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THE ECONOMICS OF
WAR AND CONQUEST



THE ECONOMICS OF WAR AND CONQUEST

AN EXAMINATION OF
MR. NORMAN ANGELL'S
ECONOMIC DOCTRINES

BY

J. H. JONES, M.A.

LECTURER ON SOCIAL ECONOMICS IN THE UNIVERSITY
OF GLASGOW; HONORARY DIRECTOR OF THE GLASGOW
SCHOOL OF SOCIAL STUDY AND TRAINING



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it rests upon economic grounds, would have met with universal approval. But he has travelled far beyond this simple truth, and by creating controversy about assertions which are either false or incapable of proof has obscured what is beyond controversy and yet sufficient in itself. In the following pages it will be shown that some economic gain may be achieved by means of a war of conquest. But the money value of the expectation of such gain is considerably less than the money cost of such a war.

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The references in the text are to the 1914 edition of "The Great Illusion."

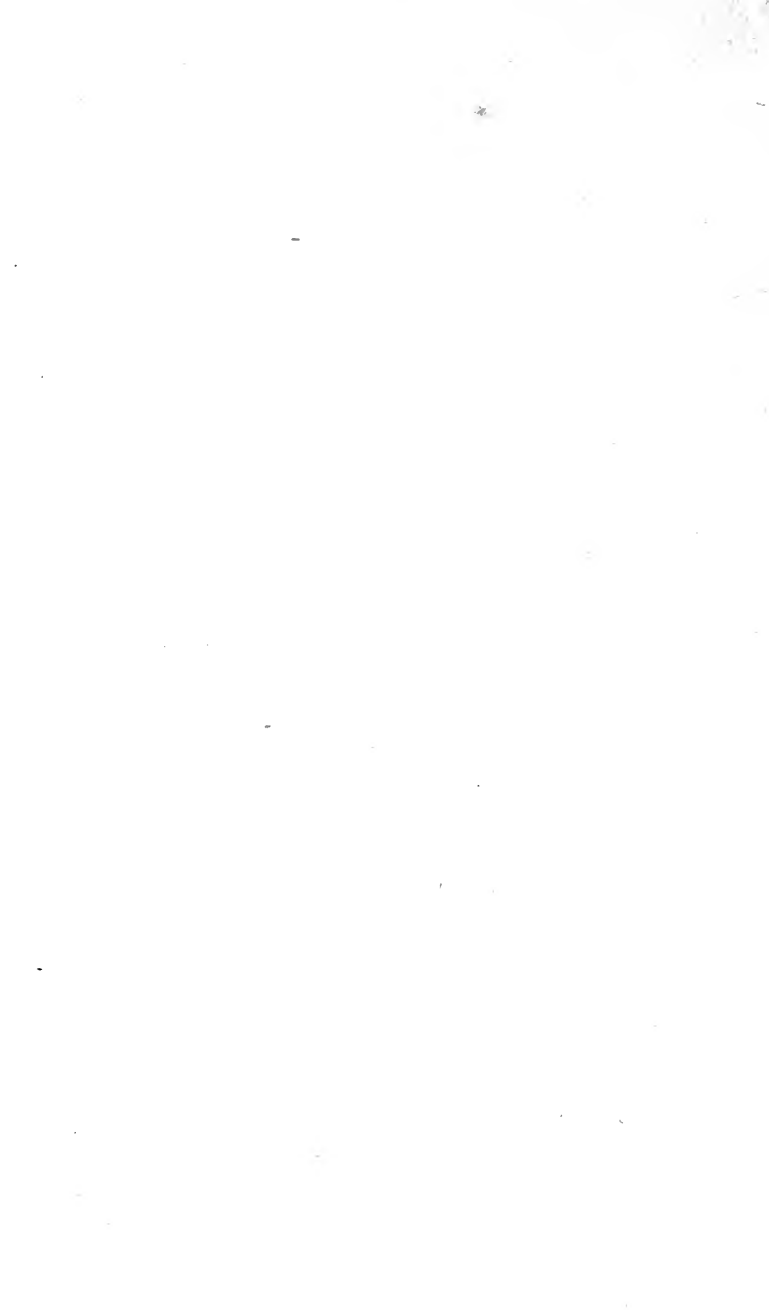
J. H. JONES.

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INTRODUCTION.

IF the value of a book is measured by the attention it commands and the discussion it provokes, "The Great Illusion," by Mr. Norman Angell, probably ranks first among recent contributions to the study of international relations. Mr. Angell and his followers have declared war upon war itself. They do not fight alone, but they fight with new weapons, and follow a different plan of campaign. It is the writer's object to examine the value of one of the instruments of attack—the heavy artillery—and to indicate the ways in which it has been and might be employed. And it may be stated here that, whereas the noise of the heavy guns is deafening, the writer believes the damage wrought among the enemy's defences to be far less than is generally supposed to be the case. He believes, moreover, that the campaign is one for which the heavy artillery employed by Mr. Angell is not required.

The artillery or "economic" attack upon the enemy forces—military power, war and conquest—which is made in the

first part of "The Great Illusion" may be briefly described as follows:—(1) The wealth and prosperity of a nation are independent of military power. That small, almost defenceless, countries like Holland are regarded by investors as more secure than military powers like Russia or Germany is clearly indicated by the relative prices of their national stocks. (2) War, accompanied by looting, would result in financial chaos; capital would be disturbed, and the credit system would collapse. If Germany invaded Great Britain and looted the Bank of England, the damage to Germany herself would far exceed the gain from such looting. Nor could compensation be sought by means of tribute, which, under present industrial conditions, is an economic impossibility. (3) If an indemnity is not inevitably futile, its value to the conquering nation must be largely discounted by the difficulties of transferring a large sum of money from one country to another outside the channels of ordinary commerce. The payment of an indemnity of £200,000,000 by France to Germany after the war of 1870 proved to be disadvantageous to the recipient. Germany would have been better without it. (4) Annexation and colonial expansion bring no economic advantage. Germany, for example, has gained nothing by annexing Alsace-Lorraine, while the

British colonies are not a source of special profit to the mother country. Finally, an invading army could not destroy the trade of the victim without destroying the market of its own people. The prosperity of Germany is bound up with the prosperity of this country, consequently a victorious German army would be compelled, from purely selfish motives, to leave Britain exactly as it was before invasion. The corollary is that defence, as well as aggression, is economically futile. Since no loss is suffered through invasion, no economic object is achieved by resistance. These propositions are examined separately in the chapters which follow.

Mr. Angell limits the application of his theory of the economic futility of war and conquest to nations which have come completely under the sway of the industrial revolution. He deals with those communities which are "firmly set," and in which the modern features of economic organisation find full expression. The main features relevant to the present discussion are (a) a considerable degree of dependence upon foreign countries for the necessaries of life and the raw materials of manufacture; (b) the existence of joint-stock companies controlling large investments of capital; (c) a highly-developed system of credit. These are inter-related,

for not only is foreign trade largely carried on by joint-stock companies employing credit instruments in the course of trade, but the shares of such companies, together with the corporate debts of communities, are bought and sold on the Stock Exchange, whose operations play an important part in the credit system.

The function of the modern bank is to focus the savings of the community and disperse them to be employed as capital by those who, presumably, are best able to make use of it. The performance of this double function has resulted in the creation of a complex mechanism which will need examination as the argument proceeds. A delicate web of finance, woven through the centuries, has spread during the last fifty years or so to the ends of the earth. Again, the development of the banking system, combined with the introduction of the principle of limited liability, has facilitated the formation of joint-stock companies to control immense undertakings which, as a result partly of inventions and partly of other economies of large organisations, it would have been impossible for an individual to control. The ownership of such undertakings can be transferred by the sale and purchase of "shares." And the Stock Exchange is the marketplace of such shares, together with the

bonds of Governments. The market for the stocks and shares of some undertakings, such as railways, as well as for most Government bonds, is world-wide. The result is that the "owners" of Argentine railways may to-day be Englishmen and to-morrow Canadians or Germans. The creditors of a Government may be Egyptians, Poles, or Americans.

It is necessary to distinguish clearly between the cost of constructing, say, a railway, its market value as indicated by the price of the stock representing it, and the tangible assets of the undertaking as they appear on the annual balance-sheet. The first two may differ materially. For the value of stock in the market depends, other things being equal, upon the anticipated net earnings of which it is the capitalised value, and over a long period it varies roughly with the actual dividends paid ; but since at any moment it depends upon the profit expected in the future, and since such expectation is affected by the political situation, it will be evident that war or the prospect of war is bound to react upon the Stock Exchange. The world-wide ramifications of credit and trade, combined with the interdependence of the banking systems of all nations, and the dependence of each upon continuity of production and sale, have made it practi-

cally impossible for war to be waged between two nations without dislocating, more or less severely, the trade and affecting the credit relations of all other countries.

This internationalisation of credit has been the main factor which, in Mr. Angell's view, has rendered war and conquest futile. Wealth has become "intangible," and cannot, therefore, be carried away in sacks by the looting conqueror. The credit system provides the "sensory nerves" of the body economic, and if credit is destroyed the result will be similar to that produced by the destruction of these nerves. It is always dangerous to argue by analogy; and in this case particularly it seems as if Mr. Angell has not escaped the pitfalls. Our own experience during the first two months of the present war suggests that the financial system should rather be regarded as the driving machinery of the world factory. It broke down, but it was not beyond repair. And the reduction in output of the world factory is due not to defective work on the part of this machinery, but to other and obvious reasons connected with actual warfare.

Mr. Angell asserts that the economic motive to war is strongly operative among modern nations. Usually the policy of aggression is chiefly dictated by the prospect of material gain. But Mr. Angell does not,

as some of his critics seem to believe, argue that the economic motive to war is the only one in operation. He does not ignore other factors. In the second part of "The Great Illusion" he seeks to prove that conquest is as futile in the moral and political sense as in the economic, and that war is by no means a "biological necessity." Nevertheless, some of Mr. Angell's statements convey the impression that he believes the economic motive to dominate all others, and that, if the economic futility of war were clearly recognised, universal and everlasting peace would not be long delayed.

In the course of a discussion of the influence of financiers on war he writes: "It cannot be too often repeated that the necessary profitlessness of war between civilised nations, (the necessary interdependence of nations, will not stop war. It is the *general recognition of profitlessness and interdependence that will stop war.*¹) Impersonal forces, the Stock Exchange and the rest of it, will certainly push these truths more and more into our notice" ("Foundations of International Polity," pp. 138-9). To interpret "profitlessness" and "interdependence" in the material sense may be wrong, but, in their context, it is the natural inference. Again, on the first page of the synopsis of the book which brought him fame ("The Great

¹ The italics are mine.—J. H. J.

Illusion"), we find the following: "What are the fundamental motives that explain the present rivalry of armaments in Europe, notably the Anglo-German? Each nation pleads the need for defence; but this implies that someone is likely to attack, and has therefore a presumed interest in so doing. What are the motives which each State thus fears its neighbours may obey? They are based on the universal assumption that a nation, in order to find outlets for expanding population and increasing industry, or simply to ensure the best conditions possible for its people, is necessarily pushed to territorial expansion and the exercise of political force against others; . . . it is assumed, therefore, that a nation's relative prosperity is broadly determined by its political power; that nations being competing units, advantage, in the last resort, goes to the possessor of preponderant military force, the weaker going to the wall, as in the other forms of the struggle for life. The author challenges this whole doctrine." The immediately relevant sentences may be paraphrased as follows: It is universally believed that territorial expansion may become an economic necessity for some nations; others fear that such expansion may be at their expense, *ergo* they prepare to meet that contingency by creating armies and navies.

Is it not natural, in view of these statements, that critics should have accused Mr. Angell of losing sight of the other and deeper forces at work?

But in other parts of his books he recognises the influence of other forces. These, however, are not relevant to the subject of this book, which is concerned only with his economic doctrines. Reference was made to them merely to avoid the possible charge of neglect or misrepresentation.

The first chapter of this book is devoted to an examination of Mr. Angell's main thesis. The meaning of the phrase "the economic futility of war and conquest" is indicated, and some of the supposed analogies are discussed. In the second, third, fifth, and sixth chapters the particular propositions which together constitute his case are analysed, while the fourth chapter deals with the immediate effects of the present war upon the credit systems of Great Britain and Germany. The reader will thus be able to estimate, in the light of recent experience, the value of Mr. Angell's treatment of finance. (The final chapter deals with the material cost of war, and indicates, in a very general way, the effects of war upon the production and distribution of the national income.)

THE ECONOMICS OF WAR AND CONQUEST.

CHAPTER I.

MR. NORMAN ANGELL'S THEORY.

THIS book is not a defence of war. On the first page of "The Foundations of International Polity" Mr. Norman Angell rightly contends that "the correction of any widespread misconception touching large human issues, or the correction of any misinterpretation of facts or false reasoning concerning them, is desirable in itself, and is its own justification, even when the immediate practical import is not apparent." These words express, with sufficient accuracy, my reason for attempting to write, in language free from the technical terms of economic science, a book devoted largely to an examination of those theories of Mr. Angell which have led him to affirm that war is economically futile, and that the economic strength of a nation is in no way dependent upon military power. This doctrine is a challenge, not only to militarists, but also to

those pacifists who, admitting the economic value of military power and the possibility of material gain from conquest, plead their cause otherwise. Much of what is written in "The Great Illusion" upon the economics of war is admirable, and will meet with universal approval, but a great part of the book is highly controversial, and, it will be argued, untrue.

My purpose in writing is not to attempt to damage the cause of peace. Rather is it to strengthen that cause by ridding it, if possible, of those fallacious arguments which appear to be among the props upon which it rests. The success of a movement depends, in the long run, not upon the unconsciously exaggerated statements of enthusiastic supporters, but upon the truth which it represents. Mr. Angell seems to have burdened his advocacy with so many arguments that some almost inevitably prove unsound. The real economic case against war is simple and clear, but unimportant: it is that the certain material cost of war and preparation for war is not counter-balanced by the *chance* of great economic gain. This statement will not readily be disputed; and if its truth is admitted the pacifist who condemns war on economic grounds has proved his case, and probably influenced but few people. For the peace movement will not, in the long run, be strengthened by any appeal to the pocket, much less by an appeal mainly to the pocket. Nor would war cease if all nations realised that it could

never bring material gain. But it happens that, as things are to-day, military power may, under certain circumstances, be employed to strengthen the economic position of a nation both absolutely and relatively to other nations. And the penultimate cause of the present war is probably economic. The war partly represents the attempt of a nation whose economic development has been subordinated to political power to defeat a rival nation whose recent political history has been largely shaped by economic ideas, and to increase its political strength by imposing its will upon that rival, largely to the latter's disadvantage. In other words, although German statesmen avow that the political policy of the nation is dictated by economic necessity, the truth probably is that that policy is rendered necessary, not by economic conditions as such, but by the will to advance, under present economic conditions, that prestige or power in international politics which is the dominating idea of Prussianism. The *weltmacht* of the Prussian statesman by no means finds approval among the German people; but the economic situation, or rather the people's interpretation of that situation, is such that the method necessary to secure world power is one that appeals to different groups in the community for different reasons. A vigorous colonial policy appeals to the industrialist because it offers the prospect of a secure market for manufactures, and ensures an adequate supply of raw materials. A strong

navy appeals to socialists (such as Rohrbach) because it guarantees a plentiful and continuous supply of the necessaries of life, which are imported in increasing quantities as the population grows and the nation becomes more industrialised.

But to prove such a material gain (with the higher standard of life thus secured for the community) to be possible by war and conquest is not to justify war. It should not be inferred from such a proof that a nation is justified in imposing its will, through force or threat of force, upon another people. Economic issues should be entirely subordinated to moral issues; and although the advance of economic civilisation and the growing complexity of industrial organisation have forced economic questions to a prominent place in international diplomacy, it is probably true that even yet those problems which endanger the peaceful relations of European nations are only in a minor degree economic. No nation is justified in sacrificing the lives of some of its members in order that the remainder may enjoy material comforts which would otherwise be unattainable.

Industry, too, has its losses; trade exacts its toll of lives. Experiments are conducted and enterprises started which almost inevitably result in human suffering. It may appear at first sight that the two cases are analogous, and that to oppose war for economic advantage is also, in effect, to oppose all industrial effort involving

considerable human risk. But there are fundamental differences between the two cases. The one involves compulsion; the soldiers of the State are given no option. Nor are taxpayers allowed a reduction by that proportion of their annual contributions to the State which would be employed to defray the cost of such a war of aggression. The other is a voluntary contract. There is no compulsion to risk one's life in a dangerous industrial occupation. If anyone takes the risk he does so voluntarily. Moreover, the one involves deliberate destruction of human life, the other implies co-operation on the part of all human beings to destroy the obstacles presented by ungenerous Nature—to use Mr. Angell's phraseology, the one connotes the employment of physical force, the other the abandonment of such force. Nor is it an adequate reply to say that the mere threat of force is sufficient when the stronger nation opposes the weaker, for the threat derives its efficacy simply from the certainty of action if the threat is not itself sufficient. The attitude of the stronger nation is essentially that of an enemy; it is the opposite of mutual agreement. Consequently no inconsistency is involved in holding the belief that, on the one hand, it may be desirable to undertake risky enterprises in order to increase the nation's command over Nature, and that, on the other, all war is immoral.

Nor is the contrast any less sharp if for co-operative attack upon Nature is substituted

industrial competition. Mr. Angell defines war as "the use of physical coercion for the purpose of imposing the will of one group upon another, and, to the extent to which force is operative, dispensing with the need for understanding common interest, and for free agreement. It is the rule of coercion, eliminating consent, reason and co-operation, in the relationship of the two parties involved" ("Foundations of International Polity," pp. 62-3). Yet he believes that "the 'common' sense of humanity" sees no difference between war and industrial competition when the latter enables the "big man" to take advantage "of *all* the weaknesses of the small man—his narrow means, his ill-health even—to undermine and to undersell" ("The Great Illusion," p. 10).

Everyone will admit many of the evils attributed to unregulated industrial competition. But surely (since the abolition of slavery) none of the attributes of war indicated by Mr. Angell are present. Bad though the conditions may be under which a large proportion of industrial workers are compelled to live and work, they do enjoy immunity from precisely those evils which the weaker nations suffer in war. Industrial competition stops short of the very things which Mr. Angell regards as constituting war. And it is likely that the "common sense of humanity" does recognise the differences between the two cases.

Mr. Norman Angell's main contention is that war and conquest are economically futile, *i.e.*,

they do not result in material gain to the victorious nation. The statement as it stands is somewhat ambiguous. In the first place, it may mean that the fruits of victory are purchased at too high a price ; that the cost entailed by war and preparation for war is not counterbalanced by the ultimate material advantage secured by victory. In the second place, it may mean that no material advantage can ever be gained by conquest ; that nothing appears on the credit side of the balance-sheet. It is in the latter sense that Mr. Angell argues that an aggressive war must fail.

When the cost of armaments is included in the expenses of war, and all is debited against the gains that may accrue from victory, whether in the form of territory and all that it brings, or in the form of added security of peace for many years, as was said to be the case after 1870, probably it is true that there is a net loss,¹ taking, at any rate, a comparatively short view. (It is of course conceivable that, taking a much longer view, say a century, there might be a net gain, even allowing the cost of war and the annual expenses of armaments to accumulate at compound interest for the period. For the trade need only show a net gain greater than the interest on that capital sum for this result to be achieved. But, apart from other considerations, no country is justified in

¹ The cost of defending newly acquired territory against possible enemies should also be included and set against the material gain resulting from colonies or added territory.

legislating in so definite a manner for a century in advance, for the other elements which may enter and produce a fundamental change in the character of the problem, are so uncertain that such legislation would be a gamble and the gain from it highly problematic. Assuming war for material ends to be defensible, no country would be justified in going to war for a possible enormous gain a century hence.) On the other hand, it seems that there should be placed on the credit side of the balance-sheet against the cost of armaments not only the gains from war, but, under existing conditions, the gains from peace until war broke out. For, if there had been no means of defence, the country, now stronger, and prepared to wage a war of conquest at the selected moment, would have been the weaker and subject to attack by some other stronger nation, who might have waged war for precisely the same reason. Nevertheless, taking all things into consideration, few would deny that the net result would be serious loss.

But this is not Mr. Angell's case. Nor does he argue merely that conquest brings no material gain to the world as a whole. It is possible that the conquest of Great Britain or Canada by Germany, in consequence of the economic policy subsequently enforced by the conqueror, would result in a net loss to the world as a whole while securing real gain to Germany itself. And it is further possible that Germany would be content to see

the world as a whole lose twenty shillings, if, by such means, she could secure ten shillings of that sum. But Mr. Angell goes far beyond this statement of probability. He denies that Germany can, under any circumstances, capture the ten shillings. He argues that she cannot secure any gain by conquest. She cannot effect any change in economic organisation which will produce a profit to her.

“ We might conquer Germany to-morrow ” (he writes) “ and we should find that we could not make a single Briton a shilling’s worth the richer in consequence, the war indemnity notwithstanding ”¹ (“ The Great Illusion,” p. 47).

Elsewhere he writes :

“ As the only possible policy in our day for a conqueror to pursue is to leave the wealth of a territory in the complete possession of the individuals inhabiting that territory, it is a logical fallacy and an optical illusion in Europe to regard a nation as increasing its wealth when it increases its territory, because when a province or State is annexed, the population, who are the real and only owners of the wealth therein, are also annexed, and the conqueror gets nothing ” (p. 31).

Now it will be obvious that upon the assumption of universal free trade, and the retention, after conquest, of the *status quo ante*, Mr. Angell’s contention is true. The loss or gain of territory would not then involve the loss nor secure the gain

¹ This statement was made to illustrate a general proposition, so that I have done Mr. Angell no injustice by assuming, for my purpose, that Germany was the victor rather than the vanquished.

of material wealth. This is the natural corollary of the free trade theory, if not, indeed, the essence of it. If Germany were a free trade country, and continued to be a free trade country after her defeat, we would gain nothing by conquering her. Again, if free trade or protectionist Germany conquered us, and then allowed us to retain our present fiscal policy, she would gain nothing from such conquest.¹

But the general assumption of free trade, or that the *status quo ante* would be maintained, is false. Germany has long pursued a policy of moderate protection. And if, after defeating her, we compelled her to reduce her import duties on British goods, while retaining the existing duties on goods imported from other countries, Britain would gain by the particular preference, and the world would gain through the enlargement of the free trade area. If, on the other hand, Germany conquered Great Britain, and compelled her to impose moderate tariffs upon all goods imported from countries other than Germany, and to admit German goods free of duty, Germany would gain the ten shillings, while the world as a whole might lose the twenty. Since, therefore, it is possible that conquest would be followed by a readjustment of economic relations between the nations concerned, it is not true to say that material advantage cannot be secured.

¹ Neglecting for the moment such questions as taxation, tributes, and indemnities.

Again, it is true that, in consequence of division of labour and national interdependence in economic matters, we thrive, not on the poverty, but on the wealth of other nations. They are better able to purchase our goods and to send us what we want in return. It will be generally admitted that the greater the wealth of the rest of the world the better for our nation. But whether this identity of interests holds between two particular nations is a question which presents great difficulty. Mr. Angell's argument has not taken into account the two-fold character of the problem; he seems to have taken for granted that what is true of the world as a whole (outside Britain) is true of each country in turn.

"At the beginning we have a Great Britain which could have seen all its political rivals annihilated without damage; at the end we have a Great Britain in which such a thing would spell starvation to its population" ("The Great Illusion," p. 157).

It is quite true that if the rest of the world were completely destroyed the people of this country would almost starve; but this result would not follow if Russia alone, or Canada alone, or any other country by itself, were destroyed. Whether the destruction of a single political rival could possibly react favourably upon the economic development of a nation remains to be discussed in the chapter on colonial expansion.

Finally, Mr. Angell asserts not only the economic futility of conquest, but also that the "all but

universal idea " that " a nation's financial and industrial stability, its security in commercial activity—in short, its prosperity and well-being—depend upon its being *able to defend itself* against the aggression of other nations," is " a gross and desperately dangerous misconception, partaking at times of the nature of an optical illusion ; at times of the nature of a superstition." ¹ Thus a successful defensive war as well as a successful war of aggression is economically futile ; in other words, the defeated country suffers no material loss from its defeat and loss of independence. And Mr. Angell states it to be the object of his book to expose the error of the view which the quotation partly expresses. But, especially if one is to interpret the word " well-being " broadly, it is difficult to reconcile this view with his defence of our naval and military programme before the war.

It may be well at this point to refer to a confusion of ideas involved in some of the arguments which Mr. Angell employs in support of his main thesis. He seems to have lost sight of the obvious distinction between the impossibility of conquest, on the one hand, and, on the other, the futility of a secured victory. In an article reprinted in " Foundations of International Polity " the author explains why " we submit to affronts from

¹ " The Great Illusion," pp. 25 and 26. The italics are mine. In bringing these quotations together, which are separated by almost a page, I do not think I am doing Mr. Angell an injustice. The same idea runs through the chapter called " The Great Illusion " in the book possessing the same title.

America, which, if committed by Germany, would make war inevitable." The explanation, he argues, is not to be found in the blood-relationship of the two countries, which is now more attenuated than in those days when they were actually at war; it is to be sought rather in the fact that America, for geographic and economic reasons, is obviously impregnable. We cannot secure such a victory as would enable us to impose our will upon her in the matters in dispute.

"When a Great Power" (he writes) "takes an attitude calculated to hamper our movements and commerce with half the universe, we submit, because war . . . is utterly ineffective for enforcing our rights" (p. 191).

Incidentally, it may be observed that Mr. Angell gives his case away here—*i.e.*, he admits it is possible for one nation to inflict economic loss upon another, which the latter would be able to prevent by the employment of sufficient military force. But in this connection the important point is that Mr. Angell argues, from this fact, the recognition of the futility of war between the two great English-speaking nations. Surely this is irrelevant to that argument for peace elsewhere urged by him. Assuming the accuracy of his article on matters of fact,¹ it is evident that what Great Britain recognised was not the futility of conquest, but the impossibility of victory in arms. If, for example, she would have suffered economic

¹ I am not competent to discuss it.

loss through the proposed action of the United States in relation to the Panama Canal, she would have secured economic gain (by preventing the loss) had she been able to effect, by military action, that change which President Wilson introduced by constitutional means. If Britain had admitted that America's action in the Panama had not reacted unfavourably upon her economic life, or if the United States had admitted the economic futility of her action, it would have provided a particular application of Mr. Angell's main thesis, and he would have been able to claim it as evidence in support of his theory. But, of course, neither Britain nor the United States did any such thing. The same confusion of ideas appears in that chapter of "The Great Illusion" which deals with colonies. In one place he argues that Canada could not be conquered; in another that, if conquered, she could not be compelled to adopt the policy dictated by Germany, the conqueror; and, in yet another, that, if she did adopt that policy, Germany would gain nothing. And all the time he gives the impression of employing them in support of his contention that conquest cannot possibly bring economic gain. If a discussion of the possible economic effects of conquest is to be fruitful, the assumption must be made that it is effective; that it is complete conquest, *i.e.*, that the conqueror is able to impose her will upon the vanquished nation. For if the full economic gain cannot be achieved by the victor through failure

to impose her will, it is due not to the futility of conquest, but to the incompleteness of the victory. The possibility of complete conquest is a totally different matter, quite irrelevant to the discussion of the possibility of gain by means of conquest.

CHAPTER II.

ARMAMENTS AND ECONOMIC STRENGTH.

THE exact degree of dependence of the economic development of a nation upon its military strength cannot be determined. Mr. Norman Angell asserts that "the factors which really constitute prosperity have not the remotest connection with military or naval power, all our political jargon notwithstanding." While this is probably an exaggeration, it contains a truth of great importance. Recent events have shown that such power does not secure peace. For some years, indeed, the competition in armaments created and then intensified a feeling of timidity, and to that extent probably retarded economic development.¹ Moreover, the enormous cost of armaments in recent years has produced an unfavourable effect upon the social condition of the people. If, for example, the £80,000,000 per annum spent on the army and navy in this country had not been required for that purpose,

¹ The cost of "defence" has been called an insurance premium, but this is not a true comparison, for the risk itself is affected by the payment of the so-called premium. One is reminded of the effect produced upon the frequency of fires when fire insurance was first introduced, especially in the United States.

either it might have been employed to ameliorate the condition of large masses of the people, or some of our indirect taxes could have been remitted and direct taxes reduced, thus rendering possible a higher standard of life in the community. The total amount of trade would probably not be appreciably altered, but the character of much of it would be different.¹

Although, however, the general policy of arming did not produce a feeling of security, it is nevertheless true that, taking things as they are, Britain's security depended upon following the pace set in the armament race. And so with other countries. Nor is it any reply to say that we were already the strongest naval power and consequently set the pace; for adequate defence required unchallengeable naval supremacy. Thus, although German efforts were increased as we grew stronger, our strength was determined by that of Germany; we but replied to her efforts to destroy our supremacy. Each of the military nations had her own idea of what her strength relatively to that of her neighbours should be,

¹ The serious dislocation of trade which would follow disarmament is not taken into account here. But the ease with which factories established in this country for quite other purposes have been adapted to the requirements of war suggests that industries directly dependent upon war, or preparation for war, could also be accommodated to the requirements of peaceful industry with less difficulty than anticipated, and that in consequence the dislocation of trade produced by rapid disarmament would not be so serious an evil as we once supposed. Nevertheless, suffering would undoubtedly accompany the process of adjustment.

and shaped her policy accordingly. Since these ideas conflicted, constant readjustment of military and naval power was inevitable, and, if the destruction by a rival in war was to be avoided, satisfactory readjustment implied an increase in strength. This involved a change for the worse to the rival or rivals, who in turn pursued the obvious policy. And so the thing went on, making war inevitable. And if we have understood Mr. Angell aright, this statement is consistent with his views. The further conclusion is that, although the military and naval policies of nations were interdependent, it is nevertheless true that under existing conditions the security of each was dependent on its adapting itself to the policy pursued by all the others. No one could afford to disarm without taking grave risk ; and to take grave risk was to be insecure, for risk is the negation of security. In this sense it seems evident that peace, if not independence, was bound up with a strong military or naval policy.

Although this conclusion seems to follow naturally from the previous one—if, indeed, it is not a restatement of it—it is not at all clear whether Mr. Angell would assent to it. Some of his statements seem to imply the contrary, although his defence of the naval policy of this country is tantamount to an admission of its truth.

Mr. Angell supports his contention that no causal relation exists between the prosperity of a country and its political strength somewhat as

follows:—(a) The standard of life in smaller States, such as Holland and Switzerland, is not lower than that enjoyed by military States :

“ All the weight of Russia or Germany ” (he writes) “ cannot secure for the individual citizen better general economic conditions than those prevalent in the little States ” (“ The Great Illusion,” p. 36).

(b) Closely related to the first is the fact that armaments are powerless to affect the course of trade.

“ Military power can in reality do nothing for trade ; the individual merchants and the manufacturers of small nations, exercising no such power, compete successfully with those of the great. Swiss and Belgian merchants drive English from the British Colonial market ” (p. ix).

Again :

“ Large navies are impotent to create trade for the nations owning them, and can do nothing to ‘ confine the commercial rivalry ’ of other nations.” “ Norway has relatively to population a greater carrying trade than Great Britain,¹ and Dutch, Swiss, and Belgian merchants compete in all the markets of the world successfully with those of Germany and France ” (p. 35).

(c) It is evident from the relative prices of Govern-

¹ Surely geographic conditions fully explain this. The configuration of the country—a long, dented coastline and high mountains in a narrow strip of land—makes railway transport difficult, and calls for a relatively big coastal trade. Moreover, the natural wealth of the country—mineral ores—is suited to a large export trade, but not to a relatively important internal trade.

ment stocks that the weaker States enjoy greater security than stronger ones :

“ The public credit (as a rough-and-ready indication, among others, of security and wealth) of small States possessing no political power often stands as high as or higher than that of the Great Powers of Europe, Dutch Three per Cents. standing at $77\frac{1}{2}$ and German at 75 ; Norwegian Three-and-a-Half per Cents. at 88, and Russian Three-and-a-Half per Cents. at 78 ” (p. ix).

And he argues that

“ the only consideration of the financier is profit and security, and he has decided that the funds of the undefended nation are more secure than the funds of one defended by colossal armaments. How does he arrive at this decision, unless it be through his knowledge as a financier, which, of course, he exercises without reference to the political implication of his decision, that modern wealth requires no defence, because it cannot be confiscated ? ”¹ (p. 34).

The unfavourable effect of armaments upon security is still more clearly shown in Mr. Angell's statement that

“ industrial undertakings in a country like Switzerland, defended by an army of a few thousand men, are preferable in point of security to enterprises backed by three millions of the most perfectly trained soldiers in the world.” These facts carry with them

¹ The retort obvious is that if this is the implication, or if such implication is true, the wealth of the armed nations is also secure, so that armaments should not have an unfavourable influence on the price of funds, as Mr. Angell asserts, except to the extent that armaments necessitate an increase in taxation (which is not the point immediately under discussion) and so reduce that part of the taxable capacity of the nation which may be regarded as security for the funds.

“the paradox that the more a nation’s wealth is militarily protected, the less secure does it become.”

In the light of the very definite views expressed in these quotations, as well as others of the same kind that might have been taken from the same chapter, it is curious to find Mr. Angell emphasising the limits of his argument and stating that reference was made to economic rather than political security. The argument, he states,

“is not that the facts just cited show armaments or the absence of them to be the sole or even the determining factor in national wealth. It does show that the security of wealth is due to other things than armaments; that absence of political and military power is on the one hand no obstacle to, and on the other hand no guarantee of, prosperity; that the mere size of the administrative area has no relation to the wealth of those inhabiting it” (pp. 36—7).

And again :

“the political security of the small States is *not* assured; no man would take heavy odds on Holland being able to maintain complete independence if Germany cared seriously to threaten it. But Holland’s economic security *is* assured. Every financier in Europe knows that if Germany conquered Holland or Belgium to-morrow, she would have to leave their wealth untouched; there could be no confiscation.¹ And that is why the stocks of the lesser States, not in reality threatened by confiscation, yet relieved in part at least of the charge of armaments, stand fifteen to twenty points higher than those of the military States.

¹ The destruction of Belgian property by the German invaders does not invalidate Mr. Angell’s particular argument. Economic considerations naturally give way to real or supposed military necessity.

Belgium, politically, might disappear to-morrow; her wealth would remain practically unchanged”¹ (pp. 38, 39).

The inconsistency of Mr. Angell's statements adds to the difficulty of dealing with a subject which, from its very nature, is by no means easy; but it is clear that three distinct, though related, questions are raised:—(1) What are the factors upon which the wealth and standard of life of a nation depend? (2) Is it possible for military or political power to be employed in the interests of trade? (3) How are the prices of Consols and the funds of other nations determined, and what part is played by security in producing the final result?

(1) An adequate reply to the first question would necessitate a treatise on economic organisation. But it will be evident that, in the last resort, the economic possibilities of a nation depend upon its natural resources, the quality of its people, and the opportunity it enjoys for employing these to the best advantage. The last consideration calls up such questions as the reaction of the distribution of wealth upon efficiency, the effects of monopolistic combinations of capital, associations of labour, land policy, insurance, banking, Government restrictions on

¹ Her funds would be merged in those of the State which annexed her, and consequently would be fixed at the same price as the others of that State, other things being equal. The prospect or danger of annexation would therefore affect the price of Belgian funds at all times. Mr. Angell seems to have missed this important point.

trade, taxation, etc., although none of these is quite relevant to the question at issue. But the problem of making full use of the natural resources and human powers within a country gives rise to two questions—security and the cost of armaments—which are strictly relevant and inter-related; while a third—the stage of development reached—bears indirectly upon the subject under consideration.

Great Britain, Holland, and France are much older, in the economic sense, than Germany and Russia, and now enjoy the results of vast accumulations of capital. Most of our capital has been invested within the country, in the form of factories, railways, buildings, etc., and these naturally react upon the national income and the standard of life made possible by it.¹ But a considerable proportion has been invested abroad, and now brings its reward in the form of interest payments (which are made in those goods upon which our comfort largely depends), and therefore makes possible a higher standard of life.¹ What is true of this country is also true of France and Holland.

¹ When speaking of capital in this connection, I mean not a sum of money, but the forms, such as factories, in which the money has been invested. I am aware that these capital goods wear out and have to be replaced, so that only a small proportion of our existing capital in this country was not actually made in recent years. But there is a real difference between the replacement of worn-out capital and net additions to it. All countries have to replace their capital, and provision for this is, or should be, made out of current income. In spite, however, of necessary replacement of capital and great additions to it, we have been able to export, in the form

Germany and Russia, on the other hand, are comparatively new countries. The former only started on her career rather more than half a century ago, while the latter is, even yet, but preparing for hers. It is true that new countries like these (and Canada) are able to avail themselves of the resources of older countries, and, other things being equal, may be expected to advance more rapidly than we have done. Germany, indeed, has done so, and may soon overtake us. But they do so by borrowing the capital which the older countries are prepared to lend. And the payment of interest lessens the amount of the total wealth (produced with the assistance of such capital) which can be enjoyed in those young countries. The value of Mr. Angell's comparison of Holland with Russia is largely discounted, as will be shown, by his failure to distinguish between the two types of nations, the old and the young—roughly speaking, the lending and the borrowing countries. It is a comparison of the mature journeyman with the young apprentice. It is to be regretted—although it is significant—that he did not bring France and Britain, both economically mature nations possessing great military and naval power, into comparison with Holland, an old and non-military State. The test he employed is unscientific.

of machinery, rails, etc., a considerable proportion of our annual savings. New countries, on the other hand, are compelled to add to their total supply of capital, mainly or partly by importing from older countries.

The cost of armaments, other things being equal, must obviously affect adversely the standard of living, for it implies the employment of a proportion (sometimes a considerable proportion) of the capital and labour of a country in the production of things which do not directly affect the standard of living. This is of great importance to-day, when, in this country alone, before war broke out, we spent a sum on our defences amounting to practically one-half the interest on our foreign investments. And those nations, such as Holland, who can afford to dispense with adequate means of defence, enjoy a tremendous advantage, since the capital and labour thus set free becomes available for the production of goods and the supply of services tending to raise the standard of living.

But other things may not be equal. It has to be proved that the absence of means of defence in a particular country will not create such insecurity as will reduce the national income by more than is represented by the cost of armaments. It is quite obvious that, if universal disarmament were possible, without loss of security, a great gain would be effected and the world would be a better place to live in. Taking things as they are, however, the effect of disarmament by a single country cannot be estimated. It is believed in Germany that the long peace which that country enjoyed, and which made rapid economic development possible, was directly attributable to the

maintenance of a large army, and that the overseas trade which they have recently developed was conditioned by a navy that would command respect. Their two-fold belief that peace was due to military power and that rapid economic development was made possible by peace may be erroneous. But who can tell? If it was well founded, their armament policy was worth the cost—*i.e.*, the Germans enjoyed a higher standard of life than would have been possible without such expenditure on armaments. For, as a result of the development of international banking, political insecurity, as Mr. Angell himself has pointed out, would have kept the financial world in a state of agitation and in this way reacted upon trade.

Political security increases readiness to lend capital both to a Government and in aid of industrial enterprises controlled by its people. The Balkan States have evidently suffered for many years through lack of such security; and the complete domination of these States by one of themselves or by another nation might be a real gain. In this special case it is obvious that economic development would be closely related to political power.

(2) To the second question, which is closely related to the first, Mr. Norman Angell replies in the negative. People buy in the cheapest market, without reference to the flag which flies above it. The smaller States thrive in spite of the absence

of military power, and their impotence in the "councils of the nations." Swiss manufacturers, for example, are ousting their British rivals from the Canadian market, for the simple reason that they are able to provide the goods more cheaply. But the answer is not quite so simple.

It is necessary to draw a distinction between the mere existence of political power and effective employment of military force to conquer and exercise control over the policy of its rival. The enjoyment of political power brings with it one real advantage. Britain was able to enforce the policy of "the open door" in China, and in this way to secure considerable economic gain. But the open door policy also benefited the smaller States, who were thus able to enjoy the results of the exercise of political pressure by other nations; but it was necessary that some should enjoy that strength which the possession of military force provided. In some cases, however, this political strength is provided by the importance of the nation as a market. If, for example, Germany imposed a prohibitive duty upon imports from Holland, the latter could retaliate and so deprive Germany of an important market. The threat of reprisals would be sufficient in such a case to limit the power of Germany to hurt Holland without, at any rate, injuring herself seriously in the process. Political power here is a result of economic strength.

When we turn to conquest, or the effective

employment of military power, we are met by different considerations from those created by its mere existence ; and these are examined more fully in the chapter on colonial expansion. But in this connection it may be stated that while it is perhaps true that in the colonial market we are suffering from the competition of the smaller States, such competition is not inevitable, but is rather the result of a deliberately chosen colonial policy. We might have adopted the alternative policy of colonial preference, which would have limited, if not prevented, such competition ; but we believe the loss of the kind indicated by Mr. Angell to be counterbalanced by gains in other directions. The average customer buys in the cheapest market ; but we have the power so to modify the conditions that Belgium and Switzerland would become dearer markets. This is neither a plea for nor a defence of such a change in policy : it only shows that such is possible, and that, in consequence, Belgian and Swiss manufacturers, to the extent that they depend upon the colonial market, are at the mercy of the Empire. And, as everyone knows, one of the objects of colonial federation is to effect such a change in the direction of trade as is implied above.

Mr. Angell states that

“ the foreign trade of most great States is mainly with countries over which they exercise no political control. Great Britain does twice as much trade with foreign

countries as with her colonies (which she does not control). The enormous expansion of German trade, mainly in countries like Russia, the United States, South America, owes nothing to her military power.”¹

This argument, which is employed in support of the contentions already examined, is beside the point. Our trade with the United States, a relatively populous country, is naturally greater than our trade with her neighbour, Canada, which is sparsely populated; our trade with almost seventy million Germans across the narrow North Sea must (in the absence of prohibitive tariffs) obviously be greater than that with the young and distant Australian nation. Population and geographic conditions are two of the three important factors. The third is tariff policy. And the point is that if we could induce Germany and the United States to admit our goods as freely as we admit theirs, our trade with them would be much greater than it is at present. If conquest could effect this, it would be a considerable gain to be placed on the credit side of the balance-sheet.

The answer to the second question thus seems to be that military power can be and is employed in the interests of trade, though not to any great extent. Whether a particular colonial policy, enforceable through political power, is to the interest of the ruling nation is a question which free traders and protectionists will answer differently; but that it produces immediate

¹ “Foundations of International Polity,” pp. 21-2.

effects upon the economic activities of the foreign countries (including the small States) cannot be denied.

(3) The third question is one which presents considerable difficulty on account of the elusiveness of the word "security." It is obvious that security is not the only factor in the determination of the price of funds; it is but one of an assemblage of conditions. Others suggest themselves at once. The rate of interest is obviously the most important.¹ The wealth, population, and amount of national debt all play their part. If the wealth of the nation is increased while population remains stationary, or if the population is increased proportionately to the growth of wealth—in other words, if the wealth per head increases while the population remains unchanged, or the wealth per head remains constant while population increases—the price of the public funds will tend to rise. The same result follows if the funds are reduced by repayment. These facts may be brought together by stating that the price will depend partly upon the proportion the national debt bears to the wealth per head of the people. The prospect of an increase in the debt produces a depressing effect upon Government stock.

¹ It should be observed that the prices of stocks do not vary proportionately to the rates of interest paid on them. If a stock issued at 4 per cent. can be sold for £100, probably it would command less than £200 if issued at 8 per cent., even though all other conditions remained the same.

The price of funds will also be influenced by the state of trade. It is well known that guaranteed stocks bearing a fixed rate of interest fall in value during a boom in trade, when most people are bent on investing in a form which will bring a return commensurate with the real or supposed profits of business, and rise in value during a period of depression, when secure investments are in great demand. Further, such factors as the intervals at which interest is paid and the general attitude of Governments towards their obligations are reflected in the price. Interest at 5 per cent. per annum paid quarterly represents a slightly higher rate than if paid in two instalments a year. If a nation repudiated her debt, say, during a war, she would afterwards find much greater difficulty in obtaining fresh loans.

In the next place, the price depends upon the extent to which the funds possess what Giffen called a "free market." The condition of a "free market" is the presence of a considerable body of speculators who deal in the particular stock. Where such a market exists the speculative holders respond much more readily to the other influences, which thus operate more strongly than would otherwise be the case. Again, special factors may call for consideration; for example, until recently, the powers of trustees in this country were severely limited, and when the number of trustee investments was increased the price of British Consols suffered. The new War Loan must be

repaid in 1928, consequently the price of the stock representing it is higher than it would otherwise be.

Finally, a country which normally invests capital abroad is able to borrow for Government purposes more cheaply than a country which normally imports capital for industrial enterprise. A Frenchman will not purchase Russian stock in preference to French stock unless the terms are distinctly more favourable. This last factor seems to play a more important part than has been generally realised, and, along with others which have been ignored by Mr. Angell, should be taken into consideration in estimating the extent to which political insecurity reacts upon the prices of funds. The factors above enumerated determine the mean level of prices from which the wave-like movements created by political events can be measured. If peace could have been guaranteed to Germany for a considerable period of years, while the general conditions (such as interest, the period for repayment, etc.) relating to the loans were identical, the price of her funds would be brought much nearer to that of Dutch stocks. There would still be some margin between the prices, due to the difference in the degrees of "economic maturity" of the countries.¹ Indeed, it is probable that the difference of $2\frac{1}{2}$ in the prices of the Three per Cents. quoted by Mr. Angell

¹ Germany now invests capital abroad. Nevertheless, she is still a "borrowing country," and will be until her foreign investments exceed her indebtedness to other nations.

is accounted for in this way. Mr. Angell should have compared lending countries with lending countries when examining the extent to which military power reacted on the price of funds, or a lending with a borrowing nation when both were strong in armaments.

Since the effect of military power upon security is really one of the main props upon which Mr. Angell's case rests, it may be well, at the cost of reiteration, to examine his views on this particular point in greater detail. He develops his case as follows :

(1) If it is argued that the security of small States " is due to the various treaties guaranteeing their neutrality, it cannot be argued that those treaties give them the political power and ' control ' and ' weight in the councils of the nations ' which Admiral Mahan and the other exponents of the orthodox statecraft assure us are such necessary factors in national prosperity." We have already replied to this by showing that the insistence upon the open door policy by the Great Powers reacts favourably upon the smaller States, so that the latter gain through the existence of military force which is not their own ; and that in other cases the possibility of inflicting injury upon others by reprisals gives those small States, of importance economically, political power as effective for the purposes as that created by military strength.

(2) " Those who argue that the insecurity of

the small States is due to the international treaties protecting their neutrality are precisely those who argue that treaty rights are things that can never give security!" This is no reply. The statement may be true of some, but it is not true of all.

(3) In Mr. Angell's view the real truth, as already indicated, is that "the political security of the small States is *not* assured; no man would take heavy odds on Holland being able to maintain complete independence if Germany cared seriously to threaten it. But Holland's economic security is assured." It is true that no one would feel confident of the ability of Holland to defend herself against a German invasion; but investors did feel confident that international treaties would be honoured, and *do* feel confident that a German invasion would be opposed by others who signed the treaty, and who conceive their own safety to be bound up with the independence of the small States. And that investors *do* "take heavy odds" on the maintenance of Holland's independence is clearly indicated, in spite of Mr. Angell's statement, in the price of Dutch funds. If, a year ago, it had been made clear that the independence of the small States had lost its importance to the stronger nations, the price of Dutch funds would have fallen considerably. Thus the political security of Holland, Belgium and Switzerland, and probably Norway, was largely dependent upon the military strength of other Powers. If we had disarmed before the war, the national

credit of Holland would have suffered. Again security is given to some small States (*e.g.*, Norway) partly by geographic conditions, but the geographic factor is becoming less important. Security against aggression from Europe is given to South American States by the force behind the Monroe Doctrine of the United States.

It is true that a comprehensive treaty between the States of Europe might, and probably would, enable each to reduce its armaments to but a small fraction of the existing strength, without endangering its security; and in this way economic progress would be accelerated. But the security of each would then depend, in the last resort, upon the coercive force of the federated States, *i.e.*, upon the military force which could be brought by the group against a recalcitrant. And so we are brought back to the dependence of security upon military power.¹ Nevertheless, the new State would obviously be preferable to the old, for the security itself would be greater, and the cost of providing it less.

There are two kinds of security—that of peace and that of independence. Although closely related they are quite distinct. We have not been in danger of losing our independence to Germany or France, but during recent years there

¹ It is not part of my work to deal with Mr. Angell's view that force is a diminishing factor, destined to disappear. But I may express the belief that this argument rests on a confusion of a reduction of force with a change in its manner of operation.

was danger of war on a number of occasions. Without the assistance of other countries Denmark would be quite powerless to resist Germany, who might possibly have annexed it without war as we commonly understand the term. A threat might be sufficient. So long as the independence of the smaller States (except Belgium) was beyond doubt, they were practically secure against war. The danger of annexation to which they were exposed was also a danger to European peace. But the peace of Europe was also exposed to other dangers: the independence of small States was not the only possible cause of war. Hence the stronger nations—the big brothers who would fight for the small ones, but also for other reasons—were necessarily less assured of peace than the small ones were of their own independence. The armament policy of the stronger nations brought greater security to the smaller, non-military States than it did to themselves. Nevertheless, as things were, the degree of political security actually enjoyed by the strong ones was largely due to their military or naval power.

CHAPTER III.

WAR AND THE CREDIT SYSTEM.

IN those parts of his books which deal with modern finance Mr. Norman Angell shows, in an interesting and convincing manner, the susceptibility of modern credit transactions to the influence of political factors, and the difficulties which confronted the German Government during the crisis of 1911, through the dependence of German industry upon French capital. But his deductions are not clear. It is sometimes concluded that he believed war to be impossible. This is quite untrue. Nothing in his writings seems to warrant such a conclusion. Again, some people are under the impression that a part of his case was that our credit structure would collapse in time of war. And this is the impression that one might easily gather from a first perusal of "The Great Illusion."¹ For, after showing that continuity of production in one country was an absolute necessity to another, Mr. Angell goes on

¹ In his latest book, "War and Lombard Street," published after this chapter was written, Mr. Hartley Withers writes to the effect that the war demonstrated the truth of Mr. Norman Angell's major premises, which "is to the effect that modern nations are so closely knit together by the bonds of international finance that they cannot go to war without inflicting enormous damage on themselves as well as on one another."

to say that this "vital interdependence is largely the work of the last forty years; and it has, during that time, so developed as to have set up a financial interdependence of the capitals of the world so complex that disturbance in New York involves financial and commercial disturbance in London, and, if sufficiently grave, compels financiers of London to co-operate with those of New York to put an end to the crisis, not as a matter of altruism, but as a matter of self-protection."¹ He further quotes, apparently with approval, a French writer who argues that this financial interdependence not only has created an international solidarity, but was one of the principal causes which prevented the outbreak of war between France and Germany over the first Moroccan difficulty. This quotation, in the absence of other evidence, might have been taken to suggest the probable consequences of war.

On more careful reading, however, it becomes evident that he does not refer to the effects of a state of war upon the financial relations of the nations. That war would result in a collapse of credit seemed obvious to most people. But Mr. Angell's treatment of the financial consequences of conquest and confiscation implies the belief that, at any rate in the early stages of war, there would be little, if any, interference with international finance. All his arguments relating to the effects

¹ "The Great Illusion," p. 49.

of war are based upon the assumption of conquest and confiscation.

(1) In the first place he assumes that, if the German army reached London and looted the Bank of England, the consequence would be a run on every other bank and universal suspension of payment. Since bills held by foreigners could not then be met they would lose all their value.

“ The loanable value of money in foreign centres would be enormously raised, and instruments of credit enormously depreciated ; prices of all kinds of stocks would fall, and holders would be threatened by ruin and insolvency. German finance would represent a condition as chaotic as that of Great Britain. Whatever advantage German credit might gain by holding Britain's gold, it would certainly be more than off-set by the fact that it was the ruthless action of the German Government that had produced the general catastrophe. A country that could sack bank reserves would be a good one for foreign investors to avoid : the essential of credit is confidence, and those who repudiate it pay dearly for their action ” (p. 51).

What the result of such action by the German army would be is a matter for speculation ; the important point is that the whole argument quoted is based upon the assumption that finance would continue practically on a peace footing during the early part of the war. Confiscation, not war, it is argued, produces the monetary crisis, destroys values, and shatters the credit system. But we know now that war makes trading with the enemy illegal ; that the outbreak of war results in serious dislocation and loss, breaks down

the old system, and necessitates a complete re-organisation of our financial methods. How this was actually done in Great Britain and Germany will be shown in the next chapter.

Mr. Angell provides a second illustration. He assumes the conquest and annexation of Hamburg by Britain and the confiscation of all property in the city. The Hamburg Government stock would lose almost all its value, while the value of stocks and shares in industrial enterprises would be completely destroyed. Since the latter are held by banks and insurance companies as collateral security the solvency of these institutions would be shattered, and, since German banks owe money to London, this country would also be involved. Moreover, confiscation would produce a monetary crisis in Germany which in turn would cause the withdrawal of balances in London by German banks. Thus confiscation would prove a failure as the result of what Mr. Angell calls the intangibility of wealth. The argument here again is based upon the same assumptions, namely, that property is confiscated by the conquering nation, and that during the previous stages of the war the belligerent countries traded with each other.

The conditions which are stated to have made confiscation too costly are of recent growth. In olden times, when tribes and nations were economically self-sufficing and property consisted mainly of movable goods, conquest was accom-

panied by looting ; and such looting was a real gain : there was no reaction. In later times, too, the conquest of savage tribes by civilised nations was an advantage to the latter, since it enabled the surplus population to migrate and to live in the conquered territories, when order had replaced disorder, under conditions preferable to those obtaining in foreign countries. But these factors are no longer operative in modern countries, which are fully occupied, whose civilisations are so firmly set that their character could not be sensibly modified, and where modern industrial and financial conditions obtain. Confiscation of the kind already indicated would produce such violent and serious reactions that it would quickly defeat its own end.

(2) To those critics who urge that confiscation need not take the form indicated Mr. Angell replies that modern wealth is intangible in another sense, and that such intangibility makes other kinds of confiscation, such as a tribute, an economic impossibility. While few would deny the futility of confiscation in the first sense, there seems to be no economic reason for its futility in the second. Economically there is little difference between it and a voluntary contribution by, say, Australia of a battleship to our navy. Mr. Angell's argument on this point is somewhat unusual.

He assumes, with his critics, that Britons are reduced almost to a state of slavery by their

German conquerors ; that the workers are allowed little beyond the necessities of life, and that the Germans seek to confiscate the remainder of the nation's wealth, or dividends. But how can they do it? he asks. The nation's wealth, thanks to modern finance, is largely intangible ; it consists of services such as transport, travel, amusement and recreation, medical attendance and the like. Moreover, the dividends are themselves created by generous consumption. Reduce the consumption of the workers and the dividends disappear.

“ If the German taskmasters are to take these dividends they must allow them to be earned. If they allow them to be earned they must let the population live as it lived before—spending their income on themselves ; but if they spend their income on themselves, what is there, therefore, for the taskmasters? In other words, consumption is a necessary factor of the whole thing. Cut out consumption, and you cut out the profits. This glittering wealth, which so tempted the invader, has disappeared. If this is not intangibility, the word has no meaning ” (p. 58).

We shall examine this doctrine in a moment ; its corollary calls for comment first. If Germany could take nothing from us, then, since there is no necessary difference between confiscation and a gift—the former is but a “ forced gift ”—the United States cannot send food to Belgians in their own country ; Australia cannot make a gift of warships to Britain ; we cannot send clothing to Serbians.

The theory is based upon an obvious fallacy.

It assumes either that the wealth of a nation consists wholly of such services as those indicated above, or that all the wealth produced by a nation must be consumed within its own borders. Mr. Angell, we know, does not believe this; nevertheless, the argument we have quoted implies it. What he seems to have in mind is the necessity for continuity of production; anything which interferes with such continuity naturally stops the flow of wealth which constitutes the national income of goods and services. Consequently the *method* of confiscation must obviously be adapted to the conditions of modern industry. But a proof of the necessity for a change in the method of confiscation is not a proof of the impossibility of confiscation. Germany obviously cannot convey the service of transport to her own people; she cannot carry home the medical service without taking the doctors who provide it. But it is not economically impossible for her to confiscate a part of the supply of engines, rails, etc., which would provide similar transport services to the Germans, or to tax the profits of medical men so that better service should be given to her own people. It is not economically impossible—nor would it be “futile”—to impose a tribute of, say, two battleships a year. Germany could become part of our nation for purposes of consumption, as far as portable commodities are concerned. And this is precisely what she would be doing if she

exacted a tribute. She would negotiate with our own Government, and the Government would collect the money to pay for the ships by means of taxation. Thus there is no real difference in the nature of the transaction between the payment of a tribute and an indemnity or (for the time being) the export of capital. Tributes and indemnities, in their economic significance, are but exports of capital where the exporter loses his right to such capital upon exportation and, consequently, loses his claim for interest upon it. Mr. Angell illustrates his argument as follows :—

“ Here is a German manufacturer selling cinematograph machines to a Glasgow suburb (which incidentally lives by selling tools to Argentine ranchers, who live by selling wheat to Newcastle boiler-makers). Assuming even that Germany could transfer the surplus spent in cinematograph shows to Germany, what assurance has the German manufacturer in question that the enriched Germans will want cinematograph films? They may insist upon champagne and cigars, coffee and cognac, and the French, Cubans, and Brazilians, to whom this ‘ loot ’ eventually goes, may not buy their machinery from Germany at all, much less from the particular German manufacturer, but in the United States or Switzerland. The redistribution of industrial rôles might leave German industry in the lurch, because at best the military power would only be controlling one section of a complex operation, one party to it out of many.”¹

The essential parts of this quotation may be paraphrased as follows : If the residents of the

¹ “ The Great Illusion,” p. 59.

Glasgow suburb handed over to Germany all their money now spent in attending cinemas, instead of (indirectly) that part which now goes in payment for the appliances, the German machine and film makers might lose their occupation, and, consequently, Germany as a whole would be worse off than before. Mr. Angell implies there would not then be enough work to "go round" the German nation. It is an ancient fallacy, which one imagined to have been long buried, and beyond hope of resurrection. One might, with equal truth, say that the receipt of interest on our foreign investments results in loss of work to our workpeople, since they might have been making those goods which now come to this country in the form of interest payment.

Mr. Angell elsewhere ¹ states that

"it is evident we have here, on the very first analysis, two fundamentally important features in which the early pre-economic statecraft would quickly prove unworkable in our day, in which the motives dictating the relationship of States are subject to great modification. It is merely silly to argue (and yet I have heard it argued by a great University professor) that there is no change. All that remains in doubt is the degree of change and its direction; whether it has moved sufficiently far as yet to reach a condition which makes military power economically futile, as I have declared."

That there have been changes no one would deny: that these changes necessarily make confiscation

¹ "Foundations of International Polity," p. 98.

futile and tributes an economic impossibility, as Mr. Angell argues, is not true. Industrial changes have merely necessitated a new method of exaction.

(3) In the chapter entitled "Credit and International Relations" of "Foundations of International Polity,"¹ Mr. Angell indicates two important results which follow upon the development of international finance, and the vital interdependence of industrial nations. The first of these is the impotence of a conquering nation in changing the established order to its own advantage. To prove his point he assumes that a modern nation adopts the colonial policy pursued for three centuries by Spain. The Spanish colonies of South America were bled of their gold and other valuable possessions for the benefit of privileged groups in the Mother Country.

"All goods had to be taken to certain centres and there shipped in a certain way, this sometimes involving mule transportation thousands of miles out of the direct route; and this was merely a detail."

Naturally this was not a profitable policy; in spite of its wealth of gold Spain remained one of the poorest countries in Europe. But the effect of such a policy became evident only after a long period had elapsed. The plentiful supply of gold was the evident fact; and this, to the crude mercantilists of the time, was evidence of wealth.

¹ Most of it appears also in "The Great Illusion" under the title of "The Bearing of Recent History."

The more this policy was enforced, the poorer Spain became.

Mr. Angell then describes the effects of a similar policy introduced under modern industrial conditions.

“Now, imagine a modern Spain” (he writes), “responsible for the policy of a modern South America, developed industrially and financially to a high degree. We should best understand the relationship, perhaps, if we could imagine the American Revolution not having taken place, and Great Britain still ‘owning,’ in the meaningless phrase of our politics, North America, and then imagine Great Britain to-day trying to *introduce* the sort of policy which Spain enforced during three hundred years in South America : enacting in Parliament, for instance, that every mine and oil-well in the United States should pay a tribute of 80 per cent. to certain monopolists in London ; ordaining that all cotton coming from Louisiana and destined for Lancashire should first be taken to Winnipeg and there pay a special octroi tax, and then be handled by certain privileged firms, shipped in certain privileged ships at certain fixed rates, and arriving, shall we say, at Deal, because that happened to be the seat of another monopolist, be brought inland, shall we say, to the town of Derby, because that happened to be the seat of a business having influence with the Government, and from Derby shipped to Manchester. You know, of course, that an Act of Parliament of that kind, merely a *paraphrase* of the sort of legislation enforced by Spain on South America during three hundred years, if passed to-day, would precipitate a financial crisis, first in America, but immediately after in Great Britain, which would involve tens of thousands of business men in London, having, at first sight, but the remotest connection with the interests involved,

and would practically annihilate a great national business in Lancashire—on which thousands of our countrymen depend for food. No man would know whether he would find his bank closed in the morning or not.”¹

Mr. Angell's argument seems to be open to two serious criticisms. In the first place the cases cited by him are not analogous. Spain's colonial policy produced its harmful effects through continuous operation; it was the constancy of its application which wrought such evil. In the other example the evil is produced by the *sudden* departure from a policy so long established that vested interests have grown up around it. If, before war broke out, all European nations had *suddenly* abandoned their armament policies, no less serious a crisis would have ensued than that which Mr. Angell describes above. But it does not follow that disarmament is bad policy; it merely follows that a *sudden change* of policy is bad. To make Mr. Angell's illustrations parallel one would need to assume that Britain's policy had been pursued from the earliest days of the colonies. But no financial crisis would now take place; the Lancashire industry would not be annihilated, because it would have developed in quite another way, and, undoubtedly, to but a much smaller extent—in other words, there would exist no national cotton industry to be annihilated. The tens of thousands of London business men would

¹ “Foundations of International Polity,” pp. 106—8. The italics are mine.—J. H. J.

not be in financial straits. Mr. Angell compares the permanent effect of a long-continued policy in the one case with the momentary effects of a sudden and violent change in a long-established policy in the other. Consequently the analogy is false and the comparison useless. If it be urged that Spanish policy was modified from time to time, the reply is that either such modification was unimportant relatively to the policy itself, or the change, if relatively important, did produce the serious and immediately perceptible results, which are lost to us because they were not recorded, not because they were produced slowly.

In the second place, no conquering nation would be so foolish as to adopt, and quite without warning, the policy outlined by Mr. Angell. Consequently his example of modern statecraft possesses no practical value. If Germany conquered Canada, she might and probably would modify the economic policy of the colony, with the object of securing a gain for herself. Whether or no such gain be possible, such a change of tariff policy would be introduced gradually, if we are to credit Britain or Germany with any wisdom in economic matters. No violent changes affecting every industry would be enforced suddenly and without warning, except, possibly, for political purposes, in which case the economic loss suffered would presumably be cheerfully borne for the greater political gain to be achieved. And changes intro-

duced gradually and after due warning would be discounted, and would thus produce their effects slowly. Consequently, there would be little danger of financial panic and a monetary crisis. The United States has changed its tariff policy four times during the last quarter-century,¹ but none of these changes can be said to have created a panic, although the McKinley Act of 1890 did probably contribute to the serious financial unrest of the time.

The second result of the growth of modern finance is shown by means of an illustration. Mr. Angell points out that when, in 1911, war almost broke out between Germany and France, the prices of stocks on the Berlin Exchange fell, and German banks were seriously embarrassed. French capitalists, who had invested largely in German securities, sold rapidly. In the end the German Government yielded to the pressure of German financiers and business men, who were threatened with ruin, and war was averted. The history of this political crisis and its effects on German business is highly instructive, and shows three things, one of which is the particular point which Mr. Angell appears to be dealing with, namely, the sensitiveness of the world of finance to changes in the political relations of nations. The others, which Mr. Angell does not refer to, are—(a) the financial loss incurred through prolonging diplo-

¹ Acts amending the tariffs were passed in 1890, 1893, 1896, and 1913.

matic negotiations, *i.e.*, through delaying the actual declaration of war ; (b) the disadvantage suffered by a debtor nation, contemplating war, during this period of delay. Germany learnt her lesson : the political crisis of last year developed so rapidly in the summer that French capitalists were unable to realise many of their investments. The German Government recognised the necessity for rapid mobilisation in the financial as well as the military sense. Once war was declared foreign capitalists were practically helpless. The laws enforced in time of peace were no longer operative.

We have been compelled to follow a zigzag course through this chapter ; it was necessary to do so in order to examine Mr. Angell's views upon the relations of war and credit. It may be well to bring the particular propositions together. The chief difficulty is to discover Mr. Angell's main thesis. He shows quite clearly that if a war cloud appears on the horizon financiers grow nervous, and the money market and stock exchange are affected. The capital values of industrial undertakings and the prices of Government funds fall ; credit institutions may suffer through the actions of their creditors or the financial position of their debtors. And the dislocation of finance is world-wide. So far Mr. Angell is undoubtedly right. But these are truths which have been fully appreciated for many years.

He also attempts to prove that the financial interdependence of modern States does not permit a nation to modify the economic conditions of a vanquished rival. His illustration was fantastic and his comparison of the past with the present (Spain with Great Britain) misleading. Nations *do* modify their own economic policies from time to time, without the financial consequences indicated by Mr. Angell; and it is urged by the Conservative party that the economic policies of Great Britain and her colonies should be modified in the immediate future. Whether this would be a gain or loss to those concerned is irrelevant at this point.

Mr. Angell further holds that confiscation would create a loss for which the confiscated property would not be adequate compensation, and that a tribute is an economic impossibility. These are consequences of the changes which have made wealth "intangible." He uses the word "intangibility" in two senses. In one place "intangible wealth" means exchange value or price (mainly capital value); in another it means services, such as those rendered by an actor or lawyer. Wealth has become intangible, he argues, through changes in economic organisation of which banking is the final expression; but he does not seem to realise that capital values and services are quite independent of banking in the sense that they may exist without it. Banking has facilitated economic development. We found that the

changes in economic organisation call for new methods of exacting tributes, and probably limit the goods capable of direct confiscation to a smaller proportion of total wealth than before. For the nation's wealth consists of capital goods, such as factories and houses, which cannot be carted away, and of a flow of wealth and services made possible by the utilisation of such capital goods and the people of the country. But it was shown that confiscation or tribute is still possible, and need not be followed by the undesirable results indicated by Mr. Angell. The method alone is changed: it is now necessary to redirect the flow of wealth. The German army appears already to have confiscated property and gold in Belgium; and, if the Germans were victorious, it is unlikely that such confiscation would react unfavourably, in the economic sense, upon them.

Finally, the strange conclusion was arrived at that, contrary to popular belief, Mr. Angell does not argue that warfare would destroy the credit system. On the contrary, his contention that conquest, if accompanied by confiscation, would do so is based upon the implicit assumption that it had not already been destroyed. It implies that financial operations were conducted, during the early stages of war, by German bankers in London and British bankers in Germany. It will be shown in the next chapter that as soon as war broke out financial business between the

belligerent nations ceased, except in so far as it could be carried on surreptitiously, through the agency of neutrals. On the whole, the chapters on Finance are among the least convincing in the two books. Mr. Angell seems to have missed the obvious, and, for this reason, much of his argument falls to the ground.

CHAPTER IV.

THE IMMEDIATE FINANCIAL EFFECTS OF THE WAR.

A. GREAT BRITAIN.

SINCE Mr. Angell wrote on the effects of war and conquest upon the credit system the money market has witnessed an upheaval far beyond the dreams of speculators. And it goes without saying that what really happened in the world of finance was precisely what few expected, although the predictions of a writer in the *Round Table*, about two years ago, were partly fulfilled. It may be well to complete the examination of Mr. Angell's views on finance by describing briefly the effects of the outbreak of war upon the banks and finance houses of this country, and, as far as they can be ascertained, upon credit in Germany. It is obviously impossible to discuss adequately the many financial problems created by the war. Such a discussion would call for a lengthy volume of a highly technical character.¹ Since this book

¹ The reader who desires to know more about the history of the crisis than can be described here will find much valuable material in the *Economist* and *Statist*. Mr. J. M. Keynes' articles in the *Economic Journal* (September and December) are invaluable as a critical survey of the position of the banks,

is written for the general reader, it seems necessary first to describe those features of banking, in normal times, which are relevant to the examination of the chief financial effects of war.

Credit is a term which eludes definition. For our purpose it may be regarded as the privilege of using the money or purchasing power of another person for a stated or indeterminate period. The most essential feature is confidence on the part of the person who supplies the purchasing power, *i.e.*, of the lender, in the ability and intention of the user to repay. The ability of the user to do so depends upon the manner in which he employs his loan, or on the value of the security which he offers. A bank is a medium for focussing and facilitating transactions in credit; it collects and redistributes purchasing power. When A. deposits cash with his banker he buys a claim upon the bank for that amount of money or purchasing power. He is a "depositor" by virtue, not of the money which he surrenders, but of the claim which he buys with it. He pays for the claim in advance. When B. borrows money from the same banker he, like A., purchases a

while an unsigned article in the September number of the *Round Table* gives an interesting account of the crisis and the way in which it was met. Since the lectures of which this chapter is a summary were delivered, Mr. Hartley Withers has published a characteristic book, "War and Lombard Street," which gives the most satisfactory account I have seen of the breakdown of the foreign exchanges. The January number of the *Journal of the Royal Statistical Society* also contains a brief account of the foreign exchanges during the last few months,

claim upon the bank, but undertakes to pay for that claim at some future date ; and in the meantime deposits something of value with the banker to secure the latter against possible loss. By virtue of the claim he possesses, B., like A., is a " depositor." Thus a depositor is one who possesses a claim upon the bank, and deposits, which, of course, are greater in amount than the cash deposited, represent liabilities or claims which the bank may be called upon to meet. The main assets are the cash, together with the securities deposited by those who, like B., pay for their claims at a later date.¹ The banker is able to sell claims upon the bank to " borrowers " because (a) the group of which A. is the representative—*i.e.*, the cash depositors—will not, in normal times, utilise more than a fairly definite proportion of their claims ; their cash deposits represent savings, and the proportion of uninvested savings left on deposit with bankers is fairly constant ; (b) the claims of the group of which B. is the representative—*i.e.*, the " borrowers," using the term in a very wide sense—do not represent more than a fairly definite demand for cash. All depositors *might* make their claims effective at the same time ; and, even if the cash depositors alone did so, the bank would not be

¹ I purposely neglect the various kinds of dealings with customers and their differences from the legal standpoint ; for in this connection I am merely concerned to show their essential economic features, and to give the minimum that is needed to comprehend the nature of the panic of August.

able to meet them. But experience—upon which banking, like insurance, is based—shows that they do not all demand their money together. And this makes it possible for the banker to redistribute, in the way of loans, the surplus cash of A. and his fortunate brethren. Nevertheless, the bank must be prepared to meet A.'s claim when it does appear, and, meanwhile, to fulfil his agreement with B. For A. only refrains from claiming his share so long as he is confident that he can obtain it on demand. He acts on the principle "If you can pay me, I don't want my money; but if you can't, I do." The necessity for retaining sufficient reserve to keep A.'s mind at ease limits the power of the bank to lend to B., and determines largely the character of the loan which is made. The credit system rests on confidence; and anything which shakes confidence tends to bring A. and his group to the bank clamouring for a settlement of their claims—*i.e.*, for cash. If too many come together, the bank may be unable to meet its obligations. The bank, therefore, needs to keep an adequate supply of cash at hand to meet the possible demands of the cash depositors during a period of stress, as well as "till money" to meet the daily needs of all classes of depositors.¹ The greater the amount of transactions settled by

¹ A manufacturer cashes a cheque for a big amount on Friday or Saturday to provide money of small denomination for the payment of wages. This money finds its way back to the bank on Monday or Tuesday *via* the grocer, butcher, publican, etc.

cheque, the less, other things being equal, the need for cash.

Cash lying idle in the vaults of the bank represents dead loss; it might have been earning interest as a loan to a borrower. The banker is thus controlled by two motives which conflict. The one is to retain the complete confidence of his customers by holding more than an ample reserve in cash; the other is to earn as much profit as possible by reducing reserves to the minimum consistent with safety. The result is a compromise, which is seen by examining the credit side of the balance-sheet—*i.e.*, by observing the ways in which A.'s money is utilised. In the first place, a reserve in actual cash must be kept. Part of this is deposited with the Bank of England, for reasons which we need not discuss here. In the second place, the bank invests some of its money in gilt-edged securities. Since these can easily be sold on the Stock Exchange, they are, normally, almost as good as cash. Investments are thus "liquid assets," which, at the same time, are a source of profit. In the next place, the bank lends money "at call" or "short notice" to brokers on the Stock Exchange, and to discount houses or bill brokers—*i.e.*, it lends money at low rates of interest to these firms on the understanding that it may call in the loan immediately or in a few days. Such loans, therefore, provided the firms remain solvent, are almost equivalent to cash in hand. Thus, in addition to cash

reserves, the bank has other reserves which can be converted into cash in a few days. Advances to industrial enterprises, Stock Exchange dealers, private customers, etc., form the largest item among the loans ; and these are not regarded as "liquid." They represent assets which cannot always be quickly realised.

The remaining loan transactions are directly or indirectly connected with bills of exchange, and these need some explanation. Economically, and under normal conditions, there is no essential difference between a bill of exchange and a promissory note ; and perhaps the best method of approaching the former is by way of the latter. Macdonald, a Scottish boot manufacturer, sells boots and shoes to Williams, a London dealer, who, working with a scanty supply of capital, cannot make payment until he has in turn disposed of part of his stock. But Macdonald is equally short of cash, and desires payment at once. Williams therefore sends him an I.O.U. (dated two months later), which is taken to the local branch of a Scottish bank. The banker has confidence in Macdonald, his customer, but none in the nonentity from London, and so refuses to buy the note at its present value unless some well-known London firm, such as Hindenburg, becomes guarantor. Williams approaches Hindenburg, who, confident of the ability of the boot dealer to pay, consents (for a commission) to guarantee the payment of the note on maturity.

And when the day arrives Hindenburg advances the payment and collects the money himself from Williams. His name is so valuable for this purpose, and he receives so many applications for its use, that he finds the commissions provide him with a comfortable income ; consequently he makes this his calling, and devotes his time to examining the stability of the applicants. In this way those worthy of assistance are given the credit they need, and are allowed to trade upon his name and reputation. The important point is that the promissory note acquires its value to the bank through the guarantee of a firm of repute.¹

Now the mechanism of the bill of exchange is not that of the imaginary note described above, but the complete transaction possesses precisely the same economic significance. Hindenburg, by arrangement with Williams, writes a letter to the Scottish manufacturer empowering the latter to draw a bill upon himself (Hindenburg). Macdonald is the *drawer* and Hindenburg the *drawee*. The Scottish bank, having seen Hindenburg's letter, now buys the paper, and Macdonald thus gets his money. The bill is sent to the London agent, who presents it to Hindenburg, and the

¹ Readers of Mr. Hartley Withers' books will have noticed that my account of this imaginary note is a poor copy of the author's description of the bill of exchange. The modern Bagehot must pay the penalty of fame. Who, having read his works on finance, can write or lecture except in imitation of his method ?

latter, by signing his name, signifies his acceptance and becomes the acceptor. The bill is now complete, and is sold at a price determined by the current rate of discount to a discount house. Again, be it observed, the bill is negotiable by virtue of the reputation of the accepting firm. Macdonald and Williams have disappeared for the time being.

Discount houses are merchant firms whose merchandise consists of bills of exchange. Usually they borrow money from the banks to enable them to carry on a larger business than their own capital would permit. Thus the liquid assets of banks consist partly of loans to discount houses. Some of the bills are held by the brokers till they reach maturity, when they are naturally presented to the accepting houses, who meet them and, in turn, recoup themselves by obtaining payment from Williams. The latter may be a New York or Berlin dealer, not a Londoner ; and Macdonald may be a Canadian farmer, not a Scottish manufacturer. An exporter of goods from Sweden to Holland may draw a bill on a London accepting house, because such bills are negotiable anywhere, and will certainly be discounted in London, the world's financial capital being a "free market for gold." Thus London finances a considerable part of the foreign trade of the world, even when such trade is not with this country.

Some of the bills—the best—are purchased by

the banks, and form an asset somewhat less liquid than those already mentioned. Banks select their bills in such a way that they mature regularly—*i.e.*, so that a steady flow of money returns through the maturing of the bills. This constant circular motion of money and bills makes it easy for the bank to strengthen its reserves by refusing to rediscount some of or all the bills which they usually take up. In this way it throws a dam across the stream and creates a fairly deep pool.

Finally, the modern bank has taken to "accepting" on its own account. As an acceptor of bills it incurs an obligation to the holder, so that acceptances are liabilities. On the other hand, by accepting on behalf of Williams and others, it makes these firms its debtors, so that their debts on account of acceptances represent an asset of the same amount as the corresponding liabilities. It will thus be seen that the position of the bank depends partly upon the financial stability of the discount houses; that the stability of the discount house depends mainly upon the financial strength of the accepting houses, and that the strength of the accepting houses depends upon the solvency of the ultimate debtors, the purchasers of goods. And if these are in foreign countries, it depends upon the ability to send payment to London. Anything which seriously interferes with this payment to the acceptors of bills reacts upon the banks as lenders to discount houses, as holders of bills, and as acceptors. The existence of means

of payment depends upon continuity of production and sale, while that of external facilities depends upon the maintenance of peace, or, during war, the control of the seas.

We are now in a position to examine the financial panic created by the war and prospect of war, and to understand the measures taken by the Government to deal with it.

The dramatic history of the money market during the fortnight following the Austrian ultimatum to Serbia and the necessity for Government action become intelligible to those of us who are laymen when attention is fixed upon the position of the joint-stock banks. One of their needs, as already indicated, is to maintain a considerable proportion of their assets in a "liquid" form, so that the claims of the depositors, even in time of stress, may be readily met. The net effect of the political situation—first the crisis, and afterwards the outbreak of war—was, on the one hand, to solidify or make unrealisable those assets which the banks had looked upon as quickly convertible into cash, and, on the other (and partly as a result of the first), to create alarm among the bankers lest A. and his group should become panic-stricken and clamour for their cash.

In the first place, the feeling of unrest, intensified by the ultimatum, reacted upon the stock exchanges, and also caused the foreign exchanges to break down, so that within a week remittances

could not be sent from one country to another.¹ Holders of securities sold rapidly and prices fell heavily. Apparently Berlin and other Continental banks endeavoured to realise those securities which they held—partly for strategic purposes—as reserves. Moreover, other holders, speculators and investors, sold because they feared worse might follow, and so developed an affection for cash. The consequence was that in a few days all the Continental bourses were closed, and London and New York alone remained open. Naturally—and especially as the political crisis was rapidly growing more acute—masses of securities were unloaded on these exchanges, which were compelled to close (on the Saturday before Bank Holiday) as a measure of protection to their own members.

The banks were affected in two ways—through their loans to the Stock Exchange and as investors in securities. Brokers holding purchases on behalf of foreign clients could not receive payment, and were therefore unable to repay their loans to the banks. Again, the securities held by the banks for loans to brokers shrank in value. The loan normally obtainable on securities depends upon their market prices; a margin of about 10 per cent. is insisted upon to secure the bank against a fall in price. Thus £100 Government stock quoted at 80 will be regarded as sufficient security for a loan of about £70. If the price falls to 70,

¹ See p. 66.

the borrower must find other cover, or redeem part of the loan. This is often done by selling some of the stock.

The serious fall in values on the Stock Exchange¹ placed many borrowers in Queer Street, and these were saved by the closing of the exchange. The banks—some of whom had not inspired confidence by their attitude towards Stock Exchange clients—could not insist on more cover, since there were no official quotations for the securities. Nor could they sell the securities themselves, since there was no market.

Finally, they could not sell their own investments. Thus two liquid assets—short loans and investments—lost that very characteristic which made them so desirable from the banker's point of view. And to that extent the position of the bank, in the face of possible panic demands from the depositors, was weakened.

In the second place, the position of joint-stock banks was made precarious by the effect of the collapse of the foreign exchanges upon the bill market and the reaction of the political situation upon the prospects of trade. The acceptor of a bill expects to be placed in funds by the client for whom he has acted. Many of these debtors or clients, as already stated, are foreigners, who cancel their debts, under ordinary circumstances,

¹ The average fall for a mass of securities was a little over 5 per cent. during the week following the ultimatum; the fall in Consols was slightly above the average.

by means of bills on London purchased from those who have sent goods to this country and are therefore our creditors, but occasionally, under special circumstances, by sending gold. But before the end of the last week in July it became practically impossible to send remittances to this country, so that much of the circulating capital of the accepting firms was lost for the time being. Moreover, the outbreak of war between Russia and Germany, and the subsequent entry of the other nations, made doubtful the solvency of home debtors—Williams & Co.—who had been accustomed to rely upon the acceptors, so that the latter were also in danger of losing considerably on home bills. The effect was two-fold. Accepting houses could not undertake fresh business in bills, so that our trade, which is so largely financed in this manner, was in danger of serious dislocation. Moreover, discount houses would be seriously injured if the accepting houses failed to make payment on maturity, and would thus find it extremely difficult, if not impossible, to repay their loans to the banks. The banks were thus affected in three ways—(1) as acceptors they would be called upon to meet bills on maturity, but could not expect to be repaid by all their debtors, for whom they acted; (2) as holders of bills accepted by the chief accepting firms, they would be injured where the latter proved unable to meet those bills on maturity; (3) as lenders to discount houses, they would be injured where the latter had been

made insolvent through similar failure on the part of the accepting houses. All three classes of assets were frozen, and so could not be relied upon in the emergency.

Consequently those joint-stock banks which pursued a short-sighted policy, while endeavouring to realise as much as possible of the above assets (thus adding to the embarrassment of the other sections of the financial community), did three things. First, they drew upon their reserves in the Bank of England, and so increased their individual holdings of gold and Bank of England notes (which are legal tender). Secondly, they refused to discount any more bills and called in their loans to discount houses. Consequently the latter were compelled to have recourse to the Bank of England, which never refuses to discount a good bill, although it may increase its charge for doing so—*i.e.*, raise the rate of discount.¹ One would expect to find that these joint-stock banks, so solicitous of the welfare of their cash depositors, would have treated the latter handsomely. But such was not the case, for (thirdly) they curtailed payment of gold over the counter. Their customers, whenever possible, were handed bank-notes on the Friday before Bank Holiday. Now a bank-note (which is always convertible into gold at the Bank of England) is an extremely inconvenient

¹ It appears that the Bank of England discounted bills to the value of £14,000,000 in two days, mainly in consequence of the action of such banks.

form of money for holiday purposes, and quite unsuitable for payments of wages and small debts. So great was the need for coins of small denomination that on Friday afternoon and Saturday morning large crowds of those who had received paper the day before appeared at the Bank of England to change the notes into gold and silver. Thus some of the joint-stock banks helped in three ways to drain the gold reserve of the Bank of England. This reserve, which on Wednesday, July 29th, amounted to £27,000,000, was reduced by Friday, August 7th, to £10,000,000. It is doubtful if there was a serious run upon the joint-stock banks; ¹ but some of the joint-stock banks certainly acted towards the central institution as they expected their depositors would act towards themselves.² The result was a violent upward movement of the Bank of England rate of discount, first from 3 to 4 per cent. (Thursday), then to 8 per cent. (Friday), and ultimately, on the Saturday, to 10 per cent. The declaration of the 10 per cent. Bank rate was the signal for Government interference. Such, then, was the position over the holiday week-end. In a week the storm had wrought greater havoc upon

¹ In view of the holidays there was naturally a greater demand than usual for cash.

² The writer witnessed "runs" on three banks in Rotterdam on Bank Holiday. Barriers were erected outside the buildings, and the police guarded the premises. But these "runs" were said to be due to the scarcity of silver which, apparently, the Dutch working-class families suddenly began to hoard.

finance and commerce than anyone had dreamt possible. So great is the interdependence of nations that mere suspense destroyed completely the delicate fabric of world credit. A new and tougher one had to be substituted without delay.

The problem which faced the Government was two-fold. The banks required assistance to meet a possible panic among depositors after the Bank Holiday. Moreover, it was necessary to secure continuity of trade by preventing the complete destruction of the financial machinery by which it is carried on. The primary need of a bank during a crisis is a plentiful supply of currency in which the depositors have complete confidence, and which, therefore, they will accept without hesitation. Gold is, of course, the perfect currency in this respect. Hardly less acceptable is the Bank of England note, which is regarded as being practically State-guaranteed paper. But the issue of such notes (except as a substitute for cash deposited) is limited, by the Act of 1844, to an amount which now reaches approximately £18,500,000. The Government could provide the banks with all they needed in one of two ways—by suspending the Bank Act and permitting an unlimited issue of the notes with which we were familiar, or by issuing notes from its own Treasury Department. The latter method was adopted. The Bank Holiday was extended three days, at great inconvenience to the public, to enable the Government to prepare the new issue, and to

allow time for the fears of nervous depositors to diminish. Postal orders were made legal tender until an adequate supply of notes could be manufactured. The Bank Act was also suspended, so that, presumably, an unexpected shortage could be met immediately by an additional supply of bank-notes ; but the new powers of the Bank of England were not employed in this manner. Joint-stock banks were allowed to borrow Treasury notes to the amount of 20 per cent. of their liabilities. Since these total more than £1,000,000,000 for all the banks, the Government made provision for a possible addition of over £200,000,000 to the currency of the nation. When the banks were reopened on the Friday it was found that depositors were not the victims of the infectious disease which had been so much dreaded. They had been successfully inoculated.

The other aspect of the problem presented greater difficulty. One writer has stated that the Government's action produced the effect of a dose of morphia ; it deadened the sensibility of the credit organism. Another affirms that it quickened its activities, which had been almost paralysed. Morphia can scarcely be regarded as a stimulant ! What the Government did was to give a mixture of morphia and strychnine.

In the first place the difficulties of the accepting houses were met for the moment by the declaration of a moratorium covering bills of exchange—*i.e.*, accepting houses were relieved, for a month,

of their liabilities on maturing bills. But this left the banks and discount houses in an awkward position, so that a few days later (August 8th) the moratorium was extended to almost all transactions of £5 and upwards. Thus a holiday was granted to debtors at the expense of creditors ; and banks frequently employed the shelter of the moratorium against the claims of their own creditors, the depositors. So much for the morphia.

The strychnine was equally effective. The problem of the banks and discount houses was solved with comparative ease. The assets of the banks in the form of bills of exchange and loans to discount houses threatened to be unrealisable, consequently the Bank of England was empowered (August 13th) by the Government, and at the latter's risk, to rediscount, at 2 per cent. above Bank rate, all bills normally regarded as good bills drawn before the moratorium of August 4th. Thus all such bills could be turned into liquid assets, and the discount houses were able to repay their loans to the banks. Both institutions were in a position to undertake fresh work of the same kind, since they availed themselves largely of the powers conferred by the Government. It is surprising they did so to such a great extent, for, as Mr. Keynes points out, they were practically borrowing at 7 per cent. (the Bank rate having been reduced to 5 per cent.) to lend again at a much lower rate. The fact

that they could rediscount their bills at any time secured them against possible loss, so that it would have been more profitable to hold them longer than they did. But the net effect of the policy pursued by the Government was that the capital of the holders of bills—banks and discount houses—which had been locked up was once more realisable. The accepting houses were for the moment protected by the moratorium, which gave them time to recover from the stunning blow delivered by the outbreak of war. But they could not be expected to entertain fresh business. Nor could the other institutions be expected to discount, so readily as before, the bills of acceptors whose solvency was now seriously threatened. Trade was in imminent danger of being curtailed beyond the point to which war itself would reduce it. Consequently the Government authorised the Bank of England to allow acceptors to reaccept pre-moratorium bills as they fell due. Since there was no basis for confidence that the political and industrial conditions would be improved before the reaccepted bills again matured, this measure proved inadequate. Ultimately (September 5th) the Bank was authorised to lend money to acceptors (also at Government risk and at 2 per cent. above Bank rate) to enable the latter to meet their bills (most of them now held by the Bank itself) at maturity. The bills thus disappeared and the acceptors became simply borrowers. The loans need not be repaid until

twelve months after the conclusion of peace except in those cases in which the ultimate debtors—Williams & Co.—placed the acceptors in funds in the usual way. Thus the acceptors are relieved, for the time being, of the dead weight which hampered their movements and are able to proceed with their accustomed work. Moreover, since the Bank's claims will rank second to those of holders of bills at the time of settlement, the banks and discount houses (who have realised their assets, and so possess, or can obtain, money to discount fresh bills) are ready to accept the guarantee of the acceptors.

The history of the crisis and the measures of the Government raise many questions which have been fully discussed in newspapers and journals, and which would need careful examination in a treatise on banking. But, since the purpose of this chapter is to indicate what really did happen to the financial machinery on the outbreak of war (for purposes of comparison with Mr. Angell's supposed predictions), such an examination would be irrelevant. Reference may be made, however, to three criticisms.

(1) It is sometimes contended that since the bill market has been dull since August, and banks cannot find outlets for the capital set free by the measures of the Bank of England, the machinery has not been fully repaired. This is not quite true. The machinery may not be so powerful as of old; but the chief reason for the lack of bills

is to be found in the state of trade. Bills do not make trade, but trade creates bills. It is obvious that trade must be dislocated and materially reduced when five great nations are at war; the belligerents cannot exchange goods, and at least fifteen million men are withdrawn from their ordinary occupations to take their places on the battlefield or behind it.

(2) Complaints have been uttered by traders that finance houses have received preferential treatment, while they themselves, equally in need of assistance, have been left to fight their battles unaided. Such is not the case. Traders were protected when assistance was granted to finance houses. The latter were not assisted in their own interests, but in the interests of the community. The bank has been termed the power-house. If power fails, all the machinery in the factory is brought to a standstill. The measures of the Government can scarcely be called "paternal legislation," such as assistance to traders, in their own interests, would be termed.

(3) It is sometimes argued that the Government was not justified in incurring such enormous liabilities as were involved in the guarantees it offered to the Bank of England. That there will be losses cannot be denied. It is impossible to say how serious they will be. But even if they amount to forty or fifty million pounds, the gains already achieved are probably more. Not only was credit restored, but (to a great extent as a

result of this) the war loan was issued with complete success. The terms were much more favourable to the Government than would have been likely if credit had not been fully restored. It is not improbable that the Government will gain as much by issuing war loans under favourable conditions as it is likely to be called upon to pay as the price of its policy in protecting the financial market. The damage caused by the temporary collapse of credit was far less than anticipated; and the courageous action of the Government was undoubtedly the dominating factor in its restoration.

B. GERMANY.

It is never easy to disentangle the strings of assets and liabilities published at regular intervals by those who take care of the nation's money, but the task of estimating the significance of the periodic statistical statements of the Imperial Bank of Germany presents almost insuperable difficulties. Beyond these statements—which may or may not be reliable—the financial news which percolates through the national boundaries is somewhat meagre. Nevertheless, it is important that such facts as are obtainable should be examined; for not only may the duration of the war be partly determined by the manner in which the financial machinery performs its work, but the state of credit is itself a manifestation of the economic and moral condition of the people.

It is generally admitted that for many years past the economic policy of the German nation has been subordinated to presumed political necessity. What is equally evident to those who are interested in the German credit system is the care which was devoted to financial preparations for war. Professor Riesser, of Berlin, in an elaborate treatise on the concentration movement among German banks, dwells upon the need for facilitating, by carefully considered methods, "the marshalling of financial forces" corresponding to that of military forces—"it is impossible without severe losses to evolve a battle formation in the face of the enemy." Scraps of information have appeared from time to time in the *Economist* which, together with the canons laid down by Professor Riesser and the balance-sheets of the Reichsbank, make it possible to visualise, somewhat dimly, the present state of credit in Germany.

The modern banking system of Germany possesses one feature which is characteristic of our own. It rests upon or radiates from a central institution, the Reichsbank, which corresponds to our Bank of England. But it differs from the latter in being under Government control and management. Joint-stock banks keep their bullion reserve on "giro" account with the Reichsbank, so that, as with us, their mutual indebtedness can be cancelled and clearances effected by means of cheques (or their equivalent) upon the latter. But banking in the German

States is not so highly developed as in this country; the method of payment by cheque is not so extensively employed, so that bank-notes play a much more important part as currency. Normally the issue of Imperial bank-notes is limited to £27,500,000 plus the value of the reserve, which consists of bullion (gold and silver), Treasury notes, and the notes of the four other banks of issue—Württemberg, Bavaria, Baden, and Saxony. For any issue beyond this limit a tax of 5 per cent. is payable. The Reichsbank notes are legal tender, normally convertible into gold at headquarters.

The economic disturbances during the "black week" of July and immediately after the outbreak of war were of almost the same character in Germany as in Britain, although the remedial measures adopted by the two Governments were quite different. When the political crisis reached an acute stage the Germans became panic-stricken. Excessive demands for cash were made upon the private banks, which, immediately before the declaration of "*Kriegszustand*" on the Wednesday, refused to meet more than 20 per cent. of their liabilities in gold. It has been stated that they entirely suspended cash payments at this stage. Such was not the case; the writer (like many others present at the time) was paid gold on the Friday evening (July 31st). The newspapers called attention to the efforts of the people to hoard gold and silver during that week, and

urged them to act exactly as they were accustomed to do under normal conditions. Banknotes were regarded with suspicion, and apparently depreciated in terms of gold. Sometimes they were refused, and the military governor was compelled to intervene, and to threaten punishment for non-acceptance of paper which had always been legal tender. Food prices rose rapidly, and many householders played into the hands of the shopkeepers by laying in large stores of non-perishable household goods. Immediately after the declaration of war against Russia maximum food prices were established by many local authorities in Prussia and elsewhere ; the Reichsbank was relieved of its obligation to pay gold for its notes, and, apparently, the Act limiting note issue was suspended. Thus the first two steps taken—one, at least, after careful thought—in the economic mobilisation of the nation were precisely those which, according to orthodox British theory, should have been regarded as among the last resources. But before the notes were made inconvertible the gold reserve of the Reichsbank had been depleted to the extent of about £5,000,000.

The great need during a crisis (when hoarding is general and gold therefore scarce) is a plentiful supply of currency which will be accepted without hesitation by the community. Such a currency was provided partly by coining and issuing silver to the value of about £15,000,000, which had

previously formed part of the Reichsbank reserve ; partly by the issue of Treasury and bank notes ; and partly by the issue of war notes (*Darlehnskassenscheine*) by special war banks, to which reference will be made later. The initial expenses of military mobilisation were met from the contents of the "war-chest." After the Franco-Prussian war the sum of £6,000,000 in gold was deposited in the fortress of Spandau, near Berlin, and remained there until the outbreak of the present war, when it was apparently transferred to the Reichsbank. Moreover, a few years ago provision was made for a second war reserve of the same amount. Two-thirds had been collected and deposited at the bank before war was declared, so that the effective reserve of that institution was strengthened, to the extent of £10,000,000, soon after the withdrawal of gold and silver made necessary by the panic and scarcity of currency. The remaining two millions of the new war-chest apparently existed in the form of Treasury notes.

It seems fairly evident that the trading community was directly and immediately assisted by the Imperial Bank. For not only had this part of the plan been advocated long before, but the "discounts and advances" in the weekly statements of that institution increased from about £40,000,000 on July 23rd to about £230,000,000 on August 15th. It is extremely probable that such increase was at first mainly due to the discounting of bills of exchange. The item roughly

corresponds to "other deposits" in the weekly returns of the Bank of England.

The Germans are proud of the fact that, alone among the belligerent nations, they found it unnecessary to declare a moratorium, and that the official rate of discount never exceeded 6 per cent. These facts are undoubtedly evidence of financial strength. But they are also evidence of financial immaturity. Comparison of Germany and Britain on the basis of the emergency measures which proved necessary is impossible. For, first, even in time of peace the Reichsbank frequently refused to part with gold (while retaining a moderate rate of discount) when the state of the foreign exchanges made such action profitable, so that the 6 per cent. rate of discount would not be operative in the case of transactions calling for the export of that metal. Secondly, the fact that the Reichsbank had suspended gold payments—when the notes were made inconvertible—renders comparison with our own country futile. When the Bank of England rate was 8 per cent. every bill discounted *might* have meant the withdrawal of gold, for the bank-note was (and is) convertible. But a bill discounted at the Reichsbank could not mean more than a withdrawal of notes, which could be replaced without difficulty so long as the printing machine remained in working order. In other words, the rate of discount possesses little or no significance where the currency can be inflated without limit. Finally, bills of exchange pre-

sented to the Reichsbank were held in Germany, and were mainly of a domestic character. And such bills play a much less important part in the economy of the nation than is the case here. What made a moratorium necessary in Britain was the great extent to which London accepting houses were then financing the trade of the world, and to which they were creditors of foreign merchants who could not pay their debts. The argument that because Germany was able to dispense with a moratorium she was stronger, financially, than Britain is as valid as the argument that because Timbuctoo has been less seriously affected by the war it is in a better economic condition than the United States.

The following tables, selected from the weekly returns of the Reichsbank, provide some of the data upon which the remainder of the chapter is based :—

BANK OF GERMANY (000's omitted).

—	July 23.	Aug. 15.	Sept. 23.	Nov. 7.	Dec. 23.	Feb. 27.
Assets:—	£	£	£	£	£	£
Gold	} 84,570	} 79,511	83,791	94,271	103,774	113,532
Silver			1,435	1,808	2,064	2,181
Treasury notes Discounts and advances ..			7,465	42,961	37,707	10,801
	40,055	230,348	241,881	133,804	185,123	206,899
Liabilities:—						
Notes in circula- tion ..	94,545	194,096	199,640	204,242	221,599	243,135
Current ac- counts (or deposits) ..	47,198	127,588	135,449	64,103	102,727	79,076

The addition of about £190,000,000 to "discounts and advances" between July 23rd and August 15th was probably due, in the main, to the rediscounting of bills of exchange. This was done partly by payments of gold, silver, and Treasury notes, but mainly, as the tables show, by means of bank-notes and "current accounts" (*i.e.*, entries in the bank books against which the depositors could draw cheques).

Nearly £100,000,000 of additional notes were issued, while deposits (or current accounts) were augmented by about £80,000,000. These together represented an enormous increase in the currency available for circulation. On the other hand, when war became inevitable private individuals hoarded as much gold as possible, and to the extent of the affection displayed for the golden nest-egg the amount in circulation diminished. Consequently, it is likely that the active currency was not so seriously inflated as the above figures suggest—certainly not to the extent of over £200,000,000 suggested in the *Economist*.

The "life" of a bill of exchange is usually two or three months; it is rarely longer than six months. Some of those rediscounted at the Reichsbank were probably already advancing towards old age, while others had passed their early youth. As these bills reached maturity and were cancelled one would expect to find a gradual but steady reduction in "discounts and advances." Such was not the case. Their place

was taken either by Treasury bills or, what comes to the same thing, by advances to firms engaged on Government work, who would ultimately be paid from the proceeds of the war loan. For several weeks, indeed, the advances of the bank increased, until on September 23rd (when they were approximately £242,000,000) the upward trend came to an end.¹ Afterwards they fell steadily to about £134,000,000 on November 7th. The first war loan of £250,000,000, authorised on August 4th, was floated on September 19th. The natural inference is that there was a considerable reduction in assets which was closely related to the issue of the Imperial loan. Advances made to the Government or its contractors were repaid out of the funds provided by subscribers to that loan. In this connection it is significant that, corresponding to the shrinkage of assets, the reductions of liabilities were entirely in "current accounts." The issue of bank-notes steadily increased during this period. Obviously many subscribers to the loan obtained funds in the form of such notes, so that notes first issued as emergency (temporary) currency to finance trade during the critical period were employed by subscribers in payment of their shares, and afterwards replaced in circulation by the Govern-

¹ Under normal conditions "advances" increase towards the end of the quarter; but in the quarter under consideration one would expect to find such increase counterbalanced by a reduction on account of the maturing of rediscounted bills.

ment as part payment of its debts to contractors and others.

The war banks—of which more than two hundred were established in various parts of the country—call for comment here. These are, in effect, special mortgage banks with a two-fold object. It was obvious that the outbreak of war would dislocate trade and embarrass many tradesmen and others, who, while solvent, might be unable for a time to realise their assets. The war banks were established mainly to provide temporary assistance to such people by lending “money” (for three months at $6\frac{1}{2}$ per cent.) upon such security as produce, stocks, bonds, etc. The “money” lent consisted of special credit instruments or war notes, which, although not legal tender, were accepted by the Government and honoured by the Reichsbank, which was authorised to exchange them for bank-notes on demand and empowered to classify them as Treasury notes. Although the bulk of such notes as were actually borrowed found their way to the Reichsbank and were replaced by bank-notes, a considerable proportion circulated freely. They were mainly of small denomination (10, 15, 20 and 50 marks) and corrected the lack of coin. Between July 23rd and September 30th the amount of “Treasury notes” in the Reichsbank reserve increased by about £13,500,000, while on the latter date there were almost £10,000,000 of war notes in circulation. The second object of the

war banks was to enable the general public to raise funds for subscription to the war loan ; and to this end the total amount which the special credit institutes could advance was increased in September from £75,000,000 to £150,000,000. Further discussion of this point would necessitate an examination of the methods employed in financing the war, which is beyond the scope of this chapter. It is sufficient to say here that the activities of the war banks have resulted in an appreciable increase in the currency of the nation. Moreover, since the beginning of November " discounts and advances " have steadily increased until, in the latest returns (February 27th), they amounted to approximately £207,000,000, while during the same period bank-notes in circulation increased to £243,135,000. The bank-notes now in circulation amount to more than the total gold supply of the empire ; and when the second war loan is issued the supply must be still further increased.

From what has already been stated it is evident that, although the gold reserve has been enormously strengthened, the currency of Germany has been considerably inflated at a time when the need for currency (as distinct from the demand for gold) has been considerably reduced ; for the isolation of the empire and the withdrawal of several millions of soldiers from their ordinary avocations must have seriously curtailed trade. Economic theory tells us that under such circum-

stances the value of money must fall—*i.e.*, prices must rise. In this way alone can the inflated currency be completely absorbed. But immediately war was declared maximum food prices were established by many local authorities, and subsequently the Imperial Government fixed maximum prices for foodstuffs and metals. It seems as though the German economists called into consultation believed it possible to neutralise the effects of economic forces by legal enactment.

The material available is too scanty to justify dogmatic utterance upon the efficacy of the measures adopted. The price policy is said to have proved a failure. It is true that the earlier methods of enforcing it proved inadequate, and that the resulting friction has led many to believe that economic exhaustion is at hand. But it is by no means clear, from experience already gained, that a stricter application of the same policy must fail completely. During the first five months of war the price of copper advanced 44 per cent., tin 58 per cent., lead 22 per cent., and zinc 68 per cent. The prices prevailing at the end of the year were declared maxima. That they proved to be too low is evident from the fact that no private dealing afterwards took place. Sellers would not part with their stocks except to the Government, which was above the law. But the rise in the prices of the minor metals is fully explained by their scarcity. The maximum prices of foodstuffs were advanced from time to time.

During the last quarter of the year the price of butter, for example, rose 27 per cent., and that of lard 42 per cent. There is a fundamental difference in the immediate significance of the necessaries of life and the metals. A *continuous* supply of the former is absolutely essential. And since sellers held up their stocks for higher maxima in the future, the Government was compelled practically to commandeer bread to secure supplies for the poor, as well as economic consumption with a view to the future. At this point the assumption of economists—free play of economic forces—completely breaks down. It will be interesting to see what has happened to the prices of commodities other than metals and necessaries of life.

It is practically certain that if gold circulated freely in Germany two prices would already have emerged—gold and paper prices. The former would be lower than the latter. German paper (in terms of German gold) has already depreciated in other countries. Such depreciation is quite distinct from, though closely related to, the foreign exchanges, which are not within the scope of this chapter. Early in January the writer converted, into British money, gold and paper which he brought from Germany on the outbreak of war. For two Reichsbank notes of 100 marks he was given £8 6s. 8*d.*; and for a German sovereign 19s. 2*d.*, so that for ten German sovereigns he would have been given £9 11s. 8*d.*, or 25s. more

than he obtained for the same sum in paper ; in other words, German paper had depreciated about 13 per cent. as compared with German gold.

It is highly probable that in the near future, when a great part of the new loan has been spent and the issue of bank-notes again considerably increased, the latter will be further depreciated. And it is still more probable that the restoration of the credit system after the war will necessitate a considerable loan to cover the damage already wrought ; while further depreciation of paper will but add to such cost of restoration. The only alternative will be to allow the holders of notes to bear the loss entailed by the emergence of two prices when gold again enters into circulation.

The final point for consideration is closely related to the above. Since war was declared about £50,000,000 of gold has been added to the reserve of the Reichsbank, so that, in spite of the enormous issue of bank-notes, the proportion of reserve is still high, and the legal limit of total indebtedness far distant. But it should be observed in passing that a reserve of (say) 50 per cent. on a normal paper issue of (say) £100,000,000 is not the same as a 50 per cent. reserve on an abnormal issue of £200,000,000 ; for a reduction of the issue once more to the normal amount would sweep away the whole gold reserve. Where has the gold been obtained ? The sum of £10,000,000 in gold was already to hand in the form of a war chest. The rest, according to the

German authorities, has been withdrawn from circulation. Probably most of it is accounted for in this way, although the steadiness of the increase (which cannot continue indefinitely) remains a mystery. A writer in the *Economist* suggests that since the Bank of Austria ceased to publish returns after the declaration of war, the gold reserves of the two Imperial banks may have been pooled. It is not a convincing theory. Probably the explanation is to be found in the suspension of cash payments. In a speech in the autumn Herr Havenstein, the President of the Reichsbank, complimented the joint-stock banks upon having strengthened their reserves in the central institution while continuing to advance freely to their own customers. The inference is that the Reichsbank, which could seriously damage the credit of reluctant private banks, calls upon the latter for their gold in such a way as to show a steady increase in its own reserve. The other banks no longer require their domestic supplies of gold, for they may advance freely to their own customers either by paying (inconvertible) notes or by granting deposits upon a reserve of notes.

The impression conveyed by such facts as we know is that the currency measures constituting the "financial mobilisation," upon which Professor Riesser and others lay such stress, were well adapted to a short war which would not isolate Germany from the rest of the world, but are no more effective than those employed by the

United States Government, during the Civil War, for a long struggle against a combination which seriously interferes with the external trade of the German Empire. And there is ample reason for the view that before economic exhaustion is reached the financial situation may become intolerable to the Liberal party, representing the industrial and commercial interests. The longer the war lasts the greater will be the difficulty of restoring credit, and, therefore, of resuming trade with foreign countries.

CHAPTER V.

TERRITORY AND ECONOMIC WELFARE.

A. ANNEXATION.

MR. ANGELL'S views on territorial expansion by means of complete annexation are expressed in language which gives no room for misinterpretation. Annexation cannot bring economic gain.

"The wealth of conquered territory remains in the hands of the population of such territory. When Germany annexed Alsatia, no individual German secured a single mark's worth of Alsatian property as the spoils of war. Conquest in the modern world is a process of multiplying by x , and then obtaining the original figure by dividing by x . For a modern nation to add to its territory no more adds to the wealth of the people of such nation than it would add to the wealth of Londoners if the City of London were to annex the county of Hertford" ("The Great Illusion," p. viii, preface).

"When Germany annexed Schleswig-Holstein and Alsatia not a single ordinary German citizen was one pfennig the richer" (p. 31).

In regard to the annexation of Holland, "we may, indeed, say that the Hollander would be certainly the worse, in that he would have exchanged the relatively light taxation and light military service of Holland for the much heavier taxation and the much longer

military service of the 'great' German Empire" (p. 40).¹

The view expressed in these quotations seems to be erroneous. If no gain was effected by the annexation of Alsace-Lorraine, no loss would be suffered if it were now returned to France. Nor would any loss be felt if Schleswig-Holstein were handed back to Denmark, East Prussia were presented to Russia, Westphalia ceded to Belgium and Holland, Saxony to Austria, Silesia to the new Poland, and so on, until "Germany" was left with only the plains and pleasant lakes of Brandenburg. Her remaining people, according to Mr. Angell, would be no worse off, economically, than before. He has obviously neglected important factors contributing to the wealth of nations.

In the first place, his argument denies the validity of the contention, both of free traders and of many modern protectionists, that an extension of the free trade area is followed by an increase in the total wealth of that area. If the free trade argument is sound, Germany gained appreciably by bringing the annexed provinces within the customs union.--The gain to Alsace-Lorraine is not so obvious, since it but exchanged one free market (France) for another. But, even to that province, the exchange probably

¹ From his statement, on p. 28, to the effect that if Germany annexed Holland Dutch merchants would be competing more keenly than ever with their German rivals, we infer, perhaps wrongly, that Mr. Angell believes Germany would suffer through such annexation.

proved advantageous in the economic sense, for, while the population of France has remained practically stationary, that of Germany has increased steadily, so that the new free market is considerably larger than the other would have been. Moreover, the direction of industrial development in Germany has proved advantageous to the new province, which contains valuable deposits of iron ore and coal.¹ It is probably true to say that if Alsace-Lorraine had been kept on the remote side of the German customs barrier it would not have enjoyed so much economic prosperity during the thirty-five years or so that have passed since the discovery of a method of utilising the special quality of ore found in that region. But whatever doubt may exist about the economic gain to Alsace-Lorraine, there is certainly none as to the advantage which annexation brought to Germany, with its prevailing tariff policy. Similarly the annexation of the Low Countries would benefit, in this sense, not only those countries themselves, but also Germany, which is now hampered by the barrier separating the Rhine provinces from the sea. It is, of course, obvious that if one free trade country annexed a portion of another free trade country the free trade area would not be extended. But

¹ And the fact that much of the trade of the annexed provinces with foreign countries was made to pass through Germany rather than France must have brought considerable gain to the transport industries and commercial interests of the empire.

even in this case, provided the two employed different systems of weights and measures, and different coinage, the former would gain slightly from an extension of its area. For the adoption by the annexed territory of the systems of the conqueror would undoubtedly react favourably upon the trade of the latter. Differences in the systems employed by the different German States before 1870 seriously hampered inter-State trade; and the adoption of a uniform standard after the French war assisted materially the development of trade within the new Empire.¹

In reply to a critic Mr. Angell writes :

“ We realise that when Germany has conquered Alsace-Lorraine she has ‘ captured ’ a province worth, ‘ cash value,’ in my critic’s phrase, sixty-six millions sterling. What we overlook is that Germany has also

¹ Mr. Angell lays great stress in his writings upon the fact that trade does not respect political boundaries. But trade even yet is not entirely indifferent to them. Differences in coinage, in weights and measures, and in laws relating to trade and finance still compel a certain amount of such respect. The truth of this may become very evident after the declaration of peace, when Germany will be faced with the serious problem of reducing her inflated currency (which even now is not accepted abroad at its face value) to normal proportions. The fact that currency is under the control of Governments, that the fiat of Governments is practically ignored in other countries, and that an international currency is more restricted in its forms than internal media of circulation will, for a long time to come, make political boundaries an effective barrier, within well-defined and narrow limits, to international trade. The absence of that knowledge of industrial and financial conditions of foreign countries which is possessed of one’s own country is also a retarding influence of no small importance. These differences in laws and degrees of acquaintance with markets act in the same *manner* as protective tariffs.

captured the people who own the property and who continue to own it. We have multiplied by x , it is true, but we have overlooked the fact that we have had to divide by x , and that the result is consequently, so far as the individual is concerned, exactly what it was before. My critic remembered the multiplication all right, but he forgot the division " (pp. 42, 43).

The paragraph has been quoted because Mr. Angell seems to lay great stress upon this process of multiplication and division. Three comments may be made upon it:—(a) If what we have already stated is true, the wealth per head is increased. The enlargement of the free trade area has added to the wealth more than proportionately to the addition, through annexation, to the population. (b) It is difficult to give a meaning to Mr. Angell's algebra. The multiplier is x . Now what is x ? Apparently the population of Alsace-Lorraine. If anything is multiplied by x it must be the average wealth per head in that province. So the net result is that we multiply the average wealth per head in Alsatia by the number of people, and then divide by that number, and so obtain—the average wealth per head in Alsatia! But that gives us no information about Germany, and is, of course, an absurd process. What Mr. Angell probably means is that if the *property* of the new province is added to the wealth of Germany, then, in order to ascertain the wealth per head, the population of the province must also be added to the population of the conquering nation. And the resulting

wealth per head is the same as before. It is perfectly true that, since the annexation of French territory did not interfere with the property rights of its inhabitants, the individual Germans did not gain much *immediately*, but the present chapter shows that they probably gained considerably in the long run. (c) The inference from the quotation seems to be that if Germany could have annexed the land and property and expelled the people she would have been better off. This assumes that the country was already overpopulated.¹ Surely it was better to have the people along with the property, since the well-being of the Germans would only be increased by the employment of such property. Merely to have factories which must remain idle and houses which must be empty was of little use. To have the people also, to produce a flow of wealth, was an advantage, provided not all that flow was appropriated by the Alsatians.

Thus we are brought to the second important effect of annexation. The annexed territory may be a real gain, in that it adds to the taxable capacity of the nation. Mr. Angell denies that this can be so. Replying to a critic who stated that the cash value of Alsace-Lorraine was £66,000,000, and that consequently, at its present rate of taxation,

¹ I refrain (because it is not important in this connection) from a discussion of the theoretical question of the possibility of gain to the members of a nation by the emigration of those who are engaged in "marginal employments" to another country—uninhabited or thinly populated—where they would be engaged in "intra-marginal employments."

the French Government was losing an income of £8,000,000 a year, he writes :

“ If we take the interest of the ‘ cash value ’ at the present price of money in Germany, Alsace-Lorraine should be worth to the Germans about three millions a year. If we take the other figure, eight. Suppose we split the difference, and take, say, five ”¹ (p. 41).

But is it not obvious that

“ this whole notion of national possessions benefiting the individual is founded on mystification, upon an illusion? . . . Alsace-Lorraine is owned by its inhabitants, and nobody else ; and Germany, with all her ruthlessness, has not been able to dispossess them, as is proved by the fact that the matricular contribution (*matrikularbeitrag*) of the newly acquired State to the Imperial Treasury (which incidentally is neither three millions nor eight, but just about one) is fixed on exactly the same scale as that of the other States of the Empire ” (p. 41).

Elsewhere (p. 43) he states that

“ in every civilised State, revenues which are drawn from a territory are expended on that territory, and there is no process known to modern government by which wealth may first be drawn from a territory into the treasury and then be redistributed with a profit to the individuals who have contributed it or to others.”

These statements are not wholly true. In the first, Mr. Angell implies that the contribution of Alsace-Lorraine to the Imperial Exchequer is only

¹ There can be no question of splitting the difference ; they are two essentially different things. The one is taxation of total income, the other interest on capital value. One might just as well speak of splitting the difference between eight apples and three oranges.

the *matrikularbeitrag*. Such is not the case. It is true that each of the States in the federation manages most of its own affairs, but in addition to the *matrikularbeitrag*, Alsace-Lorraine, and all the others, contribute towards the Imperial revenue by means of customs, excise, stamp and inheritance duties, so that the new province pays roughly in proportion to its wealth and trade. And if these are above the average for the rest of the Empire, Germany undoubtedly gains in this particular sense. Moreover, the reproductive undertakings of the empire, such as the post office, are more profitable than they would have been if they had not included Alsace-Lorraine. Finally, this province makes a special contribution to Imperial funds in that its railways—unlike those of other German States—are owned by the empire (having been purchased from France out of the war indemnity), so that the profit from them, instead of being spent in that State, is used to meet the needs of the empire as a whole.¹

Again, it is not true that in modern States the revenue obtained from one part of the community must be spent on that part. The main accepted principle of taxation—payment according to ability—is the negation of this view. The modern State taxes its citizens according to their

¹ It is, of course, true that the indemnity might have been otherwise invested. But the net profit of the undertaking (after allowing normal interest on capital), which now goes to the empire (but in each of the other States to the State itself) is a clear loss to the province and a gain to the Imperial Government.

wealth, and renders assistance according to need. Ireland, for example, pays proportionately less than England to the Exchequer of Great Britain, yet it enjoys not only the same protection, and the same "general" advantages conferred by Government, but also special advantages where these are desirable. And the same principle holds in local government. It may be true that London would gain nothing by incorporating the county of Hertford; but the county might gain considerably by being incorporated. The recent development of the British policy of making "grants in aid" of poor localities provides further evidence of the error of Mr. Angell's view; and if still more were needed it could be found by examining the advantages offered to small villages on the fringe of large cities like Birmingham and Glasgow, when the latter wish to extend the city boundaries. Now if Alsace-Lorraine has proved to be richer, as a province, than the average for Germany, and an appropriate share of the Imperial taxes is paid by its people, the amount of taxation falling upon the rest of the empire is reduced, and consequently the citizens are individually richer by the amount of additional taxation they would have had to pay if Alsatia had not been annexed. If the new province enjoys but average wealth and prosperity, there is neither gain nor loss in this special sense; while if it is poorer than the average, a loss is experienced, since it draws more from

the Imperial Exchequer than it contributes to it.

Finally, the cost of government does not increase proportionately to the value of territory added. Reference has already been made to the reproductive undertakings of Government, such as the post office, railways, etc. But the same is true of other administrative departments, such as the Board of Trade and insurance, and of the administration of justice and the provision of means of defence.¹ The cost of defending the empire was not materially changed by the annexation of the Danish and French provinces. If the cost of governing the people increases more slowly than the population, obviously it was a real gain in this particular sense to add to the territory and population of the empire, for in this way the cost per head was diminished, and the individual Germans were richer by the annual amount saved to them. The national debt provides the extreme example of what is meant here. It is evident that if the wealth and population of a country are doubled while the national debt remains unchanged, the annual charge per head and the amount per individual to be paid on redemption are reduced by one half. It was clearly a gain in this respect to the Germans to annex Alsatia.

¹ Mr. Angell holds the view that the military policy of Germany was largely forced upon the empire by its annexation of the French province. It may be true; we do not know. Many believe that it was not appreciably influenced by the *terms* imposed upon France in 1871.

The interest charges were spread over a larger population, and so the cost per head was reduced and the individual Germans made richer than they would otherwise have been. France lost heavily in this way, for the enormous additions to the national burden had to be borne by a smaller population, so that each had to shoulder a greater part than would otherwise have been the case.¹

If the annexed territory was previously an independent nation with a debt of its own, like Holland, rather than a section of a country, like Alsace-Lorraine, which had incurred no debt of its own, it follows that the gain to the conquering nation will be proportionately less; for if Germany, for example, retained Belgium in her grip, and annexed Holland, she would need to accept their debts as her own. And if these were greater per head of population (in the smaller countries before annexation) than the German debt, the result in this respect would be unfavourable.

The conclusion, then, is that, whether wealth be measured collectively or per head of population, the annexation of a territory of average prosperity is a gain to the conquering nation. Mr. Angell

¹ The loss to France was relatively greater than the gain to Germany. Assume the population of each of two countries to be 100,000,000, that the annual debt charge of each is £100,000,000, and that part of one country, containing, say, 20,000,000 inhabitants, is annexed by the other. The interest per head on the debt of the latter is reduced from £1 to 16s. 8d., but on that of the former it is increased from £1 to 25s.

emphatically denies this conclusion. If it were true it would be found, he argues, that small countries, like Holland and Denmark, would be immeasurably poorer than the vast territories of Russia, or a large country like Germany: wealth does not vary with the size of the administrative area. So much has already been written upon the factors upon which the wealth of a nation depends that it is unnecessary to labour the point here. The comparison is unjust. Climatic conditions, topographical features, geological factors, and the stage of economic development reached, differ so much in the countries of Europe that few are really comparable. What Mr. Angell regards as the real test is no test at all. The point at issue is not whether Germany is richer than Holland, but whether she is richer than she would have been without the annexed provinces—whether the individual German has gained by compelling the Alsatian to work under the Imperial flag. And, unless one subscribes to the views of the narrowest school of protectionists, the reply is in the affirmative.

B. COLONIES.

The changes in economic organisation indicated in previous chapters have profoundly altered the character of the colonial problem. In earlier centuries the policy of the merchant adventurer towards the newly-discovered lands, containing

precious metals and inhabited by savage and semi-savage peoples, aimed at two things—

“ first, such effective political occupation of the country that he (the merchant adventurer) could keep the savage or semi-savage population in check, and could exploit the territory for its wealth; and, secondly, such arrangements as would prevent other nations from searching for this wealth in precious metals, spices, etc., since, if they obtained it, he could not ” (p. 97).

But changes have occurred since then: the savage tribes have been civilised, the colonies have been organised in much the same way as the conquerors, and the character of international trade has undergone material change. Colonies, like other foreign countries, have become “ firmly set,” and are useful as markets for our products and as sources of supplies of foodstuffs and raw materials.

“ And if their value in those respects is to be developed to the full, they inevitably become self-governing communities in greater or less degree, and the mother country exploits them exactly as she exploits any other community with which she may be trading ” (p. 98).

Germany would have to “ own ” Canada exactly as we do; she would buy from her merchants and sell to her importers just as we do now.

Mr. Angell argues that two important results follow from the changes outlined above. In the first place, a modern colony or State cannot be fully conquered. It might be defeated in a war,

but not so completely that the enemy would be able to enforce his will upon it in economic or political affairs. Great Britain does not impose her will upon the colonies. Australia and Canada are, for all practical purposes, politically independent. The British Empire is really an alliance of free independent nations. Britain is impotent even where the foreign policy of Canada is concerned. And if she now wished to enforce her own ideas upon a colony, contrary to the will of its inhabitants, she would lack the power to do so. Canada and Australia are not colonies in the old sense of the term; they are rather States upon equal footing with the mother country, bound to the latter by sentimental ties.

If Germany, or some other Power, were

“ to use force to conquer colonies, she would find out that they were not amenable to force, and that the only working policy was to let them do exactly as they did before she conquered them, and to allow them if they chose—and many of the British Colonies do so choose—to treat the mother country absolutely as a foreign country ” (pp. 100-1).

Nor is the control of the economic policy of the colonies in the hands of the British Government.

“ If fiscal preference is extended to Great Britain, that preference is not the result of British ‘ ownership ’ of the colonies, but is the free act of the colonial legislators, and could as well be made by any foreign nation desiring to court closer fiscal relations with Great Britain ” (p. 107).

Thus the colonies do not represent any special

economic gain to this country. The profit they bring is simply the profit that all foreign countries bring—by means of their trade. Great Britain would actually gain economically by formal separation, since she would be relieved of the cost of defending them.¹

In the second place, assuming the possibility of conquest so complete that the will of the conqueror in political and economic matters could be fully enforced upon the new colony, no economic policy could be devised which would not inevitably react unfavourably upon the former, except that of allowing the colony to exercise its own judgment and pursue its own policy. Britain did not act in a philanthropic spirit towards her colonies when she granted them complete control of their economic destinies. In the early days of colonisation she pursued the mercantilist

¹ It is extremely doubtful whether Britain would be relieved of the "cost of defence" if the colonies were formally separated from her. The experience of the present war clearly shows that complete naval supremacy is necessary to secure adequate supplies of food for the inhabitants of this country. But when this is assured all the warships may be withdrawn from the ocean highways and employed to blockade the enemy's coast. If the colonies were cut off we would require, other things being equal, practically the same relative strength as we do now. The two objects—securing food supplies and defending the colonies—are achieved with practically the same naval force as would be necessary for the attainment of one alone. To the extent, therefore, that the colonies provide ships towards the Imperial navy they are not a burden, but a real material gain. It is conceivable, indeed, that if our colonies were separated from us a still greater navy might be necessary, since one or more of them, possessing a navy of its own, *might* throw in its lot with the enemy.

policy ; but this system of "exploitation by monopoly" broke down. It was a complete commercial and political failure long before it was abolished. Freedom to develop along their own lines was ultimately granted to the colonies, and such freedom has proved successful from the point of view of both the mother country and themselves. The earlier policy prevented the development of these colonies ; they remained poor, and were therefore unable to purchase the goods we were eager to export. Mr. Angell goes on to say that the recent experience of France is not unlike our own. The French Colonial Law of 1892 compelled those colonies not already bound by international treaty to admit French goods free of duty, while France still taxed goods imported from the colonies. And those alone prospered which were already bound by treaty with other nations. Where the Colonial Law was fully operative trade was strangled, the colony remained poor, and, consequently, France derived no benefit. A change of policy was inevitable in the interests of France herself.

What proved impossible to Great Britain and France must be impossible to Germany or any other modern nation.

"As Great Britain is not able to exact tribute or economic advantage, it is inconceivable that any other country, necessarily less experienced in colonial management, would be able to succeed where Great Britain had failed, especially in view of the past

history of the Spanish, Portuguese, French, and British colonial empires" (p. 99).

Is it conceivable, then,

"that Germany, if the real relations between Great Britain and her colonies were understood, would undertake the costliest war of conquest in history in order to acquire an absurd and profitless position, from which she could not exact even the shadow of a material advantage?" (pp. 107-8).

The two propositions elaborated above are quite distinct. The first denies the possibility of complete conquest; the second denies the utility of complete conquest. In the first Mr. Angell states that a war of conquest must fail—the aggressor cannot win; in the second he states that conquest cannot achieve its object. Failure to distinguish between the two cases leads inevitably to confusion. Mr. Angell is probably right when he states (in effect) that Germany could not conquer, with one effort, a large colony like Canada or Australia. But, with Britain out of the way, it is not unlikely that she would be able to conquer and establish a strong colony in, say, Western Australia. And having obtained a footing in that continent, the gradual extension of control would not present insuperable difficulties. It is not improbable that, if British South Africa were formally separated from Britain, Germany would soon be able to secure complete control over that colony. It is not long since France and Italy acquired territory in North Africa, and Britain

annexed the Boer Republics. It is true that the South African colony was afterwards granted virtual independence. But this was not so much dictated by necessity as the application of the British idea of colonial government. German standards differ from our own. Complete self-government may be desirable ; it is not inevitable. It is not impossible to conquer a nation so completely as to be able to exercise more or less permanent control over its government, until at any rate the population of the latter reaches a point which would represent ultimate military power corresponding to that of the conqueror.

The statement that Germany cannot win in a war of conquest is of the nature of a challenge ; it is a denial of the existence of that military power upon which she has long prided herself. It is practically an assertion that her preparations for such a war are, and must inevitably be, inadequate ; that she is attempting the impossible. " You are not so mighty as you imagine yourself to be, nor will you ever attain such might, so why not give it up as a bad job ? "—this accurately represents Mr. Angell's argument on the first point. " Even if you win outright you will get nothing out of it ; any and every colonial policy you can devise will be without profit to you " sums up the second contention, which is obviously distinct from the first.

In examining Mr. Angell's second contention it will be assumed that the economic policy which

now finds favour in Britain—free trade—is the best that human agency has yet devised. It is believed by the majority of our people that this system makes possible the fullest utilisation of our national resources. Moreover, since we believe our wealth to depend upon the wealth rather than the poverty of the rest of the world, we would regard with favour the adoption of our policy by other nations. Taking this extreme view of the benefits of free trade between nations,¹ even the preference now given by our colonies to British imports is not so desirable as a universal system of free imports would be. Nevertheless, if the two alternatives at present are (a) equal duties upon British and foreign goods imported into, *e.g.*, Canada, and (b) differential duties (*i.e.*, lower duties or no duties at all upon imports of British goods), the latter is decidedly better for us, as well as for the Canadians, because the industrial development of Canada is facilitated to the extent of such preference. Whether the existing colonial preference is a real gain therefore depends upon the extent to which the policy of

¹ Which I believe to be the right view *for practical purposes*, taking the distant future into consideration as well as the immediate effects. If it be assumed that colonial federation, as advocated by the late Mr. Chamberlain, would bring economic gain to this country the conclusions indicated later will still hold good, and even be strengthened. The assumption in the text was made partly because Mr. Angell seems to believe in free trade (although part of his argument denies its value), and partly because the conclusions which follow are weaker upon such assumption and therefore place Mr. Angell's case in the best possible light.

the colony is one of differentiating *against* other countries, or, on the other hand, differentiating *in our favour*. To illustrate this point, we may suppose (a) that Canadians believe a general duty of, say, 20 per cent. upon imports to be the best general policy for their country, but that, for political reasons, they allow British goods to enter on payment of a duty of 10 per cent. ; (b) that Australians believe a 10 per cent. duty to represent the degree of protection most consistent with the prosperity of their nation, but that, for political reasons, the duty against foreign countries (*i.e.*, other than the British Empire) is raised to 20 per cent. In the former case we gain directly and the world gains indirectly ; for the alternative is a greater degree of protection, which, by assumption, arrests the development of Canada and reacts upon the industrial progress of the world. In the latter example we gain directly by the preference, but the world, and therefore ourselves, loses indirectly ; for the alternative is greater freedom of trade, more rapid development of Australia, and a favourable reaction upon the industrial progress of the world. But our direct gain is much greater than our indirect loss. Probably neither of these is a true description of the existing policies of the colonies, but, where preference is given, the former seems to be nearer the truth ;¹ for the preference

¹ Although the figures employed are merely illustrative, such seems almost to be Canada's policy. Recently she

to our imports is regarded as a concession to a greater extent than the discrimination against foreign imports is regarded as a *quasi*-punishment. Consequently one may justly regard colonial preference, where it exists, as a real gain to the mother country and, indirectly, to the world as a whole.

The case of Germany is quite different. The German Government has for many years pursued a moderately protective policy, and it may be presumed that this policy finds favour among the people. If Germany "acquired" Canada she would enforce a policy beneficial to herself, if not also to the new colony. Presumably she would extend the customs union. Canadian goods would enjoy preferential treatment in the German market, and to that extent the exports of the colony might be expected to grow. Wheat now purchased by Germany from Russia and Argentina would be obtained from Canada. Moreover, Canada would be compelled to discriminate in favour of manufactured goods imported from Germany and against similar goods sent from this country. We would suffer in the Canadian market in the same way as Russia would suffer in the German market. Such a policy might make little difference to Canadian importers and con-

appeared to be contemplating the abolition of preference to this country; but, according to latest newspaper reports, she is about to increase the duties upon foreign imports, while retaining the old duties upon British goods. The war is responsible for the change in the proposed policy.

sumers, since Germany would probably be able to supply them almost (if not fully) as cheaply as we did. The net result of the change of "ownership" would therefore be a rearrangement of the parts played by the various nations involved, without much, if any, loss to the world as a whole. It is possible, indeed, that the world as a whole would gain; for, while Canada would not necessarily be more highly protective than she is at present, Germany would have made some progress towards a free trade policy.¹ Russia and Britain would lose, and Germany, if not also Canada, would gain. Whether the world as a whole would gain would depend upon the manner in which the protective system had been affected. If the total amount of protection proved to be not greater than formerly—if the barriers to trade, in the form of duties, had merely been shifted, without being increased—the world would probably not lose. The argument is somewhat intricate. The essence of it is that it is possible to alter the industrial arrangements of nations in such a way that some will lose and others gain materially, without seriously affecting the rate of world progress. But Germany would

¹ The result would depend upon the kind of preference given to Canadian goods. If Germany retained, as a minimum, her existing tariffs on agricultural products to protect home farmers—which is not unlikely—and discriminated against foreign wheat-growers by imposing higher duties upon their produce than upon Canadian produce, her policy, in this respect, would be more highly protective than at present, and, upon our main assumption, she would be the loser to this extent.

not trouble herself about world progress ; she would be concerned merely with her own advancement and the welfare of her new colonies.

A slight preference may produce, in some cases, far-reaching effects. The sites of some industries, such as mining, are exactly determined by nature ; but the homes of others may be fixed by more or less " artificial " conditions. A fall in freight rates, a bounty in the form of a cheap site, a new invention, the growth of shipping facilities—a host of such causes might be mentioned which influence the progress and may even change the location of a large part of an important industry. It is sometimes argued that a secure market such as a colony might provide would enable a group of industries to flourish in Germany, which growth would bring many economies into being ; and the latter, in time, would enable the Germans to produce for the colonial market more cheaply than they or their competitors do now, so that the colonies would ultimately benefit. In other words, transport facilities have lessened the importance of purely geographic factors in the determination of national industries, and increased the importance of moral factors and others directly under the control of man. The aniline dye industry provides an excellent illustration of the importance of the " human factor " in economic development. But the general argument, though theoretically sound, has not yet been sufficiently tested by experience.

The weakness of Mr. Angell's case is that it is based upon the assumption that the only alternatives are the policy now pursued by Britain, and that enforced recently by France in Africa and, in earlier days, by ourselves. There is a third option—a *zollverein* between the mother country and her colonies; and if these previously employed the system of protection, such a *zollverein* would probably mean development towards free trade and, consequently, a gain to the world as a whole, as well as a special gain to the nations affected, through the preference granted to each by the others. The extension of a customs union is the next best thing to universal free trade; it brings advantages of the same character as those enjoyed through the absence of trade restrictions.

It is quite true, as Mr. Angell points out, that German trade with Canada and our colonies is growing under the conditions now obtaining; but such trade has grown in spite of these conditions, and is less than it would be if Germany were granted the same facilities as we enjoy. We could not, if we would, supply the whole world with all it needs of those goods—steel, cotton manufactures, etc.—which we are accustomed to export. There must obviously be room for the manufactures of other nations in the world market. And Germany is well equipped for the task of producing for export. But she has made progress against the stream; she now wishes to row with the stream. Since the object is to

make headway rather than to develop muscles, the direction of the stream is an important factor.

This does not exhaust the colonial problem. A section of the German people look beyond the possible material gain to the next generation or so. They believe it to be the duty of the nation to legislate for the time—not very distant—when the population of the world will have increased to such an extent that a real scarcity of materials will prevail. For the present it is to the interest of all nations that new countries should be exploited and peopled. But later, when no virgin territories remain, and new countries like Canada and Argentina have populations of their own so large as to require all the agricultural products grown there, the older industrial nations will experience difficulty in feeding their people. But before that stage is reached the metals, it is argued, will probably give out, and before the supplies are exhausted their prices will rise to a much higher level than that now prevailing. This modern Malthusianism leads to the advocacy of a colonial policy which will enable Germany to secure a permanent supply, at relatively low prices, of the necessaries of modern industry and life. It is the duty of Germany, it is said, to acquire colonies containing metals and minerals, such as copper, coal and iron ore. Such colonies would not be allowed to develop freely. Presumably they would be compelled to impose duties on exports

to countries other than Germany; and their population would be kept within safe limits, in the interests of the mother country. Although such a view may not be defensible, it is certainly intelligible. The world as a whole (if that day ever arrives) will be in the same position, in regard to metals, as Germany is during the present war in regard to the minor metals and oil. It will be competing for a supply of necessaries which cannot be increased by mutual co-operation and further exploitation. Nature will be almost at the end of her resources. If Germany or Austria had annexed Roumania and her oil-fields both might now be better able to withstand the siege of the Allies. Similarly, if Germany now acquires suitable colonies, she will be better able in the distant future to maintain her place in the world and provide for her inhabitants. Mr. Angell, as already indicated, states that the merchant adventurer of old, acting on behalf of his country, aimed at "such arrangements as would prevent other nations from searching for this wealth in precious metals, spices, etc., since, if they obtained it, he could not." Some Germans believe that the policy they advocate will become necessary in the future for precisely the same reason. The economic philosophy which is at the root of such a policy is highly speculative; but such a charge can be brought against all the colonial theories of a nation which has only recently looked beyond its own boundaries.

C. DESTRUCTION OF MARKETS.

There are people who believe that the present war is certain to prove beneficial to the trade of this country, in that it will enable us to capture Germany's foreign markets. They seem to imagine that the industrial development of Germany was a menace to us. Such is not necessarily the case. If Germany were removed from the map we should probably suffer considerable material loss.

It is conceivable that the destruction of one country would prove a distinct advantage to another. Such a result would follow if both depended mainly upon the same industry, and traded but little with each other. If the South African goldfields were destroyed, California would undoubtedly benefit through the consequent rise in the value of gold; if Argentina were laid waste, wheat would become dearer and Canada would grow richer. The world as a whole would be poorer, but the resulting loss to the surviving nation would not counterbalance the direct gain from the destruction of its rival. Where two countries are mainly competitive their interests naturally conflict.

On the other hand, if two nations are complementary—*i.e.*, if each is a valuable customer of the other without being also a serious competitor—the destruction of one would involve considerable loss to the other. Russia and Britain,

Canada and Britain, China and Germany are examples of such profitable interdependence. The destruction of China would materially affect German exporters of manufactured goods as well as consumers of China tea; and such exporters could not recoup themselves by growing the tea of which the consumers had been deprived.

It is probably true to say that Germany and Britain are complementary nations to a greater degree than they are rival. Both are exporters of iron and steel, cotton manufactures, etc., and so compete, within limits, in neutral markets. Moreover, each sends goods to the other which compete directly with the products of the home manufacturers, so that they are also competitors within their own borders. To this extent they are competitive rather than complementary. But, apart from the gain to each from imports which are cheaper than the corresponding home products, the one profits by the existence and prosperity of the other in that a great part—perhaps the bulk—of their foreign trade makes them complementary to a greater extent than they are rival. All modern nations which foster a great variety of industries are probably complementary rather than competitive. For competition itself results ultimately in such a readjustment that the loser becomes a producer of goods in which there is less keen competition. It would be dangerous to dogmatise in this matter. A quantitative proof

is lacking. The nature of the changes in industrial arrangements which would occur if, say, Germany were sunk beneath the ocean, can easily be indicated, but it is impossible to state the net effect of such changes. On the one hand, German exports would cease. The deficiency would be made good by the other nations: the Americans, as well as ourselves, are now seeking means of supplying aniline dyes, for which, before the war, we looked to Germany. It is here that we are expected to gain. We would export steel, machinery, rails, etc., to foreign nations who previously dealt with our German rivals. But, on the other hand, German imports would also vanish, so that certain of the trades of all countries exporting to Germany would suffer. And to those who argue that we would profit it is replied that this loss would be greater than any gain we could achieve by capturing Germany's foreign markets. Instead of sending more machinery and rails to South America we would need to make for ourselves the semi-manufactured steel which was previously imported from Germany, while American manufacturers would look after the needs of that continent. Or, again, we might supply the American market (which we could not do so cheaply as Germany did) while American manufacturers would supply us with semi-manufactured steel (which they could not do so cheaply as Germany did). Whether the ultimate result would be gain or loss depends upon the character

of the nation destroyed and that of the nations affected thereby.

Considerations of space prevent a complete examination of this problem. It is sufficient to say here that Mr. Angell is probably right when he states, in effect, that the prosperity of Germany is largely dependent upon the prosperity of this country, so that she would lose, rather than gain, if Britain were "wiped off the map." But he is probably wrong when he implies that what holds for Germany and ourselves holds also for every pair of nations. Every case has to be taken on its merits, for the ultimate effect will depend upon the economic characteristics of the two nations compared. No general conclusion is possible.

CHAPTER VI.

THE INDEMNITY PROBLEM.

IN a discussion of the value of economic motives to war the question of an indemnity would demand little or no attention, for it is almost inconceivable that a modern civilised nation, carrying on trade with most of the countries of the world, would undertake a war against another merely for the sake of a sum of money euphemistically called an indemnity. Not only would it excite the indignation of other nations, but a "victim" sufficiently wealthy for the purpose would probably possess great military power, and the resulting war would prove so long and costly that the indemnity would bring little, if any, net gain. Such a war defeats its own end.

But the question of an indemnity assumes real importance in a detailed examination of the economic effects of a war produced by other causes. If Britain and her allies prove to be victorious in the present struggle, an indemnity to Belgium, if not also to France, will undoubtedly be provided for in the final settlement. It is important, therefore, that the economic effects of the payment of a large sum by one nation to another be carefully estimated. It is not our present purpose to do

this ; we are merely concerned with the manner in which the subject is dealt with in " The Great Illusion."

In a chapter entitled " The Indemnity Futility " Mr. Angell asserts that the payment of £200,000,000 by France to Germany, after the last war between those nations, proved worse than useless to the latter : " All the evidence plainly and conclusively shows that it was of no advantage ; that the conqueror would probably have been better without it " (p. 93) ; the " flood of gold turned indeed to dust and ashes so far as the German nation is concerned " (p. 84). Elsewhere he states that " the exaction of a large indemnity [has become] so costly directly and indirectly as to be an extremely disadvantageous financial operation " (p. 28). It is not clear, however, whether Mr. Angell believes it possible for a nation to gain at all from an indemnity, for on another page (83) he merely tells us that

" the history of the German experience with the French indemnity suggests the question whether in every case an enormous discount on the nominal value of a large money indemnity must not be allowed owing to the practical financial difficulties of its payment and receipt, difficulties unavoidable in any circumstances which we need consider."

The evidence adduced by Mr. Angell in proof of the futility of the French indemnity does not call for lengthy comment. It is so inadequate, and in every way so unsatisfactory, that it can scarcely

be called 'strong circumstantial evidence.' Germany, he tells us, suffered from a crisis soon after the final instalment of the indemnity was paid, and experienced a period of severe depression lasting six or seven years. France, on the other hand, escaped both the crisis and the depression, and soon after the war was able to capture German markets. The depression in Germany, he asserts, was caused by the receipt of the indemnity, which led immediately to abnormal speculation, which, in turn, culminated in a crisis. During the eighties trade recovered rapidly, and ever since industrial Germany has advanced by leaps and bounds. But such recovery was not in any way related to the indemnity; it was rather due to a combination of circumstances, among the chief being the customs union formed before the war.¹ A well-known economist once wrote :

" A panic follows the creation of a debt, a panic follows the payment of a debt ; in either case some

¹ Mr. Angell does not attempt to show why this factor only began to operate about ten years after the war. One would imagine that the indemnity provided the capital necessary to give effect to the extension of the unrestricted trade area. Moreover, the evidence which he adduces to show the existence of depression is of little or no value. For example, he states (as evidence of depression) that within twenty months of the payment of the last instalment of the indemnity the bank rate was higher in Berlin than in Paris. Such a statement conveys nothing. Apart from the fact that one usually associates a *low* bank rate with comparative depression, the average official rate of discount *for every single year* between 1876 and 1908 (and probably since the latter year) was higher in Berlin than in Paris. The Paris rate fluctuated less during this period than the Berlin and London rates, a fact partly due to the banking laws of France.

wise man will surely appear to charge the commercial disaster upon the financial policy of the Government. It is a safe rule . . . to deny a causal relation which cannot be traced with some degree of clearness." ¹

It is a rule which Mr. Angell has ignored.

It is quite true that the payment of the indemnity was followed by a period of depression. It is probably true, moreover, that the indemnity intensified the depression at first. But to attribute the depression to the indemnity is a serious error. Mr. Angell has omitted other factors, which were undoubtedly of much greater importance.

In the first place the depression, as Sir Robert Giffen long ago pointed out, was almost universal, and followed upon financial panics in Vienna and New York. For some years previously the trade of this country had increased very rapidly; new countries had been exploited, railways constructed and other speculative enterprises undertaken. In Germany the expansion of trade, whether judged by the number of joint-stock companies established or by their total capital, was greater during the three years 1871—1873 than in any similar period before or since. It was the culminating point of the industrial revolution in that country; it was the inevitable consequence of the developments of the previous quarter-century. Speculation was undoubtedly encouraged by the

¹ Adams, "Public Debts."

ease with which the indemnity provided capital for the purpose and the readiness of the Government to finance trade through the banks. But it should not be forgotten that only a part of the indemnity could have been used in this way ; the remainder was employed as loans to Austria and Russia, and in other ways which could not influence speculation.

The German industries mainly affected by the speculative fever were railway transport, building, banking, mining and iron production. A well-known economist has clearly shown that the severity and duration of a depression are largely determined by the degree of maladjustment between the different stages in the complete process of manufacture.¹ Over-speculation in railways, iron manufacture and building generally results in a fairly long period of bad trade. As was the case in Germany during the period under consideration, these speculative enterprises outrun the immediate needs of a nation, and are compelled to wait until the remaining industries and the consuming powers of the community have 'caught up' with them. The almost inevitable result is a number of failures. But when firms go into liquidation their assets are by no means destroyed ; they become available for use later, so that such financial failures do not necessarily indicate an equivalent loss to a nation as a whole. Many of the German companies floated during the

¹ Taussig, " Principles of Economics."

boom of 1871—1873 were forced into liquidation ; but their properties—factories and mines—were afterwards employed and added to the wealth of the nation.

This leads to the consideration of the second feature of the depression following the indemnity payment, viz., the fall in prices. There can be no doubt that some part of the fall was due to the over-capitalisation caused by the artificially high prices previously prevailing. The removal of the stimulus immediately caused over-production and a collapse of prices. But to ascribe the whole effect to this particular cause—a method frequently adopted by Mr. Angell—is obviously illogical. As we have pointed out above, some part of the over-speculation would have taken place in the natural order of things—how large a part it is impossible to say. But, apart altogether from that, two main causes of the low prices, quite neglected by Mr. Angell, have to be noticed. The first was the establishment of a gold coinage in Germany and the resumption of specie payment, in the United States, for the paper currency issued during and subsequent to the Civil War. The resulting scarcity of gold was severely felt in both countries, as well as in Britain. France, however, suffered less from this cause, for the inconvertible notes issued there during the war with Germany remained in circulation, and so lessened the strain upon gold. The second cause was the failure of the harvests of 1875, 1876, and 1877, which delayed

the recovery of trade, and even accentuated the depression. Germany, which was at this time almost entirely independent of foreign supplies of wheat, naturally suffered more than most countries. The prosperity of her industrial enterprises was bound up with the prosperity of agriculture ; and the suffering of the agricultural interests was intensified by their obligation to pay interest upon comparatively heavy mortgages upon farms which had been purchased during a period of great agricultural prosperity, at prices determined by the profits realised at that time.

It is, of course, impossible to form a precise quantitative judgment as to the effects of these particular causes, but it is evident that the indemnity was no more than a comparatively unimportant factor contributing to the depression of the seventies in Germany. Taken cumulatively, the main causes were the industrial changes preceding the war, culminating in a fever of speculation which infected most countries ; the scarcity of gold during a period when the demand for that metal increased by leaps and bounds ; and, finally, a series of bad harvests.

It is highly probable, however, that the fall in prices exaggerates the suffering of the time. Prices suffered more than the volume of trade ; in other words, the depression reacted more strongly upon the employers than upon the working classes. Employment, both in Germany

and in this country,¹ was steadier, apparently, after the immediate effects of the crisis had disappeared than the study of prices would suggest, and although money wages may have been reduced, the still greater fall in prices made the period far less unfavourable to employed workmen than Mr. Angell seems to believe.

France, we are told, escaped the depression.² This is only partly true. Naturally her trade during the payment of the indemnity was brisk, and the country presented an appearance of prosperity; but the goods she made for export constituted, to some extent, the indemnity itself. Her exports, which, normally, would have purchased a great wealth of imports, brought nothing in return. She was heaping up vast wealth with feverish haste, for no return. Brisk trade and

¹ We received no indemnity: on the contrary, we assisted France by advancing part of the payment she had to make. Nevertheless, our experience was similar to that of Germany, and the depression in this country probably as severe as that suffered by the recipient of the indemnity.

² The three important countries which almost escaped the depression were France, Spain, and Italy—*i.e.*, those countries in which industrialism, as we now understand the term, had not yet appeared. France even yet seems to suffer less from the rhythmical movement of trade. The "big factory" does not predominate. It is rather a country of small organisations, which are not influenced so largely by speculative movements as our own intensely localised manufacturing industries, which are mainly in the hands of large joint-stock companies. This fact partly explains the early success and determined character of the French syndicalist movement. It also partly accounts for the comparative steadiness of industry in that country. The traditional frugality of the French people, and their love for safe rather than highly remunerative but more speculative investments, must also be taken into consideration.

prosperity are, accordingly, not always interchangeable terms. Moreover, France paid a great part of the indemnity by transferring some of her foreign investments to Germany. The former thus lost imports in the form of interest payments on her investments abroad. The alternatives open to her were—(a) to do without such imports altogether, and be content with a lower standard of living; (b) to pay for them by means of additional exports, which amounted to harder work for the same remuneration; and (c) to manufacture at home goods which were previously imported. Mr. Angell has confounded prosperity with harder work for the same pay. To state the argument otherwise: the payment of the indemnity by France was equivalent to abnormal speculation, after which all the enterprises created by it—factories, railways, etc.—completely disappeared. When reaction followed speculation in Germany, values suffered seriously, but the factories, etc., which grew out of such speculation, remained and contributed to the ultimate prosperity of the nation. In France nothing remained: the results of the toil of the people were almost as if the products had been thrown into a bottomless pit.

During recent months most of the factories in this country have been working at highest speed, using up the war loan, and many industries are suffering from a shortage of labour. But it can

scarcely be maintained that the war has made the nation prosperous. We are merely using capital as income, *i.e.*, living beyond our income. Again, when the war is over the shipyards will probably continue to be busy until the merchant vessels lost during war are replaced. But it would be foolish to argue from this that the nation is prosperous. The so-called prosperity enjoyed by France subsequent to the last war with Germany was precisely of this character. Mr. Angell's whole argument on this point implies the old-fashioned belief in the economic service rendered by the window-breaker, who stimulates trade in glass.

But assuming all he asserts to be true ; admitting Germany to have lost rather than gained by the receipt of the indemnity, Mr. Angell has shown no more than that this particular indemnity was futile. It is dangerous to generalise from a single example. The loss might have been due to the size of the indemnity or to the manner of payment. The reply to Mr. Angell might then be that Germany was suffering from "economic indigestion" ; the body economic had taken a greater quantity of food (capital) at one meal than it could assimilate. But it would by no means follow that food in itself was not desirable or necessary. In another part of his book (pp. 153, 154) Mr. Angell states that the recent development of German trade would have been impossible without the aid of French capital. Assuming the

statement to be true,¹ why should the same capital, because it enters the country through the instrumentality of the Government, be economically futile?

Mr. Angell, in dealing with the general question, seems to admit that an indemnity is not entirely without economic value. He suggests that its value must be largely discounted for two reasons.

(1) He quotes, with approval, Giffen's assertion that Governments cannot control capital so efficiently as private individuals. Giffen made the statement over forty years ago, when the Manchester school of political philosophers reigned supreme. Since then Governments have acquired considerable experience in the management of capital funds. But assuming such a view to be true, the Government could transfer the indemnity almost immediately to individuals by employing it in repayment of the national debt.

(2) "The transfer of an immense sum of money outside the ordinary operations of commerce" is attended with great practical difficulties. Mr. Angell quotes the following paragraph from Giffen:—

"The financial operations incidental to these great losses and expenses seriously affect the money market.

¹ It is only a partial truth. France supplied the capital at a lower rate than it could be obtained at elsewhere, so that if Germany had been unable to borrow from France she would have been compelled to attract capital from other countries by offering slightly higher rates. Thus her development would probably have been only slightly retarded.

They have been a fruitful cause, in the first place, of spasmodic disturbance. The outbreak of war caused a monetary panic in July, 1870, by the anxiety of people who had money engagements to meet to provide against the chances of war, and there was another monetary crash in September, 1871, owing to the *sudden*¹ withdrawal by the German Government of the money it had to receive. The war thus illustrates the tendency of wars in general to cause spasmodic disturbance in a market so delicately organised as that of London now is."

Mr. Angell adds that the difficulties experienced forty-five years ago were "trifling" in comparison with those which would attend a similar operation to-day, when the credit system has become highly organised and the financial relations of nations are extremely delicate.

The truth of the quotation cannot be denied. The *sudden* withdrawal of a large sum of money by one nation from another must obviously upset the money market. Moreover, if the whole indemnity were *suddenly* handed over, in the form of goods and cash, serious dislocation of industry in the receiving nation would follow. But it is by no means necessary that a large indemnity should be paid at once; nor is it necessary that, if paid at once, it should take the form of money or concrete goods. Giffen was careful to point out that the monetary disturbance was caused by the *sudden* withdrawal of money by Germany. In view of the present situation this point demands further examination.

¹ The italics are mine.—J. H. J.

It is conceivable that Germany will be compelled to compensate Britain for the material loss involved in the present war ; and it is further likely that the need for capital in Germany will be greater than in this country. Under such circumstances Germany might become the debtor of Britain ; our own Government would become holders of German " script " or bonds and be entitled to interest payments ; in other words, we could lend money to Germany for the purpose of paying us the indemnity. The Government need not hold such bonds indefinitely—they could be sold on the market and a part of our national debt cancelled with the proceeds. The net result would be that some investors, previously holding British Consols, would become investors in German Imperial funds. If Germany, for the first few years, found it unprofitable to meet the interest payments from the proceeds of industry, such interest would be reinvested as capital in that country ; or, again, if it paid Germany to remit the interest, while we preferred to postpone its acceptance, it would be reinvested abroad.

On the other hand, if the need for capital proved to be greater in other countries than in Germany and Britain, the indemnity to us might take the form of exports from Germany to those countries, who would become our debtors ; in other words, the goods ultimately comprising the indemnity could be sent to the country in greatest

need of them, while the claims, or bonds, representing such goods would be sent to our Government, who would be entitled to interest. When one nation "pays an indemnity" to another it presents the latter with a claim upon itself; but it does not necessarily follow that the creditor nation presses for immediate payment. Such payment will be made not "outside the ordinary operations of commerce," but in response to the relative needs of the creditor. And the development of international credit, so far from making the payment of an indemnity more difficult, has probably facilitated such payment.

The foreign exchanges present an abnormal appearance when one nation imports, on balance, large supplies from another, but their appearance becomes normal when a loan is issued in the creditor country, and the proceeds are employed in payment of such goods. During the past few months we have imported vast supplies from the United States, which are not paid for directly by exports to that country or indirectly by exports to some other country, which, in turn, sends goods to the States. The result is that the "exchange" on New York has gone steadily against us. But it will be righted partly by the sale of American securities held by British investors, just as the Russian exchange on London is now being assisted by the issue of a Russian loan in this country. If Germany agreed to pay us an indemnity of, say, £100,000,000, the position

would be precisely the same as though we had exported goods of that value to Germany and were awaiting "payment." The exchange on Germany would be strongly in our favour, and would present an unusual appearance. But it could be righted by the issue of a loan and the exportation of bonds by Germany to London, just as in the case of Russia now. If we realised such a security with great speed, it is likely that its value would fall, and we should lose in the process. Probably such a loss is being experienced at the present time both by France and Britain, for they are calling in their foreign investments with considerable rapidity. These are being paid in goods—wheat, boots and shoes, copper, airships, etc.—which are sold by America at abnormally high prices—*i.e.*, the Allies are realising their investments at a heavy discount; they are receiving in return fewer goods than they would be receiving under normal conditions.

The conclusion, then, is that the payment, in bulk, of a large indemnity may mean no more than the issue of a loan. Whether the value of such indemnity has to be discounted depends upon the manner in which the new bonds are utilised. If they are carefully manipulated trade will not be seriously disturbed by the indemnity itself. If the new loan or investment is called in suddenly the money market, and trade itself, will be dislocated in precisely the same manner as they would be if other foreign investments were quickly

realised. In the circumstances we have assumed the only danger of dislocation would be that caused by the payment of interest. An indemnity loan of £200,000,000 to Germany, if issued at 5 per cent., would mean a payment of £10,000,000 a year in the form of interest. But the sum is so small that the danger is quite negligible. Moreover, as already observed, if it were more profitable to reinvest it in Germany or elsewhere the exports from Germany on its account would not enter this country.

The political question remains whether it would be possible to permit the payment of an indemnity by the issue of a loan. There seems to be no valid reason why it should not be done, for the German Government, by subsequently repudiating its obligation, would be injuring, not our own Government, but the holders of the bonds, who might soon be private individuals in this and other countries. And it is hardly possible that it would so injure private bondholders. But if the danger were too great it would be possible to compel the German Government to surrender the foreign bonds held by its own people, to whom it would issue its own bonds in exchange. Such a method of payment is essentially the same as the other.

So far we have assumed that Germany pays an indemnity to a nation which is not in need of capital. The case of Belgium differs slightly from the above. The need for capital to carry on the

work of restoration would be considerable, so that the indemnity would be paid up almost immediately. The transaction would take the same form as the first, and the Belgian Government or the holders of bonds would sell these either in Germany itself or in other countries. In return Belgium would receive the necessary commodities in such manner and to such extent as she desired, while those who sent goods to her would be exporting capital and would become creditors of the German Government.

The implicit assumption in Mr. Angell's statements seems to be that the nation receiving the indemnity must accept, within the stipulated period of payment, either goods or cash. Even Germany, as we have seen, reinvested part of her indemnity in Austria and Russia, while part was employed in cancelling State debts, thus releasing capital for investment elsewhere—even in France, if the interest offered there had proved sufficiently attractive. Only a portion of the indemnity was paid in goods and cash ; and only such portion can be said to have materially assisted speculation in Germany itself. The payment of the indemnity, as Adams and Leroy Beaulieu pointed out long ago, was but a " transaction in credits " ; and the wonder is, not that Germany and France were affected so much, but that they were affected so little.

CHAPTER VII.

THE MATERIAL COST OF WAR.

ONE of the striking features of the twentieth century, in the world of thought, is the readiness of people to abandon orthodox views, simply because they are orthodox. In philosophy, art, religion, and economics new ideas are often accepted, and become popular, simply because they are new or are supposed to be new. Bergsonism in philosophy, futurism in art, and the "new theology" in the world of religion have captured the popular imagination. Who has not heard Bergson expounded by one who had never made the acquaintance of Kant, Hegel, or Green, "cubism" extolled by a man wearing brown boots and a grey tie, Campbell discussed by the stranger to Harnack and Fairbairn? Heterodox views may be right, nevertheless they often become popular, not because they are right, but because they are heterodox.

Mr. Norman Angell has gathered around him a large, influential, and responsive audience. It is highly probable that many of this audience have never heard of Marshall, Wagner,¹ and

¹ Nor is any indication given in Mr. Angell's books of the views of economists of repute upon any of the subjects dealt

other outstanding writers on economic subjects. And yet a knowledge of current economic doctrines, and the foundations upon which they have been built, seems essential to an adequate discussion of Mr. Angell's theories. The previous chapters of this book have been devoted to an examination of the particular propositions laid down in "The Great Illusion." Taken together they may convey the impression that the writer is not among Mr. Angell's admirers. Such is not the case. It is not necessary to agree with an author's views to appreciate his ability and earnestness. "The Great Illusion" must leave a deep impression upon the mind of every reader. Argument has followed argument, assertion been added to assertion, until the accumulated effect is almost overwhelming. It is difficult to recall a book in which facts have been so cleverly marshalled to a given end. Nevertheless, when the personality of the barrister is removed and the argument stripped of rhetoric and restated in simple and unambiguous terms, the doctrines are not satisfying. The reader and listener are carried away by the pleading eloquence and earnestness of the barrister rather than convinced by the evidence.

Mr. Angell has given expression to two truths which need to be emphasised at a time when most

with in the various chapters. Mr. Hartley Withers has been quoted ; but none of the quotations is strictly relevant to the main subject of the book—the economic effects of war and conquest.

of the European nations are engaged in a war which must help to shape the development of all concerned. The first, to which reference has already been made, is that it is folly to imagine that Germany can completely destroy Britain or Britain Germany. The people of the conquered nation will continue to exist; most of the factories, workshops, railways, etc., will remain, ready to be employed in competition with, or as a complement to those of the conqueror. And even if the country could be laid waste and its people killed off, the actions of the conqueror would recoil on his own head.

The second truth is that defeated nations recover quickly after war. Mr. Angell points out that the history of France after 1871, Russia after the war with Japan, and Spain after her defeat by the United States provides ample proof of this. The explanation seems to be that the energies of the nation, which were previously expended in the interests of militarism and political aggression, are employed in economic and social reorganisation. This is a message of hope. If Germany is completely defeated, and her genius is afterwards concentrated upon political and economic advance rather than expended upon military and naval affairs, the material loss to Europe caused by the present war will the sooner be made good.

The other doctrines expounded by Mr. Angell are, as already shown, largely false. They are

plausible, and when joined together seem to prove the main thesis. Yet at best they are but half-truths. The argument is mainly inductive; Mr. Angell's conclusions appear to be based upon evidence provided by the experience of nations. But he seems to have misinterpreted such experience. Two important errors of reasoning are evident in most of the chapters. The first is what logicians call the *post hoc ergo propter hoc* fallacy—*i.e.*, that if A. follows B. in point of time, A. is caused by B. Depression followed the receipt of the indemnity by Germany; the indemnity was therefore the cause of such depression. Again, he writes:

“It is since Great Britain added the goldfields of the world to her ‘possessions’ that British Consols have dropped twenty points. Such is the outcome, in terms of social well-being, of military success and political prestige!” (“The Great Illusion,” p. 78).

No reference is made to Lord Goschen's conversion scheme, to the widening of the field of trustee investment, and to the general downward trend, in recent years, of guaranteed stocks bearing a fixed rate of interest (or, in other words, of an upward trend in the net rate of interest) through the opening up of new countries and the consequent “pull” of capital away from this country.

The second recurring error in Mr. Angell's reasoning is that of contrasting present economic conditions in military and non-military States

without reference to the non-military factors in their development. To take one example :

“ All the might of Russia and Germany cannot secure for the individual citizen better general economic conditions than those prevalent in the little States ” (p. 36).

This is beside the point, which is whether the military State is in a better economic position than it would have been in the absence of adequate means of defence.

Military power may be used for defence or for aggression. Safety of life and security of property depend upon power. In civil life the safety of the individual depends upon his power ; and his power lies in his ability to call in the policeman. The citizens of all modern States have pooled their power, and so increased their individual strength and reduced the cost of maintaining it.¹ This is but the method of insurance. And it is no more the negation of “ force ” than insurance is the negation of saving. The greatest sinner against society recognises the futility of attacking an individual able to draw upon the superior collective power ; but if such power is not available (as in a lonely road after dark) the criminal accepts his chance and the victim of attack suffers.

Nations have not yet employed the method of mutual insurance, consequently most of them are

¹ In doing this they abandoned all idea of employing it in attack.

compelled to rely upon individual effort. Some, like Holland and Belgium, depended upon a power similar to though weaker than that enjoyed by the individual within a State ; they looked to the military power of those States which had signed treaties guaranteeing their independence. For the security of the weaker States ultimately depended upon the power of the signatories to enforce the treaty, just as the security of the citizen depends upon the power of the State to enforce its laws. Probably these States also expected much from the sense of moral indignation of other nations. But their faith was misplaced. The spirit of help and sacrifice is still weak among nations acting in their corporate capacity.

It may be that one result of the present war will be the substitution of strict international law and order for the chaos of the past. If so, the separate States will then be adopting the method of mutual insurance, or pooling their wealth of power. But this means the centralisation of "force," not its abandonment. Each of the States will still be powerful in defence, but its power will consist in being able to call upon the collective military and naval strength of the States controlled by such law. Such an arrangement involves the abandonment of all idea of aggression, for aggression now implies criminality. Moreover, it will mean the definition and enforcement of the "civil rights" of the units

(nations) in the world State ; and " civil rights " here practically means the power of each nation in its dealings with other nations. The arrangement seems to assume that nations are or will be psychological entities ; and at present they are too loosely bound to be so regarded. Such a world Government would be as unstable and impotent as a coalition Government in a democratic State containing a large number of distinct parties with interests which conflict more often than they are identical. And just as Prussia became the dominating State in the German confederation, so, too, one (or a combination) of the nations of the European or world confederation might grow to be a dominating and dangerous power within it.

For this reason the success of such an international arrangement, under present conditions, is doubtful. It would almost inevitably mean the retention of the *status quo*. Britain would retain her colonies, while Germany would need to be content with her present possessions. For it is scarcely conceivable that Britain, in her present temper, would readily present Germany with some of her own colonies, or that such colonies would consent to be transferred. It is somewhat doubtful, however, whether international law and order similar to that prevailing within a State is consistent with the colonial system as we now understand it.

When a State pursues an aggressive policy for

material gain the end in view is likely to be annexation or colonial expansion.¹ It is of the nature of an industrial enterprise. The State sinks capital because the return seems adequate to the expenditure. Mr. Angell denies the possibility of a return in any shape or form. But this seems an exaggeration: all that can be asserted is that the "income" is remote, uncertain, and often inadequate. What the cost of such a war would be it is impossible to indicate; nor is it part of our object to provide an estimate. The experience of the world during the present conflict shows that it is not fully borne by the belligerent nations. All the countries of the world which trade outside their own borders are affected by the disturbance of credit, interference with transport, and the contraction of markets. But the injury inflicted upon neutral nations would not be taken into consideration by the nation seeking economic gain by means of conquest, except in so far as such injury might react upon its own welfare.

The cost to the aggressor is partly direct and partly indirect. The indirect cost we know to be heavy, from recent experience. Many industries have suffered materially during the war. First, industries catering to the luxurious habits of the people, both rich and relatively poor.

¹ In the first chapter it was pointed out that States are not often influenced by economic motives to the exclusion of all others.

Secondly, industries such as cotton manufacture, depending upon European markets. The enemy countries buy nothing, while the Allies and neutral countries import far less (excluding war material) than in time of peace. Thirdly, industries depending upon foreign supplies of raw material. Such material is either unobtainable, as in the case of synthetic dyes, or obtainable only at considerably higher prices, as in the case of pit-props. Finally, many of the professions have been seriously injured. The loss caused by the dislocation of industry should be included in any estimate of the cost of war.

A second indirect cost of war (closely related to the first) shows itself in the rise in prices. The cost of living has increased materially since July. Briefly stated, the cause of the rise in prices is a shortage of supply. The reduction in supply is due, in some cases, such as (in Scotland) coal,¹ to scarcity of labour. The proportion of workmen who have joined the army is greater than the industry could spare upon the assumption that prices were to remain practically undisturbed. If, in consequence of the war, demand is reduced by 5 per cent. and 10 per cent. of the workmen are withdrawn, a rise in price is inevitable if the remainder do not consent to increase their output. In other cases the shortage of supply is due to a reduction of transport facilities of all kinds—

¹ The rise in the price of coal is due partly, if not mainly, to other causes.

shipping, railway, and motor. Again, the prices of some articles (such as aspirin) have materially increased because such articles were partly or wholly obtained from the Continent. In some cases the total supply of a commodity has been increased rather than reduced, but the requirements of the Government are so great that the proportion available for private consumption has been largely reduced. Hence the rise in the prices of woollen material, leather goods, etc. Finally, where combinations among sellers exist, consumers are probably made to suffer more than market conditions seem to justify. Probably the high prices prevailing for house coal in some districts are partly accounted for in this way.

The direct cost of war is not so easily explained. We are told, on the one hand, that the war now costs the nation well over a million pounds a day, so that the wealth of the people is being rapidly exhausted. On the other, it is urged that the nation is well able to bear the strain, which is much less than appears at first sight. The amount of unemployment is practically negligible ; prices are high and wages are rising, so that neither employers nor workmen suffer much as producers and consumers. Those alone suffer much who pay heavy taxes. There is an element of truth in both statements ; the latter is less plausible than true provided certain conditions are fulfilled. Unemployment figures published by the Board of Trade convey little information, for those indus-

tries which are injured by the war are not adequately represented in the Government returns. Moreover, the extent of dislocation of industry is hidden by the fact that large numbers of workmen who would otherwise have been unemployed have become soldiers.

The first approximation to the real cost¹ of the war may be obtained in the following manner. Assume, for purposes of illustration, the contribution of Britain (*i.e.*, excluding that of the colonies) to the army and navy to reach an *average* of 2,000,000 men² during the war. Assume, further, that for every soldier and sailor one civilian is engaged in the production of strictly war materials and services, that is, materials and services which would not be required for the soldiers and sailors in times of peace. Thus 4,000,000 men are engaged, during the war, in "occupations" not all of which would exist under ordinary conditions. If it be assumed that 1,000,000 men were engaged as soldiers and sailors, or at industrial and other occupations connected directly or indirectly with national defence, in time of peace, it follows that 3,000,000 men have been withdrawn from their ordinary employments to assist on the field of battle or behind it in the present struggle. And the direct material cost of the struggle to the nation is

¹ Material factors alone are dealt with, and no attempt is made to "capitalise" the wealth lost through loss of life in war.

² All the following figures are merely illustrative, and are taken almost at random.

equivalent to the cost of maintaining 3,000,000 men (with their families) in idleness, together with that of replacing property destroyed by the enemy. The loss to the nation seems at first to be the sum total of goods and services which these 3,000,000 men (and women) would be adding to the national wealth if there were no war. But this is not quite true ; it is necessary to deduct the extra work performed by those who remain at home : for example, married women, once teachers, resume work at school, while continuing to perform their domestic duties, in place of men who have joined the army ; clerks, accountants, lawyers, shop assistants, etc., work harder than ever before ; Belgians in some places are given opportunities to work at their callings.¹ Moreover, a small percentage of the new army were probably " men of leisure " or young apprentices before war broke out. Finally, industry has been to some extent reorganised to meet the new conditions. Assuming the above factors to account for 200,000 men, and that 50,000 aliens are interned and so unable to work, the loss to the nation is the normal contribution of 2,850,000 men to its annual income.

The ability of the nation to continue the war for a long period depends upon three factors, which are distinct, though related. These are—(1) the goods and services which are sacrificed ;

¹ Canadians have been brought to work in engineering factories on the Clyde.

(2) the manner in which the burden is distributed between the different classes in the community ; and (3) the extent to which it is spread over a long period.

The goods and services which are least useful socially are not the ones in least demand. The amount of human energy annually devoted to the supply of harmful or useless luxuries, together with the amount spent on the manufacture of capital goods for export (to which reference will be made in a moment), is probably greater than that withdrawn from ordinary occupations for employment in carrying on the present struggle ; so that if industrial capital could be immediately adjusted to the new conditions, and we gave up all luxuries and ceased to export capital, the war could be continued almost indefinitely without additional burden.¹ But such an adjustment cannot be made without loss and in a day or a week. The production of luxuries, like all other goods, is a long process. The appliances (factories, machinery, warehouses, etc.) which contribute to it—which are really the *past* labour employed in it—are already in existence ; and, unless such appliances can be employed for other purposes, the only human energy engaged in the production of luxuries at the moment is the direct labour engaged by the employers, and that which is represented in the price of raw material. A

¹ It is obvious that the annual interest lost to this country is a steadily accumulating sum.

sudden break with luxuries (assuming that the fixed capital employed in the industries concerned are not adaptable to other uses) would therefore produce considerable dislocation and loss, which would need to be added to the cost of war. But it is unlikely that the consumption of luxuries will be reduced to the extent which seems desirable. Among some sections of the community it will be largely diminished, because these suffer more than others from the effects of the war. This leads to the examination of the second factor—the distribution of the cost of war between different groups in the community.

War not only reduces the wealth of the nation,¹ but also affects its distribution. In the first place, as already indicated, the cost of living is raised ; and the loss entailed by a rise in the cost of living varies inversely with the income—the smaller the income the greater is the suffering. Secondly, money incomes are affected in different ways. Workpeople employed in trades which are depressed during war probably face the higher cost of living with wages smaller in amount and more irregular. Those employed in industries affected directly or indirectly by war contracts may be able to secure an increase in wages commensurate with or even greater than the rise in their cost of living. They share the “windfall” with their immediate employers. What is true

¹ Using the term “wealth” in the sense in which it is generally employed, *i.e.*, with no ethical significance.

of workmen is true also of employers and owners of capital. People in receipt of nominally fixed incomes, and those engaged in professions, are called upon to bear a disproportionate share of the burden, in reduced salaries, harder work in many cases, higher cost of living, and increased taxation. Consequently the burden of war is unequally distributed as between different groups in the same class.

Probably no economic question raised by the war has led to so much confusion of thought as that of controlling and altering such distribution. Nor is this surprising, for it raises a number of difficult problems, which cannot be discussed here. At this point it need only be stated that where employers enjoy great increases in total net profits in consequence of the war, or workmen secure relatively higher wages rates through the same cause, such additions should be deducted from the total cost of the conflict; for they merely represent a transference of money from one group to another, in virtue of the fact that the latter, for the moment, enjoys a *quasi*-monopoly. They do not represent expenditure of labour and capital.¹

The cost of war is spread over a long period. It is commonly supposed that such a distribution is

¹ The same will be true of the salaries of Government officials if the proposal to increase them is adopted. The defence of the proposal (the rise in the cost of living) is irrelevant. But the "war-bonus" given for additional work performed during a period of stress is fully justified. The

effected by means of loans and taxes. It is held that the burden is placed on the present to the extent that funds are obtained by means of taxes and postponed to the extent that funds are obtained by borrowing. This is not wholly true. Suppose A. pays £20 additional income tax in consequence of the war. If it is paid out of income which would otherwise be devoted to the purchase of consumption goods—clothes, luxuries, etc.—it represents a present burden. But if it is paid out of income which would otherwise be saved, it represents a future burden—it diminishes the supply of capital. If A. *lends* £20 to the Government which he would normally spend as income, it represents a present burden. If that sum would have been saved in any case, it represents a future burden. It is not so much the method of obtaining the money as the way in which such money would have been employed, if there had been no war, that indicates the extent to which the burden is distributed between the present and the future. If the labour energy withdrawn from industry would otherwise have been employed in the production of goods for current consumption, the burden rests upon the present ; but to the extent that such labour force would have been employed in the production of capital goods (to be used

case of the engineers in the Clyde valley is quite different. The present dispute is largely connected with events which occurred before war broke out. The labour problem as it is affected by war is examined by the writer in an article which appears in the May number of *The Political Quarterly*.

ultimately in the manufacture of consumption goods) the burden is transferred to the future. Nevertheless, it is probably true to say that loans are made largely out of current savings, while taxes generally restrict consumption, so that the method employed by the Chancellor in financing the war is important. Taxation tends to restrict consumption at a time when such consumption should be restricted among the relatively rich.

If the loans are obtained within the borrowing country the war is carried on out of current savings, voluntary or forced; the nation is not increasing its indebtedness to other nations, or reducing its claims upon them. Probably nearly all the first British loan was obtained out of current savings. It is true that we imported large quantities of war material from the United States, but such imports took the place, to some extent, of other goods (such as raw cotton), which are normally sent over in payment of interest upon our investments in that country and elsewhere. Moreover, we exported considerable supplies of war materials to our Allies, so that the net effect seems to have been as stated above. We did not seriously injure our position as a creditor of foreign nations. But it is equally likely that we did not strengthen it. Current savings, which would normally have been employed partly in the export of capital and partly in extension of home trade, were employed in carrying on the war.

The rate of expenditure has since increased, and it is likely that we are now utilising the resources of other countries—*i.e.*, we are reducing our claims upon our debtors. The new loan may possibly be fully subscribed by the people of this country ; but they will only be able to supply all the “ money ” if they realise their foreign investments. Such a process is equivalent to borrowing capital abroad. The capital is repaid or advanced in the form of goods—war materials or other commodities. Such commodities are either (*a*) those which were normally imported, for which other goods were previously exported as payment, but now are not so exported, so that those who manufactured such exports are set free to assist in carrying on the war ; or (*b*) those which were not previously imported, but made in this country, so that the makers of such goods in the past are also set free for the purposes of war. In other words, the excess of imports (which have materially increased) over exports (which have diminished) indicates the extent to which we are reducing our exports of capital and calling in capital already invested abroad. The “ willingness ” to do this depends upon the relative rates of interest at home and abroad, together with the rate of discount at which we call in our capital.¹

¹ We are importing at exceedingly high prices—in other words, we receive relatively little for each £100 of capital which we recall. We gave much more for that sum when we invested it, so that we are realising our investments at a heavy discount.

The extent to which the normal extension of home trade and the exportation of capital are reduced, and our foreign investments are realised, is also the extent to which the burden of the war is transferred to the future.

These facts are of considerable importance in a discussion of the effect of the war upon distribution. Stated briefly, war destroys capital; during the present war we are using capital as income. It is inevitable, therefore, that scarcity will prevail in the future, and that the rate of interest will rise. And since the present war practically involves the whole world, in the economic sense, and the world as a whole is using most of its free capital as income, the scarcity is likely to be so serious as to affect the world rate of interest very materially. In previous wars the world supply of free capital was not appreciably affected, so that the scarcity prevailing in one country could be made good by foreign loans. But on this occasion other countries will suffer from lack of capital even more seriously than ourselves, so that we shall probably continue to export capital which we can ill afford. Unless, therefore, a heavy tax is placed upon foreign investments,¹ in order that the net return obtainable from them may be reduced, a considerable rise in the rate of interest in this country is inevitable. And a rise in the rate of interest

¹ This is not a plea for such a tax. There are other factors to be taken into consideration.

is likely to press heavily upon the working classes.

The indirect cost of war to recipients of small "earned incomes" provides a strong argument against placing much, if any, of the direct cost to their account, in the form of indirect taxes, or direct taxes upon relatively low incomes. For it should be observed that the proceeds of the taxes are not lost, but repaid as interest to people within the country. It is merely a transference of wealth—and a transference largely from those who will have suffered much indirectly—to those who have benefited by being able to invest at a higher rate than would have been obtainable if the war had not taken place. The destruction of capital on a large scale is a loss to society as a whole, but a gain to investors of fresh capital; in other words, scarcity of capital in general is advantageous to owners of new capital, while a plentiful supply of capital is beneficial to society as a whole.

There remains a final point for consideration. Those who held secure investments, at a fixed rate of interest, before war broke out will naturally suffer through depreciation in the value of such investments. The price of Consols, for example, will be considerably lower in the future than they would be if there were no war. And the difference will be mainly due to the possibility of obtaining a greater net return in other investments. The foregoing remarks (which are based

upon the assumption that trade will go on as usual)¹ seem to be beyond the subject of this book. It is true that some of the points have been dealt with in greater detail than strict relevance permits; but the main factors indicated bear directly upon the problem.

Reference has already been made to the fact that the economic return from a war of conquest (in so far as it is permanent) need only be greater than the interest upon the capital cost of such war. But to arrive at the cost of war it is necessary to take into consideration all the factors indicated—the present cost or burden² and the future direct and indirect costs. In the latter must be included the effects of the war upon the distribution of wealth.

It is evident that, since a war of conquest is likely, in future, to draw other countries into the struggle, the cost of such war will be enormous; and, since the use of capital as income will involve the employment of world capital on a large scale, the resulting scarcity of capital will react unfavourably upon the conqueror. But it is clear also that such loss is not so much due to the internationalisation of credit (although this move-

¹ In other words, we are dealing with the trend of interest over a period of years, rather than the fluctuations immediately after the war. The actual rates will oscillate about a mean level higher than that which would prevail if war had not occurred.

² The perpetual annuity which could be purchased with this sum should be set against the annual gain from the conquest.

ment has greatly facilitated world progress) as to the economic interdependence of nations and the great importance of capital in modern economic organisation. It is less the financial machinery than the material upon which the machinery is employed that is, in the long run, important.

The proposition with which we started seems therefore to be true. That proposition may be stated as follows:—Although a war of conquest is likely to bring some return of wealth, and *may*, over a long period, bring a return commensurate with the outlay, the *chance* of a gain equal to or greater than the cost is never adequate compensation for the outlay itself. Even if he proved the chance of gain to be of greater material value than the certain loss, the conqueror, as already stated, would not have justified his action. Economic considerations should be entirely subordinated to other considerations. And in almost all international questions which endanger peace in the West it is probable that economic questions do occupy a subordinate position. Japan is perhaps the only important nation whose foreign policy is determined mainly by material considerations.

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