WHO PAYS THE COST OF THE WAR?

By A. Barton Hepburn

SINCE the war was brought to an end a controversy has been waged in the halls of Congress and in the various forums of public opinion in regard to the proper means of financing it, and the revenue bill now before Congress brings renewal of this discussion. The issue resolves itself into this question:

Should the government raise the required funds wholly by taxation, or should taxation be imposed as severe in amount as may be without impairing the business efficiency of the country, and the balance of funds required be raised by the proceeds of bonds sold?

A large number of economists have said that the "all-taxation" policy is practicable, because the current income of the people in any case must pay all war expenditures; that the choice between bond issues and taxation is merely a choice whether the government shall take income with a promise to repay those who furnish it, by issuing bonds; or whether the government shall take income without such promise, in the form of taxes; that the amount issued in bonds might just as easily be taken in the form of taxes; that the policy of borrowing within the country itself does not shift any part of the nation's war expenditure from the present to the future; that if the people can support the war at all, they can do it on a cash basis; that borrowing creates nothing; that except by borrowing abroad, we cannot get anything which we do not produce; that borrowing and issuing bonds produces inflation and increases the cost of the war; that taxation does not produce inflation and makes for rigid economy. In effect, it is claimed that the cost of the war must unavoidably be paid by the present and is paid by the present, and issuing bonds payable in the future does not relieve the present, but imposes a burden upon posterity, who are compelled to pay a second time.

We could have entered the war and have been more or less efficient by using such funds as we could raise by taxation, but could we have accomplished the proud results we did achieve? We placed 2,000,000 men in France, and we were a most important factor in feeding our allies as well as furnishing military supplies. In fact, we have been given the credit by our allies of winning the war; at least we were the determining factor.

To accomplish this gigantic task, we expended, in nineteen months, about $22,000,000,000,* including loans to our allies. The devotees of the "all-taxation" principle would have had this amount raised by taxation and paid by our citizens within said nineteen months.

The question is, would such a thing be physically possible? The net income of our nation before the war was variously estimated as from $2,000,000,000 to $5,000,000,000. No economist, to my knowledge, placed it higher than the latter figure. Of course, the net income or net increment of the nation is the net profit left after the payment of all expenses, including the cost of living and expenditures for indulgences of any kind. With the stoppage of all unnecessary expenditures the increment available for taxes would be very materially increased; the amount of the increase depending, of course, upon the rigidness of the economy exercised. But with rigid economy would the amount equal the enormous expenditures which our government has incurred?

If taxation is to be depended upon, the first necessity is to have something to tax. Since the income tax and war-profits tax are the main reliance, the government revenue would depend largely upon individual and corporate prosperity. All agree that taxes should be made as high as business will bear without discouragement, but too great taxation would, in effect, be a capital tax and would reduce the capital investment, and hence the volume of business. The imposition of $11,000,000,000 yearly in taxation would

* The amount authorized by Congress by appropriation and contractual obligations available by July 1, 1919, amounts to $57,000,000,000.

have paralyzed business and have severely curtailed the volume of production. All business is a risk. By wise management and great industry, business hopes to succeed, but it may fail. If the government proposes to take all the profits, if profits there be, beyond a very limited amount, and does not propose to make good the loss, if loss should ensue, it would certainly tend to circumscribe business activity and minimize business output. That is true and always will be true as long as human nature remains the same. And this limitation of productive capacity would occur at a time when the government's necessities demanded maximum results. The war must be won, and munitions, guns, equipment, and supplies generally must be had at any price, and in the shortest possible time. Any experimental attempt to finance the war in a manner which would endanger the supply of needful articles would be as unpatriotic as it would be unwise. The government could, of course, impose any amount of taxation, even to the extent of confiscation, for *once*, but taxation so rigorous as to impair capital investment in business would not only inevitably reduce the volume of business, as just pointed out, but would also reduce the amount of income possible to the government in succeeding years. It is never wise to kill the goose that lays the golden eggs.

We all agree that the only source from which taxes can ultimately be paid or bonds bought is net income. But not the net income of one or two years. If the net income of the present year is not sufficient for the government's needs, the government may anticipate the net income of the future by borrowing. We will all agree that the anticipation of future income in the form of credit does not *create* any value, but it does render future values available in the present, and lends to them a present usable cash valuation, predicated upon the income which it is believed property will produce in the future. The apparent conflict of ideas between the economist and the business man arises from the assumption on the part of the economist that furnishing the implements of war pays for the war. It is evident that the war must be prosecuted with existing goods, but those who supply these goods may be paid in part by the proceeds of bonds payable in the future.

The "all-taxation" advocates draw a line of demarcation between the present and the future, which in reality does not exist. There is no way of separating the present from the future in such *ipse dixit* manner. The truth is that the present is constantly melting into the past, and the future, immediate and remote, is the main consideration in all transactions in the practical affairs of mankind. All values are predicated upon the future. The farm, the factory, bank stock, railroad stock, are all valued according to the income which it is believed they will produce in the future.

When a farmer buys a farm and leaves a purchase-money mortgage upon the same for a part of its purchase price, running ten years, he is mortgaging his future income as well as his property. The tenth crop is a part of the consideration as well as the present one. His ambition is that his income will pay his debt and free his property. Business is largely done by credit resulting from utilizing the future income, by mortgaging the future. Every entrepreneur who is using borrowed capital in his enterprise is anticipating future profits and offering what capital he has and his character and industry to inspire confidence.

The Allied governments anticipated their future incomes by borrowing $8,000,000,000 from us, and we might ask the "all-taxation" people whether this also should be raised by taxation! Our government anticipated its future income—taxes—by selling to the public bonds payable in the future. And the public anticipated its future income in buying the bonds. In a business sense, future income is just as real and just as available through credit as any other resource. It is the function of credit—of finance—to render future income available in the present, and upon that function the whole superstructure of business is based. In view of this well-known, world-wide characteristic of business, how is it possible to maintain that the cost of the war must inevitably be borne by the present, and that it is physically impossible to devolve any portion of the same upon the future, except as a double payment? For what are present resources? Are they cash and bank credit only? The total currency in circulation in the country is about $4,000,000,000. It would cut a sorry figure compared to the cost of the war and the enormous daily cost of business. The resources of the commercial banks of the country include, in round numbers, $12,000,000,000 invested in commercial obligations, notes, drafts, bills of exchange, running thirty days to six months, and sometimes longer, and also a reasonable percentage of long-time bonds. These commercial banks are the reservoirs wherein business reduces its future maturities, by loans and discounts, to available present credit.

But, say my opponents, even though future income can be anticipated, it can as well be anticipated for purposes of taxation as for the purchase of bonds. Let us see. The income which goes into taxes is gone forever so far as the taxpayer is concerned, but income invested in bonds provides an asset which may be used as collateral to support his credit in case the capital needs of his business render borrowing on his part necessary.

The income-tax law fixes the fiscal year, defines assets and liabilities, and determines the method of ascertaining the income. It seems to assume that all business profits are in a form available for the payment of taxes. But it should be borne in mind that the profits of a business do not take the form of money except to a moderate extent. A farmer's profits are represented by live stock; a merchant's or manufacturer's profit by goods on hand; a railroad company's profits by additional siding facilities, rolling-stock, etc. And in these days of rising prices, a very considerable proportion of all business profits are represented by the enhanced valuation put upon goods on hand, and even the enhanced valuation of real estate would be included in localities where real estate was advancing.

The "all-taxation" advocates tell us that issuing and selling bonds create inflation. True, the issuing of any new credit instrument tends toward inflation. But extraordinary taxation that would force borrowing in order to pay taxes would also produce inflation. Professor Carl C. Plehn, of the University of California, points out the real determining factor in the question of inflation when he says, in the *American Economic Review*, September, 1918: "It will possibly be agreed that it is the sudden increase in spending for non-economic purposes that creates the inflation. Hence both taxes and loans will create some inflation." The imposition of $11,000,000,000 in taxation per annum would have driven all industry to the banks for loans in order to pay their taxes. The credit instruments placed in banks by such borrowing would tend to inflation, which these economists so much dread, in the same proportion that bond issues would. During the past two years, even under existing taxation, there has been much borrowing to pay taxes, and some corporations have resorted to new financing in anticipation of taxes foreseen.

On the other hand, all bond-issuing does not create inflation. Pethwick Lawrence says: "Inflation is inherent in the flotation of a loan for purposes other than the construction of material reproductive capital." Issuing bonds or credit instruments to obtain funds to build a knitting-mill does not produce inflation, because the value of the mill offsets or equals the bonds issued. The same is true as to credit used for the creation of any productive property. The "all-taxation" advocates seem to assume that all funds secured from bond sales are expended in war activities which are destroyed by their use. That is far from true. The property of continuing value created by our government with proceeds of funds raised runs into billions. Since the beginning of this war the government has expended, and is expending, hundreds of millions in construction of vessels to supplement our navy, transport our troops, transport supplies, and for other purposes. When the war is over these vessels will still be in valuable use. The government has built shipyards, munitions and aeroplane plants, and other plants, which will have a continuing value after the war is over. There is no more reason why the present taxpayers should pay the entire cost of these production goods than why the cost of the Panama Canal should have been imposed upon the taxpayers at the time of its construction.

Again, did the bonds our government sold to raise money to loan our allies involve inherent inflation? Our government holds interest-bearing bonds of the Allied countries for the amounts borrowed.

Another serious mistake which these "all-taxation" people make is in assuming that all war supplies are furnished by private corporations and individuals, whose profits would be subject to an income tax. The war was on such a magnificent scale, the demands so enormous, that the government, as already pointed out, built shipyards, and ships, docks, munition-factories, powder-mills, aeroplane plants, etc., in fact, went into business on a large scale, and in addition commandeered other plants. The government could not await private enterprise, and used the proceeds of bonds sold to divert production from a peace to a war basis, to command men and material, to intensify activity, increase efficiency, and increase production of the things they needed.

Inflation of prices, whether from taxation or bond issues, increases the cost of living and affects more than all others those who work for a fixed stipend, or live upon a fixed income. However, the price of labor in the present crisis, with the great demand for man-power, has fully kept pace with the advance in prices. Industrial and financial corporations have treated their employees most liberally. But colleges and schools have been hard hit, crippled in their finances, and compelled to reduce their force at a time when faculty and instructors were in need of increased pay. Far the greater percentage of present inflation in prices came to us from the effects of the war in Europe before we became a belligerent.

Over 20,000,000 individuals subscribed to the last loan, thus broadening the war constituency of the government—increasing the stockholders in the government—and materially contributing to the funds necessary to prosecute the war. Funds were thus made available from people who would not have been reached by taxation.

Professor Plehn discussed this subject with great force and clearness in the *Review* above referred to. He says:

The "all-taxes" extremists argue that in any event it is impossible to draw the actual costs of war from the future. They say, for example: "We cannot (in 1918) shoot a shell to be made in 1930," a statement of fact which need not be disputed. But when they add, "the future is not here to bear burdens," and then conclude "the surplus of current income must be the source (sole source) of funds for financing the present war," and hence would have us infer that borrowing is a mere hocus-pocus, which "postpones no burden to the future," they are dealing in pure sophistry. The trick in logic is turned by the concealed assumption that funds, which only stand for and represent realities, represent only present realities. Such a conclusion runs counter to the judgment of the business community which is thoroughly convinced that it is easier to pay heavy taxes for ten consecutive years than ten times those taxes in one year. . . .

There is the further fallacy of assuming that it is possible to draw a sharp line between the present and the future in any economic process. We can stop the clock, but we cannot stop time. Any moment now in the future glides through the present into the past with tremendous certainty. Every economic process is a process involving time, and of the three—past, present, and future—the future is the most important. The whole fabric of economic life is built on hope, confidence, and faith in the future. We plant in the springtime for an autumn harvest. We build railroads not to move our accumulated products of the past, but to gather the expected future crops and manufactures. Our capital with which we work and bring forth results is not merely a hoard of accumulated savings "against a rainy day," it is the living power of future production. Its value is the present value of a stream of future income. . . .

In war finance we aim to place in the hands of the government funds with which it can induce men to produce war supplies, to-morrow and the day after, not yesterday nor the day before. Credit is the means by which the shadows of coming crops and the toil of future generations are cast before them into the present. Credit, of course, has no magic power to create something out of nothing, nor can it set the table to-day with viands to be grown next year, but it does enable us to overleap the barriers of time and claim the *values* of the future as our own now.

Now, it was physically impossible to raise by taxation enough funds to enable us to get into this war and prove a winning factor as we did. In order to get money fast enough to make over the industries of the country to a war basis, supply the needs and pay the expenses of warfare on such a phenomenal scale, and supply the financial needs of our allies, it was necessary for the government to anticipate future income by selling bonds. It was necessary for the public, in order to respond to the government's needs, to antfcipate their income by borrowing in order to turn funds over to the government. This did involve inflation and resulted in hardship to many. *There was no other way to win the war. Finance by* *means of credit brought future income to the aid of present income.*

The United States entered this war to defend and enforce certain basic principles in government administration deemed indispensable to the protection of our citizens and the preservation of their liberties. Surely posterity is interested in the proper issue of such a controversy, and will gladly bear the burden of paying the interest upon and retirement of the principal of bonds issued and sold to the public in order to secure funds for the successful prosecution of the present war.

We are told, however, on high economic authority that we cannot postpone to the future the payment of part of the war cost by means of loans; that the cost of the war has to be produced to-day in terms of goods; that when bonds are paid in the future by taxes, it is simply a readjustment—some people pay and some receive—and the public as a whole are neither richer nor poorer. But adjustment and readjustment are the crux of living. Our government has $600,000,000 of bonds outstanding which were issued for funds to put down the rebellion in 1861–5, many times refunded, but the principal is still unpaid. Was not that amount of debt transferred from the Civil War period to the future?

Although these logicians conclude to the contrary, the man in the street, the man on the farm, the man in the counting-house, and the man in the legislative halls will always believe that a portion of the present-day expense can be devolved upon the future, and will act accordingly.

I recall an example of false premise which was current in my school-days. A man goes into a saloon, leans over the bar and says: "Well, I believe I will spend my ten cents for crackers this morning." The barkeeper sets him up a plate of crackers. The man turns the plate of crackers around two or three times and says: "Really now, I don't want crackers. I would like to swap these crackers for a cigar." The bar keep makes the required exchange, but after toying with the cigar a moment or two, the customer says: "Now, what I really want is a drink. If it is all the same to you, I would like to swap this cigar for a drink." The bar keep takes the cigar and sets up a drink. The customer rapidly disposes of the drink and starts off. "Hold on there," calls the bar keep, "you haven't paid me for that drink." "But," calls back the customer, "I gave you the cigar for the drink." "Well, then, pay me for the cigar." "I did. I gave you crackers for the cigar." "Well, then, pay me for the crackers." "You've got the crackers. You don't expect to keep them and get pay for them too, do you?"

THE ILL-FATED CHILDREN OF THE CZAR

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ILLUSTRATIONS FROM PHOTOGRAPHS BY THE COURT PHOTOGRAPHER FOR THE CZARINA'S COLLECTION, AND BY THE CZAR'S CHILDREN

AFTER three hundred years of the ruling of the house of Romanoffs, the war, which has taken 6,000,000 of Russian lives, has brought the absolute monarch to a painful end. For three centuries one man always alone had the absolute control of 175,000,000 people. Their word was law and their names put fear into the souls of the Russians. Revolution after revolution took place to overthrow the absolute monarch and failure to succeed cost hundreds of lives. The Czar has always been separated and distant from his people. Peter the Great was the first to mingle freely with the populace. The second was Alexander the Second, who liberated the serfs, and was the grandfather of Nicholai the Second, the last ruler of Russia.

Twenty miles from Petrograd, the capital of Russia, is situated the Palace of Czarskoe Selo (Czar's Village), the favorite home of the Czar and his family. There is a Winter Palace at Petrograd,