

CHAPTER II

A LEVY ON WAR-MADE WEALTH *

§ I. **T**HERE are two proposals for a levy upon capital for the purpose of reducing the burden of indebtedness which deserve consideration. The first would confine the levy to the new capital values created in the period of the war. The general argument is to the effect that this increase of wealth is presumably due in its origin to war conditions, consisting in the main of squeezes and wind-falls, the product of war needs and war extravagances. Originating in this manner, much of this enlarged capital has escaped taxation, though the income it furnishes is taxed. It has a large ability to pay, and a post-war levy made upon it is in effect a correction of the financial negligence and error which permitted this war-made wealth to come into the possession of its owner. It is contended that, at a time when war claimed from every one his proper sacrifices, such profits ought not to have been made, and that having been made, they ought to be reclaimed by the State, which

could thus remedy in part the injuries caused by its loose war-finance.

The brunt of this contention is contained in its assertion of the magnitude of what is termed war-profiteering. Now, while it is common knowledge that great fortunes have been made during the war by various business firms and speculators, no close computation of the aggregate of such profiteering is available. If any special levy were to be placed upon it, the first step would necessarily be the appointment of a Commission, with authority to examine the accounts of businesses and individuals whose incomes showed a *prima facie* case for the existence of war-made capital, and to make a valuation of their pre-war and post-war properties, so as to ascertain the amount of this war-profiteering, with a view to its assessment for the special levy.

Over a great part of the business field no considerable difficulty would be encountered. For the large war-gains are for the most part registered in the increased value of the shares of public companies. The biggest profiteers are to be found in those trades which have passed through the stage of private businesses into that of joint stock companies with listed securities. The records of the war departments have already revealed a number of scandalous

examples, and closer investigations made by a Commission with full powers to call for accounts would make further important disclosures. Now that almost all income-tax payers are required to disclose their incomes from all sources, it should be possible for the Income-Tax Commissioners, by the closer scrutiny needed for other purposes of tax reform, to give great assistance to the valuation of capital needed for the levy.

§ 2. As regards the aggregate quantity of such war-made wealth and the amount made by certain trades, we may cite certain facts and figures in order to establish a *prima facie* ground for supposing the quantity to be so large as to be capable of making a sensible reduction in the war-debt, if half of it could be recovered by a levy.

Before the war the annual aggregate savings of the nation were generally computed at some 400 millions available for investment at home or abroad. Sometimes they were put at the higher figure of 500 millions. About half of these savings were put into public Companies or Government or Municipal loans, in this country or abroad. The other half were presumably absorbed in private business undertakings. Now the testimony furnished by the recent records of savings put into the former class of investments deserves attention. The

168 TAXATION IN THE NEW STATE

subscriptions of 'New Capital' during recent years are as follows:—

1912	.	.	.	.	£210,850,000
1913	.	.	.	.	196,537,000
1914	.	.	.	.	512,522,600
1915	.	.	.	.	685,241,700
1916	.	.	.	.	585,436,400
1917	.	.	.	.	1,318,596,000
1918	.	.	.	.	1,393,381,400

These figures do not include Government borrowing in the form of Treasury Bills, nor do they take account of distributions of bonus shares. Now, though the great bulk of the national savings during war time has of course gone into war loans, there is no reason to doubt that as much money as usual has been 'put back into private businesses,' much of it indeed escaping taxation as income. When the quantity of outstanding Treasury Bills and other floating debt (some 1400 millions at the close of the financial year) is taken into account, we have *prima facie* proof of new capital coming into existence during the war amounting to a figure of not less than 6900 millions.¹ Allowing for the transfer of money from the sale of foreign investments and for contributions to our War Loans from

¹ For footnote, see note 1, page 169.

LEVY ON WAR-MADE WEALTH 169

foreign sources, the amount of new savings effected in this country during the war can hardly be less than 5000 millions, exhibiting an increase amounting to treble the pre-war rate.² It is impossible to impute any large proportion of this increased saving either to the undoubted economy of the well-to-do classes in personal expenditure, or to the new savings of a considerable section of the wage earners. It is certain that several thousand millions of the money income 'saved' during the war, and mostly capitalized in loans to the Government, represents swollen profits obtained from business pulls or other advantages attributable to war conditions.

§ 3. Shipowners and shipbuilders, munition and other engineering works, mine-owners, contractors, controlled or free, supplying war

¹ WAR BORROWINGS AND NATIONAL DEBT.

(Statistic) April 5, 1919.

	War Loans.		National Debt.	
	April 1, 1918, to March 31, 1919.	Aug. 1, 1914, to March 31, 1919.	March 31, 1919.	March 31, 1918.
Floating Debt	1,557,522,000 223,324,000	5,785,798,000 1,395,610,000	6,240,729,000 1,411,971,000	4,683,207,000 1,188,647,000
Total . . .	1,780,846,000	7,181,408,000	7,652,700,000	5,871,854,000
Deduct Re- payments .	95,219,000	317,515,000	95,219,000	...
Net Total	1,685,627,000	6,863,893,000	7,557,481,000	5,871,854,000
		August 1, 1914 .	652,270,000	
		Increase since 1914 .	6,905,211,000	

² 5000 millions is the figure adopted by Dr T. S. Stamp as the net addition to individually owned capital during the war period See *Economic Journal*, June 1918.

stores of food, clothing, etc., to the Government, brewers, farmers, bankers, have made enormous gains, either directly from the high prices paid by the Government, or by squeezing the consumer under war conditions. To these must be added innumerable other minor profiteers taking advantage of war shortages to raise prices to extravagant heights on pretexts of dear materials and labour. Several reports of Government Committees reveal the huge profiteering done by many business firms in their dealings with the Government, especially with the Ministry of Munitions. But careful analysis, were it possible, would probably show that the biggest aggregate of profits were made by shipowners, brewers, farmers, and bankers. No published accounts give any true notion of their dimensions, which are concealed by various devices. The case of shipowners is particularly flagrant and has been brought before the public by statements of Sir Leo Chiozza Money,¹ whose official position as a Secretary to the Ministry of Shipping gives authority to his revelation.

“In the first two years of the war the net profits of British shipowners came to about £300,000,000. In the same time the capital value of British ships rose by another £300,000,000.” In respect to ships sunk by

¹ *The Herald*, Jan. 4 ; cf. also *The Times*.

LEVY ON WAR-MADE WEALTH 171

the enemy, Sir Leo informs us that "the Government paid out to shipowners the war price of ships," thus converting into cash these enormous war profits. It is important to realize that the bulk of the profits here indicated never figured as income and never contributed a penny to war taxation either under the head of income-tax or excess-profits tax. They were an addition to capital values attributable entirely to high freights and sinkings. These huge fortunes of shipowners came out of the misfortunes of war.

Bank profits are more obscure. They have been chiefly due to the extravagance and foolish borrowing policy of the Government. For the Government incited bankers to inflate the currency, by helping to create large volumes of credit, so that either by subscribing large sums themselves to war loans (*e.g.* the 200 millions furnished by the banks to the 1915 loan), or by advances to their customers or to insurance companies, enormous masses of sham-savings were concocted and handed over to the Government. The result of this inflation (supported by the Treasury's own 'printed money' in the shape of Treasury notes) was a rapid increase in prices, in money incomes and in bank deposits. Thus the banks made a double war-gain, first out of the dangerously enlarged credits given to support the war

172 TAXATION IN THE NEW STATE

loans; secondly, out of the enlarged deposits thus brought into being and the high interest rates at which those enlarged resources could be loaned. The aggregate bank deposits at the end of 1918 were approximately twice the amount recorded at the end of 1913. Here again most of these war profits have been kept out of income, partly by putting them into reserves, partly by hiding them in an excessive writing down of securities, temporarily depreciated, which will recover value when it seems safe to realize them. The size of the war profits of the liquor trade in Great Britain as shown in the rise of capital value may be indicated by the following estimates for the first three years of the war. The "Brewers' Year Book for 1914" reckons the capital value of all breweries, distilleries, licensed houses, wines and spirit trades, etc., in the United Kingdom to amount to 240 millions. The Report of the Liquor Trade Finance Committee, appointed in May 1917 to report on State Purchase and Control, put the value of these same properties at the close of 1917 at the figure of 441 millions. Since that time considerable further advances of value are indicated in the share market, in spite of the widely-published statement of the recommendation of the Committee that in the probable event of State Purchase,

LEVY ON WAR-MADE WEALTH 173

the basis of valuation must be pre-war profits.

The case of the landed interests, including owners and tenant farmers, deserves a separate word. The profits of all decently capable farmers in most parts of the country have risen to unheard of heights, as every country banker knows. From the early rises there was no contribution to the income-tax, which was fixed on a basis of assessing profits at the ridiculously low figure of one-third of the annual value. Even when in 1915, the basis of assessment was raised to the full annual value, the taxation was exceedingly low, the net yield for 1916-17 amounting to £2,850,000. Farmers' profits have been enhanced, not only by the fact of the enormous rise of food prices, but by the legal prohibition upon any rise of rent on sitting tenants which prevented many landlords from taking most of the increased profits in heightened rents, as normally they could have done. But landowners have by no means failed to participate in war prosperity. For all over the country they have been selling land, chiefly to their tenants, at prices based upon the inflated war prices and profits guaranteed by governmental subsidies. A large share of the farmers' war profits have thus passed to landowners in lump sums which, not ranking as income,

174 TAXATION IN THE NEW STATE

are not subject to taxation, even the land values increment tax having been repealed in their favour.

§ 4. A great amount of other war-profiteering has also escaped the public eye and the income-tax by failing to figure as 'income' in any stage of its production. Where a firm doing war-work has been making extra high profits, it has, in many instances, been permitted to apply a very large proportion of these profits to the purpose of enlarging its plant and extending its business, instead of distributing it as dividend. This policy continued over several years, has enabled such favoured firms to convert income into capital and increased earning power, without paying any tax on such elements of income. The profit thus withheld from dividends, and reinvested in a business operating on a high profit level, will necessarily swell the size of the reserve until it reaches such a magnitude that it is deemed well to capitalize it in the form of 'bonus shares' allotted to existing shareholders either for no cash payment, or for a payment less than their actual market value. So far as the distribution of 'bonus shares' represents extra earnings withheld from distribution as dividend at the time when they were earned, it merely serves to conceal from the general eye a part of the excess-profits

upon which income-tax is paid and to escape super-tax. But so far as the bonus shares represent growth of capital value due to further advances of price and profit rates, and based upon estimates of high future earning capacity, they constitute a distribution of unearned wealth which apparently does not rank as income or contribute to taxation at any stage either of its growth inside the reserve, or of its distribution among the shareholders. Nor is this growth of untaxed wealth confined to these cases. It applies to all cases of enhancement of capital values, such as have occurred in businesses favoured by war conditions. I have cited the case of shipping. Here was no instance merely of capitalizing reserves withheld from distribution as dividends, but a continuous automatic growth of values of ships due to freight conditions and governmental guarantees. These gains might be realized by shareholders either in the shape of higher dividends from existing shares, or in a distribution of bonus shares, or in a preferential right to purchase new shares at a figure below their estimated market price. If the shareholders took their gain in the first way, it would represent war profit upon which income- or super-tax would be incurred by them. But if they took their war gain in bonus or new shares, they would incur no

176 TAXATION IN THE NEW STATE

such taxation upon the sum they received, but only on the future interest paid on these new holdings. The bonus or share distribution, when it is made, ranks as an addition to their capital but not to their income. And yet, if desired, it can be converted by the shareholder into cash, and used for any purpose of expenditure. During the war immense increments of capital value have thus been created and passed into the possession of the capitalist classes, contributing nothing to taxation, even when they are realized in cash and spent.

This share distribution is, however, only one of the ways in which this untaxed war gain is realized. Where no such distribution of capital increment takes place, the increased value of existing holdings, due to high present and prospective dividends, may be converted into cash, and rank as effective income to be spent, by any shareholder who chooses to sell out. For the cash profit of such selling does not rank as taxable income, unless it is made in the regular way of business by a financier or professional speculator in some class of property.

Large masses of war-profits, unearned and untaxed, have within the past four years, thus passed into the possession of rich and fortunately-placed business men, to be retained in

the business for the earning of high future dividends, to be invested in other lucrative businesses, to be loaned at 5 per cent. to the Government, or to be spent on objects of personal satisfaction. But the war-profiteering does not disappear with the war itself. This war has left the nation in possession of expensive and valuable properties in the shape of ships, factories, buildings, lands, machinery, vehicles and vast stores of materials of various kinds. Most of these properties have been bought by the nation during the war at profiteering prices. After the war they are being sold back, in many instances, to the very firms who supplied them to the Government, at prices far below their market value. The shipping, engineering and other war-profiteers are thus enabled to reap a second harvest as rich as the first. What they sold dear to the nation they buy back cheap from the nation. This second harvest will be very gainful. For in few cases will the profit rank as income or excess-profits for purposes of taxation. Most of it will accrue to the purchasers as an addition to their capital. The shipping and engineering firms which buy the Government vessels and factories will pay no tax upon their profit from the deal.

§ 6. I have disclosed four principal forms of war-profits which have been incorporated in

178 TAXATION IN THE NEW STATE

capital values without contributing to income- or super-tax or excess-profits tax in any appreciable degree. (1) The manufacture of credit by bankers and finance houses operating to inflate the currency and raise prices. (2) Extravagant prices, subventions and compensations paid by Government to private firms for goods, services or damage. (3) Extortionate prices exacted from consumers under the duress of war conditions. (4) Purchase from the Government after the war of plant, stocks, etc., at knock-out prices. The fact that income-tax, and, in the later war years, excess-profits tax takes some considerable share of the increased annual income accruing from these dealings, does not dispose of the charge that war-gains, hitherto untaxed, have added several thousand million pounds to the property of the profiteers. That this mass of new wealth, due to war scarcity and risks, and obtained at the expense of the taxpayer or the consumer by a comparatively few rich, powerful, lucky or unscrupulous men, should have contributed little or nothing to the expenses of the war, is widely and justly resented, and lies at the root of our present discontents.

§ 7. It is no adequate answer to this criticism to urge that large quantities of capital values have depreciated under war conditions.

Perhaps under an ideally equitable government compensation would be made for such war damage. But the taxation of positive income and increments has never been accompanied, in any State finance, by compensations for losses or decrements. The accepted attitude is that the State should raise its income from sources where there is ability to pay. Now here is a body of wealth which, considering its origins, its magnitude and its distribution, has a very high ability to pay. I speak of the capital wealth created by the war conditions, some of which will continue to accumulate for years to come. This body of wealth does not pay taxes. No doubt the annual income it yields to its holders pays income-tax, and the 'corpus' itself will eventually pay death duties. But neither of these payments meets our reasonable claim. If it be true that 300 millions has been added to the wealth of shipping companies by the war, an annual payment of the six or eight millions representing the income-tax upon the dividends of this enlarged capital is no adequate contribution to the revenue. Nor is it a reasonable ground for immunity, that in the course of the next thirty years it will all pay death duties. The critical situation of our finance requires that every source with a present capacity to pay should now be tapped.

180 TAXATION IN THE NEW STATE

No close computation of the aggregate amount of this war-profiteering is yet practicable. Much of it is not revealed in any published government or company accounts. Nor, as we see, is the process yet completed. Moreover, for the purpose of considering a levy on this wealth, some time must be allowed for the settlement of capital values.

The most authoritative conjecture of the increase of aggregate individual wealth during the war is that given by Dr J. C. Stamp,¹ who, after allowing for the depreciation of some values and the wholly incalculable character of others, registers this judgment: "These adjustments result in a net addition of £5250 millions to the individual wealth which would be both subject to, and likely to be revealed for the purposes of, a capital levy as generally put forward by its protagonists." In viewing this sum, however, as a measure of what we term war-profiteering reflected in enhanced capital values, two considerations must be taken into account. In the first place, Dr Stamp is here concerned with measuring the total increase of capital values during the war in connection with a proposal, not for a levy upon war-made capital, but upon all forms of capital. He, therefore, rightly deducts from his computation of the increase

¹ *Economic Journal*, Sept. 1918.

such falls of value as have taken place through our reduced holdings of foreign investments, and the reduced value of railway stocks. But, as we have already seen, any proposal to make a levy upon war-made capital alone, upon the accumulated wealth due to war conditions, would not take account of these falls of value except when they appeared as set offs against war gain in the several businesses or ownerships assessed for the levy. Again, recognizing that post-war values must depend largely upon the rate of investment interest and the level of prices, Dr Stamp assumes that while the former will stay at the present 5 per cent. level, the latter will decline to an average level 25 per cent. higher than before the war. In this latter assumption he will, however, find little support in any business or financial quarter. Present prices are more than 100 per cent. above the pre-war level, and it is generally held that they will stand for a long time to come at 50 per cent. over that level.

Having regard, therefore, to these considerations, it would seem a reasonable assumption that the capitalized war gains which we are here investigating would amount to a considerably larger sum than 5250 millions. Some figure between 6000 millions and 7000 millions would seem not excessive. Nor would

182 TAXATION IN THE NEW STATE

it ill accord with the knowledge we possess of the huge accumulations of wealth made during the war by many trades, firms, and individuals. Some 6000 millions will have been saved and invested in war-lendings, besides large sums subscribed to new issues of capital here and abroad, and still larger sums employed in extensions of business operations or put to reserves. While some 1600 millions of this saving and investments must rank as ordinary pre-war savings, and a considerable allowance may be made for an enlargement of this fund due to reduced personal expenditure among large sections of the rich and middle classes, the vast bulk of the increase of wealth is directly assignable to profiteering in the sense of taking advantage of war conditions to make and capitalize gains due to high prices and other favourable opportunities.

Would it not seem just and reasonable that this war-made capital should make a large contribution towards the reduction of the war debt? It has mostly originated in the extravagant expenditure and the bad finance which has been responsible for the unwieldy size of that debt. In other words, war debt largely represents war-profiteering. If our war-finance upon its revenue and expenditure sides had been conducted honestly and competently, most of this war debt would not have been

incurred, the high prices which played into the hands of profiteers would not have occurred, and the new wealth which flowed into war loans and Treasury bills would not have been there to flow and would not have been wanted by the Government. The vicious circle made by war-debt and war-profits was due to the failure of the Government to finance the war out of taxation, supplemented by such borrowing as could be obtained by diverting into Government uses the enlarged amount of genuine savings which increased personal economy and the stoppage of unnecessary new issues of business capital would have supplied.

The *prima facie* case for assessing war-made capital in order to repair the negligence and folly which led to its creation is, therefore, extremely strong. This ill-gotten gain, entirely the product of war destruction, war want and war extravagance, has contributed nothing to the cost of the war. Its income has made some contribution during the latter years of the war, the capital has made none. Why should not at least half this 6000 millions pounds or more be taken by a levy, either in a single lump sum, or if that be deemed dangerous or impracticable, in a quick series of instalments, so that the capital and interest of the war debt may be speedily reduced, and

the otherwise inevitable increase of income-tax be avoided?

§ 8. Some readers will have observed that in this chapter the term war-profiteering is used in two or even three senses. Sometimes it is exclusively applied to abnormal and excessive gains made for war conditions and reflected in capital increase. At other times it is so applied as to cover all increased profits whether made from war-conditions or due mainly to other causes, such as improved methods of production or better business organization. Thirdly, it is sometimes used so as to cover all profits of any size or nature applied to the increase of capital. The full force of the plea for a levy on 'war-profiteering,' as expressed in increased wealth, is evidently applicable only to the first meaning. That some man should have made big money out of the war is a just cause of resentment, and a levy on this wealth appears a reasonable way of getting some of it back. To get all of it back would be impossible. For much of war-profits may have been spent by its recipients, not put to capital. But that seems no reason against getting back as much as possible of that* which has remained in a capital form and is susceptible of a levy. Here, however, we encounter another difficulty, that of discriminating what we may call

excessive and illegitimate war profit from that which is 'reasonable' and legitimate. For our analysis of ability to pay has required us for ordinary taxing purposes to recognize a reasonable and legitimate profit and a useful increase of capital. If we were to direct our levy, not exclusively to the excessive gains, but to all increases in capital during the war, we should appear to be neglecting this equitable distinction. Yet in any valuation that was attempted it might be impossible to reach any measured differentiation between the enlargements of capital that came from 'war-profiteering' in the vicious sense and those which represented the play of the normal forces of increase in profits and investments. All, I think, that could be done would be to exempt smaller proportionate increases of capital, and to apply a progressive levy upon larger ones, *i.e.* to presume that war-profiteering in the vicious sense varied directly with the proportion of the increase in capital values. This is the same sort of assumption adopted for the defence of the general equity and reasonability of a progressive income-tax, and it is applicable to the present case in, at least, an equal degree. For, though such a levy might hit hardly a few cases where enlarged capital value was primarily due to improved efficiency of method and organiza-

tion and not to war conditions, there would be hardly any instances where war conditions had not contributed in an appreciable degree.

But there is a wider consideration, partly economic, partly ethical, which has, I think, a right bearing in favour of the imposition of a levy upon all new capital accumulated under war conditions, even including the savings that represent personal economy in expenditure. All such savings imply the acquisition during war time of wealth which is 'surplus,' in the sense that it is not needed for the maintenance of the owner's adequate standard of consumption. If a margin be allowed for small savings at such a time, it seems reasonable and equitable that the nation should take for the urgent national needs some share in all saving effected under the protection afforded by the State, at a time when that protection has involved unusual expenditure of life and money.