by the reasonable requirements of the civilian population. If an acute shortage develops in a particular direction, baker's pull will become stronger and devil's weaker; and something will be done to

allow a larger release. But unless we are to fall far short of our maximum war effort, we cannot allow the amount of mere money in the pockets of the public to have a significant influence, unjustified by other considerations, on the amount which is released to civilians.

This leads up to our fundamental proposition. There will be a certain definite amount left over for civilian consumption. This amount may be larger or smaller than what perfect wisdom and foresight would provide. The point is that its amount will depend only to a minor extent on the amount of money in the pockets of the public and on their readiness to spend it.

This is a great change from peace-time experience. That is why we find it difficult to face the economic consequences of war. We have been accustomed to a level of production which has been below capacity. In such circumstances, if we have more to spend, more will be produced and there will be more to buy. Not necessarily in the same proportion. Supply for immediate consumption may not increase as much as demand, so that prices will rise to some extent. Nevertheless, when men were working harder and earning more, they have been able to increase their consumption in not much less than the same proportion.

In peace time, that is to say, the size of the cake depends on the amount of work done. But in war time the size of the cake is fixed. If we work harder, we can fight better. But we must not consume more.

This is the elementary fact which in a democracy the man in the street must learn to understand if the nation is to act wisely—that the size of the civilian's cake is fixed.

What follows from this?

It means, broadly speaking, that the public as a whole cannot increase its consumption by increasing its money earnings. Yet most of us try to increase our earnings in the belief that we can thus increase our consumption,—which is usually true. Indeed in a sense it is true still. For each individual can increase his share of consumption if he has more money to spend. But, since the size of the cake is now fixed and no longer expansible, he can only do so at the expense of other people.

Thus, what is to the advantage of each of us regarded as a solitary individual is to the disadvantage of each of us regarded as members of a community. If all alike spend more, no one benefits. Here is the ideal opportunity for a common plan and for imposing a rule which everyone must observe. By such a plan, as I hope to show, the wage and salary earner can consume as much as before and in addition have money over in the bank for his future benefit and security, which would belong otherwise to the capitalist class.

Without such a plan we shall consume no more than otherwise, but will have spent all our money and have nothing over. For prices will rise just enough for the money we spend to be used up by the increased cost of what there is to buy.

If all earnings are raised two shillings in the £ and are spent on buying the same quantity of goods as before, this means that prices also will rise two shillings in the £; and no one will be a loaf of bread or a pint of beer better off than he was before.

Unless the whole cost of the war were to be raised by taxes which is not practically possible, part of it will be met by borrowing, which is another way of saying that a deferment of money expenditure must be made by someone. This will not be avoided by allowing prices to rise, which merely means that consumers' incomes pass into the hands of the capitalist class. A large part of this gain the latter would have to pay over in higher taxes; part they might themselves consume thus raising prices still higher to the disadvantage of other consumers; and the rest would be borrowed from them, so that they alone, instead of all alike, would be the principal owners of the increased National Debt,—of the right, that is to say, to spend money after the war.

For this reason a demand on the part of the Trade Unions for an increase in money rates of wages to compensate for every increase in the cost of living is futile, and greatly to the disadvantage of the working class. Like the dog in the fable, they lose the substance in gaping at the shadow. It is true that the better organised sections might benefit at the expense of other consumers. But except as an effort at group selfishness, as a means of hustling someone else out of the queue, it is a mug's game to play.

In their minds and hearts the leaders of the Trade Unions know this as well as anyone else. They do not want what they ask. But they dare not abate their demands until they know what alternative policy is offered. This is legitimate. No coherent plan has yet been put up to them.

I have been charged with attempting to apply totalitarian methods to a free community. No criticism could be more misdirected. In a totalitarian state the problem of the distribution of sacrifice does not exist. That is one of its initial advantages for war. It is only in a free community that the task of government is complicated by the claims of social justice. In a slave state production is the only problem. The poor and the old and the infant must take their chance; and no system lends itself better to the provision of special privileges to the governing class.

The aim of these pages is, therefore, to devise a means of adapting the distributive system of a free community to the limitations of war. There are three main objects to hold in view: the provision of an increased reward as an incentive and recognition of increased effort and risk, to which free men unlike slaves are entitled; the maximum freedom of choice to each individual how he will use that part of his income which he is at liberty to spend, a freedom which properly belongs to independent personalities but not to the units of a totalitarian ant-heap; and the mitigation of the necessary sacrifice for those least able to bear it, a use of valuable resources which a ruthless power avoids.

CHAPTER II

THE CHARACTER OF THE SOLUTION

EVEN if there were no increases in the rates of money-wages, the total of money-earnings will be considerably increased by the greater number of insured men engaged in the services and in civilian employments, by overtime, and by the movement into paid employment of women, boys, retired persons and others who were not previously occupied.

It will be shown in the next chapter, what is fairly obvious to common sense, that in a war like this the amount of goods available for consumption will have to be diminished,—and certainly cannot be increased above what it was in peace time.

It follows that the increased quantity of money available to be spent in the pockets of consumers will meet a quantity of goods which is not increased. Unless we establish iron regulations limiting what is to be sold and establishing maximum prices for every article of consumption, with the result that there is nothing left to buy and the consumer goes home with the money burning his pocket, there are only two alternatives. Some means must be found for withdrawing purchasing power from the market; or prices must rise until the available goods are selling at figures which absorb the increased quantity of expenditure,—in other words the method of inflation.

The general character of our solution must be, therefore, that it withdraws from expenditure a proportion of the increased earnings. This is the only way, apart from shortages of goods or higher prices, by which we can secure a balance between money to be spent and goods to be bought.

Voluntary savings would serve this purpose if they were sufficient. In any case voluntary savings are wholly to the good and limit to that extent the dimensions of our problem. No word should be said to discourage the missionary zeal of those who campaign to increase them or the self-restraint and public spirit of those who make them. Nor is there anything in the plan which follows to make voluntary personal economy useless or unnecessary. I aim at a scheme which will achieve the bare minimum; and by the time it has been qualified by practical concessions nothing is more likely than that it will fall short of the bare minimum, and will not be sufficient by itself. Every further economy in personal consumption beyond what is prescribed will either ease the position of some other consumer or will allow an intensification of our war effort.

But the analysis of the national potential and of the distribution of the national income, which will be given in the next two chapters, shows clearly enough how improbable it is that voluntary savings can be sufficient. Those who allege otherwise are deceiving themselves or are victims of their own propaganda. Moreover, many people would, I think, welcome a prescribed plan which indicates to them their minimum duty; and those

who feel moved to do more can rest assured that their effort is not useless. A minimum plan will not close the way to the voluntary self-sacrifice of individuals for the public good and the national purpose, any more than our system of taxation does. The nation will still need urgently the fruits of further personal abstention,—always bearing it in mind that some forms of economy are much less valuable than others. But I also reckon it a merit of a prescribed plan that it reduces for the average man the necessity for a continuing perplexity how much to economise and for thinking about such things more than is good. An excessive obsession towards saving may be more useful than lovely; it is not always he who decides to save who makes the real sacrifice; and public necessity may sometimes become an excuse for giving full rein with self-approval to an instinct which is also a vice.

The first provision in our radical plan (Chapters V and VI) is, therefore, to determine a proportion of each man's earnings which must be deferred;—withdrawn, that is to say, from immediate consumption and only made available as a right to consume after the war is over. If the proportion can be fixed fairly for each income group, this device will have a double advantage. It means that rights to immediate consumption during the war can be allotted with a closer regard to relative sacrifice than under any other plan. It also means that rights to deferred consumption after the war, which is another name for the National Debt, will be widely distributed amongst

all those who are foregoing immediate consumption, instead of being mainly concentrated, as they were last time, in the hands of the capitalist class.

The second provision is to provide for this deferred consumption without increasing the National Debt by a general capital levy after the war.

The third provision is^{to} protect from any reductions in current consumption those whose standard of life offers no sufficient margin. This is effected by an exempt minimum, a sharply progressive scale and a system of family allowances. The net result of these proposals is, to increase the consumption of young families with less than 75s. a week, to leave the *aggregate* consumption of the lower income group having £5 a week or less nearly as high as before the war (whilst at the same time giving them rights, in return for extra work, to deferred consumption after the war), and to reduce^{the} the aggregate consumption of the higher income group with more than £5 a week by about a third on the average.

The fourth provision (Chapter VIII), rendered possible by the previous provisions but not itself essential to them, is to link further changes in money-rates of wages, pensions and other allowances to changes in the cost of a limited range of rationed articles of consumption, an iron ration as it has been called, which the authorities will endeavour to prevent, one way or another, from rising in price.

This scheme, put forward in the light of criticism and after further reflection, is more

comprehensive than the plan for deferment of income which I proposed in the columns of *The Times* last November. Nevertheless this original proposal is the lynchpin of the whole construction, failing which the rest would be impracticable. Without this proposal the cost of family allowances would aggravate the problem of consumption by increasing it in one direction without diminishing it in another; and would merely make the progress of inflation more inevitable. The same is true of an iron ration at a low price. Unless we have first of all withdrawn the excess of purchasing power from the market, the cost of subsidising consumption will lead the Treasury deeper into the financial bog. But if a deferment of earnings is agreed, the whole construction stands solid.

A general plan like this, to which all are required to conform, is like a rule of the road—everyone gains and no one can lose. To regard such a rule as an infringement of liberty is somewhat silly. If the rule of the road is imposed, people will travel as much as before. Under this plan people will consume as much as before. The rule of the road allows people as much choice, as they would have without it, along which roads to travel. This plan would allow people as much choice as before what goods they consume.

A comparison with the rule of the road is a very fair comparison. For the plan is intended to prevent people from getting in one another's way in spending their money.

CHAPTER III

OUR OUTPUT CAPACITY AND THE
NATIONAL INCOME

IN order to calculate the size of the cake which will be left for civilian consumption, we have to estimate

- (1) the maximum current output that we are capable of organising from our resources of men and plant and materials,
- (2) how fast we can safely draw on our foreign reserves by importing more than we export,
- (3) how much of all this will be used up by our war effort.

The statistics from which to build up these estimates are very inadequate. Every government since the last war has been unscientific and obscurantist, and has regarded the collection of essential facts as a waste of money. There is no one to-day, inside or outside government offices, who does not mainly depend on the brilliant private efforts of Mr. Colin Clark (in his *National Income and Outlay*, supplemented by later articles); but, in the absence of statistics which only a government can collect, he could often do no better than make a brave guess. The basis of what follows is given in more detail in Appendix I, prepared with the assistance of Mr. E. Rothbarth.

The money measure of our output capacity will, of course, vary according to the levels which are

reached from time to time by wages and prices. To avoid this complication the following figures are all given in terms of pre-war prices.

In the year ending March 31, 1939, the value of our output, measured at cost, including invisible exports, was about £4,800 million. Of this amount

£3,710 million was the current cost (inclusive of the cost of maintaining plant) of the consumption of the public;

£850 million was the current cost (inclusive of the cost of maintenance) of the services provided by the Government, excluding "transfer" payments to pensioners and holders of the national debt, etc., since these are merely out of one pocket into another, but including capital expenditure;

£290 million was devoted to increasing our privately owned capital equipment in the shape of buildings, plant and transport.

£4,850 million

This output can be increased (1) by absorbing a considerable proportion of the $12\frac{3}{4}$ per cent of insured workers who were unemployed in that year, (2) by bringing into employment workers from outside the insured population, including boys, women and retired or unoccupied persons, and (3) by more intensive work and overtime (a lengthening of working hours by half an hour would, for example, yield an increase of about $7\frac{1}{2}$ per cent). On the other hand, there will be a loss of efficiency from withdrawals to the armed forces (whose output should be measured, if it is to tally with the other side of the balance-sheet, by the cost

of their pay, allowances and keep), from shortage of raw material and shipping, and from A.R.P. On balance an increase in output of 15 to 20 per cent should be practicable when our organisation is working properly. Taking an intermediate figure of just under $17\frac{1}{2}$ per cent, let us assume an increase of £825 million in the value of output measured at pre-war prices. It is important to add that no such rise in output has taken place as yet.

There are two other sources from which government requirements can be met. Included in the cost of public and private consumption there is a figure of £420 million for the cost of making good current depreciation, in addition to about £300 million spent on additions to capital. Some of this output, costing £710 (£420+£290) million altogether, could be diverted to government purposes. Let us put the contribution from this source at £150 million from depreciation funds and £300 million from normal new investment, making £450 million altogether.

The second and only remaining source is from selling our gold and foreign investments and borrowing abroad. If we are to be prepared for a prolonged war, we must be strict with ourselves in limiting the rate at which we expend these resources. I put the maximum contribution which we can safely take from this source in a year at £350 million.¹

Altogether this yields us resources for additional government requirements and current private

¹ Some details in justification of this figure are given in Appendix II.

consumption of £1,625 (£825 + £450 + £350) million a year.

What relation does this bear to present facts? The Chancellor of the Exchequer announced in the late autumn of 1939 that the rate of government expenditure already reached represented an increase of somewhere in the neighbourhood of £1,500 million a year. Thus *if* we had already reached the increased rate of output assumed above, we should have had at that time a small margin (of £125 million) out of which private consumption could be increased. But everyone knows that we were, and still are, a long way from having organised output on this scale. Indeed it is certain, in my opinion, that the existing rate of government expenditure leaves no margin for increased private consumption; and that the maintenance of consumption is already leading to a reduction in stocks of commodities and of foreign reserves at a higher rate of depletion than that assumed above,—at a higher rate, that is to say, than is safe.

Moreover it is certain that our war expenditure has not yet reached its maximum. Let us assume that in the next year government expenditure rises by no more than a further £350 million above the estimated level of last autumn, and that we are successful in raising our output to the maximum suggested above, which is an optimistic view of the prospects. This will involve a reduction of £225 million below the pre-war rate of consumption for the community as a whole. We have, therefore, to withdraw from consumption £825 million of

increased incomes *plus* £225 million of incomes previously spent.

That is a modest statement of the problem. Some would say that it is a serious understatement, which allows inadequately for the magnitude of the war effort which will be needed. This may be true. Moreover, unless we mend our ways quickly, it greatly overstates our rate of output. Nevertheless, to establish my present argument it is not necessary to go beyond what is already plain. If a greater decrease in consumption proves necessary, that will reinforce all that I have to say.

Now we can see what the problem is and how it comes about. Even if there are no increases in wage-rates or in prices, incomes will rise by an amount equal to what is earned in producing the increased output, namely £825 million a year on the above assumptions. Yet in spite of these increased incomes, those who receive them must consume less than before. Whilst earnings will be increased, consumption must be diminished. That is the conclusion to hammer home. It is beyond dispute. And it is gradually penetrating to the general consciousness. But we have become so accustomed to the problem of unemployment and of excess resources that it requires some elasticity of mind to adapt our behaviour to the problem of full employment and of resources which are no longer adequate to supply our needs. In war we move back from the Age of Plenty to the Age of Scarcity.

Moreover the imminence of the new problem has been obscured from our eyes by the fact that

after nearly six months of war there still persists a substantial volume of statistical unemployment. This is due to a failure of organisation, partly unavoidable in so short a space of time, partly avoidable if there was more energy and intelligence in the government. But anyone who argues from this that we are still in the Age of Plenty makes a mistake. The nature of unemployment to-day is totally different from what it was a year ago. It is no longer caused by a deficiency of demand. There is no longer a potential surplus supply of the things we want. The transition to full employment is hindered by two obstacles. The first is due to the difficulty of shifting labour to the points where it is wanted. The second—and, for the time being, the chief—obstacle is caused by the difficulties, other than the shortage of labour, in the way of existing demand becoming effective. For example, there may be a demand for cloth on the part both of exporters and of home consumers and there may be less than full employment in the woollen industry, and yet this demand will remain ineffective if the manufacturers cannot—for one reason or another, good or bad—obtain raw wool for the purpose of meeting these demands. Shortages of essential raw materials due to shipping delays and other causes, and artificial shortages due to the inefficient workings of our newly-born controls who cannot learn their unaccustomed job all at once, are in many cases a more limiting factor than the shortage of labour. And in other cases there is a shortage of plant.

But I repeat that this does not mean we are

still in the Age of Plenty. It means that the Age of Scarcity has arrived *before* the whole of the available labour has been absorbed. I am not saying that our output cannot be increased beyond its present level. Surely it can and must be so increased as our organisation improves. But we are already making all we know how. We have to learn *how* to make more; and that takes time.

Our ability, for the time being, to draw on stocks is another factor which is obscuring from our eyes the transition to the Age of Scarcity. There can be little doubt that during the first months of war our rate of private consumption has exceeded our surplus of production on a scale which cannot be continued indefinitely. Government demand has been greatly increased. There is no reason to suppose that private consumption has been sufficiently diminished. It is by drawing on our stocks of commodities and foreign resources and on our working capital that the deficiency has been met. The task of adjusting private expenditure to the supply which will be available is, therefore, more urgent than appears on the surface. It is not true that we can postpone action until after full employment has been reached.

The magnitude of the problem is now stated. The reader will appreciate that there is unavoidable guess work and crude approximation in the figures which I have given. If anyone knows better, his criticism will be welcome. But I believe that the *size* of the result is roughly right and that more accurate details would not change the broad outline of the picture.

CHAPTER IV

CAN THE RICH PAY FOR THE WAR?

WE have shown that, quite apart from war increases in rates of wages, the earnings of the country as a whole should increase by as much as £825 million merely as a result of the increase in output and employment. At the same time private consumption will have to diminish by at least £175 million, taking a moderate estimate. Thus altogether £1,000 million of private incomes must be withdrawn from consumption. This figure has been reached on the basis of pre-war wages and prices. Since significant rises in these have already occurred, all our figures should be somewhat increased in terms of present prices and wages. By the end of January 1940, wholesale prices had risen by 27 per cent, the cost of living (seasonally corrected) by 10 per cent, and wages by perhaps 5 per cent; which means that the aggregates I am using should be increased by nearly 10 per cent to conform to the wage and price levels current at that date.

I have heard it argued that, whilst these figures may be correct, they do not prove that the working class need be asked to make any sacrifice. Admittedly they will work harder. But if so their consumption must be increased proportionately. If the cost of living rises, wage-rates, and not merely total earnings, must be increased to the

same extent. The whole of the real cost of the war, it is claimed, should be borne by the richer classes. Nay, more. The increased demand for the services of labour due to the war, offers a much-needed opportunity for increasing working-class consumption above what it was previously.

Do the workers really claim that they alone should be war-profiters, taking advantage of the war to increase their consumption, and that more than the whole of the burden of the war should be borne by others? Or is it only some of their leaders who are claiming this on their behalf? This is a political question to which I am not competent to give an answer. Nor is it necessary that I should do so.

For, from the practical point of view, I doubt if this is one of the alternatives offering. At any rate, it is not something which will come about automatically as a result of having no policy and doing nothing. If we drift without a comprehensive plan, not this but inflation or shop-shortages will result. And inflation, as we shall see, will be to the clear advantage of the richer class and will result in this class bearing not more, but less, than their fair share. I shall have to urge more than once before I have finished, that my proposals should be compared, not with some imaginary alternative, but with actual alternatives which are happening, or about to happen, before our eyes.

Let us, however, examine the facts. Once again the figures which I use are no better than

rough approximations of the truth. We do not know accurately how the national income is distributed between different income-groups, although this is clearly a matter of the first importance. There is some fairly good evidence of the proportions belonging to those with less than £250 a year and to those with more than £2,000 a year; but for the important intermediate groups the information is defective. But whilst many details in the following are probably inaccurate, I do not think that the picture as a whole is misleading. As before, we shall use pre-war prices and wages as our measuring rods; for, if we depart from these, we are on shifting sands.

We will begin with the sum-total of personal incomes before the war, (See Appendix I for the basis of this total), add to this the prospective war increase, and take away the rates and taxes which were already being paid in the pre-war years:

<i>Income group</i> ¹	<i>Below £250</i>	<i>£250—£500</i>	<i>Above £500</i>	<i>Total</i>
	<i>£</i>	<i>£</i>	<i>£</i>	<i>£</i>
	<i>million</i>	<i>million</i>	<i>million</i>	<i>million</i>
Pre-war	2,910	640	1,700	5,250
War increase	425	100	300	825
<hr/>				
Total war incomes	3,335	740	2,000	6,075
Pre-war rates and taxes	390	50	780	1,220
<hr/>				
	£2,945	690	1,220	4,855
<hr/>				

¹The groups are to be interpreted to cover those who were in these pre-war, even though war increases may be moving them into higher income groups.

The last row of figures leaves us with the incomes out of which the increased war expenditure has to be met either by additional taxes or by borrowing, after allowing for what can be provided out of existing capital. (The manner in which the income-group from £250 to £500 is at present escaping its proper share of taxes is strikingly brought out. They actually paid a much smaller proportion of their pre-war incomes than the lower income-group below £250, namely 7·8 per cent compared with 13·4 per cent.)

The figure which we have taken in Chapter III for the increased expenditure of the Government is £1,850 million, of which £150 million could be taken out of accruing depreciation not made good at home and £350 million from assets and borrowing abroad before allowing anything for normal saving. This leaves £1,350 million to be raised from additional taxes and from new savings (including normal savings) voluntary or involuntary.

We can rely in present circumstances on at least £400 million of voluntary savings, even if taxation is raised to a high level and if the proposal for deferred income made below is also adopted. Indeed I believe that this figure is considerably below the most probable expectation which might be put as much as £150 million higher; and I am reserving this margin against errors in the opposite direction elsewhere in the calculation. I include in this at least £100 million accruing in the hands of the Government in the Unemployment Fund, Health Insurance and Pension Funds, War Risk Funds and the like; which is best regarded as

diminishing the net Government demands on the public by this amount, since it cannot easily be allocated to the personal savings of any group. In addition fully £300 million are likely to accumulate through Building Societies, Life Offices, Superannuation Funds, the undistributed profits of companies (which alone were estimated at £300 million pre-war) and other institutional channels, even if individuals make no voluntary savings in addition to the other demands made on them. If this sum is allocated somewhat arbitrarily (for exact information is lacking) between the different income groups, we are left with the following:

<i>Income group</i>	<i>Below £250 £ million</i>	<i>£250-£500 £ million</i>	<i>Above £500 £ million</i>	<i>Total £ million</i>
War incomes less pre-war taxes	2,945	690	1,220	4,855
Minimum vol- untary savings	50	75	175	300
	2,895	615	1,045	4,555

out of which £950 million has still to be found for the Government. Even allowing for a wide margin of error in this calculation, it shows that if everyone with more than £500 a year had the whole of his income in excess of that sum taken from him in taxes, the yield would not be nearly enough,¹ being £625 million or only two-thirds of the Government's requirements.

¹ There are about 840,000 heads of households with more than £500 a year and their aggregate war incomes, after deducting pre-war taxes and minimum saving, is put above at £1,045 million, which leaves £625 million after deducting £500 per head.

Yet this suggestion is a wild exaggeration beyond what could be expected from our fiscal system. Indeed taxation on this scale would involve such wide-spread breaches of existing contracts and commitments that the taxable incomes themselves would be largely reduced. An important part of these incomes is spent on rates and other purposes which do not increase personal consumption, on current resources, the alternative uses of which are much less valuable, and on payments to dependants. It follows that an important contribution must be obtained one way or another from the income group below £500 a year.

Nor is it practicable to put the exemption limit at £250 a year. There are about 2,430,000 persons with incomes above this level. If the whole of the excess of their remaining incomes above £250 was taken from them, namely £1,050 million¹ and if this caused no reduction in the incomes by repercussion (which is far from the truth), it would only just exceed the Government's requirements. If the cost of the war is to be met by the income group above £250 a year, it would mean taking from them in savings and taxation (new and old) about three-quarters of their total war-time incomes, leaving them with less than a quarter of their incomes for their own consumption.

In the light of these figures it is not sane to suppose that the war can be financed without putting some burden on the increased war incomes

¹ Total available incomes of this group £1,660 million less about £610 million (in respect of 2,430,000 at £250 each).

of the class with £5 a week or less. For this income group accounts for about 88 per cent of the population, for more than 60 per cent of the total personal incomes of the country after allowing for war increases (due to greater output but allowing nothing for higher wage-rates) and deducting pre-war rates and taxes, and for about two-thirds of current consumption. Moreover the incomes of this group will have been increased on the average by some 15 per cent as a result of the war. Is it seriously expected that those with less than £5 a week will be allowed to increase their average consumption by 15 per cent, while all those with more than £5 a week will be left on the average with only a quarter of their incomes to consume? The only question is, therefore, how large the contribution of this class must be, and how it can be obtained with least sacrifice and most justice.

If we have a deliberate plan, considerations of social justice can be weighed and considered. Without such a plan (as at present) they go by default.

As a basis of discussion I offer in the next two chapters a proposal, capable, I expect, of amendment and improvement in a hundred details, but embodying a principle which will achieve more social justice than any other plan. It should be judged by comparison, not with some imaginary alternative or unattainable counsels of perfection, but with what is actually happening before our eyes.

CHAPTER V

A PLAN FOR DEFERRED PAY, FAMILY
ALLOWANCES AND A CHEAP RATION

I HAVE now reached a stage in the argument where I have to choose between being too definite or being too vague. If I set forth a concrete proposal in all its particulars, I expose myself to a hundred criticisms on points not essential to the principle of the plan. If I go further in the use of figures for illustration, I am involved more and more in guess-work; and I run the risk of getting the reader bogged in details which may be inaccurate and could certainly be amended without injury to the main fabric. Yet if I restrict myself to generalities, I do not give the reader enough to bite on; and am in fact shirking the issue, since the size, the order of magnitude, of the factors involved is not an irrelevant detail.

I propose to run the risk of giving too many details and estimates rather than too few,—relying on the reader's benevolent understanding of my method. But I may help him to distinguish between principles which are essential and details which are illustrative if I begin, in this chapter, with some generalities (though not entirely divorced from figures), leaving to the next one the blueprint.

We have reached the broad conclusion that allowing for the increase in war output and taking

credit for the pre-war yield of taxes and for those savings on which we can rely in any case, there remains about £950 million of incomes in private hands which must not be spent but must be diverted to the finance of the war.

I suggest that perhaps as much as one half of this, namely £500 million, can be raised by taxation. Indeed in a full year and disregarding time-lags in collection the war taxes already imposed in Sir John Simon's emergency budget may provide £400 million towards this. I include in this at least £100 million from Excess Profits Tax even if we avoid any significant degree of inflation. Inflation would, of course, greatly increase the yield of this tax; but the yield should be substantial even without this adventitious aid, partly as a reflection of the higher level of output and partly on account of the distribution of profits between individual businesses being materially different from what it was in the base year. Other fiscal devices, including a sales-tax on certain classes of non-necessities, should be capable of finding another £100 million. But it would not be easy for our fiscal machine to raise much more than this with due regard to justice and efficiency, except by a general sales-tax, a wages-tax or the use of inflation as a tax-gatherer.

The idea of bridging the remaining gap of £450 million, in addition to the £400 million for which we have already taken credit, by voluntary savings without any aid from inflation is chimerical. It must be remembered that we have already assumed an annual subscription by the

public to government loans of £900 million (£350 in exchange for foreign assets, £150 from depreciation funds and £400 from new savings) less such amount as accrues for investment in government funds etc., from overseas borrowing and from the proceeds of sales of gold; for the total increased expenditure of the Government is not £950 million a year but (on our assumptions) £1,850 million. For reasons we have already given, the additional savings would have to come largely from the income group with £5 a week or less and would require a change in their habits of expenditure for which there is no evidence.

For these same reasons the amount by which the potential expenditure of the lower income-groups has to be curtailed will be more or less the same whichever method is adopted. Inflation will be the most burdensome alternative, since this will inevitably bring some advantage to the entrepreneur class, and might cost the worker 20 per cent in terms of the real value of his earnings. Inflation will also be the most burdensome on the smallest incomes,—a defect it shares with a general sales-tax. New taxes, such as a sales-tax or a wages-tax, or old taxes aided by inflation are alike in that they finally deprive the workers of the benefit of their earnings from their heavier burden of labour. They will work harder, but, as a group, they will *never* derive any personal benefit from it. That is what will happen, will inevitably happen, if the Treasury and the Trade Union leaders agree on the one thing where they will find agreement easiest, namely to drift

along without a definite policy, following the usual methods and rejecting new ideas.

Is there no better way? We have seen that it is physically impossible for the community as a whole to consume *now* the equivalent of their increased war effort. That is obvious. The war effort is to pay for the war; it cannot also supply increased consumption. Those who make the effort have, therefore, only two alternatives between which to choose. They can forego the equivalent consumption altogether; or they can *postpone* it.

For each individual it is a great advantage to retain the rights over the fruits of his labour even though he must put off the enjoyment of them. His personal wealth is thus increased. For that is what wealth is,—command of the right to postponed consumption.

This suggests to us the way out. A suitable proportion of each man's earnings must take the form of *deferred pay*.

With this general principle established, the practical difficulties of our task begin. If we were to apply the principle in the crudest possible way by deferring, let us say a level 20 per cent of all income remaining after payment of pre-war taxes, it would still be much better than the alternative of inflation. But public opinion requires, justly perhaps, that a deliberate plan, and particularly that a *new* plan, should not merely be better than doing nothing, but *much* better. A new plan is required to meet objections, which apply equally to the old plan, but which in the case of the

latter custom has caused us to forget. The new plan is required to satisfy ideals of social justice much higher than we have been attaining without it.

Let us welcome this demand. If we can make the upsetting of established arrangements, which the exigencies of war finance require, the opportunity to improve the social distribution of incomes, all the better.

With this object in view we can add a second and a third principle to the first principle of deferring a proportion of current earnings. We have suggested that about a half of what is required can be obtained by outright taxes, leaving a half to be supplied by deferment of earnings. Let our second principle provide that the bulk of the new taxes shall fall on the income groups of £250 or more, and that the main part of the contribution of the lower income groups shall take the form, not of foregoing income outright, but of merely deferring it.

The third principle must be directed to the maintenance of adequate minimum standards,—better and not worse than have existed hitherto. Thus, whilst the second principle puts heavier burdens on the richer classes, the third principle allows special reliefs to the poorer.

To carry out the third principle requires two distinct proposals. In the scheme which I first put forward in *The Times* I attempted to deal with the problem by proposing a minimum exempt income, this minimum to be increased for a married man in accordance with the size of his

family. This proposal was rightly criticised on the ground that the resulting allowance was inadequate. The following scheme goes much further and is, I venture to think, a great improvement.

For some years past the weight of opinion has been growing in favour of family allowances. In time of war it is natural that we should be more concerned than usual with the cost of living; and as soon as there is a threat of a rising cost of living and a demand for higher wages to meet it, the question of family allowances must come to the front. For the burden of the rising cost of living depends very largely on the size of a man's family. At first sight it is paradoxical to propose in time of war an expensive social reform which we have not thought ourselves able to afford in time of peace. But in truth the need for this reform is so much greater in such times that it may provide the most appropriate occasion for it.

I share the view held by many others that this is so. I recommend, therefore, that a family allowance of 5s. per week should be paid in cash for each child up to the age of fifteen. I am estimating the net cost of this at £100,000,000 the basis for which is explained in Appendix III.

Is this provision enough? We have to consider the fairly large class with small incomes which will not be increased by the war, or at any rate not sufficiently to keep pace with the increase in the cost of living. And there is the demand of the Trade Unions for some security against the risk that the rise in prices will outstrip the level

of wages, even if a scheme for deferred pay or the like is agreed to.

To meet this an important section of opinion, which has received the weighty support of Sir Arthur Salter, Mr. R. H. Brand and Prof. and Mrs. Hicks, recommends that a minimum ration of consumption goods be made available at a low fixed price, even though this might involve subsidies. If I were advising the Treasury, I should look with anxiety on such a proposal taken by itself, since it might in certain circumstances place an almost insupportable burden on the Exchequer. But if it were made part of a comprehensive scheme, including the deferment of a proportion of earnings, agreed with the Trade Unions, I would welcome it.

The minimum ration should not comprise all the articles covered by the cost of living Index, but should be restricted to a limited list of necessaries available in time of war. Nor should any absolute undertaking be given as to future prices. It should be agreed, however, that in the event of any rise in the cost of the minimum ration, the Trade Unions would be free to press for a corresponding increase in wages.

But it should be an absolute condition of such an arrangement that a scheme for deferred pay should be accepted at the same time, and that the Trade Unions should agree, subject to the above safeguard, not to press for any further increases in money wages on the ground of the cost of living.

Without these conditions the weight of purchasing power available in the hands of consumers

would render any attempt at price fixation excessively dangerous. The low prices for the minimum ration would merely release more purchasing power for use in other directions, which would drive up other prices to an excessive disparity with that of the fixed ration. To attempt to fix consumption prices whilst allowing an indefinite increase of purchasing power in the hands of consumers would be an obvious error.

For the Trade Unions such a scheme as this offers great and evident advantages compared with progressive inflation or with a wages tax. In spite of the demands of war, the workers would have secured the enjoyment, sooner or later, of a consumption fully commensurate with their increased effort; whilst family allowances and the cheap ration would actually improve, even during the war, the economic position of the poorer families. We should have succeeded in making the war an opportunity for a positive social improvement. How great a benefit in comparison with a futile attempt to evade a reasonable share of the burden of a just war, ending in a progressive inflation!

CHAPTER VI

DETAILS

I HAVE avoided in the previous chapter precise figures of the proportion of earnings to be deferred and of the minimum standard which should be

free from deferment. Those who agree on the principle may differ on the details. It is better, therefore, to separate them so far as is possible. I put forward the following as a basis of discussion. The details are a question of degree and of opinion. If these proposals err, it may be in the direction of making concessions to the income-group below £5 a week, greater than it will be easy to maintain—concessions which are, I believe, still possible on the assumption that output is adequately increased and that government expenditure does not exceed the estimate given above, but no longer possible if either of these assumptions fail.

The basis on which the details have been arrived at is the following:—

(1) The aggregate real consumption of the group with £5 a week or less should be maintained for as long as possible at or near the pre-war level.

(2) Those who remain in the lower half of this group are likely to have benefited least, or not at all, from the aggregate increase in war incomes, and cannot afford, therefore, to have any important part of their current earnings deferred if they are to maintain their standard of life.

(3) Since some rise in the cost of living relatively to wage-rates (though not to total earnings) is inevitable, and since it is impossible under any scheme to avoid individual inequalities of treatment, we should make sure by means of family allowances that the inequality will work out in favour of households with families, so that these will be for certain better off.

(4) Since the increased war incomes of the lower

income groups probably represent increased work to a greater extent than in the case of the higher income groups, the contribution of the former should be mainly in the form of deferment of earnings and the contribution of the latter mainly in the shape of increased taxation.

(5) The increase in the cost of imports is likely to involve an increase in the cost of living relatively to wages of not less than 5 per cent, even with the existence of subsidies.

There remains the question whether we can hope to provide the whole of the £950 million required, or rather £1,050 million including the cost of family allowances, by taxation and the deferment of pay. The proposals, which I put forward in *The Times* and the *Economic Journal*, were a little faint-hearted in this respect and avowedly fell short of what was required. It now seems to me better to start with a scheme which aims at being adequate, even if this is a counsel of perfection. For subsequent concessions are sure to whittle away the yield; so that a scheme which is moderately less than adequate at the start will be seriously inadequate at the finish. Since various concessions recommended in the next chapter are likely to cost at least £50 million, I shall aim, therefore, at a scale of deferment which should yield £600 million gross.

Whether the actual scales proposed below will in fact achieve these objects, it is impossible to forecast with accuracy. They *aim* at carrying out the above principles. If it is shown that they would fail to do so, they can be amended accord-

ingly. Put into figures the distribution of the burden aimed at is the following:—

<i>Income-Group</i>	<i>Below £250</i>	<i>Above £250</i>	<i>Total</i>
	<i>million</i>	<i>million</i>	<i>million</i>
Increased Taxes ¹ . . .	£150	£350	£500
Deferment of Earnings . .	250	350	600
Loss through relative rise in the cost of living . . .	125	50	175
	£525	£750	£1275
Less increase in war incomes	425	400	825
	£100	£350	£450
Less family allowances ² . .	£100	—	£100
Decrease in real consumption	nil	£350	£350

The loss, estimated above, due to a rise in the cost of living relatively to wages, allows for a cost of living 10 per cent above pre-war only partially offset by a 5 per cent rise in wages. This is, roughly speaking, the present position. The estimate assumes that the higher income-group will be somewhat less affected by this factor than the lower.

In terms of pre-war real consumption the final result means, very roughly, that the aggregate consumption of the higher income group will be reduced by fully a third and the aggregate consumption of the lower income group not at all.

¹ Including increased yield of pre-war taxes.

² For the sake of simplicity, I am assuming that the existing income tax allowances for children already cost on the average 5s. per child for the income group about £250, which may or may not be correct. Probably it is an overstatement, since the allowance works out at 3s. 9d. per child up to about £400 earned income, gradually rising thereafter to 7s. 6d.

But the reader will understand that I am by now in deep statistical water and that there is room for serious errors of detail in figures which I have been bold, perhaps too bold, to give.

This distribution of burden may be open to the criticism that it demands too heavy a relative sacrifice from the higher income group. It certainly uses the opportunity of war finance to effect a considerable re-distribution of incomes in the direction of greater equality. Does any responsible leader of the working class believe that rising wage-rates vainly pursuing a rising cost of living, or any other alternative, will work out more justly than this or more advantageously to the lower income group?

It should be a strong recommendation of what is here proposed that it offers a special protection to the lowest income-group of £3 a week or less, who are not benefiting from war increases of earnings, and to family men who are least able to forego any improvement which may come their way.

What is the best formula to reach this result? In my *Times* articles I proposed a formula which had the advantage of showing the combined result to the tax-payer of direct taxes and of deferment of pay. This formula was open to various minor criticisms of detail, which the Inland Revenue would have to meet in an actual scheme. But after much reflection I have not been able to find a better one for expressing the general purpose and result of the plan. I am, therefore, retaining it subject to cer-

tain changes made necessary by the redistribution within the lower income group which it is now proposed to make through family allowances, or by a more careful consideration of how it interlocks with the burden of direct taxes. The revised formula is given in Appendix IV, and its effects in detail are shown below.

(1) *Children's Allowances.* The system of children's allowances under the existing income tax appears highly anomalous when it is examined in detail. For a man with an earned income of £250, it works out at £7 per annum for the first child and nothing for subsequent children; and it gradually rises with income to a maximum of £18 15s. for every child. For non-income-tax payers there is no general children's allowance, though allowances are paid in a number of special cases. In lieu of the whole of the present system of children's allowances, I propose a flat payment of 5s. per week per child or £13 per annum, both for income-tax payers and for the insured population.

(2) *Basic minimum income.* As the basic minimum income which should be allowed free of deferment, I propose 35s. a week to unmarried and 45s. a week to married men. If different figures are preferred, this can be adjusted by altering the percentage to be taken in excess of the basic minimum.

(3) *Incomes in excess of the basic income.* A percentage of all incomes in excess of the basic minimum to be paid over to the Government, partly as direct taxes and partly as deferred pay;

the combined percentage to be taken rising steeply as the level of income increases. The formula for making the calculations is given in Appendix IV, but the effect of it at various income levels is shown more clearly in the following table. Taking as the standard case the married man with no young children, the percentage of his income to be withheld to cover his deferred pay (and also his income-tax and surtax) works out thus:—

Up to 45/- weekly	nil
At 50/-	3½ per cent
55/-	6
60/-	8½
80/-	15½
100/-	19¼
£300 annually	21
400	25
500	27
700	29
1,000	35
2,000	37½
5,000	53½
10,000	64
20,000	75
50,000	80
Over 50,000	85

As will be shown in the next table, the proposed family allowances make the result far more favourable than this for the man with young children in the lower income ranges. With two children he is a substantial gainer on balance at all levels up to 75s. a week.

(4) *The division between taxation and deferment.* The appropriate part of a man's income withheld under the above formula will be used to

discharge his income tax and surtax if any. The balance will be credited to him as a deposit in the manner to be explained in the next chapter. The final result of all this in different individual cases is shown in the following tables:

	<i>Weekly earnings</i>	<i>Deferment of pay</i>	<i>Existing Income Tax</i>
Unmarried	35/-	nil	nil
	45/-	3/6	nil
	55/-	5/9	1/3
	75/-	9/9	4/3
	80/-	10/9	5/-
	100/-	14/3	8/6

Married	35/-	nil	nil
	45/-	nil	nil
	55/-	3/6	nil
	75/-	10/6	nil
	80/-	12/3	nil
	100/-	15/10½	3/4½

	<i>Weekly earnings</i>	<i>Deferment of pay and Income Tax</i>	<i>Family Allowance</i>	<i>Cash remaining for consumption</i>
Married with 2 young children	35/-	nil	10/-	45/-
	45/-	nil	10/-	55/-
	55/-	3/6	10/-	61/6
	75/-	10/6	10/-	74/6
	80/-	12/3	10/-	77/9
	100/-	19/3	10/-	90/9

Married with 3 young children	35/-	nil	15/-	50/-
	45/-	nil	15/-	60/-
	55/-	3/6	15/-	66/6
	75/-	10/6	15/-	79/6
	80/-	12/3	15/-	82/9
	100/-	19/3	15/-	95/9

D

Thus a married man with two young children has actually more left in cash for all rates of earnings up to nearly 75s., and with three children for all rates up to nearly 95s. In addition family men will have substantial deferred pay credited to them besides their cash for immediate consumption being increased.

For a married man¹ with an earned income above £5 a week the result is as follows:

<i>Total Income</i>	<i>Income Tax and Surtax payable</i>	<i>Income Deferred</i>	<i>Remaining Income</i>
£300	£15	£49	£236
400	31	68	301
600	93	76	431
1,000	218	135	647
2,000	562	285	1,153
5,000	2,055	630	2,315
10,000	5,268	1,156	3,576
20,000	13,018	1,896	5,088
100,000	80,768	4,133	15,099

At the higher income ranges the percentage of income deferred to total income falls considerably. But it cannot be considered too low if allowance is made for the enormous sums taken in income tax and surtax at these ranges. For example at £100,000, the income deferred is only 4 per cent of total income, but it is 21½ per cent of the income which is left after payment of these taxes.

(5) *Method of Collection.* For the insured population the method of collection would be the same

¹ He also receives £13 per annum for each young child. An unmarried man pays from £13 to £16 more in income tax and has a little less deferred. There should, perhaps, be an additional allowance for married men in these income ranges.

as for social insurance. Each insured worker would hold a Deferred Pay Card which would be stamped by the employer. For income-tax payers the method would be the same as for income-tax. For incomes up to £750 a year the whole question of deferred pay can be dealt with when considering income-tax allowances. For surtax payers the method would be the same as for surtax. Thus no new machinery either of assessment or of collection will be required,—a great advantage for a war-time measure.

In the case of fluctuating earnings, the proportion of deferred pay appropriate to each pay period would be withheld in the first instance. But this could be adjusted to the proportion appropriate to the average earnings at quarterly or any other convenient intervals, since the card would carry on its face all the information required for this purpose.

(6) *The Depository for Deferred Pay.* Considerable choice could be allowed to the individual in what institution his deferred pay should be deposited. He might choose his Friendly Society, his Trade Union, or any other body approved for the purposes of Health Insurance; or, failing such preference, the Post Office Savings Bank. Thus there would be an encouragement to the working-man's own institutions to take charge of his resources for him, and, if desired, a considerable degree of discretion could be allowed to such bodies as to the conditions in which these resources could be released to the individual to meet his personal emergencies, as is proposed in the next chapter.

The reader will readily perceive that the same results could be obtained by reducing the exemption limits for income tax and raising the rates of income tax and surtax effective at different levels of income to the percentages of income set out in Appendix IV. For those who dislike fancy schemes and prefer to keep to well-understood methods, this is the sound alternative. If it is accompanied by family allowances, I see no fiscal objection to this solution. Socially I prefer the more novel proposal, which retains a stronger incentive to effort, gives less sense of sacrifice and indeed requires less, and spreads through the community the advantages of security, which saved resources afford, far more widely than before.

CHAPTER VII

THE RELEASE OF DEFERRED PAY AND A CAPITAL LEVY

THAT part of the earnings and other income of the public to be deferred under this plan would be placed to the credit of its owner as a blocked deposit in the friendly society or the approved institution selected by him, as proposed above, or, failing such choice, in the Post Office Savings Bank carrying interest at $2\frac{1}{2}$ per cent compound interest. If the yield aimed at in the above scheme was reached, the gross amount accumulated in this way would amount to about £600 million a year. In fact the accumulations might

come to less than this because there are various concessions which it would be fair to make.

In the first place there are certain definite commitments to save entered into before the war which a man might reasonably be allowed to meet out of his blocked deposit such as instalments due to a building society, premiums due to a Life Assurance Office, hire purchase commitments, and perhaps bank loans. (I have already allowed £50 million as a margin and, if this is insufficient, there is also, I believe, a substantial hidden reserve in my estimate of the voluntary savings to be expected outside the deferment scheme.) It would also be reasonable to release them for the payment of death duties.

In the second place, a man might be allowed to apply his deferred pay to the purchase of new life insurance or an endowment policy. Schemes to encourage this might be prepared by the Life Offices on lines adapted to the special circumstances.

In the third place, since these deposits are a man's own property intended to increase his sense of security and as a reserve against his family and personal emergencies, he should be allowed to use his deposit in any case approved by his friendly society or, in the case of the P.O. Savings Bank, by a local committee, as for example to meet illness, unemployment or special family expenses.

In general, however, the deposits are not intended to be used until after the war when they would be released by a series of instalments at dates, not unduly delayed, to be fixed by the

Government. Meanwhile they should not reckon in calculations arising out of the Means Test or eligibility for old age pensions or the Capital Levy to be proposed below or the like.

The appropriate time for the ultimate release of the deposits will have arrived at the onset of the first post-war slump. For then the present position will be exactly reversed. Instead of demand being in excess of supply, we shall have a capacity to produce in excess of the current demand. Thus the system of deferment will be twice blessed; and will do almost as much good hereafter in preventing deflation and unemployment as it does now in preventing inflation and the exhaustion of scarce resources. For it is exceedingly likely that a time will come after the war when we shall be as anxious to increase consumers' demand as we are now to decrease it. It is only sensible to put off private expenditure from the date when it cannot be used to increase consumption to the date when it will bring into employment resources which otherwise would run to waste.

If the deposits are released in these circumstances, the system will be self-liquidating both in terms of real resources and of finance. In terms of real resources it will be self-liquidating because the consumption will be met out of labour and productive capacity which would otherwise run to waste. In terms of finance it will be self-liquidating because it will avoid the necessity of raising other loans to pay for unemployment or for public works and the like as a means of preventing unemployment.

Nevertheless it has been my experience that no part of the scheme has raised more doubts than this supposed difficulty about the ultimate repayment of the blocked deposits. I am surprised at this criticism which seems to me unreasonable. For the National Debt will be no greater than if the same results were produced by voluntary savings. Moreover the discretion reserved to the Treasury for the date of release makes it easier to handle this particular section of the National Debt than the rest of the large volume of short-term debt which the war is likely to leave behind it. The argument is, I suppose, that savings deferred in this way are more likely than normal savings to be spent by their owners as soon as they are free to do so. How far this will prove to be true in fact, I am not sure. It may be that the blocked deposits will be instrumental in spreading the habit of small savings more widely, and that a large proportion will be left undrawn as conservatively as the existing Savings Bank deposits. But I am not relying on this. Indeed, in so far as the deposits are not spent when the time comes for their release the advantages to employment which I have forecast will not mature. I am doing no more than assume that steps can be taken to prevent the deposits from being spent faster than they can be replaced by new loans which would have been required in any case for the relief or the avoidance of unemployment.

If, however, public opinion still feels a difficulty here, it is one that can be met in a manner which has advantages for its own sake. If the

war continues for two years or longer, the National Debt will reach an unmanageable figure, which will hamper national finance for years to come. In such circumstances a Capital Levy will be advisable just as (in my opinion) it was at the end of the last war, if it could have been carried out before the post-war slump. There may be a good case, therefore, for linking a Capital Levy (or tax) to the Deferred Pay.

I suggest, therefore, that an undertaking should be given that a Capital Levy will be enforced after the war to bring in an amount sufficient to discharge the liability in respect of Deferred Pay. I should still argue that it would be better not to synchronise the two. I would not willingly forego the great advantages of withholding the deferred pay until the onset of serious unemployment, whereas this would be the worst possible time for the Capital Levy. If the Levy is to be paid in a lump sum, it should be discharged at the earliest possible date after the close of the war, especially if temporary boom conditions seem imminent. But it might be preferable, as facilitating collection and greatly lessening the disturbance, to collect it in a series of instalments over a period. This procedure would have the special merit that it might pave the way administratively for a permanent capital tax which would be a valuable addition to our fiscal machinery and has certain important advantages over income tax. In any case there will be plenty of Treasury Bills after the war waiting to be cared for, so that there is no technical reason why the Capital Levy

and the release of the blocked deposits need be simultaneous.

It is often argued in labour circles that a Capital Levy should form part of the immediate programme for the finance of the war. The sound reasons which lie behind this, namely that the war should be an occasion for diminishing rather than for increasing the existing inequalities of wealth, are completely met by the above proposal. At the same time, the great and indeed overwhelming objections to an immediate war-time levy are avoided. I am not thinking mainly of the administrative difficulties, though these might prove insuperable. The main point is that a Capital Levy now would do little or nothing to solve the immediate problem. A Capital Levy on a scale worth having could not be met out of the current consumption of the wealthy. They could only pay it by handing over assets to the Government, the capital value of which would be of no assistance whatever to the immediate financial task. Nothing is of the least use now which does not diminish consumption out of current income; and for the reasons which I have given in Chapter IV no expedient can be adequate which allows the increased purchasing power of the lower income groups to materialise in a corresponding increase in their consumption. There is no avoiding a postponement of expenditure on the part of this group, except by inflation which allows them to spend and deprives them of the fruit of spending. But the proposal here made secures them the *ultimate* enjoyment of their earnings unabated.

When general principles have been established for the management of blocked deposits, there may be other good opportunities for the use of this device. In particular, men on active service might have their economic position made a little more equal to the position of those remaining in civilian employment by being credited with an appropriate blocked deposit proportional to their length of service. A "veteran's bonus" is a peculiarly fit obligation for discharge by a capital levy on wealth.

The device might also be useful for dealing with excess profits. A counsel of perfection would require that no excess profits should be allowed during the war. This is not advisable in practice because it would deprive those, who would nevertheless remain in control of their businesses, of any incentive towards economy; and the experience of the last war showed that this is liable to lead to great extravagance and waste. It is in the interest of the Treasury that the gross figure of excess profits before deduction of tax should be as large as possible; and this will not be attained if those in charge of business are deprived of all incentive. The existing tax on excess profits is at the rate of 60 per cent which means that, including income tax, 75 per cent already accrues to the Treasury and even a larger percentage in the case of surtax payers. If the basis of calculation was rendered more equitable so that what legally reckons as excess profits really are so in fact, there would be room for a moderate increase. But it might be a

better plan to require the balance of excess profits after deducting E.P.T. and income-tax to be held in a blocked deposit.

CHAPTER VIII

RATIONING PRICE CONTROL
AND WAGE CONTROL

THE mechanism of reaching equilibrium by means of a rising cost of living, which is vainly pursued by a rising level of wages, will be described in the next chapter. But it is admitted on all hands that this is the worst possible solution.

It has been argued here that the only way to escape from this is to withdraw from the market, either by taxation or by deferment, an adequate proportion of consumers' purchasing power, so that there is no longer an irresistible force impelling prices upwards. But there are many who believe that there is another alternative open, namely to control the cost of living by a combination of rationing and price fixing, and that, if this was done, wage control would become manageable.

I believe that it is a dangerous delusion to suppose that equilibrium can be reached by these measures alone. Nevertheless some measure of rationing and price control should play a part in our general scheme and might be a valuable adjunct to our main proposal. It is relevant, therefore, to debate the matter in this place.

There are two central objections to rationing and price control unaccompanied by a withdrawal of consumers' purchasing power. The first objection arises out of the great variety of personal consumption between one man and another. If our needs and tastes were all the same, there would be no real loss in abolishing consumers' choice. In fact there is a great deal of waste, both of resources and of enjoyment, in allotting to each of us identical rations of every consumable object. There are some articles of consumption—bread, sugar, salt, bacon perhaps—where no great harm is done, though even here there are in fact wide differences of personal habit. But as one proceeds through the list—milk, coffee, beer, spirits, butcher's meat, clothing, boots, books, articles of clothing, furniture—the variety of taste and need dominates the scene. It becomes ludicrous to compel everyone to divide his expenditure between the different articles of expenditure in exactly the same way. Moreover, it would never be practicable to cover every conceivable article by a rationing coupon; and if there are certain articles uncontrolled the pressure of purchasing power will tend to divert production in their direction, although they may be what the consumer least wants and what it is least desirable that he should have. Finally, if by a miracle the method was substantially successful, so that consumption was completely controlled and consumers were left with a significant fraction of their incomes which they were unable to spend, we should merely have arrived by an elaborate,

roundabout and wasteful method at the same result as if that fraction of their incomes had been deferred from the outset.

If our object is to prevent a certain proportion of consumers' incomes from being spent, the only sensible thing is to start at that end, withholding by deferment or by taxation that proportion which is not to be spent and then allowing a free choice to the consumer how he shall divide what he is allowed to spend between different articles of consumption. A world of trouble and an ocean of waste will be avoided, and the consumer will enjoy far more satisfaction. A recent cartoon by Low, in which Sir John Simon was depicted struggling with a belt unable to decide whether he should constrict "the pantry or the pocket", conveyed profound comment on this matter. Constriction of the pocket is the alternative which a free community should prefer. The abolition of consumer's choice in favour of universal rationing is a typical product of that onslaught, sometimes called bolshevism, on differences between one man and another by which existence is enriched.

A well-conceived policy of rationing has quite a different object from this. Its purpose is not to control aggregate consumption but to divert consumption in as fair a way as possible from an article, the supply of which has to be restricted for special reasons. For example, interruption of trade with Denmark and the Baltic necessarily restricts the supply of bacon below normal, and replacement is only possible by purchases in U.S.A. which would compete with more important

claims on our dollar resources; or it is impossible to allot enough shipping tonnage to satisfy the current demand for sugar. It is necessary, therefore, to force people to consume less bacon or less sugar and to buy something else instead;—quite a different problem from reducing their aggregate expenditure. If the article is not a conventional necessary or one of general consumption, the end is reached most easily by allowing a rise in the price of the article, the consumption of which we wish to restrict, relatively to other articles. But if this article is a necessary, an exceptional rise in the price of which is undesirable, so that the natural method of restriction is ruled out, then there is a sound case for rationing.

There is hardly less objection to price fixing and legal restrictions against price increases, unaccompanied by any restriction on the volume of purchasing power. For this policy has the effect of positively increasing the pressure of consumption and of facilitating the conversion of money income into the use and depletion of valuable resources. If the quantity of resources which the authorities are prepared to release for civilian consumption is strictly limited, price fixing practices are likely to end in shortages in the shops and queues of unsatisfied purchasers.

It is, however, undoubtedly the fact that price fixing and propaganda against price raising are much more *à la mode* to-day than old-fashioned inflation. The political advantages of this policy are obvious. The objection to it is that, unlike

old-fashioned inflation, it does nothing to bring about equilibrium, indeed on the contrary. My belief is that, if in the next six months no adequate steps are taken to curtail consumers' purchasing power, the consequences are much more likely to be seen in the shape of shortages in the shops than in a runaway price level. There is a strong feeling both amongst the public and amongst producers and retailers against rising prices. The mentality which used to result formerly in rapid price inflation is replaced to-day by a different conception both of private advantage and of public spirit. I believe, therefore, that a typical price inflation is much further off than some people are thinking. I welcome this new attitude. For it means that we have a longer time in which to implement a policy of genuine equilibrium before irremediable damage is done. Nevertheless it is no genuine solution. Shop shortages and queues lead to great injustices of distribution, to an abominable waste of time and to a needless fraying of the public temper. It is the alternative which both Russia and Germany have long preferred to old-fashioned inflation, and it is, as I have said, *à la mode*. But it is for us to find the third alternative, which is the genuine solution, preserving both the general interest and the free choice of the individual consumer.

I have not attempted to deal directly with the problem of wages. It is wiser, I expect, to deal with it indirectly. If the necessary proportion of consumers' purchasing power is not withdrawn

from the market, a significant rise in prices cannot be avoided, even though there is no runaway inflation. An attempt on the part of the Government to keep down the price level of a range of articles in general consumption will require, sooner or later, subsidies on a scale which would impair still further the equilibrium of the budget. (The Chancellor of the Exchequer stated recently that the tentative moves in this direction already made are costing the Treasury £1,000,000 a week). And a significant rise in the cost of living is certain to be followed by a more or less successful agitation for higher wages.

If, on the other hand, the problem is tackled indirectly by withdrawing purchasing power, there will be no reason why the vicious process should be started by prices being forced up at the demand end. There might be certain subsidies in part compensation for price increases due to the higher cost of imports and some rise of wages for grades of labour which already had a special claim for an improvement. But the main reason for the development of an acute wages problem would have been removed, and we could safely leave the sequel to the common-sense and public spirit of trade unionists as to what is or is not reasonable in time of war.

Nevertheless, if a scheme for deferment of pay is adopted, this would make practicable a further measure which might considerably ease the wages problem. For with an adequate proportion of consumers' purchasing power withdrawn, the risk and expense of a deliberate policy to keep down

the prices of a limited range of necessities might be no longer prohibitive. I suggest, therefore, (contingently on the adoption of a scheme for deferment of pay) that a limited range of essentials, considerably narrower than the list covered by the Ministry of Labour Index Number for the cost of living, should be drawn up and that the Government (without giving any specific pledge) should do their best to prevent any rise in an index number based on the cost of these articles; and that on their side the Trade Unions (also without giving any specific pledge) should agree that they will not press for any wage increases *on the grounds of the cost of living*, except in so far as the Government may be unsuccessful in keeping the above index number from rising. This suggestion is in no way essential to our main proposals, but is a further development which these proposals would facilitate.

CHAPTER IX

VOLUNTARY SAVING AND THE MECHANISM OF INFLATION

THERE exist alternatives to the plan proposed in the previous chapters which are not less drastic and, if they were to be put into operation, not less effective. For example, a retail sales-tax of 50 per cent or a wages-tax of 20 per cent; or, as I have pointed out above, a heavier income tax, the increased incidence of which was exactly the same

as that of the deferment of pay here proposed. The choice between these drastic and equally effective alternatives must be decided on considerations of public psychology, social justice and administrative convenience.

Those, however, who are opposed to a scheme for deferred pay, do not, as a rule, oppose it because they prefer one of the drastic alternatives, but because they believe that we can win through by "normal" methods, that is to say by stiff taxation on existing lines and by voluntary savings stimulated by active propaganda.

Now this policy might mean either of two things. It might mean a repetition *mutatis mutandis* of our policy in the last war, namely a sufficient degree of inflation to raise the yield of taxes and voluntary savings to the required level. The mechanism of this process is the main subject of this chapter.

But it might also mean—and that is what its advocates would claim for it—something much better than this, namely an equilibrium between supply and demand without any aid from an inflation.

The practicability of so happy an outcome is clearly a question of degree. For example, if the increase in the expenditure of the Treasury, compared with the financial year 1938-39, was no more than £1,000 million, or perhaps £1,250 million, we might reasonably expect "normal" methods to be adequate (supplemented, of course, by drawing on the available capital resources). If, on the other hand, the increase in expenditure

is of the order of £1,750 million or more (measured in pre-war prices), it is virtually certain, in the light of the examination of the statistical background which we have made in Chapters III and IV, that the normal methods would be inadequate. Between these limits there is room for a difference of opinion. I should be inclined to put the maximum expenditure which we could safely handle by normal methods at an increase of about £1,250 million. And I should be fairly confident that they could not handle an increase of £1,500 million.

We must next emphasise a consideration, commonly overlooked, which is of the first importance. Let us suppose that in the absence of drastic methods we can rely on voluntary savings of (say) £500 million, but that we require £750 million to balance the war budget. We therefore resort to one or other of the "drastic" methods open to us to find the balance of £250 million. Now the fundamental difficulty, which we have to face and are apt to overlook, is this. As soon as we apply a "drastic" method we can no longer rely on the same volume of voluntary savings which was available so long as we restricted ourselves to "normal" methods. For some part of the funds which we extract by our drastic methods are certain to be at the expense of the voluntary savings previously available. To give a simple example, the volume of voluntary savings is not independent of the level of income tax. If income tax is raised, the gross increase in the yield exaggerates the increase in resources from taxes and

voluntary savings added together, since the higher tax will not be met entirely by a reduction in consumption but partly at least by a reduction in savings.

Thus, as soon as the rate of expenditure has exceeded the maximum which can be handled by normal methods, our drastic methods must be sufficient to produce a yield greater than this excess, since we can no longer rely on the same yield as before from voluntary sources. For this reason I have put no reliance above on voluntary savings by private individuals as distinct from institutional and contractual saving, though I hope that this may prove unduly pessimistic.

I should mention in passing, what is obvious, that the excellent success of the War Savings Campaign gives no useful statistical guide to the prospects of the voluntary method. The terms offered, being attractive compared with the deposit rates of the Post Office Savings Bank and the Joint Stock Banks, naturally attract old savings previously held elsewhere. Moreover, the formation of savings groups is frequently assisted by advances from employers for the purchase of certificates to be paid for gradually by future deductions from earnings. Thus the published totals comprehend both past and future savings, and it is impossible to say what proportion of them is attributable to current savings in the sense of an excess of current income over current expenditure during the period in which the nominal total has been subscribed.

The force of this general argument appears to

me to be such as to make it very unlikely that we can achieve our maximum war effort by "normal" methods of taxation on existing lines supplemented by voluntary saving. The danger of depending on voluntary savings lies in the fact that, if we adopt no drastic method, we are liable to slip insensibly into stimulating voluntary savings by inflation. And that leads us to the main theme of this chapter.

There is no difficulty whatever in paying for the cost of the war out of voluntary savings;—provided we put up with the consequences. That is where the danger lies. A Government, which has control of the banking and currency system, can always find the cash to pay for its purchases of home-produced goods. After allowing for the yield of taxation and for the use of foreign reserves to pay for the excess of imports over exports, the balance of the Government's expenditure necessarily remains in the hands of the public in the shape of voluntary savings. That is an arithmetical certainty; for the Government having taken the goods, out of which a proportion of the income of the public has been earned, there is nothing on which this proportion of income can be spent. If prices go up, the extra receipts swell someone's income, so that there is just as much left over as before. This argument is of such importance and so little understood that it is worth our while to follow it out in detail.

Let us suppose that the value of the output¹

¹ I am taking round figures in the neighbourhood of the facts. But I simplify the illustration by ignoring the depletion of capital as a source to meet government expenditure.

of the country is £5,500 million at pre-war prices, that individual incomes (including transfer payments) come to £6,000 million, that the yield of taxation is £1,400 million, that we supplement our own output by importing £350 million more than we export paid for out of foreign reserves or overseas loans, and that the expenditure of the Government, also reckoned at pre-war prices, is £2,750 million, *i.e.* £2,250 million excluding transfer payments. After deducting £1,400 million which they pay in taxation, individuals are left with £4,600 million which they are free to spend if they choose. But, since the Government has already purchased £2,250 million of the output, there is only £3,250 (£5,500 - £2,250) million of goods (valued at pre-war prices) left for the public to buy with their remaining incomes of £4,600 million. Now if the public voluntarily save £1,350 million, that is to say the whole of the difference between their incomes of £4,600 million and the value of the available goods, namely, £3,250, at pre-war prices, obviously the problem is solved. There will be just the right amount of goods available to satisfy the demand without any rise of prices.

But, if in these circumstances, the public do not choose to save so much as £1,350 million, does the system of financing the war by voluntary savings break down? Certainly not. For in the last war we used the voluntary system successfully; yet, since prices rose more steeply than wages, it follows that the readiness of the public to save cannot have been sufficient to satisfy

the above conditions. What happens then? How is the paradox explained?

Let us suppose that, instead of saving the necessary £1,350 million, the voluntary savings of the public are, in the first instance, only £700 million, and that they try to spend the rest of their incomes, namely £3,900 million, on goods worth only £3,250 million at pre-war prices. Obviously prices will have to rise 20 per cent which will equate supply and demand; for the goods will then be worth £3,900 (£3,250 + £650) million, which is just equal to the desired expenditure. Moreover, those who have sold for £3,900 million goods which only cost them £3,250 million will have the balance of £650 million left over as extra unspent income, just the amount the Government requires.

It soon appears, however, that this only solves the problem momentarily. For we have no reason to expect that the whole of the unspent windfall profits of £650 million will represent permanent savings. A certain time will elapse before this sum reaches those who will be entitled to spend it. But in the next innings, so to speak, it will be added to the total of potentially spendable incomes, so that we shall have incomes of £5,250 million (£4,600 + £650) facing goods which, after allowing for the continuance of the 20 per cent price rise, are only worth £3,900 million. Moreover, it will be impossible for the Government to keep down the prices of its own purchases if open market prices have risen 20 per cent. Thus we shall soon find ourselves in much the same position as before with a substantial discrepancy between

the amount of money which the public are preparing to spend and the value (at the new price level, 20 per cent higher than before) of the goods available for them to buy. A further rise in prices will be required to provide a temporary respite; and so on.

Fortunately this is not a complete picture of the second chapter of the story. If it were, the voluntary savings system would *not* have been successful, and we should be faced with a progressive inflation of prices without limit. Yet this is not what happened in the last war. And it is not likely to happen this time, even if we pursue the same policy of depending on voluntary savings.

What, then, is the actual course of events? The initial rise in prices will relate to goods which were produced at the lower pre-war price level, and the resulting profits will belong, as we have seen, to the owners of these goods. That is to say, aggregate incomes will indeed rise by £650 million (apart from the effect of any rise in the price of goods bought by the Government), but not everyone's income will rise in the same proportion, if at all. The initial increase of income will mainly belong to a limited class of individuals and of trading and manufacturing companies, whom (without intending any insult, for it is by no fault or intention of theirs) we can call for short "the profiteers." Now the profiteers are liable to a very high rate of taxation, both on account of Excess Profits Tax and because many of them will be rich enough to be liable to a high

rate of income tax and surtax. Thus the profiteers become, so to speak, tax-collectors for the Treasury. More than half (more than three-quarters in some cases)¹ of the £650 million will become payable as taxes. Moreover it is likely that a considerable proportion of the balance will be voluntarily saved; not so much because the recipients, being relatively rich, will save more readily, but because the profits will largely belong to companies which will be disinclined, for various reasons, to distribute the bulk of them in higher dividends but will prefer in the circumstances to save them on behalf of their shareholders. Thus, in fact, only a small part of the £650 million (or of this figure augmented by such higher prices as the Government may pay for its own purposes) will come on the consumption market in the second innings. Instead of another 20 per cent rise of prices being required to preserve equilibrium, it may be that a rise of 2 or 3 per cent would be sufficient. In this case a modest increase of taxation on the general public will be sufficient to offset the increased consumption of the profiteers, and avoid the necessity (if it were not for what follows in a moment) for any further rise of prices beyond the initial 20 per cent.

Unfortunately this is not yet the complete story; for we have now gone to the other extreme, having slipped in an assumption much less troublesome than the facts. We have assumed that, in spite of the rise of 20 per cent in prices,

¹ E.P.T.+Income Tax is 75 per cent, and E.P.T.+Income Tax+Surtax on incomes of £5,000 is 83.5 per cent of the increased income.

workers are content with the same money-wages as before; so that the profiteers continue to make a profit of £650 million in the second innings and to act as tax-collectors for the Treasury on the same scale as before without the aid of any further rise in prices. But in fact the workers will press for higher wages,—with at least partial success. For employers will put up much less resistance than usual to a rise in wages. The scarcity of labour will force them to agree if they are to retain their men; and, since the Government is taking away in taxation 75 per cent of their excess profits, it will not cost them much to share their profiteering with their employees and their salaried staff. If, indeed, wages and other money costs were to go up fully in proportion to the cost of living, we should be faced, as before, with an unlimited inflation, proceeding by 20 per cent at each step,—the process generally known as the vicious spiral.

But we still have one more card to play. Some costs are fixed by law or by contract, so that the *rentier* and pensioner class who have fixed money-incomes cannot escape the sacrifice. Wage adjustments and the like take time. It takes time, and sometimes a considerable time, before adjustments are made even when the pressure is sufficient to make them inevitable sooner or later. It is these time-lags and other impediments which come to the rescue. Wars do not last for ever. Wages and other costs will chase prices upwards, but nevertheless prices will always (on the above assumptions) keep 20 per cent ahead. However much

wages are increased, the act of spending these wages will always push prices this much in advance. If at the end of six months wages and other costs have risen by an average of 10 per cent, prices will have risen 32 per cent (120 per cent of 110). If at the end of two years costs have risen 40 per cent, prices will have risen 68 per cent (120 per cent of 140). Thus, after all, the system of voluntary savings will have worked successfully. That is to say, the money will have been raised "voluntarily" without an unlimited increase of prices. The only condition for its success is that prices should rise relatively to wages to the extent necessary to divert the right amount of working class and other incomes into the hands of the profiteers and thence into the hands of the Treasury, largely in the form of taxes and partly in the form of extra voluntary savings by the profiteers.

The larger the amount of voluntary savings at each stage, the better, of course, it will be for everyone. If the campaign of the National Savings Movement increases the volume of voluntary savings, the necessary rise in prices relatively to wages will be correspondingly smaller. Let us go back to our arithmetical illustration. We started with an excess of spendable incomes, over the available supply of consumption goods valued at pre-war prices, amounting to £1,350 million and we assumed that £700 million of this was voluntarily saved. This left £650 million, or 20 per cent more than the available supply of goods at pre-war prices. But if the National Savings

Movement were to be successful in increasing the amount of the voluntary savings by (say) another £100 million, making £800 million altogether instead of £700 million, then the excess of spendable incomes is reduced to £550 million or about 17 per cent above the available supply at pre-war prices. In this case we can reach equilibrium with a rise in prices only 17 per cent (instead of 20 per cent) in excess of the rise in wages and other costs.

Thus an increase in voluntary savings is entirely beneficial. There is nothing to be said against it, except its inadequacy. The question for the individual is whether he would prefer to become £2 richer by deferment of pay, and have no inflation of prices or become £1 richer by voluntary savings, and suffer inflation with its evil social consequences. For the individual (unless he belongs to the profit-making class) the answer is surely obvious. He is certain to gain by the system of deferment. It is like asking him whether he would prefer to have a compulsory rule of the road with few accidents and no traffic congestion, or a voluntary rule with many accidents and much traffic congestion.

For the Treasury and for future taxpayers the answer is not so obvious. A system of deferment of pay—and equally, a system of highly successful voluntary savings—will leave us with a larger national debt measured in terms of real value, than if we adopt the method of imperfectly successful voluntary savings supplemented by inflation. For inflation is a mighty tax-gatherer.

But the Treasury and the tax-payer of the future need only remain in doubt if they expect the price-level reached by inflation to continue permanently. For the national debt under the inflationary system is likely to be larger in terms of money than under the system of compulsory savings; so that if prices subsequently fall back, the benefits of inflation will have proved illusory even to the Treasury.

Thus it is quite true that, in the last resort, the amount of saving, necessary to balance the expenditure of the Government after allowing for the yield of taxation, can always be obtained by "voluntary" savings. But whether this is a good name for it is a matter of taste. It is a method of *compulsorily* converting the appropriate part of the earnings of the worker which *he* does not save voluntarily into the voluntary savings (and taxation) of the entrepreneur. "We shall depend on the voluntary system" is another way of saying "We shall depend on inflation to the extent that is necessary." Sir Robert Kindersley in his Savings Campaign could justly argue as follows:

"The Government needs the money. But this is a free country. Someone, therefore, must save it voluntarily. If you (and your friends) do not do so, the necessary amount will be taken compulsorily from the real value of your earnings through the action of higher prices and handed to the profiteer; and *he* will save it voluntarily (such part as he does not pay in compulsory taxes). In this way we shall avoid

any departure, which would be anathema to the city, from the voluntary system."

Ambiguous though this may be, as a defence of the principles of liberty, it would be a sound and convincing argument to the worker in favour of increased saving if it were not for one flaw. An individual cannot by saving more protect himself from the consequences of inflation if others do not follow his example; just as he cannot protect himself from accidents by obeying the rule of the road if others disregard it. We have here the perfect opportunity for social action, where everyone can be protected by making a certain rule of behaviour universal.

This analysis of how inflation works is fundamental. And it is fairly simple. But it is not yet understood by everyone,—for the reason, surprising perhaps, that it is comparatively novel. Economists have only got clear about it (although it is a case much simpler than what happens in peace-time, when, instead of a fixed maximum output, we have to allow for the effect of fluctuations in employment) in the last quarter of a century, since, that is to say, those now in authority acquired their dogmas. During the last war I was in the Treasury. But I never at that time heard our financial problem discussed along these lines.

It will be interesting, therefore, to throw our minds back and consider, in the light of this analysis, what happened on that occasion.

July	Money Wage Rates	Cost of Living		Real Wage Rates	
	Rough average of per cent increase in the wages of the workers mentioned below ¹	Labour Gazette Index	Modified Index ²	According to: Labour Gazette	Modified Index
1914	100	100	100	100	100
1915	105-110	125	(120)	84-88	87-92
1916	115-120	145	(135)	79-83	85-89
1917	135-140	180	(160)	75-88	84-88
1918	175-180	205	180	85-88	97-100

Thus, the Labour Gazette index of the cost of living rose by 25 points a year and the modified index (compiled in 1918) by 20 points a year, with the truth probably lying between the two; and by the end of the war the value of money was about halved. As against this, money wage rates rose on the average about 10 points a year during the first half of the war and about 30 points a year during the second half. The net result was that the purchasing power of wages during the first three years of the war up to July 1917 ranged about 15 per cent less than before the war. The considerable recovery shown in the last year and a half of the war was made possible by the relaxation of financial pressure due to the entry of the United States, but the extent of it is difficult to calculate accurately on

¹ Bricklayers, Bricklayers' labourers, Compositors, Railwaymen, Dock labourers, Cotton operatives, Woollen and worsted operatives, Engineering artisans, Engineering labourers, Ship-building platers' time rates, Coal mining, Agriculture England and Wales.

² The Modified Index is based on the findings of the Sumner Committee in 1918. The chief differences from the official index arise with respect to clothing, sugar, butter, margarine. The Sumner index allows for substitution when the pre-war qualities were not obtainable on the market. The official index does not.

account of the statistical deceptions arising out of the change of system and of the diversion of consumption after the introduction of strict rationing and fixed prices.

The above analysis tells us how to interpret these results. The volume of spendable earnings (which increased more rapidly than wage-rates owing to better employment, overtime etc.) increased 15 per cent relatively to the supply of consumption goods (rather less than this at first and rather more eventually), as is indicated by the 15 per cent rise in prices relatively to wages. This rise in the cost of living provoked a corresponding rise in wage-rates with a time-lag of almost exactly a year and was off-set simultaneously by an equal further rise in prices. In each year wages rose almost exactly to the price-level of the previous year. Thus the time-lag was just long enough to prevent disaster. If prices have to keep 15 per cent above wages and if wages rise half this amount in the first year and then follow prices with a time-lag of a year, we can get through four years of war by a little less than a doubling of prices. How closely this rule of thumb corresponded with the facts is shown in the following table:—

	<i>Theoretical rate of rise</i>		<i>Actual rate¹</i>	
	<i>Wage Rates</i>	<i>Prices</i>	<i>Wage Rates</i>	<i>Prices</i>
1914	100	100	100	100
1915	107½	122½	107½	122½
1916	122½	141	117½	140
1917	141	161	137½	170
1918	161	185½	177½	192½

¹ Average of the two estimates.

But what a ridiculous system with wages and prices chasing one another upwards in this manner! No one benefited except the profiteer. The seeds of much subsequent trouble were sown. And we ended up with a National Debt vastly greater in terms of money than was necessary and very ill distributed through the community. Compare this with a system of deferment of pay. A levy averaging 15 per cent would have allowed the same relationship as before between money wage-rates and the cost of living; so that the pressure of the former to chase the latter upwards would have been withdrawn. The real consumption of the working-classes would have remained in the aggregate exactly the same as under the inflationary system. If average earnings at the old wage-rates were 15 per cent higher than before on account of fuller employment and overtime (which is approximately what happened in fact), the working class standard of consumption would have been maintained at the pre-war level without any sacrifice except the harder work accomplished. This harder work would have been recompensed by the workers becoming the owners of a significant proportion of the National Debt. For at the end of the war (to take very conservative figures) the money total of the National Debt would have been reduced by more than £2,000 million, and of this reduced total more than £500 million would have belonged to wage and salary earners instead of to the profiteers. That is to say, dependence on the method of "voluntary" savings in the last war put some

£2,500 million into the pockets of the entrepreneur class.

In the last war we achieved the miracle of maintaining aggregate working-class consumption at, or near, its pre-war level,—the fall in real wage-rates being offset by increased employment and hours worked. I am not yet convinced that we may not achieve the same result this time. Until the full economic demands of the war have been disclosed, one cannot tell. But if aggregate earnings at the existing wage-rates increase because of overtime and full employment, a rise in basic wage-rates sufficient to compensate for higher prices would set our national economy the impossible task of raising consumption *above* the pre-war level. We cannot reward the worker in this way, and an attempt to do so will merely set in motion the inflationary process. But we can reward him by giving him a share in the claims on the future which would belong otherwise to the entrepreneurs.

CHAPTER X

THE SYSTEM ADOPTED IN FRANCE

It is worth pointing out that the proposals of this pamphlet are exceedingly mild (and may well prove much milder than we can afford) compared with the measures adopted in either of the other two belligerent countries, enemy and allied.

In Germany there have been rumours of the

adoption of a system of deferred pay which would bear a superficial resemblance to the above. But if these reports are correct, this measure would be on the top of other measures already taken which are far more drastic than anything suggested here,—a complete fixation of wages, hours and prices, a comprehensive system of rationing supplemented by shop shortages and prohibitions of every kind, and a series of deductions from wages, quite apart from any system of deferred pay, which already add up to a formidable total several times heavier than the scale of deferred pay proposed above for the lower group of incomes. I wish I was in a position to give more exact, quantitative particulars. But I should guess that if we were to enforce in this country a control of general consumption as drastic as that which is already in force in Germany, we should be in a position to increase our war effort by fully 50 per cent and perhaps substantially more. We shall, therefore, reject at our peril initial measures at least on the scale here recommended, or their equivalent.

Since the German system in its entirety is that which it is our object to avoid even as a temporary measure by any means short of jeopardising ultimate victory, it may be more to the point to quote the measures which have been adopted in France. For reasons which are not entirely due to the censorship a veil seems to separate us from what is happening in France almost thicker than that which divides us from the enemy. British public opinion is, I believe, almost

completely unaware how far-reaching is the French control over wages and the conditions of labour.

By a series of official decrees culminating in that of November 16, 1939, a complete official control has been established over wages and the conditions of labour, more far-reaching in the munition industries and less so in the others. In the non-munition industries wages must not be changed from their pre-war level by collective agreement or otherwise without the approval of the Minister of Labour. In the munition industries wages are fixed by the Minister of Labour and the Minister of Munitions (or other service department); employers are prohibited from paying wages in excess of a stipulated maximum (in general the pre-war level); employees may not leave their present employment without permission and may be moved by the authorities at will. Thus any tendency towards a rising wage level has been legally inhibited at the outset.

In addition to this a fund has been established called the National Solidarity Fund out of which will be met any special expenditure in the civilian sphere due to the war, including, I think, any losses arising out of official measures to keep down the cost of living. Into this Fund there will be paid the proceeds of an excess profits tax and a general levy on wages. The levy on wages consists of:

(a) 15 per cent of the wages of workers who are liable to military service, but have been exempted

because, as we should express it, they are in a reserved occupation;

(b) the whole of the earnings both of these and of all other workers in respect of their work between 40 and 45 hours a week, and one third of their earnings in respect of hours worked above 45 a week. (In the numerous cases where the hours of work are now 50 a week or more, this works out at almost another 15 per cent).

Against this there are rigorous measures to maintain the cost of living at the pre-war level, but, so far, rationing has been avoided. I have no particulars how this is working out in practice or whether it is involving the French Treasury in expensive subsidies in the case of imported or agricultural goods.

This account is imperfect and perhaps inaccurate as an up-to-date statement. I hope that its publication may stimulate a Frenchman into giving us a fuller account of the French home front than I have found readily available at present.

In a talk to the French nation over the wireless at the end of January, 1940, M. Daladier commended these stern measures to the civilian population and urged their willing acceptance of them in the following terms:—

“When they left for the frontier, our sons accepted a total transformation of their lives. Those who have stayed behind and do not have to put up with the same sufferings and dangers must also agree to transform their lives. They must sacrifice their personal interests, renounce certain commodities. Above all, they must con-

centrate all their strength and activity in the service of the French community without which they would be nothing. It would be vain and even criminal to conceal the fact that Germany's material power is one of the most formidable in the world. The issue at stake is not merely the existence of the nation, but our whole conception of life. . . . To-day it is to the France behind the lines that I wish to speak. I wish to speak to it with candour and even brutality. . . . It is essential, in a word, that those of the interior succeed in making themselves respected by those at the front through work, renunciation and discipline." And in conclusion he summed up German propaganda which speaks like Satan, as follows: "It says to the wealthy, 'You are going to lose your money.' It says to the worker, 'This war is the war of the wealthy.' It says to the intellectual and the artist, 'All that you love is threatened by destruction.' It says to him who loves the goods of this world, 'A few months more and you will have to accept painful restriction'. It says to the believer, 'How can your faith accept this massacre?' Finally it says to the adventurer, 'A man like you can make something out of your country's misfortunes.'"

It is well to conclude this pamphlet with these eloquent words of the leader of a nation at war—even if it makes the careful humanitarian arguments and apologetically mild proposals of the previous pages sound pitiful and weak.

APPENDIX I

THE NATIONAL INCOME

THE discrepancies between various current estimates of National Income are more largely due to different ideas of the meaning of this concept than to strictly statistical differences,—uncertain though many of the underlying statistical estimates may be. The following note accepts Mr. Colin Clark's statistics, but not his concept of gross national income, without attempting to go behind them or to criticise them. The actual figures given are Mr. Clark's brought up to date where necessary by Mr. Rothbarth for the financial year April 1, 1938—March 31, 1939 in terms of the prices of that year.

There are two fundamental concepts which are serviceable for general use. The first is the total current output measured in terms of money cost, already given in the text, namely:

£ million

3,710	current value of private consumption excluding indirect taxation but including the cost of making good current depreciation;
290	current cost of net new investment in buildings, plant, transport and stocks, <i>i.e.</i> , current capital outlay in excess of what is required to make good current capital depreciation;
850	current cost of Government operations excluding "transfer" payments to pensioners, holders of national debt, etc., expenditure out of which is already included in the previous items.

4,850

I propose to call this the National Output.

The second concept is that of Taxable Income, namely the aggregate of individual incomes (including charities, private institutions and companies). It differs from the above in that it includes "transfer" incomes of £500 million and excludes Government non-tax income of £50 million from trading profits. It follows that its amount is £5,300 (£4,850+£500—£50) million. It can also be broken down into the following constituents:—

	<i>£ million</i>
Private consumption at market prices (made up of indirect taxes and rates £670 million and current value £3,710 million including current depreciation as above)	4,380
Private saving (made up of £290 million new investment as above and £80 million lent to the Government to cover the excess of the cost of Government operations over revenue from taxes and trading profits)	370
Direct taxes	550
	<u>5,300</u> ¹

It may be useful to add a list of the principal elements out of which these or other concepts of income can be built up.

Government Income and Outlay (Central and local)

	<i>£ million</i>
Government Income: Direct Taxes	550
Indirect Taxes	460
Rates	210
Government Trading Profits	50
Loans from the public (net)	80
	<u>1,350</u>
Government Outlay: Transfer Payments	500
Govt. Services	850
	<u>1,350</u>

The above Government Outlay does not include Government expenditure on investment in new houses, roads, etc. (£50 to £100 million), since this has been already included in the estimate of investment (which, being based on the Census of Production, inevitably includes all such investment whether by Government or private agencies). To balance this, the above figure for loans from the public is correspondingly reduced below the actual amount borrowed

¹ The reconciliation between my *Economic Journal* figure of £5,700 million and the above figure is as follows: deduct £380 million for depreciation included twice in Mr. Clark's figure (total current depreciation £420 million less £40 million upkeep of roads by the Government not included twice), £50 million for Government trading profits previously included in private profits, and £30 million due to a revised estimate of the Government deficit. The logical difficulties lying behind these figures I am discussing in detail in the March (1940) *Economic Journal*.

by the Government and represents only that part required to cover the net current deficit exclusive of the above investment expenditure.

<i>Private Income and Outlay</i>		£ million	
<i>Private Income:</i>	Wages and Profits derived from current output . . .	4,800	
	Transfer Incomes	500	
		<u>5,300</u>	
<i>Private Outlay:</i>	Consumption at market prices	4,380	
	Saving	370	
	Direct Taxes	550	
		<u>5,300</u>	
<i>National Output:</i>	Private and Government consumption apart from making good wastage and depreciation	4,140	
	Making good wastage and depreciation	420	
	New investment	290	
		<u>4,850</u>	
	Private wages and profits derived from the above . . .	4,800	
	Government profits	50	
		<u>4,850</u>	
	<i>Gross Investment:</i>	Net new investment	290
		Making good wastage and depreciation	420
			<u>710</u>
<i>Saving:</i>	Net new investment	290	
	Government deficit	80	
		<u>370</u>	
<i>Distribution of Private Incomes:</i>	Individuals below £250 a year	2,910	
	Individuals above £250 a year	2,340	
	Charities	50	
		<u>5,300</u>	

Undistributed incomes of companies, etc., are included as part of the incomes of the individuals owning them.

<i>Sources of Incomes below £250 per year :</i>		<i>£ million</i>
Wages and salaries		2,390
Incomes of independent workers, employees and unoccupied workers		240
Transfer incomes		280
		<hr/> 2,910

<i>Expenditure of Incomes below £250 per year :</i>		
Value ¹ of Consumption		2,420
Rates and Taxes		390
Saving		100
		<hr/> 2,910

<i>Sources of Incomes above £250 per year :</i>		
Salaries and profits		2,170
Transfer incomes		220
		<hr/> 2,390

<i>Expenditure of Incomes above £250 per year :</i>		
Value ¹ of Consumption		1,290
Rates and Taxes		830
Saving		270
		<hr/> 2,390

The sources of the above figures are given in the *Economic Journal*, Dec. 1939, p. 638.

APPENDIX II

THE EXTENT OF OUR RESOURCES ABROAD

AN important source of our war strength, both in itself and especially in comparison with the enemy's, lies in our capacity to finance an adverse balance of trade out of the resources which we had accumulated before the war in the shape of gold and foreign investments.

¹ Spread over private consumption and government services, the cost of making good wastage works out at 8½ per cent. This is included in the above value.

On March 31, 1939, the gold resources of the Bank of England and the Exchange Equalisation Fund amounted to 79,950,000 ounces, worth £671,600,000 at the present value of gold (168/- per oz.). Between that date and September 1 there was a substantial reduction to meet withdrawals of foreign balances from London, but the figures for later dates are not being published. The Federal Reserve Board of the United States has, however, published an estimate of the resources of the belligerents on the eve of the war (end of August, 1939) according to which British gold holdings had fallen by that date to approximately £500,000,000. This figure has to be taken in conjunction with a similar estimate of £750,000,000 gold held by France at the end of August and £54,000,000 held by Canada. It takes no account of other Empire gold reserves or of the annual output of newly mined gold within the Empire estimated at £187,000,000.

This authority estimates British dollar balances at the same date at nearly £150,000,000, French dollar balances at nearly £80,000,000 and Canadian dollar balances at nearly £90,000,000. There is no available estimate of other British balances abroad.

Sir Robert Kindersley has estimated the total nominal capital of British foreign investments at the end of 1938 at nearly £3,700 million, of which, however, only a fraction is easily realisable. About £3,000 million of this total consisted of sterling loans and of shares of companies registered in Great Britain, most of which could not be realised. Nevertheless there is a fair proportion of these holdings which is being repaid each year in ordinary course, say £40 to £50 million annually; and some substantial loans for which repayment could be arranged in existing circumstances (an important Canadian loan already dealt with in this way is a case in point) are included in this total. Perhaps we could put the total figure thus realisable over a period of three years at not less than £250,000,000.

Holdings in companies registered abroad, estimated by Sir Robert Kindersley at nearly £700,000,000, can be regarded as much more liquid. The U.S. Federal Reserve Board estimate of British holdings of American readily marketable securities at the outbreak of war is about £185,000,000, to which can be added in case of necessity a further £225,000,000 of other securities, including direct British owned property in U.S.A. It is interesting to note that, according to American

reports, about 10 per cent of the above marketable securities (*i.e.* £18,000,000) was in fact liquidated in the first two months of the war.

Some offset must be allowed against the above for the subsequent withdrawal by foreigners of assets held in Great Britain at the beginning of the war. The existing exchange restrictions are effective against British nationals, but by a strange oversight (unless it is a deliberate decision in the interests of the City as an international banking centre after the war) are not effective against the withdrawal of assets by foreigners. I do not make any important allowance for this, partly because the level of the free exchange (over which such transactions are carried out) does not at present indicate any serious pressure for such withdrawals, and partly because if such pressure were to develop we can scarcely suppose that the post-war interests of the City will be preferred to the immediate task of winning the war. It may be that a large part of apparent foreign balances and other assets, which were still held in London at the outbreak of war, were not free assets strictly speaking, but were necessary to meet various contingent liabilities in sterling or for the purposes of current business.

Indeed so far from making an important allowance for withdrawals, we can safely reckon, I think, when we are considering the British balance of payments, as distinct from that of the Empire or sterling area, on considerable annual accretions of Empire and other over-seas balances left in London. In the last war, even during its darkest days, such increases played an important part and had reached a huge figure by the end of it. I should guess the annual gain from this source at not less than £100,000,000 and it might well be more.

It would not be prudent to add up all the above figures, which are subject to considerable error, in order to reach a final estimate of available foreign resources. Nevertheless, taking everything into account, I suggest that we can put the total of our fairly liquid assets at a figure of the order of £1,000 million at least; and allowing also for the gradual increase in our liabilities to overseas creditors, we can finance for more than three years an adverse balance of payments of the order of £350 million annually.

Our total gold and dollar resources are appreciably greater than in 1914 (*cf.* table below) in spite of our dollar securities

being much less; and immeasurably more liquid, inasmuch as they are now predominantly gold. French holdings of gold and dollar resources are not far short of double what they were in 1914, and Canadian some ten times. Taking Great Britain, France and Canada together, gold and dollar resources are not far short of double what they were in 1914. Germany's similar resources, on the other hand, which in 1914 were nearly half of our own, are to-day less than one-twenty-fifth of ours and less than one-fiftieth of the total allied resources. Moreover, our liability to Allies, which was our over-whelming financial task in the last war prior to the entry of the United States, is to-day negligible in comparison. Since all monetary commitments are on a much larger scale now than they were twenty-five years ago and since an evident power to endure indefinitely is essential, utmost economy in the use of foreign resources and utmost effort to add to them by exports are of the first importance. Nevertheless, I cannot agree that we start, taking everything into account, with inferior financial staying power than in 1914. The ability of the sterling and French area to meet a continuing adverse balance of trade is, taken in the aggregate, enormous; whilst the foreign resources of the enemy are non-existent and already replaced by liabilities.

U.S. FEDERAL RESERVE BOARD ESTIMATE

End of August 1939

(£ million at \$4 to the £)

	<i>Central Gold Reserves</i>	<i>Dollar Balances</i>	<i>Securities readily marketable in U.S.A.</i>	<i>Direct & other in- vestments in U.S.A.</i>	<i>Annual Gold Production (1938)</i>
Great Britain	500	149	184	225	—
France	750	79	46	20	—
Canada	54	89	125	140	41
Other British & French countries	135	—	—	—	146
TOTAL	1,439	317	355	385	187

APPENDIX

COMPARATIVE GOLD AND DOLLAR RESOURCES
(1914 and 1939)
(U.S. Federal Reserve Bulletin: Approx. figures in millions
of dollars)

	<i>Total Gold and Dollar Resources</i>	<i>Central Gold Reserves</i>	<i>Monetary Gold out- side Cen- tral Re- serves</i>	<i>Dollar Resources</i>
	1939	1914	1914	1914 ¹
United Kingdom	4,230	3,365	165	600
France	3,580	2,045	680	965
Canada	1,630	115 ²	115	—
Total	9,440	5,525	960	1,565
Germany	160	1,505	330	475
				700

APPENDIX III

THE COST OF FAMILY ALLOWANCES

IN round numbers there are 10,000,000 children in the country up to 15 years of age. Thus the gross cost of a weekly allowance of 5/- for every child, *i.e.* an annual allowance of £13, is £130,000,000. A more exact estimate is £132,000,000. There are, however, some important offsets against this, as follows:—

(1) About £20,000,000 of the above cost is in respect of children of income-tax payers. It has been assumed above as a rough approximation that the existing income-tax allowances already cost as much as the new allowances which will take their place; so that there is no additional cost on this head.
(2) In 1937 there would have been the following saving in respect of existing allowances:—

	£
Ordinary pensions . . .	2,500,000
Unemployment Benefit . . .	2,750,000
Unemployment Assistance . . .	8,500,000
	<u>13,750,000</u>

¹ Estimates given in *Review of Economic Statistics*, Vol. I, p. 230. Much higher estimates were given by Sir G. Paish in 1910 before the U.S. National Monetary Commission. But the above take account of later information and are more reliable.

² Gold only.

(3) In 1940 the saving in respect of the children of the unemployed is likely to be less than in 1937. On the other hand, there will be additional war-time savings in respect of payments for evacuated children and separation allowances.

Thus, taking everything into account, a net cost of £100,000,000 should be a safe figure.

If the allowances were to be given only in respect of the second and subsequent children, the cost would be more than halved and could be safely estimated at not above £50,000,000. An allowance of 3s. (in place of 5s.) to the second and subsequent children would, therefore, cost less than £30,000,000, or more exactly £27,000,000. If the allowances were to be restricted to the third and subsequent children the cost would be more than halved again, amounting (at 5s.) to some £20,000,000; and a restriction to the fourth and subsequent children again halves it, bringing it down to about £9,000,000.

APPENDIX IV

THE FORMULA FOR THE AGGREGATE OF DEFERRED PAY AND DIRECT TAXES

The results given in Chapter 6 above result from the following formula. For incomes up to £750 a year, 35 per cent of the excess of the income over the basic minimum of 35s. a week for an unmarried man and 45s. for a married man. This is, of course, very far from a flat rate, since the proportionate effect of the fixed allowance is much greater at the lower income ranges, as appears in the table in Chap. VI, where the proportion of income withheld is shown to rise under this formula from 3½ per cent at 50s. a week to 29 per cent at £700 a year. For the higher income groups the percentage of the excess of income over the basic minimum rises as follows:

<i>Per cent of excess over basic incomes</i>	
£750—£2,000	40
£2,001—£3,000	45
£3,001—£5,000	55
£5,001—£10,000	65
£10,001—£15,000	70
£15,001—£20,000	75
£20,001—£50,000	80
Above £50,000	85

The above does not attempt so elaborate a system of allowances as the income tax, and in particular it makes no distinction between earned and unearned income. As a result of this, some of those who receive special consideration under income tax would have a larger proportion of their earnings deferred than those who do not receive such consideration. It would be easy to tackle those minor anomalies in a fully detailed scheme; but it would only confuse the main issues if I were to attempt to deal with all of them here. It may be that the allowance to married men is insufficient. It might be advisable to grade more finely by introducing a larger number of steps, and there should be a provision to prevent sudden jumps. It would certainly be desirable to include a clause similar to that in the latest Finance Act for mitigation where a man's income has fallen substantially below its pre-war level.

Acknowledgments

The substance of the plan here proposed was originally published in *The Times* in two articles on November 14 and 15, 1939, followed by a third article replying to criticisms on November 28 and a letter on December 1. These contributions were supplemented by an article giving the statistical background which appeared in the *Economic Journal*, December, 1939, page 626.

I have been assisted throughout on the statistical side by Mr. E. Rothbarth of the Statistical Department, Cambridge University, who is responsible, in particular, for the estimated division of total income between the income groups.

The cost of family allowances is based on figures supplied by the Family Endowment Society. Family allowances have been advocated in many quarters, particularly by Mr. Amery, Miss Eleanor Rathbone and Mrs. Hubback.

The proposal to meet deferred pay out of a post-war capital levy was first made by Prof. von Hayek in an article published in the *Spectator* on November 24, 1939.

The proposal for the maintenance of an "iron ration" at a low price was first made to me by Sir Arthur Salter. It has also been advocated by Mr. R. H. Brand in *The Times*, and, in more detail, by Prof. and Mrs. Hicks in the *Manchester Guardian*.

I am indebted to many critics and correspondents besides the above.