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THE PRICE SYSTEM AND THE WAR ECONOMY

THE shape and content of the paper may be outlined in the beginning. It has three parts. The first suggests that the war economy is essentially distinctive. The transformation of life and purposes in war involves a revaluation of the factors into which we customarily subdivide the consideration of the social organization—the political, the administrative, the technical, and the economic. In its essence the war economy, concerned with victory not individual wants, strengthens the administrative, the technical and political, factors and reduces the importance of the economic *as we know it*. The ordinary economic criteria no longer apply. This raises the question discussed in the second part of the paper, the place of the price system in a war economy. In the private economy, the price system was the key to the distribution of resources, and in previous wars governments made the transformation to war mainly by acting on the price system via finance, by fiscal policies that expanded taxes, loans, and government expenditures and that thereby secured the re-allocation of resources. But this method and all its implications require reconsideration as a method of transition from peace to war, because the war economy is now so distinctive and because even in recent peace-time the price system was ceasing to be a satisfactory allocator of resources. The third section discusses the inapplicability of certain economic criteria in a war economy. The implications of this are left to the academic economist himself.

The first requirement is to define the place of economy during wartime. In war, the social ends are revalued. A new emphasis is given to the basic institutions and to their preservation, that is to the state, its frontiers, its way of living, its place in international society. The maintenance of the state is a basic end, even in peace-time, but in war this social end takes precedence. Other social ends may have to be sacrificed, like housing, and many individual ends have also to be forgone. And the main sacrifices are private consumers' wants, whether previously provided by the state, as in social services, or whether provided by firms. In commodity terms, it becomes necessary to transfer resources for private consumption to war goods. And this problem is essentially technical, administrative, and political; it is only in part economic. The subordinate nature of economic considerations in war becomes clearer when the war and peace economies are contrasted.

In our social organization in peace-time, the economic system is still essentially private, not public, although the emergence of group interests is important—groups of producers like associations of firms, farmers, labour, and so on. Nevertheless it is essentially individual. Because

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of that the relation between individuals in exchange is the heart of economics—the market economy, the price system that institutionalizes that market. The preferences of individual consumers, however determined, ultimately dominate the allocation of resources by their influence on commodity and factor prices. Supplies, demands, and the price system are the corpus of economics in an individualist society at peace. But in war, by definition, a society now ceases to be individualistic: the required allocation of resources is no longer determined by private consumers' preferences. The new allocation is dependent mainly on military strategy which rests in the hands of the supreme command. Their needs, their wants are independent of the price. The problem becomes increasingly a technical one, an administrative one, with politics lurking everywhere. But economics, as we know it, remains important only in that segment of the economic system that continues on its peace-time basis, a diminishing segment since war ceased to be a casual addendum to normal living. In the war segment, the supreme command cannot rely on profit returns of individuals producing the required commodities in the time required. They may have to commandeer productive resources, men, machines, and materials; they may pay them more or less than their marginal productivity, for who knows what marginal productivity is, when the goods go, not to market, but to war? It is not dollars, but man-hours that count. The test is not whether a factory is economic or not (i.e., making a profit, allowing for depreciation, etc.). The test is whether it is operating efficiently, whether there are sufficient of them to produce the required supplies. These are technical, not economic tests. Similarly with respect to the labour required to man war industries and war machines; they cannot be procured by the normal economic forces of the market. The securing of labour personnel is a technical question mainly, a matter of education and training, and only in minor degree a matter of wages.

In war, the economic factor has a new place: its function is to act much less as a determinant of distribution of resources but to complement the technical and other factors and so to ease the changes. In war, economics and finance are important only in so far as no decision is taken on economic and financial grounds.

The shift in emphasis on economic factors in a war economy is a matter to which English-speaking economists have given little attention. The war economy is not yet a separate branch of study as it is in Germany: that this German study emerged only recently is not attributable merely to National Socialism. The great divergences between English and German economists' views on war finance during the nineteenth century reflected a similar difference in attitude, and the present German

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writings on the war economy are perhaps a logical development of the finance views expressed there even a hundred years ago.

Today, despite the new and all-pervading nature of modern war, English-speaking economists (and governments) have tended to adopt the traditional approach. The tendency has been to discuss the war economy primarily in terms of finance, to discuss taxes, loans (voluntary and compulsory), and expenditures, credit policy—in short, the fiscal and monetary aspects. Behind this attitude there lies a presumption, which, when it is explicitly put, becomes untenable: the presumption that the transition from a peace to a war economy can be achieved within the existent social organization and the institutions belonging to it; the presumption that the basic transformation can be secured by financial and monetary policies that act on the price system, reducing private consumers' demands, raising government demands, diverting resources through the traditional method of the market and the price system. There is a basic reliance on financial and monetary actions through which, it is hoped, the physical transformations will be secured as the market and the price system indicate the new alternatives.

This view is much more qualified in practice than it is in theory. Indeed, it has always had some qualifications in practice. In the last war, it was further qualified, and increased reliance was placed on deliberate expedients designed to serve war ends outside the operations of the price system. In this war, still further reliance is placed on direct acts of physical transformation. In short, conditions have forced governments to use methods other than that of acting on the price system via finance.

This is perhaps a necessary condition of a war economy. The method of government finance by taxes and loans is part of the individualistic system, as is also the institution of the market and the price system. These are institutions subordinate to the great institutions of private property and individual liberty. If these great institutions are modified so are their subsidiaries. If the social organization is changed, the institutions of the economy change with them. But in war it is admitted that individual liberties may have to be profoundly modified: the principle of private property has to give way to state needs. *Ipso facto*, reliance on traditional finance acting on the price system has also to be modified; because if the institutions to which the price system is the complement are being modified by heavy taxation, by government commandeering, by reduction in liberties of action, in liberties of profit, and so on, so also will the price system. In this war, governments still rely largely on the individualistic method—on taxes, loans, and expenditures, but increasingly they have to adopt more deliberate expedients

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of transformation. They manipulate the price system itself, they resort to direct control of essential industries or important commodities, they have begun to demobilize labour in non-essential industries, to retrain it, to concentrate production in most economic plants, even combining parts of plants from different firms, thus cutting through the institutional unit, the firm, to the basic technical unit, the plant. These actions on the part of governments indicate the recognition that the physical problem of transformation is different from the money problem in a war economy. To this we shall return later. Here it is sufficient to indicate that the economist, impressed by monetary and fiscal controls as applicable to a peace-time economy, may be prone to use similar criteria in a war economy where, by definition, the new situation requires new tools.

* * *

This raises the question of the place of the price system in a war economy. Reliance on the price system as an effective allocation of resources implies certain conditions within the state. It first of all implies individual motivation. But, in war, that condition is removed. It implies also, even in peace-time, the existence of certain conditions for the price system to be effective. These conditions may be summed up under three heads.

(1) In an economy in which there happened to be perfect competition, the price system would work out an equilibrium of maximum economic production. But the economic maximum, such as was sought in the early nineteenth century, soon revealed that it was not necessarily the social maximum. The price system in perfect competition will not maximize welfare because in a system of private enterprise only private costs enter into the price system. Private costs account only for what the entrepreneur or group has to pay, and unemployment, occupational diseases, etc., do not enter private reckoning at all. The price offered by the consumer does not reflect urgency alone; it reflects also his purchasing power, which is ultimately dependent on the social organization. The wage or marginal product of labour only slightly reflects the marginal disutility of the work; it is more dependent on the supply of workers of that class available, and that in turn depends on the labour pyramid whose shape is determined by social organization. So that even in perfect competition, the price system, while it can yield an economic maximum, cannot perform a better social distribution than the social organization permits. Before the price system can operate effectively from a social point of view, even given perfect competition, there would have to be great modifications in income distribution, in

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the nature of the social organization. This explains why modern governments with welfare leanings have to adopt revenue systems that aim at modification of the income distribution. Each modification of income distribution allows the price system to reflect increasingly differences in urgency of desire and to reflect differences in purchasing power decreasingly. Graduated taxation need not always be justified by reference to some sacrifice principle that cannot be logically upheld.

(2) Complete reliance on the price system as an allocator of resources implies a harmony of interests which just does not exist. It implies that what is economically good is also morally and politically good, and economists are often prone to make this deduction. For example, they can show the economic maximum that follows from free competition or free trade. They are inclined to deduce that such conditions are therefore politically good; that free trade and competitive equilibrium are norms to which the economic system ought to conform; that deviations from these ideals, such as we find in fact, are due to frictions, ignorance, or some such condition. Such an attitude probably results from the theoretical separation between economics and politics that most schools adopt. But it is nevertheless dangerous, tending to make the economist obsessed with the virtues of competitive equilibrium and neglectful of the fact that within countries and between countries individuals and groups do their best to get as far from free competition as is possible. The harmony of interests, on which this intellectual separation between economics and politics depends, does not exist. Within states this fact is recognized: there has emerged the social service state, the state in which new ends are accepted. Economic advantage has been increasingly abandoned as a test of internal policy; employment has become more important than profit, more equitable distribution more important than maximum production. Internally we accept the fact that what is economically good need not be politically good: between nations that is not yet accepted. But internally it is, and with it much of our economic teaching is so much baggage.

(3) This raises the third condition, namely, the fact of imperfect competition. The economy is increasingly trustified in producers' groups, whether in trade associations, labour associations, or farmers' ones. No longer does the price system work automatically. In perfect competition, it is made up by market forces: to each producer a price is given. They are "angel" prices, in Professor Schumpeter's phrase. But in imperfect competition increasing segments of the price system have become man-made. And this introduces a factor that detracts greatly from the virtue of the price system as an index of alternatives: it will still so act, but the alternatives indicated by it are not necessarily those that

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make even for an economic maximum. In perfect competition the price imposes a *rule* on producers—they must accept the price and adjust their costs appropriately. They have to get on at the going price or get out, so the price system ensures efficiency. But in imperfect competition there is no such rule imposed on them. A monopoly price is not a "must"; it is merely a logical point which the monopolist may or may not accept. In imperfect competition price becomes a matter of policy, a matter of behaviour as well as economics. Since the price is not *given* by market forces, there is no longer any guarantee that the price system is acting towards the most efficient distribution. While in perfect competition the entrepreneur can profit only by cost-reducing innovations, in imperfect competition he can affect prices and make his profit, which then is really a monopoly rent, without concerning himself about cost-reductions. Indeed, cost-reducing innovations are the last thing that such producers' groups want because such changes render obsolete their present investment. The bulwark in imperfect competition is not progress but the *status quo*, the rights of those in possession, stable prices, fixity of values: and the same bulwark is desired by each producers' group whether they are firms, or farmers, or trade unions: they permit change only when the old is amortized or when the change seems such as to offset the consequent devaluation of the present vested interest. In firms, this means that innovations are permitted only when the average total cost after innovation is likely to be smaller than the average prime cost at present.

The effect of trustification on the efficacy of the price system is clear: only when prices are *given* can the minimum average cost, the output which equalizes average cost and the price of the product, and the best allocation of the productive resources be determined. But price is not given here: it becomes an effect of certain producers' policies, not a determinant. Hence the possibility of waste, even in the equilibrium situation—systematic under-employment of ultimate resources.

The full significance of trustified capitalism has not yet been grasped by the economist, partly because of the traditional neglect of politics. But the emergence of group interests and group action has to be understood because the economy, while still adhering to private ownership, is motivated by groups possessing not individual but collective hopes and aspirations and possessing collective power. The economic environment, so far as it is characterized by trustified capitalism, is a novel environment, and the behaviour of personified groups a matter deserving political economic attention. The relations between an employer and an employee are very different in kind from relations between trade unions and management. The latter groups have a different distribution

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of political and economic power, each group has its own morality, and each its own degree of power over opinion. It is a distinct economic environment, one of vested interests, each desirous, among other things, of having the price system adjusted to its requirements. The angels operate a declining part of the price system: in the remainder the price system is not permitted to secure efficiency. The new rules that have been emerging do not stress efficiency. The new tests are social stability rather than wealth, steady employment before profit, equitable distribution before maximum production.

It is this price system that operated at the beginning of the preparations for the present war. The desired war-ends were quite clear: the military needs of the supreme command involved certain physical transformations, but these had to be achieved in a certain time. This time element was important for any country that desired arms, whether its possible enemies were arming or not, for it is inherent in the international distribution of power that an arming by any one will provide a similar reaction among others. Time is the essence of armament whether there is military warfare or not. But if actual warfare exists, the time element becomes supreme, since the new techniques of warfare involve instruments of transport, highly mobile and able to strike at industrial plants over wide territories. Accordingly, the economics of modern warfare is as always a transformation problem, but since the great development of the gasoline engine in the twenties, it is now also concerned with the unpleasant fact that slowness in transformation may reduce the possibility of transformation through attack on industrial plants. The war potential is not a matter of relative national wealths alone: it is a function also of the military power available to defend the economic power until it is transformed into military striking power. In short, military technique dictates the economic problem. It requires first a transformation to yield military power sufficient for reasonable defence of the war potential and this amount is dictated partly by the striking force of the enemy, whether his force can range over part or all of your industrial system, and so on. Secondly, within the protection thus afforded, the military technique requires the full transformation that is necessary. But, in these terms, there are two economic programmes required, one a programme of speedy transformation, which may or may not be compatible with the best use of resources in a long war but which has to be achieved to make a long war possible. The second programme is the longer-run utilization of resources. Up to this war, England, for example, always had the first programme completed even in peace-time. The great investment in the navy provided a military defence that allowed safety to home industries and civilian

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morale. The outbreak of war, formerly, necessitated only a long-run programme. But the new techniques of this war meant that the first requirement was no longer fully satisfied: the speedy production of an air force to defend the home industries and maintain morale was an economic problem distinct from that of transforming resources to fight a long war. How distinct these two economic programmes are depends on the military strength of the opponent, his propinquity, the degree to which home resources can easily be transformed, the extent of reliance that can be placed on allies, and so on.

Given these requirements, it is possible to reconsider government economic policies in war. Here we may disregard the question of whether there is or is not "full employment" at the outset of war preparations. What the term means is not very clear. In imperfect competition, even in equilibrium, there are likely to be some unemployed resources: to get them into full employment may require a change in the organization itself (i.e., to force such industries into efficiency). This is not what is usually meant when full employment is discussed. It has reference to the kind of economic conditions prevalent in the last decade, and new economic thinking has generalized on the basis of this experience and evolved ways of securing fuller employment. For governments in countries with much unemployment of this latter sort it is to be expected that the initial stages of war preparations might aim at using the unemployed resources for war purposes. And this has been done: the familiar methods of credit use and government spending worked to create greater employment. Unfortunately, reliance on these methods is apt to postpone the problem because in moving towards fuller employment these methods do not guarantee that the new employment is mainly in war industries: certain private industries expand with the general stimulus, and even new factories for private purposes emerge. The problem of transformation is left for the happy day when full employment is reached. Of even more importance, perhaps, this sort of preliminary war economics policy may endanger the ultimate war effort itself, for it creates a volume of private consumption and a rise in private consumers' tastes which the government may later find it difficult to check. Still worse it helps to strengthen the presumption that the war effort can be achieved within the traditional economic framework (i.e., reliance on private enterprise operated by private motives and so on). Such an initial policy not merely postpones the truth that maximum efficiency involves some unpleasant readjustments in traditional methods but, by creating economic ease for a period, makes individuals and groups less ready to accept the necessary adjustments.

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This sort of preliminary economic war policy leads very naturally into the traditional war finance methods, the reliance on government revenue and expenditures operating via the price system in order to get the shifts in resources and occupations. This traditional method is much concerned with the money aggregates in the system, with the national income, with the proportion of it that is being spent on war, with the proportions raised from loans and taxes respectively, and so on. At its worst this method produces the attitude—so typical last year—that if a community completed a "spitfire" fund in two days it thereby added a spitfire to the forces, that because there was a money transfer therefore there was a real transformation of resources to parallel it. In less degree, some governments encountered the same fundamental difficulty: they made large money appropriations for certain expenditures, but found that this could not secure the physical transformations. They were asking too much from the price system in the budgetary year. So the price system has had a new staff added to it: usually these are controllers of some sort, often controllers over the essential commodities and responsible for their distribution, often controllers that try to lay down certain rules, perhaps rules of priority or rules of price. Anyway the price system is supplemented as it was in the last war. But, so long as such controllers are only complementary to the price system, it is still left as the key to the transformation.

This raises the question of its ability to perform this function in a war economy. The task of the price system may be increased if the government cannot solve its fiscal problem. This in turn raises a matter of some interest but it does not concern us here. If a government has determined to secure the shifts mainly via finance it can pursue a vigorous fiscal policy that will cut down consumption (by taxes and loans, voluntary or compulsory, or in the last resort by rationing private expenditure, allowing expenditures of only so much per head per week or month) and a policy that will prevent undesirable expansions of private business (by restricting private capital issues, by getting banks to deposit surplus reserves with the treasury, by persuading banks as to what they can do with their advances, in short by controlling their lending policy). Clearly a government can go far in these ways towards solving its fiscal problem.

If it does not solve the fiscal problem, a new burden will be thrown on the price system. Not only will it have the major part of the responsibility for guaranteeing that the falls in private expenditure clearly indicate the required new distribution of resources, but it will also have to perform the undone part of the fiscal task: in simple phrase it will have to impose savings as well as re-allocate resources. In Dr. Schumpeter's language, there will be changes in the price *level* as well as in the price

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system and, in consequence of the change in level, since all prices cannot respond equally, there will be certain upsets in the appropriate price system.

But assuming away the fiscal problem, there is still the question of the ability of the price system to meet war requirements. The matters of discussion may be reviewed shortly.

(1) The first doubt concerns the time taken by the normal price system to make re-allocations. It is notoriously slow. The private economy has its inertia, particularly when the price system indicates forthcoming bankruptcy for those resources that are in private trades which the loan and tax policy of the government is dooming. Indeed, there might have to be excessive shifts in relative prices to get the shifts in industrial structure undertaken, but the price system merely responds to what is asked now, not to what is ultimately desired. It is hardly ready to guarantee 50 per cent shifts in industry at rapid speed: and that may be what war requires. Governments are fully aware of this tardiness, and they do not ask too much at one time. They look to a policy of gradualism, hoping that each additional step-up in taxes, etc., will bring the required readjustment. In short, governments that pursue this policy have to give up the hope of achieving a speedy war economy.

(2) The shift in industrial production is not merely slow, but it may be impossible, technically, for any conceivable price change to call forth the required materials. They may be scarce naturally, they may take long to increase, they may be monopolized: any of these conditions may render government bidding through expenditures and the price system really impossible. In such cases the government is apt to add its staff to the system and introduce a new principle of distribution for the scarce good (priorities or rationing). When a government does so, it admits a new principle: it is indulging now in direct control as against acting indirectly via the price system. It is now doing for materials what it has traditionally done for men, that is appropriated them, but generally it still pays the market price for materials if not for men.

(3) The changes via the price system are likely to be intolerably slow in shifting labour: the war industries involve new occupations and new locations. The price system usually creates this sort of shift more among the children of present workers than the present workers themselves. To shift the occupations or localities of present workers, requires retraining: this the price system cannot give, for it is determined by the social order of the day: presumably a new institution for such training is a prerequisite of a war economy in order to mobilize men.

(4) The price system in imperfect competition cannot guarantee full utilization of plant capacity nor can it guarantee appropriate shifts in

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real capacity in response to shifts in demand as between private persons and governments. Given heavy taxation and saving and reduction in private demand, there is no guarantee that any one firm will close down because there are no marginal firms. They will, of course, release men, materials, and power as they adjust themselves to lowered demands but they may all persist and work at very low capacity. They may even fight among themselves to try to hold the remaining market, using reserves to do so. In such a case only direct intervention can impose economy on them, leaving one or two plants (not necessarily firms) to operate at full capacity to feed the private consumption, and converting the others or simply closing them. Such a rule has to be imposed: it is imposed in perfect competition by the price which is a given datum and, as demand falls, the price will impose its rule. But in imperfect competition there is no such rule, and economy requires that the government provide it directly. The problem is easy if the plants can be used for war purposes: but, if they cannot, the problem still remains in imperfect competition, and there is no means of securing full utilization of plant capacity except by imposition of rules. The price system cannot do it.

Accordingly, we have to conclude that a policy depending primarily on finance and traditional reliance on the price system with transfers by taxes and loans is inadequate to create the required transformation whenever there is an approach to a fully employed economy. The price system is a slow indicator of new alternatives. As lowered consumption releases labour, materials, and management in certain industries, there is no automatic means of reabsorbing them and, finally, the price system cannot guarantee any efficiency in transformation whenever competition is not perfect. To meet these, deliberate expedients are called for.

These matters raise a question of major importance. Since a war economy does require transformation, it involves progressive bankruptcy for certain firms. Usually governments cannot say this but, in this war, even if they use indirect methods, the result is unmistakable. If the government solves its fiscal problem, the reduction in private consumption will create the bankruptcies: direct measures will then be needed. But meanwhile the reliance on heavy taxation and borrowing has its dangers because it is not discriminatory enough. It relies on the profit motive but attacks all profits on a similar basis. The heavy taxation hits also the industries in which expansion is socially desirable and some of these find it profitable to cut their operations in half. Others are trying to raise certain capital costs that will yield returns to the plant in the long run because the rate of interest becomes an unimportant determinant alongside the war rates of taxes: others charging differential prices are apt to change their price patterns, even at slightly

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lower gross profit, if this seems likely to expand post-war profits, e.g. they may even sell below cost to one group of consumers, to build future preferences. This may be good private policy, although not the best use of national resources. The same applies to firms making several products: new price patterns may become worthwhile from a long-run point of view even if it means some temporary sacrifice in total.

These considerations suggest a very severe limitation on old-fashioned war finance in a modern war, in a trustified system. If a government is reluctant to face the deliberate expedients and specific controls that war requires, if it leans too heavily on the indirect method via finance, it simply adds to the real cost of the war: it fails to get an approach to maximum efficiency, yet its tax burden is high, impinging heavily on all, even on those industries that must be expanded. It has to be recognized that this method cannot hide the problem because the fiscal question alone, if it is to be solved, requires direct controls over consumers' expenditures (forced saving or rationed expenditure) or else direct controls over the production and sale of consumers' commodities. In short, to get adequate savings within the fiscal method, it is probable that new direct expedients will be necessary. Already commodity imports are within control, but it seems inevitable that the government will soon have to curtail the production of consumers' goods, especially manufactures, just to get adequate consumers' savings. This method would probably be more satisfactory than rationing expenditure. So even with the fiscal method, it is still imperative to adopt specific expedients, deliberate industrial and personal regimentations, in order to secure fullest physical effort in a reasonable time.

These considerations suggest a reconsideration of the policy that concentrates on the fiscal part of the war economy to the neglect of the physical elements, and the necessity of internal efficiency. Fiscal changes may be appropriate for a peace-time economy when induced changes can be gradually effected by such a means. But a war economy is by definition not effectively achievable by gradualism: war is not for the timid, the economic policy has to be as courageous as the military forces.

* * *

For the economist, the war economy presents some new analytical problems. The economist's tools have been fashioned for use on a different material. The war economy is a new kind of economy. This truth may be hidden by attempts of governments to use peace-time methods in a war economy, for example, a simple extension of old financial methods. But the new task will overwork the methods: if taxation or borrowing amounts to 60 per cent of the national income, the possibilities of peculiar reactions on the part of households and

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firms are great. Let us try to consider some of the analytical issues in this.

First, that part of economic analysis that uses the margin as a tool requires reconsideration, for the margin is a method applicable only to gradual change. The new government expenditures, the new volumes of taxation and loans are shifts of the first order, breaking off old production functions, necessitating not marginal shifts but complete changes in the whole budgetary pattern of both firms and households. The change is behaviouristic. But, in addition, the change is not motivated by business: it is a change to meet the preference scales of the supreme command. That is the determinant of economic change, and the price system alone is inadequate to make the shifts, for they are not marginal. They have to be secured directly. But how can the economist say anything about the shifts achieved by, say, the commodity controller or the price controller, when these actions are achieved by the political rather than the economic method. It is true that the economist may have something to say about the economic effects of such shifts if he can discover the principles used by the controller, whether they have considered the commodities in a specific or in a wide sense, what principle of distribution they use when they take the commodity out of the price system. He can speak about these effects. But what can he say about the rules to be used when such regimentation supplants the price system? The rules depend on politics, administrative convenience, etc.

Secondly, consider the concept of national income in a war economy. Apart from the usual difficulties of measuring, the difficulties in a war economy render a measure still less meaningful. A war economy, however achieved, is not an income economy: it has a new general end which is collective rather than individual. In the case of the Allies, the service of war is like an "insurance," and the cost of the war a "premium" to ensure our present institutions. Our war cost is a "premium" against the death of our institutions. Germany's war investment is to her more like the purchase of an "annuity," which will yield a future return when she has changed these institutions. The premium the Allies have to pay is a function of Germany's war investment, which determines the risk to our historical institutions. Now how is this premium to be entered in our computation of the national income? The valuations are put on the factors by the supreme command: we don't know these valuations because the government does not pay the productive resources used in war, their marginal productivity. Hence it is impossible to value them at cost, to say that a soldier's pay equals his contribution to the national income.

Or looking at the same difficulty from another angle—the resources used in the war represent a diversion of commodities away from private

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consumption. The consumers' budget has fewer commodities, but a large service of insurance in its place. Now this service does not re-enter the consumers' budget as would, say, a programme of public works, like new roads, rehousing, etc. When a government spends on these the commodities enter the consumers' commodity stream, altering old valuations, and so on. But, in war, the new commodities provided do not so enter the commodity stream although, of course, the incomes paid to producers of war goods *do* enter the consumers' income stream. That is why inflation is inherent in war, even with balanced budgets: there must be inflation relative to consumers' goods, unless private spending is prevented. But there need not be inflation relative to total consumers' utilities since he gets the insurance, i.e., the promise that after the war the old institutions will remain. It is the insertion of this great premium that makes the war economy unique, and that upsets traditional ways of thinking about national income, inflation, and so on.

Thirdly, since this premium is heavy, leading to heavy finance or else much regimentation of private enterprise, it necessitates our being wary of our intellectual presumption about "maximization of profits," "marginal productivity," "rates of interest," "labour relations," and many others. As to profits, since they, in a war economy, are retained only in part, the economist has to look for new attitudes among business men. This is especially necessary where there is imperfect competition. The heavy taxation of profits may make it profitable in the long run to alter differential prices: it may become profitable to readapt plant to a more capitalistic basis, even if it means operating with lower marginal returns from capital than from other factors. It may pay them to use such uneconomic methods for, by making such adaptations, they continue to have plant after the war, only at the sacrifice of a small amount of profit now. It may maximize profits in the long run. Or consider the rate of interest in relation to the marginal efficiency of capital: this rate may become a much less important consideration when the rate of taxation is high. Or consider the traditional capital-labour problem: when taxation is high it becomes economic in some firms to share more with labour, and the possibilities of groups of management and labour combining against government and consumers to get larger mutual rewards is a matter also of possibility.

Without pushing these, it seems clear that in a war economy, where the price system breaks down steadily as an allocater of resources, where groups, whether government controlled or business groups, begin to adopt rules of their own, the economist can be much less certain of the validity of the old tools of analysis. The separation of economics and politics becomes quite impossible in a war economy.

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