UNIVERSAL
LIBRARY

OU_156099

UNIVERSAL
LIBRARY

THE ECONOMIC BASIS OF CLASS CONFLICT AND OTHER ESSAYS IN POLITICAL ECONOMY

THE ECONOMIC BASIS
OF
CLASS CONFLICT
AND
OTHER ESSAYS IN POLITICAL ECONOMY

BY
LIONEL ROBBINS
PROFESSOR OF ECONOMICS IN THE
UNIVERSITY OF LONDON

MACMILLAN AND CO., LIMITED
ST. MARTIN'S STREET, LONDON
1939

COPYRIGHT

PRINTED IN GREAT BRITAIN
BY R. & R. CLARK, LIMITED, EDINBURGH

PREFACE

THE papers which form the main part of this collection were not written with a view to collected publication. They have been written at different times in the last twelve years, some for public lectures, some for learned publications, some for journals more accessible to the general reader. In editing them now, I have endeavoured to eliminate terminological inconsistencies and to improve the exposition generally. But to bring about anything like complete systematization would have involved a degree of rewriting which other preoccupations do not permit; and I have made no attempt to do so.

Nevertheless I venture to hope that they do possess a sufficiently common focus of interest to warrant the claim that they are something more than a merely miscellaneous collection. That focus, as I conceive it, is the problem of the relation between the interests of society and the interests of different groups within society — groups of producers, groups of workers, the geographical groups which we call nations; and the *leit-motiv* of the analysis is exposition of the way in which forms of organization facilitating group exclusiveness may be the cause of social disharmony. Thus, the first paper, *The Economic*

Basis of Class Conflict, examines the nature of group interest in general and the conflicts to which it gives rise. The second, *The Economics of Restrictionism*, explores further particular manifestations of such conflicts with special reference to the effects of state-imposed monopoly. The third paper, on *The "Inevitability" of Monopoly*, traces the extent and the origin of monopolistic organization of production, and examines a little the claims that an increasing degree of such organization is inherent either in scientific technique or the necessary conditions of a private property system. The fourth paper, on *The Economics of Territorial Sovereignty*, discusses the way in which the restrictionism of national groups creates an argument for wide national areas, the fifth, the causes of increased protectionism, and the last three, various local aspects of that general problem of agrarian restrictionism which, in its world perspective, gives rise to what is perhaps quantitatively the most important economic conflict of our day. I believe that the political thought of the recent past has suffered greatly from a lack of realization of the implications of the disharmonies between group and social interest, although it is matter on which economists are probably more agreed than on almost any other practical subject. In my *Economic Planning and International Order* I attempted a systematic analysis of such issues in

their international aspects. It is my hope that the present volume will help to throw light on certain other aspects not dealt with in that work.

The upshot of these enquiries is decidedly unfavourable to all forms of group organization involving powers of exclusion and restriction. Whether the general interest is better served by unified collectivism or by that system of decentralized initiative which, within a suitable framework of law, is provided by private property and free markets, is a problem which has occupied me much but which here I discuss only incidentally. The critique, implicitly here developed, is essentially a critique of what, according to its political origin, is variously designated as syndicalism or corporativism; and I have some hopes that, in its broad outlines at least, it may be acceptable both to socialists and to liberals — in so far as those who bear these names still really believe the views they profess. The modern world, deluged by the *clichés* of propaganda and second-rate thinking, believes that it is becoming collectivist. But this is self-deception. The apologia for many recent tendencies, from the "co-ordination" of British transport to the corporative chambers of the fascist state, is collectivist. But the substance is essentially something different. It is the consolidation of group interest. And, if the analysis of these papers is correct, this is incompatible with the general interest. It

is syndicalism which is the enemy.

I may say that this is not a conclusion which, at the commencement of my thinking about these subjects, I should have at all expected myself to reach. Twenty years ago, a disgruntled ex-soldier, I was an enthusiastic partisan of the more radical corporative movements. I cannot say that I was ever taken in by the stunt anti-rationalism of the French syndicalist intellectuals. I could never bring myself to take very seriously the so obviously sham baroque of Georges Sorel's apotheosis of mass violence. But the more serious projects of English revolutionary guild socialism attracted me greatly; and under the spell of Maitland and Gierke and Mr Tawney's marvellous prose, I believed that within a system of functional groups there was a home for the spirit of man more congenial than in individualist or collectivist societies. I took up the study of economics in the hope that I might play a part in giving to this vision a concrete reality. If, in seeking to do this, I have become convinced that it is essentially a delusion, an *ignis fatuus* leading to a quagmire of poverty, injustice and conflict, and that the choice for men of goodwill now, as before the rise of this latter-day romanticism, is between collectivism and liberalism, I can at least plead that it has not been for want of will to do otherwise or for lack of experience of the state of mind of those who have cherished the other hope.

I have added in a separate section three short papers dealing with certain problems of government expenditure and its reaction on economic activity. I do this with great hesitation, for the analytical propositions which they involve are still matters of controversy and I am far from believing myself to have reached settled conclusions on these very difficult questions. But the problems with which they deal are matters of immediate importance, and since, in the course of public discussion, my name has often been associated with views which I do not hold, it seems useful to take this opportunity of making available some of the few very tentative opinions in this connection which I have been able so far to reach. The first paper, *Government Expenditure and Economic Activity*, attempts to set out certain general principles. The second, *How to Mitigate the Next Slump*, develops some of these principles a little further and contains a practical suggestion for developing our present practice in regard to the Social Service Funds, for which I am anxious to secure further publicity. The third, the *Long-Term Budgetary Problem*, deals with the present position in Great Britain with special reference to loan finance.

In preparing the various papers for publication in this form, I have felt no particular obligation to present them exactly as they were previously published. If, by cutting out a

sentence there or by introducing a new illustration here, I felt I could make an improvement, I have not hesitated to do so. But I have never changed the nature of the argument. Nor have I attempted to remould the exposition so as to conceal the fact that several of the papers were originally written for presentation as lectures. There is a certain tone and balance in the structure of a lecture which cannot be removed without destroying the life of the whole thing. I hope that this may excuse a somewhat greater intrusion of the personal note than would otherwise seem to be justified.

I have indicated in connection with each separate paper the place where it originally appeared and the date of publication. I take this opportunity of rendering to the various editors and publishers involved my thanks for permission to reprint. In particular I would like to acknowledge an especial obligation to the proprietors and to the editor of *Lloyd's Bank Review*, from whose pages no less than three of the following papers are reprinted. The policy of this notable journal in providing a forum for the expression of conflicting views on the economic problems of our day is a policy to which all lovers of the tradition of free opinion and serious argument would wish to pay public tribute.

LIONEL ROBBINS

THE LONDON SCHOOL OF ECONOMICS
January 1939

CONTENTS

PART I

THE INTERESTS OF GROUPS AND THE INTEREST OF SOCIETY

CHAP.		PAGE
I.	THE ECONOMIC BASIS OF CLASS CONFLICT	3
	(1) Introduction	3
	(2) Subjective and Objective Interest	3
	(3) The Market Theory of Group Conflict	5
	(4) The Significance of Market Homogeneity	14
	(5) The Theory of the Class War	17
	(6) Class Conflict and Inequality of Opportunity	22
	(7) The Class War and the System of Free Enterprise	26
II.	THE ECONOMICS OF RESTRICTIONISM	29
	(1) Introduction	29
	(2) Restrictionism *versus* Price-fixing	30
	(3) Restriction and the Restrictors	31
	(4) Restriction and the Community	32
	(5) Restrictionism as Planning	34
	(6) Restrictionism and Investment	39
	(7) Restrictionism and Monopolistic Competition	41
	(8) Restrictionism and Social Conflict	45
III.	THE "INEVITABILITY" OF MONOPOLY	45
	(1) Introduction	45
	(2) The Definition of Monopoly	46

CHAP. PAGE

(3) The Extent of "Spontaneous" Monopoly . 50
(4) The Causes of "Spontaneous" Monopoly . 63
(5) The Political Inevitability of Monopoly . 76

IV. The Economics of Territorial Sovereignty 81
(1) Introduction 81
(2) Property and Territory . . . 83
(3) The Fallacies of Economic Nationalism . 86
(4) The Positive Gains of Empire . . 89
(5) The Positive Costs of Empire . . 95
(6) The Negative Gains of Empire . . 97
(7) The Haves and the Have-nots . . 101
(8) Federation the only Remedy . . 103

V. The Causes of Increased Protectionism . 107
(1) Introduction 107
(2) National Interest and Protectionism . 108
(3) The Causes of Increased Protectionism . 122
(4) The Growth of Protectionism . . 128
(5) Strategic Considerations . . . 132

VI. The Planning of British Agriculture . 135
(1) Introduction 135
(2) The Political Background . . . 137
(3) The Sanctions of Marketing Control . 144
(4) The Four Main Schemes . . . 148
(5) Prospects 156

VII. The Consequences of Agricultural Planning 161
(1) Introduction 161

CHAP. PAGE

(2) The Implication of Agricultural Protectionism 162
(3) The Economics of Import Quotas . . 169
(4) The Economics of Market Reorganization . 173
(5) The Balance Sheet 179

VIII. The Economics of Import Boards . . 182
(1) Introduction 182
(2) The Rationale of State Trading . . 182
(3) The Efficiency of State Trading . . 194
(4) The International Significance of State Trading 203
(5) Conclusion: Socialism and Economic Nationalism 207

PART II

GOVERNMENT EXPENDITURE AND ECONOMIC ACTIVITY

I. Government Expenditure and Economic Activity 213
(1) Introduction 213
(2) Government Expenditure on Income Account 215
(3) Government Expenditure on Investment Account: Taxation *versus* "Normal" Borrowing for Investment . . 218
(4) Government Expenditure on Investment Account: Extraordinary Investment . 222
(5) Extraordinary Expenditure and Expectations 228
(6) International Aspects of Shock Tactics . 231
(7) Recapitulation 234

CHAP. PAGE

II. How to Mitigate the Next Slump . . 237
(1) Introduction 237
(2) The Prevention of Booms . . . 238
(3) The Technical Position in London in the Recovery of 1933-36 . . . 239
(4) The Right Kind of Public Works . . 242
(5) A New Method of Stabilization . . 249

III. The Long-term Budgetary Problem . 256
(1) Introduction 256
(2) The Prospects of the Short Period . . 257
(3) The Long-term Problem . . . 262
(4) The Real Burden of Public Debt . . 265
(5) The Growth of the National Debt . . 269
(6) Debt Reduction by Inflation . . 272
(7) National Finance and International Politics 274

PART I

THE INTERESTS OF GROUPS AND THE INTEREST OF SOCIETY

The concentration of *all* the individuals in the State, or even in a single city, engaged in the same craft, in one *single* productive society, would lead again to the old tyrannical monopoly of the corporations. It would make the producer arbiter of prices to the injury of the consumer, would give a legal form to the oppression of minorities, would deprive a dissatisfied workman of every possibility of getting work, and would suppress the necessity of progress by extinguishing all rivalry in work, all stimulus to invention.

MAZZINI, *The Duties of Man*, XI, iii.

I

THE ECONOMIC BASIS OF CLASS CONFLICT [1]

(1) Introduction

The task which has been assigned to me in this symposium is to analyse the economic conditions which may give rise to conflict between different classes. Accepting the view that such conflicts arise from a disharmony of interests, I have to set out in what senses and on what occasions the disharmony may be said to be economic in origin.

(2) Subjective and Objective Interest

Now it would be possible to spend much time making precise exactly what we mean by an "economic basis", an "economic interest" and so on: and in view of the great ambiguity of language here, it is probable that such enquiry would not be unprofitable. But for purposes of this paper I shall assume that we know roughly what is meant by such phrases, leaving any ambiguities to be disentangled in the course of

[1] This paper was first presented as part of a symposium on *Class Conflict and Social Stratification*, held under the auspices of the Institute of Sociology in the autumn of 1937.

the spoken discussion. There is one matter, however, on which it is necessary to be more explicit: the distinction between what I shall call subjective and objective communities of interest.

I can best explain shortly what I have in mind by means of an example. The members of a group of peasant proprietors believe that a certain line of common action will increase the value of their sales: such belief constitutes, I would say, a subjective community of interest. If at the same time it is true that, in the absence of disturbing circumstances, such action will actually have this effect, then, I would say, they have an objective community of interest. I should even say that there was an objective community of interest if such conditions existed unbeknown to the producers in question: for the real position would be such that, if the conditions were perceived, then common action would present certain attractions.

At first sight, this distinction may be thought to be very trivial. But I do not think that this is so. Of course it is possible that, to the majority of cases of subjective communities of interest, there may correspond the real conditions which are believed to exist. But there is nothing in the nature of things which would lead us to suppose that people are never mistaken. And certainly popular discussion of such matters suffers greatly from failure to keep the distinction in mind. How

often do we hear it said that, whether or not the workers have actually anything to gain from class conflict, they believe that they have, and that therefore the conflict exists ? And then, if it is objected that, in such and such a situation, no feeling of this sort has been present, it is replied that, in any case, the underlying conditions are such that, whether it is realized or not, there is an actual class conflict.

(3) The Market Theory of Group Conflict

Now my task, as I understand it, is to investigate the basis of clashes of objective communities of interest. No doubt it is always belief which is the immediate cause of action. It is important, therefore, to trace the causes of all beliefs, whether they be correct or erroneous. But that is not my object here. However much we are interested in the causes of error, be they in any sense economic or otherwise, what we want to discover in these discussions is whether there are inherent in certain social structures, not merely optical illusions, but objective disharmonies which exist whether perceived or not.

Having said this, I ought perhaps to say at once that I believe in the possibility of such disharmonies. I do not believe that, under any conceivable conditions, social life is entirely free

from potential conflict arising from such causes : and I certainly do not think that, in the absence of suitable institutional restraints and remedies, there is any inherent tendency to harmony which will prevent such conflicts emerging. If there be any " invisible hand " in a non-collectivist order, it only operates in a framework of deliberately contrived law and order. What is more to the point, I believe that simple economic analysis casts considerable light on these matters.

But — and perhaps this is where one who approaches these matters from the economic point of view may differ from his fellow sociologists — I do not think we are likely to secure results which are very helpful if we start, in advance of our analysis, by laying down hard-and-fast definitions of classes and then asking if anything can be said about them from this or that point of view. For a class, after all, is not something which is necessarily given independent of the forces which are operative in society ; and I think we shall be much more likely to get a proper sense of proportion if we look first at the conditions conducive to conflict and then arrange our classifications accordingly than if we proceed in the reverse direction. For this reason I cannot believe that it is the most satisfactory starting point to assume that the only classification worth discussing is a vertical stratification. I do indeed think that there is something to say about

vertical stratification; but I am inclined to think that we get a false sense of its proportionate importance if we ignore other groupings which are certainly not essentially vertical.

The clue to a successful approach to the problem, as I see it, lies in the analysis of markets. In the exchange society the market is, as it were, the reflection of the whole network of economic relationships. The market phenomena, the prices of products and factors, provide the immediate stimuli to action, the indices according to which men arrange their consumption and production. There may be matters lying beyond immediate market analysis to which we should also give attention. But it is surely to the market that we should look first if we wish to understand the economic basis of conflict.

Let us therefore start by considering the interests of groups, homogeneous in their market relations to particular goods or services, either as buyers or sellers. We can at once discern two main types of situation in which there may exist conflict between the interest of such groups and the interests of others: firstly when, *as individuals*, they are confronted by monopolistic groups: secondly when, *as groups*, their position is contrasted with others.

Let us consider each of these cases separately.

(i) The case where individual buyers and sellers are confronted with monopoly need not

detain us long. It is well known that, if supply or demand is in the hands of a monopoly, the prices paid or the prices realized by the individuals with whom the monopoly deals may be less favourable than if the market were competitive. If, for instance, peasant producers are confronted with a single buyer or small number of buyers acting in concert, they may feel that their interests are damaged by such conditions ; and very often they will be right. Similarly, if they buy their implements from a monopoly or if they borrow money from a closed group of money-lenders, there will exist a like community of interest. Situations of this sort will often be ephemeral, scarcely worthy to be dignified by the name of group or class conflict. But in certain conditions, where mobility is low, they may persist or tend to repeat themselves : and in such cases far-reaching divisions may appear. I have mentioned already the agrarian case. I am inclined to think that some, though certainly not the larger part, of the history of trade unionism is to be explained in similar terms. The only sense which the economist can attach to the term exploitation of labour is as a description of what happens where a group of competing workers is confronted by a monopolistic buyer. The frequency of such a situation is capable of great exaggeration. But when it does occur, and when for long periods no competing demand arises on

the employers' side, sharp conflict is likely to be engendered.

This is all very simple. I ought perhaps to add at this point that by "monopoly" I mean monopoly in the sense of control of the sources of supply or demand by one seller or buyer or, at most, by a small number. I do not mean conditions such that, under competition, the individuals on one side of the market get higher incomes than their opposite numbers. If, for instance, Lancashire were the sole source of supply of cotton goods and if all the manufacturing units there were controlled by one group of sellers, I should say that there was a Lancashire monopoly. I should not say that there was a monopoly, however, if the different mills in Lancashire were in competition with each other, even if the proceeds of sale gave incomes there higher than elsewhere. The word "Monopoly", if applied to such a case, can only mean scarcity, and although it has been so applied by many economic historians and by a few competent economists, I believe that it is a usage which can only cause confusion and which conceals differences which it is important to keep clearly in view.[1]

(ii) Let us now turn to the second case in which conflict is incipient — the case where the interest of the group *as group* is in disharmony with the interests of others. In a purely formal

[1] For a further discussion of this point see pp. 49-50 below.

sense this is simply the opposite side of the picture we have just been examining. But it has an interest of its own quite sufficient to warrant separate examination.

Speaking broadly, we may say that the interest of such a group acting as a group is to maximize its net takings: in the first approximation we may neglect the other advantages and disadvantages which will actually influence action. Now this is an aim which may well be in conflict with the interests of other members of society. If, for instance, the conditions of demand are such that a smaller quantity sells for a higher aggregate value, then usually the group interest calls for restriction; whereas the interests of society demand the contrary. It is said that a century or so ago, when high transport costs still limited supplies of foreign grain to English markets, it was an acceptable toast for English farmers to drink to " a bloody war and a wet harvest ". Here clearly was a sharp conflict of interest.

It would be possible to dilate at length on the exact nature of the market conditions which lead to different degrees of such disharmony. But these are matters of technique well discussed in standard works, and for our purposes they are less interesting than certain broader considerations.[1]

Let us note in the first place that, so far as

[1] Such matters are further discussed below in the paper on *The Economics of Restrictionism.*

the cash incentive is concerned, the conflict we have discovered is between society (or other groups) and the members of the group *acting as a group*. It does not exist between society and the members of the group *acting individually*. For each member of the group, with any given degree of restriction, the more he himself can sell the better. When the individual farmer raised his glass to the dreadful toast we have just been considering, he must have murmured, "But, Lord, don't let the rain fall on my crop!" It is only if individuals are able to act as a closed group that the latent conflict becomes actual. When it is said that the infringers of restriction agreements act in an "anti-social" manner, what is meant is that they are acting in an *anti-group* manner. "Social" conduct in the sense of group loyalty may quite easily lead to social conflict. The qualities which lead a man to be loyal to his profession or to his industry in a manœuvre to raise prices, or to prevent prices from adjusting themselves to a state of greater abundance, may, according to some systems of ethics, be thought to be valuable in themselves. But, from the point of view of the rest of society, it is the interloper who acts in the social interest.

But let us notice, in the second place, that so long as the services of the producers are not specialized and so long as neither they nor the members of other groups enjoy permanent mono-

polistic status, the conflict of interest we have discovered may itself not be permanent in character.

We can, perhaps, best see what is involved here if we take an example rather more dynamic in character than the case of the farmers and the wet harvest. Let us suppose that there occurs an invention which facilitates the production of wheat. If the conditions of production are competitive, there will be an incentive to individual producers to utilize this invention; it will diminish costs of production. But if the elasticity of demand for wheat is low, then, if the supply is increased, the fall in price necessary to clear the market may be such as to lower receipts even more than the lowering of costs of production. From the point of view of the group therefore, for the time being at least, there is a community of interest in conflict with the interests of consumers; and if group action can be organized through the instrumentality of the state or by spontaneous agreement to limit competition, there is an incentive to restrict the exploitation of the invention.

But suppose that this does not happen, and suppose that the producers of wheat are free to turn their activities and resources to the production of other commodities. What happens? If we assume monetary conditions conducive to full employment, we may expect transfers to other

lines of production to take place, until the incomes of transferable factors in wheat production have risen once more so as to be as favourable as the incomes obtainable elsewhere for similar services. The mobile producers, as producers, are no worse off than before. As consumers they share with others the benefits of the cheapening invention.

But notice that this is only possible if there is mobility. There must be no obstacles to the entry of new producers to other branches of production: that is to say, there must not be group monopoly elsewhere. Furthermore, the resources concerned must be capable of employment elsewhere: they must not be specialized on the line of production at first affected. Now this is not always the case. Young labourers may be able to turn to other things. Older men may find it more difficult. Moreover, material resources may be so specialized that changes of the sort we are discussing may involve a permanent lowering of their yield: in the case we have been considering it is probable that, whatever the eventual position of farmers and labourers, the owners of land will suffer some tendency to a permanent lowering of their rents. In such cases, for factors which are more or less specific to particular branches of production, there may be a long-period as well as a short-period conflict of their interest and the interest of other groups. It is of course arguable that, even here, the balance of long-run

advantage is against restriction: if restriction becomes general, there is likely to be loss all round. But important as are such considerations — and on a broad view they are very important — they are on a plane of analysis different from that on which we are moving at present. If there is no mobility, then conflicts of interest of the kind we have been discussing are clearly possible.

(4) The Significance of Market Homogeneity

Such, in very general and loose terms, is an outline of what I would venture to call the market theory of group conflict. When the conditions of supply and demand are such as either to confront buyers and sellers with monopolistic organizations or to permit buyers or sellers themselves to act as groups, then the objective conditions of conflict are present. It is not certain that consciousness of these conditions will always develop, or that, if it does, it will necessarily be so important and permanent as to give rise to anything which may usefully be described as class conflict. Clearly this depends partly upon the degree of the disharmony, partly upon the apparatus of communication, partly upon propaganda and leadership. In a society in which many different changes are taking place at the same time and in which the general institutional

framework is conducive to mobility, many minor conflicts of this sort may escape notice or cancel each other out. But obviously this may not happen. If there are extensive institutional influences conducive to an absence of mobility and the creation of positions of privilege, conflicts may develop which are certainly worthy of the term class conflicts. In societies in which producers' organizations are given powers of exclusion based on statute or coercive custom, such conflicts must be permanently present. It is not difficult to think of historical examples: the guild societies of the European middle ages, the caste societies of the East. If we try to get the social phenomena of our own time into proper perspective, it is arguable that the European agrarian reaction, which is based essentially upon a clash of interests of this nature, is quantitatively more important than any other conflict of the day. And certainly the stream of tendencies, which, when they appear on the right, are known as corporativism and, when they appear on the left, as self-government in industry, works strongly to create such conflicts. Speaking generally, I would be prepared to argue that the whole theory of social classes has tended to suffer from a serious lack of proportion because of a neglect of conflicts of this kind. Preconceived ideas of social stratification have prevented us perceiving other classifications which are

historically and actually at least of comparable importance.

Now there is one feature of this theory which has already been mentioned in passing but which is so fundamental that it deserves a separate emphasis: the groups whose communities of interest are thus analysed are homogeneous in relation to the market. Either they sell or they buy commodities which the market ranks as similar. This does not mean, of course, that the commodities concerned need be exactly the same. Commodities which are closely related may be the subject of a community of interest. In so far as they are competing substitutes, one grade of wheat may be the subject of a community of interest as against other grades: but there may be a wider community of interest relating to wheat in general. Obviously it is a matter of degree. We must not draw hard-and-fast lines. But this should not blind us to the fact that, as market homogeneity weakens, so the objective community of interest weakens too: and there comes a point at which it disappears altogether. Because the markets for their various products move together there may be a potential community of interest between producers of various types of cereals. There is no community of interest of this sort between the producers of, say, cereals and coffee.

(5) The Theory of the Class War

All this becomes highly relevant when we proceed to apply our apparatus to the examination of what some think is the most important conflict of class interest, the alleged conflict of interest between the propertied and the propertyless — the class war of Marxian theory.

I do not think we shall be doing great injustice to the orthodox theory of this subject if we take as our starting point its international character. In the Communist Manifesto it is the workers of the world who are exhorted to unite. And since it was necessary to exhort them to unite, and since it is clear that even today there is no very marked international proletarian solidarity, we are surely on fairly firm ground if we assume that it is an objective community of interest between the propertyless, an objective clash between their interest and the rest of society which is in question. Whatever the apologia on the part of what I believe would be called subjectivist epigoni, the main Marxian theory asserts an objective community of interest among the proletariat the world over.

But, judged by our tests, this assertion does not seem immediately plausible. *For the different groups of labourers in the different national areas do not supply services which the market treats as homogeneous.* They do not sell identical

commodities. In the present organization of the world into different national groups, with its almost total prohibition of international migration, the interests of labourers in different parts of the world are often violently opposed to each other. Measures which perpetuate the poverty of Japanese labourers are beneficial to the Lancashire cotton operative. Indeed, it can easily be shown that not infrequently there is more solidarity between the interests of groups of labourers in one place and groups of property owners in another than between the labourers of the two places in question. The restriction of migration of Prussian peasants into the United States of America, for instance, which benefits certain classes of American labour, benefits also certain classes of Prussian landlord : in the one case the relative price of certain kinds of labour is maintained ; in the other, the relative price of certain kinds of land. There is a sense in which it may be said that the long-run interests of the majority of the human race are not in fundamental disharmony. Our discussion of the significance of mobility and the general interest in restricting restriction, perhaps, shows the way in which such a proposition could be developed. But an objective community of interest of the various individuals composing the international proletariat is not disclosed by the methods of analysis which we have so far been using.

I stress this point because, despite the overwhelming realistic and quantitative significance of the international problem, it has become the fashion to neglect it. For reasons which are not easy to follow, attempts to argue the matter on the international plane are looked upon as bad form or as pedantry. But it is surely not bad form to discuss the merits of a theory on the plane chosen by its proponents : and it is hardly pedantry to discuss the world as it is rather than a hypothetical closed society. I think that people have got into far too facile a habit of saying simply that " of course " national divisions may " overlay " the divisions of social classes, and then going on to assume that the creation of a classless society within each national area would automatically eliminate these divisions between national areas. There is, in fact, as I have argued elsewhere, strong reason to suppose that it would do exactly the contrary.[1]

Nevertheless, for the sake of argument, let us abstract from the complications of national grouping. Let us enquire concerning the community of interest of the propertyless in a closed society, which, however, in other respects has the extent and the complexity of the world as we actually know it. Even so, I suggest the classification does not conform to our criteria. It is true that the classical economists were in

[1] *Economic Planning and International Order*, pp. 60-68.

the habit of generalizing widely about a class of factors of production which they labelled "Labour". But I do not think that this is a part of their work which has shown itself particularly valuable for purposes of realistic analysis. There is not one, there are many separate types of labour services: and their several relations in production and in the market do not give rise to a general community of interest of the type we have been discussing. On the contrary, the interests of the different groups are often sharply opposed: and if exclusive group organization is possible, violent conflict may develop. We have only to think of the relations between male and female labour, skilled and unskilled, white and coloured [1] — to adopt classifications only one degree less crude than that which we are discussing — to convince ourselves of this. Measures which benefit one class may injure another and injure the other far more than any injury inflicted on property owners.

But let us once more waive such realistic objections. Let us imagine that we are dealing with that remote world in which all labour is homo-

[1] On the conflict between labour groups of various racial origins see A. Plant, "The Economics of the Native Question", *Voorslag: A Magazine of South African Life and Art* (Durban), vol. I, no. ii, pp. 21-38; and W. H. Hutt, "The Economic Position of the Bantu in South Africa", in *Western Civilization and the Natives of South Africa* (Routledge). It is greatly to be regretted that Professor Plant's highly important paper is not available in a more accessible form.

geneous in efficiency and disposition and in which the phrase "*the* labour market" is not a simplification but a reality. Are we here confronted with an objective clash of interest in either of the senses of our market theory? I doubt it. For, in the first place, it does not seem plausible to argue as if such a group were confronted by a general monopoly on the part of the employers. I do not deny the existence of buyers' monopoly in particular branches of industry: indeed it has been part of my contention that, where such conditions exist, there group conflicts are latent. But a universal monopoly of employers is something very different from this: and I do not think there is any empirical ground for regarding it as a plausible assumption. A universal employers' monopoly is a chimera of the imagination. Nor, in the second place, do I think the situation is to be saved by assuming that the labourers have anything to gain from restriction. If the elasticity of demand for labour were less than unity, then certainly there would exist disharmony, at any rate in the short run; a restriction of the supply of labour would cause the rate of wages to rise more than proportionately, so that the total amount of wages would increase. But I have yet to see a demonstration that this is likely to be the case. The economists known to me who have thought it worth while to speculate about so highly unrealistic an instance,

have come to a different conclusion. I will not press this point, for it seems to me rather futile to attempt an empirical solution of a problem which is not given empirically. But I would suggest that, if the theory of objective clashes of interest here is to be anything more than mere dogmatic assertion, some other approach is needed.

(6) Class Conflict and Inequality of Opportunity

But cannot such an approach be provided? It is certainly worth while making the attempt.

Let us revert to our former examples. It will be remembered that we argued that if producers were confined to particular lines of production by inability to secure opportunities elsewhere, then objective conflicts of interest were present. Now, in the purely individualistic society there are opportunities for the sale of some kinds of labour which are only accessible to those who have command of capital, either for expenditure on training or for security against the risks of enterprise. It is not necessary to quote examples: they are the commonplaces of the elementary textbooks. Is it not the case that those who lack such advantages are confined to work at margins lower than otherwise would be necessary? And if this is so, is this not a sense in which there may be said to be an objec-

tive conflict of interest between the propertied and the propertyless ?

We seem to be on firmer ground now : and I do not doubt that there is a core of truth here which is important. But let us be quite sure what exactly is involved.

In the first place we should observe that the degree of conflict here depends essentially on the inequality of income : it is only in so far as inequality of income is due to inequality of property-holding that the category of property is involved.[1] It follows, therefore, that the degree of conflict will in part depend on the distribution of property. In any society in which there exists inequality of property-holding there are bound to exist some inequalities of economic opportunity. But the extent to which this becomes a serious social problem will depend essentially on the degree of inequality. In a society in which differences of property-holding were narrow, the problem would be much less formidable than in a society in which differences of property-holding were great. Before, therefore, it can be claimed that such conflicts are inevitable in a society in which private property is permitted, it must be shown that there is inevitability about the present framework of law relating to property.

[1] There would be inequality of opportunity in a propertyless society if incomes were markedly unequal and if education and training were financed only by the family unit.

And, in spite of the enthusiastic support given to the view by Marxians, I am yet to be persuaded that it is true.[1]

Secondly, I do not think that the situation which we are now contemplating is one which can be most conveniently described as one of monopolistic exclusion. If we are properly to grasp the rather complex position here, it is necessary to make certain distinctions. If entry to a profession, for instance, were only to be secured by the payment of a heavy fee quite unrelated to the cost of training, I should agree that the use of the term monopoly was appropriate. If it were limited to members of certain race or caste, again I should hold the term to be justified. The caste society is the monopolistic society *par excellence*: it is a society in which economic conflict of interest must be permanent. But if the position of advantage were one to which anyone with property of a certain amount might have access who incurred the necessary expenses, and if there were no legal obstacles to accumulation, then I should not use this term. Membership of a certain income group is not the same as membership of an exclusive caste or estate. There are points of similarity. But there are

[1] I have suggested elsewhere (*Economic Planning and International Order*, pp. 264-265) that the present distribution of property could be substantially modified in the direction of greater equality by the substitution of the succession duty principle for the principle on which the estate duties are now levied.

also points of difference. The position may be the same as regards advantage to exploit a given opportunity: it would be silly to pretend that the fact that a man may accumulate property in the future gives him the same advantage at any moment as the actual possession of property But, whereas the advantage of a closed caste or estate is based on a right of exclusion which serves no economic function whatever, the advan tage which comes from property comes from an institution which, in some forms at any rate, can be said to discharge a function which is necessary and which, in some way or other, would have to be discharged whatever the structure of society. If the institution of private property is necessary to secure an organization of production adequate to the demands of society, the inequalities which it may engender cannot be described as restrictionist. There will be more to be said about this later on. But I submit that it constitutes a difference of substance.

Nevertheless, when account is taken of all these points, there can be no doubt that inequality of opportunity due to inequality of income does create clashes of interest in a significant and objective sense. And although I hold that some inequality of income rests upon institutions which discharge a necessary social function and a function whose benefits are not confined to the property holder, I hold too that, up to the point

at which attempts to remedy such inequality take a form which definitely reacts unfavourably on the long-run interest of the inferior income groups, these clashes continue to exist. I would add that, in my judgment, in rich countries there is probably a considerable margin before this point is reached. Often as it is misrepresented for propagandist purposes, belief in a system of international liberalism does not exclude belief in energetic measures designed to reduce inequality of opportunity.

(7) The Class War and the System of Free Enterprise

But is this all that can be said about the matter? The Marxian case is certainly not limited to inequalities of work income due to inequalities of opportunity: it concerns the whole range of inequalities of income due to the existence of private property of any kind. Is there no sense in which it can be said that the propertyless would be better off if the whole institution of private property were abolished?

Now it is possible that, in the very short run, a general expropriation of property and sharing-out of the proceeds might raise the wealth immediately available to the average proletarian.[1]

[1] On a world scale the amount available for redistribution per head would be small. The more important sources for levelling up the lower incomes would be the high work incomes of the West!

This obviously would apply to any sort of confiscatory transfer between other "classes" — Jews and Aryans, whites and blacks, men and women, etc. In the same way, if we consider forms of taxation and subsidy which run far short of complete expropriation, similar gains and losses are discernible: if this paper were a comprehensive treatment of its subject, much space would have to be devoted to conflicts in the sphere of public finance. But it is not in this short-run sense of mere "divisionism" that the Marxian asserts a conflict of interest. The Marxian equally with the liberal knows that a mere process of redistribution settles nothing. He asserts rather that in the long run, too, there is conflict inasmuch as the productive functions now discharged by private ownership could be better discharged another way.

To investigate the legitimacy of such a claim obviously lies outside the scope of this paper. But I think it is worth while insisting that a mere assertion of this sort does not itself establish an objective conflict of interest: the assertion must be proved. And in order that it may be proved, it is necessary to show that a society in which private ownership of the means of production has been abolished will satisfy the demands of the citizens of the world better than before. It is necessary to show that this is possible, not merely on a provincial or a national, but also

on an international scale. And, while I am aware that there are some who think that such proof can be given, I venture to suggest that nothing of the kind has as yet been generally accepted, and that, indeed, the expectations of such a society which have hitherto been prevalent have rested on assertions and theorems which even the most enthusiastic socialist of today would admit to have been mistaken.[1] Certainly the actual experience of those states which have approached nearest to the ideal of total collectivism affords little support to optimism in this respect.

Hitherto, then, such community of interest of the international proletariat as has rested on this claim has been subjective rather than objective in nature. The objective clashes of interest which can be actually demonstrated to operate in the world of reality suggest a classification of social groups more related to the phenomena of the market and to possible limitations on industrial and international mobility than any which rest on a general division between the propertied and the propertyless. In such a classification horizontal clashes of interest are at least as important as vertical.

[1] It is probable that Marx himself thought that computation in terms of labour costs would be an adequate basis for socialist planning.

II

THE ECONOMICS OF RESTRICTIONISM [1]

(1) Introduction

Among the many types of policy designed to promote recovery which have been introduced during the last few years there is probably none which will appear more significant to the historian of the future than the group of measures which can be described by the omnibus title Restrictionism. All over the world, with the enthusiastic support of electors (who at the same time complain that their incomes will not buy enough) the various governments are carrying out schemes which bring about a limitation of production. In America they are burning hogs; in Brazil, coffee. In Great Britain potatoes below a certain size must be fed to animals; and the development of the most economical forms of road transport is limited by restricted licensing. Schemes for the restriction of output of many of the most important raw materials are the subject of international agreement; and even the restriction of

[1] This paper was first published in *The Banker* (January 1935, p. 19 *seq.*). It has, however, been considerably extended and remodelled to fit its place in the present series of studies.

wheat supply has been the subject of repeated negotiation. When the historian of the future comes to choose a label for our time he might well call it the Age of Restrictionism.

(2) Restriction *versus* Price-fixing

Now, provided that recovery is to be sought by increasing the profits of particular groups of producers — or diminishing their losses — it is quite clear that limitation of the supply of their product is a much less self-frustrating policy than measures which operate solely on prices or on margins. To maintain prices by market intervention or to provide profits by subsidy, without in some way controlling supply, is to invite catastrophe. The disastrous operations of the Federal Farm Board in the early days of the slump and the interventions of the Egyptian Government in the cotton market are sufficient evidence of this. All that happens is that the government intervening loses a lot of money, that the normal operations of the market are paralysed while the government stocks are hanging about, and that in the end the volume of "surplus" stocks to be disposed of is greater than it would have been in the absence of any intervention whatever. The fact that both with bacon and with milk our own Ministry of Agriculture has seen fit to ignore the results of past

experience and to manipulate price without control of domestic supply seems no reason for rejecting this generally accepted conclusion, or, indeed, for expecting that in these cases the ultimate outcome will be different from what it has been elsewhere.

(3) Restriction and the Restrictors

But while it may be admitted that restrictionism is more logical than all this, it is still open to question whether it is correctly to be described as a policy which tends either to recovery or to progress. It is not certain, even, that restriction inevitably benefits the restrictors. Restriction schemes are notoriously hard to enforce, even when they are administered by only one government. To administer the American Agricultural Adjustment Act, which pays cultivators to throw part of their lands out of cultivation on condition that there is no increase of commercial fertilization per acre, must impose a very considerable strain on the not very efficient American bureaucracy. When more than one government is involved, as in the case of several of the raw material restrictions at present in operation, the difficulties are much greater. And, even if the restriction is successful among the original parties to the agreement, the very fact that it is successful is likely to call into being competition elsewhere,

either by way of supplies of more or less similar commodities or by way of the discovery of efficient substitutes. If this happens, then the original degree of overproduction, which the scheme was intended to remedy, is likely to be surpassed and the last state of the producers concerned to be worse than any which preceded it. We have seen this exemplified in the history of rubber restriction. It is highly probable that many of the schemes which have recently come into being will eventually come to grief in a similar manner.

(4) Restriction and the Community

But supposing this were not the case. Suppose that every restriction scheme were at once fool-proof and comprehensive. It is easy enough to see that such a state of affairs might be very agreeable to the producers concerned. But it is not so easy to see how the community as a whole could be regarded as being benefited. We know that in competitive conditions the profitability of enterprise is contingent upon ability to satisfy demand at least cost. There is no presumption of such relative harmony in conditions where competition is authoritatively prevented.

Consider the effects of limitation in a single line of industry. Let us suppose that the limitation is effective. The price of the product is

raised, the profitability of production increased. It is clear that the producers in question, the shareholders and the wage-earners concerned, have more to spend : and at first sight it might appear as if this would have favourable repercussions upon industry as a whole. It is probable that this is how the matter presents itself to many of the disinterested persons who support the restriction. But none the less it is an optical illusion. For the gain here is accompanied by a corresponding loss elsewhere. If the Minister of Agriculture makes us pay more for potatoes by prohibiting their sale for human consumption when they are below a certain size, the potato growers have that much more to spend. But we have that much less. If we spend more on potatoes, we spend less on something else. What the potato grower gains, some other producer loses. There is no *net* gain here. And, as we shall see later on, there is some reason to suppose that the indirect effects are deflationary.

There are, therefore, no gains from restrictionism in the monetary sphere. But from the point of view of the consumer — that is, the community other than the producers of the commodity in question — there is a net loss, a loss which may be measured by the amount by which production is restricted below what it would otherwise have been. The consumers of the world are worse off by reason of the destruction

of hogs and potatoes and coffee — no matter how much the producers in those particular lines are benefited. The producers in one group get more by the impoverishment of all the rest.

(5) Restrictionism as Planning

But the intelligent apologist for restrictionism will not deny the validity of this diagnosis. He will not deny that higher prices in one line of industry, brought about, not by revival of demand but by limitation of supply, may take purchasing power from other lines, or that thereby the real incomes of persons other than the producers restricting will be restricted. His argument, rather, will be that production has been *abnormally* expanded — that is to say, it no longer affords normal returns to the capital and labour already committed to it — and that therefore the restriction is to be regarded merely as a short and effective measure for getting back to normal conditions — a method of securing by authoritarian measures in a short time what would only be brought about by the market after lengthy and distracting delays.

The argument is plausible and, to many, it appears persuasive. But close consideration reveals certain grounds for hesitation. Abnormal expansion can mean one of two things — *either* that free capital and labour (*i.e.* capital and

labour which can move out of the industry) are not making as much as they could somewhere else *or* that resources irrevocably committed to the industry are not making the returns expected at the time of their investment. Does the argument for compulsory contraction really apply to either or both of these cases ?

Take first the case of labour — there is no reason to worry about free capital ; it looks after itself. Suppose that an industry has expanded so that, at the prices prevailing for its products, the labourers employed are not getting as much as they could get elsewhere. Is this a ground for excluding some of them from employment ? Surely not. If the opening elsewhere is obvious, it is to be presumed that sooner or later they will go. If it is not, then the hypothesis itself is dubious. Agricultural labourers in certain places are obviously in receipt of unusually low incomes. Is this a ground for making them unemployed on the chance that they will be reabsorbed later on into industry ? Surely the argument is all in favour of the slower contraction resulting from the pressure of the market.

We are left therefore with the case of the resources irrevocably committed to the industry, the machines, the fixed equipment. In the past the investors of free capital have made mistakes. Either because they have failed to foresee a diminution of demand or because they have over-

estimated the rate at which demand was to grow, they have committed to the line of production in question more resources than are now capable of earning a normal profit. Unless some of these resources are now scrapped, they will not make normal profits again until by a process of physical depreciation the industry is sufficiently contracted. This is of course the standard case of the restrictionist — the case for the closing-down of dockyards, the shutting-up of cotton factories, the restriction of surplus capacity. And to many it is overpoweringly persuasive.

But is it really so impressive ? It is quite true that, from the point of view of capital invested in the industry, restriction of this sort may pay. But it is not at all clear that, from the point of view of the community as a whole, it would be regarded as desirable if its implications were fully realized. From the point of view of the community other than the owners of the fixed equipment, the point at which it pays to discard the fixed equipment is the point at which capital invested in *working expenses* ceases to yield a normal profit. Beyond that point it is obviously more productive of the things which consumers want to invest it elsewhere. Before that point is reached, consumers' demand in that line is more urgent than elsewhere. It may very well be that when the fixed equipment is worn out it will not pay to replace it. But until it is worn

out, if the return to its use will cover working expenses there seems no reason, from the point of view of the community, for discarding it. Indeed, retaining it is the one way in which the community saves something from the original misdirection of capital. If I have devoted time and energy in the past to making some tool, it may well prove that the tool is not as useful as I hoped. But unless the time which I spend using it could be better spent in other ways, that is no reason for throwing it away. When it is worn out I may decide that it is not worth while renewing it. But, while it lasts and helps me to make things for which there is a use, it would be foolish to destroy it. No doubt when surplus capacity of this sort exists, it is sometimes to the interests of the owners to come together to arrange some limitation of its use. So far, however, in the absence of governmental backing, either direct or indirect, such schemes have not usually been successful. From the point of view of those interested, the failure of voluntary agreement to secure permanent restriction is a strong argument for attempting to secure authoritarian sanctions. But if the foregoing analysis is correct, this is not a very strong argument from the point of view of the community.[1]

[1] It is perhaps worth noting that all schemes for scrapping, closing down " redundant " works, etc., almost inevitably have the effect of *increasing* unemployment.

Such doubts are greatly reinforced if we consider the way in which restrictionism actually operates in practice. The typical mode of restriction is the allocation of production quotas. Now it is highly improbable that even in the worst depression all producers will be doing equally badly. Even in the unlikely event of everyone making losses, some are likely to be making smaller losses than others. It follows, therefore, that a proportionate restriction all round involves a double waste of resources. If the restriction were limited to the less efficient concerns, there would still be waste in the sense that equipment which someone still thought worth while using was excluded from operation. But when the more efficient producers are also restricted, there is a waste of productive power that is still more glaring. Low-cost production is penalized for the benefit of high-cost producers. The expansion of more efficient units is held up to keep in being units which the market would eventually force out of operation. The British coal scheme is a conspicuous example.

This abuse is so glaring that, in some restriction schemes, provision is made for the transfer of quotas. The low-cost producers are not favoured in the initial distribution. But they are permitted to take over the quotas of the high-cost producers if they are willing to pay for them. Such arrangements are certainly an improvement on the

system of non-transferable quotas. But they are nevertheless a tax on progress — a tax on efficiency for the benefit of the inefficient; and they do nothing to remove the main offence of restrictionism — the restriction of total output. The dilemma is inescapable; either restrictionism restricts, in which case output is lower than it would have been and consumption suffers, or it does not restrict, in which case it is unnecessary. The pressure for restriction on the part of those who hope to save the value of already invested capital scarcely suggests that the latter alternative is a very serious possibility.

(6) Restrictionism and Investment

It is sometimes argued that if the value of *already* invested capital is not maintained, by restriction or similar measures, there is a grave danger that in the future a sufficient supply of *new* investment will not be forthcoming. New investors will not appear because old investments have lost their value — so it is said. The argument is not intrinsically illogical: it is *conceivable* that investors might react this way. But there is no reason to suppose that in fact their behaviour conforms to this supposition. Hitherto in the history of the world the shrinkage of the value of old investment on account of the miscalcula-

tions of investors does not seem to have had a deterrent effect on the conduct of new investors. There is no evidence that the willingness of investors to put new money into what they think to be a good thing has been diminished in a manner detrimental to business by the fact that, in the past, other investors have lost their money. Indeed, if this were so, it is hard to see why the advocates of restrictionism are often so anxious to obtain governmental sanction to prevent new investment within their own industry. If the investor were not willing to come into finance developments in which he sees a profit, the need to limit the operations of low-cost producers in order to keep high-cost plant in operation would be very much less urgent.

In fact, when we look at the wide effects of restrictionism on the scale on which it is at present practised, not in one but in many industries, the boot seems to be very much on the other leg. So far from restrictionism being conducive to equilibrium of the capital market — new openings for capital being restricted in order that new capital may be forthcoming! — it is arguable that in fact it works strongly in the other direction. The various restrictions which are imposed almost inevitably have the effect of lowering the rate of return on new investment. When the field of investment is restricted the rate tends to fall. The investor who would have put money

into developing the business of a low-cost producer has to look elsewhere for an opening. In the long run, no doubt, some opening is forthcoming. But if, as seems probable, the rate of return is lower than he expects, he is likely to hesitate before committing himself to it. He says "Things cannot be as bad as this. I'll wait and see if something better doesn't turn up" — and keeps his money on deposit at the bank. This of course tends to lower the velocity of circulation; that is to say, it is definitely deflationary.

(7) Restrictionism and Monopolistic Competition

There is a further argument for restrictionism which has had a certain popularity recently. In certain lines of production where, for technical reasons, the productive unit is necessarily large, it is possible that producers may spontaneously restrict output for fear of provoking price competition from their rivals. Even though no explicit monopoly exists, each producer works under his full capacity for fear that if he increases output the fall in price will more than offset any gain in number of units sold. In such circumstances, it is argued, if the number of productive units could be limited, the same volume of output could be produced at a lower cost. The "wastes of competition" would be curtailed and

the community would be benefited.[1]

Now it is certainly true that situations of this sort are conceivable. It is probable indeed that a cross-section of industry at any moment would reveal many such situations to be in existence. Save at high peaks of industrial activity, it is probable that there always exist some lines of industry in which output could be produced more cheaply if its production were more concentrated in the more efficient units. We must not exaggerate the proportionate importance of this kind of situation. But it would certainly be foolish to pretend that it never exists.

But to argue from this to the desirability of restricting competition is to conceive the situation from altogether too static a point of view. At any moment it is indeed possible that the situation here contemplated may exist. But its persistence over a long period, in the absence of authoritarian restriction, is very much less probable. The fear that rivals will get in first is still a spur to cost-reducing improvement. The possibility of stealing a march on rivals by price reduction is still a standing temptation. Under licence systems these incentives are weakened, if not completely absent. And the healthy fear

[1] This argument, which of course has been the small-change of discussion of the monopoly problem for the last forty years, has recently been rediscovered by the specialists of diagrammatic analysis, with results not always altogether beneficial to their general sense of proportion.

of potential competition from new establishments, or the extension of activities of establishments hitherto devoted to other purposes, has gone altogether. To contend that the momentary advantages conceivable from a forced concentration of output would outweigh such losses, suggests either extreme naivety or extensive financial interest. It is a great pity that the technique of production does not give scope to a greater multiplicity of competitors. But it would be a still greater pity if what competition is technically possible were to be further restricted by law. The static " wastes of competition " in such cases are the price which technical indivisibility compels us to pay for the maintenance of conditions in which dynamic benefits are probable. The whole history of licence systems and forced amalgamations is one vast mass of evidence for this view.

(8) Restrictionism and Social Conflict

One general remark in conclusion. The creation of state-aided restriction is the creation of privilege. It is the creation of closed groups, the creation of a syndicalist society. When such measures are exceptional, their sociological significance may be exaggerated, although the fact that they are taken at all creates a presumption that they will be extended. What is granted to

one group is not easy to deny to others. And as the area of such privilege is extended, the structure of society is modified. Conflicts of interest which, in a system of no privilege and free mobility, would at most be of short-period significance, assume bigger and more permanent proportions. The struggle for wealth becomes a struggle for privilege — a struggle not for technical efficiency and adaptation to the wants of the community of consumers, but a struggle for status and the power of monopolistic exploitation. National politics become the play of rival pressure groups and international relations are similarly affected. Such a process in the end destroys, even for those who are most successful, the wealth and security it was originally designed to safeguard. If one line of industry practises restrictionism it may make gains which compensate the producers in question for the obvious danger they run. But if others follow suit, then these gains are likely to be wiped out in a process of general impoverishment and national and international conflict. These are truths which were platitudes to our grandfathers. They are not for that reason unprogressive. It is high time that we realized that our present relapse into the methods of medieval monopoly is not progress but reaction.

III

THE "INEVITABILITY" OF MONOPOLY

(1) Introduction

Among the intellectual influences upon contemporary policy there are probably few which have been so potent as belief in the inevitability of monopoly. Welcomed by the socialist as support for the view that there can be no organization conducive to the general interest while private property persists, supported by vested interests anxious to screen their depredations by the whitewash of alleged technical necessity, and countenanced by harassed officials who prefer to deal with one interest rather than with many, it has passed into the sphere of those general truths to question which is a sign of inferior understanding; and the programmes of political parties accept it as an unquestioned axiom. Even those who are most acutely aware of the dangers of monopoly and the dangers to liberty and prosperity of systems which are based upon it, reluctantly accept it as inevitable and resign themselves either to devising minor checks and balances, or to forwarding comprehensive projects

of collectivism which will replace the monopolies of private interests by the more comprehensive monopolies of states.

It is the object of this paper to enquire how far this belief is justified.

(2) The Definition of Monopoly

To do this it is necessary to be reasonably clear about definitions.

The word monopoly comes from the Greek and means literally single sale. We say, therefore, that there exists a monopoly when the sale of any type of commodity is in the hands of a single controlling authority.

There are some difficulties in this conception. There is no great ambiguity in the idea of single control. But there are ambiguities in the idea of a commodity. It is generally agreed that for purposes of exact analysis a commodity is to be defined not merely with reference to its physical character, but also with reference to its availability in space or time and to any psychological or social characteristics inseparably associated with its sale. Thus coals in London are not the same as coals in Newcastle; cotton now is not the same as cotton six months hence; and a made-up product bought from a manufacturer of repute is not the same as a product bearing the same name but bought from a manufacturer of

dubious reputation. Pedantically interpreted, such definition would carry us far towards belief in the complete ubiquity *at all times* of the phenomena of monopoly. For, for example, every single commodity at any one time must occupy a different position in space, and ultimately not more than one control can be responsible for its supply. But to carry things thus far, to regard all competitive influences as working on the side of demand via the influence of substitution, would be a very inconvenient use of language. There may be a certain gain in theoretical elegance. But there is a more than commensurate loss in intelligibility. Definitions must be servants and not masters; and, where differences in space and time and other characteristics of availability are not large, for purposes of practical analysis we are often well justified in grouping together slightly unlike commodities and enquiring whether their supply is in the hands of one or more than one seller.

There is, however, one direction in which it may be desirable to extend the conception of monopoly, or, at least, our conception of what may be called monopolistic conditions. Analysis shows that it is a salient contrast between the behaviour of the monopolist and the behaviour of the purely competitive seller that, whereas the competitive seller takes the prices of the market as more or less given, independently of what he does, the monopolist is concerned essentially to fix

prices in the light of what he thinks the market can bear. Now such concern is not necessarily limited to the seller who has complete control of supply; it may be present if a seller controls an appreciable fraction of supply. This is not always so, for reasons which will be examined later on. But it may be so; and, when it is, there seems reason for saying that, in *this* respect, the conditions of the market are monopolistic. As we shall see later on, there is no sharp line between monopolistic and competitive conditions. But, for practical analysis, the distinction is clear enough and springs naturally from the original conception of monopoly.

There is a further extension of the meaning of the term which seems justifiable. If entry to any line of supply is limited by law or by coercive custom, let us say by a licence system or by the institutions of a caste society, it seems reasonable to speak of the existing suppliers as possessing a monopoly and the incomes resulting from their position as essentially monopolistic. There may be competition within the group in the sense that the sellers take the market prices for granted. There may be competition in service. But the fact of the limitation of entry gives the group a monopolistic status.

All these usages must, however, be sharply distinguished from another which is frequently to be encountered.

In popular discussion and sometimes in scientific discussion, language is often used which suggests that the total number of suppliers of a particular commodity have a monopoly of that commodity, whether or not they are acting in concert or are protected by legal or customary regulations. Thus it is often said that English producers of certain textiles had a monopoly of the world market in the nineteenth century, that the proprietors of agricultural land have a monopoly and so on.

This usage has wide currency and a not disreputable ancestry.[1] But it is surely highly misleading. For it begs the whole question whether or not the total supply of the commodity in question is subject to single or limited control. In fact, during the nineteenth century the supply of English textiles for the most part was highly competitive. There were few coercive restrictions anywhere on entry into the various lines of business; and the prices charged were entirely different from what they would have been if — as seems likely to be the case in our own day — the industry had been subject to restrictive regulation. On such a use of terms, indeed, if we wished to know the extent and area of monopoly, we should look simply at the various censuses of industry and occupation for world figures of the different groups, and, having found the total

[1] It is sometimes used in this way by Senior and J. S. Mill.

numbers in each, we should say there are the monopolies. The wheat producers have a monopoly of wheat production, the coal producers of coal, the metal producers of metal.

But our problem is to discover whether, at any time, production in these industries is monopolistic or whether it inevitably tends to become so. It would be scarcely sensible therefore to adopt a usage of the term monopoly which would make them monopolistic in all circumstances.

(3) The Extent of "Spontaneous" Monopoly

Let us now turn to actual conditions.

If we survey the world as we find it in the year of grace 1939, we might well conclude that the theorem of the inevitability of monopoly was justified. For, turn where we will, in almost every direction we find monopolistic controls conspicuous. It would of course be an exaggeration to regard these controls as universal. There still remain considerable areas where monopoly is absent; and in many cases where monopoly is present its hold is as yet insecure. There is no doubt, however, that in world production at present the sphere of monopoly, in the senses in which we have defined it, is large.

Nevertheless to infer from this the inevitability of monopoly would be totally unjustified. It is notorious that the vast extension of monopoly

in recent years has been the result of state policy. Lines of industry in which the sharpest competition has prevailed have been forced by state action into uniformity and single control. It may be that such happenings give countenance to vague theories of the *political* inevitability of monopoly. There will be something to be said about that later on. But they lend no countenance to the theorem that the " natural " tendency of modern production is towards monopoly. To prove or to disprove that, we have to look more deeply into the actual condition of industry.

Let us therefore attempt a brief survey of the different branches of production. For these purposes we may well adopt the traditional divisions : agriculture, extractive industry, transport and public utilities, manufacturing industry and distribution. Let us ask, in what degree, in the absence of the emergency legislation of the last few years, monopolistic conditions would be prevalent in each of these groups ; and let us ask, when we find them, concerning the origin of these conditions. This is surely the right way to examine the alleged inevitability of monopoly. Of course it is impossible to do the thing on any exact or exhaustive scale ; exact statistical information is not available for the world as a whole, and no single man possesses sufficiently detailed knowledge. But broad survey is possible ; we can only plead complete ignorance

because of the absence of exact statistics, if a survey of this sort yields no result at all. And in fact, as we shall see, even the broadest survey, such as is attempted in the next few paragraphs, does yield substantial information.

(i) *Agriculture.*—Agriculture is still quantitatively the most important branch of world production. There are no exact statistics of world population or the value of world production. But there can be no doubt that, however it be measured, agricultural activity must occupy a predominant part of any picture of world economic activity.

Now, there are agricultural products which, in the absence of state coercion, would be still produced under monopolistic conditions. The products of certain French vineyards are an obvious case in point. In the neighbourhood of small towns, in the absence of easy transport, it is possible that producers of certain vegetables may enjoy a position of local monopoly. In certain branches of timber production, either because of the distribution of land ownership in the distant past or because of the obvious ease of the supervision of large areas, production units are very large and in certain cases may occupy monopolistic positions. But taking the broad field of world agricultural production, it would be completely fantastic to believe that, in the absence of positive regulation by states, the

conditions of production would be anything but highly competitive. Opinion may differ about the relative efficiency of large and small farms. It may well be the case that, having regard to the possibilities of modern technique, the average size of unit in many branches of agricultural production is still too small. But nobody with the slightest knowledge of the subject could possibly urge that, in the vast majority of cases, the optimal size of unit would contribute anything but a tiny fraction of the total supplies with which it was concerned. And it is well known that, hitherto at any rate, any attempts which have been made to form monopolistic selling pools to manipulate prices on behalf of the producers have foundered miserably if they have not received governmental support.

The sale of agricultural products at the present day is largely if not yet predominantly monopolistic. But this is the result of state intervention.

(ii) *Extractive Industry.*—In extractive industry the position is different. Where mineral resources are rare or where the available resources are predominantly situated in one region or a very few regions, there are obvious possibilities of monopolistic control; and not infrequently these possibilities are exploited. Thus, for example, for many years the diamond monopoly maintained its position without important aid

from the state; the position has changed in recent years with the control of alluvial digging by the South African Government. The bulk of the supplies of mercury comes from Spain and Italy; this has facilitated the operations of a strong international cartel. For the same reason producers of nickel have been able to act much in concert. Nor must we forget that, even in the case of extractive industries where the material dealt with is scattered widely over the earth's surface, such as different kinds of stone and brick-earth, the costs of transporting the material for even short distances may often be such as to give substantial local monopolies to particular producers.

Nevertheless we must preserve a sense of proportion. Before the legislation and government action of the last few years, there were large areas of extractive industry where conditions were highly competitive. Coal mining for instance, perhaps the most important single branch, was certainly in this condition in Great Britain and in many other countries. In Germany, where it was not, the existence of cartels and syndicates was supported by deliberate state policy. The production of iron ore is not subject to monopolistic control; nor is the production of bauxite. The international restriction of tin owes its origin to obvious government support. The attempted restriction of copper sprang from

support from the American Government. Potash is the subject of state monopolies in Germany and France, competition having proved "too violent".

It is clear therefore that there is no one tendency in the extractive industries. There is an important area where, in the absence of state support, natural conditions would still create conditions favourable to monopoly or strongly monopolistic conditions. But there is another area, probably much the larger if value of output be the test, where this is not true at all and where, in the absence of state intervention, highly competitive conditions would still prevail.

(iii) *Transport and Public Utilities.*—The field of transport and public utilities is conspicuous as comprising in many cases types of technique which almost necessarily involve large productive units. Where the supply of a particular service, as for instance rail transport or the provision of water or gas, involves technical apparatus necessitating the possession or use of long strips of the earth's surface connected without a break, it is highly probable that monopolistic control of supply will be prevalent. It is of course erroneous to say that this is likely to come about without state intervention of any kind; without intervention by way of the grant of powers of compulsory purchase many of these undertakings would not come into being at all. Nor is it certain that in every case this must necessarily

involve the existence of single monopoly; the argument, for instance, that it would be absurd to have the streets torn up for half a dozen competing electric-light lines ignores the possibility of the construction of underground tunnels through which competing lines could be laid.[1] It is certainly not true that the refusal by the state of facilities for competing undertakings is in any sense inevitable; such powers have often been granted. But whatever the arguments for and against particular forms of state action here — and it is a subject of immense difficulty, little explored as yet by disinterested and candid minds — it may be generally agreed that here is a field in which monopolistic conditions are probable.

But it would be a great mistake to suppose that this field was coterminous with the whole area covered by our heading. Public utilities do indeed derive their definition from the technical conditions which have just been described. Rail transport falls into the same class. But the other types of transport services are subject to no such conditions. The air and sea are not naturally limited and neither horse nor motor transport runs on rails. So far as sea transport is concerned, a distinction must be made between liner and

[1] Nothing of what is said in this connection should be interpreted to imply the view that state intervention in this field is necessarily undesirable. The desirability or undesirability of particular forms of state action here must be argued in each case separately.

tramp shipping. Where liner shipping is concerned, the size of the technical units involved and the limitation of dock facilities (often the result of state policy) not infrequently conduces to the emergence of combinations, although this is not universal; on many lines sharp competition prevails. But tramp shipping has been exceedingly competitive; and so, in the absence of state-imposed licence systems, would be most forms of transport on roads.

The case of road transport is perhaps deserving of special notice; for it is particularly illustrative of the way in which much of the monopoly of our time is the result, not of technical evolution making for monopoly, but of monopoly imposed against a technical evolution working unmistakably in the opposite direction.

In the nineteenth century the discovery of the power of steam and the speed of wheels on iron or steel rails were technical changes making strongly for monopoly of many kinds of land transport. Stage coaches were driven out of business. Traffic on the canals stagnated. For many types of transport, for many distances and directions, the various railways were in strongly monopolistic positions. In the course of economic history there is no example of any other single group of technical inventions tending to produce monopolies on so large a scale. The nineteenth-century writers who stressed the changes in technique

making for monopoly must have had this example largely in mind.

But at the beginning of the twentieth century there occurred technical inventions which completely changed these conditions. The invention of the internal combustion engine and the discovery of the rubber tyre produced a new form of transport which, in many lines, was capable of rendering the same type of service as the railways and of rendering it under competitive conditions. The cost of lorries and charabancs is not such as to prevent effectively free entry into many lines of transport; and although, for long hauls and for very heavy hauls, the railways retained monopoly over a large part of the field, there was now the possibility of really effective competition.

But the development of policy ruled otherwise. Enormous sums of money had been sunk both by private enterprise and by states in the building of the railways. The trade unions of the railway operatives were in an especially strong position. The combination of shareholders and trade unionists made a vested interest strong enough in many countries to impose effective limits on the competition of the road. This competition has not been completely strangled. Private persons who can afford cars and private traders who can afford to provide their own transport, can still in this way have recourse to conveniences other than those provided by rail transport. But the de-

velopment of road haulage and road passenger transport has been severely curtailed. One of the most spectacular inventions of modern times — the invention perhaps most capable of increasing, directly or indirectly, the real incomes of the poor — has been limited in its application.

(iv) *Manufacture.*—We may now turn to manufacturing industry, using that term in a wide sense. If we were to go by much of what passes for serious discussion nowadays, we might almost suppose that here was a sphere in which monopoly, or at least highly monopolistic conditions, were almost completely prevalent. The world of manufacturing industry, it is said, is a world in which competition, in any effective sense, has virtually ceased to exist.

Such statements are not merely exaggerations. They are quite definitely incorrect. There is a wide area of manufacturing industry in which conditions are competitive in the most obvious sense or, at least, would be competitive in the absence of state prohibition to compete. In most parts of the world the cotton industry is unmistakably competitive. So is wool. Indeed, apart from artificial silk, almost the entire textile group, one of the most important classifications in the whole list, works under such conditions. Much activity on the part of governments recently has been devoted to attempting to prevent competition in this sphere, hitherto

without complete success. In densely populated centres house-building is often to all intents and purposes competitive, even if it does not work for an organized and standardized market.

Moreover, once we turn to the field of more specialized production, we must not be misled by appearances. The fact that, at any time, an article is actually being produced by a comparatively small number of firms, which is certainly very often the case, does not necessarily mean that competition is not effective, in the sense that the limits within which variations of output by single firms can affect price are large. The important thing affecting these limits is of course not the proportion of *actual* supply controlled by any one unit but rather the proportion of speedily available *potential* supply. If the potential supply outside the control of any one manufacturer is large, he will not devote much time to price policy. He will produce as under the rule of competition.

Here, it may be submitted, is a matter in which certain of the expository devices of elementary analytical economies may seriously distort judgment, if not supplemented by more advanced examples. In the customary treatment of the theory of production it is the usual habit to expound the more elementary propositions regarding costs, returns and the policy of the firm, by means of examples in which the productive

unit is wholly specialized. It is a single-product firm. This practice has obvious convenience from the expository point of view. But unless it is at once supplemented by analysis based upon more realistic assumptions, it is apt to be seriously misleading concerning the actual conditions of supply. In a world of single-product firms — firms completely specialized on one product — enlargement of supply, once existing firms are working to capacity, can only come by the setting up of new firms or the complete transformation of other plant, often a long and costly process. But this is not a correct picture of the actual conditions of industry. Over a wide area of the field, the single-product firm is not the rule but the exception. The typical firm produces more than one product and much of its apparatus is not completely specialized. It follows, therefore, where such conditions prevail, that the flexibility of supply of any particular product is enormously greater than it would be in a world of single-product establishments. If the price of any particular product rises much above its marginal cost and if competition is not restrained by prohibitions or agreements, there is likely to be a number of establishments which, without much extra expenditure, can turn over part of their plant to manufacturing the more profitable article. This means that, even where the actual sources of supply at any

moment are comparatively restricted in number, price formation is competitive in nature. Such conditions are especially prevalent, for example, in the light metal and engineering industries. But there are few branches of industry where, in the absence of other influences making for monopoly, this factor is not important.

Nevertheless at the present day, even where government regulation does not restrict competition, there are still sections of manufacturing industry where, if there is not complete monopoly, conditions are still monopolistic, where cartels, combinations, giant trusts, tying agreements and trade boycotts are the order of the day. And although the extent and significance of this area may be exaggerated in popular discussion, it is still sufficiently great to constitute a social problem of great importance. Why it exists, why it has extended in recent years, are questions to which attention will be given in the next section. For the moment it is sufficient to state quite definitely the fact that it exists and that its existence is not the direct product of governmental measures of industrial organization.

(v) *Distribution.*—Finally we come to distribution, including merchanting and dealing. Here, perhaps, the need of analysis is to look for monopoly beneath competitive appearances. Wholesale marketing and dealing, where it has not been squeezed out by producers' selling-

organizations, is, of course, highly competitive. The market for standardized products forms the model for the theoretical analysis of competitive markets: the fact that actual membership of the market may be restricted in one way and another may introduce a monopolistic element into brokers' incomes, but it does not create monopolistic commodity prices. In the sphere of retail distribution, however, matters are rather more complicated. No-one can urge that there is much obvious monopoly in the sphere of retail distribution. Nevertheless, in this field, the factors of spacial position and goodwill often constitute differentiating elements in retail services which create small margins within which individual pricing policy has some scope. It is very doubtful whether this has much quantitative significance in the broad perspective. Nevertheless it must be kept in mind as a qualification to the claim that, speaking generally, distribution must be regarded as competitive. There is little conspicuous monopoly. But there are many small areas where conditions are mildly monopolistic.

(4) The Causes of "Spontaneous" Monopoly

It is now time to dig rather deeper. So far our analysis has been confined to asking whether, in the absence of direct authoritarian restriction

of competition, the sphere of monopoly is ubiquitous; and it has appeared that this is certainly not the case. In surveying the various types of production, we have found areas of competition and areas of monopoly; but there can be little doubt that on any quantitative test, such as proportion of world population employed or value of output produced, the competitive area would be considerably the larger. We have, however, found much monopoly which, directly at any rate, has not been deliberately imposed by state action, and if we are properly to appreciate its significance and to assess propositions concerning its inevitability, it is necessary to enquire further concerning its origin. We must enquire concerning the causes of monopoly.

Now the desire for monopoly is more or less general. Monopoly means higher gains, less effort, more security than competition. There are few men who do not covet such a position or who, if they see a chance of achieving it, deliberately refrain from making the attempt. "People of the same trade", said Adam Smith, "seldom meet together, even for merriment and diversion but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." [1] The representatives of the modern trade associations may say that they have changed all that. But the reasons they adduce

[1] *Wealth of Nations* (Cannan's Edition), vol. i, p. 158.

are slender; and their actions belie their claims.

But it is one thing to want monopoly. It is quite another thing to be able to achieve it. If producers are able to induce governments deliberately to prohibit competition, well and good. But if this fortunate event does not occur, it is only under certain conditions that the attempt to secure monopoly is likely to be successful. The world is a wide place. The gains of monopoly are tempting to outsiders. Fortunately for the rest of humanity, there is usually a plentiful supply of would-be interlopers and blacklegs. Combinations which are not enforced by the sanction of the state are in danger of breaking down. To understand the continuance of monopoly, therefore, we have to enquire what are the conditions which conduce to its survival. We have to ask to what extent these conditions can be regarded as natural, to what extent they are the indirect result of policy.

(i) We may start with conditions which are obviously "natural". If the supplies of any natural resource are concentrated in one place, or in a small number of places, it is easy for them to gravitate into the hands of one control or of a very limited number; and there is a strong incentive to action which will bring this about. We have seen already that this is the case in certain extractive industries. One can easily conceive of worlds in which the physical con-

stitution of the planet would give rise to widespread monopoly of this type. But in our own, while such conditions are important in certain narrow lines, in modern times, they have not been responsible for any but a small fraction of the area of " spontaneous " monopoly.

(ii) Somewhat similar, and probably quantitatively much more important, is the influence of costs of transport. We have seen that position in space may, in certain circumstances, be regarded as constituting a unique source of supply. Even where exact position is not of great importance, in areas where demand is small, single units of supply — local shops or brickworks for example — may have positions of monopolistic power. It is important to observe that the extent of this power will depend essentially upon costs of transport from other areas. The middle ages must have been honeycombed with this kind of monopoly ; and the deliberate restriction of transport development on the roads in our own time must be regarded as a factor tending to sustain it where it still persists. The lower the cost of transport, the less the danger of local monopoly.

(iii) Thirdly comes the influence of technique. We have seen already that, in the sphere of the so-called public utility enterprises, there are types of service where the technical conditions of production are such that competition between more

than a small number of producers is unlikely and monopoly is very probable. The same conditions prevail in certain types of manufacturing industry. Where the economies of large-scale production are very great and where the equipment is very specialized, the number of establishments is likely to be few and the degree of potential competition small. In the most general analytical terms, we may describe these conditions as conditions of extensive indivisibility of the mechanism of production. The advantages of superior technique cannot be reaped on a smaller scale. Where such conditions prevail, there monopolies, or at least monopolistic conditions, are probable.

Now it is probable that in some lines of industry, in recent years, the evolution of technique has been such as to extend the area of conditions of this sort. But there is no inevitability about this. In other lines, technical evolution has proceeded the other way. We have seen already how, in the field of land transport, the invention of the internal combustion engine introduced technical conditions once more permitting a wide extension of effective competition. Examples of this kind could be multiplied.

Moreover these technical advantages of large-scale production have obvious limits. There is always a point beyond which increases in scale of output are attended by no further gain in

efficiency, and may indeed easily be attended by considerable loss due to the increased difficulties of administration. This fact is well attested by experience. We hear much of the technical economies of combination while combination is being negotiated. But we hear much less when the combination is achieved, and the results are seldom conspicuous in costs. Speaking generally, it is safe to say that, outside the public utility group, it is rare, in industries of any magnitude of output, for the economies of large-scale production not to be exhausted long before a monopolistic position is achieved. The gains of monopolistic combinations are chiefly due, not to technical economy, but to monopolistic buying and selling.

But why, then, is monopolistic combination to be found at all outside the comparatively limited group where the "natural" conditions favourable to monopoly, already enumerated, prevail? This brings us to influences of a more artificial nature.

We have seen already that much of the monopoly at present prevailing — quantitatively considered, indeed, probably the larger part — is due to direct governmental intervention. The vast structure of agricultural marketing controls which all over the world have come into being in the last few years is of this nature. So are such arrangements as the British coal quotas, the

various international raw material restriction schemes, the totalitarian export controls, the many consolidations of interests which, in the last war and in the course of preparations for the next, have been instigated by governments, and so on. These are obviously artificial in origin. They spring from no technical necessity. But they are not our immediate concern at present. At this stage we are seeking for less obvious artificial conditions which conduce to monopoly even in the absence of such direct measures.

(i) We may notice, first, influences springing from the nature of the law relating to property and contract. The framework of law within which free enterprise is permitted to function is not the simple matter which the incautious terminology of certain early enthusiasts for the so-called "system of natural freedom" might lead us to suppose. On the contrary, it is matter of the utmost complexity; and it is very easy for apparently slight differences in legal codes to give rise to extensive differences in industrial organization. In Germany, for instance, the law regarding restraint of trade has been much less severe than in Great Britain. Long before the Great War, rules had been established in Germany which made cartel agreements enforceable in the courts; there can be little doubt that this was one of the more important reasons why monopolistic conditions were so much more prevalent

in Germany than elsewhere. The state definitely favoured combination ; and the law was developed accordingly.

Again, we may take as an example the law relating to joint-stock companies. It would be wrong to contend that the invention of limited liability has always told in favour of the consolidation of monopoly. But there certainly seems reason to suppose that the development of the law relating to holding companies, especially in the United States, has tended in this direction. There is nothing " natural " about such a development. Given a different state of public opinion it might be otherwise. But, given present conditions, monopoly has been facilitated.

Similarly, in the more minute ramifications of legal systems the close student of industrial organization can recognize a multitude of small inflections, upon each of which a whole range of monopolistic practices depend. Judgments upholding particular forms of tying clauses, deferred rebates, trade boycotts and the like are all influences conducive to monopoly, not necessarily implied by the general concept of free contract, which in all sorts of subtle ways can be invoked to support the limitation of competition and which are so invoked continually.[1]

[1] This paper is not concerned with monopolistic combinations among the suppliers of various forms of labour services. But it is interesting to note that here, too, there is an extensive substratum of special legal provisions facilitating their existence. The exclusive

(ii) We may next consider the rôle of restrictions on international trade. These tend to promote monopoly in two distinct ways.

In the first place, they narrow the market. If the number of sources of supply within any national area is small, the existence of restrictions on import creates monopolistic conditions. In the absence of restriction, competition may be reasonably effective. If restriction is present, the situation may be totally changed.

But beyond this, the existence of such restriction is an actual incentive to the formation of monopoly. In an area open to world competition, the elasticity of potential supply from outside may well be so great that it is not worth while for the national producers to attempt concerted action. They are much better advised to concentrate upon the efficiency of their own establishments. But if supplies from outside are restricted, the position is changed. A national combination may be effective. International arrangements with foreign competitors become much more practicable. Moreover, the very fact that restriction is contemplated as lying within the range of accepted national policy, is a spur to concerted action for purposes of political pressure. The competitors come together to

practices of many of the professions are unthinkable without special legal privilege. And it is well known that, without a series of special modifications of the law (especially the law of torts), the powers of trade unions would be entirely different.

finance the appropriate political measures. What begins in the lobbies is not slow to work through to the board-rooms: the tariff is the father of the trust.

It is perhaps possible to exaggerate the importance of this factor. Certainly the free-trade propaganda which attributes all monopoly to protection has been guilty of exaggeration.[1] As we have seen, there are many other causes of monopoly. But it is notorious that the growth of monopoly in the last seventy years has everywhere been closely associated with the growth of protection. In those countries where protection has been high, such as Germany and America, monopoly power has been prominent; whereas in those countries which remained more or less open to world supplies, monopoly has been a much less serious problem. In Great Britain, which in our own day has changed from a free-trade to a protectionist policy, the contrast is especially significant. Before 1931 monopoly or monopolistic conditions existed in certain restricted spheres. But over the wide field of manufacturing industry it was not a conspicuous phenomenon. Since 1931 it has become endemic. The manufacturers of Great Britain, who in the

[1] As I myself have been accused of the belief that tariffs are the only cause of monopoly, I may perhaps take this opportunity of stating that I do not hold this view, that I never have held it, and that nothing that I have ever written on the subject will bear this interpretation.

past, under the healthy stimulus of competition, have done so much to raise the general standard of living, both at home and abroad, have become, as it were overnight, more interested in the production of political privilege than in the production of goods and services.

(iii) The influence of tariffs is well known. Much less well known but not commensurately less important is the influence of patents. It is probable that even professional economists have greatly under-estimated this factor. Yet a patent is an obvious monopoly; the patentee has exclusive rights and, where patented processes are involved, conditions are necessarily monopolistic. This influence has many ramifications. Not merely does it directly protect the manufacturer of patented articles; it also permits the creation of a whole network of tying contracts, forced joint supply, resale price maintenance and other trade practices, not particularly conspicuous in themselves but cumulatively highly conducive to the consolidation of monopolistic conditions. Indeed it is so important an influence that it is no exaggeration to say that special lines of expertise exist, not to forward the progress of invention but merely to devise variations in productive processes permitting the continuation of this form of monopoly power.

It may be urged, however, that the patent system in its present form is an indispensable

condition of progress; that if patents were not granted as they are granted now there would be no spur to technical invention. If this were true, our present classification would be erroneous. The granting of patents would have to be regarded as "natural" to a system of private property and free enterprise; and to classify it as "artificial", although literally accurate, would be contrary to the spirit of our analysis.

But this belief is certainly erroneous. We may leave undiscussed the question whether if there were no patent rights of any kind there would be an inadequate flow of invention; although, as Professor Plant has shown,[1] consideration of the procedure in many branches of industry where patents are not involved suggests that the argument here is by no means all on the side of supporters of the retention of the patent system. But it is really quite ridiculous to suggest that any modification in the present law would necessarily have this consequence, that the thing is naturally sacrosanct. The patent system in its present form is a highly artificial creation emerging from a process of legislation in which the rôle of pressure groups and muddled thinking has been unfortunately only too prominent: and no convincing argument has yet been put forward to show that the abolition of

[1] "The Economic Theory concerning Patents for Inventions" (*Economica*, February 1934).

the present system and the substitution of a "licence of right" system whereby, after a very short period, anyone might use a patent on paying a licence fee to the inventor, would be unjust to inventors or diminish the flow of invention. But certainly it would sweep away the whole network of monopolistic practice which rests on the present system.

Consideration of the patent system leads naturally to the last condition conducive to the existence of monopoly which has to be mentioned in this connection, existing business prestige. Each particular firm has its own reputation for quality and service; and, if this reputation is high, it may well confer upon its products a status of uniqueness involving a position of some monopolistic power. Moreover, in the very process of economic change, the fact that a producer is first in the field with a new product means that, for the time being at least, his position may be monopolistic.

At first sight such cases might appear to have a close relation to the case of monopolistic positions due to patents. But there is this important difference: that, in these cases, there is no legal exclusion and that the position is obtained only in virtue of the performance of services which are preferred.[1] The gains which come from a

[1] It is sometimes urged that the provision of new products closely elated to products already on the market — a process sometimes

reputation for uniqueness of service and from more rapid anticipation of public demand are gains which definitely conduce to efficiency and variety: without begging the question whether such efficiency could be otherwise evoked in a system in which private enterprise was abolished, it may safely be concluded that they are necessary to the operation of a system in which private enterprise persists. In our present universe of discourse, therefore, we may classify such factors as " natural " rather than artificial.

(5) The Political Inevitability of Monopoly

We embarked upon our survey to examine the truth of the view that at the present day the conditions of production are such as to make a predominance of monopoly inevitable. If the facts which have been cited are correct and if the analysis of these facts is well founded, then, it is submitted, the answer to this question must be negative. We have found indeed that monopoly

referred to by the somewhat sinister name of product differentiation — is itself a source of waste and misdirection of productive factors, and that it would be better from the point of view of consumers if this were prevented, to allow more mass production of existing products. So long as price competition is permitted, so that consumers may choose between relatively dear new products and relatively cheap old products produced on mass-production lines, I see no argument in favour of this view that is not ultimately authoritarian in origin. The so-called evils of product differentiation only arise when price competition is not permitted.

predominates over a large part of the field at the present day. But we have found that much of this has been imposed by deliberate state intervention; and in the area of "spontaneous" monopoly which remains, we have found that a large part, probably the larger part, is the indirect product of policy. There are indeed "natural" conditions favourable to monopoly in certain parts of the field, the distribution of certain natural resources, the costs of transport to areas of small demand, the technique of certain forms of production; and, in the absolute sense, these are quantitatively sufficiently important to give rise to serious problems of ownership and control. But relatively their quantitative importance is not large. In a world in which there was no state creation of monopoly, no forms of law favouring restraint of trade, no barriers to trade, and a patent system conducive to competition, the area of spontaneous and long-lasting monopoly would be small compared with the area of effective competition. The theory of the technical inevitability of monopoly is not in accordance with the facts.

Nevertheless, under present conditions, the extent of monopoly is great, so great indeed that we may well ask if there is not some other kind of inevitability at work. Monopoly may not be *technically* inevitable. But is it not *politically* inevitable?

This question may have different answers, according to the exact meaning we attach to the idea of political inevitability.

If it is meant that at the present day people are so convinced of the *technical* inevitability of monopoly that they will offer no resistance to its encroachments, and indeed facilitate its creation, there are very good grounds for the argument. It may well be that constant reiteration of the theorem that monopoly is inevitable has actually made that theorem come true, in defiance of the technical conditions of production — a fitting outcome of standing Hegel on his head. From this point of view the political inevitability of monopoly may be admitted as a strong probability, and those intellectuals who enjoy being right, in the sense of having shouted with the crowd, may be neglecting valuable opportunities of prestige by not shouting even louder now.

But if it is meant that in a regime in which there is no encouragement of monopoly, direct or indirect, the interest of groups of producers in manipulation of the market must inevitably be politically preponderant over the diffused interest of the rest of the community, the proposition is not so plausible. No-one who has studied the operation of the urge towards monopoly is likely to under-estimate its power or its lack of scruple. Men as producers are active

in pursuit of their own interest; as consumers they are too often passive. The price of freedom is a vigilance which twentieth-century man, doped with overmuch misery or enjoyment, has shown small disposition to afford, and which the intellectuals from whom he takes his lead have done little to evoke. Nevertheless the victory of the pressure groups is not inevitable. In a community in which they receive little support from the state and in which intellectual leadership does its job, their conspiracies against the public would not be at all difficult to meet. In a community in which they have been allowed and encouraged to consolidate and in which intellectual leadership has lost its way, their influence is much more powerful. But resistance is not hopeless. In fact to any who can stand aside from the unrealities of contemporary party dogmas it must be clear that such resistance is a much less hopeless policy than the alternatives now pursued. A policy of removing the artificial conditions making for monopoly and of controlling the relatively small area of "natural" monopoly which would then exist,[1] still offers

[1] I have said nothing in the foregoing paper on this problem, which is too complicated to be dealt with incidentally. Broadly speaking, my attitude is as follows. The best way to deal with monopoly is to create conditions of competition by removing the obvious legislative and administrative limitations. But where this is not sufficient, I am by no means opposed to definite state action to prevent or to control monopoly. In those cases where technical conditions make monopoly inevitable I am definitely in favour of regulation if suitable methods can be devised. If I might take the

much more chance of practical success than the policy of encouraging monopoly to grow in the hope that, when it has become ubiquitous, it will become less dangerous and easier to manage. The belief that once monopoly is established all round it will be easy to control is indeed widely held. But it runs counter to all experience. It is based on no reasonable presumption. Its prevalence only serves to hasten the coming of the servile state.

present case of the British railways as an example, I would be in favour of removing all limitations where road competition can be effective. But where road competition is not permitted or where for technical reasons it is impossible, control of rates and such matters as undue preference seems to me to be obvious prudence. The claim of the railways to be freed from control themselves while a tight control is maintained, via the licence system, upon competition from the road hauliers is so palpably antisocial, so obviously the reverse of a square deal for the public, that, were it not for the great power of the interests involved, it would be unbelievable that it should be taken seriously.

IV

THE ECONOMICS OF TERRITORIAL SOVEREIGNTY [1]

(1) Introduction

My task in this lecture is to examine in what ways territorial inequalities may have economic consequences which are a danger to world peace. Some states control large territories; others control small territories. It is notorious that disputes concerning the justice of this division are a continual menace to peace. It is my business to investigate, from the economic point of view, some of the complaints underlying these disputes and the conditions under which these complaints are valid.

I can perhaps best approach this problem by eliminating others with which I am not concerned. The demand for extensions of territory may arise for a number of reasons. It may arise for reasons of prestige; it may be thought to be

[1] This paper was first delivered, in the winter of 1936–37, as one of a series of lectures at the London School of Economics on the subject of Peaceful Change. The whole series has been edited by Professor Manning and published by Messrs Macmillan under this general title.

the destiny of a certain national group to occupy a position of great power. It may arise for reasons of military security ; it may be thought that, in the absence of extensive possessions, the citizens are exposed to the dangers of military attack. It may arise for reasons of " race " ; it may be felt that it is intolerable that people of the same " blood " should not be united under one government. These are demands which no doubt will be investigated by my colleagues with at least as much sympathy as they deserve. But my business here and now is different. I am concerned with a demand which arises not from considerations of prestige or security or race, but from considerations of real income other than prestige or security : a demand which arises because it is claimed that the citizens will be better off as regards the ordinary goods of private life if the territories of their state are wider.

Now there are various ways in which this demand may be examined. But for my present purposes it is probably best approached by the investigation of a general question. I propose to enquire what are the economic advantages of wide possessions, or, to put it in a way which I think we shall find more helpful at a critical stage of our enquiries, what are the economic disadvantages of the absence of wide possessions ? In what way are those ingredients in real in-

comes, which we attempt to measure statistically, affected by the width of the territory in which the recipients of the real incomes reside ? It is to the solution of this problem that I ask you to direct your attention this evening.

(2) Property and Territory

To get clear views on this subject we must start by recognizing a distinction which the usages of everyday speech are in continual danger of confusing, the distinction between *property* and *territory*. In the English language at least we are apt to use the word " own " in connection with each of these concepts. We say a man owns a farm or a workshop or a share in an industrial undertaking. We also say that the citizens of a state own the territory over which the state has jurisdiction : we say Holland owns Java, Great Britain owns Jamaica, and although no doubt in each case the use of the word is legitimate, it is fundamentally important to realize that it implies quite a different relationship. In the one case it implies property rights, in the other territorial jurisdiction.

Now, perhaps in earlier times this distinction may have been blurred. In primitive societies, the distinction between property rights collectively enjoyed and the territorial jurisdiction of the society in which these rights were observed

must have been very difficult to draw. But in modern times, at any rate until the coming of collectivism, the tendency has been for the distinction to become more and more definite. Certainly, from the legal point of view, there is an obvious distinction between one's rights to the disposal of particular items of property and one's general rights as a citizen of a state with a jurisdiction over a certain area.

Now, there is an economic distinction corresponding to this which is no less unequivocal and which is fundamental to our investigation. In the case of property we can say quite definitely that, other things being equal, real incomes vary with its extent. The more property a man has, the higher his income. But with territorial jurisdiction there is no such clear connection. It may be that, indirectly, the real incomes of the citizens are influenced by the area of the jurisdiction of the state. This is indeed the question which we have to investigate. But certainly the connection is not immediate. The income of the average citizen of Great Britain is not directly increased by the " ownership " of Jamaica by the state in which he happens to live.

We can perhaps see this more vividly if for the moment we examine the respective advantages of property rights and citizenship, in areas other than the areas ruled by sovereign states.

It is obvious that, if a man living in one local government area happens to own property in another local government area, to that extent he is better off; the greater his property, the greater his income. But it is not at all obvious that he would necessarily be any better off if his local government area and the areas adjacent to it were to be placed under one common authority. It is quite possible that there might be an indirect benefit if the original areas were inconvenient for carrying out certain administrative functions; up to a point there might be an economy of expenditure in the operation of a larger unit. It is possible that the value of property in one area might be such as to afford the possibility of considerable tax relief to the citizens of the poorer areas which come into the common pool. Such advantages may not be negligible. But they are quite different from the direct advantages or disadvantages of more or less property.

Exactly the same considerations apply when the areas under consideration are sovereign states. It is a direct advantage to the citizen of Great Britain to own property anywhere, at home or abroad. He gets an income from it. But if it is an advantage to him for his government to "own" extensive areas elsewhere, it is an advantage of quite a different nature. It is this advantage which we have to analyse.

(3) The Fallacies of Economic Nationalism

Before we can proceed directly to this task it is necessary for us to rid ourselves of certain modes of expression which are an obstacle to a correct understanding of the problem. We are often told that it is necessary that the state should have wide territories in order that its citizens may enjoy a sufficiency of raw materials. We are told that wide territories are necessary to provide sufficient opportunities for investment and migration. We are even told that they are necessary in order that the national bank may have an adequate supply of foreign exchange to meet the external obligations of its citizens. As we shall see later on, there may be some core of truth underlying such views. But as they are stated here they are fallacious. If we are to understand wherein the true advantages of wide possessions consist, it is essential that we should eschew such modes of expression.

Let us first start with the raw material argument. At first sight it may seem overwhelmingly plausible to argue that wide possessions are necessary in order to obtain a sufficiency of raw materials. But it is certainly not true. Whether to buy cotton from India or America is no doubt an important question for the individual cotton spinner in Great Britain. But, from his point of view, it is a question of technical quality and

price. In either case the import will have to be paid for; and, price and technical quality being the same, his resources will be diminished by an equal amount by a purchase from either centre. Price and quality being the same, from the accounting point of view, a purchase from another *country* is no different from a purchase from another *county*. During the nineteenth century the bulk of the raw cotton used by the Lancashire cotton industry was procured from the United States of America. It has yet to be shown that the necessity of paying for it was less arduous than would have been the case had the United States remained within the Empire and evolved into a self-governing dominion.

The argument that wide possessions are necessary for adequate investment opportunities rests on no better foundation. It is quite untrue that advantageous investment is impossible outside the area of jurisdiction of the state to which the investor belongs. Provided that, in the area in which investment is made, contracts are enforced and a certain minimum of security is preserved, the fact that it is under a different government need not militate against its attractions as an area for investment. In the nineteenth century the citizens of Great Britain invested more in the United States of America than they invested in any particular part of the Empire. It is probable that European external investment in general

has gone more to areas not under European jurisdiction than to the various European colonies.

Similarly with migration. It is certainly not necessary that a state should own wide territories in order that its citizens should be able to migrate. During the nineteenth century migration from Great Britain to the United States was probably greater than the migration to the Dominions or to the Colonial Empire. And Continental migration in general has been predominantly to areas not owned by the Continental powers — much to the disgust of militarists and mystic reactionaries.

Finally, it is really quite absurd to argue that the supply of foreign exchange is directly affected by the extent of the imperial dominions. When Dr. Schacht buys nickel from Canada his resources of foreign exchange are indeed depleted. But so, too, are ours if we make a similar purchase. No doubt if Canada and Great Britain enjoyed a common currency, the business of transfer would be less liable to go wrong than it is when different currencies are in use. But this is not because under a common currency the business of transfer does not involve a burden; rather it is because, under such arrangements, the banking system carries out automatically certain unpleasant adjustments in the distribution of money in different parts of the common area, which, with different currencies and different banking

systems, may not be carried through so quickly.[1] If they are carried through, then differences in currency arrangements are no obstacle to the possession of an adequate supply of foreign exchange.

(4) The Positive Gains of Empire

So much by way of clearing the ground. Now let us proceed to attempt to furnish a definite answer to our question. What are the economic advantages of size ?

To do this a certain division of our subject matter is desirable. I propose to divide the advantages of wide territories into two groups, positive advantages and negative advantages. Positive advantages are conditions which bring it about that real income is definitely raised by reason of their existence. Negative advantages are conditions which bring it about that real income is not definitely lowered. The distinction is rough but for the purposes of exposition it will serve.

Let us proceed then first to examine the positive advantages. Here too we shall find some division of material desirable. We may divide our investigations according to the

[1] See Hayek, *Monetary Nationalism and International Stability*, and the chapter on International Money in my *Economic Planning and International Order*.

assumptions we make concerning the nature of commercial policies. Let us therefore divide our enquiry into two parts. In the first we may assume that the commercial policy pursued is one of free trade, free investment and free migration. We may then drop this assumption and explore the possibilities of other forms of policy.

On the assumption of free trade, free migration and free investment, the positive advantages of wide possessions are small. There is a certain advantage in a common law and common language which even the absence of legal discrimination does not altogether remove. It is a fact that, even under a liberal commercial policy, some trade does tend to follow the flag. But it should be observed that common law and common language are not necessarily associated with common sovereignty. So long as the legal institutions of different states conform to a common type, there is even a certain advantage if some of the expense of maintaining law and order is borne by the nationals of other areas. As we shall see later on, the expenses of administering colonial possessions may be very great. If they are borne by states who do not practise discrimination in favour of their own nationals, this may be a definite gain for the inhabitants of other areas. It used to be argued that the break-away of the North American

colonies proved in this way to be a definite advantage to Great Britain. We continued to have the trade, but we ceased to have the responsibility. This is perhaps debatable. But the fact that it has been urged by serious authorities is significant. Broadly speaking, under liberal conditions, the positive advantages of empire are not great.

If we drop the assumption of liberal trade policy, the possibilities of positive gain from wide territorial possessions seem at first sight to be more considerable.

It is highly doubtful whether a policy of restrictionism in regard to trade and investment can be regarded as being likely to be beneficial to the real income of the majority of the inhabitants of the area as a whole. Theoretical economics shows us certain conceivable possibilities of snatching advantages in trade by restrictionist commercial policies. It is possible that the larger the state, the greater is the opportunity of such gains. But, speaking broadly, these arguments are not very convincing. The theoretical considerations on which they rest assume implicitly that other things in the rest of the world remain unaltered, that restrictionism is not met with restrictionism and that the ill-effects of the erection of obstacles do not involve the erection of still further obstacles elsewhere. On the whole, taking the long view, nothing that

has been said in recent years really shakes the proposition that, for the majority of the citizens, a liberal policy as regards trade with the rest of the world is most conducive to the satisfaction of demand.

But if we are willing to consider the interests of particular groups within the sovereign state, then obviously possibilities of gain present themselves. It is clearly possible for the members of one industrial group to gain by restrictions which damage the rest of the community. And it may sometimes be possible for the inhabitants of a metropolitan area to gain at the expense of colonial areas. The possibilities of gain by the imposition of direct tribute are obvious. But perhaps in the modern world they need not be taken very seriously. Much more important is the possibility of gain by the imposition of restriction on freedom of consumption, etc. If, for instance, the inhabitants of colonial areas are forbidden to buy save in the metropolitan area, if they are forbidden to give contracts save to tenders from the metropolitan area, it is quite conceivable that some gain to the latter may arise.

It is not difficult to illustrate this possibility. At the present time there can be no doubt that the incomes of the landlords of East Prussia benefit considerably by the fact that German consumers of certain agricultural products coming from East Prussia are prevented by high tariffs

from buying in cheaper markets. If East Prussia were a separate state, cut off from the rest of Germany and unable to enforce the imposition of such restrictions, the value of land and the incomes of the landlords would be considerably lower. Similarly, in recent years the incomes of textile manufacturers and workers in Lancashire have benefited by the quota restrictions which have been imposed in certain parts of the British Empire on the purchase of cheap goods from Japan. The consumers are worse off. The producers benefit.

Both these examples refer to gains on the part of particular groups of producers. So far our diagnosis would be generally accepted. It has sometimes been denied, however, that gains of this sort may be enjoyed by the majority of the members of a metropolitan area. It is agreed that it is possible that particular lines of industry may benefit from this type of restriction. But since, if competitive conditions prevail, more capital and labour will tend to go to the industries thus privileged, it is argued that after a time these gains will be wiped out. It was on such lines that the great liberal utilitarian, Jeremy Bentham, argued to the French Revolutionary Assembly that they should emancipate their colonies. The gains of empire, he argued, were either completely sectional or else completely illusory.

Now, on general grounds there is much to be said for this position. But on the strictly analytical grounds adduced the argument is fallacious. If the demand of a colonial area is restricted to the products of the factors of production of the metropolitan area, then even when there has been such a reshuffling of the factors of production that all relative gains are wiped out, it is still possible that the terms of trade may have moved in favour of the metropolitan area. It is still possible, that is to say, that the majority of the inhabitants of that area may be better off because their services and the services of the other local factors of production are in higher demand than would otherwise be the case.

How important all this is from a practical point of view is a question which is very difficult to answer. It is perhaps arguable that gains of this sort may be very greatly exaggerated. As we shall see in a moment, when we look at the costs, there is much to be said for this view. Nevertheless we must admit that exploitation of this sort is possible, and we must admit, too, that it is probable that it sometimes occurs. Certainly some groups in metropolitan areas do gain from discrimination in public contracts. It is probable that some at least of their gain is diffused among other classes.

(5) The Positive Costs of Empire

But before we conclude that such gains are very important, it is desirable to look at the other side of the account. It is notorious that if colonial exploitation is carried very far, discontent is provoked. The mere cost of maintaining political ascendency may vastly exceed the gain. The experience of Great Britain under the Old Colonial System was certainly not such as to encourage high hopes in this respect.

Quite apart from this, however, the actual cost of maintaining the governments and defences of colonial dependencies is capable of being seriously under-estimated. This is a matter which has not received from economic historians the attention which their not infrequent infatuation for the economic advantages of empire would have led one to expect. The costs of empire have not been investigated as minutely as might be wished. Quite recently, however, Mr. Grover Clark, of the Carnegie Foundation, has attempted to furnish some estimates, with results which are truly remarkable.[1]

Let me quote to you a few of his figures. We may take first the German experience in this respect. Mr. Clark computes that, during the years 1894 to 1913, the German expenditure on the colonial empire, exclusive of defence, was in

[1] Grover Clark, *The Balance Sheets of Imperialism.*

the neighbourhood of 1002 million marks. In the same period the total German trade with the empire was 972 million marks. These figures take no account of expenditure on the German navy or of any of the expenditure on the Great War.

Similarly with Italy. Mr. Clark computes that, from 1893 to 1932, 6856 million lire were expended on the direct cost of government of the Italian colonies. In the same period the volume of trade was of the order of magnitude of 5561 million lire. The British figures are much harder to compute. The Colonial Empire is partly self-sufficing as regards the direct expenses of government. But it is at least legitimate to attribute to the trade with the Empire some part of the expense of defence. If we take trade with the Empire between 1894 and 1934 as 31 per cent of our total trade with the rest of the world, we shall find that on that basis the amount of defence expenditure which may be regarded as its share was £1295 millions. . . . And so I could go on, but I hope I have said enough to persuade you that, if we have regard to the costs, the positive gains of wide possessions, even to members of the metropolitan areas, are capable of great exaggeration.

(6) The Negative Gains of Empire

I imagine that by this time some of you must be feeling very rebellious. The tendency of my remarks so far has been to suggest that the positive advantages of large governmental areas may be greatly over-estimated. And no doubt you feel that there is a catch in all this — that no matter what may be the result of all this analysis and computation, wide territorial possessions do matter very much indeed.

Of course you are completely right. It is indeed an advantage to belong to a state with wide territories — a great advantage. But, as I conceive it, it is an advantage not because policies of the kind I have been discussing are able greatly to *raise* real incomes. It is an advantage rather because, within such territories, there is an absence of restrictions which might *lower* real incomes. If part of the territory were owned by another state, that state might impose limitations on trade, on investment, on migration, which would limit the division of labour and make the value of the local factors of production less. That is to say, using the terminology I have already suggested, the real advantages of territorial possessions are negative rather than positive. They are a safeguard against certain ills rather than a means of positive advancement.

A simple example should make this clear. If, in the days when the colonial dependencies of the British Empire were run on free-trade, open-door lines, those dependencies had been handed over to some international authority to be run on lines exactly similar, it is very doubtful whether there would have been any substantial economic loss. It is possible that the international authority might have carried the policy of the open door in regard to government contracts even further than it was carried by the authorities of the Empire. To that extent certain contractors in Great Britain might have suffered; certain contractors outside the Empire might have gained. There would have been some loss of opportunity of employment in the colonial services for university graduates. But, speaking broadly, the effect would have been negligible. The organization of administration would have been different but the network of economic relationships would have been the same.

But if, instead of this, the Colonial Empire were to be confiscated by some power practising, not the policy of the open door, but the policy of restriction, the position would be very different. The market for our products would be restricted. The channels for investment would be narrowed. Migration possibilities would be reduced. There can be no doubt at all that if the British Empire, including the self-governing Dominions, were to

fall into the hands of a power actively discriminating against Great Britain it would be a very great disaster indeed for the inhabitants of this island. The balance of trade would turn against them; their real incomes would be lower; and if the transition were at all abrupt, there would be a crisis of the very first order of magnitude.

Here at last then we are at the very heart of our subject. It is not in the power to manipulate or to restrict trade that the advantages of wide territorial jurisdiction consist, but rather in immunity from the manipulations and restrictions which might be practised by other states if the area of jurisdiction were narrowed. The British Empire is not an asset in the sense that the policy of exclusion permits large positive gains at the expense of the rest of the world. It is doubtful whether the discriminatory arrangements within the Empire secure even sectional gains which are anything like as considerable as they are often represented to be. But in so far as, for the inhabitants of the Empire, it keeps open at least some channels of economic freedom, it means that the division of labour is more extensive, the productivity of the factors of production is greater than might otherwise have been the case. As a safeguard against loss it is very important indeed.

Now, if we recognize this we must recognize

that the erroneous arguments with regard to the advantages of wide possessions, which we examined earlier in the lecture, can be re-stated in such a way as to have very considerable cogency. It is not true that it is necessary to have governmental jurisdiction over wide territories in order to have a sufficient supply of raw materials. But it is true that, if the consumers of other territories are prevented by their governments from buying your products, it is more difficult to buy from them: real incomes are lower; the power to purchase foreign products is reduced. It is not true that it is necessary to possess governmental jurisdiction over wide territories in order to have investment opportunities there. But it is true that if other governments discriminate against foreign investments, then your investment opportunities are restricted. It is not true that it is necessary to have governmental jurisdiction over wide territories in order that migration may be possible. But it is true that if other governments restrict migration, then the home population may have to work at margins of lower productivity. It is not true that in order to have a sufficient supply of foreign exchange it is necessary to have governmental jurisdiction over a wide area. But it is true that if the governments of other areas erect new barriers against your products there may arise a need for a relative contraction of

money incomes if the supply of foreign exchange available is not to be restricted. If the governments of the " satisfied " states do not practise restrictionism, then on economic grounds the case of the " unsatisfied " is weak. But if restrictionism is generally practised, they have a case which is very difficult to answer. The root of the trouble is not inequality of territory, but the prevalence of discrimination.

(7) The Haves and the Have-nots

If this diagnosis is correct, the position of the world is serious. For restriction is indeed prevalent. Though they may not know how to put their case, the " unsatisfied " powers have indeed a very real grievance.

Let us take, for instance, the case of Germany. It is not true, as for propagandist reasons is sometimes contended, that great economic damage was done to Germany by the confiscation of the German colonial empire. The justice of that act may be disputed. The expediency on general grounds of some gesture of reconciliation is a matter on which we certainly do well to preserve an open mind. But, economically, the effect was of the second order of smalls. The real grievance lies not here at all but in the exclusion from free intercourse with wider areas — in the restriction of outlets for German exports which

has resulted from the Hawley-Smoot tariff and the Ottawa system, in the general limitation of migration in the post-war years and in suchlike restrictionist measures. It is very difficult to believe that if the Germans were in a superior position they would eschew these restrictive practices. It would not be difficult to show that the prevalence of restrictive imperialism owes much to German inspiration. It was the sycophantic German intellectuals who provided the ammunition for the reaction against liberal internationalism the world over — the great *trahison des clercs* of European history. But however much we may hate the dominant German outlook, it is not open to us to deny that Germans do suffer from the prevalence of these practices.

Similarly with Japan. Indeed the Japanese case is much more flagrant. Staggering beneath the onset of the Great Depression, which affected especially the markets for their main export, the Japanese turned elsewhere for outlets for their products. They have been met almost universally by restrictions, not merely by tariffs but by deliberately discriminating quotas. When I read of the great reduction of Japanese exports to certain parts of the world under the government of Western powers, which has followed the application of these measures, I cannot help remembering that it is not yet a hundred years since the Western powers thought it justifiable

to send warships and armies to the East to open up the channels of trade; and I ask myself to what principle of justice will the West appeal if the East attempts to follow this precedent.[1]

Let us be under no illusion. So long as the richer powers practise exclusion, so long can the poorer say with truth: "Our poverty is greater because of their policy. Our misery would be less if their barriers were shattered." It is not a pleasant thought.

(8) Federation the only Remedy

But I shall have failed altogether if what I have had to say leaves you with the impression that the remedy for all this lies in the transfer of territory. In certain cases transfers of territory may be desirable on other grounds. But so long as the authorities of the various states act as if the territories over which they have jurisdiction were not territories but property, private estates —private preserves for their own citizens—there is no way out of the *impasse*. Even if you could imagine a re-partition of the world which for the

[1] This was written before the commencement of the present war with China. I would say nothing to extenuate this ghastly crime against humanity. But I should be glad to think that some of those leaders of English opinion who wrote so glibly to *The Times* and the *Manchester Guardian* on the necessity of checking Japanese exports in the interest of Lancashire cotton could have it brought home to them that they, too, are not wholly guiltless of the desolation of the Chinese peasantry and the murder of women and children. The downfall of liberalism in Japan is not unconnected with English trade policy.

time being would secure contentment between the various states, there can be no security that it would last if these principles were adhered to. The people who think that it is merely a question of one gigantic act of altruism as regards the division of territory, do more credit to their hearts than to their heads. For the general conditions of consumption and production are continually changing. A settlement which produced equality between the citizens of different areas at one time might well be a settlement involving gross inequality when conditions have altered. So long as the right of territorial jurisdiction carries with it the right of restriction, so long the war of all against all is implicit; and real war will not be infrequent.

Nor is there any way out by national expropriation of private property, firmly as this belief is held by many sincere internationalists. Indeed, there can be little doubt that national socialism of this sort would render the inequality of the citizens of different states even more obvious, and, it is to be feared, even more permanent than ever before. To make the *territories* of the different states the actual *property* of the citizens *qua* citizens would make things worse, not better.[1] National socialism is no step for-

[1] Is it to be supposed, for instance, that if the land and industries of Australia were nationalized, the inhabitants of that country would be any more eager to share their continent with the less fortunate ?

wards to internationalism — either liberal or communist. It is a step in the reverse direction.

The only way out is the total abandonment of restrictionist policies and the construction of an international political system under which such policies cannot arise, a system under which the political administration of countries no more than the political administration of counties or provinces is allowed to serve the purpose of local monopoly. The national states must learn to regard their functions as the functions of international local government. They may assist in the development of the territory over which they have jurisdiction. But, no more than existing local government authorities, must they restrict the interlocal movement of mobile products and resources. If the national states in their present form cannot be trusted to abstain from such measures, then the national states must give way to forms of federation which will make such measures illegal. This may seem very utopian at the moment.[1] But whether we live

[1] Perhaps I may be permitted to add, in the early days of 1939, that so far from regarding such a policy as utopian, I myself regard it as one of the few hopes of still saving Western democracy. If the vision of our leaders were not so limited, they would speedily realize that something like federal arrangements as regards defence and foreign policy, at least with France and preferably with as many other Western powers as care to join in is the only certain method now left to us of building a Byzantium of the West in which liberty and decency can be preserved until the forces of barbarism which have conquered the rest of Europe have spent themselves. The strength of the totalitarian powers is the disunity of the democracies. It is not the attitude of federalists but the attitude of those who

to see it or not, sooner or later it must come. National restrictionism can no more co-exist with modern weapons and modern technique of communication than feudal restrictionism could co-exist with gunpowder and the discoveries of the Renaissance. And who that is sane will regret its disappearance ? Sectional groups may indeed suffer from the abolition of nationalist restriction, but the great mass of the people have nothing to lose but poverty and the risk of violent death.

think they can preserve both liberty and national separatism which really deserves the epithet utopian. It is not international liberals but the *soi-disant* practical politicians who still live in cloud-cuckoo land.

V

THE CAUSES OF INCREASED PROTECTIONISM [1]

(1) Introduction

The object of this memorandum is to examine the fundamental reasons for the great increase of protectionism which has been characteristic of the commercial policies of the last half-century.

We can all agree that this increase is something which needs to be explained. The last half-century has been a period of rapid increase of all means of communication. The railway systems of the world have been extended and consolidated. Shipping services have been increased and made more reliable. Today the aeroplane is making distance still more negligible. Yet, in spite of all this, we find that the nations of the world are busily engaged in erecting ever greater and greater obstacles to the increased volume of trade which these developments make possible. An inhabitant of another planet, informed of the scientific

[1] A memorandum prepared for the Joint Committee of the Carnegie Endowment and the International Chamber of Commerce and reprinted from the publication of that body, entitled *The Improvement of Commercial Relations between Nations: the Problem of Monetary Stabilization.*

progress of the last hundred years, might expect to discover a world organized to take advantage of the increased division of labour which these increased facilities for communication permit. If he actually paid a visit of inspection he would find the queer animals which inhabit this earth devoting much of their energy to what must appear to be a sort of self-frustration, destroying with one hand the riches which the other has created.

Why has this come about ?

(2) National Interest and Protectionism

If the different parts of the world were organized into one state, there is no reason to suppose that the existence of inter-local obstacles to trade would be regarded as desirable. It has been characteristic of the development of modern states that, within their boundaries, the obstacles to trade have been removed. The formation of the German Empire, the reforms of the French Revolution, are conspicuous examples of a process which, when there has existed a sufficiently powerful state machine, has everywhere been thought to be desirable. If by the accident of history the Roman Empire had persisted and its dominions had been continuously coterminous with the borders of the known world, it is hard to believe that the persistence of local barriers

to free exchange would have been thought to be consistent with the greatest benefit of the majority of its inhabitants. Whether a world state was organized on individualist or on socialist lines, a division of labour not limited by artificial territorial divisions would clearly be in the interests of the majority of its citizens.

But the world is not organized on these lines. It is organized into a number of territorial groups, constituted very largely as a result of historical accident. The controllers of these states do not profess to legislate for the benefit of the world as a whole. They claim only to legislate for the benefit of their own members ; and though from time to time they may pay lip-service to international solidarity — this is much less obligatory now than it used to be — there can be no doubt that if there were a conflict between the interests of the world as a whole and those of their own group they would unhesitatingly choose the latter.

It follows therefore, if we are to examine the evolution of policy, that we must take as our starting point the interests, real or imaginary, of the national state. We need not enquire why the economic activities of the world as a whole are not deliberately organized with a view to the benefit of the majority of its inhabitants ; given the absence of an international authority, there is no problem there. We must ask rather why

it is that the policies of the different national states are such as to create international disharmony.

Now, it is conceivable that there may be a real clash between the interests of the world as a whole as regards trade and the interests of particular national groups. As we shall see later on, it is doubtful whether real clashes of this sort have played a very large part in bringing about the present international chaos. But it is obviously possible that such clashes may exist; and in a vague way, many people believe that they do exist. It will be convenient therefore to commence our investigation by enquiring in what way they may arise.

To do this, two issues must be very clearly separated. We must separate the question of what people want, of how they conceive their interests, from the question of how best they actually may secure what they want. It is obvious that disharmonies may arise, either as a result of differences of ultimate aim, or as a result of differences in opinion as to the best way in which ultimate aims may be realized. It is conceivable that the different nations of the earth may entertain fundamentally different conceptions regarding the ultimate aims of national policy and that disharmony may arise in this way. Or it is conceivable that they may each be striving after the same thing and yet,

by reason of differences of opinion regarding the best way to get it, their policies may create disharmony.

Let us commence with disharmonies originating in the ultimate aims of policy. If the government of a particular area regards it as an end in itself that the organization of production should be self-sufficient, it is obvious that its trade policy will be inimical to international division of labour. From time to time such ideals of self-sufficiency have indeed exercised some influence on political thought. It was held by Plato and other Greek philosophers that foreign trade was in itself to be regarded as inimical to the atmosphere of the ideal state. The austerity of the alleged self-sufficiency of Sparta was contrasted favourably with the cosmopolitan atmosphere of Athens, whose prosperity depended on foreign trade. In recent times similar views have been held by less worthy and less interesting writers: Fichte, Adam Müller and the so-called Romantic school of German economists, whose writings have unquestionably influenced the thought of the leaders of present-day Germany, exalted the idea of the *Geschlossene Handelsstaat.* To eat home-grown rhubarb has been held to be more virtuous than the consumption of the foreign lemon. But it is doubtful how far ideas of this sort have been responsible for the development of policy. From time to time they may

have been used to defend measures introduced for other reasons. But although at the present time they are undoubtedly rapidly attaining great ascendancy in those parts of the world now given over to barbarism, their influence on policy elsewhere has probably not been very great.

But although it is possible to exaggerate the influence of the idea of self-sufficiency as a means of preserving the characteristic *ethos* of the national state, it is important not to underestimate the influence of the ideal of economic self-sufficiency, regarded, not as an end in itself, but as a means of military defence. It has always been conceded by free traders that, if the location of any particular form of production within the borders of the national state was regarded as essential to security against outside attacks, then measures designed to foster this industry could not be regarded as contrary to national policy. Even before the Great War considerations of this sort played some part in the determination of policy. The German agrarian policy was defended on military grounds. Since the war, experience of the difficulties which may arise in case of blockade or widespread interruption of international commerce has led to a vast extension of such measures. The extensive protection of industries capable of being used for munition-making has also been defended on this ground.

The cost of such measures is obvious. The factors of production which are used for producing expensive supplies at home might have been used to obtain them less expensively from abroad by exchanging goods for whose production local conditions are better fitted. It is arguable moreover that, even granting the necessity for regarding the danger of war as a permanent factor in international relations, much protection is ill-conceived. The experience of the last war, while it undoubtedly shows the value of security from blockade, has shown also the advantages of the riches which come from international commerce. It is not possible to have both of these, and it is not certain that in the majority of cases the latter is of less importance. But in recent years such considerations have tended to lose influence. As the danger of widespread international conflict becomes more acute, the area of military protectionism increases.

It is possible, however, to regard policies based on circumstances of this kind as being essentially abnormal. It is still arguable that the average citizen, even the citizen of the lands of hatred and mass murder, regards war as an evil which ought eventually to be eliminated, and conceives the main object of policy to be the inception of conditions in which the non-military requirements of the race are satisfied as far as the niggardly provisions of nature make possible.

It is arguable, that is to say, that the main aims of national policy may still be conceived as being the maximization of the ingredients of real incomes other than security and military power. We may proceed therefore to enquire whether, in the realization of such aims, the interest of one national group may conflict with the interests of others, that is to say, whether one country can gain by a policy of trade restriction.

Now, it is certainly possible to conceive of cases in which, by erecting obstacles to trade, one national group may gain at the expense of others. Theoretical economics demonstrates clearly that, in certain circumstances, it is possible that a tariff may have the effect of turning the " terms of trade " in favour of the inhabitants of the country imposing the tariff — that is to say, of bringing it about that they get more imports for a given quantity of exports. This, after all, is only what we should expect from the most general propositions of the theory of exchange. We know that if particular groups of producers happen to occupy a position of strategic advantage in the market, then by suitable restrictions they can secure monopolistic gains. Obviously this must apply not only to industrial groups but to geographical groups also.

In fact, however, it is possible greatly to over-estimate the applicability of this argument. The circumstances in which an unequivocal gain

of this sort is realizable do not often occur in practice. The geographical group which attempts to turn the terms of trade in its favour will find, as likely as not, that it is merely invoking new competition in other quarters. Moreover, the whole argument depends upon the assumption that conditions in the outside world remain unchanged, that other nations pursue a passive policy in the face of isolated protection. In practice these conditions are not likely to be realized. The erection of a protective tariff by the members of one national group is likely to be countered by the erection of protective tariffs elsewhere ; and though it is not *certain* that all the possible gains will be cancelled out, the probabilities are overwhelmingly in favour, not merely of cancellation, but also of net impoverishment all round.

Exactly the same considerations apply to the other arguments by which it is attempted to establish the possibility of a permanent gain from the erection of protective tariffs. Other things being equal, for instance, it is possible that the erection of a bargaining tariff may result in a lowering of tariffs, in which case these tactical manœuvres will have been productive of lasting benefit. But experience suggests that in practice other things are not equal. It is probable that the erection of a bargaining tariff will bring about a situation in which that tariff

becomes permanent — to say nothing of the increases elsewhere which its erection may have occasioned. Similarly, it has always been conceded that cases are conceivable where protection to infant industries may result in national benefit. But again experience shows that such a form of assistance is almost always abused. The industry is called into being and the tariff is not removed. If there be a case for the fostering of infant industries by national states, a subsidy rather than a tariff seems to be the appropriate instrument: it is much less likely to be prolonged once the occasion for its use has disappeared.

The foregoing arguments apply to the possible long-run gains from protection. It appears that the prospects of such gains are very slender. If we restrict our view to the immediate effects, however, there are other cases where some benefit may be conceived. If a tariff is imposed at a time when trade is bad and a considerable margin of the factors of production are unemployed, it is possible that the result may be a net gain of production; though it is almost certain that the gain involved will not be as great as that which might have been achieved if the unemployed factors of production had been re-employed by recovery under free trade conditions. It is possible, too, that if a general tariff is imposed at a time when the central bank of the country, imposing the tariff, is losing gold, some credit

contraction may be made unnecessary, though the tariff itself will be productive of some permanent maldistribution of resources and its existence will be no safeguard whatever against a similar drain of gold in the future.

It is notorious that arguments of this sort have played a considerable part in determining the policies which have been actually adopted during the recent depression. But the result of such policies indicates the consideration which has obviously been overlooked. If, in an otherwise stable world, a single nation has recourse to such policies, it may conceivably snatch for itself some gain — or, perhaps better said, some avoidance of loss. But if such policies are applied simultaneously by a number of nations, their effects, so far from being productive of gain all round, have in fact cumulative results of a negative order. If all countries impose emergency tariffs at a time of crisis, the effect is likely to be deflationary. More unemployment is produced than would have occurred in the absence of such policies. It is probably true that much of the increase in the height of international obstacles to trade has taken place in this way. But it is difficult to argue that the world is richer than it would have been if no such increase had taken place.

In recent years the case for trade restriction has sometimes been argued from a different

point of view. It has been defended as a policy of national planning. To protect planned industry at home it is necessary, it is said, to restrict foreign imports. The tariff is essentially to be regarded as an instrument of that " scientific " control of economic activity which is to replace the individualistic " chaos " of the free market and private enterprise.

Such a view, however, betrays a most paradoxical conception of the aims of national planning. If national planning is intended to bring " economic " advantage — if, that is to say, it is desired for the sake of " wealth " rather than military power, aesthetically pleasing lay-out of the countryside, etc. — it must surely be designed to use the national resources in the most productive manner. Now, resources will not be used in the most productive manner if they are used to produce at home what could be obtained more cheaply from abroad. It is the essence of the case for free exchange that it permits local resources to be specialized to produce the things which they are best fitted to produce and thus to procure, by way of exchange from abroad, *more* of the things which they cannot produce so efficiently at home. A national plan which does not proceed on the same principle is not a national plan but a national muddle.

Against all this, however, and against the case for free trade in general, it is sometimes argued

that the advantages of international division of labour are really very small. The technique of modern machine production, it is said, renders the location of industry a matter of comparative unimportance. There may be some sacrifice in greater self-sufficiency; but it is more than compensated by the greater stability of a more autonomous system. Such arguments find support, not only among those who attach importance to the abracadabra of planning, but also among those monetary reformers who hold that their attempts to secure the advantages of a constant domestic price level would be considerably eased by the diminution of the dependence of particular industries on events in other parts of the world.

All this is surely very much in the air. The sacrifices involved by a policy of self-sufficiency must depend essentially upon the size and natural equipment of the particular national area in question. They would be one thing for an area such as the United States, another for an area such as Belgium or Holland. It is perhaps arguable that, *if* the benefits to be secured by a policy of national planning undisturbed by outside forces were very great, an area such as the United States might make such an experiment without catastrophic impoverishment. But for smaller areas, more dependent upon international trade, such a policy would inevitably be catastrophic. Vague talk about national planning

which takes no account of the differences in the international situation of different national areas is not merely useless, it is positively misleading.

Further enquiry only tends to strengthen this conclusion. If modern machine technique is to be maintained (and it is the existence of modern machine technique which is usually the pretext for this type of argument), it is clearly impossible that the different national areas should become entirely self-sufficient. The necessity for obtaining raw-material supplies makes that out of the question for almost every national area in the world. Yet, if trade in raw materials is to continue, there must be also some trade in finished products. The distribution of natural resources between the different national areas is not such as to permit trade to be carried on only by the exchange of one kind of raw material for others. If the exporters of raw materials refuse to import manufactured articles, then the would-be importers of raw materials will be unable to secure the means of paying for them. The dislocation which would thus be occasioned in a world which hitherto had been organized for fairly extensive international trade for all must more than counterbalance the extremely doubtful benefits of increased national planning. The distribution of men and natural resources in different parts of the world is not such as to permit the existing national areas to plan far towards self-sufficiency

without danger of grave loss. Here as elsewhere the belief that it can be otherwise rests on the naive assumption that, while one nation plans to produce everything save raw materials at home, others will pursue a more or less free trade policy.

But even if this were not so, it would still be untrue to argue that the existence of modern technique renders the international division of labour any less advantageous. The case for international division of labour rests on differences of costs. So long as the costs of production of different commodities are different in different areas, so long will it be advantageous for each area to specialize on producing those things in which its costs of production are least and to procure the rest by way of exchange from elsewhere. And these cost differences depend in the last resort on the different relative scarcities in the different parts of the world of the different factors of production — depend, that is to say, on the existence of differences of efficiency wages, differences of rents, differences of raw-material costs, differences of transport charges, etc. And there is really no presumption that modern technique renders any less essential nice attention to these particulars. Rather the contrary indeed. Moreover, in so far as the achievement of the economies of large-scale production depends upon large markets, the general case against trade

restriction is all the greater. There may be some national areas, such as the United States of America, offering so wide a market that the maximum economies of mass production can be secured at home. But in the majority of cases it is safe to say that limitations on trade are a definite hindrance to the achievement of these economies. The world would be much richer today if markets were more extensive.

(3) The Causes of Increased Protectionism

If all this is true it follows that, save as a means of securing military security — and a rather dubious means at that — policies of protection are not likely to secure to the inhabitants of different nations any of the aims which most of them would acknowledge if they were seriously to reflect on these matters. The problem we are trying to solve, the problem, namely, of the causes of the increased protectionism characteristic of the last fifty years of world history, finds no solution in consideration of the actual benefits to be secured by policies of restrictionism. The phenomenon of increased protectionism is essentially a manifestation of irrationality.

What, then, are the roots of this irrationality, and why is it more prevalent at the present day than in earlier times ? To see this it is necessary to look a little more closely at the influences

shaping policy and the general conditions under which these influences are exerted.

It is a fundamental argument for free trade that the market tends to bring about that specialization of the use of national resources which is conducive to the greatest national income measured in price terms. But this argument, while it promises advantage for the majority of the inhabitants of the national area, does not promise advantage for lines of industry in which the comparative advantage of the area in question is less. The process whereby, under free trade, international division of labour is brought about, has thus a double aspect. It brings prosperity and expansion to those industries in which the advantages of local specialization are greatest, but it brings loss and depression to those industries whose products it is more expedient to obtain by way of exchange from elsewhere. The argument of those free traders who sometimes suggest that the disappearance of any industry as a result of foreign competition is the result of gross inefficiency on the part of the management of that industry is false. Under free trade conditions an area cannot keep within its borders branches of *all* types of industry ; it will keep only those branches in which it has the greatest comparative advantage, the rest will tend to disappear. It is childish to suppose that we can have at once the benefits of territorial division

of labour and the range of industries characteristic of national isolation.

Now, in conditions of equilibrium such a state of affairs would be advantageous for everyone. But equilibrium seldom exists. The general conditions of supply and demand are continually changing, and with them must change the conditions of most advantageous specialization. In such circumstances some groups suffer disadvantage. Unless the members of these groups are willing to transfer their services to other lines of production they may suffer some impoverishment. Such cases of hardship attract attention. The general public, which, as Bastiat explained, is always more impressed by what is seen than by what is not seen, perceives the losses of the groups which are being squeezed and tends to ignore the general gains which are made elsewhere. Unless there exists a body of vigilant and informed opinion continuously active to resist the appeals of special interests for protective measures, the tendency to impose such measures is very strong. The group is always active to defend its own interest. The society of consumers is unfortunately often passive and unorganized.

But it is not only under such conditions that the tendency to protection is active. It sometimes happens that changes in general trade conditions bring it about that, in order to maintain international equilibrium, some credit con-

traction is necessary within a national area. In such circumstances the disadvantages of such contraction are not limited to special groups. The effects of the contraction are widespread. Although general considerations of long-period advantage are all against resort to protection, considerations of short-term alleviation seem all in its favour. Again, if there is not a powerful intellectual tradition of adherence to free trade principles, the arguments for imposing restrictions may appear almost overwhelming.

Now in the modern world resistance of this sort has been conspicuously lacking. It is probably true to say that the majority of competent economists are still convinced believers in the advantages of free exchange. But their numbers are few : and in recent years the weight of their advice has been greatly weakened by dissensions upon special issues. It is probable that the majority of the English economists, for instance, who for special reasons of monetary policy were willing to countenance a departure from free trade in England in 1931, would have still acknowledged the validity of the general arguments for free trade. But the confusion caused in the minds of the general public by their attitude was great, and the abandonment of the policy of free trade by Great Britain substantially weakened the resistance to free trade all over the world.

Moreover, it must not be forgotten that the political resistance to protectionism which used to be maintained by the parties of the Left, so long as these parties were inspired by the nineteenth-century liberal tradition, has in recent years greatly weakened, if it has not ceased altogether. The modern socialist, fascinated by the prospect of political power and the possibility of a little planning in his own national area, is apt to regard arguments relating to the advantages of international division of labour and exchange as having only academic importance. And if, as is very likely, he is supported financially by groups of workers whose employment may be endangered by the incidence of foreign competition, he may be as willing as the politician of the Right to support a protectionist policy. Modern socialists, though they may still render lip-service to the ideals of international economic co-operation, in fact, for the most part, support policies which lead in exactly the opposite direction.

This weakening of the intellectual resistance to the persistent tendency of lay opinion to acquiesce in measures of protection is paralleled by important changes in economic organization which make the apparent ravages of foreign competition more conspicuous and damaging. In a system in which movement of resources from one branch of industry to another is easy, the

damage caused even to particular groups by foreign competition is likely to be very small: capital and labour can be rapidly transferred to other lines of occupation and the benefits of increased cheapness are shared by all but the owners of fixed resources specialized to one line of production. But if mobility is hindered by the existence of monopolistic obstacles of one kind or another, then the damage to the groups affected is likely to be of much longer duration. If rigidity of wages impedes the absorption of displaced labour into other industries, if restrictions on investment and artificially sustained monopoly impede free enterprise, then the difficulties of the transition are likely to be considerably enhanced. It is well known that obstacles of this sort, themselves the product of the decline of economic liberalism, are characteristic of the economic organization of most countries in the post-war period; and it should be noted that their effect tends to be cumulative. The existence of protective tariffs gives rise to monopolistic obstacles. The existence of monopolistic obstacles gives rise to resistance to free exchange. Resistance to free exchange increases the difficulty of new adaptation. New protection is therefore granted; and the accumulation of obstacles to international trade makes the incidence of change in the remaining parts of the system which are free much more oppressive and productive

of sharp disequilibrium. In the panic atmosphere of general depression, measures which would have been resisted in times of good trade are willingly agreed to. There are few politicians nowadays who can refrain from measures which promise hope of any alleviation of unemployment, however ultimately damaging such measures may promise to be: and even the number of economists who are willing to suffer unpopularity by drawing attention to long-period considerations is diminishing. Understanding of the "exceptional" difficulties of any particular political or industrial situation is an easy way to a reputation for great sagacity. There are snug jobs for safe men in the quasi-corporative state.

(4) The Growth of Protectionism

The growth of protectionism in Europe during the last sixty years affords ample vindication of this diagnosis.

The turning point in the tariff history of the last century was Bismarck's re-imposition of the iron and steel duties at the end of the 'seventies. Up to that time the tendency had been in the opposite direction. The free trade movement had moved from victory to victory, and it did not seem absurd to suppose that within a short period comparatively free exchange would become general. The fall of Delbrück and the creation

of the new German tariff changed all that Henceforward protectionism was to grow.

This reaction was the result of a conjunction of influences. On the one hand the growth of an anti-liberal social philosophy in the German universities had provided intellectual weapons for the representatives of special interests. The Historical School, which was then dominant, was imperialist, anti-utilitarian and anti-intellectualist in outlook. It was led by men who had never really understood the classical arguments for freedom of trade, and whose idea of the good society was typified by army barracks and the Prussian landed estate. This created an intellectual atmosphere favourable to the growth of protectionist ideas among the masses. The prolonged crisis which followed the collapse of 1873 provided the economic atmosphere in which the intellectual reaction could be politically effective.

In the same way, the growth of agrarian protectionism later on was the product of a conjunction of painful economic change and confused thinking. Throughout the 'seventies and the 'eighties the competition of the agricultural products of the new world caused difficulties to the agricultural interests of Europe. Again German economists provided the appropriate apologia for policy. The ideal of a " just balance " between agriculture and industry, which from the " economic " point of view is

completely devoid of meaning, was exalted by such men as Wagner and Oldenberg. The agricultural interests were not slow to make political terms with the representatives of industry. Henceforward agrarian protectionism and industrial protectionism advanced hand in hand.

But the reversal of free trade policy which had been achieved up to the outbreak of the Great War was slight compared with what has happened since. The war itself produced a great extension of the branches of industry devoted to the manufacture of war materials. When the war was over, it was desired as far as possible to safeguard these industries against the consequences of a falling-off of demand for their products and the increased competition from similar industries abroad. The creation of new states and the fear of new wars afforded a pretext for high protection for manufacturing industries in areas which, from a purely economic point of view, would have been well advised to concentrate on other developments. Resistance to the changes brought about by the catastrophe of the war is a conspicuous feature of the policy of the post-war period; and protectionism is one of the manifestations of this tendency.

By the middle of the 'twenties of this century another influence was making itself felt. The

great increase of agricultural production which had come about during the war years and in the period succeeding the war, produced a depression among agricultural producers. The absence of opportunities for migration deprived the agricultural populations of the most obvious relief from their distresses. Fear of war on the one hand, and fear of the socialism of the urban populations on the other, led the politicians of the day to grant to the agrarian interest ever-increasing measures of protection.

The effects of all this were cumulative. The products of the new world, deprived of easy access to the markets of the old, showed a greater tendency to fall in value. The capacity of the inhabitants of these areas to import manufactures was diminished. In a desperate attempt to maintain international equilibrium they themselves imposed tariffs on industrial products, thus increasing the difficulties of the manufacturing countries and rendering the market for their own products less stable. For a time the incidence of these measures was warded off by the inflationary expansion of the pre-1929 period. But when the boom broke, their effects were manifest and the speed of restrictionism redoubled.

In the Great Depression all these tendencies were multiplied. Widespread unemployment, the contraction of markets, the political uncertainty

and unrest which has accompanied it, drove one government after another into policies which, in happier times, better judgment would have restrained. Since the autumn of 1931 and the abandonment of the gold standard by Great Britain, to the other causes making for restrictions there has been added instability of exchange rates. The depreciation of the pound sterling and the currencies which followed the pound sterling, meant increased financial difficulty to those countries which remained on gold. To meet these difficulties resort has been had, not merely to high protection, but even to more rigorous forms of restrictionism. In many important commodities trade is limited within narrowly imposed quantitative margins. It is a conspicuous feature of the history of the last few years that in Europe at least the recovery has been predominantly a recovery of trade within the different national areas. In 1937 world industrial output was over 20 per cent. above the 1929 level: the volume of world trade had not reached the 1929 level.

(5) Strategic Considerations

If the foregoing analysis is correct, two conclusions seem to follow.

In the first place, since the growth of protectionism is essentially a manifestation of the

progressive development of wrong ideas regarding its effects, it follows that only by the progressive education of public opinion to more correct ideas can the process be reversed. From time to time something may be achieved by tactics. Distressed governments may be manœuvred into a position in which, without settled views as to policy, they adopt measures conducive to greater freedom of trade. But in the long run the chronic disposition to succumb to the temptation of the seen, rather than the calculated, effects of policy, can only be resisted by an educated public opinion. Without a spiritual revival which shall recover something of the sturdy independence of the men who, without hope in their time, laid the foundations of the liberties of Europe, the prospects of such resistance are small.

In the second place, since the intensification of protectionism is to be ascribed to the cumulative effects of all kinds of restrictive policies, of which protectionism is only one, it follows that this process of education is likely to be much more effective, if it is part of a frontal attack on measures conducive to restrictionism and instability in general, than if it is limited only to an attack on limitations on international trade. There is much more hope of inducing the public to tolerate the absence of protection to special interests if the incidence of change on these special interests is minimized by an absence of

hindrances to transfer to other lines of enterprise. The public is much more likely to tolerate the disturbances incidental to tariff reduction, if at the same time it has not to contemplate the disturbances incidental to monetary instability. Only by a general rehabilitation of the principles of sound policy can the present vicious circle be broken.

VI

THE PLANNING OF BRITISH AGRICULTURE [1]

(1) INTRODUCTION

THE advent of trade depression, in Great Britain as elsewhere, has provided a significant impetus to the idea of national planning. Before 1929, advocacy of extensive regulation of industry was confined to the ranks of the socialists: the main body of informed opinion was hostile to such measures. Today, while it would perhaps be an exaggeration to say that the balance has definitely shifted, the position is more ambiguous. The events of the slump have produced a feeling of disquiet, almost of paralysis, among many who, hitherto, were unreflecting supporters of the system of economic freedom; and the view that the crisis has been caused by the excesses of

[1] This paper was written in 1934 as a contribution to a special number of the *Revue d'Économie Politique* devoted to planned economy. I have not attempted to bring it up to date, preferring that it should stand as it was written then, as a discussion of general tendencies and as a prediction of future developments. References to "recent events", "present policy", etc., must, therefore, be read as from the standpoint of 1934. It should be read in conjunction with the next paper, *The Consequences of Agricultural Planning*, which was written for an English public presumed to be acquainted with the legislation here discussed.

unregulated enterprise is not infrequently allowed to pass almost unchallenged. It would be wrong to say that there is a very large measure of support for changes which would be recognized as socialistic. But an increasing number of people tend to cherish the belief that somewhere, half-way between private enterprise and outright public ownership and control, lies the stabler economic system of the future. It may be questioned whether this belief is founded upon any very profound analysis. It is probable, indeed, that it owes its popularity much more to the reassuring emotions associated with certain catchwords — " planning ", " conscious control ", " orderly production " and the like — than to systematic thought. It is possible that with a return of prosperity its influence would disappear. But its present prevalence and its effects upon the trend of legislation are undeniable.

In no connection has this influence been more clearly shown than in the sphere of agricultural policy. In Great Britain, as in most other parts of the world, agriculture has been traditionally the home of economic individualism. Whatever measures of assistance from the state were sought or secured by the agricultural interest, it was never generally supposed that the actual conduct of business in agriculture would be carried out by anyone but the farmer. Even the socialists, who entertained the most grandiose projects of

land nationalization, seldom contemplated the control of agricultural production. Yet, in the space of three years, there have been passed into law measures which, in regard to wide fields of agricultural enterprise, virtually abrogate the farmer's control over everything but the technical details of his business. Compulsory marketing organizations have been set up for hops, potatoes, pigs and bacon, and milk; and an extension of the system to sugar beet, eggs and fat stock is by no means unlikely in the near future. It is the object of this article to explain how this change has come about, to set out the main features of the new organizations and to estimate their prospects.

(2) The Political Background.

The peculiar nature of British agricultural policy in the last few years is in large part the result of considerations of political expediency. When, in 1931, the National Government came into power and free trade in general went by the board, the manufacturing industries which were severely depressed and which were capable of being protected by duties on imports, received a liberal dose of protection. With agriculture this was not deemed to be expedient, although there can be no doubt of the severity of agricultural depression or of the technical efficiency of pro-

tective duties. The reason, of course, is simple. Unlike those nations where the preponderance of the agrarian interest has resulted in high protection for agriculture, Great Britain is predominantly an industrial community. Agriculture is the occupation of little more than one-twentieth of the inhabitants of this island ; and the weight of the agricultural interest in politics, although probably proportionately considerably greater than this, is not sufficiently great to be able with impunity to impose obvious burdens of an extensive kind on a predominantly urban electorate. Ever since the repeal of the corn laws in the middle of the last century, it has been one of the certainties of the political situation that anything of the sort was bound to be ultimately rejected. In the fifty years after the repeal of the corn laws, the policy of cheap food was common ground between the two great political parties. When, at the beginning of the present century, the late Joseph Chamberlain attempted to reverse this policy as part of a general scheme of imperial preference, the Conservative party was heavily defeated at the polls. Thenceforward, however deeply the leaders of the Conservative party might commit themselves to general industrial protection, they were always hesitant to give pledges for anything which could be described as protective import duties on food on any but a very small scale. Hence

in 1931 it was only in accordance with the tradition of all parties that a policy of straightforward protective duties on the main agricultural imports should have been rejected in favour of something more obscure in its mode of operation.

But if the avoidance of extensive resort to the instrument of protective import duties is to be ascribed to considerations of political expediency, the precise form of alternative policy which was actually adopted is to be ascribed in part to more doctrinaire influences. During the years succeeding the artificial prosperity of the war-time inflation and food shortage, it had become customary in certain quarters to ascribe the difficulties which had overtaken many branches of agriculture to deficient marketing organization. The failure of British farmers to form monopolistic combinations to bargain with the middleman was held to be a main cause of the depression of British agriculture. Attention was drawn to the success which had attended certain co-operative marketing schemes in other countries; and the troubles of British farmers were attributed to the " ingrained individualism " of their marketing methods.

In fact there was never very much reason to accept this explanation. The depression, such as it was, was to be accounted for in terms of hypotheses much less esoteric in character. On

the one hand, the enforcement of minimum wages by governmental authority, on the other the cheapening of competitive products due to scientific developments more applicable in other parts of the world than in Great Britain — these were circumstances much more likely to be responsible for the lack of profitability of British agriculture than a defective market machinery. Whether beyond this there did exist important deficiencies in the arrangements whereby various products were marketed, is a matter for detailed discussion. The appeal to foreign experience upon which such accusations usually rested, not infrequently on examination was found to involve either a misunderstanding of the foreign developments or a comparison of unlike conditions. It is naturally improbable that the various marketing systems were perfect. But to believe that, beside the big secular factors making for agricultural decline, such things were quantitatively important, is to lose all sense of proportion.

Nevertheless this explanation was very widely accepted. It was a type of explanation calculated to appeal to that frame of mind so often prevalent in the post-war period, of which it may be said that it is willing to recognize anything but a change in the fundamental conditions of demand or supply. And when various attempts at co-operative marketing broke down or failed to raise the condition of the producers concerned to

the level of prosperity desired, the failure was held to indicate, not a flaw in the logic on which the original expectations were based, but a deficiency in the nature of voluntary co-operation which could only be remedied by the intervention of the state. Accordingly in 1931, when the parties of the Left were in power, an Act was passed — the Addison Agricultural Marketing Act — enabling a majority of producers to obtain statutory powers to enforce their will in this matter on the rest, and enabling the Minister of Agriculture, if such course seemed to him to be desirable, to prepare and recommend such a form of reorganization to any section of the industry.

When the National Government came into power therefore, there existed both the machinery necessary for attempting to produce agricultural revival by marketing reorganization and a frame of mind on the part of the general public agreeable to its use. A powerful section of the civil servants employed by the Ministry of Agriculture had staked much in the shape of prestige and prospects on the reorganization of agriculture on these lines. It needed only a Minister favourably disposed to this form of regulation, and gifted with the necessary drive to carry the various schemes through Parliament, for the project to become a first-class issue of policy. Such a Minister was forthcoming in the person of the present Minister of Agriculture, Mr. Walter

Elliot, ambitious, able and attuned to the ideals of the planned economy by early affiliation with Fabian Socialism and avowed contempt for the propositions of scientific economics.

But one thing further was needed if the policy were not to be still-born — the co-operation of the producers — which in practice meant the co-operation of the powerful National Farmers' Union. Hitherto the producers had shown no great inclination to organize themselves on the lines suggested. Save in the special case of the hop-growers, the Addison Act had aroused no enthusiasm for this type of regimentation. The leaders of the Farmers' Union, themselves often working farmers of great technical ability, realized perfectly well that the effects of such schemes would be to penalize themselves for the benefit of the marginal producer, to restrict their liberty of marketing in order to keep in business the inefficient and the unenterprising; and they looked askance at the dead hand of state regulation. What they wanted was protection from foreign imports, and because the Addison Scheme made no provision of this sort they greeted it with reserve, nay, even with hostility.

But with the advent of the National Government the prospect changed. Here was a government which had no such general scruples in regard to the regulation of imports as had

inhibited the action of previous governments. If regulation of imports by quota systems could be superadded to the original schemes, was it not worth while swallowing the somewhat bitter pill of market reorganization to obtain the longed-for fruits of exclusion of foreign imports? True, straightforward protection would have been better; still, half a loaf is better than no bread. The farmers decided to send representatives to Whitehall. The historian of the future will completely miss the point of these important developments if he does not realize that the farmers' acquiescence in the inauguration of the new experiments was bought by the prospect of import regulation. The farmers had not suddenly become enamoured of the projects of the doctrinaires at the Ministry of Agriculture. But they thought that acceptance of these projects would be rewarded by tangible benefits in the shape of disguised protection. The official exposition of the Addison Act of 1931 explains that the "object of the Act" is to improve the technique of marketing and not to protect markets.[1] The amending Act of 1933 introduced by Major Elliot provides that the Board of Trade, in consultation with the Ministry of Agriculture, may make an order regulating both the quantity and the quality of the importation into the United

[1] The Agricultural Marketing Act, *Ministry of Agriculture and Fisheries Economic Series*, No. 33, p. 12.

Kingdom of any agricultural product. " Protectionism ", said Bastiat, " is the socialism of the bourgeoisie." The current form of socialism in British agriculture is essentially the protectionism of a minority agrarian interest.

(3) The Sanctions of Marketing Control

The statutory sanction for the new organizations and their procedure is derived from the Agricultural Marketing Acts of 1931 and 1933. In themselves, however, these Acts create nothing. Unless action were taken by producers or the Ministry, their various provisions would remain a dead letter. They provide the authority for the setting up of the different marketing boards and they dictate the limits within which these bodies may work. But they do nothing to regulate the sales or production of particular commodities.[1]

In order that a marketing board for any particular commodity or group of commodities may come into existence, a somewhat complicated procedure is necessary. The first step is the preparation of a scheme. This may emanate spontaneously from a group of producers or it may come from a special reorganization commission appointed by the Minister. If the Minister is satisfied that the proposal comes from respon-

[1] The 1933 Act contains incidentally certain provisions relating to eggs, but these are quite irrelevant to the main purpose of the Act and are obviously included only for administration convenience.

sible people (which will naturally be the case if it comes from his own commission), he must then cause it to be published in the official Gazette, in order that the producers affected may have the opportunity of forwarding to him objections and suggestions for modification. He may then modify the scheme or cause public enquiry to be made into the objections which have been put forward. He is under no obligation to do this, however, for the Act permits him to ignore such objection as he considers " frivolous ". At the end of the period allowed for this publicity, the Minister may then lay the scheme, with such modifications as he has introduced, on the table of the Houses of Parliament ; and on the passing of a resolution approving of the scheme by each House, he is empowered to issue an Order giving the scheme the force of law. Even now, however, the final constitution of the new organization is not complete. The scheme must be submitted to a poll of registered producers and, in order to remain in force, must secure a vote of not less than two-thirds of the total number of registered producers, this vote including registered producers who are capable of producing not less than two-thirds of the quantity which all the registered producers voting on the poll are capable of producing.

It will be seen that, in the event of any particular scheme being very unpopular with a

substantial number of producers or with those Members of the Houses of Parliament who were aware of its existence, considerable obstruction might be offered. So far this has not occurred.[1] Obstruction to a measure sponsored by a Minister is not likely in the present state of Parliament: and so far as the producers are concerned, matters are exhaustively negotiated with the officials of the National Farmers' Union before any action is taken. The producers in the country districts, who certainly do not understand the complicated schemes they are asked to vote on, then receive leaflets accompanying the voting forms explaining that the scheme has been prepared to avert a disastrous crash in their markets, and so on. The rest so far has been easy. With the leaders of the farmers in their present mood, what really happens is that officials at the Ministry of Agriculture decide that a certain branch of agriculture is to be reorganized, prepare the scheme in consultation with the executive of the Farmers' Union and their very astute legal advisers, and then in due course secure the endorsement of a passive legislature and a crowd of bewildered producers, more or less desperate after years of falling prices.

The bodies which are thus constituted are allowed the exercise of very wide powers. They

[1] Since this was written, certain projects have actually run into difficulties.

may impose levies on all producers of the product for which they are responsible, for the financing of their own business. They may borrow money both from the government and from the public on the collective credit of their registered members. They may buy and sell agricultural requisites. They may promote enterprises for subsidiary operations. They may subsidize research and education.

The most important powers, however, the powers which constitute their *raison d'être*, are those which relate to the sale of the product. It is here that the element of compulsion is all-important. They may constitute themselves into trading bodies and compel all producers, on pain of severe penalties, to sell only to themselves. Or they may rest content with issuing regulations relating either to the price at which the product may be sold or the quantities which may be placed on the market. The sanctions by which these powers are enforced are formidable. A producer who sells the regulated product without registration (*i.e.* without becoming part of the organization and assuming its financial liabilities and obligations) is held to be guilty of a criminal offence, liable on conviction to a fine not exceeding £200, plus a sum not exceeding half the price at which the goods were sold. Failure to comply with the regulations within the scheme is enforced by severe monetary penalties. These powers

have not been allowed to rest unused. The spectacle of petty tradesmen summoned in the courts for selling milk without licence or at a price below that permitted by the Board, has been by no means an unfamiliar occurrence since the coming into operation of the Milk Board.

(4) The Four Main Schemes

It will be seen that these powers, combined with the provision, to which allusion has been made already, empowering the Board of Trade and the Minister to regulate competing imports, constitute an apparatus which not only completely changes the conditions of disposal of the commodities concerned, but is also capable of producing very drastic changes in price and in quantity marketed. We can see best how this apparatus may be used if we turn to the actual schemes which so far have been put into practice.

The existing Boards are five in number: Hops, Potatoes, Pigs, Bacon and Milk. Of these, those dealing with pigs and bacon are so intimately allied that they may be considered as one. We have therefore really four examples to examine.

(i) The Hops Board has had the longest life. It was constituted in 1932 and, in its present form, has the simplest and most logical structure. The board undertakes to buy from the registered producers the whole of their crop of hops, sales

to other bodies being rigidly prohibited. It then sells to the brewers at a price determined by bargaining, the proceeds being divided among the producers in proportion to the estimated value of the crops they have handed over. Hops are a comparatively small proportion of the price of beer, and in the last twelve months the market has been strong owing to the repeal of prohibition in America. Accordingly prices secured by the board have been highly favourable. The result has been a tendency to increase production. To counter this tendency, therefore, the original scheme has been amended and the board is now empowered to allot to each producer a production quota based on his average annual production in 1928–32. No new producers are entitled to come into the scheme until the market demand exceeds 110 per cent of the basic quotas. To all intents and purposes, therefore, the board is a close monopoly. In return for certain price concessions and, no doubt, fearing the exercise of the powers of the Ministry, the brewers have agreed not to import more than 15 per cent. of their requirements from abroad.

(ii) The Potato Scheme resembles the Hop Scheme in that it exercises a control over output. But it differs in that it does not set up any body to buy from the producer but regulates the market solely by regulating production and sales. The main instrument of regulation of sales is

extremely simple. The board prescribes a minimum size for potatoes which may be sold for human consumption by stipulating a minimum riddle or sieve for different varieties. Potatoes which pass through this riddle — this year it has been $1\frac{5}{8}$ inches for some varieties, $1\frac{3}{4}$ inches for others — may not be sold for human consumption. This procedure clearly must have the effect of tending to raise prices (imports of main-crop potatoes are normally small and will be subject to restriction if they show signs of interfering with the success of the scheme). The Board is therefore empowered to impose a fine of £5 per acre on farmers who plant more than their basic acreage — roughly speaking, the area of 1933. But the scheme is not so rigid as the Hop Scheme in this respect. For, once having paid the fine, the farmer is entitled to increase his basic acreage by the amount for which he has been fined.

(iii) The scheme relating to pigs and bacon is at once more complicated and less efficient from the point of view of monopolistic control, and it has already encountered severe difficulties. The object of the scheme is to encourage the production of pigs for bacon. To do this it was decided to stabilize the consumption of bacon from all sources, home and abroad, at 10,670,000 cwt., the volume of imports being regulated according to the estimated home production. The pig producers' contracts with the bacon curers have to

be ratified by the Pig Board, and the prices they receive are determined by bargain between their representatives and representatives of the curers, who are also compelled to form a board. The Pig Board has power to limit the number of pigs that any producer contracts to deliver to the curers.

At the outset of the new regime the pig producers were guaranteed a minimum price for their contracts, based on a complicated formula embracing the price of feeding-stuffs and other variables. The results were highly disconcerting. The number of pigs offered to the curers increased beyond all expectation, the actual rate of production being nearly double that of 1930. This was partly due to diversion of supplies from the pork market, which is uncontrolled, partly to an increase in breeding. The result was that the curers found themselves unable to sell all that they had to contract for, at a profit. The situation was only saved by a loan of £160,000 from public funds. Since then the basis of payment has been altered and the contract price now varies with changes not only in the price of foodstuffs but also with the price of bacon, etc. This change has been accompanied by a falling off in the rate of production. Meanwhile the restriction of imports has raised the price of Danish bacon. But the effect on the prices of English bacon has been limited to the prevention of fall. It is clear that

in the absence of further import restriction or a restriction of contracts, the scheme may prove a disappointment to the producers.[1] But to limit imports further would give rise to political difficulties, and the restriction of contracts would annoy the producers and disorganize the market for pork.

(iv) Finally we come to the Milk Scheme, which, although involving the most extensive apparatus, is probably the least securely founded of all. To understand its position it is necessary to examine shortly the arrangements which it superseded.

The market for milk in Great Britain falls into two parts, the market for milk for liquid consumption and the market for milk for manufacturing purposes. In the years since the war these markets have not been perfectly competitive. Representatives of the farmers and the chief dairymen's organizations have met yearly and fixed the prices which were to be paid for milk according to uses to which it was to be put.

[1] Since this was written it has never been out of trouble, a monument of crass administrative inefficiency. It is difficult to understand how the advisers to the Minister of Agriculture could ever have persuaded themselves that their scheme could work at all without control of pig production in general and also of the pork market. I suspect that they knew that the scheme would break down, but that, having committed themselves wholeheartedly to the principle of market reorganization, they were content to accept this unworkable compromise in the belief that, when it broke down, the lure of policy would be " onward " to complete control rather than " backward " to the free market.

At first the mutual arrangements were not unfavourable to the farmers and as a result the production of milk tended to increase. This eventually began to affect the terms of the yearly bargains. At first the prices of milk for different purposes did not differ by a very large margin. But, as time went on, the manufacturing price tended to be lower, since the increased supplies of milk called into being by the relatively good prices came chiefly on to this market. But this in turn tended to upset the market for milk for liquid consumption. The arrangements for collective bargaining were purely voluntary, and, as the spread between the two prices became greater, the producers who had hitherto produced milk for manufacturing purposes began to invade the market for milk for liquid consumption. It became clear that the arrangements which had sustained prices in this latter market were very gravely jeopardized.

Hence the chief concern of the board, when it was constituted, was to prevent the undercutting of the market for liquid consumption by the producers of milk for manufacturing purposes. For this purpose it divided the country into a number of regions. In each region it constituted a pool. All producers of milk are obliged to sell their milk either to this pool or in conjunction with it. (Retailers who are themselves producers are only allowed to operate under licence on

condition that they do not sell below the Board's stipulated price and that they pay a contribution to its various levies.) Having acquired the milk, the pools then resell at prices differing according to the purpose for which the milk is to be used. A levy is imposed on the proceeds of all sales of milk for liquid consumption and paid over to the Central Board. This then redistributes the proceeds to the districts commanding lower proceeds, according to the proportion of milk which they have sold for manufacturing purposes. Finally the pools in each district pay the various individual producers a flat rate [1] for the milk they have delivered, irrespective of the purpose for which it has been sold. The pools are obliged to buy all the milk that is offered to them, but so far the board has been given no power to limit production.

It will be seen that the scheme is essentially a device to sustain the price of liquid milk by subsidizing the sellers of milk for manufacturing purposes as a compensation for preventing them from undercutting. But, given the present powers of the board and the general conditions of demand and supply, such a device is inherently unstable. Any improvement in the position of milk producers is bound to lead both to an increase of production and to a diversion of

[1] This may be supplemented by sundry premiums for quality, local delivery, etc.

supplies from consumption or from manufacture on the farms. This has indeed already taken place ; and, if it had not been for the drought this summer, the position would have become very difficult indeed. As it is, the government has been obliged to subsidize the supply of milk for manufacture by guaranteeing the difference between prices actually realized and certain prices agreed upon with the board. At the same time the board subsidizes the manufacture of cheese on farms to keep back from the market the large supplies of milk from this source which otherwise might be diverted in this direction. It is clear that these expedients are not satisfactory as long-run measures ; and the supply of milk is likely to increase still further. Short of restriction of domestic production, which would cause trouble with the producers, the only long-run measure which could prevent a weakening of the price of milk for manufacturing purposes would be a limitation of the import of milk products. But this is very difficult. The demand for butter is elastic : hence limitation is of little use here. And much of the cheese which competes with the home product comes, not from foreign countries, but from the Empire. Now under the Ottawa Agreement the government may not limit dairy products from the Empire until November 1935, so this resort is not available. Representations have indeed been made

to the Dominions concerned to abrogate their rights in this matter. But, not unnaturally, they have not been received with enthusiasm. The position, therefore, is by no means easy.

(5) Prospects

The economic significance of the experiments we have been examining is not a matter of any difficulty. It is obvious, in spite of the high claims which have been made for them in this connection, that they do not involve "planning" in the sense of a co-ordinated attempt to secure a proper distribution of factors of production between industries, but are essentially devices for fostering monopolistic power within industry. It is obvious, too, that in so far as they confer benefits on the producers concerned, they will do so by raising prices to consumers or preventing them from falling as low as they otherwise might be. They will do this either by restriction of domestic supplies or by exclusion of foreign imports. The prospect of a gain for the producers at the expense of middlemen without any increased burden for consumers is likely to be illusory.[1] In so far as foreign imports are excluded by means of quotas, domestic factors

[1] This is abundantly proved by the recent prolongation of the period of winter prices for milk, to which reference is made below. Milk has always been the commodity in respect of which the merits of this kind of marketing for squeezing the middleman have been most loudly extolled.

of production are being used less productively (in price terms) than would be the case were they put to the use of acquiring the cheaper foreign produce by way of exchange. In so far as a domestic restriction is secured by quota allotments, an obvious drag on efficiency is created, which is unlikely to be counterbalanced by the grant of small premiums for quality or such-like devices. In so far as the different schemes are not co-ordinated — and there is no sign of this taking place — they are likely, as they multiply, to prove more and more embarrassing to the economy of mixed farming, hitherto the predominate form of agriculture in Great Britain. It is highly doubtful whether the organizations which have been created are likely to be stable, and it is probable that in some cases they will involve the state in an extensive system of subsidies. As we have seen, this has already begun to happen.

Whether these results are to be regarded as good or bad is not a matter which need here be discussed. It is interesting, however, to speculate upon the future of the system to which they are due.

There are three sources of danger to this system: from the agricultural producers themselves, from the consumers of their products and from the producers of other products.

It is by no means certain that the present

support of the schemes by the agricultural community is likely to persist indefinitely. As has been explained already, the support has been purchased by the expectation of higher prices and the exclusion of competing imports. In so far as higher prices fail to come and the restriction of imports is itself restricted by the pressure of public opinion, discontent among the farmers themselves at the multiplication of restraints imposed and disillusionment regarding their power to help is likely to grow apace. This is not likely at first to take the form of repudiation of the schemes : rather it will take the form of the overthrow, at the elections of officers, of existing officials of the boards and their replacement by men of more extreme views.[1] But later on the schemes themselves may be assailed. In so far as the schemes do not from the outset impose rigid control of production, a result of this sort is the more likely, since the increase of production following the initial expectation of improved conditions is likely to make manipulation of the market all the more difficult. There are signs that developments of this sort are already taking place in the case of milk.

On the other hand, if the producers are made contented by the success of a scheme in raising prices, it is likely to be the subject of severe criticism by consumers. As was indicated earlier,

[1] This actually happened in the case of the Pig Board.

the political resistance of a predominantly industrial community to substantial increases in the price of food is likely to be great; and, in the long run, the fact that these increases are brought about by quota restrictions and control of production is not likely to render them any more acceptable to the urban voter than they would be if brought about by high import duties.[1] So far, save in the case of hops, the effects of the schemes have been more to prevent a further fall of prices than to produce an actual rise. But the increase in the price of imported bacon has given rise to discontent, and a recent extension of the period of winter prices for milk is likely to cause much criticism. If prices do rise — and if they do not, the producers will not be satisfied — the volume of criticism is likely to grow. And if it becomes very great, then it is highly probable that a large body of the Conservatives, whose seats are in industrial constituencies, will be anxious to throw the Minister of Agriculture to the wolves. The way of retreat would presumably be via a moderate and "definite" tariff. They would say: "We can't let the bottom fall out of the market altogether for these fellows, so we shall give them a moderate tariff. But we are not going to let prices rise any more, so we are going to abolish the present system." It is possible in the present confusion that such a manœuvre might not be politically fatal.

But probably the most immediate menace to the system comes not from consumers of agriculture products but from imperial producers. It is doubtful to what extent the City and the export industries realize the danger to their immediate interest which is constituted by the present policy. But this unawareness is not shared by the Dominion exporters of cheese and other dairy products. Nor would any further attempt to interfere with Dominion exports of beef and mutton fail to encounter the most furious resistance. There can be no doubt that opinion in the Dominions is already highly indignant at the agricultural policy of the Home Government: indeed it is not going too far to say that what has been done already is likely to be a severe obstacle to extensions of the preferential system. Any further developments on these lines might well endanger what has been secured already and cause real political embitterment. Now, rightly or wrongly, the Conservatives, on whose backing Major Elliot depends for the maintenance of his schemes, attach great value to imperial economic co-operation, and they are not likely to tolerate anything which gravely estranges the Dominions.

Hence the political future of this system, on which such high hopes have been based, is likely to be perilous in the extreme.

VII

THE CONSEQUENCES OF AGRICULTURAL PLANNING[1]

(1) Introduction

It is a common complaint among critics of the present government that its policy has been marked by inaction and undue caution. Whatever the justice of this complaint elsewhere, it certainly does not apply to policy in regard to agriculture. In the last few years it has brought about a complete reversal of the general policy as regards food supply which has prevailed for the last three-quarters of a century, and a substitution over a wide field of agriculture of a system of centralized regulation for the system of free enterprise which had hitherto been ubiquitous. This is not a policy to which the epithets inactive or over-cautious can possibly be held to be applicable. Nor is it possible to accuse it of any excessive disposition to economy. The zeal of the Ministry of Agriculture has already committed the country to subsidies, open and

[1] Reprinted from *Lloyds Bank Review*, November 1934. References to ministers and policies in the text relate to that date.

concealed, running into many millions of pounds per annum ; and it is highly probable that they will increase. For all these reasons it is a matter of some importance to ask what it all means and where exactly we are going.

(2) The Implications of Agricultural Protectionism

The traditional policy of this country in regard to food supply has been to buy in the cheapest market. If home produce was cheapest, well and good : it was purchased. But if foreign produce was cheaper, it came in. Neither by way of subsidy nor by way of obstruction to imports was there any attempt to keep in being a larger volume of agricultural enterprise at home than was profitable at world prices. This meant that a smaller proportion of the population was employed in agriculture and a larger proportion in occupations in which we had relatively greater efficiency, than would have been the case had agriculture been protected. But it meant too the growth of a larger population at a higher level of real income than would otherwise have been possible. It meant that no advance of knowledge or improvement of organization making food production cheaper was prevented from reaching the people. Our export industries developed to pay for the food we imported ; and

the effort that was spent in this way procured, by way of exchange, a larger reward of products than would have been procured by its expenditure in cultivating these products at home.

The new policy changes all that. A foretaste of what might come existed in the shape of the sugar subsidy, which, in the course of ten years, cost the nation a sum of some £35 millions and made profitable the production of sugar which very often could have been bought abroad for less than the cost of the subsidy.[1] Recent policy simply generalizes the application of the underlying principles. "It is no longer the national policy", a recent Minister of Agriculture has declared, "to buy all over the world in the cheapest market, because we cannot afford it."[2] Accordingly, by subsidy, by quota restriction, by market reorganization and (to a very small extent) by tariffs, it has been the object of policy to maintain and even to raise the price of food and to keep in being a volume and a type of agriculture which otherwise might have disappeared. It is important not to under-estimate the extent of this policy. Subsidies of one kind or another are paid to the producers of beet sugar, wheat, cattle and "manufacturing" milk. Quota restrictions (either statutory or the result

[1] Lord Astor has calculated that in 1930–31 we paid £11 millions for sugar, the equivalent of which could have been bought abroad for £4,703,000.

[2] *Parliamentary Debates*, vol. 275, No. 48, p. 1631.

of gentlemen's agreements) operate for beef, mutton, lamb, bacon, potatoes, hops, butter and eggs. Marketing boards have already been set up for hops, potatoes, pigs and bacon, and milk, and extensions of the system to meat and eggs are in process of active preparation.

Now there can be no objection to a policy of buying in the dearer market if the implications of such a policy are clearly recognized by all. The ultimate aims of policy are not susceptible to scientific criticism, and if for aesthetic or political reasons it is decided that the maintenance of a larger volume of wheat production is worth what we sacrifice in foregoing the opportunity of getting it cheaper elsewhere, there is nothing in economics which can be appealed to against the decision. If I buy matches from an ex-Service man at 3d. a box rather than from an automatic machine at 1d., that is obviously not necessarily a foolish thing; I am paying for something other than the matches which is worth the cost. Similarly, if it is decided that the £35 millions which have been paid to the producers of beet sugar is worth the satisfaction of seeing it grown on English fields, there is nothing more to be said about the matter — if both gain and cost are generally realized.

But it is important that they should be fully realized. It is important to realize that the gain is just whatever may be the aesthetic or the politi-

cal advantage of growing beet (or whatever it is) on English soil. To those who set special value on the prevalence of agricultural occupations or who see (wrongly, I believe) an important source of military security in an enlargement of domestic food supplies, this gain may not be small.[1] But there is no net gain so far as the real incomes, in terms of goods and services, of persons other than the beet producers are concerned — quite the contrary. Mr. Elliot says we cannot afford to buy in the cheapest market. But either he is using the term afford in a very special sense or he is labouring under a misapprehension. The fact that food is procured from abroad by way of exchange rather than produced at home means that we are using our resources more, not less, productively than would otherwise be the case. This is not one of the matters on which, so far as my knowledge goes, there is any disagreement among economists. There is no gain, so far as real incomes are concerned, in subsidizing or pro-

[1] It is important to realize that it is agriculture as such and not merely rural occupation which must be valued in this way if the exclusion of cheap food is to be counted to this extent as a gain. If for reasons of public health it is thought desirable to maintain a certain proportionate distribution of population between rural and urban occupations, then it is highly probable that it would be cheaper to foster the migration of certain forms of manufacturing industry to the country than to protect, in one way or another, branches of agriculture which international competition renders unprofitable. As for the military argument, is it really open to doubt that our security would be much greater if all the money which has been spent on agriculture had been put into battleships and aeroplanes? The military argument is just a red herring.

tecting forms of agricultural production that otherwise would be unprofitable.

Nor can it be argued that there is any gain in the volume of spending on the products of other industries. Mr. Elliot sometimes speaks as if the raising of the receipts of domestic agriculturalists (which is an undoubted result of his policy) has the effect of causing more to be spent on the products of other industries. But this is just a mistake. If I pay more for bacon, the bacon curer has more to spend. But I have correspondingly less. The thing is as broad as it is long. There is no reason to suppose that the creations and cancellations of bank credit which may accompany such manipulations are, on balance, conducive to more spending or more investment. On the contrary, they are probably deflationary.

The gain, therefore, of such measures is limited to whatever " non-economic " advantage may be supposed to inhere in the maintenance of a volume and a kind of agricultural production which would not otherwise be profitable. At the same time there is a cost. If the policy is executed by means of a subsidy this is obvious, whether, as in the case of sugar beet, it comes out of the pocket of the taxpayer or whether, as in the case of wheat, it comes out of the pocket of the consumer. But it is no less real when the same end is secured by measures which, by limiting supplies from abroad, so raise prices (or

prevent them from falling) as to maintain the profits of producers. In the last analysis, resort to the advantages which increasing technical progress makes possible, is sacrificed to the other ends of policy.

It is sometimes thought that this is not so because of the inelasticity of demand for certain agricultural products. If the price of a commodity such as wheat is very considerably lowered, there will not be a large increase of consumption. It is argued therefore that consumers are not greatly benefited. But this is a simple error due to looking at markets one at a time instead of at expenditure in all markets. If the price of bread is halved, it certainly is most improbable that its consumption would be anything like doubled. But it is quite absurd to say that the consumer would not be benefited. He would have more to spend on other things. Now the prices of bread and the other commodities which are now under control bulk very large in the budget of the poor ; to stabilize at the present level is to abandon, at what some might think an unnecessarily early stage, one of the chief hopes of the diminution of poverty. It may be thought that the preservation of domestic agriculture in its present form is worth the sacrifice of the prospects of the urban population. But if this is so it should be clearly stated, not concealed in a cloud of sophistry about the expense

of buying from abroad and the importance of the rural market.

Such sacrifices are common to agrarian policy in general as it is practised today by food-importing nations. There is a further sacrifice, however, which must be taken into account in the case of the British Empire. The policy which we are pursuing at present is a policy which involves not merely a sacrifice on the part of our urban proletariat, it involves also a sacrifice of agricultural producers in the Dominions. For it is essential to the success of our most ambitious schemes — the Milk Scheme and the contemplated Meat Scheme, for example — that not only should we exclude the produce of the foreigner, but that also we should exclude the produce of the Dominions. Now, it is possible to entertain very various expectations of the possibilities of far-reaching schemes of imperial economic co-operation. But in a world which is becoming increasingly cluttered up with obstructions to trade of any sort, it is surely obvious that, where the Dominions are willing to take our manufactures in return for their food products, it is a very grave step to bang the door in their faces — to say, " We don't want your cheese, your butter, your lamb and your mutton in such quantities as heretofore. We cannot afford to buy them and we propose to produce them (at greater cost) in our own particular part of the

Empire." Yet this is what the government is doing. Do they do it with the approval of the export industries, the shipping trade and all the other interests which, to say nothing of the consumer at large, must quite inevitably suffer ?

(3) The Economics of Import Quotas

Let us assume, however, that such is the case, that the abandonment of the policy of cheap food has been accepted by all with a full knowledge of its implications as regards gain and cost. It is still desirable to enquire whether the methods which have been adopted to give effect to this policy are such as to promote it with a minimum of other disturbance.

The traditional method of protecting producers from the competition of cheap imports is the imposition of a protective duty. This involves the sacrifices discussed already. But it carries with it a minimum of interference both with the conduct of domestic industry and with the machinery of import. A certain margin of protection is given to domestic producers. But the domestic market still moves in harmony with the world market. If there is a domestic shortage, recourse can be had to other sources of supply without increasing the margin between world and domestic prices. If further cost reductions take place they are not prevented from reaching the consumer.

The mechanism of quota regulation which has been preferred by Mr. Elliot is not so simple in its mode of operation. It excludes competing imports with greater efficiency than the tariff, for it places an absolute limit on the quantity of importations. To that extent it is a more effective administrative instrument. But, in its indirect effects on prices and supply, and on the general trade position of the country *vis-à-vis* the Empire and the rest of the world, it has repercussions of a sort which render its use in preference to the straightforward tariff a matter of extreme dubiety.

Assume first that the quotas are rigid. Trade agreements are negotiated such as the Beef Agreement with the Argentine or the Lamb and Mutton Agreements with New Zealand, by which the absolute quantity of a particular kind of food which it is permissible to import is fixed for a number of years. If this is less than has previously come in — and this is the *raison d'être* of such a policy — then the domestic price will tend to rise. How much it will rise, by how much it will differ from the world price, cannot be predicted in advance. This depends on conditions of demand which are not known. Here already, in the uncertainty of the price rise, is a disadvantage as compared with the tariff. Much more important, however, is the probability of more violent fluctuations. Under the tariff, the

domestic price differs from the world price, but its fluctuations are similar. If there are local shortages or surpluses, the pooling effect of the world market cancels them out. The price fluctuates with the fluctuations of world supply as a whole. Under the quota system it is different. The price fluctuates with fluctuation of *local* supply. It is obvious that severe fluctuations are much more likely. The probability of a shortage or a glut in one source of supply is much greater than the probability of a shortage or a glut in all sources taken together.

But, it will be said, in such cases the quota can be altered. This, of course, is what usually happens. An unexpected price movement occurs; political difficulties are engendered; and painfully negotiated agreements are unceremoniously thrown overboard. And the Pig Reorganization Commission, whose speculations seem to provide the *locus classicus* for the theoretical foundations of the whole policy, definitely recommended a shifting quota as a permanent arrangement. It contemplated, not a stabilization of quotas, but a stabilization of total consumption, the foreign quota being varied according to fluctuation of home production. But such a policy involves very grave difficulties. We may neglect here the implication of the calm assumption that the consumption of any commodity in the six-year period 1925–30, or any other period, is the limit

of the amount to which consumers are to be allowed access in the future. We may neglect, too, the very considerable technical difficulty in fixing aright the foreign quota on the basis of forecasts of domestic production. But we cannot ignore the very grave complication in our economic relations with other powers and with the Dominions which must result from continual alteration of the terms on which we are willing to admit their produce. We have seen already the implications as regards imperial relations of the general policy of protection for domestic agriculture. The difficulties to which such a policy must in any case give rise, must surely be most unnecessarily aggravated if the quota system becomes permanent.

There is a further disadvantage inherent in the general adoption of such methods of trade regulation. The permanent adoption of quotas by this country must inevitably impose grave obstacles to the achievement of world recovery. One of the main needs of the present international situation is that the trade of the various nations should get into some sort of equilibrium relationship. This process, difficult enough in any case, becomes wellnigh impossible if the volume of trade permitted in particular articles is the subject of strict regulation. The quota system is not new — *pace* the authors of the Pig Commission report — and it is the overwhelming

verdict of experience all over the world that full recovery is not to be hoped for until it is swept away, and that its persistence can only drive the various nations further and further along the perilous path to autarchy.[1] Is it not unfortunate that we, who have so much more than most to gain from a restoration of international trade, should, just at this moment, be leading the van in the other direction ?

(4) The Economics of Market Reorganization

The new policy of agricultural planning does not stop at the regulation of international trade. It extends the principle of quotas to domestic production. It controls prices and individual trading. Under the system which has come into force in the last two years, the marketing and the production of certain products is so rigidly controlled that it is no exaggeration to say that nothing is left to the producers of these products save the *minutiae* of technical supervision. The main decisions concerning the direction of production rest with the boards, the main risks with the National Exchequer — the *deus ex machina* of all publicly directed enterprise.

The object of the marketing schemes is the

[1] Recent British policy in regard to bacon and butter has incidentally had the effect of making Denmark, and consequently Scandinavia in general, more and more vulnerable to the policy of Nazi Germany.

maintenance or the raising of prices to the consumer. It is important that this should be realized, for public attention is often distracted by claims of a different nature. It is not true that they are necessary in order to reduce the expenses of marketing. No doubt some marketing arrangements are wasteful. But where this is the case — where real economies are to be achieved by combinations of producers, they can be achieved without coercing all producers into membership and without excluding foreign produce. A combination which achieved lower costs of marketing could underbid the recalcitrant outsider. Nor is it at all probable that substantial gains for producers can be made at the expense of the middleman. Before the days of the schemes much used to be made of this claim, especially in regard to milk. It is worth noting that the prices secured by the Milk Board have been made possible by an extension of winter prices to the consumer.

Now we know that, in the long run, the maintenance or the raising of prices can only be secured by control of supply. It is not enough to impose strict regulation on the amount coming in from abroad. If prices are fixed which offer favourable prospects to farmers, and domestic supplies are not regulated, then the amount coming forward will increase and, in the absence of artificial support, the market will collapse.

We have seen this already with both bacon and milk. In each case the arrangements as regards price have had to be safeguarded by government support in the shape of " temporary " subsidies. The Hop Board already definitely controls production. It is simply a cartel on the German model, its sanctions, however, provided by the state. And the Potato Board controls supply by varying the size of potato which may be marketed and by imposing penalties on the increase of acreage. Unless the state is prepared permanently to subsidize the Milk Board, sooner or later, here too, there will have to be established some form of production control.

If production is restricted below the point which it otherwise would have reached, then, of course, prices can be maintained. By reducing production or by keeping existing production stationary in the face of rising demand, prices can be raised considerably. But is the raising of prices in this way a thing which is generally desired ? Opinions apparently differ when some of the supply comes from abroad. But when it is a matter of domestic production, is it generally desired to establish close monopolies of the necessities of life ? Is it generally desired that a man who is willing to serve the public at lower prices should be legally prevented from doing so, in the interest of high cost producers ? During the slump people have become so accustomed to

talk about the desirability of higher prices, that they sometimes fail to distinguish between a rise of prices brought about by an increase of demand with reviving trade and a rise which is the result of a diminution of supply, of restricting trade. Yet the two things are poles asunder so far as the public interest is concerned. There is no reason to suppose that the multiplication of restriction schemes and the narrowing of markets is anything but inimical to general business recovery. The fact that less capital and labour than would otherwise be the case are allowed to operate in one line of industry, means that more will have to look for employment elsewhere. This has long been recognized in regard to industrial restriction. It is just as true in regard to monopolies of agricultural producers.

Restriction of production, however, is by no means the only implication of these schemes. The very measures which are necessary in order that production may be restricted, imply too a restriction of those tendencies which make for productive efficiency — a restriction, therefore, of those tendencies which make for diminished costs. Under competitive conditions the quantity produced by different farmers is not constant. Efficient farms will be expanding, inefficient contracting. Whether importation is free or whether there exists a certain degree of tariff protection, the competitive struggle is a con-

tinuous spur to efficiency and cost reduction. Under central regulation of production this ceases to operate. The farmer is tied to a quota which is based on his average of a period receding more and more into the distance. He is not permitted to increase his sales by lowering his price : whatever *his* efficiency and *his* cost of production, he must stick to the figure which secures profits for the most inefficient farm which the Board sees fit to keep in cultivation. If he goes below this figure he is liable to the most ferocious penalties. In such circumstances, when the farmer is reduced to a mere functionary of the Board, is it to be supposed that the spur to vigilant enterprise will operate so effectively as in the past ? Is it to be supposed that the various efficiency premiums, which are instituted by the boards, will really provide an effective substitute for the operation of the forces of the free market ?

There is a further impediment to efficiency, less obvious but no less important. The various boards regulate different products or groups of products. One group of products, one board. But the typical farmer in this country produces many products. The one-product farm is the exception rather than the rule in British agriculture. Now it is an essential condition of successful husbandry on the mixed farm that the proportions of the different products produced should be continually adapted to the varying

requirements of its particular situation. Each farm has different potentialities in this respect and these potentialities vary with the weather, with the incidence of plant and cattle disease, with the state of different markets. The successful farmer, like the successful general, is continually varying the disposition of his various resources to meet the exigencies of a varying total situation. But under the new system this is more and more difficult. The various boards to which he is subject cannot view the situation from his standpoint. They each plan only for a particular product and the limitations which they impose on him in connection with each product necessarily seriously affect the flexibility of his operations as a whole. "If I were still free," said one of the most successful farmers in the home counties to me, as we surveyed a crop that had been damaged by frost, "if I were free, I should plough that in and have a try with potatoes. But if I do I shall be fined for exceeding my quota. It isn't worth the risk." The greater the number of products controlled, the more this case will be typical.

The extension of the system is, indeed, very probable. Lack of energy is not one of the deficiencies of the present Minister of Agriculture and the proliferation of boards is obviously a development not at all unacceptable to the men by whom he is advised. But if this were not so,

there is still a cumulative tendency about this kind of intervention which is extremely difficult to arrest. As we have seen, restriction of supply in one line tends to an increase in others. If the bacon pig market is restricted, then the pork market will be flooded. If purchases of liquid milk are limited, more goes to manufacture. It is only natural that the producers who are shut out from the paradise of one monopoly should yearn for the creation of another. Consequently they protest to the Minister. Even if he does not want to go on, it is extremely difficult for him to resist. And so the monopoly system is extended. Another branch of the industry becomes a close corporation under government control. There is no limit to the process which Mr. Elliot has inaugurated save the complete socialization of British agriculture. To some this may be highly acceptable. But if it is indeed the goal, then it is surely desirable that it should be explicitly recognized as such from the beginning.

(5) The Balance Sheet

There can be no doubt that the policy of excluding competing imports increases the value of land in those branches of agriculture which it covers. There can be no doubt, where it is not accompanied by deliberate restriction of home

supplies, that it involves a tendency to the increase of certain kinds of agricultural production which in its absence might have had to give way to others. There can be no doubt, where the control of marketing is carried through to the logical conclusion of restricting the volume of production, that the producers who are permitted to produce may be in a position to make increased profits — if the consuming public does not step in and by compelling a change of policy frustrate their expectations. These, presumably, are the gains which would be claimed by the partisans of the new policy.

But if the analysis of the preceding pages is correct, there are also costs which must be counted. Dearer food, a shrinkage of those industries whose products would otherwise have been exchanged for food imports and the aggravation of our relations with the food producers of other parts of the Empire; the perpetuation of a quota system conducive to continual friction in trade relationship and inimical to the general restoration of world trade; the setting up of domestic monopolies of food producers and the abolition of the main spurs to productive efficiency; the progressive socialization of a branch of industry to which the socialist solution has hitherto not been held to be applicable — these are the costs which, if we are to strike a true balance, must be taken into account

before we estimate finally the value to the community as a whole of this hazardous experiment in planning. Is it clear that the balance is positive ?

VIII

THE ECONOMICS OF IMPORT BOARDS [1]

(1) Introduction

Mr. Wise's alternative to tariffs is state-regulated trading. To form a judgment on its desirability it is necessary to discuss three things: firstly, the object of such regulation; secondly, the technical efficiency of the means proposed; thirdly, their broad significance in regard to international relations. My discussion of his proposals will accordingly fall under these three headings. For reasons of space, I shall confine myself chiefly to the import board proposal: but much of what I have to say will apply *mutatis mutandis* to export boards and the licensing system.

(2) The Rationale of State Trading

It is clear that before passing judgment on

[1] Reprinted from the *Political Quarterly*, Vol. II, 1932. As will be seen, the paper was originally a criticism of proposals put forward in the same journal by the late Mr. E. F. Wise as an alternative to tariffs; and I have left it in this form. Mr. Wise published a rejoinder which may be consulted by the curious. But I have not felt it necessary to make any comment on this.

the technical efficiency of state trading bodies, it is desirable to know the purpose they are intended to fulfil; it is desirable to come to some common agreement regarding the criteria of success of economic organization. If, for instance, state trading were regarded as something desirable in itself, something *morally* superior to any other form of enterprise, it would not be reasonable to criticize it because it failed in other ways to be as advantageous as other forms of enterprise. Or if, again, it were regarded as valuable because it provided prestige for the national unit or the skeleton of an organization well adapted to the needs of war, it would be absurd to condemn it on more utilitarian grounds. If there is no agreement at all as regards ends, it is obviously quite ridiculous to spend much time discussing the efficiency of mere means.

Now I do not believe that any real difference as regards ultimate ends divides Mr. Wise from those of us who are not yet convinced of the wisdom of his proposals. Mr. Wise is a socialist. The critics of his proposals do not all fall under that heading. But in the end the differences between socialists and those non-socialists who do not represent special sectional interests, are differences of opinion with regard to means. We all desire peace, freedom and the maximum satisfaction of wants for the individual. We

attribute no value to social forms as such.[1] We judge institutions by the utilitarian norm. Our differences relate merely to the most expeditious ways of achieving these ends. Our disputes concern not values but machinery.

Nevertheless, I believe that there do exist important differences of opinion concerning the proximate criteria of the attainment of these ultimate ends. I am inclined to think that one of the main reasons why Mr. Wise and those of us who differ from his point of view can so seldom make ourselves mutually understood, is that we have never reached agreement on the simple issue how to describe the conditions under which the working of economic institutions really conduces to the maximum satisfaction of individuals. Yet obviously until this much common ground has been established, further discussion must involve misunderstanding and argument at cross-purposes.

For this reason, before proceeding to detailed exposition of my reasons for doubting the technical efficiency or the political desirability of Mr. Wise's proposals, I want to call in question one central assumption which seems to me to underlie the whole of his argument — the assumption, namely, that there is any other

[1] This statement must be regarded as an argumentative appeal rather than as a judgment of fact. It is to be feared that there are all too many socialists who attach much more weight to the fact of nationalization than to its effects on welfare and liberty.

desirable broad criterion of the effectiveness of economic arrangements than the maximum satisfaction of the changing wants of the consumer.

There can be no doubt that Mr. Wise rejects this criterion. It is the gravamen of his critique of free trade that it has sacrificed everything to the interests of the consumer. " We have paid and are now paying a heavy price for . . . exclusive devotion to the consumers' interests ", he says. " On more than one occasion, under different names, the electorate has been offered a system of protective duties, but it has consistently rejected them all. It has been the interests of the consumer which have prevailed in favour of a free trade policy." In this respect, at any rate, his attitude is similar to the attitude of the protectionist whose policy he condemns. Free trade is condemned because it sacrifices " industry " to the consumer. It has allowed agriculture to languish and other important industries to fall into depression. Moreover, when he comes to discuss positive remedies, his recommendations are based on a similar position. The wheat import board is recommended, *inter alia*, because it will make possible a subsidy to agriculture. The difference between Mr. Wise and the straightforward protectionist is a difference not of principle, but a difference as regards procedure.

I confess I find this very perplexing. It is

easy enough to understand the attitude of the vulgar protectionist. Either he does not understand a simple argument, or he is openly or disguisedly the representative of special interests. In any case, it does not occur to him to look beyond the significance of particular branches of industry.

But Mr. Wise is a socialist. And socialists, equally with liberals — I use the word in its philosophical sense — if they are true to their creed must look not to the special interests of any section, but always to the interests of the whole.[1] Now I can understand the socialist objection to a system of economic freedom that such a system satisfies the *wrong* consumers — that the unequal distribution of income gives the productive machine a " set ", so to speak, which unduly favours those with the largest incomes. That is an intelligible and an important objection which can only be met fairly and squarely if the liberal can produce evidence that some inequality is a necessary by-product of a system of superior efficiency. But I cannot understand socialist objections to the criterion of consumers' valuations in general. On this point, surely a democratic socialism and utilitarian liberalism are at one. For what is the end of production save the satisfaction of consumers'

[1] Such a definition does, of course, imply that many trade union representatives are not socialists.

wants ? There may be some forms of production which carry with them ultimate satisfactions, but, in any system of social co-operation, these are matters of producer's choice rather than social evaluation. A socialist society having control of all the means of production, if it is to be run on democratic utilitarian lines, must distribute these means between different branches of industry in proportions most suited to satisfy to the maximum degree possible, in the given conditions, the demands of consumers for the means of consumption.

That is to say, a socialist society, equally with a society based on free trade in the products of privately owned means of production, must value industries, not *per se* but only in so far as they minister to consumers' gratifications. The socialist, equally with the free trader, will not regard the maintenance of given industries at a given size as the criterion of economic efficiency. He will rather regard the desirable size of a given industry as being dictated solely by the purpose served by that industry in producing commodities for ultimate consumption. Thus, faced with the choice between using factors of production *directly* to produce bread at home or *indirectly* to procure it by way of exchange abroad, he will unhesitatingly choose that use which produces most bread with least expenditure. If this involves the contraction of domestic agriculture, his view,

equally with the view of the free trade liberal, must be that domestic agriculture must be contracted. The means used for enforcing the contraction may be different. But unless agriculture is regarded as having military or aesthetic values not entering into consumers' computations, the reasons dictating the contraction must be the same. Hence, in so far as state trading is designed to provide a subsidy, open or concealed, to any particular industry, I do not see how the proposal can be squared either with the socialist or with the liberal philosophy. Good Cobdenism is good socialism; the differences relate merely to machinery.

But now, if Mr. Wise has done me the honour of reading thus far, I can imagine him bursting with impatience to interrupt me. "Are you not overlooking", he will urge, "the main argument for 'controlled' production, the argument, namely, that if prices can be stabilized in any given industry and output planned for long periods ahead the resulting technical gains will be such as economically to increase the volume of production of ultimate commodities?" Does not the whole free trade argument ignore the gross damage to productive efficiency of continual shifts in consumers' demand?

Prima facie the argument is powerful. But I can assure Mr. Wise and those who argue thus that it is not an argument which is overlooked

by those who, like myself, are disposed to call their position in question. On the contrary, it is just on this point that we would most emphatically join issue with him. For it is just here that the confusion of mind which results from the abandonment of the criteria of price and consumers' demand is most insidious. It is perfectly true that a manufacturer who is planning for a certain future is in a position to secure technical economies not available or not profitable to those who are planning for a less certain future. But to argue that the technical economies thus achieved are evidence of economic efficiency (*i.e.* of the use of the factors of production to satisfy changing consumers' demands most effectively) is to fall into the fundamental fallacy of confusing physical and value productivity. Economic goods are not measured by physical quantity. They are measured by consumers' valuations. Mass production to a fixed plan may increase the volume of physical production. But if it is only made possible by the frustration of consumers' demand, it is producing mere stuff, rather than stuff to which such demand gives value.

If I may do so without offence, I would venture to suggest to Mr. Wise that it is just in this connection that too exclusive a concentration on the experience of the war, or the assumptions of the Five-Year Plan,[1] may give rise to a false

[1] Mr. Wise was an employee of the Russian Government.

perspective. Such cases fall outside the category of a democratic organization of production. During the war, for reasons which, no doubt, were regarded as adequate by a working majority of the population, consumers' choice ceased to be the criterion of industrial organization. Values, in the sense in which the word is normally used, virtually ceased to exist. Certain fixed, statistically defined desiderata, laid down by bureaucratic decision, became the objective. The same is true of the Five-Year Plan. Again consumers' choice is subordinated to the achievement of certain physically defined objectives. Again value in the ordinary sense of the word has ceased to govern.

Now, no doubt considerations of political expediency can be adduced in extenuation of both these experiments. That is not the point I am here concerned to argue. The point that I wish to bring out is that such an organization of industry necessarily suspends the criterion of the maximum satisfaction of a changing consumers' demand; and I do not believe that, as a long-run policy, such a suspension would be thought desirable in democratic communities, either by socialists or the adherents of any other school of utilitarian thought. What you are doing if you throw overboard the criterion of consumers' choice, is, in effect, to say to the general body of citizens that they do not know

what is best for them at any given moment and that you do. It is conceivable that there may be historical justification for such a procedure in certain emergencies, but as a maxim of long-run policy I have yet to learn how it can be reconciled with the first postulates of democratic theory.

There are two cases in which the argument for frustration of this sort is at first sight more plausible. If, owing to a fortuitous aberration of consumers' psychology, demand were to deviate temporarily from its general trend ; or if, owing to the predatory policy of other producers, it were to be temporarily deflected from sources of supply which in the long run are needed ; it might then perhaps be argued that temporary intervention could realize a " truer " interpretation of long-period consumers' valuations than the momentary relationship of prices and costs. This, of course, is the valid argument for intervention against predatory dumping.

The argument is plausible. But the whole burden of proof that it has much relation to reality still rests with those who continually adduce it. It is no argument in favour of intervention against continuous dumping. It is no argument in favour of intervention against changes of fashion. Still less does it provide any argument against intervention, either by way of tariffs or by way of state trading, designed to protect given industries from the effect of changes

of technique or progress in other parts of the world.

Now, as I conceive their actual mode of operation, it is just such changes as these which Mr. Wise's trading bodies would tend to delay — even if they would not hold them up for ever. Of course, this is not a conclusion which is given by analysis. I do not urge that in all circumstances it would follow. It is conceivable for instance that, in an autocratic state, adaptations to changed conditions might be carried through even more quickly than under capitalism. But in a state run on democratic lines the probability is that the special interests of particular sections of the electorate would continually override the general interests of the consuming public. For socialism makes explicit and central just those conflicts of sectional interest which are submerged and diffused under the operation of the impersonal mechanism of price in a system of free enterprise. The whole outlook of contemporary socialism assumes a *static* condition of industry.

We can see this very clearly if we consider Mr. Wise's own attitude towards agriculture. If we have regard to consumers' demand, one of the good features of recent economic history has been that it has been found possible to satisfy the comparatively inelastic demand for bread with a steadily diminishing proportion of the factors of production available. In the world as a whole this has shown itself in a tendency to a

relative depression of cereal prices. In this country it has shown itself in an absolute decline of the area under arable cultivation. The utilitarian, be he liberal or socialist, must surely welcome this progressive emancipation from the curse of Adam. He may deplore that it has not been found possible to transfer men from arable farming to other forms of production fast enough to avert a relative depression of agricultural incomes. He may think that state intervention to facilitate transfer would have been desirable. But, unless he is what may conveniently be described as an agrarian mystic — I should scarcely have put Mr. Wise in this category — he would surely do nothing which would reverse this desirable process. Yet not so Mr. Wise. He laments the " decay " of British agriculture over the last three or four decades just like any partisan of the landlords, and puts forward proposals which he hopes will make it possible to retain in cultivation land which otherwise will be put down to rough pasture. This surely is the static attitude with a vengeance. Why on earth should we grow wheat in East Anglia if we can get it more cheaply from the Argentine ? If, in future years, the world fills up, and the terms of trade turn against the manufacturing countries, then we can bring the land once more into cultivation. Nobody can pretend that the swing would be so quick and so unexpected as to catch us

entirely unawares. Why, then, until that rather improbable contingency arises, should we use the factors of production uneconomically ? Why should we set up machinery which will impede the process of adjustment ?

(3) The Efficiency of State Trading

Up to this point Mr. Wise's proposal is on all-fours with proposals for protection. He is, I think, entitled to argue that the cost of an agricultural subsidy carried out in this way need impose less burden on the consumer than a tariff of equivalent effectiveness. Given the assumption of the efficient operation of the import board — this assumption will be investigated later — the static argument favours state trading. The dynamic argument works in the opposite direction. In this country, at any rate, a food tax would be difficult to alter in an upward direction. The tariff, once imposed, would be the target of attack by at least one of the parties. Any change downward in the world price of wheat would, therefore, be reflected in the home market. The import board, however, would be liable to continuous pressure to keep its domestic buying-price constant, and this would not be so easy to resist. If the world price of wheat were falling the magnitude of the subsidy to domestic agriculture, measured in terms of the difference

between the board's price and the world price, would become greater and greater.

But Mr. Wise not only claims for his import boards that they will provide a stimulus to certain industries — the alternative to tariffs — he also contends that this method of conducting trade is likely to be technically more efficient than others : that it will secure price advantages and economies of organization not available to non-monopolistic buying. These are clearly claims which it is important to examine carefully.

Mr. Wise's claims relate to bargaining power and organization. Now, as regards bargaining power, it is impossible to lay down comprehensive generalizations. Each case has to be examined in the light of the circumstances in the particular markets concerned. It is conceivable that, in certain cases, a board which took a very large proportion of the total supplies might be in a position to force down prices below the competitive level, and thus to secure gains at the expense of the foreigner. There will be something to say about the political significance of such powers later on. But there is a strong presumption that such cases would be infrequent. It is usually the case that when government agents are in the market, prices tend to harden against them. Disciplinary measures which may be open to domestic buying boards — the Russian Wheat Board, for example — would clearly not

be available in the case of international purchase. If the speculators of Winnipeg and Chicago rigged the price against the British Government, we might deplore their wickedness, but it would not be open to us to send them to a timber camp.

In the case of wheat in particular, it seems particularly improbable that an import board of the kind suggested by Mr. Wise would be in a position to gain price advantages not accessible to the grain market in its present form. It is a well-known fact — it is indeed a fact which Mr. Wise, in his mood of agrarian mysticism, appears to deplore — that, owing to our great entrepôt trade and to our always being willing to buy — we get our wheat cheaper than it is to be had almost anywhere else in the world. Speculation, so far from raising prices *against us* in the present state of the market, actually results in our receiving a substantial proportion of our wheat below the price in the producing centres. Wheat a day or two out from Liverpool may be actually cheaper than wheat of the same quality at the elevators. We receive, as it were, a subsidy from the speculator who gets caught. I do not see how Mr. Wise could do better than this, and there are many reasons which suggest that he might do very much worse.

But Mr. Wise claims not only price advantage, but also superior organization. It is just here, I confess, that my scepticism is greatest. It is

quite easy to imagine a not inconsiderable economy of telephones and office furniture. But these are incidental advantages. The question is not whether one man will be doing the work of two, or whether one office will take the place of several. The question is whether the organization within the office will be able to secure, year in and year out, greater economies of purchase.

Now there are certain criticisms that I do not wish to be understood to be making. I am not suggesting that government buying is necessarily unworkable. In the light of experience, such a suggestion would be silly. I am not even suggesting that men with the technical qualifications are not available. I am not clear how a continuous supply of such talent is to be secured. But at the outset, as Mr. Wise would quite rightly point out, it would be quite easy to select men from existing businesses. For a generation at least, the *same* men with the *same* ability and the *same* moral habits would be working under a different label. The question that I wish to ask is simply whether, under the new conditions *necessarily created by their relation to the government*, their operations would have the *same* efficiency. My own view is that they would not be so efficient. Let me try to set out the reasons for this scepticism.

It would be possible in this context to dwell

at some length on the contrast between the relative strength of the profit-and-loss incentive under private enterprise and the incentive of duty and prospect of promotion in government service. And in the field of foreign trade, where sharpness and preoccupation with the financial prospects of the moment are the prime essentials of success, I am inclined to urge that the contrast would not be in favour of the incentive of public service. But I do not wish to press this point. We know very little about incentives. A scepticism which rests upon disbelief in the capacity of human nature to transcend itself may be warranted by history and experience, but it is no sure guide to future action. My scepticism rests, not upon considerations of this sort, but upon considerations relating to the objective conditions under which state trading must of necessity be carried on. I am not sceptical because I think the officials would be *unwilling* to operate as efficiently as under private enterprise, but because I think they would be *unable* to do so, because of their relation to the government.

It is a well-known fact that efficiency in the import trade depends essentially upon flexibility of organization and capacity for rapid and untrammelled decision. It is equally well known that capacity for rapid and untrammelled decision is a quality which is necessarily absent from all forms of organization

responsible to a democratic state. This is not because public servants are slack and inefficient. They are not necessarily slack and inefficient at all. It is because, being responsible to the state, the forms of procedure they are obliged to adopt must be more elaborate and cumbersome than the forms adopted in enterprise not so responsible. This may not matter very much in public utility supply and in various forms of production ministering to a stable home market. It would be a very grave disadvantage in international trade.

Now, it is no reply to this objection that, during the war, in this country the various buying boards operated with flexibility and success. During the war the principle of parliamentary control was in abeyance. It is no accident that the Wheat Commission, in surveying its work, was at pains to emphasize that such success as it had achieved was due to just this absence of parliamentary control and interference.

Nor is it possible to get round the difficulty by calling the board a "quasi-independent" body, and pretending that responsibility to Parliament is not there. Ultimate problems of organization are not solved by terminological jugglery. The fundamental test whether or not the board would have the freedom of private enterprise is the test of liability to bankruptcy. *Would Parliament allow the board to go bankrupt?* If not, then the essential limitation of state

enterprise would remain. In the last analysis the state would have financial liability. It would therefore be inevitable that the forms and procedure essential in an undertaking responsible to Parliament would have to persist. It is highly significant that Mr. Wise admits that the state would have to provide financial guarantees, and that the board would have to be answerable to a Minister of the Crown.

But this inherent and justifiable inflexibility of state enterprise would not be the only handicap under which a board of this sort would conduct its operations. I have referred already to the almost inevitable political pressure to pursue an uneconomical buying policy at home. It is no use pointing out that this need not be the case, that the board *could* be stern and relentless, and insusceptible to public pressure. It is a matter of common experience that wherever and whenever boards of this sort have been set up in political democracies, they have been subject to this kind of pressure and they have usually succumbed. We may think ourselves superior to this kind of thing, but such a belief is self-deception. What political party would be willing to defy the Farmers' Union if it were a matter of a shilling or two on the price of wheat ?

And this domestic pressure is probably the least of the political handicaps under which the board would labour. A British wheat import

board would be subject to continual pressure from imperial sources. This pressure would take two forms. On the one hand, it would appear as a resistance to qualitative discrimination *within* the Empire. If the Australian crop were qualitatively inferior to the Canadian crop, it would still be thought improper that such differences should be reflected in the prices offered. It is well known that such resistance was actually offered even during the war : it is a dead certainty that it would recur during the less altruistic times of peace. On the other hand, there would be pressure to conclude contracts with different parts of the Empire on terms more favourable than were granted to the rest of the world. Mr. Wise lays it down that such a policy should be avoided. He is an optimist if he thinks that this maxim would be observed.

But this brings me to the last, and in some ways the most weighty objection — at any rate so far as a wheat import board is concerned. Mr. Wise urges that the board should undertake bulk purchases on long-term contracts, and, for reasons which I confess I am entirely unable to fathom, he seems to regard such a procedure (which, having regard to the likelihood of imperial pressure, I agree to be a strong probability) as a positive recommendation for his proposal. To me it is almost proof conclusive of its extreme financial danger. For, whereas it is almost

certain that political considerations would not allow the board to reap profit in times of rising prices — there would be an immediate outcry of government profiteering if it were attempted, and it would have immediately to pass on any gains made in this way to the farmer or the consumer — it is clear that in times of falling prices it would continuously be doing worse than the market. Since there is a presumption that, over long periods of economic progress, the tendency of agricultural prices will be downwards rather than upwards, this means that the consumer would be continually getting less than he might, and in all probability that the board would be operating at a loss.

These are not academic apprehensions. They are surely the practical probabilities of the world situation. Suppose that in 1925 Mr. Wise had had his way. Suppose that an import board for wheat had been set up at the top of the world boom. Can any reasonable person seriously question that during the last few years it would have operated at a colossal loss ? Surely, when the world is strewn with the wreckage of pools and rings and similar grandiose organizations, it is an odd time to urge that we should follow their example and make instability and indeterminateness universal.

(4) The International Significance of State Trading

But, putting aside all these technical objections, there remains a further argument which, in my opinion, would be decisive against proposals for state trading, even if the other arguments were heavily in its favour — the argument, namely, that it would introduce new frictions into international relations. In all valuations of alternative policies, estimates of effects upon international relations must be given preponderating influence. For our generation at least, the preservation of world peace is not merely a pious desideratum : it is the first essential of the continued existence of the present world economy. If state trading increased the danger of international friction and disunity, then state trading should go, even if it brought with it a substantial gain in local prosperity.

In the normal course of trade, the exchange of goods across frontiers is an exchange between private individuals. In economic textbooks, in statistical tables, these transactions are described as " international " trade, but, save in so far as customs regulations and the maintenance of courts for the enforcement of contracts are concerned, the local authorities we call states have nothing to do with the matter. When " Germany " sends so many clocks, doll's eyes, cameras,

etc., into England, all that happens is that private firms in England and Germany enter into certain contractual obligations. The German Reich and the British State need have nothing to do with the matter.

This decentralization of trading functions, if one may describe as decentralized something which has not yet, as a general rule, been regulated from the centre, has important advantages from the point of view of inter-state relationships. It reduces disputes about trade to disputes between individuals. It relegates to the sphere of private law that which might otherwise be public. The innumerable disputes about consignments and contracts which inevitably arise in trade become matters, not of high diplomacy, but of private treaty. A whole world of contentious matters is removed from the field of public policy. It is the remote exception rather than the general rule for national prestige to be involved because it is alleged that merchant X in A has failed to deliver potted meat to merchant Y in B.

Now, when states participate in trade, all this is altered. It is not now a matter of disputes between private individuals. It is a matter of disputes between the organs of public policy. It is a matter, not of low commerce, but of high diplomacy. It is not possible to evade this objection by urging that the boards should be

quasi-independent. Whatever their precise political and legal status, they are essentially public bodies, and it is inevitable and justifiable that their operations should be identified with the policy of the states they represent. It may be pretended that they are not identical. Legal fictions may be invented which make it possible, for certain purposes, to regard them as separate bodies, but from the point of view of the psychology of international relations — which in this connection is the all-important thing — it will be as impossible to dissociate them from the states which set them up, as it is to dissociate the policy of the Third International from the policy of the Union of Soviets.

That is not all. It is possible that, under certain circumstances, the behaviour of these boards would have an appreciable influence on prices. I do not think that, in fact, they would often be able to operate to the advantage of the states they represent. But it is quite clear that, whether this was actually the case or not, they would be believed to be so operating. Every fluctuation in prices adverse to the parties with which they were dealing would be attributed to their machinations. Is it not probable that, in such circumstances, their existence would lead to a very considerable intensification of international friction? The existence of tariffs is a cause of occasional difficulty. The existence of

import boards would be the cause of continuous friction. I do not argue that such friction would be likely to be the immediate *occasion* of the outbreak of a major conflict. But I do suggest that it might very well be one of the main predisposing *conditions*.

Let me put to Mr. Wise a simple question. Let us suppose that a system of import boards had been operating in this country at the time the Prime Minister was visiting America and preparing the ground for naval disarmament. Let us suppose that they were doing all that he promises that they would do in the economic sphere. Can he suggest that that visit would have been as fruitful as it was, if the farmers of the Middle West, the cotton growers of South Carolina, had been receiving lower prices than they otherwise would have done, as a result of the operations of our monopoly? We know already the kind of international atmosphere which is thus created. We have had bitter experience with the Stevenson Rubber Restriction Scheme and our coal policy immediately after the war. A world in which this sort of thing had become general would not be a pleasant place to live in.[1]

[1] Written in 1932: not retracted in 1939. But the P.E.P.tonized intellects of our rulers are working overtime to make totalitarian trade methods universal.

(5) Conclusion: Socialism and Economic Nationalism

Considerations of this sort suggest one final reflection. By the middle of the nineteenth century, the main issue which men of disinterested goodwill were called upon to decide was the issue of liberalism or socialism — whether the main basis of economic organization is to be private ownership of the means of production and free exchange, or control and ownership from the centre. I do not believe that that issue has been solved, in spite of certain recent attempts to suggest that it is *démodé*. But, in recent years, a second issue has arisen — an issue which both Karl Marx and John Stuart Mill must have thought to have been successfully settled for all except the stupid, the mystical or the interested — the issue of nationalism or internationalism.

Now, this issue, which, for those who do not bury their heads in the sand, has become *the* issue of life or death for our generation, did not divide the older generation of socialists and liberals. After all, Karl Marx was nothing if not a classical economist. He realized equally with the great liberal philosophers that the economic system of our day is a world system, that it demands world peace for its successful functioning, and that attempts to hem it in within national frontiers, to make it dependent on

national states, only diminish productivity and increase the chances of war. Karl Marx would have denounced attempts at economic organization on national lines as *kleinbürgerlich* — the peddling inventions of a bourgeois mentality that was not even abreast of the times.

In recent years, however, partly as a result of the war, partly as a result of the growth of an opportunism growing as the prospects of power become closer, a change has come over the outlook of many socialists. International socialism recedes. National socialism looms larger and larger. The import board proposal and the Mosleyite propaganda are merely the logical development of this fissiparous tendency. Nor has liberalism escaped a similar degeneration. It is a far cry from the generous internationalism of a Mill or a Goethe to the parochial shortsightedness of those English liberals who would restrain the export of capital, if it meant that the standard of life of workmen elsewhere might thereby rise more rapidly than the higher standard of the workmen at home! "Never in the lifetime of men now living has the universal element in the soul of man burnt so dimly."

Now, whatever the merits of particular proposals, one thing is perfectly clear. The organization of the world on national socialist or national liberal lines is inimical to internationalism of all kinds. A world in which the movement of goods,

of money and of people is restrained and impeded by national organization, a world in which the national states separately organize economic processes which are essentially *a*national, is a world in which the achievement of the international ideal, whether on socialist or liberal lines, is more distant even than it is at present. It is mere self-deception to believe that such developments are an " inevitable stage " in the right line of evolution, just as it is self-deception to urge that it is right to arm further in order to facilitate disarmament, to erect tariffs in order to promote free trade, and so on. These are not cases of *reculer pour mieux sauter*. They are cases of recoiling to jump in the opposite direction. Nationalism and internationalism in the field of economic organization are inimical to each other. Whatever leads to the one, must inevitably lead away from the other.

It is just here, I suggest, that a truce is possible between international liberals and international socialists. We do not agree about the appropriate forms of organization in the world economy. We shall not cease energetically to debate these important questions. But, at least, we are one in regarding all sectionalism, whether industrial or local, as incompatible with our respective ideals. At least, we are one in regarding nationalism as a common enemy. Can we not agree, in this respect, to work shoulder to shoulder — to

resist this nauseating backwash of historical mysticism and geographical particularism which is threatening to destroy our common culture ? I do not hope to persuade Mr. Wise to go back to Hume and Bentham. But may I appeal to him as a good internationalist forthwith to return to Karl Marx ?

PART II

GOVERNMENT EXPENDITURE AND ECONOMIC ACTIVITY

When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy: sometimes by an avowed one, but always by a real one, though frequently by a pretended payment.

ADAM SMITH, *The Wealth of Nations*, v, iii.

I

GOVERNMENT EXPENDITURE AND ECONOMIC ACTIVITY[1]

(1) Introduction

Ladies and Gentlemen — I have to ask your indulgence this evening. My subject is a subject of very great difficulty. Alfred Marshall, the great English economist, once laid down the proposition that no short proposition in economics could possibly be true. That dictum seems to me to be especially applicable to the subject which has been chosen for my lecture this evening. It is also a highly controversial subject. I think it would be true to say that there is no outstanding problem of economic policy about which opinions between essentially reasonable people are still so violently divided. It is not possible at this stage to lecture on such a subject as this

[1] A lecture delivered before the Stockholm Economic Society in March 1936. I cannot guarantee that the lecture was delivered in exactly these words, for the version here presented is based on a stenographer's transcript: and no-one who has had to wrestle with such documents will under-estimate the difficulties of restoring what one thinks one has said. But I have not modified the main lines of treatment, preferring to leave the slightly more hopeful view which I now take, in regard to one aspect of the problem discussed, to stand where it first occurred in the second paper in this series. (See the footnote on p. 218 below.)

with the authority of united scientific opinion behind one. I put forward my own views, not with any great confidence that they are correct, but in the hope that a candid interchange of ideas may in the end help to clarify knowledge.

Let me commence by attempting to define the nature of the task which you have set me. The problem — the problem of the economic effects of government expenditure — is clearly a dynamic problem; it has its roots in the uneven nature of economic activity. If we could assume, as we do assume in elementary statical analysis, that all the factors of production are continuously employed, then the question concerning the appropriate proportion of government expenditure to other expenditure would still be an important question; but it would be a question of welfare economics only, a question of the relative importance of things supplied by government and by private enterprise. In such conditions opinions might differ as to the relative effectiveness of governmental and other forms of enterprise. But the pace of economic activity, the subject of my lecture this evening, would be continuous, whether or not it was directed to the most suitable ends. In the real world, however this assumption of continuous and full employment does not hold, and there is reason to suppose that, even in a system much less hampered by friction than our own, things would still

not work out in that way. There would still be an uneven tempo of economic development. The question therefore arises whether variations of government expenditure may not be made to have, as it were, a damping effect on the variations of activity elsewhere; whether variations of government expenditure may not be used to produce more continuous, more even economic activity.

To analyse our problem successfully, it seems to me, it is useful to make certain distinctions. We may first distinguish between government expenditure on what may be called income account and government expenditure on what may be described as investment account. Then again, we may distinguish between government expenditure which is financed by taxation and government expenditure which is financed by borrowing. These distinctions are very rough. But they facilitate the disentanglement of the issues.

(2) Government Expenditure on Income Account

Let us commence with that part of government expenditure on income account which is financed out of taxation — the current expenses of defence, education and the like. Now here, I venture to suggest, there is not really much difference of opinion. I imagine that most of us

would be inclined to agree that increased expenditure financed by increasing taxation would *not* be an appropriate cure for economic depression. It is conceivable that we might still disagree about the relative desirability of shifts in types of taxation as between depression and boom. Some may think that it would be more desirable to tax consumption during depression, others that it would be more desirable to try to tax savings. But this is surely a minor issue. We may wish to increase taxation to *maintain* expenditure. In such a case there is room for much difference of opinion concerning the right taxes to choose. But to increase taxation to *increase* expenditure is not likely to be recommended by many as a cure for the pessimism of investors.

The more contentious question as regards expenditure on income account relates to the problem of deficits—relates, that is to say, not to the question whether this kind of expenditure should be increased, but rather to the question whether deficits which arise during depression are to be met by diminished expenditure and increased taxation or by increased borrowing.

At this point opinion begins to diverge, but it is probable that here, at any rate, the divergences are to some extent differences of degree. *Prima facie* it seems that in such circumstances there is some case for some borrowing. In certain circumstances the case for some suspension of

sinking fund repayments is very strong indeed.

But, as I see it, this policy has obvious limits. Borrowing on a large scale to meet deficits on income account may very easily have adverse effects on the gilt-edged market. There has been plenty of evidence of this in recent years. Moreover, if people think generally that this policy is going to involve increasing deficits in the future, that also has an adverse effect on confidence.

There is one argument for exclusive resort to borrowing at such times which has recently attracted many adherents. It is argued that the period over which accounts are balanced is, in a sense, quite arbitrary. It is as sensible to balance the budget over, shall we say, a five- or ten-year period as it is to balance it over the twelve-month period of financial orthodoxy.

I confess that I am not altogether convinced. The fluctuations of revenue within the twelve-monthly period are seasonal fluctuations. We know their causes : they are partly determined by the movement of the planet round the sun, partly by certain fixed social habits. It is very doubtful whether the wider cycle of business activity has anything like the same regularity as this. It is doubtful, too, whether that cycle can be regarded as being independent of policy. If it is not possible accurately to foretell in advance the exact period of the cycle of prosperity and depression, then there is a danger of

drift — a danger that the movement may be all in one direction.

For all these reasons, *so far as expenditure on income account is concerned* I would resort to borrowing to meet deficits only as an emergency measure. Beyond that I still think that there is much to be said for the more austere policy. I know that this is likely to be unpopular. But I do not think that the history of public finance affords any reason for the belief that where budgets have been balanced continually without much borrowing, the instability of business has been greater than where budgets have been chronically unbalanced.[1]

(3) Government Expenditure on Investment Account: Taxation *versus* Borrowing for "Normal" Investment

But after all this is a very subordinate matter. The real difficulty relates to government expendi-

[1] I do not think that anything in the above section is wrong. But I do not think it is to be denied that it is not a very cheerful picture. For, in the modern world, with its extensive social services and its proportionately high volume of taxation, the down-turn of the trade cycle is bound to involve considerable budgetary difficulty: and measures of old-fashioned financial orthodoxy, even though they may be preferable to extensive deficits, in the short run may have the effect of intensifying depression. I was fully aware of this difficulty when writing this lecture. But at this time I did not see a way out which was compatible with long-term stability. Since then, however, further reflection has led me to suggest the plan outlined in section 4 of the paper below, *How to Mitigate the Next Slump*. I have nothing to retract. But I am happy to have something a little more cheerful to add.

ture on investment account. To that question I now turn.

Now, it will focus attention on the essential nature of the problem we have to analyse if we recollect that it is not seriously proposed to finance such expenditure out of current taxation at periods of low general activity. If we were considering the alternatives of policy in a period of full employment, then obviously the effects of non-inflationary borrowing and of taxation would be comparable. In each case there would be a transfer of resources, a withdrawal of resources from some lines of production for use in other lines; the problems involved would be merely problems of distribution and incidence. But if we are dealing with a period of slack employment — and it is of course in this context that the proposal is made — then the comparison collapses. In such circumstances the effect of borrowing may be different in kind from the effect of taxation. For the borrowing is intended to have monetary repercussions favourable to the increase of general economic activity; and it may indeed have this effect.

Before I come to the controversial part of this question, I have, however, one more distinction to make, a distinction which is difficult to draw but which seems to me to serve a useful purpose. We have to distinguish, I think, between what may be described as normal

government expenditure on investment account and extraordinary government expenditure. By " normal " investment I mean what is sometimes called reproductive investment, investment on government enterprises which pay at the current rate of interest, and I include, further, development expenditure which would normally be financed by loans rather than taxation. It is very difficult to draw an exact line between some of this development expenditure and the expenditure which I have described as extraordinary. But some rough classification of this sort is surely permissible.

Let us consider first what I have just called " normal " expenditure. Let me say at once that I see very little reason for cutting this down in times of depression. I do not see why enterprises which promise to pay the current rates of interest should not go on. I do not see why essential development should cease. The idea that *all* government enterprise, whether it pays or not, should be cut down at a time of depression is surely false economy. I do not know any competent economist who holds the contrary view.

Nor, again, do I see any objections to the device of attempting to plan, of attempting to space out this kind of work so that less is done during the boom and more during the slump. This idea was advanced, in my own country,

before the war by so cautious an economist as Professor Bowley, and I know of nothing that has been said since that time which in any way impairs the value of the suggestion. Surely what is prudent in the conduct of a large business is prudent also in affairs of state. It is good business to go ahead when the rate at which you borrow is low.

Nevertheless, having, I hope, paid sufficient tribute to the general persuasiveness of this idea, I do think that it is important to recognize certain limitations. I think there are certain practical difficulties here, which are often insufficiently recognized.

In the first place, it is not easy to predict in advance when a slump will actually arise. We may be certain that a slump will eventually come. But it is much more difficult to say when it will come. Secondly, it is often politically very difficult to stop this sort of thing during the boom. And, thirdly, it is not always expedient to plan such investments with only the trade cycle in mind. Suppose a fever hospital is needed in a large town; it would be an absurd thing to refrain from building because it was desired to stimulate employment during the slump. Conditions differ in every country and I would not presume for a moment to generalize about any country save my own, but I am inclined to think that practical difficulties of this kind are often very considerable.

The enterprises in which governments are normally justified in investing are not wanted merely as dampers ; they are also wanted in themselves. This is not a reason for not trying to work the policy : it is no justification for indifference and inertia. But it is a matter to be taken into account when we are trying to make estimates of the quantitative promise of such policies.

(4) Government Expenditure on Investment Account : Extraordinary Investment

But as I have said already, I do not think that the differences of opinion in this field are really very great. The real controversy concerns not this kind of expenditure, but emergency expenditure not expected to pay in the business sense at all, extraordinary expenditure definitely incurred to alleviate depression, accompanied perhaps by some plan for budget surpluses later on to ease the debt thus incurred.

Now, there is a real difference of opinion here. But before dealing with that, may I enunciate one principle on which I hope we may all agree. We can all agree that expenditure of this sort should not be such as to hold up or prevent adjustments which are necessary. If during the preceding boom things have gone wrong, if resources have been seriously misdirected, then if a more even economic development is to be expected in the

future, shifts are needed. It is therefore a bad thing if the direction of emergency expenditure is such as to prevent such shifts. If people think that sooner or later some important network of interests must come to grief, it is better that it should come to grief sooner rather than later. While uncertainty exists, confidence is paralysed. Any delay in the contraction of a line of industry which has become over-expanded is a thing to be avoided.

I can illustrate what I mean by what I fear will probably be one of the results of the rearmament expenditure just beginning in my own country. This rearmament expenditure will stimulate economic activity in some parts of the system which hitherto have been very depressed. In my judgment, just for this reason, the long-run effects will be bad. It will be a bad thing for certain industries, industries which apart from the rearmament are doomed to contraction, if their members are tempted to believe that after all there is a future for them on the old lines. It will be a bad thing if necessary adjustments are held up by an expenditure which revives hopes which in the long run cannot be justified.

But let us turn to more controversial issues. Let us examine the more general effects of this sort of shock tactics.

Now, extraordinary expenditure of this sort is

certainly not neutral to employment. In times of depression public borrowing does not *necessarily* take away from the market resources which otherwise would have been available for private enterprise. It is sometimes argued that opposition to schemes of extraordinary expenditure only comes from people who suppose that, at all times, government borrowing causes resources to be taken from private enterprise — a view which is sometimes called in England the "Treasury" view. In fact this is not the view of the more reputable sceptics.[1] It is, indeed, common ground that the whole business is much more complicated than a simple transfer. We all admit that, in the short run, extraordinary expenditure has effects other than the effects of a mere transfer. The question is what is the nature of these effects, under what circumstances are they conducive to long-run stability, how far do they go, and so on.

Now, it is sometimes suggested that these difficult problems are a matter of simple calculation. It is said that one can calculate, by obvious processes, the primary effects on employment of expenditure of this sort, and that then one can estimate the total effects by multiplying this initial figure by a multiplier obtained by estimates of the probable rate of re-expenditure of the initial outlay. I hope you will not think I am

[1] There is strong reason to believe that such view is not held by the British Treasury.

unsympathetic to abstract analysis. But I do suggest that, in attempting to arrive at conclusions on such complicated issues of policy, a procedure of this sort is too crude. The abstract theory of the multiplier is just as much a truism as the much-derided Fisher equation of exchange. The question is, is it helpful? Does it not give an appearance of false simplicity to what is, after all, an appallingly difficult problem? Do we not beg most of the important questions if we assume that the only influence on employment is the rate at which the initial outlay is re-spent? I, at any rate, prefer to proceed by rather different methods.

So far as the so-called "primary" effects are concerned, it is obvious that the volume of employment afforded by expenditure of this sort depends on the rate of remuneration of labour and the proportion of the total expenditure immediately devoted to procuring the services of labour. But this is a relatively uninteresting matter. Considerations of the primary effects of such a policy may be conveniently left to the proper statistical offices.

From our point of view it is the "secondary" effects which present the main interest. The interesting question is not to what extent does a given expenditure give primary employment, but rather to what extent does it have further repercussions, to what extent does it stoke up economic activity elsewhere, and to what extent are the

impact effects of these repercussions conducive to long-run stability.

Now, here I think the distinction between income expenditure and investment expenditure is very helpful. Government expenditure which is focused on consumers' goods, or on wage payments which are likely to be all spent on consumers' goods immediately, is not likely, I think, to have such extensive secondary effects as expenditure on investment goods.

My reason is quite an obvious one. I appeal to no esoteric *kapitaltheoretische* considerations here. The condition for extensive secondary repercussions is the existence of unused capacity in the neighbourhood of the impact effects of the expenditure. If this condition is not satisfied, then the expenditure is liable to exhaust its effects in raising certain prices rather than in producing increased employment. Now, it seems to be common sense to suppose that, in most depressions, there is likely to be much less unused capacity in the industries making for immediate consumption than in the industries making investment goods. I do not say that expenditure directed towards consumers' goods has *no* secondary effects. But I believe that the secondary effects here are less than the secondary effects of expenditure directed towards investment goods. I believe — though it is early days yet to appeal to the experience of recent years — that that is

borne out to some extent by experience in the United States.

But even if we accept this proposition, we must recognize that not all expenditure on investment goods is likely to be equally effective. As we have just seen, there must be available unemployed capital and labour which can be brought into operation with the requisite speed. It is important not to have to bring capital and labour from other parts. It is important that other branches of industry shall not be adversely affected by the competition of the industries stimulated by government expenditure.

At the bottom of a depression it is probable that one of the types of expenditure which satisfies these criteria most completely is expenditure on armaments. There is no *a priori* reason why this should be so. It is simply an empirical accident of the layout of the economic system of the present day. But it does seem to be the evil fate of the world in which we live that investment of this sort offers, not merely a temptation to war-like men, but also certain advantages of a rapid creation of employment, not offered, in many countries at least, by other kinds of expenditure. In Great Britain at any rate, there seems little reason to doubt that the secondary effect of expenditure on armaments is likely, in present circumstances, to be vastly greater than the secondary effects of expenditure on roads!

Expenditure on armaments has produced the most extraordinary results in Germany in recent years, and in England, too, there is reason to suppose that it will have the effect of prolonging the boom.

(5) Extraordinary Expenditure and Expectations

I now wish to touch upon an aspect of the question which, in my country at any rate, I think has been greatly neglected. I refer to the effect of government expenditure on the anticipations of private entrepreneurs. How will the expectation of government expenditure influence the planning of private business ? In so far as entrepreneurs are prompted to increase investments of their own by the prospect of increased expenditure by the government, in what direction will their investments tend ? How will their views about the future of government expenditure tend to affect the nature of the plans which they themselves will make ?

We can probably take it for granted that the impact effect of the expectation of expenditure will be favourable. Presumably much the same considerations as those which I have advanced in this lecture will be present in the minds of the business men affected. But, after all, the impact effect is not the only effect we have to take

account of. Private business will take account, not merely of the immediate repercussions, it will attempt also to take account of the *probable duration* of expenditure. Just as the enlightened entrepreneur will expect not merely primary but also secondary effects at the beginning of a period of governmental expenditure, so he will expect not merely primary but also secondary effects when that expenditure is discontinued. He will attempt to adjust his plans to what he conceives to be the total plan of the government.

Now I cannot help thinking that considerations of this sort must lead to the conclusion that the successful carrying through of this kind of policy is a much more delicate operation than one might suppose, if one were considering merely the impact effects of expenditure. There appear to be important limitations to the magnitude of successful shock tactics. Extraordinary expenditures which are small may have secondary effects which are eventually absorbed, so to speak, in the revival of private business: their prospective cessation may not cause an undue damping down of expectations. But if genuine shock tactics are employed — if the expenditure is grandiose — then surely the danger exists that the expenditure may not merely *generate* revival; it may actually *become* the boom, and when at last it ceases depression may be renewed. Surely this is likely to happen in Germany.

There is some reason to think that a similar danger will accompany any slowing down of rearmament expenditure in Great Britain.

These doubts are reinforced by others; they are reinforced by considerations of long-term budgetary equilibrium. Such things are doubtless without much analytical interest. But what is analytically trite is not necessarily practically unimportant. And the fact is that, if extraordinary borrowing is extensive, then the fear of increasing taxation later on may have a depressing effect; and it may have a depressing effect just in that part of the capital market where other considerations of policy would lead one to wish that there should exist most buoyancy; it may have a depressing effect on the value of gilt-edged securities. Perhaps it may be foolish of people to distrust the good intentions of governments. It may be very unenlightened of the holders of gilt-edged stock to feel that possibly the loans will not be repaid when it is promised they will be repaid. It may be unenlightened. But candour compels us to admit that there is no small historical justification for this slightly Philistine attitude. Hitherto in the history of the world governments have generally shown greater willingness to incur deficits than to repay debt. Hitherto a cumulative growth of deficits has usually led to repudiation or inflature.

(6) International Aspects of Shock Tactics

So far all that I have said has referred to government expenditure in a closed economy; I have assumed that there is no foreign trade, no exchanges, no foreign balance to worry about. It is now time to remove this assumption. A balanced view of policy must consider its international as well as its internal aspects.

Now, *if* policies of this kind are launched simultaneously in different countries, and *if* private business expects more or less the same duration of the expenditures, and *if* expectations regarding the balancing of budgets are the same, then generally the repercussions will be somewhat the same as in a closed economy.

But after all, such a happy state of affairs is not very probable. Politics are different in different parts of the world. The budgetary positions of different powers are different. Moreover, the incidence of depression is different. But if the various local policies are not more or less in step, then there may develop important international complications. Quite apart from the possible effects of apprehension of the local budgetary position, there may be strain on the balance of payments of particular centres.

Of course this is not certain. An expansionist policy which is limited merely to arresting deflation is not likely to have the same effects

as an expansionist policy which goes beyond that and definitely seeks to raise local prices. Moreover, a country with a strong reserve position may be able to run this risk. It is conceivable, I think it is even probable, that, in the United States of America, many of the recent experiments could have been carried out without a devaluation of the dollar.

But the position of the United States is exceptional. I am fairly certain that in Great Britain in the year 1930 and the early part of 1931 a vigorous policy on the lines suggested by Messrs. Keynes and Henderson in 1929 would have been accompanied by the greatest international difficulties. To spend hundreds of millions of pounds to cure unemployment and yet not to endanger the gold standard was not really practical. Speaking generally, I am inclined to say that in order that a policy of this sort may be carried out as "fearlessly" as is generally demanded it may be necessary to free the exchange, or to operate behind the exchange advantage of devaluation.

I confess that for me this consideration alone is sufficient to induce the gravest hesitation. If it is correct that, in many cases, when shock tactics on a large scale are involved this danger of international complications arises, must we not very seriously revise some of the hopes which might be formed from an examination of effects

of such measures in a closed economy ? Is it really desirable that, when depression breaks out, steps should be taken which seriously disturb the monetary unity of the world ? Can we view with equanimity the danger of the multiplication of barriers to trade, the multiplication of limitations of investment, which are the probable results of such disturbances ?

I cannot help thinking that in the recent discussions of these matters there has been much confused thought on the effects of fluctuating exchanges. The old purchasing power parity theory of the foreign exchanges assumed a free exchange operating in a world in which there existed considerable elements of stability ; and (rightly in my judgment) there was deduced the conclusion that, *in such circumstances*, the free exchange might have an equilibrating effect. But we must beware of generalizing the conclusion. It does not follow that, *in the absence of a wide area of stability*, fluctuating exchanges will have the same effect. On the contrary, in the absence of a considerable area of stability, fluctuating exchanges may be productive merely of further disequilibrium.

This conclusion is surely borne out by experience. Throughout modern economic history there have occurred cases where comparatively small raw-material-producing areas have resorted to exchange depreciation to cure disequilibrium.

At the cost of having to pay a rather higher price for loans afterwards, they have succeeded without much damage elsewhere. But when the larger centres have themselves cut loose, the effect has been entirely different. In these circumstances, the effects of fluctuating exchanges have been on the whole deflationary.

On these matters an Englishman must speak with some humility. Great Britain has been lucky in the depression — the abandonment of the gold standard in 1931 was attended by no grave internal disaster and the further fall of the pound in the succeeding years created conditions favourable to widespread conversion operations and general internal recovery. But I cannot view with complacency the effects elsewhere of the fluctuations in the sterling exchanges, the last agonies of liberalism in Germany, the paralysis of French democracy. Do we really want to take this risk whenever a depression occurs ? If only for such reasons, I cannot believe that the scope for variations of government expenditure in time of slump is as great as is sometimes supposed.

(7) Recapitulation

May I recapitulate my conclusions ? I am not opposed to some borrowing to finance deficits on income expenditure. I am not in favour of

closing down government expenditure on " nornal " investment activities in time of slump. I agree that the spacing out of normal investment activities is a sensible thing and that governments are still not nearly enough alive to the possibilities of such planning. I agree that there is a margin of doubt as to what is to be considered " normal ". But I do not believe that there is usually a large place for obviously extraordinary expenditure. Of course, cases may arise where, in order to prevent complete deterioration of the position, in order to prevent cumulative deflation, measures of this sort may have to be adopted. If the effect of such measures is merely to offset a deflation which otherwise would take place, and if they can be stopped in time, the effects will be beneficial. But in general I believe that the scope for this sort of thing is much smaller than is usually supposed. Even if there is success in the short run, in the long run there are difficulties. If the expenditure is large it produces expectations on the part of private enterprise not conducive to long-run stability. It tends too to break up the monetary unity of the world.

My own belief is still that the right way to prevent depression, to even out business activity, is to prevent booms getting out of hand. The right way to avoid the effects of wrong anticipations on the part of private business is to take measures to see that these wrong anticipations are not

made. I can conceive that upward variations of taxation during the boom might help here; increased sinking fund payments might indeed have that effect. But politically they are much harder to bring about than deficits. I have much greater hope of wise banking measures than of continuity of policy by successive Chancellors of the Exchequer.

II

HOW TO MITIGATE THE NEXT SLUMP[1]

(1) Introduction

If we take the summer of 1932 as the turning-point, it is now getting on for five years since the bottom of the last depression. And prudent men are beginning to ask themselves how long the good times will last and whether it is not possible to take action now which will mitigate the severity of the next depression when it comes. It is to the examination of certain aspects of this latter question that the present paper is directed. The title has been chosen very deliberately: I think it may be possible to mitigate depressions: I do not believe that, in the present state of knowledge, it is possible altogether to eliminate them. The scope of the discussion, too, has been deliberately limited to certain financial problems. On the stabilizing effect of general measures for the revival of international trade and investment I have argued before in other papers.

[1] Reprinted from *Lloyd's Bank Review*, May 1937. I should confess that I did not expect the gold scare which set in shortly after this paper was written, nor was I prepared for the sharp decline in American business in the summer of 1937. I have eliminated here and there in this paper a few sentences which show evidence of this unawareness.

(2) The Prevention of Booms

It has long been a maxim of prudence that, to avert a slump, it is necessary to avert the boom. If this is to be interpreted as implying that recovery must never be allowed to develop, there are doubtless many who would take exception to it. But if it means merely that it is desirable not to let recovery get out of hand, then surely it must be generally acceptable. It is a problem on which there is as yet no general agreement, whether recovery of any kind can be generated without at least some misdirection of investment which may be disadvantageous later on; and there would certainly be many views on the question at what precise point these mistakes became seriously important. But there can surely be little disagreement that, when a point has been reached at which prices begin to rise rapidly and shortages of labour and raw material are prevalent, the time has certainly come for the expansive process to be restrained. Only when the system is in a state of collapse and when idle capacity and idle labour abound, can a general expansion of credit be regarded with comparative equanimity.

Now this means quite definitely that, once this point has been reached, a continuance of the regime of cheap money which has accompanied the previous depression is dangerous. If

money is kept cheap by deliberate manipulation in the face of a rising investment demand, rising costs and rising money incomes, then mal-investment of the kind which sooner or later leads to a bad crash is deliberately encouraged. There is no need to be a fanatical adherent of any particular brand of trade cycle theory to believe this. There is no need to believe that all depressions necessarily come the same way. It is only necessary to recognize what has always happened in the past when such conditions have been present. The collapse of a boom of this kind has always been followed by depression. If such a collapse is to be avoided, the regime of cheap money must not be artificially prolonged. A point comes when the rate of interest must be allowed to rise: to foster the idea that money can remain indefinitely cheap is to do a bad service to stability. And there is much to be said for the belief that a small rise early will cause less disturbance and difficulty than the much greater rise which is necessary later on, if inflationary conditions develop.

(3) The Technical Position in London in the Recovery of 1933–36

I hope that what I have just said will make it quite clear that I am no friend of the view which holds that we can dispense with the use of the

discount rate as an instrument of stabilization. In my judgment it is an indispensable instrument, an instrument which we must at all times be prepared to use with speed and vigour if the circumstances appear to call for such action. I think that cheap money conditions which are prolonged beyond the period when investment is naturally stagnant, are likely to breed bad investments. And I think that at the present time we should be prepared to see money rates rise rather than permit a further expansion.

Nevertheless, I think that those who attribute all the difficulties of our present position to a failure on the part of the authorities to bring the period of cheap money to an end at a much earlier date, scarcely do justice to the complexities of the situation. There is a sense in which they are right. We should have been in a more balanced condition now if recovery had taken place at a higher level of money rates. But it is not a sense which would have justified severe measures of contraction earlier on. Let me try to explain what I mean.

The extreme cheapness of money in London in the last four years has not been due to any one simple cause. It has been due partly to operations which were thought necessary in order to carry through the conversions. It has been due partly to the inflow of foreign funds. It

has been due partly to the shrinkage of foreign trade and investment.

Now in so far as the cheapness of money was due to the exigencies of the policy of conversion, it is no doubt legitimate to describe it as artificial. It has long been clear to those who took a long view that, both here and in America, the expansion of credit of the early years of this decade had provided the basis for a general expansion which might prove eventually difficult to control. But to attribute the peculiar conditions of the market only to this factor is to get things quite out of perspective. The stoppage of foreign investment, the shrinkage of international trade, and the inflow of funds to London, are factors quite as important. And, if we have regard to these factors, we must see that it was almost inevitable that money should have been unusually cheap during this period. While such conditions persisted and while the activity of the home market had not passed the point which, at an earlier stage, could have been regarded as normal, it was inevitable that the rate which equated the demand for loanable funds with the supply coming forward should have been abnormally low.

If this was so, then surely it would have been demanding a totally wrong policy to urge that credit should be generally contracted. There may have been much to be said for a little deflation of the gilt-edged market: certainly

there was everything to be said for the utmost support necessary to prevent a further fall in the sterling exchanges. But, for the greater part of the period we are discussing, there can be no doubt that to raise rates generally would have involved a thoroughgoing policy of contraction. And that would have been inappropriate. The right policy surely was to extend the so-called principles of expansionism to the field of international trade and investment, to take measures which, by producing revival in the foreign sphere, would cause rates naturally to harden and so bring the market under control — not to contract the supply of credit but to produce a larger and a better balanced demand. We may blame the British authorities for their great timidity in this respect. We may urge that if they had shown greater initiative in restoring healthy conditions for international trade and investment many of the present difficulties of the world, both economic and political, would never have developed. But to urge that *at that time*, in the absence of such measures, a higher level of rates was appropriate is, in my judgment, gravely to over-simplify the position.

(4) The Right Kind of Public Works

No matter how resolutely we attempt to curb the boom, it is unlikely that we shall succeed in

producing a state of affairs in which prosperity lasts for ever. To believe that this can be done is to live in a fool's paradise. The question therefore arises whether there are not other measures which may be prepared against the day when bad times come. We may well believe that the break is the consequence of mistakes made earlier on, which have to be rectified. We may believe that, after a certain point, attempts to prevent it coming only serve to make things worse. But we should surely welcome any measure which, without giving rise to further maladjustment, would mitigate that secondary deflation which, following on the first liquidation, turns many sound positions into bad ones.

Now, if such measures are to be not merely panic expedients, but measures designed with a view to healthy long-run development, we can lay down certain broad criteria which it is essential that they should satisfy. It is necessary that they should do nothing to disturb confidence: deflation is essentially a product of shaken confidence, and emergency measures which disturb confidence still further do more harm than they do good. It is necessary that they should be properly timed: if they come too soon they may merely stave off necessary liquidations and so prolong the agony: if they come too late they serve merely to stoke up a boom which has

already started — as with the public expenditure on armaments in 1936–37. It is necessary that they should not figure so large in the expectations of business men that they actually become the mainspring of recovery: if they do, there is danger that when they cease, depression will once more begin — again we may draw a moral from the rearmament expenditure.[1]

Such criteria go far to condemn the shock tactics which it was so fashionable to urge at the bottom of the last depression. The proposals for grandiose borrowing for *ad hoc* public works, which were put forward in various quarters, had much to commend them to the unreflecting; to oppose them was to court much unpopularity and misunderstanding. But, judged by these tests, they fail. They would have affected confidence at a time when the utmost stability was necessary if the conversion operations were to go through successfully. They would have come into operation at the wrong time. If public works of this kind are not to be incredibly wasteful, they may take anything up to one or two years to prepare: they would therefore have come into operation just when the forces of recovery were fully in motion, and they would have produced a distorting effect on business expectations. Like the armament expendi-

[1] These criteria are developed at greater length in the paper on *Government Expenditure and Economic Activity* reprinted above.

ture, which in many countries took their place, they would have tended to *become* "the recovery", and the prolongation of the boom would have been contingent on their further continuance — to the infinite disorder of the whole system of public finances. If those who urged this sort of thing still desire recovery *à la* Hitler, they should say so. The thing has been tried out elsewhere and it does not seem that our position here is in any way inferior for its absence.

But to condemn ill-considered policies of this sort is not to rule out all measures of counter-cyclical public investment — useful as it may be for propagandist purposes to suggest that it does. During the last depression it was very easy for the exponents of any project for wasting public money to pose as the only stabilizers and to represent the sceptics as "sadistic deflationists" For the fact is that, once a slump has begun, to start planning counter-cyclical measures is to lock the stable door when the horse has bolted; almost every measure which is practicable is subject to grave disadvantages. But this is not to say that there are no measures which can be effective *if planned sufficiently far in advance.* Indeed, there is reason to suppose that there exists ready to hand the means for carrying out a policy which, without wasteful expenditure or enlargement of the sphere of governmental

economic activity, might exercise a valuable damping influence.

In the modern world a substantial proportion of the total annual investment is constituted by investment by central and local government authorities. Opinions may differ as to the desirability of certain items of such expenditure. But on the necessity for some government expenditure on roads, bridges, drainage, civic buildings and similar developments, there can be no question. If such things are not done by governments they will not be done at all or they will be done very badly. For better or worse, therefore, we are confronted with a situation in which the proportionate importance of government expenditure is considerable.

Now, other things being equal, it is good business to borrow when rates of interest are easy and the prices of materials and services are low. We, therefore, make no extravagant demand when we ask that policy should be directed to securing that, so far as is convenient, public investment of this sort should be planned so as to be slack during times of boom and more active during times of slump. If, during times of boom, public authorities were to slacken their borrowing, and if, during times of slump, they were to speed it up, there would develop a rhythm of activity which might do something to balance the ups and downs of private invest-

ment. We should not claim too much for such a policy. It is not always possible to space out public expenditure in this way. It would be very foolish, for instance, in the interests of stabilization, to postpone the building of an urgently-needed drainage system. There is probably much public expenditure of the type of which this is an instance. But there does seem a margin within which more deliberate spacing is possible; and it seems thoroughly desirable that an attempt should be made to take advantage of its existence. During time of boom, central governments, and still more local government authorities, should be postponing avoidable development expenditure and preparing plans for setting such expenditure in motion when the bad times come again.

Such policy will always be useful. At the present time it is perhaps more needed than usual. At the present time we are in a boom which has been, as it were, superimposed on a boom. We are committed to additional public expenditure just at a moment when, on any theory of the trade cycle, additional public expenditure is most inappropriate. The resources of the capital market are already beginning to be extended. At the same time, the direction given to industry by the demand for war materials is bound to lead to developments which will be unprofitable when the present demand has passed. In such circumstances the policy here

advocated would serve a double purpose. By damping down public expenditure on things other than armaments, it would ease the strain on the capital market and diminish the temptation to resort to unsound methods of finance.[1] By deferring such expenditure till the time of depression, it would prepare a store of sound projects of development which could take up some of the deflationary slack in the capital markets when private investment holds back. There is certainly nothing very risky about such a policy. It is the very minimum of common prudence.

But are we doing anything about it? The policy is not new. It was first propounded, if I am not mistaken, some years before the war, by Professor Bowley in his evidence before the Poor Law Commission. And despite much diversion of opinion about other policies, with which it has often been confused, it has had the steady support of the great majority of expert opinion ever since. Yet I doubt very much whether there has ever been any very serious attempt to carry out this type of planning. In fact, I doubt whether there even exists the machinery whereby the local authorities, whose actions are, of course, pivotal in this matter, can be systematically

[1] By the time this paper was published the slump in the stock markets had made this part of the policy out of date. I had, however, argued on similar lines in the *Economist* Symposium on Monetary Policy in the late autumn of 1936.

kept in step. Certainly, if there does, the results are not very conspicuous. Any day, at the present time, one may open one's newspaper to discover it recorded with obvious approbation that this or that local authority has just approved a new programme of borrowing for projects "left over from the last slump". But this is exactly what they ought not to be doing. They ought to be closing down borrowing and preparing projects for the slump which is to come. Is it so remarkable that some of us are still somewhat sceptical of the capacity of governments to plan in the sphere at present occupied by private business, when they seem so lamentably unable to plan in a sphere where only governments can do anything?

(5) A New Method of Stabilization [1]

We have seen already that it is a cardinal maxim of successful crisis policy that nothing should be done which is disturbing to public confidence. It follows, therefore, that it is fundamental that, save in the most exceptional circum-

[1] Some time after this section was written it came to my notice that the policy recommended had actually been put into operation in Finland. See the important paper by Dr. Suviranta, "The Budget Equalization Fund", in *Unitas*, the quarterly review of the *AB Nordiska Foreningsbanken*. I have been gratified to notice that the same policy has recently received the support of the author of an *Economist* special supplement on "The Long-Term Budgetary Problem".

stances, the budget should be properly balanced. This may sound very old-fashioned in a world of New Deals, of mounting public indebtedness, and of a general belief that what is prudent in the conduct of ordinary business has no relevance to the conduct of government. In fact, however, nothing that has happened in recent years has done anything to discredit the rule that, for business to be healthy, there must be confidence in the solvency of governments. Prudent borrowing for essential public investment may, as we have seen, be a valuable means for combating deflation. But a budget which is seriously unbalanced may easily mar its good effects.

But budgetary equilibrium does not just happen. It is something that must be deliberately planned. And in times of depression, as we have seen abundantly recently, it is often peculiarly difficult to achieve. There is a tendency for certain sorts of revenue to decline and a tendency for certain sorts of expenditure to increase.

These tendencies are particularly obvious in the sphere of unemployment relief. Most states nowadays make some provision for the relief of unemployment. But when trade is bad, the amount to be relieved increases. At the same time, under the systems of financing such relief now very often in vogue, contributions tend to fall off. Unless special provision is made there

is an automatic tendency towards an unbalancing of the public accounts, just at those times when, for the sake of business confidence, it is most desirable that the public accounts should be balanced. Yet, if the scale of relief is not excessive, to solve the problem by the reduction of relief is to frustrate the purpose for which it is instituted.

For this reason it seems desirable to make provision against the deficits of depression by building up reserves in times of prosperity. The finances of relief should be so arranged that, in times of rising revenue and falling expenditure, there arise surpluses at least equal to the deficits which are to be expected in times of falling revenue and rising expenditure. The good times should pay for the bad.

All this is the veriest platitude of traditional financial orthodoxy. And, although sound policy is never very popular, there is reason to suppose that, at present at any rate, public opinion is not unfavourable to such developments. It is well known that, since the recent reforms, an attempt is being made to run the British unemployment insurance funds on these lines.[1] It is not impossible to conceive an extension of the principle to certain other forms of public relief.

[1] The annual reports on this fund, which bear unmistakable signs of the authorship of the Chairman, Sir William Beveridge, are a mine of useful information on these matters.

Unfortunately this does not altogether solve our problem, at any rate so far as trade cycle policy is concerned. The policy of accumulating a surplus in time of boom and using it in time of depression may be a solution of the budgetary problem. But it does not necessarily exercise a stabilizing effect on business. Indeed, it may work in the opposite direction. It may accentuate the boom and intensify the slump. If the surplus which has accumulated in time of boom is invested in bills and securities, that tends to keep interest rates down and so to exaggerate the up-swing. If to realize this surplus in time of depression these bills and securities are thrown on the market, that tends to keep interest rates up and so to make the down-swing deeper.

Here, then, we have a substantial problem. If we do not accumulate a reserve but instead allow the budget to become unbalanced during depression, we run the risk of disturbing confidence. If we do accumulate reserves in the boom and then realize our investments in the slump, we run the risk of disturbing rates of interest. Is there no way of escape from this dilemma ? I think a way can be suggested.

The root of the difficulty, as we have seen, lies not in the accumulation of a reserve but in the method of investing and realizing it. If, instead of *investing* the surplus as it accrued, it was *hoarded* in some appropriate form, the effect

would be quite different. As the reserve was accumulated there would be a tendency to a contraction of spending; as it was spent, a tendency to expansion.

But is not this just the type of influence for which we have been searching in this article? In times of boom it is desirable that there should exist influences damping down the expansion. In times of depression it is desirable that there should be influences arresting the contraction. If public relief funds were managed on the financial principles we have already indicated; and if, instead of being invested, they were hoarded in some form or other, then, not only would they satisfy the canons of financial prudence, they would also play some part in the stabilization of business. As the boom increased, so, automatically, money would be hoarded. As the depression deepened, so, automatically, hoarded money would be paid out. There would be some loss of interest, it is true. But, if the stabilization were at all extensive, this loss would be more than offset in the long run.

In recent years the advocates of emergency borrowing in times of depression have sometimes sought to justify their policy by appeal to Bagehot's rule to pay out freely in time of crisis. The analogy is plausible. But it breaks down in an important particular. *Bagehot's rule assumes the existence of a reserve*: it does not advocate

the progressive creation of public debt. Is it not possible that, by using the mechanism of public relief in the manner which has been suggested, we may employ a method which may more justifiably claim the authority of Bagehot — a method which, within the limits of financial orthodoxy, will give us all the advantages claimed for the method of emergency borrowing without the obvious dangers which the advocates of such methods so persistently overlook ?

I put the suggestion in the form of a question. For the details of the problem are intricate ; and it is most unlikely that I have perceived all the snags and the difficulties. I have purposely refrained from discussing the question in what forms the reserves should be hoarded : in gold, in deposits at the central bank, or in deposits with other institutions. For this is a highly technical question whose solution must depend on detailed considerations of time and place. It may be that it can be shown that there are overwhelming difficulties here. It may be, too, that it could be shown that, in circumstances which are probable, the saving by way of stabilizing influence would be less than the loss of interest on investments. On none of these matters would I pretend to any position of certainty. Nor would I claim for the proposal that it would necessarily do very much. This is not another cure-all. But we are not yet so well

equipped with safe methods of mitigating depression that we can afford to neglect to examine any new opportunity that presents itself. It is because this particular opportunity, which exists ready to hand in our present institutional mechanism, has not yet received as much discussion as might have been expected, that I venture to draw attention to it in this paper.

III

THE LONG-TERM BUDGETARY PROBLEM

(1) Introduction

The announcement that in the course of the financial year 1939–40 the government of Great Britain intend to raise £350 millions by borrowing affords a useful opportunity of applying some of the general principles outlined in the preceding papers and enlarging upon certain general problems of public finance not discussed there at any length. For the problem raised by the present situation of the public finances of Great Britain is twofold. On the one hand we want to know what are likely to be the immediate effects of this outburst of extraordinary expenditure; on the other hand we want to know where all this is leading in the more distant future. It will be convenient to deal with these questions in the order in which they have been stated.[1]

[1] A large part of this paper is taken from an article of the same name which I contributed to the April number of *Lloyd's Bank Review* for 1938. I had at first intended to reprint the article exactly as it was originally printed; for although the figures have been rendered obsolete by the passage of time, the predictions still seem to me to be likely to be correct. But the publication of the *Statement Relating to Defence* for 1939, which appears just as my final proofs are going through the press, affords an opportunity for certain developments of the general theme too tempting to be missed. I have therefore recast

(2) The Prospects of the Short Period

Given the present position of employment and the money market, the immediate effect of the prospective increase in government borrowing and expenditure is likely to be favourable to the general tempo of economic activity.

In order that extraordinary expenditure financed by borrowing may have favourable effects of this type, four general conditions are necessary. Firstly, there must exist extensive unemployment and unused capacity. Secondly, the object of public expenditure must have been planned some time in advance so that no delay is involved in getting the expenditure going. Thirdly, the capital market must be very slack, so that no undue pressure on interest rates is involved by the borrowing operations. Fourthly, there must exist confidence in the general financial policy of the government, or at least such an absence of disposition to take gloomy views that willingness to lend is not impaired. If all these conditions are present, then the immediate effect of extraordinary government expenditure is likely to be favourable.

Now it is very seldom that all these conditions are sufficiently fulfilled for success to be very

the material extensively, the first three sections being almost entirely new. The rather gloomy predictions in the latter part of the paper remain, however, as they were in the original article.

probable. The first and the third, under-employment in industry and in the capital market, are of course the characteristics of a certain stage of every depression. But the second, the existence of plans for public expenditure which are capable of rapid execution, and the fourth, a market psychology not likely to be deterred by vast public expenditure, hitherto at any rate have not been so frequently present as to warrant high hopes for this kind of policy as a general rule. In Germany in 1933 there seem to have existed plans for armament expansion and a sudden uprush of confidence in the revolutionary government. But, speaking generally, incidents of this sort have been rare. Even in Germany, to prevent the thing going on the rocks, there was necessary such a degree of totalitarian control as would have been intolerable in a less servile, more democratic community.

But at the present moment in Great Britain, the conjunction of conditions necessary seems actually to be more or less present.

There is sufficient confidence in the general financial policy of the government. People realize vaguely that there are difficult times ahead. If they were better economists they might realize this considerably more acutely. But they do not regard the government as committed to "reckless" borrowing. They believe that somehow or other we shall muddle through.

At the same time, it is a moment of extraordinary slackness in the capital markets. For the last eighteen months, partly as a result of the slump in America, partly as a result of the exhaustion of certain investment opportunities at home, we have been sliding gently into industrial depression. On top of this has come a belated recognition of the intense danger of the international situation. In the months since Munich there have been times when private investment has been almost totally paralysed. If this were to continue, then in the absence of counterbalancing expenditure by the Government, the system of private enterprise would be in grave danger of running down very quickly. The disposition to save is still very strong. There seems no reason to doubt that, given a moderate degree of competence in the handling of the technical situation, the market can absorb the necessary loans without great difficulty.

Furthermore, the object of public expenditure has been planned in advance. The shadow factories are in working order, the models have been prepared. Those blithe spirits who thought in 1932 that it was possible, at a moment's notice, to launch expenditure of this magnitude should reflect that it has taken three years to prepare this particular experiment. It is possible that the preparation has been somewhat dilatory. It is difficult to believe that we could not have

been better prepared for Munich.[1] Nevertheless one has to take governments as they are likely to be. Inspection of the Opposition benches does not suggest that the student of public finance should pitch his expectation of competence of the average administration in Great Britain much higher than the average of past achievement. Still, the preparations have at last been made. The expenditure will not be held up by their absence.

The main difficulty, as I see the situation, is likely to lie in the supply of employable resources. When the rearmament expenditure began, it impinged upon a section of the economic system where unemployment and unused capacity were widespread. In the early years of rearmament, therefore, it is probable, as was predicted at the time,[2] that its effects in stimulating employment and further investment were more than usually effective. But at present things are different. Unemployment is extensive. But it is less serious in the armament industries than almost anywhere else; and there exists a positive shortage of certain kinds of labour and equipment. In the absence of agreements to suspend the various demarcations and limitations which constitute

[1] It is difficult to suppose, for instance, if in 1936 the anti-aircraft defence of London had been farmed out to some rather inefficient joint-stock company, with the Government's powers of borrowing behind it, that it could not have managed to produce more than a hundred guns by the autumn of 1938.

[2] See, *e.g.*, p. 227 above.

such a powerful drag upon rapid adaptation of the labour force, it is probable, therefore, that in some quarters the increased expenditure will be held up by "bottle-necks" and that its main effect will be to raise prices rather than directly to increase employment. I think this is likely to be much more important than many of the enthusiasts for this kind of policy are at present prepared to allow. Nevertheless it is improbable that this will be general. There is still some slack available in parts of the system which will be immediately affected. There will be a tendency to a rise in prices. But there will also be a tendency to expansion.

How this will exactly work out depends, of course, upon what else is happening. If war comes, as it quite easily may, even before these pages are printed, the total situation will be so altered that many of the foregoing considerations will become irrelevant. If the danger of war continues to be thought acute, it is possible that the effect of the increased borrowing will be merely to offset the paralysis of private investment. If the international situation becomes brighter, then if interest rates are kept down, the additional government expenditure and the revival of private investment may together stoke up something like a general boom. We do not know which of these things is likely to happen. But it does not seem rash to say that the short-

run effects of the projected expenditure are likely to be favourable to employment.

(3) The Long-term Problem

If we look further ahead, however, the prospects are not so favourable.

For, firstly, it must be realized that the loan expenditure proposed is likely to become, as it were, the main support of an important section of industry. While it lasts things are likely to be good. When it ceases then there is likely to be depression. In contemporary discussion we hear much of the so-called "multiplier effect" of increases in public expenditure. We hear much less of what might be called the inverse multiplier effect of diminutions. Yet this may be very important. Public expenditure is now such a large proportion of total expenditure that any substantial downward fluctuation is liable, if the moment is not exceedingly propitious, to have effects which, in the short run at any rate, are unfavourable to general activity. If more peaceful prospects were to appear at a time when a general boom was developing, this effect might not be undesirable. But we shall need an exceptional combination of luck and cunning to bring about a slackening of rearmament without producing general depression.

But this is the least of the dangers. Much

more serious, on any long view of the problem, is the general budgetary situation.

The estimated expenditure in 1938–39, exclusive of loans, was £945 millions. In 1939–40, in spite of the greatly increased resort to borrowing, this total is not likely to diminish. Apart from borrowing, public expenditure must be now between a quarter and a fifth of the total national income. Income tax is only just below the level at which it stood at the height of the difficulties of 1914–18. Save by what amounts to repudiation of external obligations, the national debt has not decreased substantially since the war was over.

Now, in spite of all this, the national credit is still strong. There can be no doubt that we can increase expenditure by borrowing for some years to come, if need be. Our position is much stronger than that of those who may attack us.

Nevertheless, every pound borrowed increases the debt charge of the future. The amount which will be added in one year's borrowing on the present scale will not be very great; the upper limit should not be more than £12 millions, and, if extensive resort is had to short-term borrowing, it may very easily be less. But it is improbable that we shall not need to borrow again. Indeed the Government has already taken powers to do so; and notice has been given that even these powers may have to be further enlarged. Three or four years' borrowing at the present rate would

involve a considerable addition to the debt charge.

It might be thought, however, that relief might be expected from fulfilment of the rearmament programme. As expenditure on defence falls off, it might be argued, there will be more left to meet the debt charges.

Such a relief is certainly conceivable. But it is not really at all probable. We may leave undiscussed the question whether it will be possible to relax the building of new armaments. For, even if we are merely content with the level at which the extraordinary expenditure of the next two or three years is aiming, it must be remembered that the maintenance of this level will involve a most extensive annual expenditure. The rate of obsolescence of the apparatus of modern warfare is enormous. Aeroplanes which were the leading models of their kind in 1935 are out of date in 1939. Every increase of rearmament, which is financed out of borrowing now, will need some increase of annual expenditure out of taxes for its maintenance later on. To hope that, by the diminution of armament expenditure, further increases in taxation may be avoided, involves the assumption, not merely that the increase of armaments is arrested, but also that there follows a positive decline. This surely assumes a change in the international situation of which there is very slight hope at the moment. Whether or not taxation is increased this

year,[1] there seems little prospect of avoiding some increase later on.

(4) The Real Burden of Public Debt

How serious is this prospect ? To answer this question it is necessary first to remove a prevalent misconception.

During the Great War of 1914–18 it was often suggested that the financing of expenditure by loans had the effect of throwing the burden on the shoulders of posterity. Taxes were paid out of present resources, it was held ; loans drew on the future.

Now this view was erroneous. There is no such simple choice for society. We cannot call future work and future resources to the service of the present. Whether extraordinary expenditure is raised by taxes or by loans, the cost of such expenditure is the sacrifice of the other things which might otherwise have been produced *at the time.* In the case of loans this sacrifice is borne by the lender : in the case of taxes, by the taxpayer. The idea that the wealth of the society of the future can be anticipated by the simple expedient of substituting loans for taxes is a fallacy. And expert discussion of these matters

[1] I ought to add that, in my judgment, taxation ought to be increased this year. If we are going to borrow extensively there is no reason to suppose that another increase in the income tax would offset this stimulus to business.

has long quite rightly emphasized this point.[1]

But while it is not possible to levy direct tolls on the future by way of domestic borrowing, it is certainly possible to pursue policies which cause future embarrassment. Current discussion of these matters, reacting from the fallacies of yesterday, tends, I think, to fall into a fallacy of the opposite order. Instead of the view that a loan policy throws all the burden on the future, we now find the view that the future cannot in any way be compromised. No matter how high the taxation necessary to meet interest on the loans of the past, it is held, such taxation is " merely " a transfer which involves no burden at all. Hence rising budgetary commitments due to continued resort to borrowing need rouse no fears. At the worst, any difficulty that they may cause is " purely psychological " in nature.

Such a conclusion is surely mistaken. It is quite true that extra taxation to meet interest on past borrowing has a significance different from taxation to meet other increased expenditure. There is, indeed, a sense in which it can be regarded as a transfer rather than a using up of income. But to argue that it is " merely " a transfer and that therefore it does not matter how high it is, seems to overlook obvious facts.

It overlooks, in the first place, the possibility

[1] Expert agreement on this matter, however, did not prevent the present Chancellor of the Exchequer from invoking the same hoary fallacy in his statement of 20th February 1939.

of international transfer. In the halcyon days of the pre-depression period it was often taken for granted that transfer of capital to escape the pressure of local taxation was an event so improbable as scarcely to merit attention. "People do not escape taxation by putting their funds abroad; they have to go abroad themselves," we were blandly told — as if this disposed of the subject. Anyone who ventured to suggest that they might think of going was thought to be an obvious ass. Today it is no longer possible to maintain this easy optimism. We now know that to prevent such transfers of capital it is necessary to establish complete control of the capital market in the thoroughgoing German manner. It is, of course, possible that many of those who are most carefree in their recommendation of loan expenditure would not object to such a policy.[1] But, if this is the case, they should tell us so. They should not pretend that the apprehensions of those who do not share their enthusiasm for these totalitarian controls are altogether without foundation.

Still, let us abstract from these international complications. Let us suppose, what is not altogether improbable, that all the nations get

[1] It is interesting evidence of the extent to which the intellectuals of the Left are the victims of unconscious totalitarian instincts to observe the lightheartedness with which the prospect of complete exchange control is often recommended. The Hitler beneath the skin which is in most of us can show itself in many ways!

into more or less similar difficulties so that the incentive to international transfer is lessened.

Even so, it is not really open to question that, beyond a certain point, high taxation is likely to have adverse effects on production, Beyond a certain point " mere " transfer from active business to the rentier class does affect the stability of the system. It is quite true that the position of this point is not necessarily fixed. We have all heard, *ad nauseam*, that, in the time of Mr. Gladstone, people thought that sixpence in the pound income tax would be ruinously oppressive to enterprise, and that, in fact, enterprise still goes on with the income tax ten times as high. We know that, in time of war or exceptional stress, people will shoulder burdens which otherwise they would not willingly carry. But this does not dispose of the matter. Because people learn to carry heavier burdens that is not to say that there is no burden that they will not carry. There seems little reason to doubt that a high income tax does tend to damp down enterprise of the pioneering or risk-taking type : and the effect of this on the general rate of investment may at times have even more far-reaching repercussions. We may not wish to bear increased taxation now, but we must not argue that, if we only postpone it till later on, it will be " merely " a transfer encountering " purely psychological " obstacles. To say, "After us the deluge ", is more

honest than to say, " Whatever we do, the deluge will not come ".

(5) The Growth of the National Debt

It seems then that there is no ground for the belief that the increase in taxation that will result from present borrowing involves future difficulties that are merely nominal. To borrow rather than to tax may be necessary in certain emergencies. It may avoid difficulties now which are greater than the difficulties which it creates later on. But it does create difficulties, and there is danger that, if it is resorted to extensively, these difficulties may be considerable. Only if there is reason to expect considerable growth in the national real income, can growth in the total of debt be viewed with equanimity.

Now some growth in the national real income as time goes on is certainly to be expected. This will show itself either by way of reduced prices at constant money incomes, or by way of money incomes rising faster than prices. In either case higher taxation will be, to that extent, easier to bear. There is no reason to suppose that we have reached a stationary condition.

But the position which we have to face at the moment is a position in which public expenditure has been rising faster than the national income. It is unfortunate that there are no

generally accepted estimates of national income by which this could be demonstrated exactly: the estimates of the leading authorities differ sufficiently to make any pretence at numerical precision misleading. But there can be no doubt that since 1935 the rise in expenditure has been relatively greater than the rise in income. The fact that it has been necessary to increase rates of taxation is sufficient indication of this. It is possible, of course, that expenditure will not go on increasing: in which case, perhaps, a rise in the national real income would gradually reduce the proportion going as public expenditure. But, in the present condition of Europe, he would be a brave man who would predict this with any confidence.

There is another feature of the situation which is relevant at this point if we are to get things in their proper historical perspective. In the nineteenth century, the weight of debt contracted during the Napoleonic wars was eased in part by a growth of taxable income due to growth in population. In this century this easement does not seem to be probable. The population of Great Britain has nearly reached the end of its growth. There will be some increase in the number of taxable incomes due to changes in the age composition of the population. But it is evident that the margin of safe policy is much less than it was. The extent to which we can

contemplate safe increases in unproductive borrowing has diminished.

At the same time it is all too depressingly clear that any further increase in liabilities starts from a level which is already somewhat precarious. It is at least arguable that, in a free economy, the higher the proportion of the national income which goes as taxation the greater is the probability of fluctuations in yield and the greater, therefore, the probability of disturbances in the running of the national economy arising from such fluctuations. It is all very well to say that with a properly planned budgetary system these disturbances need not arise. The fact is that even the best of budgetary plans are likely to go wrong and that the larger the budget the more difficult it is to forecast what happens independently of the budget. The experience of the last few years in the United States and elsewhere seems to suggest that, once budgetary expenditure reaches a certain status in the national economy it tends to supplant other forces as the pacemaker of the whole system: the independence of the free forces is suspended. It is yet possible that, if public expenditure passes a certain level, the state may be compelled to take over the conduct of the rest of the economic system in order to keep things going at all. It is not certain that this is inevitable. But what is happening already elsewhere, particularly in

Germany, gives at least some plausibility to the conjecture.

If this analysis is correct, it seems, then, that the long-period prospects of our present financial situation are grave in the extreme. At the moment our difficulties are not insurmountable. We have a sufficient margin for borrowing; in the near future borrowing may even have the effect of increasing activity and the yield of taxation. But further ahead the difficulties are menacing. Even if we avoid increases of taxation now, there will be further increases in the future. Sooner or later, if there is not a radical change in the international situation, we shall once more enter a period of acute financial crisis.

(6) Debt Reduction by Inflation

Recognition of all this has led many to the conclusion that the only practical way out is a measure of price inflation. If prices rise, it is held, the yield of taxation will increase and the relative burden of expenditure will diminish.

This view has powerful advocates. And it is probable that it indicates the course which events are actually likely to follow. At the present time, under the influence of the slump in America, trade is declining and prices are tending to fall. But this will not persist for ever. Within a year or so it is likely that the

trend will be reversed and the increase of the pressure of rearmament will once more force prices in an upward direction. With the vast supplies of gold already available, this rise of prices need have no near upward limit. In this way, some of the difficulties of the present budgetary problem may be met.

But here, as elsewhere, it is necessary to keep some sense of proportion. If prices rise, costs will rise also. The yield of taxation will increase. But so will the expenses of government. We may expect that, for some time, the salaries of government servants will not rise commensurately with the rise in prices. But in the long run only that part of the expenses of government which consists of fixed interest on long-term debt will be unaffected. (Interest on short-term debt might very easily rise considerably.) A rise of 20 per cent in prices would not reduce the relative burden of taxation in like measure. If we take the proportion of debt charges to total expenditure to be one quarter of the whole, it will be seen that if other charges rose with prices the relief would not be more than of the order of 5 per cent. To achieve a sensible relief in this way prices would have to rise very much higher.

Moreover, quite apart from the general disturbances and dislocations which we must expect to accompany a large rise in prices — labour troubles, speculative booms and collapses and the

like — this method of budget easement is in effect partial repudiation. Such methods, to put it mildly, have their drawbacks. It is all very well to say that history shows that, when debt becomes too heavy, price inflation has been the way out. This is true and it is likely to happen again. But it is also true that it has been a way out which has been in effect a discriminating capital levy on those who held government fixed-interest-bearing securities. It is also true, as recent history shows, that the impoverishment of the saving classes in this way carries with it its own legacy of political instability and disturbance. The experience of the nations which wiped out their war debts by raising prices does not suggest that this method is altogether without disadvantages.

Certainly it would be highly impolitic for advocates of the policy of borrowing to talk too freely about the relief to be obtained later on from a rise in money prices. If such things were to come to the ears of possible lenders, it is at least conceivable that the policy of borrowing might encounter unexpected difficulties.

(7) National Finance and International Politics

Is there then no other way of meeting the difficulties ahead ?

Such ways are not easy to see. It is not very likely that better methods of direct taxation are waiting to be discovered. The history of the National Defence Contribution shows that. Increases of customs and excise are perhaps less damping to trade than increases of direct taxation. But they tend to make the tax system regressive. In so far as we decide to resort to increased taxation, there is still much to be said for the straightforward methods of the income tax.

Nor are the prospects much brighter on the expenditure side. Some at least of the increase in civil expenditure might indeed be pared away. The whole system of subsidies to special industries is an anomaly and could well be dispensed with. For years we have been spending vast sums on the relief of agriculture, partly on the pretext that it was desirable as a measure of defence. How much safer we should be, both as regards food supply *and* general security, had these sums been devoted to the upkeep of the navy.

There are, no doubt, other ways in which expenditure on things other than armaments might be reduced. But, speaking broadly, it would be wrong to expect very much from such expedients. It is fallacious to suppose that all government expenditure is an evil. And, at the present time, not all reductions of government expenditure are likely to be without harmful

repercussions on the general level of economic activity. Given the present ends of public policy, it is possible greatly to exaggerate the margin of government expenditure which is susceptible of easy or desirable reduction.

The plain fact is that the main cause of our financial difficulties, as of the similar difficulties of the rest of Europe, is the pressure of rearmament. It is here that the main increase in expenditure has been : and it is here increasingly that it will be concentrated in the future. It is equally plain, therefore, that the main relief of our difficulties can only come by way of a cessation of the race of rearmament.

Such a relief, however, can only come as a result of far-reaching political changes. It is a sheer delusion to think that any temporary measure of appeasement can possibly lead to this result ; the fundamental chaos of sovereignties would still involve the different nations in a degree of armed preparation, which, in the long run, would still be insupportable. It is a delusion to think that, in the absence of a complete change of regime in the totalitarian areas, the democracies can ever disarm ; and, even if such a change took place, disarmament without international machinery precluding war would still be a folly. The only way in which the democracies of Europe can hope to preserve their safety and to support the burden incurred by its preserva-

tion is by pooling their resources, by setting up the beginnings of a federal structure which in happier days, when the totalitarian savagery has exhausted itself, may become the nucleus of a United States of Europe.[1] If they cannot do that, then the main hope for the culture which we have inherited from the Jews and the Greeks and the Romans must lie in other continents. The long-period budgetary problem is nothing less than the problem of the fate of European civilization.

[1] It should be noted that this is not a plea for the resuscitation of the League of Nations. In the years following the Great War the League of Nations was the focus of the idealism of Europe : it was the creation of the best spirits of that age. But because it was a *con*-federation of sovereign states rather than a federation of states which had surrendered sovereignty, it was always in danger of failure. Because it did not take over from its constituent members the right of making peace or war, all the apprehensions of those who distrusted disarmament have been justified. It was this and not the mediocre vision of successive British Governments, culpable as that has been, which was the ultimate cause of its downfall. We must try to keep alive the spirit of the League of Nations in the difficult times ahead. But we do a disservice to the cause we wish to uphold if we do not recognize this fundamental weakness of its present structure.

Printed in Great Britain by R. & R. CLARK, LIMITED, *Edinburgh*