War introduces into the economy an all-powerful driving force in the demand for war's necessities. The pressure of these requirements soon makes it unnecessary for monetary policy—or any other factor—to stimulate the level of production which tends to rise to capacity as quickly as labour, equipment and material resources can be brought effectively into the desired channels of production. Monetary policy, however, is a very important factor in easing the transition of the economy from a peace-time basis to a war footing and in determining the equity with which the economic sacrifices of war are distributed between various groups in the country.

In the period preceding the attainment of full activity, the problems of internal monetary policy are very much the same as in any other period of economic expansion. As the scale of operations increases, industry needs larger cash working balances and plants expanding or changing their equipment to meet war demands may require additional credit facilities. In the face of the uncertainties produced by war conditions, certain sections of the population may desire to increase their holdings of liquid assets, or, in other words, to keep some of their savings in the form of money. For all these reasons a certain amount of monetary expansion may be appropriate during this period.

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