When the point of effective capacity has been reached and any additional demands on labour and material resources would tend to produce inflation, a situation is created that normally might be expected to favour a restrictive monetary policy. This policy would raise interest rates and curb the amount of credit available for speculation and encouragement of additional activities. In war time, however, the only borrower and initiator of new enterprises of major importance is the government and, therefore, the chief effect of restrictive monetary policy would be felt by the government in the form of increased financing costs and the lessening of credit available to industries for war production. War creates a situation for the monetary authorities that is very similar in many ways to a peace-time "boom" period, both in its immediate outward appearance and its results, if uncontrolled. At the same time it renders inappropriate a policy that might be used in peace time.

In controlling this situation, the basic problem is not so much the amount of money in the country as the level of incomes in relation to the volume of goods and services available for consumption since a large proportion of the incomes have been derived from the production of war goods and services rather than from the output of goods and services designed and available for ordinary consumption. The amount of money people have in their possession is one of the factors that may influence them to spend more but the most important influence on inflationary tendencies is the amount of income that they retain to spend on goods and services. No degree of monetary restriction can equate the total income arising from production of both war and consumption needs with the value of only the consumption goods and services produced. To keep the demand for these in line with available supply, the government, by taxes and savings, must be able to divert a large part of people's incomes from spending. If savings did not withhold from spending, an amount equal to the excess of the government's expenditures over its current revenues, the government might have to finance its requirements to the extent of the discrepancy, through an inflationary increase in the volume of money. Such monetary expansion would produce sharply rising prices with consumers' incomes rising less abruptly and so reduce the real purchasing power of money incomes over goods and services to the point where the available supply would satisfy the public's demands. For various reasons the rise in cash incomes of various groups within the country would vary considerably from one group to another, and therefore, the decline in real income would be unevenly distributed. The only alternative to imposing the inequitable burden of inflation would be for the Government to set up a system of rationing the available supply of commodities among the population in relation to their real requirements. Since this would be a huge task employing many thousands of workers, it would correspondingly reduce the amount of labour available for war and other purposes.

Successful execution of a war program with the least possible unnecessary economic sacrifice requires not only a domestic monetary policy flexible enough to supply all the legitimate needs for currency and credit, but also taxation and savings adequate to divert the necessary portion of the national income out of the usual spending channels. The central bank should not create unnecessary friction in the economy by being over-cautious in its monetary policy. At the same time,