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MR. WILSON is the author of a well known work on the theory of fluctuations, and Editor of the Oxford Economic Papers. His present book is directed against Socialism and excessive central planning and control.

Part I opens with a discussion of the economic basis of democracy, considers some aspects of physical planning during the war, and points to the incompatibility of such planning in peace-time with the ultimate survival of free enterprise. In Part II, which deals effectively with the alleged evils of Capitalism, an attempt has been made to diagnose such questions as the inequality of income and wealth, monopoly and industrial efficiency, the nationalisation of industry, inflation, and mass unemployment.

It is argued that the public ownership of industry will do little or nothing to facilitate the solution of any important problem. The author also points out that there is no necessary connection between modern Socialism, which means State-ownership, and Socialism in the other sense of fair shares and equality of opportunity. Throughout, much emphasis is placed on the balance of payments, and the connections between domestic policy and foreign trade are clearly illustrated.

MODERN CAPITALISM AND ECONOMIC PROGRESS

MODERN CAPITALISM AND ECONOMIC PROGRESS

BY

THOMAS WILSON

FELLOW OF UNIVERSITY COLLEGE
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PREFACE

A BOOK in defence of capitalism by a teacher of economics will be deemed eccentric by those who believe that all economists are Socialists nowadays. The growth of this strange myth may be partly due to the fact that those economists who are Socialists have written so many more books and articles for the general reader than those who retain a strong belief in private enterprise; but it is largely the outcome of a good deal of confusion in the use of terms. If a "Socialist" is one who dislikes extreme inequality of income or of opportunity, then I suppose all economists are "Socialists"; it is a very different matter, however, if "Socialism" is taken to mean the destruction of private enterprise and the public ownership of all the means of production. Similarly, if the title of "planner" can be earned by supporting an active policy to maintain a high level of employment, then it may be true that all economists are "planners"; but they are not all "planners" by any means if "planning" implies the abandonment of the price mechanism and the profit motive in favour of authoritarian production programmes enforced by means of controls. Even Lord Keynes has been described as a "socialistic planner", which must surely be regarded as a surprising label for that great liberal economist.

The same ambiguity may lead to some confusion in working out the political implications of an attack on nationalisation and pervasive planning. All political parties, apart from the Communist and Fascist Parties, contain strong progressive and liberal elements, and I am well aware that some members of the Socialist Party would resent the

suggestion that they themselves advocate general nationalisation and the control of all economic activity by the state. On the contrary, they believe in the price mechanism and they would preserve private enterprise and the profit motive in much the greater part of industry. For any misunderstandings of this kind, I apologise, but I must plead that I am not entirely to blame. Very different views are held by other members of this heterogeneous party and its official pronouncements fall somewhat short of enthusiasm in dealing with private enterprise.

In the main the book is concerned with internal affairs and it has been possible to include only one short chapter on international economic policy. In many of the other chapters, however, I have emphasised the overwhelming importance of the balance of payments, and I have tried to indicate the connections between domestic policy and foreign trade. An attempt has been made to avoid the use of technical jargon wherever possible and to explain it in the few places where its use seemed desirable.

I am much indebted to Mr. B. D. Giles of Nuffield College who has checked my statistics, and to my wife who has been of great assistance throughout.

T. W.

UNIVERSITY COLLEGE, OXFORD
March, 1950

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Part One

CHAPTER I

PROGRESS OR LIBERTY?

"WOULD you rather have things run in the Russian way and face the labour camp; or in the American way and face the slump?" In these words Mr. G. M. Young has propounded the dilemma which, in the opinion of many students of public affairs, confronts Western civilisation at the present time. We must choose, it would appear, between private enterprise and socialism, and whichever way the final vote may go, the loss seems likely to be heavy. The evils of pre-war capitalism are bitterly familiar and a return to the old system with its dismal statistics of unemployed is unthinkable. Everyone is agreed that more state intervention will be needed to remedy these defects in the future; there is no difference of opinion on this point. A large number of people, however, have come to believe that capitalism cannot be made to work satisfactorily at all. What is required, in their view, is the abolition of private ownership in the means of production and the abandonment of the price mechanism in favour of planning. All important economic decisions should be taken by the state and the whole course of economic life centrally planned and determined. It is held that the nation's economic ills will be cured only if this is done.

But economic progress is not everything, and here is the rub. The capitalist era for all its defects has been one of the rare and precious periods in human history when the individual has enjoyed a high degree of liberty and respect. Freedom of speech and of the press, freedom of worship,

freedom from arbitrary arrest — all these privileges have been enjoyed by rich and poor, and have been exercised not least by those critics who held them to be of no account. As a ruling class, the capitalists have clearly behaved in a very different way from other ruling classes, such as the Nazis in Germany or the Communists in Russia. The capitalists, indeed, have consisted of a large number of scattered individuals who competed with each other and rarely acted as a disciplined group. The coercive use of political power was in the main repugnant to them and contrary to their whole conception of life. Occasional instances of oppression may be called to mind such as the attempted transportation from Tolpuddle of a handful of workers a century or so ago; but these incidents are insignificant compared with the Nazi gas chambers or the Soviet labour camps. The spasmodic efforts to cripple the growing power of the trade unions did not succeed because the methods employed by capitalist democracies could not be sufficiently ruthless, whereas in the Soviet Union the trade unions have become the docile instruments of a police state which does not scruple to enforce its authority. If one can forget the party rivalries of the moment and look at the matter objectively, one must admit that there has been much real liberty under capitalism. Even some socialist writers, such as Mr. E. F. M. Durbin,[1] have admitted as much and have paid tribute to what has been achieved.

One of the most crucial issues confronting us today is whether such freedoms can survive in the fully socialised and planned economy which is so often held before us as our economic objective. There are a few who would still be prepared to give a confident answer, but one is left with the impression that an increasing number of people is beginning to have serious doubts. The weight of the evidence seems to support the pessimistic conclusion, and it would be foolish to suppose that it can be dismissed as a mere bogey created

[1] *What Have We to Defend?*

by Conservative politicians to drive the frightened electors into their arms.

Socialist theory lays great stress upon the extent to which political institutions are influenced — it normally says " determined " — by economic conditions. Thus Professor Laski has traced the connection between capitalism and the growth of democratic institutions,[1] and although the economic interpretation of history can be accepted only partially, there is undoubtedly much force in his argument. His main concern, it is true, is to suggest that democracy must be tainted from its contact with anything so vile as private enterprise, but the more obvious moral is surely that capitalism must have great redeeming features, which we should do well to cherish and preserve. To put the argument at its lowest, democracy and capitalism have proved to be compatible and to some extent they have even been historically connected, but hitherto the fully socialised economies have been dictatorships. If a definition of democracy is called for at this stage, a quotation from the writings of Archbishop Temple will serve :

> " By three tests it can be known whether Democracy is true to its root principle : by the depth of its concern for justice to individuals ; by the careful regard which it pays to the rights of minorities ; by the scrupulous respect which it offers to whatever can present itself in the name of individual conscience. Of these the last is the most vital of all."

These are hard tests ; but if the capitalist countries do not always pass with honours, the areas under Communist control make no attempt to pass at all and even profess to despise the examination. Liberty and capitalism have gone together ; communism and serfdom have gone together. These are the facts. It may be possible to preserve Parliamentary government and civil liberty in some socialist state of the future

[1] *The Rise of European Liberalism.*

but that is mere surmise. To say the least of it, it is advisable to be cautious. With so much at stake, the facile optimism of the social democrats can only be regarded as irresponsible.

Unfortunately, democracy is not the outcome of mere constitutional decisions, nor can it be preserved by formal rules and paper safeguards. It reflects the will and the whole way of life of a nation, and depends for its survival upon taboos and customs which may be slowly destroyed if economic institutions undergo a complete change. In the past, the development of political liberty owed much to the economic independence of the aristocracy, the squirearchy, the yeoman farmers and the business men. The working class, it is true, did not at one time enjoy comparable independence — although even the recalcitrant worker was free to change his employer and had always some chance of becoming his own boss, if only behind the counter of a small shop. Yet, largely as a result of the competitive party system, even the workers came to share in the democratic privileges which derived in part from the economic independence of a minority to which they did not belong; and a truly progressive policy should seek to enhance the independence of the workers themselves and to widen the economic basis of the democratic system. Historically, freedom has been associated with the rights of property, and with the decentralisation of economic decisions which these rights implied. Since this is so, greater equality of opportunity and " a property-owning democracy " would appear to be the proper and logical ideals for the future. Much progress has been made in this direction already; and in so far as action by the state is required, a democratic policy can be summarised by saying that it should include measures to maintain a high level of employment, adequate social services, educational opportunities, redistributive taxation and the easing of some of the institutional difficulties in the way of the small firm. Such a policy might at one time have been described as " socialistic "; but the term " socialism " has now come to

mean the creation of vast state-owned monopolies, and in this modern and degraded sense it must, I fear, be regarded as hostile to democracy. The small man is to be eliminated and the healthy spirit of defiant individualism quenched for good.

It remains to be seen how much political freedom will be accorded to the employees of the nationalised industries; but, whatever the formal rules, the conventions are likely to be hostile to liberty. No doubt these employees will be allowed to get away with a good deal, even to the point of sabotage, provided they are to the Left of the Government; but it will require some courage to take an active part in politics as a Liberal or a Conservative. Although there may be brave men prepared to incur the risks, it is a sinister fact that such danger of persecution exists. In the case of the administrative staffs it seems probable that, in the event, the usual civil service convention will apply. They will not take an active part in politics; and thus, as the private sector is progressively reduced, more and more of those who are best fitted by training and ability to serve the nation in its political life will find themselves muzzled and impotent. Of course it is true that even under private enterprise, employees have been forced at times to watch their step; but such interference has been very mild compared with what may be anticipated under socialism. Fortunately for democracy, the employers were primarily concerned with earning a profit and would think twice before dismissing a good man because of his politics. Nor had they the same power to enforce their will when industries were broken up into a large number of firms. A Liberal mining engineer who was dismissed by an unusually bigoted Tory boss had some hope of finding another job in a firm owned by a Liberal; today he is faced with the enormous monopoly power of the National Coal Board, and if he offends his superiors his career may be ended. By contrast, even in the larger private companies, different political views were often held by the different directors and

systematic political victimisation was scarcely possible.

The future of the press and the publishing industry under socialism is particularly alarming. So long as the firms are privately owned, anyone can hope to publish his opinions provided they are of sufficient interest for the publication to sell. Of the books on politics published by private enterprise over the past thirty years, I suppose the majority have been critical of private enterprise. No-one who looks along the shelves of a large library can find much trace of " capitalist censorship "; a visitor from another planet — or from Soviet Russia — might well conclude that the publishers were secret " comrades " or, if not, that they were morbidly intent on self-destruction. What is true of books is also true to a surprising extent of the press. Newspapers usually have a " policy "; but this has not prevented them from reporting the news with reasonable fairness, nor have they refused to publish letters, articles and even permanent features which are hostile to that policy. Lord Beaverbrook is scarcely a Socialist, but for many years he gave space to the drawings of Mr. David Low which have repeatedly conveyed a socialist message. The instances could be multiplied, but it will suffice to recall the open-minded attitude towards socialism adopted by such great capitalist-owned papers as *The Times* and the *Manchester Guardian*. In this country we are inclined to take the freedom of the press for granted because we have no experience of a régime where the expression of opinion, the airing of grievances and even the publication of scientific theses must be subjected to political scrutiny. It is to be hoped that we shall never have such experience, but the spread of public ownership may well bring it in its train. It is difficult to believe that the press and the publishing industry will be left untouched, the last important island of private enterprise in the socialist state. If, as is surely inevitable, the Socialists decide that these industries too must be taken over, the outlook will be bleak. Perhaps, in theory, they

could be run fairly, but all will then depend upon the goodwill of the men in power. This is not so under capitalism, and the profit motive is surely the least dangerous of the various criteria by which the right to publication can be determined.[1] If a writer's fellow-citizens are likely to be interested enough in his views, then he has a good chance of expressing them. If one publisher or editor objects, there are others. Mr. Low's drawings helped to sell the *Evening Standard*, and if Lord Beaverbrook had put his foot down, Mr. Low could have easily found another capitalist editor to publish his socialist cartoons. Is it reasonable to expect the same freedom if the whole industry is a state-owned monopoly? Even those who are prepared to answer in the affirmative must admit that this is no more than a pious hope. On the other hand, it must be conceded that capitalism, as a matter of historical fact, has ensured such freedom.

Any satisfactory policy is bound to involve more state intervention than before the war. But if the basis of democracy is to be preserved, the individual firm should continue to enjoy great independence, and the allocation of resources should still, in the main, be determined by the pressure of consumers' expenditure. Thus, subject to the verdict of its own balance-sheet, the firm should be left to act, if not with complete freedom, at least with far more liberty than is contemplated by those Socialists who advocate comprehensive planning. According to the latter view, the state should make a survey of the resources available, decide

[1] It may, of course, be necessary to censor the publication (*a*) of extremely pornographic literature, (*b*) of state secrets, (*c*) of totalitarian propaganda. Apart from such cases, freedom should be allowed. A publisher's receipts depend upon the public taste, and the profit or loss incurred may therefore be regarded as the result of a democratic "vote" for or against the book. Some people may feel that the taste of their fellow-citizens is poor; if so, they can try to improve it by persuasion. That is a very different matter from giving any committee of politicians or officials the tremendous power of deciding what shall be published. Such power may not be used wisely, and in the end it may corrupt those who use it.

out of its wisdom what people need, and allocate the resources accordingly by means of controls. A policy of this kind will be referred to hereafter as " physical planning ", although I am aware the term is ambiguous and may be confused with town and country planning. It might be more appropriate, if more offensive, to describe it as authoritarian planning, for it is foolish to suppose that the process can be subjected to democratic control even in a Parliamentary country. It is utterly impossible for Parliament to examine, understand and regulate in detail the intricate relationships within a developed economy. Indeed the Cabinet itself and the other Ministerial Committees find great difficulty in coping with even the major issues, and more and more authority must be delegated to officials. How the activities of the latter can be co-ordinated with sufficient precision to avoid serious loss and inefficiency is in itself a nice problem, and one to which, I believe, there is no satisfactory solution; but in the present context what I wish to stress is that such planning involves pervasive executive rule which democratic institutions cannot control. Not only is much liberty of action in economic affairs taken away directly, but one is left with the gloomy feeling that in the longer run other freedoms will also be threatened. The threat will be direct in so far as dictatorial methods become necessary to settle major conflicts of interest which, although unavoidable in any community, are much more obvious and are therefore made into political issues under planning. It will be indirect in so far as the centralised control of affairs destroys the individualistic traditions, derived from a liberal economy, which have been the bulwarks of democratic government in the past. The process may be gradual, of course, but only the more insidious and dangerous for that reason.

That socialism and planning may threaten democracy is slowly becoming recognised; yet the fact remains that many people believe the new techniques to be so superior in

economic performance that they are prepared reluctantly to incur the political risks. Those who stress the political dangers may be right, but have they any positive economic policy to offer? Thus we return to the dilemma. It seems that a choice must be made between efficiency and serfdom under socialism, and economic stagnation and liberty under capitalism. It is this bitter choice which dismays so many students of affairs at the present time. Some may be sufficiently tough to admit that they can find no solution, and since the economic forces seem so strong, they usually conclude that democracy is doomed. But this conclusion, whether true or false, is too gloomy to be generally accepted, and a somewhat watery cheerfulness keeps breaking through. It is more customary to suggest that there may be some other form of socialism, vastly different from the grinding despotism of the Communist state and capable of combining economic efficiency with respect for the individual. There are many who hold that the ideal should be "democratic socialism" or "planning for socialist freedom" or some other high-sounding if dismally vague objective. Unfortunately such problems cannot be solved by stating them, and it is difficult to regard these remedies as more than wishful thinking.

Up to a point it is possible to have greater respect for the intellectual consistency of the Communists and their Fellow-Travellers; they at least are prepared to admit that Parliamentary democracy will be overwhelmed by the economic revolution which they regard as both inevitable and right. But beyond this point, respect must give place to suspicion as they proceed to elaborate what is surely one of the most curious sophisms of the present time. For they go on to claim that after all democracy has been a bourgeois affair in the past and that the loss of our much-vaunted liberties will make little difference to the proletariat. Indeed a considerable number of those who are in many respects anti-Communist are taken in by this most specious of argu-

ments. Nothing, in fact, could be more foolish than to suggest that the workers should barter their freedom in exchange for mere promises about the greater equality of a Communist economy. On any showing, it is just this political freedom which has been the main safeguard of justice as between rich and poor, and it is to the derided Parliamentary system that so much of the workers' progress has been due. If Parliamentary restraints are undermined and criticism of the Government is treason, those who hold the key positions in the state will be able to dispose of their favour as they please, and sooner or later this unassailable oligarchy will begin to enrich itself at the expense of the masses. Certainly the theories of Marx himself, if applied for a change to a Communist state, would lead one to anticipate serious exploitation; and the proletariat would do well to think twice before it yields to the blandishments of those who long to become its dictators.

It must be conceded that the bulk of the people do not take a constant and active part in cultural and political life even in democratic countries. The division of labour is rightly extended so far as to prevent it. It must also be admitted that the small minority which does play such a part in these spheres of life does not always consist of those who are most suited to do so. The inheritance of wealth has affected the position, and not always in the right way. But whereas matters have been much improved by democratic methods — free education, progressive taxation and the like — and with the passage of time can be further improved along similar lines, they are scarcely likely to be altered for the better if no-one is to enjoy the higher privileges of political and cultured life unless he sells himself, body and soul, to the governing caucus. Nor is it a statement of fact that liberty of thought is of no importance except to the ruling class and a handful of intellectuals. It is impossible to accept for a moment the claim that the working man will lose nothing if he is no

longer able to listen to diverse views, to speak his mind, to vote for whom he pleases and to sing the songs he likes.[1] The Communist conception of the state envisages a small group of party members governing a vast herd of ignorant workers, who will be content to leave their thinking to their betters. Apparently it is not for the common man to decide what God he will worship or whether he will even worship at all.

Liberty is precious and liberty is at least threatened by planning and socialism. There is no gainsaying these conclusions and it would be very wrong to regard them as merely the outcome of academic controversy, an armchair dispute about freedom in a future state. This line of defence is taken up by those who point out, first, that the Labour Party does not intend to go very far and, second, that its leaders are sound Britishers, steeped in the democratic tradition. These are comforting assurances and it is always tempting to assume that we shall muddle through somehow. It is tempting, but it is also dangerous.

With regard to socialisation, it is true that the policy of the Labour Government during its first post-war term of office was of secondary political importance, although it is disturbing to note that 4 million people now depend upon the state for their livelihood. But will the Labour Party ever feel that it has done enough? It is becoming clear that the more level-headed members of the party, such as Sir Stafford Cripps and Mr. Herbert Morrison, would probably be glad to go slow, if only for administrative reasons, but it is more than doubtful whether they will be able to resist for long the pressure within their own party. In order to win support for a limited programme they have been obliged in the past to denounce private enterprise in general and to teach that the profit motive is always wrong;

[1] At the end of the war some Russian sailors who had come into contact with the reactionary British were fiercely reprimanded by their masters for singing that decadent, counter-revolutionary, anti-dialectical song, "There is a tavern in the town"!

it will not be easy for them, however much they try, to convince their followers that capitalism is sometimes right and sometimes wrong. The inconsistencies of the Labour Party leaders are, of course, most apparent in the case of Dr. Dalton. He is no lover of Communism and no doubt he has a sincere belief in democracy. Yet he devotes most of his energy to preaching class-war and to breaking down the psychological barriers against the dictatorship he fears. His petty hatred of the Conservatives is so intense that he is prepared to say things which strengthen the hands of all the more sinister elements on the Left with whom, as a democrat, he must have less in common than he has with the Conservatives themselves. No doubt Dr. Dalton is an extreme case, and in this, as in some other, respects it would betray considerable bias to describe him as typical of the party. Unfortunately, however, he is not entirely alone and unrepresentative. The Labour Party has released forces which it will find difficult in controlling,[1] however sincerely it makes the attempt, and it would be an exaggeration to describe its present efforts as strenuous and whole-hearted.

With regard to personnel, there is no need to doubt that most, if not all, the members of the Labour Front Bench are sincere believers in Parliamentary democracy and in civil and political liberty. They will not willingly subvert the traditional constitution, but that they are preparing unwittingly for its subversion may well prove to be the case. The psychological consequences of their policy have already been stressed, but another danger must also be noted. It is quite possible that at some stage a more extreme faction

[1] These difficulties have become apparent during the drive for greater production. For many years, Socialists have taught that profits represent exploitation and that only a fool or a toady would work hard to enrich his boss. After their accession to power in 1945, the members of the Government underwent a rapid course of practical education and soon began to appeal for greater efforts even in private industry. No-one need have been surprised at the disappointing result. To many of the rank and file, the Ministers appeared to have " sold out " to the capitalists, and ca' canny and absenteeism continued.

may occupy the Cabinet seats, whether as a result of internal feuds or because the old men, with their sounder instincts, have retired or died. This is the more likely because it is still probably true that a large number in the party prefer the extreme Left to the Conservatives or Liberals and would rather have an extremist at the Home Office than witness the break up of a Labour majority. If such a Government came into power, it would find the road to totalitarianism far easier to follow if most of the staple industries were in public ownership and all the rest controlled by a planning executive. Planning and the nationalisation of the staple industries may prove to be compatible with Parliamentary government for a considerable time, but everything depends upon the good faith of the Government to a far greater extent than would be possible under private enterprise where economic power is so much divided. A change of personnel may prove disastrous and everything tends to hang upon a thread. For an economy which is already highly centralised is an easy prey to would-be dictators.

There are dangers even more immediate than these. Those who hold that socialism is compatible with democracy rest their argument upon the assumption that socialism can be achieved gradually by Parliamentary means; but there is a grave danger that Parliamentary government may be severely shaken under the strain of the transition. A small but powerful minority of the population has come to believe that the widespread nationalisation of industry will make possible an improvement in the lot of the common people which is unattainable by other means, and it is natural that those who hold this view with passionate conviction should regard their opponents as cynical and selfish reactionaries who must not be allowed to thwart the progress of the nation. One can understand such feelings, however much one may deplore the economic fallacy on which they are based. But it is more than doubtful whether, in such circumstances, Parliamentary government can operate at all

efficiently. If a party which is opposed to socialism comes into power, it is possible that its authority will be challenged by such unconstitutional means as political strikes. With our livelihood dependent on exports, a few serious and prolonged strikes, cleverly engineered on some pretext, could easily bring about nothing short of economic collapse; the balance-of-payments problem affords a wonderful opportunity for sabotage, a fact which is fully appreciated by those who take their orders from Moscow. In commenting on a recent dock strike, Mr. Herbert Morrison described how "thousands of men came out on strike at the call of a limited number of Communist plotters", and he went on to invite the dockers

> " to assert their rights as trade unionists and to refuse any more to be fooled by irresponsible conspirators whose motive is to damage the economy of their country, to produce that chaos which they believe is the easiest way of facilitating violent revolution, and who are the servile agents of a Foreign Power ".[1]

The invitation is a wise one; it has been given before and there are some signs that it is being accepted. But one wonders how many of the leaders of the Labour Party would protest in the same honest way against political strikes if a Conservative Government were in power. No doubt a few — including Mr. Morrison himself — would appreciate that the danger was still the same, but I suspect that the majority would hold their peace. Perhaps some would even encourage the saboteurs, while most of the remainder, quietly pleased by the discomfiture of their Parliamentary opponents, would allow " these servile agents of a Foreign Power " to go unrebuked.

The external dangers resulting from the socialist myth are no less alarming. In their attempt to restrain Soviet imperialism and preserve some remnant of liberty in Europe, the democratic countries are notoriously handicapped by the

[1] Reported in the *Sunday Times*, April 24, 1949.

existence of a large and vigorous Fifth Column. Nothing can be done about its hard-boiled leaders, apart from keeping them under the surveillance of the security departments and arresting them without hesitation when their treachery becomes dangerous; but the Fellow-Travellers of the rank and file are a different matter. The German Fifth Column had no comparable support; and without this large group of deluded followers, the Communists, although much more numerous themselves than their Nazi predecessors, could be dealt with easily enough. It must be recognised that many of these Fellow-Travellers are well-meaning, if foolish, and their attitude is understandable when one brings to mind what they have been taught, not only by their Communist friends but also by the leaders of the Labour Party itself. Exploitation, they have been told, is inevitable in capitalist countries, and the Soviet Union, where there are no capitalists, must therefore be more equitable than, say, the United States. Can it, then, be right for a Labour Government to side with the U.S.A. against "the leaders of the Russian proletariat"? Furthermore, capitalism is inefficient and irrational according to the theories which Mr. Ernest Bevin, to take an important example, has never explicitly denied. In dealing with Russia, Mr. Bevin's robust common sense usually conquers the doubtful tenets of his economic faith, but he need not be surprised if some Socialists are, in their queer way, more logical and are half-hearted at best in their support of his policy. The facts of Soviet aggression in Poland, Czechoslovakia, Hungary, Greece and elsewhere are beyond dispute, but the eyes which view them seem so often to have lost the power to focus. It is felt that this can surely not be regarded as imperialism, for is it not a fundamental article of the socialist creed that imperialism and war are the outcome of capitalism? Not only Lenin but a recent Minister of Food has endorsed this view.[1] The Soviet Union cannot therefore be imperialistic!

[1] John Strachey, *Why You Should be a Socialist.*

Even those Socialists who are prepared to admit that the U.S.S.R. bears little resemblance to the equalitarian society of socialist theory are still inclined to regard it as superior, in some usually undefined economic sense, to the capitalist countries of the West. It is appropriate to refer at this stage to Mr. Arthur Koestler because both his novels and his essays reflect so well the confusion and perplexities of erstwhile comrades who have now seen half the truth. With so much evidence before him, some of it derived from his personal experience, he has been forced to abandon the Soviet myth. He is still a Socialist, but he has had the courage to say that the state ownership of industry is no guarantee that society will be organised on humanitarian principles; on the contrary, he emphasises that in many respects the Soviet Union is far more reactionary than the Western countries. In *The Yogi and the Commissar* he sets down a large number of facts and figures — which are in accord with the other evidence at our disposal — to show how completely the Russian ruling class has departed, in both practice and theory, from the socialist principles for which, in the eyes of so many foreigners, it is still believed to stand. His own eyes have now been opened, but only partially so, for he claims that " Russian state-ownership and planning is economically progressive compared with private capitalism . . ." [1]

Since liberty is so gravely threatened by socialism, both at home and abroad, it is sensible to consider more critically this basic proposition that state ownership and pervasive planning are necessary for economic progress. For if this proposition is false, we shall have escaped altogether from the dilemma; freedom and progress will be compatible after all. Indeed the socialist case will have been destroyed if it can even be shown that the margin of economic superiority in favour of socialism is likely to be small: only a very wide

[1] *The Yogi and the Commissar*, p. 188.

margin — involving a contrast between hunger and disease under capitalism and plenty under socialism — would justify the nation in incurring the grave risks to both liberty and equity which are the price of public ownership and centralised direction in economic affairs. But it is possible to go beyond this. An unbiased scrutiny of the evidence leads, I believe, to the conclusion that there is no favourable margin at all. In general, it will be my contention that the original dilemma with which we started is false. There is no need to choose between liberty and progress, and this is so not because wholesale planning and socialism can be reconciled with liberty, but rather because private enterprise is more progressive economically as well as politically.

In some respects it will certainly be necessary for the state to intervene to a greater extent than was customary before the war. *Laisser-faire* is dead and there can be very few who would welcome its resurrection. But it is neither necessary nor desirable to abandon private enterprise or to dispense altogether with the flexible mechanism of the market.

CHAPTER 2

PROGRESS UNDER CAPITALISM

A " PROGRESSIVE " policy has come to mean nowadays one which involves an extension of state control. Indeed the adjective " progressive ", which is so charged with emotional significance, has been virtually annexed by the devotees of socialism and physical planning. That this should be so may seem surprising to future historians, who will note that in spite of all the evils wrought by the state in Germany, Italy, Russia and Japan, its worship is still regarded as a peculiar sign of grace by large numbers of high-minded people in the democratic countries. They may remark upon the odd fact that this laudatory adjective can still be applied without inviting ridicule even to Communist dictatorships unless, indeed, the " progressive " forces have won and historians can no longer comment freely about anything at all! Be this as it may, it would certainly have astounded Adam Smith and his followers to learn that, after a period of unprecedented progress, private enterprise would be dubbed incompetent and reactionary. In their day, the progressives were those who sought to free the economy from the shackles of the guild and the mercantilist state, and to release the tremendous force of individual initiative. It may be, of course, that the classical economists were wrong — undoubtedly they neglected some of the worst evils of *laisser-faire*. Or it may be that, although they were once broadly right in their own time, conditions have changed, and what was then progressive is now reactionary. That is the central question with which this book is concerned, but first of all

it may be well to recall how much was in fact achieved under private enterprise and how far the classical economists were, therefore, in the right.

That we are in danger of forgetting the speed and magnitude of economic development may be largely attributed to the tendency of most novelists and some historians to concentrate attention upon the evils of the early industrial era. No-one who has read the works of Dickens and Disraeli, or the more sober but no less disturbing accounts given by Mr. and Mrs. Hammond, can look back to this period without feelings of horror. If the picture is a little unbalanced, the great authors need not be blamed unduly on that account. When Dickens and Disraeli were writing their novels, it was appropriate to emphasise the sombre colours in the hope that some at least of the more bitter cruelties of the time might be removed. The philosophers of *laisser-faire* were too well entrenched, and there was altogether too much smugness and self-satisfaction to warrant any fear that the brighter side of economic development would not be appreciated. Even later writers, such as the Hammonds, were also justified, for they wrote at a time when the case for action by the state was still inadequately recognised. Today it is a different story. The need for a change of emphasis is apparent and writers who follow the older example need not delude themselves with the belief that they are performing a useful social function. To correct the present bias, which is tending to deflect us from a sane solution of our current problems, it is therefore necessary to recall two facts which, if they are obvious, are often forgotten : first, that great progress was made under private enterprise ; and second, that the main, though not the only, cause of poverty in the capitalist economies of the past was the scarcity of goods.

The first achievement to note is the prevention of famine. When Malthus wrote his *Essay on Population* in 1798 it seemed to him virtually inevitable that the growth of popula-

tion would outstrip any expansion of agricultural output on which it was reasonable to count. Continence might avert disaster, but in its absence a high death-rate, due to undernourishment or downright starvation, could scarcely be avoided. In such circumstances the earlier economists felt that many well-meaning attempts to improve the lot of the poor might prove to be futile, because the consequent growth in numbers would soon drag them back to their miserable starting-point. These were harsh things to say and Malthus has been denounced repeatedly as a cruel, cold-blooded reactionary who could regard with indifference the sufferings of the poor. It must be conceded that his arguments were used by the opponents of social reform and probably did a good deal of harm ; but it is fair to add that the other side was usually sentimental rather than scientific in its philanthropy. Today, with the problems of Asia in our minds, we are perhaps inclined to give Malthus a more respectful hearing ; he may yet be vindicated. In the West, however, the Malthusian predictions have so far been falsified by events ; and this has happened not because Malthus was wrong in supporting private enterprise, but because he failed to foresee the enormous economic expansion which took place during the great century of capitalism. At a later stage, rising standards of life were accompanied by a falling birth-rate, but the fact remains that a vast increase in population did occur without disaster. By the middle of the nineteenth century the population of Great Britain was about twice what it had been when Malthus wrote his Essay, and by the outbreak of the First World War it had quadrupled. For the world as a whole, it has been estimated that population increased by over 100 per cent between 1750 and 1900. Even the most optimistic of Malthus' opponents could scarcely have envisaged such a development.

The achievement would have been remarkable enough even if the standard of life had been no more than maintained, but in fact it was raised substantially at the same

time. A few moments' unbiased reflection will bring to mind many instances of improving conditions, and such general impressions are confirmed by what statistics are available. Admittedly, calculations extending far back into the past are extraordinarily difficult. Lack of data and difficulties of logic prevent any precise comparison, but some broad statements can be made. According to the most recent estimates,[1] the National Income of the United Kingdom had by 1938 increased to three and a half times the level reached in 1870, when an enormous expansion had already taken place since the beginning of the century. Such figures provide an indication of the growth in the productive power of the nation and scarcely support the view that capitalism implies stagnation. Population also increased, but not so fast as income, with the result that average income per head rose to about two and a quarter times its former level over the same period. Nor did the working class fail to share in this progress. Between 1860 and 1914, real wages were roughly doubled, *i.e.* average money wages would buy about twice as much.[2] The advance continued during the inter-war years and, broadly speaking, real wages rose by a third between 1914 and the outbreak of the Second World War. Over these years, hours of work were steadily reduced, so that the figures above do not adequately reflect the rise in output per man-hour which was roughly trebled between the 1860's and the late 1930's. Thus leisure increased as real wages rose and the authors of the *Communist Manifesto* were sadly in error when they said that " the

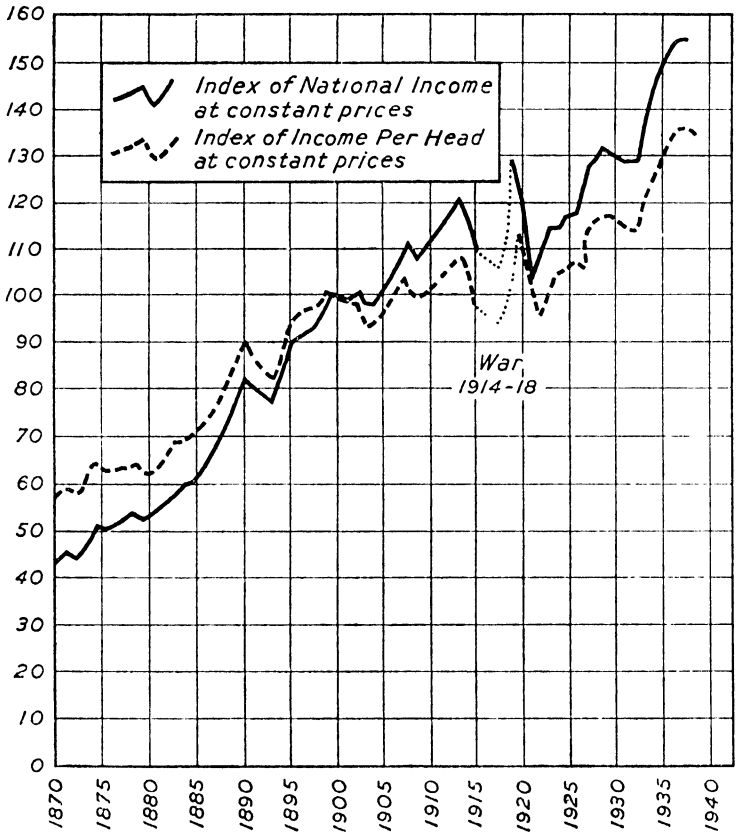
[1] A. R. Prest, " National Income of the United Kingdom, 1870–1946 ", *Economic Journal*, March 1948. The national income may be defined as the sum of all net incomes in the country, and must not be confused with the budget. The former is necessarily equal to net value of output *plus* any net unearned income from overseas. The above figures and those which follow have been corrected for changes in prices.

The changes in Mr. Prest's indices of total national income and income per head have been plotted in Chart 1. The author is indebted to Mr. Prest and to the Secretary of the Royal Economic Society for permission to use these figures.

[2] Cf. Bowley, *Wages and Income in the U.K. since 1860*.

modern labourer . . . instead of rising with the progress of industry, sinks deeper and deeper below the conditions of

CHART 1



NET NATIONAL INCOME OF THE UNITED KINGDOM, 1870–1938
(1900 = 100)

existence of his own class. He becomes a pauper and pauperism develops more rapidly than population and wealth."

The statistics for the United States are still more remark-

able. Under private enterprise, without socialism or the aid of central planners, she developed from a small group of settlements into the foremost industrial nation in the world. In the 1930's total national output was about eight times as big as in the 1870's, and although there was also a vast increase in population, income per head was nearly trebled.[1] A creditable record for " chaotic *laisser-faire* " !

Karl Marx himself was much impressed by the past vigour of the capitalist economies, but he felt that their strength was beginning to wane and complete collapse could not long be postponed. His prophecy has become an article of faith among his followers and it may be urged that the facts given above have long ceased to be relevant. The failures and mistakes of the inter-war period are familiar enough, but British industry was then confronted with structural difficulties which would have severely taxed the economy, however much it had been planned. In view of these obstacles, the progress between 1924 and 1938 which raised income per head by over 25 per cent was a far from contemptible achievement. Before the war, productivity was increasing on the average at the rate of $1\frac{1}{2}$ per cent per annum, which implied a doubling of output per head in less than half a century. If manufacturing industry alone is taken and productivity calculated, the rise is even more impressive. Before the outbreak of the Second World War, the man-hours in manufacturing industry in the U.S.A. required to produce a given quantity of goods were only one-third the amount required at the beginning of the century.[2]

At one time it may have been tempting to say that these rates of progress were too slow, but the temptation is a little less strong today when we are struggling not so much to raise the standard of living as to prevent an absolute and catastrophic decline.

[1] S. Kuznets, *National Income, A Summary of Findings*, p. 32.
[2] S. Fabricant, *The Relation between Factory Employment and Output since 1899*, National Bureau of Economic Research.

Unfortunately, estimates of this kind fail to reflect one of the main features of economic progress. Technical development consists of a great deal more than the improvement of productive methods in old industries ; it brings with it a host of new things which were not available at all in the past — such as steamships, railways, motor-cars and electricity. The importance of such changes in the composition of output cannot be reflected by global statistics, and the same is true of the great but intangible gains derived from abolishing the worst evils of the early factory system. With the passage of the Factory Acts, the development of public health services, the introduction of social insurance and the revolutionary changes in taxation, social life was transformed. That this was done is surely a tribute to capitalist democracy, but it is one which is too rarely paid. On the contrary, by a remarkable feat of intellectual legerdemain, it is more customary to pick out the early hardships as though they were a condemnation of modern capitalism from which they have been largely removed. That this implication is so often accepted without question must be regarded as the supreme tribute to the skill of the propagandist school of historians ; and it is almost necessary to point out that children of six no longer labour at the bench and that, even before the Coal Board took over, coal was not transported underground by half-naked women on all-fours.[1] Some of the reforms, it is true,

[1] Cf. the similar complaint by Professor Sargant Florence in *Britain's Industrial Future* : " Indeed I deplore the vivid teaching of economic history of the industrial revolution, particularly trade-union history of the late eighteenth and early nineteenth centuries, up to the point where audiences think that the past are the present conditions. With their leaders in this Workers' Educational Association dream (or rather nightmare) world, it is no wonder that the rank and file still think that capitalist profits and invisible exports are inexhaustible, and that high profits wherever they do appear can only mean the exploitation of labour." (P. 201.)

It may be added that the teaching of economic history in many schools, including some of the public schools, seems to be as unsatisfactory as much of the W.E.A. teaching. The pupils are often left with two impressions, both false : first, that the industrial revolution increased the poverty of the workers ; second, that this is a reason for abolishing private enterprise today.

were carried out by the state and may be described as the early achievements of planning. But it was not planning of the kind which is so hotly debated today ; it did not involve the abolition of private enterprise and the price system, which are quite compatible with a certain amount of state intervention and certainly do not imply extreme *laisser-faire* — that dismal corpse which is still thrashed with such monotonous regularity by those who call themselves the intellectual leaders of our times.

It is an arduous business to try to correct a popular bias and to destroy a myth which has become so generally accepted as to be almost taken for granted. An endless string of facts may be quoted to show that the capitalist era, for all its faults and failures, has witnessed an unprecedented increase in material well-being, but such statements are liable to be met with two objections, sometimes made by the same people although they are mutually contradictory.

It may be pointed out that material progress is not everything and that the economic development of the past two centuries has destroyed much that was precious and offered in return a dreary civilisation, in which sewers are valued more highly than poetry and fast cars preferred to the beauty of an unspoilt countryside. The objection is a weighty one and must be respected. It is certainly not for the economist, when speaking professionally, to take sides in such a dispute and reject out of hand the ideals of such opponents of industrialisation as Gandhi or Eric Gill. As a private citizen, he may hold and express strong views, but it would be wrong to imply that a conclusion either way can be derived from economic analysis. Economics is of use in clarifying the alternatives and counting the costs of different courses of action, but happily the dismal science has its limits. It must be emphasised, therefore, that economics does not rest upon a materialistic philosophy ; when the economist points to the fact that income per head in 1938 was

more than twice as great as in 1870, he should not be taken to imply that happiness or welfare in some more ultimate sense had increased correspondingly or had even increased at all. He means no more than he says : that an index of the amount of goods and services which could be purchased had gone up by this amount. If the ascetic replies that riches are a snare, no rejoinder need be sought in economic science.

The economist, however, if he can do no more, can at least perform the humble role of pointing out that one cannot have it both ways. It may be that we should have remained a primarily agricultural country, but it is by no means clear that the implications of this argument are ever accepted. It may have been folly to build factories and buy food with their produce, although it is doubtful whether those who had experienced the Irish famine would have agreed. Much was certainly lost in the development of the new economy. The expansion was so rapid that there was little time for the growth of a satisfactory community life in the new and ugly towns, and it has been held that the spiritual loss, rather than the material hardship, was the main cause of the discontent of the Chartist period.[1] No doubt there is much truth in this, but it is difficult to see what could have been done, apart from a crude attempt to slow up the building of new factories ; for the development of community life takes time and must be largely spontaneous. Perhaps the state should have called a halt and faced the material loss. Neither the historian nor the economist can say ; but the former can point out that there was no Golden Age in the past, and the latter is fully justified in rapping the knuckles of those who, while complaining that industrialisation was too rapid, yet bewail the low level of material production.

" The central problem of the age ", writes Professor Ashton in his authoritative survey,[2] " was how to feed

[1] Cf. J. L. and Barbara Hammond, *The Bleak Age.*
[2] *The Industrial Revolution, 1760–1830*, p. 161.

and clothe and employ generations of children outnumbering by far those of any earlier time. Ireland was faced with the same problem. Failing to solve it, she lost in the 'forties about a fifth of her people by emigration or starvation and disease. If England had remained a nation of cultivators and craftsmen, she could hardly have escaped the same fate, and, at best, the weight of a growing population must have pressed down the spring of her spirit. She was delivered, not by her rulers, but by those who, seeking no doubt their own narrow ends, had the wit and resource to devise new instruments of production and new methods of administering industry."

The second set of critics are those who refuse to be impressed by such achievements as the doubling or trebling of income per head over seventy years. In a planned economy, we are told, far more than this could be done and scarcity would soon be abolished. Admittedly such claims are becoming a little less frequent; for the planners are in power and are learning what scarcity means. The leaders of the Labour Party have certainly changed their emphasis, and their former statements seem rather foolish today. But the old beliefs are still held to a surprising extent among the rank and file of the party, who feel that if scarcity still exists, this is because we have not planned and nationalised enough or because the Labour leaders have " betrayed the workers' cause " !

The subsequent chapters of this book will contain much criticism of the view that comprehensive planning and socialisation are desirable from the point of view of economic efficiency, and will thus incidentally meet the argument that the rate of progress under capitalism has been relatively unsatisfactory. For the moment, however, it will suffice to note that the Soviet Union has done little to put the capitalist economies in the shade. Before the war the U.S.S.R., with an income per head little more than a quarter that of the

U.S.A., was far behind the leading capitalist countries. When this disconcerting fact is forced upon the unwilling attention of the Communists, it is usually " explained " on the ground that Russia was a poor and backward country when the Revolution occurred and that time is required before output can be expanded to reach a satisfactory level. The explanation has much validity, although it is easy to neglect the extent of industrial development even under the Tsars. But it is reasonable to complain that the same explanation is rarely mentioned by the Left in discussing the causes of poverty in capitalist countries even in the nineteenth century. The hardships of the poor are normally attributed to nothing more than the rapaciousness of the ruling class, when a glance at the statistics would show that the lack of material resources was a more fundamental cause.

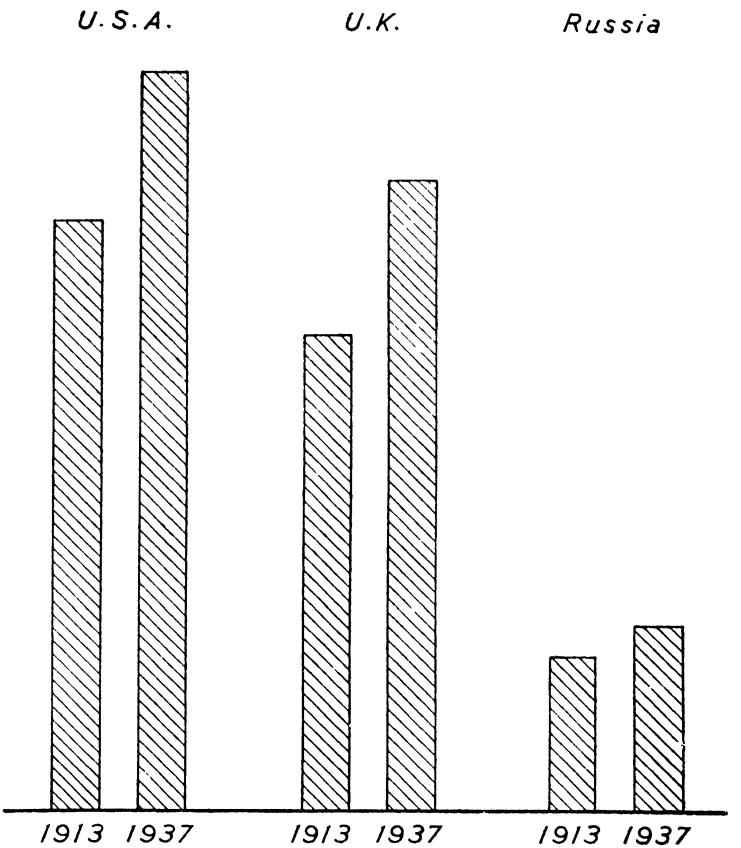
Although full allowance should be made for the unfavourable starting-point, it might be expected from all the claims put forward that at least *the rate* of progress in the U.S.S.R. has been quite remarkable. The expectation is not fulfilled. The Revolution was followed by a terrible period of chaos and famine, a grim warning to those who favour violent means. Subsequently something like pre-war prosperity was recovered during the N.E.P. period, when private enterprise was given a chance for a time in some sectors of the economy; but income per head dropped sharply once more during the confused years of the first Five-Year Plan. According to Mr. Colin Clark,[1] it was not until the late 'thirties that the Tsarist level of output per head was once more reached and then surpassed. It would

[1] Colin Clark, *The Conditions of Economic Progress*, table opposite p. 148. Mr. Clark's estimates for the U.S.S.R., the U.S.A. and the U.K. have been plotted in Chart 2. The author is indebted to Messrs. Macmillan & Co. for permission to use the data.

The figures relate to output per head of the " working population ", which consists of those who are at work *plus* the unemployed. Those who are not normally employed for gain (*e.g.* housewives who remain at home) are not included in " the working population ". This is the usual statistical convention.

be foolish to revert to the once fashionable belief that the Soviet economy is ramshackle and incompetent; but it is

CHART 2



INCOME PRODUCED PER HEAD OF WORKING POPULATION
(International Units)

clear that the progress achieved has not been remarkable when judged by capitalist standards. Furthermore, some

of the much-vaunted developments, in particular in the more remote areas, have been accomplished only with the use of forced labour. On the other hand, in California — to take an example from the free world — manufacturing output was increased by 70 per cent between 1919 and 1929.

Comparisons between countries are notoriously difficult and must not be pressed too far; but it is noteworthy that the percentage increase in income per head in both the U.S.S.R. and the United Kingdom was the same between 1913 and 1938. One difficulty in such comparisons lies in the fact that the two countries were at a very different stage of development. Generally speaking, a country which was rapidly industrialising might be expected to show a greater increase in output per head than a more mature country, and Russian development over these twenty-five years may be compared with British development between, say, 1870 and 1895. If this is done the contrast is all the more striking. Income per head in the United Kingdom rose by more than 60 per cent during the earlier period, as compared with a rise of about 25 per cent in the U.S.S.R. between 1913 and 1937.

The Bolsheviks, it is true, had to make good the ravages of the war and of the Revolution, and it may be held that special allowance should be made for these facts. The argument is valid up to a point, but two considerations should be borne in mind. First, the United Kingdom was also obliged to face a period of difficult adjustment as a result of the war; and if she suffered little physical destruction, she was far more vulnerable to adverse developments overseas. In the second place, it may be doubted whether, in judging the performance of the Bolsheviks, they can be partially excused because of the consequences of their own Revolution. Communist policy implies violence and revolution as the necessary means to a world of promised plenty, and one of the most powerful arguments against it and in favour of "gradualism", or social democracy, is that

economic life will be disrupted and much will be destroyed in the process. The second familiar excuse is no more convincing. The Communists claim that the Soviet Union had to struggle forward in face of the hostility of the capitalist world. If what is meant is the early foreign intervention, then it may be concluded that an economy which took two decades to get over such half-hearted proddings was remarkably lacking in resilience. If it is rather implied that she could have done with more imports, then the argument must be accepted, although the Soviet Union is, of course, far more self-sufficient than the United Kingdom. Large imports obtained on credit would certainly have helped, but she could scarcely expect much assistance of this kind in view of her repudiation of debts incurred before the Revolution. In any case, it is a little dangerous for Communists to complain about the lack of foreign credits. Has not Lenin taught that such lending represents the last attempt of decadent, capitalist countries to keep themselves going by the ruthless exploitation of backward peoples ? If the Soviet Union could have benefited by such loans, perhaps India and Argentina have also derived some advantages from the railways which the British financed ; and it may be that the Brazilians have not suffered after all from borrowing dollars to equip their industries. This line of thought is clearly treacherous and had better be dropped !

In general, Communists can scarcely resent a comparison of income per head in 1938, when the dictatorship of the proletariat had been established for twenty years, with income per head in 1913 or in any year of the old Tsarist régime. But since the comparison records a rate of progress which, if substantial, is not spectacular by capitalist standards, it is always open to them to repeat the claim that they were handicapped by the war and the Revolution and to promise that much greater things will be done in the future when the losses of the Second World War have been made good. Perhaps such prophecies will be fulfilled ; but to invite

support on this basis is a very different matter from claiming that all records have already been smashed. The argument must be conducted on a different plane and will rest, not on statements of accomplished facts, but on a general analysis of the relative merits of private enterprise and Communist planning. That such arguments are far from convincing will, I hope, be shown later. Meanwhile, the claim that capitalism has been progressive has been sustained.

In spite of the great economic development of the last two centuries, the world was still desperately poor when it was plunged once more into the waste and fury of a great world war. The United States had about the highest level of income per head in the world, but in 1937 this amounted to only $1400 or £280 per person in the working population. For the United Kingdom the figure was under £240 in 1938. According to Mr. Colin Clark's calculations for 1925–34, only about one-tenth of the world's population received incomes over £200 a year.[1]

> " Oft-repeated phrases ", he writes, " about poverty in the midst of plenty, and the problems of production having already been solved if only we understood the problems of distribution, turn out to be the most untruthful of all modern clichés." [2]

There is still a strong tendency to challenge such hard and unassailable facts. The memories of surplus wheat on the prairies and of coffee burned in Brazil still remain and have a quite disproportionate effect on public opinion. The world would have been wealthier if these surpluses had been used and wealthier still if the unemployed had been set to work. But not so much wealthier as to invalidate Mr. Clark's statement. These matters must be considered in quantitative terms; a few hundred thousand tons of coffee and wheat

[1] Colin Clark, *The Conditions of Economic Progress*, p. 57.
[2] *Op. cit.* p. 3.

or 10 per cent more employment in the industrial countries would not have abolished want. More attention will be devoted later to these problems of apparent " over-production " and to the appropriate remedies. For the moment, however, I wish to draw a clear but important moral from the fact that output still remained low.

It has been suggested at the beginning of this chapter that the main cause of hardship and poverty during the capitalist period was the lack of goods to go round. That this was so can be seen at once by comparing the statistics for income per head with those for average wages. In 1886, for example, the average earnings of a male worker were 24s. a week as compared with 29s. for average income per head.[1] The latter figure is calculated by dividing the value of all the goods and services available to the nation by the number of people in the working population. The resulting figure exceeds, of course, the amount available per head for consumption; deductions should be made for investment in capital goods, for overseas lending and for the goods and services used by the state. If such adjustments were carried out, the gap between wages and average consumption per head would be quite modest, which shows that, although inequality was of some importance, the Victorian economists were right in prescribing hard work and thrift as the more important remedies for want.

Admittedly this is a gloomy doctrine. The social novelist finds it more attractive to contrast the misery of the workers in a factory with the wealth of their employer, and neither he nor his readers are wont to reflect that the workers were many and the employer but one. The sentimental reformer finds it comforting to believe that, even today, it is only necessary to fleece the rich and plan the economy. How simple it would all be if he were right!

[1] Cf. A. L. Bowley, *op. cit.*, and A. R. Prest, *loc. cit.* Mr. Prest's figures relate to income per head of the total population, and an approximate adjustment has been made to obtain the above figure which relates to the working population. (Current prices.)

So much by way of a background sketch. The capitalist economies have proved to be strongly progressive in the past and this should not be forgotten when discussing the appropriate policy for the future. But it does not follow from this that the older mechanisms are still the most appropriate. New techniques have been developed since the outbreak of war which may be at once more powerful and more flexible in their operation than market forces. New problems have emerged — above all the problem of paying for our imports in spite of the losses of the war — and these may require vastly different methods for their solution.

CHAPTER 3

THE ECONOMIC PROBLEM

ECONOMICS has always been concerned with the lack of resources available to meet the diverse and apparently insatiable needs of human beings. Scarcity is an essential feature of economic life; without scarcity there would, indeed, be no economic problem. This statement may appear to be platitudinous today; but before the war, when the myth of a world of plenty was so widespread, it was a different matter, and in the eyes of many people the emphasis placed on scarcity by professional economists appeared to be ghoulish and absurd. They were practitioners of "the dismal science" who would not raise their eyes and look at the unbounded possibilities which lay within such easy reach.

That such optimistic views should have persisted although the facts were easily obtainable, and indeed obvious at a moment's reflection, is a tribute to the romantic rather than the scientific qualities of the human mind. The figures presented in the preceding chapter afford some indication of the poverty of the world even before the war and the lack of resources is apparent enough today. Of course there may be great increases in productivity, perhaps as the result of atomic developments; but it is still necessary to assume that scarcity will remain an essential feature of social life for as long a period as anyone need consider. For although the supply of goods and services may increase, the desire to use them and the various possibilities of doing so are likely to grow at the same time. The unemployed British worker in

the 'thirties was well off as compared with the Indian coolie, but by our standards he was in desperate straits. As compared with their Russian comrades, American workers have reached the dizzy heights of plutocracy, but they are far from being content. Scarcity is relative to human desires and for that reason it must continue.

Scarcity alone would give rise to no problem of choice but for two other facts.[1] First, the scarce resources can normally be put to different uses ; and second, human desires are of varying intensity. Much of economics is concerned with the implications of these three facts taken together and it is for this reason that it has been termed " the logic of choice ". The desires which it takes as its data may be spiritual or materialistic, aesthetic or vulgar, selfish or altruistic. Strictly speaking, economics has nothing to say about the worthiness or worthlessness of these desires. It is concerned with discovering the principles by which the most can be made out of what is available ; for this reason it deals with an aspect of all human behaviour rather than a compartment of life, although it is true that applied economics refers in the main to the problems of choice encountered in the market place, or in the committee rooms of the central planners.

These fundamental propositions are the stock-in-trade of the professional economist. They may appear remotely academic but deserve, none the less, to be stated in a formal manner, because they indicate the nature and importance of the costs which must be met and should be minimised under any form of economic organisation. Admittedly it is not popular to talk about costs, and to say that some project is too expensive is to run the risk of being dubbed reactionary. This attitude developed not unnaturally during the inter-war years when there was a substantial amount of unemployment and it would have been possible to have had more of some things without having any less of other things. That is

[1] Cf. Robbins, *The Nature and Significance of Economic Science.*

to say, we were making such a bad use of our scarce resources that some were not being used at all. Even then the problem of choice was only concealed, not removed. On the average, the supply of goods and services in this country might have been increased by about one-tenth if it had been possible to achieve what Lord Beveridge has defined as full employment. But although only about nine-tenths of our fully employable labour was used, the employment of the extra tenth would not have gone very far towards removing scarcity; and it was also of great importance to ensure the proper distribution of the other nine-tenths.

At the present time, with full employment, some of the basic facts are more obvious, but costs are still suspect and tend too frequently to be regarded as meaningless and irrelevant, the dreary symbols of a monetary age which is past. Yet costs should be regarded as sacrificed alternatives. The cost of building a highly desirable laboratory is the sacrifice of, say, a highly desirable hospital which might otherwise have been built. In short, the economist is constantly saying that you cannot have your cake and eat it, and if he is thought to be a dull dog who merely repeats the obvious, it is always open to him to reply that if the obvious were not so often neglected he would be content to hold his peace.

The proposition that costs are sacrificed alternatives is admittedly platitudinous, but the next questions which arise require somewhat more complex answers. First of all, how can the various alternatives be evaluated? How are the costs to be measured and by what principles should it be decided that one course of action is desirable rather than another? Second — and this is even more difficult — how can these principles be most successfully applied in a complex society with an elaborate and bewildering division of labour of the kind with which we have to deal? Or, to approach the matter from the other side, what criteria can and should be applied in judging either the efficiency of exist-

ing economic institutions or the desirability of some of the changes which reformers recommend ?

Rational accounting is possible only if there is some common denominator in which to express the demand for each commodity and its cost of production. Money has performed this function in the past and it is surely true that monetary quantities must still be regarded as the most appropriate guides to action. For example, it is dangerous and misleading to calculate efficiency in terms of output per man-hour and much loss would be involved if such crude and partial calculations were allowed to determine public policy with regard to the equipment of industry. Other costs, such as the use of scarce capital, must be included, and their inclusion is possible only in terms of a common denominator. Now if this statement is accepted, the practical consequences are of great importance ; for it follows that what is called " physical planning " is liable to result in serious error. The man-power budget, which has become the latest plaything of the intellectual Left, deals with only one factor of production which is, moreover, by no means homogeneous. The same is true of raw materials. At some stage it is necessary to add together these different costs, and socialist planners are usually prepared to agree that there should be a financial plan as well as a series of physical plans. This admission is all very well, but which plan is to take precedence ? If it is the financial plan, it is doubtful whether the physical plans are more than an unnecessary administrative encumbrance. If — as is often asserted — the physical plans are to be regarded as the more important, it may well be asked whether the monetary accounts will have much real meaning. Prices and costs are likely to be highly artificial in such an economy, and even if accounting records in terms of money are prepared, it is doubtful whether the results they yield in such circumstances afford a sufficiently reliable guide. Clearly it is of great importance

to ask how prices and costs should be determined.

First, take the case of consumer goods which are already produced. The economic problem is to distribute them in such a way as to maximise satisfaction; and under the price system consumers are left free to bid for them on the market. It is the price, in such circumstances, which acts as the rationing instrument. Some economists have devoted much time and effort to the study of how the rational consumer should behave, and their hypothetical constructions are no doubt of some value. In the main, however, their reasoning has been very abstract and the unreal nature of many of their assumptions is so apparent that students are sometimes inclined to brush aside such ingenious toys as "indifference curves", and with them to discard the whole philosophy of consumers' sovereignty. Whether or not the first step is wise, the latter is certainly foolish. The case for allowing freedom to the consumer does not rest upon the doubtful conclusions of mathematical economics but upon certain broad propositions which must surely be accepted by anyone who claims to follow in the democratic or Christian traditions. To begin with, it can be said that in the main the individual knows his own preferences best. There is indeed much conceit and megalomania behind the opposite proposition that these matters should be decided for him by the god-like omniscience of his betters in Whitehall. No-one would claim, of course, that consumers' freedom should be complete. The free sale of dangerous drugs must be prohibited and, more important, indirect taxation and subsidies will fall unevenly on various forms of consumption and alter its composition accordingly. It is also true that there is a large group of goods, such as armaments, which can only be used communally. Finally, freedom must be curtailed in what has been described as a "siege economy", such as the British economy in war-time. To this and to the allied problems of inequality we shall return in subsequent chapters.

But that there should be a strong bias in favour of consumers' freedom with regard to everything which is privately consumed, can be stated as a first principle. By and large the consumers are the best judges of their own needs and the exercise of such freedom is in itself a good. Here, as elsewhere, liberty is the prerequisite of moral action and the enjoyment of such liberty also affords much satisfaction. Even the U.S.S.R. has apparently accepted the principle that prices are the best and most flexible method of distributing consumer goods. As soon as the Russian Government felt it was practicable they abolished rationing — and it should be noted that the economic conditions in which they did so were far worse than those in this country at any time since the end of the war.

The sceptics who see little good in consumers' freedom should contemplate the results of comprehensive rationing. Even in war-time this was never attempted, not even with regard to all foodstuffs. The specific rationing of tinned meat, salmon, breakfast cereals and other goods which were in fact made available on points, would have resulted in much discontent and finally in administrative breakdown. When the war ended it was desirable to widen gradually the range of goods from which consumers could choose at will until the distribution of goods was determined once more by the old-fashioned kind of " points " — pounds, shillings and pence. Unless there is reason to anticipate a heavy countervailing loss due, say, to much greater inequality which cannot be prevented by other means, consumers' freedom should be regarded as a primary objective of policy. This conclusion does not depend upon any unreal assumption to the effect that consumers have perfect knowledge and act with complete rationality. It owes nothing to the finicky constructions of the mathematical economists and it remains fundamentally unshaken by the assaults of critics such as Veblen. It is based on common sense and holds true whether productive capital is in public or private hands.

Whatever case there may be for central planning in other sectors of economic life, there is no case, except in times of acute crisis, for the planning of personal consumption by the state.

So far the discussion has been concerned with the share-out of goods already produced. The next step is to note the various ways in which the composition of output can be determined. Under the traditional price system, the behaviour of consumers directly affects the decisions to produce; increased receipts will tend to stimulate increased production in some lines while poor sales will induce a contraction in others. The stimulus of the profit motive leads in this way to continuous changes in production plans as the consumers exercise what Professor Robbins has termed their " right of veto " on the market. The price mechanism may indeed be said to provide a democratic method of determining, by means of " monetary votes ", how much of various articles should be produced, and it may be worth while to follow this line of thought a little farther. As we have seen in the first chapter, it is out of the question for Parliament to supervise all the detailed production programmes in a fully planned economy, and the vast majority of the decisions must be left to the executive. If the control of Parliament over the executive is bound to be weak, the control of the electorate is bound to be weaker still. Elections are fought on broad issues and the return of a party implies that, in the opinion of the voters, its good points and its bad points, taken together, are a better mixture than the good points and the bad points of the Opposition. But the sanctioning of production programmes at the polls every five years can scarcely be regarded as a very feasible or effective form of economic democracy. Some alternative method of expressing opinion and exercising control is required and is, in fact, provided by the price mechanism. When people spend more on this or less on that, they are recording their

" votes " ; and if managers are free to do so, they will respond by producing more or less. Thus there is a kind of continuous plebiscite, a constant and effective expression of public opinion on these matters. When incomes are unequal there will, it is true, be " plural voting " ; but this can be regarded as right and proper unless complete equality is regarded as a practicable and desirable ideal. It may be, of course, that there is too much plural voting, but if this is the case steps should be taken — and have already been taken — to reduce the degree of inequality ; that, rather than the abandonment of the price mechanism, is the proper remedy in most circumstances. There has been much talk of late of " economic democracy " and this is often taken to mean that the workers should have a share in the management. There may be some case for such reforms, but by far the most important requirement of economic democracy is a price system by which the demands of consumers can have their effect through the market on the decisions of producers.

If the nation's scanty resources are to be distributed in a rational manner, the process of valuation must be carried backwards to the resources themselves. Every text-book on economics sets out to explain how this is done in a market economy. The various private firms will try to obtain the services of land, labour and capital ; and these resources, in their multitudinous subdivisions, will come to acquire market values which reflect both their scarcity and the fact that they can be put to various uses. The resources themselves are accorded no intrinsic value by the market but only a derived value, which has some rough-and-ready connection with their potential productivity. It cannot be pretended that the machinery operates with smooth and unerring efficiency ; imperfect foresight, inertia, monopolistic restraints and so on result in many defects and mistakes. It can be claimed, however, that the process is carried out reasonably well if judged by realistic standards,

and it must be asked how the same task can be performed in a socialised economy.

It is at this point, I think, that the theoretical distinction between physical planning and socialism becomes important. Among economists, much of the pre-war discussion of socialism assumed that some attempt would be made to operate a pervasive price system. The managers of socialised undertakings would compete for labour, land and capital and in this way prices would emerge which would make possible a rational structure of costs. These costs should then be compared with the value of output and a balance struck. Each manager would be under an obligation to cover his costs and he would expand or contract his production according to the verdict of his accounts and his estimates of the future. His receipts would consist of funds received directly or indirectly from consumers; and if this were the arrangement, he would be guided by private valuations in much the same way as the manager of a capitalist firm. That is to say, consumers' demands would be allowed to determine producers' decisions and the Socialist Government — which would show more self-restraint than most of its kind — would content itself with more general supervision.

The profit motive is usually regarded by doctrinaire Socialists as particularly sinister, but after a little reflection on these problems of costing it becomes apparent that much of the abuse misses the point. Indeed, it is possible to go farther than this and to suggest that it is not an exclusively capitalist instrument but might also be employed with advantage in a socialist economy. This is a very shocking suggestion. Mr. Strachey in his *Theory and Practice of Socialism* complains that under capitalism "production is for profit", whereas under socialism the golden rule will be "production for use". The claim is familiar enough but it is surely extraordinary that a great political movement, served by so many intellectuals, should have adopted a slogan so banal as "production for use". Of course production is for use;

but the real difficulty is that there are so many useful products among which a choice must be made. A rational choice implies accounting and the accounts must include all the costs involved. Under socialism, as under capitalism, some charge must be made for the use of capital and land; for these are scarce and if more is devoted to one object there will be correspondingly less for others. A special premium must also be included to reflect the riskiness of the venture, if its desirability is to be rightly judged, and this charge is analogous to profits. Such a procedure need not give rise to unearned incomes if these are thought to be wrong; the payments may be made entirely to state banks or the like. But the basic principle that such costs should be included somewhere can scarcely be challenged.

In a capitalist economy, the profit motive implies, of course, a good deal more than comprehensive accounting. Although profits correspond to a real social cost, they are earned as a residue and may fluctuate from time to time according to the vagaries of business life. Thus an element of flexibility is introduced which may be of great practical value. At the same time, the receipt of profits provides a direct incentive to produce economically and to adapt the volume and composition of output to changing circumstances. Whether the profit motive will ever be used in this way in socialised undertakings is highly doubtful. Experience so far suggests that managers will be given a fixed — though by no means negligible — salary and told to cover their costs. The hopelessly vague arrangements are discussed in subsequent chapters and the general argument need not be anticipated here. But it seems appropriate to refer to the claim that a personal incentive is not required for efficient management. If salaried people in the civil service and elsewhere are prepared to work hard, why should it be foolish to expect a similar response from the managers of industry? The suggestion may be attractive but it is unconvincing. Apart from the obvious point that the civil servant's

psychology may be inappropriate in business life, it is wrong to discuss the matter as though the nation's output consisted of a few well-established goods produced in a few enormous factories, which are analogous to Government departments. There are hundreds of thousands of concerns in the country engaged on the production of a multitude of different goods, many of them new and experimental. Unless industry is to be organised in vast centralised trusts — which appears, unfortunately, to be the British concept of nationalisation — much authority must be delegated to a host of separate managements, and it is surely desirable that the latter should have a direct incentive to be efficient. It may be possible to find a small group of well-educated administrative civil servants who will perform their duties satisfactorily without any hope of an immediate additional reward; but they have the compensation of a good social position and the chance of promotion — to which they are rarely indifferent. In their case a more precise relationship between effort and reward would not be feasible anyway, for the obvious reason that their "output" is not something which is sold on the market-place and its "value" cannot be measured and compared with costs. The result is by no means wholly satisfactory; for example, the importance of a civil servant depends partly upon the number of people under him and this leads to a wasteful use of staff. There is no help for this, but that is scarcely a reason for reproducing the same conditions quite unnecessarily over the rest of the economy! Moreover, in the case of the civil servant, there are strong countervailing pressures which tend to check the growth of inefficiency. By the nature of his work he is constantly reminded of its national importance, and if he tends to forget there are always Ministers, M.P.s and newspapers to jog his memory. He is clearly in a very different position from the managers of small factories in provincial towns and it is absurd to argue that because he has no profit motive, they can do without one too. In dealing with the latter, only two courses

are possible. Either they must be told exactly what to do by the central authority, which implies over-centralisation and inefficiency; or they must be allowed to get on with the job and given an incentive in the form of profits to do it well.

Although a socialised economy may suffer severely from its refusal to employ the profit motive, it may be held to possess compensating virtues. In particular, will it not be free from the unemployment, inequality and monopolistic exploitation which have caused so much suffering under capitalism? The alleged defects of capitalism are considered in the second part and it will be argued that in practically every case nationalisation would be an irrelevant and sometimes even a harmful measure. There seems no reason to suppose that a socialised society which was operated by means of a price mechanism would be at all superior to one in which private enterprise was preserved and given a reasonable chance to work.

This, however, is only part of the story and many Socialists will regard it as the least important part. In their view, socialisation is desirable in order to facilitate the planning and control of production by the state. It is true that the techniques of physical planning have been applied over a large part of the British economy since the outbreak of war and such methods can clearly be used for a time even when most of industry is privately owned. In the longer run, however, their use will prove incompatible with the survival of private enterprise;[1] and it follows that if physical planning is believed to be superior to the price mechanism, this can be regarded as a reason for supporting socialisation. Indeed, of the various arguments in favour of socialism, this indirect one is often put forward nowadays as the strongest and it will therefore be the first to which we shall give detailed attention. A start will be made in the next chapter, which is concerned with some aspects of physical planning during the war.

[1] See Chapter 5 below.

CHAPTER 4

PROGRAMMES AND ALLOCATIONS IN WAR-TIME[1]

In his lectures on *Central Planning and Control in War and Peace*, Sir Oliver Franks offered the following definition of planning:

> "Peace", he said, "is very different from war and many of the war-time functions and forms of organisation will find no application in peace. But the essence of planning and control by the State in relation to productive industry and commercial activity must be the same in war and peace. I think the essential elements are plans consisting of decisions of policy quantitatively expressed in the form of programmes and such measures as in particular circumstances may be necessary to ensure the performance of these programmes."

He goes on to add that:

> "These elements were common to all the planning and controlling organisations of the war; they are discoverable in Government action at the present time. Without them I do not see how any Government could act as a planning and controlling authority."

The definition is a neat one; indeed it is too neat for the untidy concept it is meant to describe. The term "planning", like its shadowy twin "co-ordination", is far too intangible to be defined and disposed of in this way.

[1] This chapter is a shortened version of an article which appeared in *Oxford Economic Papers*, January 1949. Reproduced with editorial permission.

Everyone is agreed upon the need for planning, but there is far too much variety among the planners for any precise definition of these views. In particular a large number of planners, who differ appreciably among themselves, would be united in their rejection of Sir Oliver Franks' definition. Many of them believe in a good deal of state intervention, but they would give greater freedom to the consumer and would rely in the main on the price system to determine the allocation of resources. Sir Oliver has in fact described, not planning in general, as he seems to imply, but " physical " planning. The distribution of resources is to be largely settled by the state and enforced by means of controls. Prices and money are not, presumably, to be driven off the stage, but their role is rarely described and is apparently obscure.

The present chapter will be concerned with the technique of physical planning and it will follow more distinguished precedent by beginning with the war. No-one will deny that when a very large proportion of the nation's resources is required by the state for its own use, liberal methods are out of place and more direct control of the composition of output is required. But there is good reason to criticise the tendency to assume that the preparation of output programmes is a fairly straightforward business, and still more reason to point to the much-neglected problem of estimating the resources required to implement these programmes.

One of the major difficulties during the war was to synchronise the flow of components, made under varying conditions in a large number of factories. If each article had been relatively simple and produced by a single integrated firm, the task would have been much easier and could have been delegated to the management. It was a different matter when a great many firms were involved, as in the manufacture of aircraft — some engaged on the final assembly, some providing the radio valves, some the nuts and bolts and so on. Bottlenecks of one kind and another were always causing a certain amount of trouble in spite of

the fact that the synchronisation of supplies was very much better done than in the 1914–18 War.

The simple method of getting synchronisation is to keep all the supply bins filled, but this is an expensive process as it involves carrying large margins. When the war effort became stretched, it was too costly to carry store margins in excess of absolute need; and an attempt was made to plan more precisely the build-up of components and ancillary stores. Given the inherent difficulties, it was fairly well done — the proof being the relatively small excesses at the end. But the performance of this complicated feat involved much weary labour on the part of large staffs inside and outside the Government service and thus diverted much highly skilled labour from other tasks.

As Sir Oliver Franks has stressed, these programmes were not merely statements of desire; they were " acts of will ". It was therefore necessary that they should be " realistic " and, in fact, they became increasingly so as the years passed. To be realistic it had to be possible to produce them with existing capacity together with any additions on which it was reasonably safe to count. Some broad assumptions had also to be made about the supply of labour and raw materials, and although these were frequently found to be over-optimistic, it was at least possible to ensure that they were not altogether absurd. Thus the programmes could be regarded as reasonable drafts, but they were no more than this until all the demands for the nation's scarce resources had been put together and a balance struck.

The next step was to make more careful estimates of the resources required to fulfil these programmes, in particular estimates of the amount of labour. It was the man-power decisions which determined the size and the broad structure of the war-effort, and most of the other decisions, *e.g.* with regard to raw materials, were brought into harmony — mistakes apart — at a later stage. Labour was the most important of the internal limiting factors and although the

supply of labour was far from homogeneous, it was sufficiently so to make possible the preparation of a budget which related to the whole economy. The following comments will therefore relate to man-power and will apply to conditions in the latter part of the war when the technique of planning had been fairly well developed.

One method of calculating requirements which was used with some success was to ask the firms how much they would need. Unfortunately the answers obtained could not be considered altogether satisfactory, partly because the firms usually exaggerated their needs in anticipation of future cuts, partly for a variety of other reasons. In general it was felt that such calculations were of value for about three months ahead but of doubtful significance for longer periods; and this was a very serious limitation. A month had usually elapsed before the figures had been tabulated, submitted to certain tests and analysed. The whole of the three months might well have passed before the Cabinet had reached a decision, especially if the man-power position was so difficult as to call for a revision of the programmes for the Services and the Supply Departments. Nevertheless the estimates provided a valuable check on conclusions reached by other methods, and by means of some manipulation and guess-work it was possible to project them forward beyond the three months. These adjustments were ingenious and a rough-and-ready answer could be reached. But the whole procedure was singularly lacking in that academic precision which "planning" is supposed to offer in contrast to the "chaos of the pricing system".

The second method was to estimate productivity in the past and then, with the aid of the ratio thus determined, to calculate the labour force required in the future. No attempt will be made to describe the nature of these complicated calculations;[1] but it can be said at once, without

[1] Some details are given in my article on planning, *loc. cit.*, from which the extracts above have been taken.

fear of contradiction, that only very approximate answers were obtained. The departments responsible for the various programmes were therefore uncertain as to their future needs, although it would, of course, have been unwise to admit as much during the inter-departmental negotiations where skilful bluff was the order of the day.

In such circumstances it was only natural that departments should play for safety by putting forward a high figure which would safeguard their position if events turned out to be unfavourable. After all, each department had been charged with grave responsibilities on which the future of the country depended, and it was natural, and indeed right, that they should try to insure against risks. It was not for them to estimate the relative importance of their own needs as compared with those of other claimants; to begin with they had not sufficient knowledge, and the task was rightly left to the central planning staff. Apart from such risks, the departments tended to write up their estimates for another reason. Everyone was aware that there was not enough labour to go round and that cuts were inevitable. The cuts would not, of course, fall with the same severity on all departments, but few, if any, could hope to escape entirely. There was therefore a strong temptation to submit a somewhat larger figure which would contain a margin not only against risks in the field or the factory but also against subsequent cuts. We have noted this tendency already with regard to firms and it was indeed apparent throughout the whole war economy. The humble quartermaster-sergeant was always on the scrounge for extra boots; far above him the Minister in his office was playing a similar game.

I do not wish to give an exaggerated impression of this difficulty or to suggest that departments set out deliberately to mislead the Cabinet. Their behaviour can only be understood if one bears constantly in mind that their own estimates were uncertain. A department might feel that an additional 175,000 was the best estimate it could make of its needs, but

there was always the possibility that 200,000 would be genuinely required. In view of the danger of cuts it would then appear unwise to submit the lower figure, for the allocation might then be no more than 150,000, and if things turned out badly this would be 50,000 below what was needed. In such circumstances it was natural that the higher figure should be submitted and subsequently defended.

The departmental estimates of requirements were first examined by a small committee of officials which included representatives of the Ministry of Labour and the Ministry of Production. The figures were carefully scrutinised and officials representing the claimants were invited to attend and justify their demands. In this way a certain amount of water was squeezed out of the estimates before they were submitted to the appropriate Ministerial Committee. The process of cross-questioning was then carried on at the higher level and a strenuous attempt was made to scale down the demands as fairly as possible by the extent required to bring them into equality with the anticipated supply of labour — itself a somewhat uncertain quantity. By the time the figures went to the Cabinet much progress had usually been made, but as a rule there was still some gap to be closed and a number of difficult issues had usually been raised which affected the nature and size of the war effort and the welfare of the civilian population to so serious an extent that the Cabinet alone could assume the responsibility of taking the final decision.

At this point the Prime Minister was frequently called on to play an important, and indeed indispensable, role. No-one was prepared to yield, but there was not enough to go round and sharp cuts had to be made somewhere. Now it was not for the claimants themselves to suggest where these cuts should fall and thus provide a solution. The suggestion could only be made by someone who stood above the departmental strife and had the authority to issue a draft directive and to insist that this should form the basis of

discussion. It required the Prime Minister, and a very unusual Prime Minister at that — a leader with great strength of will and a capacity for inspiring affection and respect amongst his divided team, an expert on logistics with a remarkable ability for hard, quantitative argument and a great capacity for mastering complex reasoning relating to a host of difficult issues. It is to be hoped that Mr. Churchill's minutes will one day be published in full. An examination of those remarkable documents, which contain so much detailed information on an enormous range of topics, should destroy at last the strange belief that Mr. Churchill's war-time role was largely that of an inspired rhetorician — if indeed any presentation of evidence can remove so unaccountable a delusion.[1] Whatever views may be held about the wisdom of some of Mr. Churchill's post-war statements, it must be recognised that he was very efficient as a practical planner — more so, perhaps, than any member of the Government of convinced planners which came into power in 1945.

Thus the final struggle might sometimes take place on a draft directive from the Prime Minister suggesting a sufficient number of cuts to close the gap. The title of the document made it clear that a solution would be imposed on the departments whether they liked it or not, but the specific proposals it contained were only tentative and were often modified appreciably by the War Cabinet. It was always convenient to have definite cuts before the meeting at the outset, even if their author himself was uncertain about their wisdom, because in this way the departments could be forced to state their case again and provide fresh information. In short the discussions must have represented something between a scientific meeting and a public auction.

Thus in the end a decision was taken and the allocations made. The cuts in demands were frequently accepted with-

[1] A large number of these minutes is now being published in Mr. Churchill's *The Second World War*.

out any change in the final programmes for the number of ships to be manned, aircraft to be produced and so on. If a figure for requirements had been deliberately exaggerated in anticipation of future cuts, the cut was to that extent of no importance to the department; the Minister might prophesy ruin to save his face but return quite cheerfully to his office. Otherwise departments were obliged to operate with a smaller margin against risks or were forced to make more strenuous efforts to economise man-power. In some cases, however, it was agreed that programmes would have to be reduced — for example, the bomber programme was scaled down on several occasions as strategy changed and other claimants received increased priority — and the planners had then to get down to work once more and examine the implications as precisely as possible. Meanwhile, however, the Cabinet allocations would be made on the basis of what information was available. It was rarely possible to postpone a decision until all the consequences had been fully examined.

Finally, it should be noted that these allocations dealt in the main with aggregate man-power and referred to the country as a whole. Of course it was often necessary to take account of particularly important complications, such as the supply of mobile women, and these were sometimes decisive in determining Cabinet decisions. But it was out of the question for a group of busy Ministers to study the regional problems in detail or to spend much time in discussing the supply of different kinds of skilled labour. By and large it was left to the Ministry of Labour, together with interested departments, to determine the detailed distribution of the allocations; and although it had at its disposal man-power controls which were far more stringent than any which can be used, or should be used, in peace-time, the performance of this task called for administrative efficiency of the highest order. That there were many failures would not be denied. If the figure for total unemployment was low, there was no doubt a certain amount of concealed unemployment, in the

sense that some factories had more workers than they required.

So much for the man-power budget. It did not result in that nicely scientific distribution of the nation's labour force of which the books on planning talk. The departments were far from certain about their requirements even when their programmes, themselves subject to serious error, were regarded as given. The neutral Ministers and officials who were obliged to arbitrate between the conflicting claimants could not be expected to know as much about the needs of a department as the department in question knew itself. They might query certain figures and ask for further information, but where the issues were so complex and the scope for disagreement so great, they were liable to be beaten in argument. Such a defeat, of course, was rarely final. It did not mean that the victors escaped a cut, but it did mean that the cut was often somewhat arbitrary. The reduced allocation was frequently in conflict with the best information before the meeting, but since that information came from an interested party it was liable to be, if never inaccurate, at least one-sided. Everyone knew that departmental demands could be scaled down to some extent without seriously endangering programmes, and strenuous efforts were made to divine the water in the estimates. But in the end there was bound to be some margin of error. When the war was over a senior official, who had great experience in these matters, observed to me that he had long since seen the absurdity of the belief that allocations could be determined by means of scientific discussion with the departments. In the end, he said, the cuts had to be more or less arbitrary.

In concluding this section it must be emphasised as strongly as possible that the defects in man-power planning were not the result of remediable faults in the war-time administration, nor can they be attributed to the lack of a sufficiently scientific approach. On the contrary, a most vigorous and sustained attempt was made to run the war

as scientifically as possible. The Prime Minister himself appreciated to the full the importance of obtaining an adequate supply of statistics. He would not tolerate arguments which were vaguely expressed and unsupported by quantitative estimates, and his demands did much to improve departmental practice in this respect. He was supported in all this by one of the most remarkable teams of Ministers in our history and by a civil service which contained within it far more ability than the country can normally spare from other occupations. The civil service has, of course, come in for much abuse and it is paradoxical that Socialists are often its most vehement detractors.[1] The permanent officials in particular are singled out for a great deal of dingy criticism. In fact, the permanents worked on cordial terms with a large body of temporaries drawn from all walks of life and sought the advice of the newcomers with great humility on the many technical points where they felt that their own training and experience had been inadequate. During these years the administration of the country was transformed. Great new ministries were created and an elaborate machine was set up for the central direction of economic affairs. The Government statistical service was vastly improved and every effort was made to evaluate as carefully as possible competing claims on the nation's resources.

It would be unnecessary to say all this but for the persistent tendency on the part of physical planners to attribute most of the defects of central planning to the folly and wickedness of those who did the job. This is in line with Russian practice. Since it is wicked to criticise the system, all faults must be attributed to sabotage and the offenders liquidated. It is some consolation that the sneering has not yet given place to shooting.

It would certainly have been possible to collect more information during the war and make more scientific allo-

[1] Cf. the recent onslaught by Professor Ian Bowen in *Britain's Industrial Survival.*

cations of man-power and raw materials. With regard to aircraft, for example, it would have been possible to learn a great deal more by employing several hundred engineers of the highest ability on this task alone. Unfortunately there would then have been very few engineers to make the aircraft, for in the industry men of such ability were numbered by the hundreds, not the thousands. The same is true in other fields. The facts of scarcity have at last been recognised with regard to industrial man-power and productive capacity, but the physical planners still make the assumption of a virtually unlimited supply of the factor of production which is so extremely scarce and in such inelastic supply — high-grade administrative ability.

The efficiency of the administration could, no doubt, have been improved during the war in spite of these limitations. It may be suggested that it could be improved at the present time by transferring some of the best officials from other departments to the Treasury, which may be too small to cope with the enormous complexities of international finance. But the very fact that scarce administrative ability is wrongly distributed is merely a further indication of the inefficiency of large units, and this inefficiency is largely unavoidable.

There is one other difficulty — familiar enough, yet often ignored — which must be mentioned in passing. Apart from the use of the price system, it is possible to delegate major decisions to only a limited extent. During the war an enormous range of topics came before the War Cabinet and a small group of senior officials. This was unavoidable because of the importance of the issues and because it was necessary to be familiar with other needs and problems in order to decide one of them. It is easy for an academic critic, who has spent twenty leisurely years in studying some specialised subject, to abuse these men for their comparative lack of knowledge in dealing with it and to forget the great versatility which they are required to display. What was true during the war is true today. The same versatility is

required, and while it should excite our admiration, it implies superficiality and arbitrary decisions when it has to be carried too far. Furthermore, since 1940, some of the Ministers and most of the officials have been working hours which, if suggested for industry, would lead at once to a general strike. Our administration is creaking under the strain and but for the great physical and mental endurance of a small group of men would have broken down before now. Sir Oliver Franks himself emphasises the importance of this problem and the need for a solution. " I am not ", he adds, " prepared to make suggestions on how it should be done." [1] But it is surely a little unfair to raise a major issue in this way and then leave it unsolved without modifying his conclusions about the advisability of the central direction of economic affairs. He has in fact pointed to the final and insuperable obstacle to scientific, authoritarian planning. There are only two remedies — to put up with more or less serious inefficiency or to decentralise by means of the price mechanism.

[1] *Central Planning and Control in War and Peace*, p. 57.

CHAPTER 5

PHYSICAL PLANNING IN PEACE-TIME

THE man-power budget, enforced by direct controls, was the major instrument of domestic planning in war-time; and in those years it became fashionable in some quarters to regard it as a wonderfully powerful device which could be used to drive the economy forward in the right direction when hostilities ceased. Yet it ought surely to have been clear from the start that the man-power budget in peace-time was bound to be much more "an aspiration of the heart" than an "act of will", unless the Government were prepared either to use man-power controls indefinitely or to break the power of the trade unions and enforce a national wages policy. Both these alternatives would be considered feasible by a Communist Government but a democratic Government is in a very different position. Of course, something can be done by less drastic methods to affect the distribution of labour, but nothing like enough to ensure that a statistical plan, after the war-time pattern, can be carried out. The man-power budgets in the Economic Surveys are not plans; they are an odd mixture of plans, forecasts and somewhat wistful desires. As Professor Robertson has put it, this is the "Achilles heel of central planning".[1]

As a result of this weakness much greater reliance must be placed upon the control of raw materials, building and finance, and it may be noted that in some respects, though not on balance, the statistical problem of calculation requirements may be simpler. It is, I think, less difficult to work

[1] "The Economic Outlook", *Economic Journal*, December 1947.

out the amount of a particular raw material required to fulfil some programme than to calculate the amount of man-power. Coefficients are easier to find, a raw material is more homogeneous and there is less likelihood of sharp changes in its " productivity ". Unfortunately, however, the greater simplicity is largely spurious. If a particular raw material is more homogeneous, raw materials as a whole are not; a large number of raw material programmes must therefore be fitted together and related to the plans for building and finance. The whole picture is more confused than in war-time and can no longer be expressed in terms of a master plan such as the old man-power budget. Not that the latter, even if it were feasible, would be adequate. As we have seen, a more comprehensive reckoning which included all costs and was expressed in terms of a common denominator would be required.

In one respect, at least, conditions are unlikely to have changed fundamentally. The administrative apparatus must be very similar to that described in connection with the war and some of the most important lessons of war-time planning are unfortunately relevant to planning in peace-time, in particular the strength of departmentalism and the comparative isolation and ignorance of the central planning staff. There must be the same meetings of committees, the same defence of sectional needs, the same groping after truth and the same arbitrary solutions. In such circumstances it is difficult enough to perform the first function of economic organisation, the synchronisation of the flow of raw materials, components, factory space, equipment and labour in such a manner that output is not retarded by endless bottlenecks. To go beyond this and attempt to estimate the costs of all these diverse items in terms of some common denominator must lie beyond the reasonable ambitions of any central planner who has had six months' practical experience; only arbitrary solutions can be considered possible. Everything would be straightforward enough, of course, if the country

were producing only a dozen or so commodities in a couple of hundred factories; but this, unhappily, is not the case and the student of these problems would do well to begin, where Adam Smith began, with the division of labour. It is still true that "the division of labour is limited by the size of the market", and we may add to this another proposition — the success of central planning is limited by the division of labour.

In some respects the task of preparing programmes is more difficult in peace-time, and there are two aspects to this complexity which are not always distinguished. In the first place the variety of goods and services is greater. It is true that the output required to meet the needs of defence was also very diverse, but clearly less so than civilian output.[1] It may be pointed out that the civilian needs were not simply ignored in war-time and that a very wide range had to be covered then as now; this objection, however, misses the point. During the war civilian consumption was pushed down as far as was thought to be consistent with efficient production, and to a large extent the goods and services required were produced by immobile workers with existing equipment sited in existing factories. It is a rather different matter when the objective is to raise the civilian standard of living gradually by means of mobile resources which may be put to alternative uses. This leads on to the second cause of increased complexity in peace-time. When the nation's objectives are clear and unambiguous, as in war-time, and involve centralised action for common ends, the problem of valuation becomes much easier. The country has to be organised for defence and the Government has to decide how this may best be done. When the objective, however,

[1] The differences were, I think, reflected in the different characteristics of the main Government Departments during the war. The Supply Departments were much more tightly knit than the Board of Trade, which always seemed to be somewhat amorphous. M.A.P. had a fairly clear idea of its general policy but the Board of Trade, with its multitudinous interests and responsibilities, could scarcely be expected to formulate a "policy" in the same sense.

becomes more generalised and vague and takes the form of a rise in the standard of living of the millions of individuals who comprise the nation, then it is very much more difficult for the Government to choose rightly between the alternatives, nearly all of which can be defended to some extent as " priorities ". Indeed, in a very large measure, this is not a task for the Government to perform at all.

During the war, the Government itself was the purchaser of most of the goods for which output programmes were prepared, but it has never been considered feasible to buy the whole supply of civilian goods and services and subsequently dole them out to each individual in prescribed proportions. The sovereignty of consumers has been restricted, but they have not been entirely divested of power; this is true even of the home consumer, and the foreigner who buys our exports is obviously in a still stronger position.[1] Thus while goods may be produced according to one set of priorities — those of the state — they will have to be sold on markets where the private priorities may be different. That all kinds of difficulties may result from this system of dual control is clear. It is true that such anomalies have not been of major importance so far because the planned output has been sold on a sellers' market, but as the inflationary tide recedes the reefs will soon appear. If, with the passing of inflation, such differences of opinion between the Government and the consumer — or even between the citizen as a voter and the citizen as a spender — became general, an all-persuasive and extraordinarily intricate system of subsidies and indirect taxes would be necessary to bring the two sets of preferences into line.

There is another formidable difficulty to be noted at this stage. Are Sir Oliver Franks and a good many other supporters of physical planning justified in regarding the issue between public and private ownership as of secondary importance? Who is to bear the risks in a planned economy

[1] Cf. Sir Hubert Henderson, *The Uses and Abuses of Central Planning*

of this kind? In the old private enterprise economy, the entrepreneur embarked on some project on his own responsibility and stood to gain or lose in the event; he risked private capital in the hope of private gain and profits were the reward for incurring the risk of loss. But in the physically planned economy it is a very different matter; those whose capital is put to the hazard are no longer to be allowed freedom of action. It is true that, according to Sir Oliver, the Government is to depend on "undertakings voluntarily given" by business and this concession would seem to meet the case were it not qualified by the somewhat discouraging condition that

> "the method of agreement does not leave business free to agree or disagree as it likes with the programme laid upon it by the government. The condition of the method of agreement is that prior agreement to agree, which characterised the working, for example, of the Combined Raw Materials Board." [1]

The latter analogy can be somewhat misleading. We are no longer concerned with different Government agencies deliberating together but with a planned economy in which an all-powerful state confronts private firms who have a limited amount of capital. Admittedly, it would be foolish to suppose that in the course of negotiations with an industry, the representatives of the state will always impose their initial views on the representatives of private enterprise. During the discussions the original views themselves will be changed, there will be the usual attempt to find a compromise, and in the end something which may be formally described as an agreed conclusion will ultimately emerge. But the threat of coercion, even if it is never made explicitly, will be implicit throughout. The representatives of the firms will be aware from the beginning that they can be compelled

[1] *Central Planning and Control in War and Peace*, p. 44. We are not told whether the trade unions are also to be given a dose of Hegelian liberty.

to behave as the state sees fit, and negotiations which take place under such conditions can scarcely be described as freely conducted. Apart from the danger of specific commands to do this or that, it will be generally appreciated that an industry which refuses to play ball with the controllers may find itself next on the list for socialisation. As a result, private capital may be ventured against the views of those who own it or are legally responsible for its control.

In some cases of failure, the state may consent to give a subsidy; in others it may not. Even when a subsidy is given, it may not always be clear whether the losses should be regarded as the result of faulty forecasting or whether they could have been avoided, at least in part, by better management in the industry. Part of industry may therefore be working on what virtually amounts to a cost-plus contract, with all the evils which this entails. But many firms may not be certain where they stand; they may receive assistance or they may not. The state will not have admitted any prior obligation to underwrite the ventures for which both state and industry are somehow jointly responsible, and in the event, it may compensate the losers or leave them to suffer. It must surely be conceded that although everything may be concealed for a time by an inflationary smother, central planning of this variety is bound to have the most adverse effects on enterprise and initiative.

The logical corollary of this form of central planning would be the acceptance by the state of financial responsibility for its programmes. The private firms would then be mere agents of the planning authority and although they would operate with what was nominally termed " private capital ", the risks would be carried by the tax-payers. Such an arrangement would rightly be regarded as a little queer and if this is the first corollary of such planning, the second is clearly socialisation. If the state is to bear the risk of loss, it should also stand to gain from successful ventures. It should own the whole equity interest in the industries for

which it prepares, and on which it may enforce, its production programmes. These corollaries may be logical and in the long run they would probably have to be accepted. But since, for other reasons, no practical person contemplates the immediate socialisation of the whole of industry, there is likely to be a most awkward period of transition in which enterprise is discouraged by the uncertainty as to who is in the end financially responsible for what. As we have observed above, the programmes are discussed with industry; and such discussions may not only lead to a modification of the programmes but may serve to obscure the identity of those who can be said to have taken the final decision. Presumably, both the state and the industry can be held responsible and this provides scope for mutual recrimination and argument. Such an economy is unlikely to display much vigour or enterprise.

Even socialisation, if it were feasible, would not, of course, provide a satisfactory solution to this problem of divided responsibility. For it would still be desirable in the interests of efficiency to delegate a good deal of authority to the managers of public corporations, and if this were done it would be unwise to make them carry out programmes prepared by central planners. If such programmes were enforced and losses were subsequently made, the managers would be in a position to blame the planners, and the planners, for their part, would be able to reply that all might have been well had the managers done their job properly. The only difference in this respect between socialism and capitalism is that under socialism all losses would be underwritten by the taxpayer, and this would be a great convenience to both managers and planners. But the inefficiency resulting from divided responsibility would still remain.

This, of course, is not the only reason why inefficiency may be expected to result from physical planning. Unfortunately it is impossible to operate controls in such a way as to permit the gradual expansion of the more efficient firms

at the expense of the less efficient. The controllers may try to ensure that only so much of a certain raw material is used by a particular industry, but even in so far as they are successful this is only the first step. The total allocation has to be shared out between the different firms and these shares tend to be related to consumption at a base date or to be fixed according to some rule of thumb. No doubt an attempt is sometimes made to introduce a certain amount of discrimination, especially with regard to very large projects; but it remains true that as a rule the less efficient firm stands virtually the same chance of getting a quota as its more efficient competitor. Various criteria are applied by the controllers; but as far as the vast majority of firms are concerned, efficiency is not one of them. This is true now and it was, of course, the case during the war. Neither manpower nor raw materials were doled out with much regard to efficiency, except in the more glaring cases.

Firms operating under the rule of prices and costs are clearly in a very different position. Anyone can increase his purchases of some factor of production so long as he has the money and thinks it worth while; and there is at least a strong presumption that the firms which wish to increase their output at this cost are those which ought to do so. The efficient firm will tend to have a better profit-and-loss account and will therefore have more funds at its disposal for such purchases. To claim that the price mechanism gives an ideal result would be absurd, but common sense suggests that its defects should be analysed and remedies sought. If some firms have what is considered to be excessive buying power, is this because the critic disapproves of the consumers' preferences which give rise to their large receipts? Or can their strong position be attributed to some monopolistic restraint and, if so, can they be made to cease and desist? At all events it is along these lines that the inquiry should be conducted; for it is scarcely sensible to reject out of hand a price system which does not

give ideal scope for the efficient firm in order to substitute a régime of controls which gives far less.

That controls are defective in this way must be clearly recognised and one would have to be stubborn to the point of folly to contend that the weakness could be removed. Here, as always, the complexity of the economy must be borne in mind. It is out of the question for each controller to send his inspectors to each firm in order to investigate their efficiency — somehow defined — and no office, on receipt of such information, could hope to ration out supplies accordingly. The very inefficient might be detected readily enough and forced to close down ; [1] but such cases are rare. What is required is the gradual expansion of one firm and the gradual contraction of another ; both may remain in business but their relative outputs should alter. It would be foolish to expect that controls can be operated with the flexibility and sensitivity necessary to bring this about. Yet this, it will be recalled, is the physical planning so strongly recommended by Mr. Strachey and others as the only way of attaining a world of plenty !

I think it is fair to say that this grave charge against physical planning is not contentious. It is a fact which must be accepted and if such planning is still defended, its supporters must find offsetting items on the credit side. A Socialist President of the Board of Trade has conceded as much in a broadcast statement.[2] On this and on other occasions, Mr. Wilson and some of his colleagues have expressed criticism of controls and a good many have now been abandoned. But I do not recall their questioning the desirability of centrally planned production, and after all controls are simply the corollary of such a policy. There appears therefore to be some play upon words which may

[1] Provided the organised workers agreed ! It is far more difficult to bring about changes by means of Government fiat than by means of the profit-and-loss account. In the first case there is someone to blame ; in the second the firm is making losses and that is that

[2] On the occasion of removing certain controls, November 4, 1948.

be the result of the conflicts within the Labour Party. No doubt the more sophisticated Socialists are not prepared to challenge explicitly the mythology which so many of their supporters accept; yet they know that controls are generally unpopular with the electorate and their own experience tells them that they are inefficient as techniques for the allocation of resources. In so far as the policy of the Labour Party is determined in future by its more liberal members, the criticisms in this chapter will cease to be applicable to its actions, although they will continue to apply to the views of its more Left-Wing element and, of course, to those of the Communists. If the majority have seen the light and are prepared to rely more upon a price mechanism, including the much criticised profit motive, so much the better; in spite of the recent relaxation of some controls, however, the party as a whole has still a long way to go.

The inflexibility of physical planning leads to inefficiency and delay of another kind. When production is highly specialised and divided between a bewilderingly large number of firms, it is a ticklish business for any planning authority to ensure that each one of them gets the bits and the pieces it requires in the right proportions. Furthermore, even if the plans are dovetailed with ideal accuracy on the basis of information which appears to be reliable at the time, unforeseeable developments may cause disruption. Similar mistakes are bound to be made in any kind of advanced economy; but there is some reason to suppose that they will be less frequent and, above all, more easily rectified, if affairs are regulated by financial accounts rather than by remote economic planners. In a free economy, private firms will order what they want from other firms, and since the bills must be paid, they will try to order carefully. Thus "the programmes", which are only implicit in such circumstances, may well be better than those which can be prepared in Whitehall in an explicit and pseudo-scientific manner. Mistakes are always made and under both systems the firm's

stock-pile may meet the need. If it fails to do so, however, it is very much easier to make good the deficiency in an economy where most things can be had at a price. A firm which needs a little more timber than was anticipated, can buy it and may be prepared if necessary to pay dear in order to get it when the alternative is to hold up production. Thus the mistake may not go unpunished; but it is the firm's profit, not the national output, which is likely to suffer most. The alternative procedure in a controlled economy is too bitterly familiar to call for any description — the form-filling, the elaborate explanations in triplicate, the administrative delays, the too frequent refusals on the part of officials who work by inflexible rules, the consequent piling up of unfinished goods and the discouragement of the workers.[1] It may be noted in passing that in such circumstances firms will tend to hoard supplies and carry bigger stocks than would be necessary under the rule of the market; such hoards are said to have reached substantial proportions in recent years. It is surely common sense to prefer a more flexible method which permits of great delegation and takes advantage of the knowledge of the men on the spot. Unless its other defects are overwhelming and irremediable, a market economy must be regarded as a much more rational alternative.

In the last sentence I have used the word " rational ' to mean " more efficient " ; but I am aware that it is frequently employed in a different sense and in such a way as to apply to a physical planning but not to a free economy. Sir

[1] The U.S.S.R. has experienced these difficulties. For example, in their book on *Management in Russian Industry and Agriculture*, Messrs Bienstock, Schwarz and Yugow refer to the piling up of unfinished tractors in the famous Stalingrad Tractor Works in 1940, when the financial plan was out of alignment with the physical plan and the management lacked the small sums required to purchase the missing parts. The main factory, it may be noted, relied on 283 small and medium-sized factories which supplied 4300 kinds of machine parts. The authors have based their remarks on an article by the Chief Engineer of the Stalingrad Tractor Works which appeared in *Pravda*, October 27, 1940.

Oliver Franks, for example, has claimed that the policy he favours will increase the control of reason over economic affairs.[1] I think such statements can be taken to mean that decisions to produce are irrational unless they have been pondered by a Central Mind and express the purpose of a General Will. The shade of Hegel is close at hand once more and as always the unpleasant corollaries follow. For it is rather less than sensible to suggest that a group of planners can express the Will of the People in such matters. As we have seen, even Parliamentary control is out of the question and the " rational " Hegelian system implies something very close to an inflexible economic dictatorship. I am not a philosopher and to criticise Sir Oliver's use of the term " rational " may therefore be imprudent; but to my untutored mind there appears to be a false anthropomorphism in his argument. It is not immediately obvious that a more rational pattern will emerge if the state determines how I shall use my income or my time. If the argument were carried to its logical conclusion it might be thought irrational that people should be free to wear hard collars or soft, with all the social implications for the laundry industry. It is certainly irrational to allow them to marry whom they please for the social implications are then incalculable ! This *reductio ad absurdum* is not unfair. Almost everything one does affects society in some way, and if society is to be rationally controlled in this strange Hegelian sense, then practically every action must be centrally planned. The argument is foolish when carried to such extremes, and the practical task of good government is to decide how far it should be carried. Some decisions should be taken by the state and some by the individual, and it is quite unfair to imply, as Sir Oliver Franks and many others have done, that the first set of decisions is more " rational " and that every extension of the public sector implies an increasingly " rational control " over man's environment. To use the

[1] *Central Planning and Control in War and Peace*, p. 35.

emotive term in this sense is to obscure the whole issue and to give a blessing — however unintentional — to totalitarianism. If, on the contrary, the term is employed in the more normal sense, then it can be held that a market economy may be more rational — that is to say, more sensible and generally satisfactory — than one which is elaborately planned.

Widespread corruption appears to be a chronic feature of physical planning. Money cannot be exiled, although it may be dethroned, and it makes repeated sorties against the new régime. When the regulations conflict with what people want, a black market may be taken for granted, and attempts will also be made to get round the regulations by pulling strings or even, in extreme cases, by bribing the officials. Old-fashioned morality may condemn such practices, but it must be conceded that they often help the wheels of industry to turn in an over-planned economy. I am inclined to the opinion that our economic plight might have been worse in some respects over the last few years if business men had not resorted to the only method by which they could combat the inflexibility of controls. With regard to consumers' goods, the black market has certainly done some good as well as much harm.[1] In the long run, however, such practices may have disastrous consequences by undermining the respect for the law and the Puritan business morality to which the country's economic prosperity has owed so much in the past. It is only necessary to reflect on conditions in India or France to appreciate the importance of straight dealing even from the point of view of material progress. Yet in post-war Britain the business man who retains old-fashioned scruples is seriously handicapped as compared with his rivals, and the honest consumer is at a similar disadvantage.

Finally, it must be observed that a planned economy requires an enormous amount of man-power for its administra-

[1] The Soviet Union recognised many years ago that a black market was inevitable and, indeed, desirable. When rationing was in force, it provided an official black market, or free market, even for very scarce foodstuffs.

tion. At mid-1948 there were 2,128,000 people employed by central and local government (excluding civil defence and police), or over 10 per cent of the working population. This staggering figure reflected an increase of 743,000 as compared with 1939; and some allowance should also be made for the man-hours used up in private industry in such sterile pursuits as form-filling. By way of comparison, it may be noted that the increase in the numbers employed on orders for export in manufacturing industry was only one million between these two dates; that is to say, the extra direct burden of the state in terms of man-power [1] was of the same order of magnitude as the burden of the export drive. In the light of such facts, Sir Stafford Cripps' austerity appeared a good deal less heroic; it cannot be doubted that there has been much waste and inefficiency in the administration of the country. (Mr. Churchill's Government managed to run the most highly mobilised economy in the world with a smaller civil service than Mr. Attlee has required in peace-time.) But these great staffs were not merely the result of bad management; in part, they were the unavoidable price of a planned economy.

It seems appropriate at this stage to summarise the arguments against physical planning:

(1) Such planning implies centrally determined output programmes enforced by means of controls. The innumerable decisions involved cannot be effectively supervised by Parliament or submitted to the electorate for its approval. By its nature, planning of this kind must be authoritarian. The price mechanism, on the other hand, provides a continuous plebiscite by which individuals, as spenders, can express their preferences. In this manner, the pattern of production is subjected to democratic control.

[1] Those employed in nationalised industries are not, of course, included.

(2) There is no satisfactory common denominator under physical planning, but the complicated task of reducing demands and costs to a common denominator is performed reasonably well by the market when it is allowed to work. More rational accounting is then possible and therefore a more rational allocation of resources.

(3) It is extraordinarily difficult for a central planning staff to synchronise programmes and estimate requirements; and the whole procedure is made more difficult by departmentalism. The task is likely to be better performed if it is delegated to the men on the spot. The "invisible hand" will co-ordinate decisions and the financial accounts will provide both a check on performance and a stimulus to improvement.

(4) Controls retard the relative growth of the more efficient firms; whereas the price mechanism — although its operation is far from perfect — permits and encourages such growth.

(5) Controls require an enormous amount of man-power for their operation.

(6) Controls breed corruption.

The case against physical planning and in favour of the market is overwhelming as far as it goes, but it is not yet conclusive. Enough has been said to warrant a strong bias in favour of the price mechanism, and it must surely be granted that its delicate instruments should not be cast aside unless it is quite certain that they will not serve. But it may yet be true that physical planning is so much superior in dealing with certain particularly difficult problems that it must be preferred after all. Planning of this kind, for all its faults, was thought to be necessary during the war; may it not be that similar considerations warrant its continued use in peace-time? Such a conclusion would certainly be depressing, but it is not a law of nature that the truth is

always cheerful. In particular, it may be asked how we are to cope with the following problems :

(1) *Inequality of Income and Wealth.* The market may be likened to a ballot-box, but there is plural voting as a result of inequality of income and wealth. To what extent is this inequality justifiable ? In so far as it is thought to be excessive, what are the remedies ?
(2) *Monopoly and Industrial Efficiency.* To what extent is it true that the operation of the price market is vitiated by monopolistic restrictions ? Is there any truth in the charge that private enterprise is no longer enterprising ? If such claims are valid, does the case for the market economy still hold ?
(3) *Inflation.* Controls were necessary in war-time partly because of inflation. Is there any danger of chronic inflation in peace-time ?
(4) *Mass Unemployment.* Planning of some kind is necessary to remove this scourge of extreme *laisser-faire* ; but is physical planning necessary, or will liberal planning of the Keynesian variety suffice ?
(5) *Foreign Trade.* This is the most difficult problem of all and it may be urged that controls should not be relaxed while the balance of payments presents such difficulties.

In the next part an attempt will be made to diagnose these problems ; and where state intervention appears to be necessary, to indicate the forms it should take. The case for physical planning will be scrutinised and reference will also be made to the related but less interesting argument that the means of production should be publicly owned. Nationalisation may follow as a long-run corollary of physical planning, but the socialist case is weak and tottering when it is set upon its own feet. The arguments in its favour must be seriously considered, nevertheless, if only because, in spite of their naïvety, they are so widely held to be true.

Part Two

CHAPTER 6

THE REASONS FOR INEQUALITY

At one time a Socialist could be described as a person who strove for a more equitable distribution of income and wealth, but that definition will not do today. To begin with it is too broad to conform with current usage. Many people who have a most keen and sensitive regard for equity in these matters would deny that they are Socialists in the modern sense of the term and would oppose with the utmost determination some of the more "socialistic" measures of the modern British Labour Party. For socialism has come to mean, first and foremost, the abolition of private enterprise and the creation of vast industrial monopolies owned by the state. There is, of course, no necessary connection at all between the old-fashioned socialism and the new. Private enterprise is not inconsistent with equity, and, by itself, public ownership is no guarantee that justice will be done. Capitalism has been swept away in Soviet Russia, but inequality remains and is, indeed, more marked there than in any of the great capitalist economies. Thus the term "socialism" is ambiguous in the extreme and is the cause of much confusion in political life.

The dislike of inequality is itself an odd compound of altruism and jealousy. If it derives its moral force from a generous regard for the underdog, the vehemence with which it is expressed is sometimes due to less noble motives. The idle and the incompetent can find great comfort in the theory that their more prosperous neighbours have made good only by profiteering and exploitation. The disgruntled intellectual who dislikes his job can assure himself that his neglected

genius would be more fully recognised in a socialist commonwealth. The harsh neurotic, who is out of tune with his society, can look forward to a Communist state in which he would be able to rule the dolts around him. It would be unrealistic to pretend that everyone who denounces inequality is disinterested and nothing will be gained by ignoring the covetousness, the rankling ambition, the lust for power and the petty-minded conceit which too often pass for socialist virtue. Nevertheless, when all due allowance has been made, the more noble motives remain and must receive the respect they deserve. It would be another form of hypocrisy to ignore any avoidable injustice in our society, and morally wrong to disregard any means by which a greater fairness could be achieved.

Inequality of Earned Income

The equalitarian ideal is expressed very clearly in the famous slogan: " From each according to his ability, to each according to his needs ". The needs differ and complete equality would be inequitable; but, it has been held, the inequalities permitted should not reflect differences in the productive contributions of the recipients. Fundamentally, this is an ethical judgement and its proof or disproof need not be sought in economics. But the economist can at least point out the practical implications, and unless these too are accepted, the ruling, however fine it may appear, must be regarded as sentimental rather than moral.

An equitable distribution, in the sense defined above, cannot be reconciled with a high level of output. Incentives are required, not only incentives to work a little harder but also incentives to acquire a skill and make a more substantial improvement in one's lot. Perhaps all self-regarding action is wrong, but even from a Christian point of view, it is bad theology to ignore the reality of sin. Furthermore, since some people would always slack, their fellows might reasonably complain against the injustice of a system by which the

fruits of their labours had to be shared on equal terms with those who contributed very little. Perhaps the hard workers should behave like saints; they are more likely to feel that they are not saints but suckers. It is certainly true that at the great moments in a nation's history, material rewards become less important. During the Battle of Britain people worked and fought for other reasons but, as the danger of national extinction grew more remote, there was a perceptible moral decline. If this is so in war-time it is still more true in peace-time. For most people work is bound to be something of a routine, and it is not very sensible to suppose that they will go to it each day with feelings of spiritual exaltation. (How wearing it would be if they did!) An appeal to higher motives can certainly be made, often with success, but repeated exhortations are likely to fall flat, as they have tended to do since the war in the United Kingdom. In a totalitarian state the full blast of official propaganda can be turned on, and people may work better if they are led to believe that a foreign enemy is plotting the ruin of their country. Yet even in the U.S.S.R. class-hatred and chauvinism have not been enough, and material incentives are used to the utmost degree. Marx himself admitted that inequality would be necessary after the Revolution, and the original slogan has now been modified significantly—"From each according to his ability, to each according to his work". The modification is supposed to apply only during the transition to "true Communism", a happy state when material incentives will be unnecessary and the state itself will have "withered away". Presumably in this millennium the old Adam will be dead, but for an indefinite period he must be reckoned with and that is all that need concern us![1]

[1] This ultimate objective bears so little resemblance to current Soviet practice that the Politburo seems to find it irritating. At all events the doctrine that the state will wither away has been officially dropped. Nor is it very plausible to hold that the Soviets are moving towards the predestined goal of their theology. Rather are they moving backwards. See Chapter 7 below.

There is another less familiar but no less potent reason for inequality. If earnings bear no relationship to output it will be impossible to distribute resources in a reasonably economical manner. Where the skilled worker is paid just the same as the unskilled, no proper accounts can be kept. The worker himself will have no material incentive to move ; and even if he is entirely disinterested, he will be uncertain where to go or what work to choose without the signpost of higher earnings. In pure theory the state could put the right relative value on each productive service and rule that these figures be recorded in the books of every undertaking, even although the services in question were not actually paid at these rates. Thus there could be two sets of account books, one merely for the guidance of the authorities and the other for the recording of actual monetary payments. The distribution of resources would then be determined by direct allocation through man-power controls and the like. Each person would be told precisely where he should work and what he should do. All industry would be publicly owned, all labour would be conscripted and all liberty would disappear. Thus, in the end, the attempt to divorce incomes from the value of the work done would result in frustration and defeat. It would imply dictatorship and that in turn implies privilege and inequality as we have seen in the first chapter.

In any case, the direct allocation of resources by the state without the aid of material incentives would present an impossible administrative problem. It was not attempted during the war, and it is sheer nonsense to suppose that it could be done. Once more Russian experience is relevant. The high turn-over of labour has been a cause of much concern to the authorities. Workers, both skilled and unskilled, tended to flit in large numbers from factory to factory, the labour force was badly distributed and efficiency was correspondingly reduced. In his famous speech of June 1931, Stalin offered both an explanation and a remedy :

" In what lies the reason for the flow of labour? In the incorrect wage scales, in the ' left ' equalitarianism in the sphere of wages. . . . In order to destroy this evil it is necessary to abolish equalitarianism and to destroy the old wage scale system." [1]

There was nothing like complete equality in the U.S.S.R. before this speech was made but there has been a good deal less since.

In spite of every difficulty, there may be some Christian socialists who are still convinced that income should be distributed only with regard to people's needs — which would be determined, in turn, by some unspecified process. It is better, they may claim, to face economic disorganisation, hardship, stagnation and under-nourishment rather than rely upon incentives which appeal to human selfishness. Other Christians may reply that you cannot make people good by legislation, and there is plenty of scope here for a merry controversy! We shall leave them to fight it out, but since the whole discussion of inequality must be based on some ethical belief,[2] the only thing the economist can do is to begin from an assumption and, as a safeguard against concealed personal bias, he should make it explicit. I assume, therefore, that inequality of earned income is desirable in principle, although the range of inequality may be reduced by taxation or other means. I think this proposition would be accepted by the vast majority of people. The practical objective is some kind of compromise between what is required for " efficiency " and what is required for " equity " in the sense defined by the old-fashioned Communist slogan.

[1] Quoted from the translation on p. 178 of Professor A. Bergson's informative work entitled *The Structure of Soviet Wages*.

[2] Mr. T. Barna is in error when he writes: " The economist argues that given the total national income satisfaction is maximized with an equal distribution of income ". (*The Redistribution of Incomes*, p. 5.) The economist may feel that this is or is not true, but his opinion will be determined by his views on psychology and ethics and will not be derived from economic science. Economics proper is no more of a guide than chemistry or horticulture.

Unearned Incomes

The next question is whether or not people should be allowed to save a part of their incomes. The practical means by which they could be prevented completely from doing so would be difficult to devise ; and in so far as their application proved effective, it would be necessary for the Government to keep taxation at a sufficiently high level to provide by way of a budget surplus the finance required for additions to the capital stock. Or to put it differently, if private savings were prohibited, the Government would have to reduce consumption forcibly with the aid of the tax-collector, in order to release resources for the making of capital goods. That would be very paradoxical and foolish. In any case it would be an intolerable infringement of liberty to say that no-one could save, and on ethical grounds such a policy must surely be rejected.

I do not think the abolition of private saving has ever been seriously proposed, and if it is permitted the corollary is the accumulation of privately owned capital. This is the point at which real controversy begins, for the capital may be used in different ways and may, or may not, be allowed to provide its owners with unearned incomes. In a capitalist economy, the private owners may " do what they will with their own " so long as they keep within the fairly wide limits set by the law. Apart from buying houses for their personal use, their capital may be left at the bank, or put into other houses or land, or lent to the Government or industry by the purchase of bonds, or invested in public companies by the purchase of shares, or tied up in a private company, a partnership or a one-man business. The range of choice is wide and corresponding to each alternative is a different degree of safety or risk. The small private company may earn a high rate of return on capital, but the return is uncertain and the danger of bankruptcy, involving the loss of the capital itself, is very real. It is usually safer to buy shares in a large well-established firm and the prospective rate of monetary return

is correspondingly less. Redeemable Government bonds are safer still; the capital will be repaid one day unless the Government goes bankrupt. But even in this case there is the risk that the purchaser will need to turn his capital into money before the redemption date; he will only be able to do so if he can find someone to buy his bonds and he may not be able to sell them except at a loss. Thus there are two kinds of risks which must be faced: (1) the risk that the capital may never be recovered in full once it is committed, and (2) the risk that the investor may be in need of money and obliged to sell at an unfavourable moment, thus incurring a loss although his assets may be perfectly sound if only he could wait. Both risks must be faced if one invests in private industry; the former may be avoided, but not the latter, if one buys redeemable Government bonds.

One reason for unearned income should now be apparent. Pound notes are completely "liquid"; they are available at a moment's notice for any purpose. A deposit at the bank is almost as good and is better protected from other perils such as theft. Thus one can feel secure if one's capital is at the bank, and there would be no point in investing it in less liquid forms unless there were some additional reward for doing so.

Unearned incomes are a reward for parting with security and this is one of the justifications for them. The other purpose they serve is to encourage thrift. It is inconceivable that the flow of private savings from individuals and firms would be anything like as great if there were no prospect of earning a return on any capital accumulated. Once again it would be necessary to hold consumption down by means of heavier taxation.

In a fully socialised economy the number of ways in which accumulated private savings could be used would be much reduced. Funds could still be left on deposit at the banks or invested in Government securities but they could not be

employed directly in industry. Broadly speaking, the state would borrow from its citizens and pass on the funds received to the corporations which ran its industries. There would still be unearned incomes in the form of interest on the funds lent to the state by the purchasers of its bonds, and the importance of these interest changes would depend partly upon the manner in which the socialist economy had been created. If there had been a revolution and the previous owners of capital had been expropriated, the state would have obtained possession of existing factories, equipment and the like without there being any corresponding block of national debt owed to its citizens. Subsequently, when it wished to increase the capital stock, it could finance the operation by levying taxes in excess of its ordinary expenditure, by running its industries at a profit and thus acquiring reserves, or by attracting new private savings. In so far as the last-mentioned method was employed, there would be a new national debt corresponding to the new productive assets, and on this debt interest would be paid. In the U.S.S.R., it will be recalled, the state pays unearned incomes to its citizens who have saved and purchased bonds. As real incomes grow, and with them the flow of private savings, this feature of the Soviet economy is likely to increase in importance.

" Democratic " socialism does not demand expropriation. If some people are deemed to possess too much capital and to enjoy unearned incomes which are unreasonably large, the more equitable remedy is progressive taxation. Nationalisation as such is irrelevant unless the Government pays less than the full compensation which it has always promised to pay. The case for full compensation is, of course, overwhelming when industries are taken over gradually in the manner always envisaged by the social democrats. It would be grossly unfair to penalise those who put their money into railways or steel if those who had invested in other industries were allowed to escape for an indefinite period. If there is

to be any justice, privately owned capital must be taxed because it is large, not expropriated because it happens to be invested in one line rather than another. Thus, corresponding to the assets acquired by the state, there will be an addition to the national debt on which interest will be paid. Provided compensation is fair, unearned incomes will be as large as before.

Since socialism does not imply the abolition of unearned income, it may be asked how it differs from capitalism. The essential difference lies in the transfer of the control of productive capital from private hands to those of the state. The question at issue is not unearned income but rather the relative merits of private firms as compared with public corporations. Which will be more efficient at delivering the goods? Which will be more adaptable to changing circumstances and provide the greater scope for the industrial genius with new ideas? Under which system will there be greater equality of opportunity? In view of the vast confusion of thought on these matters, it cannot be too strongly emphasised that these are the real questions. Later in the book it will be contended that the answer in most cases is indubitably in favour of private enterprise.

Without anticipating the arguments which come later, it can be claimed that unearned incomes are justifiable in principle.[1] That is not to say that all unearned incomes, whatever their size and whatever the source of the capital from which they are derived, can be viewed with equal approval. Very large unearned incomes, especially if they are the return on inherited capital, should certainly be attacked on ethical grounds, and in this sense our conclusion is in line with traditional liberal policy. But the remedy is taxation, not the elimination of private enterprise.

[1] Whether or not unearned incomes are paid to individuals, some charge corresponding to these incomes must be made in fixing prices. This is so because capital is scarce, and risk is also a cost which must not be disregarded. (Cf. Chapter 3.)

Inheritance

The last issue outstanding is the inheritance of wealth. My ethical assumption in this case is that inheritance is justifiable unless the bequests are very large and are passed on from generation to generation. Surely it would be morally wrong to prevent a man from saving for the sake of his children, and apart altogether from the morality of it, it is certain that men will work harder and with a better heart if they feel that their families will benefit after their death. In itself this is a tribute to human nature. Perhaps it is not the highest tribute, for it may be argued that we should think only of the general good and seek to benefit our neighbours as much as our own kith and kin. That is the highest moral claim but it can be met only in a personal way. The state cannot enforce it. It can allow those who admit this claim to dispose of their lives and their wealth as they wish, and within narrowing limits that is what it does do. For most people, however, it is the family which touches the springs of altruism, and much will be lost if people are no longer allowed to provide for those who are dearest to them. I think this would be the general view and it is interesting to note in passing that the inheritance of wealth is permitted by the Soviet Constitution of 1936 (Article 10).

Very large estates, passed on from generation to generation, are another matter. As always, the practical task is to find a reasonable compromise and what can be regarded as reasonable will vary from time to time and depend in part upon the personal judgement of the commentator. In poor societies there is a strong case for an aristocracy, whether titled or not, by which I mean a small class which enjoys an appreciably higher standard of living than the rest of the population. Such privileges are necessary if the nation is to be provided with proper leadership in both politics and culture, and nothing will be gained by reducing everyone to the low average level, which is the inevitable lot of the majority until production can be expanded, capital

accumulated and education extended. The Communist Party in the U.S.S.R. is a kind of aristocracy in this sense, and the hereditary aristocracies of the past can be regarded in a similar light. Leadership by inheritance has, indeed, more to be said for it than it is fashionable to admit at the present time. Family tradition counts for something, and the children of men who have occupied important positions are bound to enjoy advantages in their early lives which are denied to the majority of their contemporaries. Every human institution has its defects, and there is no need to dwell upon the evils which may result if an aristocracy is too exclusive. If newcomers are kept out because their blood is too common, or because — as in the U.S.S.R. — they have not submitted their minds with sufficient humility to the discipline of a narrow creed, then the usefulness of the aristocracy will be reduced. All this may be conceded without implying that a class of leaders is a fundamentally wicked arrangement irrespective of circumstances. All one can say is that, as a community grows richer, equality of opportunity becomes a more feasible objective, and social institutions can be modified in such a way as to tilt the balance in favour of democracy. In the Western nations the tilting has begun long ago, and large inequalities in the inheritance of wealth have no longer as much justification as in the Middle Ages or even in the nineteenth century. We have not, however, reached the position where all inequality of this kind is unnecessary, and we are not likely to reach it for a long time to come.

Conclusion

So far the argument has been couched in general terms. Inequality of earned income, the private ownership of capital, inheritance and the receipt of unearned incomes have all been sanctioned in principle, subject to the proviso that the income of the rich is not too large a proportion of what is available for all. These conclusions are basically ethical and

have been reached by attempting to balance the advantages and disadvantages involved in different courses of action. I think they would be accepted by the majority of the British electorate and would certainly receive the support of the vast bulk of the American people.

From a practical point of view this is only the beginning of the story. Since inequality is not denounced on principle and it is all so clearly a question of degree, the problem becomes essentially quantitative. How much inequality is in fact to be found in the British economy? To this factual question we shall turn in the next two chapters.

CHAPTER 7

INEQUALITY OF INCOME

WAGES accounted for only a third of all private income before taxation in 1938, and even in 1948 their share was less than two-fifths. On the face of it, the proportion seems to be small, and seems to justify the claim that the workers could be made much better off if profits were abolished or at least substantially reduced. How easy it would be if this were so! Unfortunately the remainder did not consist entirely, or even in major part, of the profits of the idle rich, and in order to understand the distribution of income it is necessary to abandon the simple-minded division into wages and profits which seems to be suggested by Marxian theory. Those who are not classed as wage-earners are a very mixed lot; they even include shop assistants whose incomes are regarded as salaries by the official statisticians!

If it is unearned incomes which are to be singled out for attack, then salaries can be grouped with wages, and presumably social security benefits, war pensions and the like can be added as well, on the ground that the recipients are, in the main, wage-earners or salaried people. Wages, salaries, social security payments, etc., accounted for between three-fifths and two-thirds of the total in both years. Thus it would appear that " unearned incomes " can be put at just over a third, but even this conclusion would be wrong. For the " unearned " incomes are still very mixed in character and comprise some incomes which are as much earned as wages or salaries. Within them are included not only the profits of joint-stock companies, debenture interest, rent, and interest on the national debt, but also professional earnings, farmers'

incomes and the incomes of all sole traders and partnerships. No useful conclusions can be drawn until this figure is subdivided, and unfortunately it was not possible to do so in a satisfactory way until recently. In previous White Papers on the National Income the total was labelled " rent, interest and profits ", and although there were explanatory notes, these tended to be disregarded and false conclusions drawn. Government spokesmen might emphasise that increased production was the only way to improve the lot of the common man, but it was easy for its Left-Wing opponents to contradict this unpalatable fact by referring to the official figures and ignoring the qualifications. Even the label, " rent, interest and profits ", was usually abbreviated to " profits " alone, and most profits are supposed to go into the pockets of the very rich. If, therefore, " profits " still accounted for one-third — in debate it often became one-half — of private income, only one conclusion could be drawn ; the Labour Ministers had " sold out " to the bosses and betrayed the working man ! There was no need to mention that taxation had not been deducted, that savings were necessary, or that the " bosses " included the farmer who was too poor to employ a labourer and the old lady round the corner who kept a sweet shop !

In Table I, I have set out the more detailed figures which have been made available in the White Paper for 1949.[1] Professional earnings should, in the main, be classified with salaries, and the bulk of farmers' incomes should be regarded as earned. The profits of sole traders and partnerships — which should long since have disappeared almost entirely that the Marxian scriptures might be fulfilled [2] — are partly earned and partly unearned. These small men, however, are not usually condemned by Socialists, who are often at pains to explain that they have no quarrel with them. Since

[1] Cmd 7649, April 1949 These figures have been plotted in Chart 3.

[2] Cf. the *Communist Manifesto* : " The lower strata of the middle class — the small trades-people, shopkeepers and retired tradesmen generally, the handicraftsmen and the peasants — all these sink gradually into the proletariat ".

this is so, it is the remaining items which must be subjected to critical scrutiny.

Rent, interest and profits were about a quarter of private

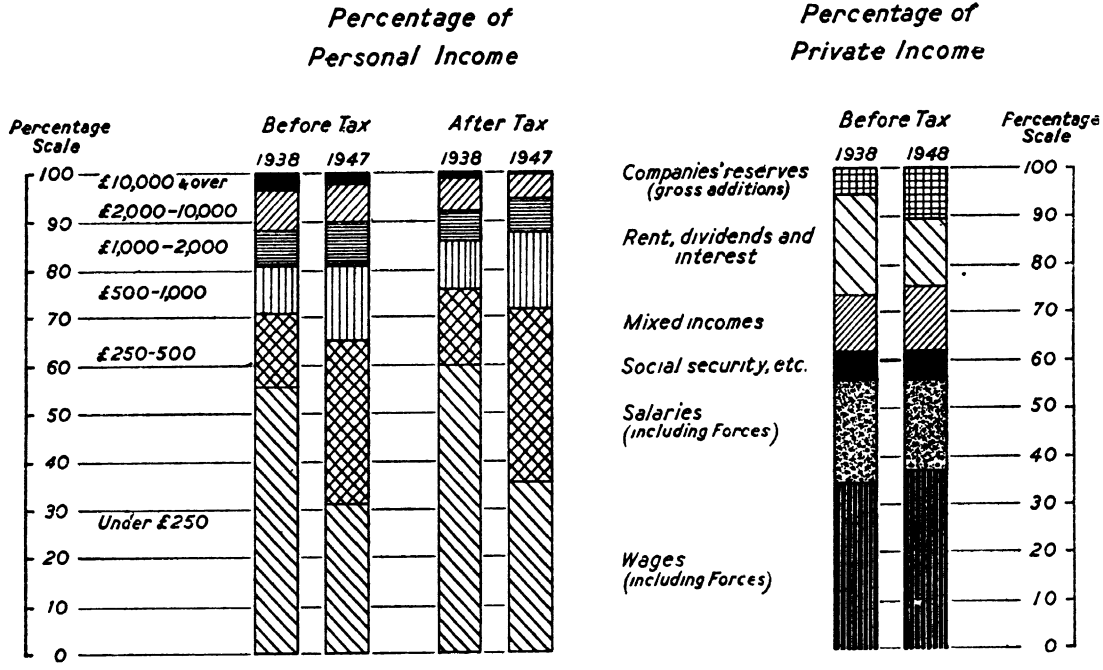
TABLE I

PRIVATE INCOMES BEFORE TAX

	£ million		Percentages		Percentage Change, 1938–48
	1938	1948	1938	1948	
(1) Wages	1735	3,975	33·7	36·8	+ 129
(2) Salaries	1110	1,850	21·6	17·1	+ 67
(3) Income of the Armed Forces	78	246	1·5	2·3	+ 215
(4) Total earned income (1 + 2 + 3)	2923	6,071	56·8	56·2	+ 108
(5) Social security payments, war pensions, etc.	270	663	5·2	6·1	+ 146
(6) Professional earnings	84	161	1·6	1·5	+ 92
(7) Income from farming	60	248	1·2	2·3	+ 313
(8) Profits of sole traders and partnerships	440	970	8·6	9·0	+ 120
(9) Total "mixed" incomes (6 + 7 + 8)	584	1,379	11·4	12·8	+ 136
(10) Rent, dividends and interest	1109	1,479	21·6	13·7	+ 33
(11) Gross additions to companies' reserves	257	1,215	5·0	11·2	+ 373
(12) Total unearned income (10 + 11)	1366	2,694	26 6	24·9	+ 97
(13) Total private income (4 + 5 + 9 + 12)	5143	10,807	100 0	100·0	+ 110

incomes in 1938 and 1948. Of this fraction, a part represented gross additions to the reserves of companies, and it is the remainder which can be regarded as the unearned income of persons. That is to say, the owners of capital,

CHART 3


Percentage of Personal Income
Percentage Scale
Before Tax
After Tax
1938
1947
1938
1947
100
90
80
70
60
50
40
30
20
10
0
£10,000 & over
£2,000–10,000
£1,000–2,000
£500–1,000
£250–500
Under £250
Percentage of Private Income
Before Tax
Percentage Scale
1938
1948
Companies' reserves (gross additions)
Rent, dividends and interest
Mixed incomes
Social security, etc.
Salaries (including Forces)
Wages (including Forces)

apart from farmers and very small business men, received as personal income nearly 22 per cent of all private income in 1938 and nearly 14 per cent ten years later. As the table indicates, these incomes have increased much less than any other incomes since before the war. Indeed, the small rise of a third, as compared with a doubling of total private income, has by no means compensated for the increase in prices. The fraction received as rent, dividends and interest is still substantial but, apart from the fact that no taxation has been deducted, there are two further qualifications of some importance to be made. First, a large part of personal savings came from these incomes, and it would therefore be wrong to suppose that if they were reduced or abolished, the consumption of other income groups could be increased accordingly. Second, it is not true that " rent, interest and profits " go in the main to the very rich. The total includes interest on the national debt, some of which is held by the workers themselves, and even the shareholders are by no means always wealthy people! It is possible to be reasonably precise about this by referring to the statistics for surtax. Those with incomes over £2000 a year received less than a quarter of all rent, interest and dividends in 1946. The rest of these incomes went to people with less than £2000 a year, a fact which is not as fully appreciated as it ought to be. The unearned personal income of the " wealthy ", defined as those with over £2000 a year, accounted for only $3\frac{1}{2}$ per cent of all private income *before tax* — a fairly modest share, one would have thought, for the monsters of " monopoly capitalism ".

The final item to be discussed is that which shows the gross additions to companies' reserves. These additions have increased, over the last decade, much more than any other item of private income; but two complications must be borne in mind. First, no taxation has been deducted and the figures for gross additions to reserves therefore include large sums which were taken away by the tax-collector. These

amounted to £87 million in 1938 and £670 million in 1948 (an increase of 670 per cent) and left £170 million and £545 million as the net additions to reserves in each year respectively. Thus undistributed profits rose by 220 per cent over the decade, and in 1948 provided much the greater part of the private savings which were so badly needed for the re-equipment of industry.[1] Second, in estimating the amount of net profits, a deduction has to be made for the depreciation of equipment, etc.; and it is generally agreed that the allowances permitted for this purpose by the Inland Revenue are inadequate, because they are based on the original cost of the equipment which is often well below its replacement cost at post-war prices. A large part of so-called " undistributed

[1] Wildly exaggerated impressions of the rate of return on capital are often derived from the artificial manner in which balance-sheets are prepared. It is not uncommon for firms to state that they have earned a very high percentage on their " capital " — say fifty or even more — but such statements do not mean what they appear to mean The " capital " referred to is the nominal value of the shares and that may be of no more than historical interest. Let us suppose that a company was founded in 1900 and — to make it easy — that no more shares were ever issued. During the last half-century this firm, if it has been successful, will have added substantially to its capital by means of its own savings. That is to say, part of its profits will have been ploughed back into the firm and withheld from dividends. Thus the real value of its capital will be very much greater than the *original* value of shares issued, but it is as a percentage of the latter figure, which is now meaningless, that profits are often expressed in company statements The *current* value of the shares themselves will reflect, with some imperfection, the increased earning power of the company and these figures have therefore some meaning. It is partly in order to mitigate this absurd artificiality in the accounts that firms are wont to issue bonus shares. Such issues do not imply that shareholders are given something for nothing. They merely receive certificates reflecting the increase in the amount of the firm's real capital which is due to the thrift imposed upon the shareholders themselves. (On all these matters, see *Manufacturing Business*, by P. W. S. Andrews, p. 68 *et seq.*)

It has been argued that shares should not be given any " par value " at all, since such values are in any case of no significance whatsoever after the shares have been offered for sale. It would certainly be more accurate to label each share certificate as representing a fraction of the company's capital — which is all it does. If such a change is not considered feasible, firms should at least abandon the practice of expressing profits as a fraction of nominal capital and relate them explicitly to audited estimates of total invested capital. Much confusion and ill-will might be prevented if this reform were adopted.

profits" must therefore be set aside to meet replacement costs and does not represent net saving at all.

The Revolution in Public Finance

Under capitalist democracy, the unequal distribution of income has been modified by progressive taxation and by Government expenditure for the particular benefit of the lower income groups. Mr. Gladstone held that money should "fructify in the pocket of the taxpayer", but his voice sounds faint and distant today. Lord Randolph Churchill was horrified by a budget of £90 million, and when his economy campaign, which would have made possible a reduction of the income tax to 5d. in the £, was defeated, he resigned in a rage. The Lloyd George budget of 1909, which led to a constitutional crisis, involved an increase in expenditure of merely £14 million and the highest rate of income tax was to be a trivial 1s. 2d. in the £. Those days are now very remote and everyone is aware that a great increase has taken place in the size of both Government expenditure and taxation. What may not be so fully appreciated is the magnitude of the revolution in the tax structure which has made it a powerful weapon for the reduction of inequality. The revolution has been far too quiet and gradual to stir the imagination. There have been no barricades in the street, no massacres, no liquidations. The earlier Radicals and Socialists would have been amazed by the achievement, and Marx himself might have modified his views and perhaps given up in disgust, if he had been able to perceive that changes of a kind which he regarded as impossible under capitalism, were to be carried out in the main by capitalist Governments. Worst of all, the peaceful capitalist revolutionaries made the disastrous mistake of propounding their reforms in ordinary English, without Germanic pedantry and without any reference to dialectics. With such failings they had little hope of winning the support, or even attracting the attention, of the Marxian Left.

The reader who wishes to examine the matter in detail is referred to a careful study entitled *The Burden of British Taxation* by Professor G. F. Shirras and Mr. L. Rostas. I am much indebted to the authors and the National Institute of Economic Research for permission to reproduce the chart on the opposite page. Not all taxes are included in the chart; in particular general industrial taxes, taxes on business profits, protective duties and purchase tax have been omitted. Furthermore, the chart relates to earned income, and the progressive taxes fell more heavily on unearned income. Nevertheless, it reveals the remarkable change which has taken place and no commentary is required. We shall now turn to an examination of personal incomes by size both before and after taxation.

The Statistics for Personal Income

The official statistics for the distribution of personal incomes in 1938 and 1947 [1] are set out in percentage form in the following table and illustrated by Chart 3 (p. 94):

TABLE II

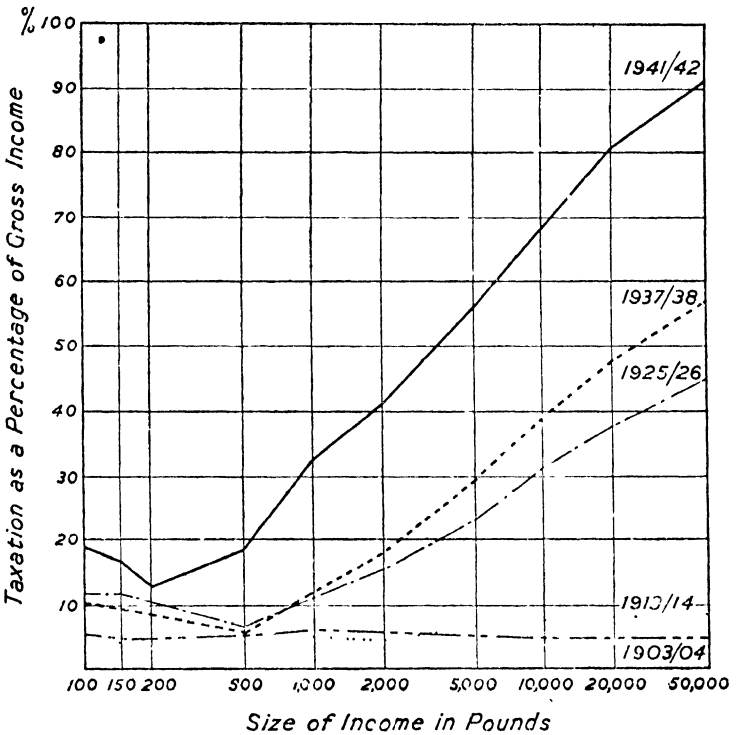
PERCENTAGE OF PERSONAL INCOME

Income Range	1938		1947	
	Gross Income	Income less Income Tax and Surtax	Gross Income	Income less Income Tax and Surtax
(1)	(2)	(3)	(4)	(5)
Under £250 .	55·5	59·6	31·7	36·3
£250–£500 .	15·3	16·0	34·4	36·7
£500–£1000 .	10·3	10·1	15·6	14·7
£1000–£2000 .	6·9	6·3	8·3	6·9
£2000–£10,000 .	8·1	6·2	7·6	4·8
£10,000 and over	3·9	1·8	2·4	0·6
	100·0	100·0	100·0	100·0

[1] Cmd. 7371. "Personal incomes", as the name implies, are the incomes of individuals. "Private incomes" consist of personal incomes

To begin with it should be noted that the figures for income received are divided between ranges of *gross* income, a fact of some importance in interpreting the figures in

CHART 4



THE REVOLUTION IN BRITISH TAXATION

columns (3) and (5). In 1938, for example, 10·3 per cent of all gross personal incomes went to people who started with gross incomes of £500-£1000, and after taxation they

plus the retained incomes of institutions and corporate bodies such as joint-stock companies.

had 10·1 per cent of total net personal incomes. Some incomes in this group would, however, be less than £500 a year after deduction of taxes. It is regrettable that the official statisticians do not provide figures for the total sums of net income corresponding to each *net* income group.

The official statistics are also incomplete in that no estimate is provided of the number of incomes below £250. Before the war, most wage-earners received less than £5 a week, and for this reason particular interest attaches to the size of this group. Fortunately, an estimate can be made [1], and it would appear that about 87 per cent of all income recipients fell into this category in 1938, and received about 60 per cent of all personal incomes after taxation. The remaining 13 per cent of income recipients — who were, of course, mainly people of moderate means — received 40 per cent of the total.

These figures provide some indication of inequality but they can still be misleading. Many of those who received incomes below £250 were juveniles, pin-money girls, old-age pensioners and the like, who were not obliged to support a family. Fortunately, a married couple is treated as a single individual which removes one difficulty, but it would be desirable, if it were possible, to make further adjustments and to turn the figures into estimates for families. A rough guess can be made with the aid of some Ministry of Labour data on numbers of dependants; and it may be concluded that roughly four-fifths of all families had incomes below £250 in 1938 and received three-fifths of personal incomes after tax. It must be noted, however, that if the family incomes of workers were often increased by the fact that there was more than one earner in the family, this involved additional labour. It is impossible to divide people into categories which are satisfactory from all points of view, but it seems appropriate that both the distribution among income recipients and the

[1] Cf. the estimate for 1937 in *The Social Framework*, by J. R. Hicks, p. 181.

distribution among families should be considered.

A comparison of the figures for 1938 with those for 1947 is rendered difficult by the change in the value of money. The decline, in the latter year, in the share of income going to those with less than £250 does not imply, of course, a fall in the share of the wage-earners. It reflects rather a rise in money wages and the translation of many workers into the higher grades. If the share of gross incomes of less than £500 is considered, it will be seen that it has remained fairly constant after tax. On the other hand, the share of the higher incomes (£2000 and over) declined in the case of both gross and net income.

Only direct taxation has been deducted in this table and there is no official estimate of the incidence of indirect taxation. Furthermore, allowance should also be made for social security contributions and the charges imposed by local authorities. Mr. T. Barna [1] has made a more comprehensive estimate for 1937, and without plunging the reader into a mass of statistics, his conclusions may be summarised. Indirect taxation in total — though not necessarily every indirect tax taken separately — is regressive; that is to say, the proportion of income paid as indirect taxation is greater in the case of lower incomes than in the case of higher. But in attempting to estimate the effect of Government finance on the distribution of income, allowance must also be made for the fact that part of total Government expenditure is specifically designed to benefit the lower income groups. Mr. Barna concludes that the total amount paid as taxation by those with less than £5 a week came back to the same class in the form of benefits of one kind or another which were supplied by the state. The benefits, indeed, appear to have been a little greater than the taxes.

In the light of this information, the complaints of the well-to-do which were so customary before the war can scarcely be allowed to pass. They were not in fact despoiled

[1] *Redistribution of Incomes*, p. 225 *et seq.*

in order to provide social services and the like for the workers ; the lower income group paid for what it got. Nevertheless, the structure of British finance was markedly progressive in a different way, for the middle and upper classes paid the entire cost of administering and defending the country, and thus provided the services and the security enjoyed by rich and poor alike. As Mr. J. R. Hicks has observed :

> " This was itself a great social achievement, whose magnitude will be appreciated when it is remembered that the general practice of most communities in the past has been for the State to be supported almost entirely by contributions levied mainly on the poor." [1]

The author is not aware of any estimate on similar lines of the incidence of indirect taxation for a post-war year, and it is doubtful whether there is enough basic data on personal expenditure to permit of any reasonable calculation. The broad trends, however, are clear enough. In 1938, indirect taxes provided 57 per cent of all tax revenue, central and local ; in 1948, about 52 per cent. If subsidies are deducted from indirect taxes, the proportions become 54 per cent and under 40 per cent for the two years respectively. These figures in themselves afford some indication of the increased progressiveness of the tax structure.[2]

Are there Two Nations?

What broad conclusions can be drawn from these figures ? Apparently it makes some difference whether one starts from the bottom of the scale or the top. Starting at the bottom, one notes the disproportionately small share of income received by those with less than £250 per year. Starting at the top, one is, I think, impressed with the fact that,

[1] *The Social Framework*, p. 188.

[2] Mr. Dudley Seers has made an ingenious attempt to derive conclusions from what information is available in an interesting study entitled : *Changes in the Cost of Living and the Distribution of Income since 1938.*

although the rich received a disproportionately large share, their share was a modest proportion of all personal incomes — indeed very modest if it is only the large unearned incomes which are resented. The apparent conflict between these conclusions is important and calls for further examination.

The class with gross incomes above £2000 received about 8 per cent of all personal incomes after tax in 1938 and 5·4 per cent in 1947. If these wealthy people — including, in the latter year, the Labour Ministers — had been led to the scaffold and their incomes redistributed, nearly 7s. a week would have been available per head for the rest of the working population in both years — on the assumption that total output did not fall as a result of the executions. According to Professor Bowley, average male wages were 69s. a week in October 1938, and 128s. in October 1947,[1] so the bonus resulting from redistribution would not have been a very large proportion of earnings. (It would now be the equivalent of about two packets of twenty cigarettes — only two days' smoking for a large number of people.) Furthermore, apart from the fact that the flow of savings would have been reduced by a measure of this kind, it is most unlikely that the total volume of output would have been so high in 1938 if there had not been a few glittering prizes to attract ambitious men. The prizes were smaller and duller in 1947, it is true, but we might have been better off if this had not been so. In general there is much to be said for offering a few large rewards as a means of calling forth greater efforts, as the Soviet Union has recognised long since. "Petty bourgeois equalitarianism",[2] as the Russians term it, may make everyone worse off. It is only when the large incomes absorb a great proportion of what is available that serious objections can be raised; and this was not the case either before the war or since.

[1] London and Cambridge Economic Service, Bulletin for February 1949, p. 18. Average earnings in "principal" industries.

[2] This original term of abuse was used at the Ninth Congress of the Soviet trade unions in 1932.

Nor was the number of individuals in these upper ranges large. Although there are no figures for the amount of net income received by people in each net income range there are official estimates of the numbers. In 1938–39 there were 75,000 incomes above £2000 a year; in 1945–46, 35,500. What is still more striking is the small number of really wealthy people. In the earlier year there were only 7000 incomes of £6000 or more and in the later there were only 45.

In *The Socialist Case*, Mr. Douglas Jay delivers a vehement attack on the British economy. At one stage he points with indignation to the proportion of income received as " rent, interest and profits " and does not allow his indignation to be calmed (1) by deducting taxes, (2) by examining the real nature of " rent, interest and profits " or (3) by reflecting that some of the incomes in this category were quite modest. At the next stage he grows very angry over a table which shows the distribution of personal incomes, and the reader must continue for several pages before he discovers a casual admission that no taxes have been deducted. Apparently all is grist to the socialist mill; but in the end, when he attempts to put forward constructive proposals, Mr. Jay becomes more moderate, and since his views may be regarded as representative of those held by the better informed Socialists, they deserve close attention. The need for inequality in earned incomes is conceded, and it is pointed out that although some of these incomes may be large, they do not " add up to a significant proportion of the national income ".[1] Nor does he stop here, for he says that " it is not profit as such that Socialism should seek to remove ". On the contrary:

". . . the imagination and initiative required to start a new venture are essentially the qualities which private

[1] *Op. cit.* p 194. Since the earned income of the surtax payers was equal to their unearned income in 1945–46, it follows that if one part was an insignificant proportion of income, so was the other!

> enterprise is best fitted to show. Here is private enterprise at its best: and if it is allowed to operate at its best, it must be allowed in this sphere to make profits as well as losses."

(A magnanimous concession!) Private property as such is not to be abolished and private saving is not to be prohibited. The storm and fury have passed and Mr. Jay has become reasonable again. His readers can amuse themselves by trying to decide how much of his earlier onslaught on capitalism is consistent with his subsequent concessions.

The crux of the matter seems to be inheritance.

> "Socialists have been mistaken", says Mr. Jay, "in making ownership of the means of production instead of ownership of inherited property the test of socialization. . . . It is not the ownership of the means of production as such, but the ownership of large inherited incomes, which ought to be eliminated." [1]

This is all that remains of the original charge against private enterprise under the heading of inequality of income. Is it weighty enough to warrant execution?

Half of all gross incomes assessed for surtax (£2000 and over) is derived from property [2]; and these large property incomes added up to about 2½ per cent of all personal incomes after tax in 1947. Of course not all the property from which these incomes were derived was inherited capital, so that even this small fraction of incomes does not stand completely condemned. Unfortunately there is no information as to the division of capital between inherited and saved, but let us suppose that three-quarters was inherited. On this assumption about 2 per cent of all personal incomes fell into the condemned category, while about 98 per cent escaped! It would be quite wrong to suppose that this was mainly the result

[1] *Op. cit.* p. 195.

[2] Ninety-First Report of the Commissioners of the Inland Revenue, Cmd. 7738, tables 39 and 40.

of redistributive taxation ; even before deducting taxes over 96 per cent of personal incomes would have passed muster !

It may be objected that this definition of a large income as one over £2000 before taxation is unacceptable, but the choice made above has not been entirely undeliberate. Any dividing line of this kind must admittedly be somewhat arbitrary, but in socialist propaganda it is customary to contrast the extravagance and luxury of the rich with the miserable hardships of the poor. " The wealthy " in these descriptions are clearly the very wealthy. They drink champagne while the poor lack milk ; they have town houses and country houses ; they belong to the most expensive clubs ; they have one or two costly cars ; and they bask in idleness on the Riviera while the wage-slaves, hungry and half-naked, toil to provide them with the incomes they so ill deserve ! To say the least of it, it is only those with £2000 and over who need be considered as plutocrats in the sense in which the term is normally employed by Socialists. Those who earn between £500 and £2000 a year are merely the drab middle class.

On the basis of the figures given above it is clear that the share of total income received by the plutocrats, even before the deduction of personal taxes, is far smaller than is usually believed ; and the scope for redistribution as between rich men and workers is therefore modest. If substantial sums are to be obtained, it is necessary to turn, not only to the rich, but also to the middle class. In 1938, people with incomes between £500 and £2000 amounted to only 4 per cent of all income recipients but they received 16½ per cent of net personal incomes. The facts are obvious and indisputable and their prolonged neglect may be partly attributed — like so many intellectual follies — to the influence of Karl Marx. Marx believed that as capitalism tottered towards its collapse the middle class would be submerged in the proletariat until there were only two classes, the big capitalists and the workers, the exploiters and the dis-

possessed, confronting each other in glowering hostility. In fact, it is not so much a " conflict " between the millionaire and his valet as between the general practitioner and the man who comes to mend his drains, between the prosperous owner of the small shop and his working-class customers, between the Communist professor and the common-room servant, between the engineer and the unskilled labourer, between the Socialist M.P. and his constituents. If there is to be a class war, it is the " petty-bourgeoisie ", and not merely a handful of plutocrats, who should receive the workers' bullets. That such a war would be extremely foolish and mutually destructive is clear enough. That it has never been openly declared by the Left is also significant. It is true that the middle class has been heavily taxed, but it has not been told that socialism implies its elimination. Perhaps the Socialists do not wish to eliminate the middle class, but, if not, they should follow the example set at times by Sir Stafford Cripps and cease to pretend that there is a large amount of unjust inequality in the distribution of income which they will remove. As it is, the attack is confined to " the plutocratic capitalists " who are too few to matter! Of course, a more consistent policy would involve the loss of too many votes, and it is safer to shout the war-cries of a mythological conflict and thus acquire support for quite different and irrelevant policies.

This situation is not new. Even before the war it was misleading to talk in Disraeli's phrase about " the two nations ", the rich and the poor. British society — and American society for that matter — did not consist of two classes, but rather of a long line of income grades with the numbers in each grade declining sharply as income per head increased until, at the top, both the numbers and the share of total income became very small. The facts have been there for anyone to see who cared to look at them with an unbiased mind. What they show may appear dull and disappointing to the revolutionary but that cannot be helped.

Unearned Income and the Middle Class

The payers of surtax received unearned income to the value of £337 million before tax in 1946–47. That is to say, the " wealthy ", in this sense, got about one-fifth of all unearned income, while the remaining *four-fifths* went to the " middle class ". This fact may appear surprising. It is generally known that very high incomes are often mainly unearned, and there has been a strange tendency to conclude from this that most income from property goes to the rich. The conclusion is a complete *non sequitur* and it is disproved by the facts. The vast bulk of unearned income went to the middle group to which most socialist M.P.'s and intellectuals themselves belong. What is more, it is this group which owns the greater part of inherited property.

It does not follow, of course, that the incomes of the middle class must not be touched ; they receive rather more than a touch from the tax-collector at the present time ! Nor is it the author's intention to suggest for a moment that the existing distribution of income and capital is all that it might ideally be made. No doubt there are incomes from inherited property within the middle grade which would be difficult to justify. One is seriously handicapped in attempting to make any further statements by the deplorable lack of statistical data, which could be slightly remedied if the tax returns received by the authorities were tabulated in more detail, if only for one year. All this is conceded but the basic conclusions remain. It is not true that the country is divided into two groups, the wealthy capitalists and the workers, and it is not in the least high-minded to talk as though this were the case. It is neither moral nor responsible to pretend to be on the side of the underdog and to foment class war, which may destroy democracy and create a new class of privileged dictators.

Further redistribution may be thought proper, and the more appropriate methods will be mentioned in the next chapter, which is concerned with the inequality of capital.

But the standard of living of the bulk of the people will depend in the main upon other factors. The major cause of avoidable hardship before the war was unemployment — not so much because of the loss of potential national output but rather because some individuals were condemned to long and bitter spells of idleness. If this can be prevented in the future the worst evil will have been removed, and further advance will depend upon rising productivity. The different classes in the country will gain far more by working together in good-will than by snarling at each other and grabbing at what the other has. Between 1914 and 1937 average real working-class earnings in the United Kingdom increased by a third, a rise which may be compared with the modest fractions quoted above in discussing the share of the rich. If output per head can be increased by 2½ per cent per annum, as is contemplated in the Four-Year Plan, this will give the nation as much in a single year as could be achieved by confiscating all large incomes from inherited property. Moreover, if this rate of increase can be maintained real wages will be doubled in twenty-eight years; and nothing like this could be done by means of redistribution, as can be seen by making another simple calculation. For 1947, total personal consumption divided by the number in the working population works out at £7 : 1s. a week. (Expenditure out of expenses allowances and sums withheld from the tax-collector are included in this amount, so one possible objection to the preceding figures is met implicitly.) For October of the same year, Professor Bowley's figure for average male wages is £6 : 8s. a week, and it is usually assumed that practically the whole wage-packet is spent. That is to say, if the consumption of every member of the working population had been exactly the same, it would have worked out at 13s. a head more than average male wages, a difference of about one-tenth. Of course some wages fell below this average, but it is also true that there was usually more than one earner in a working-class family. (In 1938 there was 1¾.)

Thus even the most inconceivable degree of equality — which would soon have defeated its objective by leaving too small a margin for the skilled worker and the salary-earner, as well as the farmer and the business man — would have resulted in far less gain than is offered by increased productivity. It is on the latter that we must count, and nothing will do more to hold down productivity and the standard of life than ill-feeling and suspicion. Those who seek to foment class antagonisms are in no sense the friends of the working class; it may be their own careers they are advancing as future commissars.

Inequality in the U.S.A. and the U.S.S.R.

In concluding this chapter it may be of interest to refer to the statistics for income distribution in the U.S.A. and the U.S.S.R. The data for the latter country are notoriously inadequate, but sufficient exist to make possible some broad comparisons.

In his elaborate study of *The Structure of Soviet Wages*, Professor Abram Bergson has compared the figures for wages in U.S. manufacturing industry in 1904 with those for the manufacturing industry of the U.S.S.R. in 1928. (The different dates are chosen because he wishes to compare the countries at what he believes to be a similar state of development.) The comparison shows roughly the same degree of inequality in both countries and he concludes that "the results must be regarded as (further) support for the conclusion that Soviet wages varied in accord with capitalist principles".[1]

The result is interesting but it relates only to wages, and the higher incomes are omitted for both countries. Elsewhere,[2] however, he provides figures for the combined wage

[1] *The Structure of Soviet Wages*, p. 96. The figures for the U.S.S.R. are taken from official data. No-one who reads the book will be left with the impression that Professor Bergson is anti-Soviet.

[2] *Op. cit.* p. 123. I am indebted to the Harvard University Press for permission to use Professor Bergson's estimates and to make some quotations from his book.

and salary bill of industrial workers in the U.S.S.R. in 1934 from which the following table can be constructed :

TABLE III

U.S.S.R., 1934

Incomes ranked from Lowest to Highest	Per Cent of Total Wage and Salary Bill
Lowest fifth .	7·8
Second ,, .	12·8
Third ,,	16·7
Fourth ,,	22·4
Highest ,, .	40·3
TOTAL .	100·0

Professor Bergson does not attempt to compare these figures with any available for the U.S.A., but it is suggestive to set down some official estimates : [1]

TABLE IV

U.S.A., 1947

Family Units ranked from Lowest to Highest	Per Cent of Total Income	
	Before Tax	After deducting Direct Federal Taxes
Lowest fifth .	4·0	4·3
Second ,, .	9·8	10·4
Third ,, .	15·4	16·2
Fourth ,, .	22·6	22·8
Highest ,, .	48·2	46·3
TOTAL .	100·0	100·0

[1] Report to the President by the Council of Economic Advisers, January 1949, p. 92.

The tables are not, of course, directly comparable. The former relates to wages and salaries, the latter to " family " units, *i.e.* related persons living in one dwelling and single persons living alone. The former covers only part of the economy, the latter is more comprehensive — although it excludes income in kind, such as food produced and consumed on farms. A number of other adjustments would have to be made before any precise conclusions could be drawn. In particular it would be necessary to deduct state income tax and all indirect taxation from the American figures, and all taxation from the Russian figures. If this were done, the result might become less favourable to the U.S.S.R., where the tax structure was highly regressive.[1] Allowance should also be made for the shops with special prices which existed in the U.S.S.R., and for rationing. Some of these arrangements were designed to favour the workers, some the well-to-do, and it must be recalled that the non-monetary privileges of a high position are of great importance in Russia.

In spite of these difficulties the two tables are suggestive. The lower two-fifths got a larger share in the U.S.S.R. and the top fifth a smaller one, but in the main the similarities are more striking than the differences. The Soviet figures do not, of course, include anything like all the high incomes in the country whereas the American figures do. In Russia, it is the higher officials, the senior officers, the artists, the engineers and the shock workers who receive large incomes, and only the incomes of the last two groups are included in the table. Furthermore, there has been a marked increase in inequality in the U.S.S.R. since 1934 with the growth of

[1] In 1934, turnover taxes in the U.S.S.R. yielded 30 billion roubles as compared with a trivial 2 billion collected as income tax, *i.e.* the former brought in 94 per cent of the total. (Bergson, *op. cit.* p. 49.) Sales and excise taxes accounted for only one-sixth of all taxes collected in the U.S.A. in 1947. Communists usually try to defend the regressive nature of Soviet taxation on the ground that this feature is of little importance when gross income is fairly equally distributed; but it is not so distributed in the Soviet Union.

the Stakhanovite movement and the tremendous emphasis on bonus payments of all kinds.

Whether or not more comparable statistics would now reveal any greater equality in the U.S.S.R. than in the U.S.A. it is impossible to say, but one thing is clear. The figures do not reflect the alleged differences between a socialist classless society and a plutocratic capitalist economy which the Communists, with more regard for the Party Line than the truth, are at such pains to emphasise.

A final reference may be made to Bergson's detailed figures which divide wages and salaries into groups according to size. The income at the bottom of his highest group for 1934 is twenty-eight times the income at the top of his lowest group, and the full range of inequality must have been greater than this. Further information can be obtained from other sources, and the Soviet income-tax schedules are instructive in themselves. In 1940, for example, rates of tax were quoted for annual incomes ranging from anything over 500 roubles to 300,000 roubles and more. Nor did taxation remove even the more glaring differences. A professional man with just over 300,000 roubles paid 100,000 to the tax-collector [1] and was left with a net income about fifty times the average income in that year. By way of comparison, there were only forty-five net incomes of £6000 or over in the United Kingdom in 1945–46, and this figure of £6000 was only about twenty times the average personal income after taxation of all kinds had been deducted.

It may be held that nothing can be learned from the Russian income-tax schedules because no-one may in fact have earned the higher incomes, but the objection is scarcely convincing. To begin with, if the U.S.S.R. were really as equalitarian as her agents abroad would have us believe, it would surely be singular if her Government, which is said to be so rational in its methods, wasted its time in devising rates of tax which would never be paid. Furthermore, the

[1] Baykov, *Soviet Economic System*, pp. 381-3.

Russians themselves have admitted that very high incomes are earned, and their press has frequently boasted about the new Soviet millionaires. What is true of industry is also true of the armed services. A Russian lieutenant gets one hundred times as much as a Russian private and a Russian colonel gets two hundred and forty times as much.[1] Anyone who has come into personal contact with the Russian army and observed the tremendous emphasis on caste will find it difficult to take altogether seriously the complaints of the British Communists about the class divisions in our own forces.

The Soviet Union has certainly taken to heart Stalin's famous denunciation of equalitarianism in 1931. Before the war, three-quarters of all industrial workers in heavy industry were on piece-rates and those who worked hard earned more and were honoured for it. British workers, on the other hand, have always been suspicious of piece-rates and accurate time-fixing. Their usual objective is to obtain a rate which will enable them to earn what is regarded as reasonable without too much effort. Even when they could produce more and earn more by doing so, they prefer too often to go slow; and a "scab", who breaks the customary rules, can expect to lead an unpleasant life. There is no such nonsense in the U.S.S.R. — not, at least, in so far as the Party and the trade unions can prevent it. The latter, of course, have long since been deprived of the usual function of fighting for higher wages. They can still seek to improve the workers' lot a little by securing better welfare facilities, but their primary function — which must appear novel to their British colleagues — is to increase productivity![2]

In general it would probably be unfair to criticise the U.S.S.R. on the ground that the distribution of income among the "free" citizens is very unequal. In some

[1] *Economist*, July 3, 1943.

[2] Cf., *e.g.*, *Management in Russian Industry and Agriculture*, by Bienstock, Schwarz and Yugow.

respects, perhaps, the Soviets have gone too far for Western susceptibilities. The British public, for example, would scarcely approve of the arrangement, which persisted even in war-time, by which the well-to-do in Russia could buy such scarce commodities as meat off the ration. In the United Kingdom, by contrast, even sweets were rationed! By and large, however, the Russians have merely come to terms with human nature and economic reality. No doubt, the masses will benefit more in the end than they would have done with greater equality and corresponding stagnation.

> "There is no question", writes Mr. Davies, "but what human nature is working here the same old way. There are many indications of it. The bureaucracy all live very well and many have their country houses, or *dachas* in the country. Many of the workers are earning more money by reason of the piecework system which is being installed to speed up industry. There are luxury shops in the streets here in profusion . . .; the old biological urge stimulating both women and men to acquire capitalistic money more than somebody else in order to indulge themselves in luxuries." [1]

Forced Labour in the Soviet Union

The more idealistic Socialists may be shocked by the complete abandonment of equalitarian principles in the U.S.S.R., but most people, I imagine, will accept the fact tolerantly enough with no more than a shrug at the realities of economic life. After all, it is primarily the concern of the Soviets themselves, and we could leave it at that were it not for two other considerations.

First of all, it is insufferable that Communists in the democratic countries should be able to enlist support for their policies of wrecking and sabotage by pretending that the

[1] *Mission to Moscow*, by J. E. Davies, U.S. Ambassador, 1936 to 1938. Left Book Club edition, vol. i, p. 60. Quoted with kind permission.

Soviet imperialists have a great respect for equality.[1] It is most important that this deception should be stopped; and it could be stopped if the democratic Governments were to present more fully the facts in their own possession. The Labour Party's campaign against communism in this country would be far more effective were it not for the general ignorance about these matters which the Party spokesmen could so easily remove.

The second consideration relates to internal Russian affairs. When the minimum rights of human beings are so cruelly denied by the institution of forced labour it is no longer fair to say that it is none of our business and to pass by on the other side. The introduction of slavery in the most literal sense represents so great a relapse towards barbarism that the civilised world can scarcely be expected to maintain an attitude of tolerance or indifference. On this subject it is as well to appeal to authority, so I shall confine my own comments to a minimum and quote, with kind permission, from a statement made by the Under-Secretary of State for Foreign Affairs in a Labour Government, who has set his colleagues an admirable example in plain speaking.

In a speech delivered before a Committee of the United Nations in Paris on October 15, 1948, Mr. Mayhew referred to " the hunger and exhaustion imposed as a deliberate act of State policy on the armies of slave workers in the Soviet Union ". He went on to say:

> " It can no longer be denied that the Soviet Union is making use of large numbers of prisoners as forced labour in conditions denying to them the basic human rights; that these human beings, once deprived of their liberty, are maintained in conditions of wretchedness and under-

[1] In giving instructions to Communists as to how they should behave inside the trade unions in non-Communist countries, Lenin told them " to resort to all sorts of devices, manœuvres and illegal methods, to evasion and subterfuge " (*Left-Wing Communism*, chapter vi). This advice has been accepted wholeheartedly.

nourishment; that under the cloak of arrest for crimes and other offences against the régime, the Soviet Government has acquired for itself a vast body of cheap labour utterly without rights. That, in short, the Soviet Union has instituted a slave system recruited from among its own citizens which in scope has no parallel in history.

"These, Mr. Chairman, are serious charges. If they were substantiated, indeed if only a small fraction of them were substantiated, they would prove to the world that Soviet claims to having established a high degree of civilisation to replace a previous oppression, to have instituted a workers' paradise, to have secured human rights and a monopoly of progressive political thinking and action, these are founded on a shameful fraud. Unfortunately, however, there appears to be most serious evidence to support the belief that such a slave system does indeed exist in the Soviet Union. In the Soviet Union vast industrial complexes have been set up. Roads have been built through undeveloped territories; great canals have been cut; minerals have been extracted from the soil in increasing quantities. But there is also a terrible and overwhelming volume of evidence that these works have been made possible in part, even in large part, by the creation of a vast class of slaves made to work long hours, paid, if paid at all, only a fraction of the proper wages; maintained as domestic animals are maintained, only for what they can produce. The system, it is alleged and testified to by an increasing number of its victims who have survived and escaped, has become an integral part of the Soviet economic system, without which, indeed, the régime would face great difficulties.

"Any reasonable opinion, Mr. Chairman, would accept from the mass of evidence available a figure of millions in Soviet forced labour camps. If we put the estimate as low as 5 million we find that about 2 per cent of the population is engaged in collective labour.

" In certain areas in the Soviet Union, notably in the Far North and the Far East, the M.V.D. appears to be almost in sole charge of the administration. They have to maintain large staffs of technicians to cover the many-sided activities for which they are responsible. It appears that the population of these areas almost entirely consists of persons who have been deprived of their liberty. The M.V.D. also uses other kinds of employees but mainly to maintain the elaborate organisation necessary for the control of the enormous number of slaves involved. One of the main tasks of the M.V.D. in these, and no doubt in other regions, appears to be deportation, resettlement and exploitation of prisoners.

" Mr. Chairman, if the great body of evidence on Soviet Forced Labour that is now available to us has any meaning at all, it means that there exists in Soviet Russia a monstrous system of oppression, which makes a mockery of the claim that that country is a democratic or socialist state. It bears out the truth — that for democrats, socialists and working men and women the world over Soviet Russia provides not an example, but a deadly warning."

No-one can say exactly how many are employed on forced labour by the Soviets, and the estimates range from 5 to 20 million, depending in the main on the number of categories included. The lower figure of 5 million is probably more appropriate if attention is confined to concentration camps of the very worst kind, but it is too low if prisoners of war, deportees, and those Asiatic tribes which took ill to Soviet colonial policy, are included.[1] The latter groups may not be treated quite so badly as the first category, in the sense that an old-fashioned slave was better off than the inmates of Belsen or Buchenwald. But they are slaves nevertheless, entirely at the disposal of M.V.D. and utterly without civil rights of any kind. Whatever the correct

[1] Cf. the survey by Judith Listowel in *Soundings*, January 1949.

statistics may be, it cannot be doubted that millions of people are living in such conditions — indeed as much can be inferred from a book edited by Mr. Vishinsky himself.[1] That is all we need to know. When the Under-Secretary of State made his speech he had at his disposal not merely published data but also the information available to the British intelligence departments.[2] If there are still any sceptics — apart from those whose political ambitions oblige them to close an eye — they would do well to reflect upon that fact.

Whatever defence there may be for the more usual forms of inequality in the U.S.S.R., there can be no excuse for forced labour. It is this which represents the final abandonment of all the ideals for which Socialists and radicals of every description have always striven. The gap which separates these miserable creatures from the Soviet upper class is far greater than that which separates the wealthiest handful of British or American capitalists from any group of workers in their respective countries. In the Socialist Fatherland there is more bitter inequality than in any of the great capitalist economies, even including their colonial territories overseas; and its supporters elsewhere, who seek to cover up and ignore the unpleasant facts of forced labour, have sacrificed all claim to the respect of decent men.

[1] *From Prisons to Educational Institutions.* The "mass projects employing those deprived of liberty" were also described by Mr. Molotov at the Sixth Congress of Soviets, 1931.

[2] Since this was written, the Foreign Office has released to the press a translation of the official Corrective Labour Codex of the R.S.F.S.R.

CHAPTER 8

INEQUALITY OF CAPITAL

THE national capital is distributed much more unequally than the national income. According to the calculations of Mr. H. Campion, which are based on assessments for death duties, nearly three-quarters of all adult persons did not own estates worth more than £100 each in 1936.[1] Between them, they possessed only 5 per cent or less of the national capital and all the rest was owned by the more fortunate one-quarter. There is a great deal of evasion and under-assessment with regard to small estates which are anywhere near the exemption limit, and the statistics must not, for this reason, be taken at their face value. But when all reasonable allowances have been made, it may be assumed that appreciably more than nine-tenths of the national capital was owned by one-quarter of the adult population. What appears even more striking is the fact that about 1 per cent possessed over half the total.

As with the distribution of income, it can be misleading to compare percentages of people with percentages of estates and leave it at that. The size of the estates must also be mentioned lest the number of the wealthy and their share of the national capital be exaggerated out of all reason. The propertied one-quarter were practically all small people with estates worth between £100 and £5000 per head. Even the top 1 per cent referred to above did not consist in the main of very wealthy people, and it may be well to

[1] *Public and Private Property in Great Britain.* The calculation is made by multiplying the assessments by the reciprocals of appropriate death-rates.

quote Mr. Campion's subdivision of that figure: about 0·6 per cent of all adults owned estates worth between £10,000 and £25,000, which accounted for 16 per cent of the national capital; one-third of 1 per cent came within the range £25,000 to £100,000 and held just over one-fifth of the total; finally, at the very top, a small fraction of 1 per cent owned just under one-fifth of the national capital.

The reader must decide for himself the size of estate which he regards as unreasonable. It is certainly wrong to imply, as some socialist writers seem to do,[1] that the vast bulk of the national capital is owned by a few plutocrats who can afford to live in the kind of luxury normally described by the Left. What can be said is that the very wealthy (capital of £100,000 or more) owned something like 20 per cent of the total — or, say, a quarter if one draws the line some distance below £100,000. Or, to put it differently, the substantial middle class (£25,000 to £100,000) together with the wealthy (over £100,000) possessed about two-fifths of the national capital between them. That was bad enough but there is nothing to be gained by so exaggerating the evil that only the most extreme remedies, which may well be worse than the disease, appear to be appropriate.

The Significance of Unequal Ownership

(1) The effect of capital ownership on the distribution of income has been discussed above, and the arguments need not be repeated. It will suffice to note that rent, dividends and interest accounted for under a quarter of total private incomes before the war and for only about 14 per cent in 1948 (before deduction of personal taxes). Thus the effect on income of the great inequalities of capital ownership was confined to a fraction of total income. It is for this reason that the unequal distribution of income, even before taxation, is less marked than one might expect from a study of the figures for the distribution of capital.

[1] *E.g.* Jay, *op. cit.* chapter IV.

(2) The ownership of capital provides a form of security as well as an unearned income. It is always possible for individuals to live on capital during a period of crisis in their personal affairs; and it would certainly be desirable for as large a proportion of the nation as possible to enjoy the degree of independence which this implies. This is, in fact, one of the objectives of a property-owning democracy.

(3) Apart from its effect on income, the unequal distribution of capital fosters a concentration of economic power. Those with large sums at their disposal are clearly in a better position to obtain control of important business concerns than those who have no more to offer than their ability. Not only is this inequitable, but it means that the selection of leaders may be on the wrong basis; and the position may be particularly unsatisfactory when the capital is inherited. Most people would consider that in the latter case there is more inequity, and there is certainly much greater danger that the economic power will fall into the wrong hands. A man who accumulates a large fortune during his life is likely to have sufficient ability to warrant his possession of the power which his fortune conveys; but his son may be a fool who ought to be sweeping the streets, not sitting in a director's chair.

The consequences of this form of inequality would, indeed, have become intolerable long ago but for the development of an elaborate credit structure. The small man without much capital can borrow and then build up his own capital out of his savings. The owner of capital, for his part, may simply purchase bonds, which will give him an unearned income but no control over the use of his capital. Alternatively he may buy shares, and although he will then have a right to intervene in management, he may not choose to exercise this right. His shares may, indeed, be scattered over so many companies, that he may have little say in the policy of any one. Before the war it was not economical to float a public company with a share capital of less than

£200,000, and most firms were, of course, above the minimum size. A very large personal fortune was therefore necessary in order to own over half the shares and control a company, and most capitalists were inclined, in any case, to spread their risks by holding shares in several companies which reduced correspondingly their power of control. Even if the capitalist does concentrate his holdings, he may be content to sit back and interfere very little. Much stress has been laid on the divorce between ownership and management in the modern joint-stock company,[1] but I do not think it has been emphasised sufficiently that this development goes a long way towards mitigating the evils of an unequal distribution of capital. The owner of a large fortune may not choose to exercise the power at his disposal although he will be prepared to incur the risks involved in allowing others to use his capital; the executive, who may begin with no capital and may subsequently acquire only a little, can control enormous assets which belong to others.

The Taxation of Wealth

The private ownership and control of capital is one of the foundations of democracy. If the ownership is felt to be too much concentrated, steps should be taken to mitigate the evil and encourage the growth of smaller properties. This is the essence of a truly democratic policy. It is radical in the older and more acceptable sense of the term and does not involve the contradictions and inconsistencies of " democratic socialism ". Lloyd George was on the right lines; Mr. Attlee is not. In Chapter 6 it has been pointed out that nationalisation will do nothing to reduce the inequality of capital unless the Government cheats in the payment of compensation. Taxation is still the appropriate remedy and need not imply the abolition of private enterprise, with a consequent threat to democracy itself.

For many years death duties have been biting into the

[1] Cf. Berle and Means, *The Modern Corporation and Private Property*.

large inherited properties which are the legitimate object of attack. Some socialist writers have complained that in spite of such measures the ownership of capital was very unequal before the war, and it is certainly true that the country had still a long way to go in the direction of reasonable equity. This conclusion does not mean, of course, that death duties were of no avail, and a number of considerations must be borne in mind:

(1) Since death duties are levied only when property changes hands, the axe falls on little more than a thirtieth of the national capital each year. The effect of death duties must, therefore, be gradual.

(2) Until recently, death duties were much more modest than is usually supposed. Between 1930 and 1938, the estate duty on a capital of £100,000 amounted to only one-fifth. The owner of £300,000 could pass on a little over £200,000 to his son; even the millionaire could leave £600,000 after the tax-collector had done his worst. The highest rate of tax was 50 per cent on estates of £2 million and over. I think these figures lend only partial support to the usual complaints about the crushing burden of death duties.

(3) If what is resented is large inherited estates, it may be misleading to judge the efficiency of the measures directed against them by reference to the inequality in the ownership of capital at different dates. The measures may be quite effective, but all the time some people are amassing new fortunes which will fill at least some of the empty places at the top of the scale. This is a very different matter from inheritance and much more justifiable. In order to judge with precision the efficacy of death duties, statistics for the distribution of inherited capital at various dates would be required and such figures do not exist. It is clear, however, that it is becoming increasingly difficult to inherit a large fortune; the statistics of the amounts collected as death duties are a good enough indication of that.

Death duties were put up during the war and have been

raised twice since 1945. About a third of an estate worth £50,000 goes to the Exchequer. At £100,000, one-half is taken; at £200,000, three-fifths; at £750,000, three-quarters; at £1 million, four-fifths. Thus a millionaire can leave his son £200,000; of this inheritance the latter can pass on only £80,000; in the next generation the million will have fallen to £44,000 — and it will usually have been divided at each stage among several beneficiaries.

Death duties, however severe, may be held to operate too slowly, and it may be argued that there should be some new tax, or levy, on capital which would be imposed in the near future without waiting for the owners to die. Furthermore, with death duties at a high level, the inducement to make substantial transfers before death is all the greater, and it may be desirable to tighten up the present restrictions and, perhaps, to impose a tax on all large gifts, even when made long before death. There is a gifts tax in the U.S.A. and the possibility of levying a contribution in this country may deserve examination.

Whether it would be desirable to do more than this and impose a regular capital tax or a capital levy is more doubtful. The practical obstacles in the way of such measures are formidable, and the reader is referred for a detailed discussion to the Report of the Colwyn Committee [1] and to the more recent examination in *The Taxation of War Wealth*, by J. R. Hicks, U. K. Hicks and L. Rostas. The problems of speedy valuation and of the subsequent collection of the charge are grave enough to enjoin caution on any responsible reformer. Nevertheless, there is some evidence for the view that a " once-for-all " levy could be imposed with reasonable success provided it were confined to the really large estates, which are not, after all, so numerous. The authors of *The Taxation of War Wealth* go so far as to suggest that even an annual tax on capital would be feasible. The tax would, of course, be much less severe than the levy and might be

[1] Cmd. 2800.

paid, at least in part, out of income, provided the other direct taxes had been lowered; but the annual assessment of capital values would be no easy task.

If the administrative problems could be solved, taxes on capital would be preferable to taxes on income. Heavy charges on earned income, which cut into marginal rewards, are generally regarded as harmful, but it is also true that taxes on unearned income may discourage enterprise where it is most needed. A high rate of return on capital is usually the reward for bearing serious risks, and the steep taxation of unearned income, by reducing the net return, creates a bias in favour of less venturesome investments. For this reason the Profits Tax has been strongly criticised in the *Economist* and elsewhere. It falls on the profits of all companies, unless they are very small, but it does not touch the rents of the landlord or the interest of the bond-holder. A steeply graduated income tax has a similar effect. In this case everyone must pay, unless his money is left idle on current account at the bank, but those who bear the risks have to pay the most. An annual tax on capital values, which fell with the same severity however the resources were employed, would be much less harmful in its effects, and if it were feasible to adopt it, income tax might be reduced correspondingly. (The iniquitous Profits Tax should be abolished at once, even although no alternative were devised.)

The proceeds of a capital levy, if used to repay part of the national debt, would lower the gross interest charges on the budget, but the net gain would be greatly reduced by the loss of revenue in the form of some taxation paid on the interest accruing to the holders of Government bonds. For this reason, and also because of the administrative difficulties and the monetary cost of collection, the case for imposing such a levy would be unconvincing if the only objective were a reduction in the burden of the national debt. The proposal, however, can still be defended on social grounds; and for political, rather than economic, reasons it might even facilitate

a reduction in income tax and surtax. It would provide a political *quid pro quo* and would strike at the less defensible forms of inequality which still exist. Undoubtedly it would be preferable to face the administrative difficulties and cut more quickly into the few really large fortunes, rather than to allow the progress of the nation to be hampered by heavy taxes on income, and social relations to be soured by perpetual class jealousy.

Politics and Thrift

High death duties discourage thrift and even encourage dissaving ; for this reason there is a conflict between different social objectives. A capital levy or an annual capital tax would have a similar effect, especially a levy. It must be strongly emphasised that the strength of these unfavourable reactions will depend very much on general economic and political conditions, and the Labour Party, by its general policy, has made the position unnecessarily difficult. Private enterprise has been denounced in unmeasured terms, the profit motive condemned, and the capitalist described as a kind of parasite who must be gradually eliminated. If such a Government were to impose a capital levy, this would be regarded as the last straw, not only by those directly affected but by the vast majority of people who own any property at all. The latter would conclude that their turn would come next, and the shadow of the scaffold, which is already perceptible, would grow darker and more ominous. Hard work, enterprise and thrift are scarcely encouraged by the knowledge that, if one fails, one faces bankruptcy, and if one succeeds, one is branded as a capitalist *kulak* who must be liquidated as soon as possible.

All this is most unfortunate. If the Labour Party had not been led up the garden path by its Leninist intellectuals, it might have stood for a radical policy which aimed at the removal of the worst forms of inequality while preserving a free economy. There should have been no question of a

general attack on private property and capitalist enterprise; the large inherited properties, and even perhaps all very large estates, however acquired, could then have been taxed and whittled away more quickly without creating general dismay and alarm. High death duties and a capital levy would have been more, not less, feasible if the Liberals had retained their strength and the Labour Party, with its present philosophy, had remained small and obscure. As it is, who would trust any Socialist pledge that only the large estates were going to suffer?

A radical policy of the kind suggested is scarcely one which makes an obvious appeal to the Conservative Party! Yet some of its leaders have spoken of a "property-owning democracy", and although levelling up is far more important than levelling down, they must also be prepared for the latter. Fortunately their actions have usually been much more equalitarian than anyone would be led to expect by their statements, including the periodic references to the rights of property. They themselves have imposed high death duties, and it is inconceivable that the still higher rates introduced by their successors will be substantially reduced with the Conservative Party in power. Perhaps it is unfortunate that they refer so often to the defects of death duties instead of emphasising their equalitarian merits; for such complaints are liable to be ill received from a party which is believed to represent the interested classes. Not that the defects are merely imaginary; on the contrary, the discouragement of thrift is a very serious matter. It is disturbing to observe that personal savings after taxation were more than halved between 1947 and 1948, and in the latter year were very much lower than in 1938 — £96 million as against £148 million, including additions to tax reserves in each case — in spite of the fall in the value of money. This ominous development must be attributed very largely to the burden of taxation, including the Special Contribution, and among the taxes which were most adverse in their

effect, death duties must be included. All this is true, but it is a matter of politics as much as economics, and the equalitarian arguments must be given much weight. A radical party might, perhaps, lower the duties on the medium-sized estates without making any change in the amounts levied on the handful of really large fortunes, and it could investigate the possibility of attacking the latter more quickly by means of a levy. Such a levy would be a great administrative nuisance and might not appear to be worth the trouble, especially at a time of crisis in the balance of payments. The author himself would be inclined to this view if he believed that these matters could be viewed in a rational way. The general prosperity of the country is more important at the moment than social reform, and it would probably be wiser to rely upon death duties and await with patience the greater equality which they will produce. But if the control of wages depends on some reform elsewhere, it is desirable that the measures taken should be directed against the real types of injustice, not against private enterprise in general. Indeed the future of democracy may depend upon the possibility of deflecting the reformers' zeal away from socialism towards other measures, which are in any case more relevant to the question of equity.

Capital Taxes and Government Savings

If death duties and other taxes on capital discourage private saving, it is all the more important to ensure that the Government does not squander the proceeds. A change in budgetary practice is therefore required.

Death duties are paid out of capital, and a part of the estate must usually be sold to obtain the cash demanded by the tax-collector; but a sale implies a purchase by someone else. Some person or institution must be prepared to buy the assets which come on to the market, and in this way part of the net savings of the community are absorbed. In 1948, £180 million of gross savings were required, directly or in-

directly, to pay the bill for death duties — a much larger sum than the amount left as net personal savings. If the growth of the nation's capital is not to be retarded, the Government is under a clear obligation to save a corresponding amount. The receipts should not be treated as ordinary revenue which is available to meet any ordinary expenditure.[1] The proceeds of such taxes should be employed to redeem part of the national debt, and in this way funds should be returned to the capital market for the finance of industry.

Similar considerations apply with regard to a capital levy. A small part of the levy could be paid out of cash and a larger part by surrendering Government bonds, which would then be cancelled. But some people would be unable to meet all the claims upon them in this way and large blocks of assets, in the form of industrial securities, land and houses, would come on to the market. Unless something were done, the prices of these assets would fall very sharply and perhaps render impossible the full payment of the levy. The Government itself should strengthen the market by redeeming part of the national debt corresponding to the amount of the levy outstanding, and the former holders of Government bonds would then be provided with cash which could be used by them, or, after indirect exchanges, by some other people, to buy up the assets which were coming on to the market. The synchronisation of these processes would be very tricky, and no doubt some interim arrangements should be made with the banks for the provision of finance. This is one of the worst of the technical administrative difficulties in the way of a levy, but there is no need to elaborate the analysis. The final outcome can be described by saying that the Government would use the proceeds of the levy to reduce the size of the private national " capital " by cancelling some Government securities, which do not correspond to any real pro-

[1] It may be argued that the Government should be free to exercise its discretion in such matters, unhampered by any rules. But discretion may be lacking and formal rules, if a little artificial, are some safeguard in practice against faulty action.

ductive capital and represent a burden on the tax-payer. Since about half of the private national capital consists of Government securities, and only the quarter or less of the total which is held by the very rich should be subjected to the levy, the procedure suggested would be quite feasible from a quantitative point of view. If it is asked how this would improve the position from the point of view of equity, it may be replied that the volume of unearned income would be reduced and the remainder of the private national capital would be more equitably distributed. The important point to stress is that the Government itself should not acquire and retain the possession of industrial securities or title-deeds to houses or land—apart from a few estates for parks. There is every reason to suspect that a Labour Government would use a levy to further its doctrinaire policy of eliminating private enterprise, and for this reason it is fortunate that no such measure has been adopted so far. A more progressive Government might, however, employ a levy in the interests of greater equity without undermining private enterprise.

Towards a Property-owning Democracy

The measures required to provide reasonable equality of opportunity may now be summarised. Government expenditure, as well as taxation, can help by providing free elementary education for all, and free education in secondary schools and universities for those few who are likely to benefit by it. A great deal has been achieved already in these respects to mitigate the consequences of inequality in the income or capital of parents; and if some differences still remain it is worth bearing in mind that the same is true of the U.S.S.R., where the introduction of school fees in 1940 has benefited the children of the new Soviet bourgeoisie. The development of the credit market is the second way in which greater equality of opportunity has been secured, and more may yet be done in this direction by the provision of

better facilities for the finance of small businesses. The third measure is the levelling down by means of taxation. In time, the death duties already in force will eliminate the worst features of the distribution of wealth, and the possibility of adopting some additional and more speedy measures, such as those discussed above, deserves consideration.

When British society is viewed objectively, many of the strictures levied against it seem exaggerated. Great progress in the direction of equity has been made, and the importance of the remaining defects appears less grave when it is recalled that there is, in any case, no short cut to a higher standard of living for the nation as a whole. Increased output per head, the fruit of industry, enterprise, risk-bearing and thrift, is the only way to a substantial improvement. The Conservatives are perfectly right when they say that the possibility of increasing the size of the national cake is far more important than the possibility of changing the size of the slices.

What is true in this respect with regard to income is perhaps even more true with regard to capital. In a poor industrial economy, marked inequality in the ownership of property is unavoidable — unless, indeed, a Communist policy has been adopted, when other inequalities of a more sinister kind will appear. When the level of output per head is low, the equal redistribution of capital would reduce disastrously the level of savings and would, indeed, be followed by a substantial amount of attempted dissaving which would lead either to a fall in capital values or to inflation. Even in the United Kingdom in 1936, the equal distribution of the national capital would have given each member of the working population less than £1000; it cannot be doubted that a large number of people would have tried to spend their share.

The progress towards a property-owning democracy, defined as an economy where everyone — except the idle and ill-deserving — possesses a substantial competence, can only be gradual and slow. Levelling down will help but there must also be a building up from below; and the latter

is the more important of the two methods. Higher output per head, thrifty habits and a sense of responsibility are essential if the mass of the people is to acquire property by its own saving, or to consolidate the benefits of redistributive public finance. I know it is unfashionable to make a statement of this kind and " reactionary " to suggest that anything can be done by self-reliance and personal initiative. The sturdy virtues which made Britain a great nation have fallen into disrepute, and we have slowly come to accept what can only be described as the philosophy of the scrounger. If a man has not all he wants, this must be the fault of society and he must look to the state for help ! If another man has wealth and power, this cannot possibly be due to his own efforts ; it is the fault of capitalism ! What began as a healthy reaction against the injustices of the earlier industrial society is rapidly becoming the spiritual basis of a totalitarian state.

A property-owning democracy is something for which the nation will have to work, and it cannot be achieved overnight. But it represents by far the best of the practical ideals before us. It offers more rapid material progress, it will ensure greater freedom for the consumer and the producer, and it will strengthen and extend the foundations of civil and political liberty. If the pace is regarded as too slow, the more speedy changes offered by the Socialists and Communists will not provide what is required. Inequality in the ownership of capital results in unequal opportunities in industry, but the position will scarcely be improved by the policy of the Labour Party which involves the creation of large state monopolies. Nor have the Communists anything better to offer. In the U.S.S.R. the means of production are all in public ownership, but their control — and that is what matters — is the close preserve of a small privileged class, the members of the Communist Party. Why should a Communist wish to own part of the means of production when he can control their use without doing so and at the same

time receive an income far larger than that of the workpeople? He can accumulate a substantial private capital and leave it to his children; there is no need for him to subject his resources to the hazards of economic life. The money will be safer in Government bonds and at the same time he can exercise more control over the workers than any capitalist in Britain or America could ever hope to do. The only thing he lacks is personal security in a police state where he may be arrested at any moment for deviating, however unwittingly, from the Party Line; and this will tend to make him play for safety rather than show initiative.

Not only were the top positions in the state monopolised by the Communists, but even at the factory level they held almost every managerial post before the war. In Britain it is easier to become a manager if one owns capital; in Russia it is virtually impossible to do so unless one belongs to the party, submits to its discipline and accepts without question the whole Marxian philosophy.[1] "Christian Communists", who are wont to denounce Britain and America and to look with favourable eyes on the U.S.S.R., should recall that in the Soviet Utopia they themselves could not expect to hold any responsible post unless they renounced their faith.[2] Perhaps if they reflect on these matters they will conclude that even the pre-war British economy was not so black as they pretend. The privileges of inheritance are far less obnoxious than those which are the reward of a servile mind.

[1] Although Stalin has undoubtedly strengthened the dictatorship of the party, which he controls, it would be wrong to regard these developments as a deviation from the Communist tradition. As early as 1920, Lenin wrote: "Not a single important political or organisational question is decided by any state institution in our republic without the guiding instructions of the Central Committee of the Party. In its work the Party relies directly on the *trade unions*, which . . . formally, are non-party. In reality, all the controlling bodies of the overwhelming majority of the unions . . . consist of Communists, who secure the carrying out of the instructions of the Party" (*Left-Wing Communism*, chapter VI).

[2] This statement is not invalidated by the fact that Stalin now allows the Orthodox Church to hold services. The Church is under the control of the M.V.D. and enjoys even less liberty than did the German churches under Hitler.

CHAPTER 9

INDUSTRIAL EFFICIENCY AND MONOPOLY

SINCE the socialisation of industry has nothing in particular to do with greater equality of income or capital, fresh arguments are required in support of such a policy. It is true that the need for these arguments is not always apparent on political platforms where the equalitarian sentiments, which were the moral driving force of old-fashioned socialism, can be diverted easily enough to the support of the new; but if the debate is to proceed on a rational basis something more than this is called for. It is possible, indeed, to detect a change in emphasis in the statements now made by the more sophisticated Socialists which refer less to equality and more to planning and similar matters.

First of all, there is the claim that state ownership is necessary for the prevention of unemployment, a very superficial proposition which is discussed and rejected in Chapter 11. Next comes the argument that it will be easier for the state to determine how much of each kind of commodity should be produced and supplied to consumers if most industries are in its possession. This contention must be accepted, but it does not in itself constitute a defence of socialism unless one also accepts the dubious major premise that detailed authoritarian planning is desirable. Finally, it has been held that capitalism must go because it has lost its virility. Private enterprise, so it is claimed, is no longer enterprising, and business men are more anxious to secure a safe monopolistic position than to perform the traditional functions of the entrepreneur.

The last of these arguments appears to deserve more serious consideration than the rest — if only because the others are so poor. Indeed it may be said that the case for socialism depends in the main upon its validity. If there is good reason to suppose that public corporations will serve the public in a more satisfactory way, socialism should be supported — unless of course the materialistic gains are felt to be an insufficient recompense for the political risks which would be incurred. In so far as increased production and greater efficiency are the objectives, the crucial issue is whether or not a socialised concern will do a better job and provide a more satisfactory service to the consumer than one in private hands.

The Efficiency of British Industry

The complaints about the performance of British industry usually relate to the difficult period between the two wars when adjustments of large but uncertain magnitude were required as the old " staples " declined and new industries developed. Some of these difficulties were due to the mistakes of general economic and financial policy, such as the over-valuation of the pound in the 'twenties, which can scarcely be laid at the door of private firms ; many of them were altogether inescapable in a changing world economy. The cotton industry was bound to suffer as other countries built their own factories, and it suffered all the more because its competitors had protected home markets. British coal was threatened by the competition of alternative fuels and by rising coal production elsewhere; it is difficult to see how its sales overseas could have been maintained. The railways were clearly destined to lose traffic to the road industry unless motor vehicles had been prohibited by law. And so on. There is no need to multiply the instances so long as it is borne in mind that no industry has a right to a place in the sun. On the contrary, a number of declining industries can usually be expected in a healthy economy — a feature

which must be distinguished from a general deflationary slump.

Large structural adjustments to changing circumstances were required during the inter-war years ; and if the record of private industry is to be fairly judged, it must be recalled that substantial adjustments were in fact made and are reflected in the statistics for the composition of output and the distribution of labour. It is also true, as we have seen already, that in spite of everything total production increased substantially and would have increased still more but for the inadequate volume of monetary expenditure. Without doubt many serious blunders were made and some of these were inexcusable. But we can disregard the more extreme charges, such as the statement made by two severe critics to the effect that " if all [pre-war] inefficiency had been got rid of, this might easily have doubled or trebled the amount of goods produced ".[1] Everyone will agree that in a perfect world things would have been done a good deal better, although not everyone can pretend to have the same familiarity as these authors with the arithmetic of perfection.

If some indication is to be given of the quantitative loss due to inefficiency, a criterion of efficiency which has some practical meaning is required but is singularly difficult to devise. The best one can do is to compare the performances of different firms within an industry and to contrast the productivity of an industry in one country with its productivity in another. Mr. L. Rostas has attempted to perform both of these tasks, and although his elaborate statistics cannot be summarised in the space available here, it may be noted that output per man-hour appears to be a good deal higher in American manufacturing industries than it is in this country.[2] Indeed, the weighted average records a superiority of about $2\frac{1}{2}$ to 1. The Cotton Textile Mission

[1] M. Joseph and N. Kaldor, *Economic Reconstruction after the War*, p. 21. (How the additional raw materials, necessary for such an expansion, would have been obtained, is not explained!)

[2] *Comparative Productivity in British and American Industry.*

to the United States reported on similar lines at the end of the war, and the Reid Report on coal showed that output per man-shift was lower here than in a number of Continental countries.

It is true that unless careful attention is paid to the qualifications which beset such statistical comparisons, it is easy to draw conclusions which are sometimes false and often exaggerated. Mr. Rostas' calculations are the most comprehensive, but they relate only to manufacturing industry which employed only 25 per cent of the American and 36 per cent of the British working populations before the war; if all industries are included, then American superiority appears to have been a good deal less. Furthermore, the higher output per head in American manufacturing industry is no new phenomenon. As far back as the nineteenth century the U.S.A. appears to have been so far ahead as to make one suspect that measurements of output per worker may conceal other differences which vitiate the comparison. A country may be deemed efficient when it makes good use of all its resources; but since different countries are differently endowed, the same pattern of costs need not be expected in each case, even if all are efficiently organised. In the U.S.A. labour has been traditionally scarce, whereas land has been relatively plentiful; there was therefore a stronger incentive to use labour-saving machinery than in the United Kingdom. Manufacturing industry provides great scope for the introduction of such devices which may account both for the higher level of output per head in that group of industries in America and also for the fact that the margin of superiority is smaller over industry as a whole. Furthermore, as Mr. Rothbarth has pointed out,[1] the bias in favour of labour-saving machinery in the U.S.A. may have had institutional effects which have persisted even after land has ceased to be so plentiful.

[1] " Causes of the Superior Efficiency of U.S.A. Industry as compared with British Industry ", *Economic Journal*, September 1946.

What is needed, therefore, if sound generalisations are to be made, is a much more elaborate comparison between the two countries which would take account of all costs, not merely man-hours or man-years. For example, if raw material costs were included, the British cotton industry would make a better showing, because American methods, although economical of labour, are wasteful of yarn.[1] Capital costs should also be included — both the cost of making such goods as labour-saving machinery and the cost of waiting for a number of years while the fruits of the increased productivity made possible by the additional capital are slowly gathered. Attention should also be paid to the location of industry and to transport costs: the concentration of industry in a few large factories may raise productivity as measured at the works, but may lower it, if haulage costs are greatly increased, as measured at the points of delivery. And so on. The number of complications is dismally large and no-one has succeeded as yet in mastering them. The logical, as well as the statistical, difficulties are so formidable that one is defeated at every turn, and I do not believe that a comprehensive comparison of productivities is possible.

For these reasons it would be wrong to conclude that the statistics for output per head in an industry provide a satisfactory guide to differences in its productivity as between this country and the U.S.A. Nevertheless, the margin of superiority in favour of the U.S.A., as shown by Mr. Rostas' figures, is so big in the case of so many industries as to warrant the conclusion that the Americans are well ahead of us in the production of most manufactured articles. It is difficult to believe that their more economical use of labour is fully offset by increased costs in other directions. Apart from statistics, the comments of direct observers seem to support the same broad conclusion.

Various explanations have been offered to account for this

[1] Cf. Jewkes, " Is British Industry Inefficient? " *Manchester School*, January 1946.

apparent fact. It is sometimes held that the larger U.S. market makes possible a larger volume of production with greater economies of mass-production; but this explanation is ambiguous. In most industries of any importance the volume of output required to supply the British home market and fulfil export orders is quite large enough to permit mass-production on the most economical scale — provided the industries are organised on the right lines. It is often argued that they are not so organised and that we do not standardise enough; but this raises another question of some difficulty. Traditionally the British prefer more variety in their goods than the Americans, and although this puts up costs, it is not necessarily wrong. A standardised article is not the same "commodity" as one which is more individual; but both may be called by the same name in the Census of Production and false conclusions about efficiency drawn therefrom. Nevertheless, it is probably true that there has been too little standardisation in the manufacture of components, and reforms might be effected here without necessarily standardising the final product. (The large variety in the sizes of lamps fitted to pre-war British motor-cars is an example. The Americans had far fewer types, and it is difficult to believe that the consumer in this country would have felt any loss, or even have noticed any difference, if transatlantic practice had been followed here, in this and in similar cases.)

No doubt there are many reasons for the superior performance of U.S. manufacturing industry and the contrast can scarcely be explained by singling out only one or two, such as differences in equipment or managerial skill. In this connection it is interesting to note that the subsidiaries set up by American companies in this country and organised and equipped on American lines, do not appear to have been notably more efficient than the native concerns in the same industries. Perhaps the explanation must be sought in part in the attitude of British labour, which appears to be more restrictionist and more firmly opposed to new developments

than American labour. For example, the Cotton Textile Mission to the U.S.A. has observed that

> " American management has greater scope than British management in its utilisation of labour because of the absence of long-standing practices and conventions and because of the acceptance of labour of scientific methods to matters of work-assignment." [1]

Sometimes the opposition to new techniques may be so open as to take the form of a strike, such as the Bermondsey dock strike of November 1948. Sometimes it is more concealed and results in a tacit agreement not to make the fullest use of new equipment. The vast expenditure on equipment for the coal mines may well yield the most disappointing results for this reason, and it would be most unwise to suppose that, over industry as a whole, the introduction of more modern methods and the better training and selection of managers will suffice to raise productivity to the required extent, so long as ca' canny continues among the workers. The attitude of labour is often explained, with some plausibility, as the result of serious unemployment in the past and a consequent " fear of goods " which the workers share with the more restrictionist of the employers. But if this were the only explanation, the difference between America and Britain would remain as mysterious as ever. Nor is it true that a " full employment policy " will bring a complete cure, for the fact remains that, if output per head is raised, particular workers in particular trades may lose their jobs and be forced to look for work elsewhere. The Government may succeed in holding monetary expenditure at a satisfactory level, so that there should be plenty of work for all; but the displaced worker will find, nevertheless, that his old skill is no longer so valuable and he will have to face the hostility of the trade unions elsewhere to new entrants. Thus he has an apparent incentive to protect his monopoly position although both he and his fellows will suffer in-

[1] Report, p. ix.

evitably from such short-sighted action.[1]

What conclusions may be drawn from all this about the future of private enterprise? Socialists would be more than human if they did not welcome these criticisms of British industry. Yet it requires somewhat unusual powers of reasoning to conclude that the case for nationalisation has been strengthened in any way. The criterion by which British business men are judged and condemned is not the efficiency of socialised industries but the remarkable performance of American capitalism!

When should New Equipment be installed?

If comparisons between British and American methods were to be made, not out of academic curiosity, but as a means of obtaining some guide to future investment policy, the procedure might take the following lines. First of all, each inquiry should be confined to a specific commodity which is very similar in both countries. Next, the investigators might study the best American methods and analyse the composition of costs; and when this had been done, work out what the costs of production on such methods would be in the United Kingdom, where wages, transport costs, raw material prices, interest rates and the like may not bear the same relationship to each other as they do in the U.S.A. In this way, the cost of applying American techniques in a British environment could be calculated, at least roughly, but it would still be necessary to compare the answer with the costs which would be incurred if existing British equipment continued to be employed. This raises fresh complications and a criterion is called for which should be used

[1] "The docker", writes the *Economist*, "is ill-housed partly because of the job-safeguarding restrictive practices of brick-layers, carpenters and plumbers; his clothing is rationed and expensive because his trade-union comrades in the textile industries have objected to automatic looms; . . . his whole standard of living is held down and endangered by his country's insolvency, to the cure of which the shipping industry could make a perceptibly larger contribution but for the slow turn-round imposed by his own actions"

in considering the desirability of a new method, whether it were one suggested by foreign practice or one devised by our own technicians. An engineer may be able to demonstrate that output per worker could be increased by installing equipment of a different kind, but it does not follow, of course, that the project will be " economical ". The meaning of this slightly mysterious term has to be investigated in some detail; and when this has been done, it must be asked whether the right procedure, from the point of view of society, is likely to be observed by business men, who are primarily concerned with profits.

The new equipment should be installed if it will reduce costs per unit, and it is convenient to divide these costs into capital costs and running costs. The latter will consist of expenditure on labour, raw materials, maintenance and repairs, and in some cases there may be good reason to believe that a more modern device will result in economies under this heading. Whether total costs will be reduced is more doubtful, for capital costs must be included and these are tricky to handle. The manufacture of the new equipment will in itself impose a burden on society as well as on the firm's finances. Furthermore, this initial cost will represent a substantial lump sum, but it will be necessary to wait for several years before the benefits which the equipment has to offer have flowed in on a sufficient scale to provide some compensation. By contrast, the old equipment is already there and, from the point of view of society, its original cost is a bygone. At one time real resources were needed to produce it; but the commitment has been incurred in the past and nothing can be done about it today. The immediate problem is to make the best use of resources already available, not to add up figures from historical account books. It is true that the old equipment may still be put to alternative uses; at worst it can be broken up and used for scrap. Some current cost is therefore involved in continuing to employ it in its present use, and it is this cost,

not the original cost, which should be taken into account.

We are now in a position to say when it is economical to instal new equipment. The condition is that *the capital cost of the new* (*expressed as an annual rate*) plus *its annual running costs* should be less than *the annual running costs* on *the old* plus *an allowance for what might be obtained by disposing of the old for scrap, or for some other purpose.* I am aware that this statement of the principle is too abbreviated to bring out all the points which should be taken into account in concrete situations, but it does at least indicate the principal issues and that is all that is required here.

When this criterion is applied, it will often be sensible to retain the more old-fashioned machines to the chagrin of the technician who would like to see the latest methods, which are so clever and intriguing, supersede the old. It is not always right to denounce a firm or an industry because it has not " kept up with technical progress ". The older and shabbier equipment may be the more economical from the point of view of society; and at the present time in particular, when savings are so scarce, it is all the more important to ask whether new projects are likely to be economically as well as technically superior.

The social criterion has now been described. Is it sensible to suppose that it will be observed by private firms? What reactions may be anticipated if the existing equipment has not been fully amortised with the result that a part, at least, of its financial cost is still on the books of the firm? In the latter circumstances will the new method be neglected or suppressed?

A private firm in a strongly competitive industry may be obliged to change its equipment even although the cost of its old machines has not been fully recovered from sales. It will not be worth while producing at all for more than a very short period unless running costs can at the very least be covered; but these costs may be too high with existing equipment to allow it to compete with its more up-to-date

rivals. In such circumstances it will be obliged to modernise before long or go out of business, and that is that. It may be doubted whether a firm which enjoys a monopolistic position is likely to behave in the same way, but on closer examination it becomes clear that the rule for the maximising of profits is the same. By way of illustration, let us take the case of a firm which borrowed £100,000 five years ago for the purchase of machinery in the anticipation that this sum would be recovered from receipts over a period of ten years. A sum of £50,000 is now outstanding; but an unexpected technical development has occurred and more economical equipment can be installed. The encouraging conclusion is that it will pay the monopolist to make the change. Whatever he does — short of going bankrupt — he will have to meet the old obligation for £50,000, and his objective should be the maximisation of the profits out of which this obligation can be met. In considering his costs he need only think of those he has not yet incurred, which are: (*a*) the running costs involved in operating the old machines *plus* the sacrifice of what he could get by selling them for scrap, etc., and (*b*) the running costs with the new machines *plus* the annual capital cost which their purchase will involve. If (*b*) is smaller than (*a*) he should install the new machines and dispose of the old, because in this way he can expect to receive larger profits. Thus in following his own interest, he will satisfy the social criterion.

Strictly speaking, the latter statement must be qualified in so far as some social costs and some social gains do not appear in the account books of a private firm. To quote the usual example, the new equipment may increase the pall of smoke over an area and thus inflict a general loss on the community without involving the firm in any corresponding cost. More important is the possible divergence between public and private interest with regard to the location of industry, although the introduction of this example rather broadens the context of the discussion. Liberal economics has always recognised the need for state intervention, and in

such cases this may take various forms. Flat prohibitions may be in place occasionally but these are likely to be rare. Taxes or subsidies may introduce new items on the firm's accounts and deter or encourage as is thought fit. But this is a very different matter from simply disregarding the other costs which are common to both the private and the social calculus. In general, these qualifications do not upset the argument; and it must be added that they apply whether the industry is competitive or monopolistic. They also apply to public corporations and Government departments: the War Office or the Coal Board may attempt to embark on projects which will destroy beautiful scenery or do other damage. The public bodies concerned are likely to be pre-occupied with their own immediate concerns, and it is the proper function of Ministerial Committees to resolve conflicts of this kind.

Apart from such complications, private firms may be expected to behave in the right way; but they may lack the wherewithal to do so. If some old debt has not been fully repaid, the firm may not have sufficient resources to buy the new equipment and may have difficulty in raising fresh funds or new capital. The smaller firms will often be more seriously handicapped than the large, and the possibility of adapting financial institutions in order to improve their supply of funds should be under constant review as one part of a general policy of increasing efficiency. The banks might, perhaps, be encouraged to take greater risks in providing short-term funds, and new organisations might be used to meet the needs of the smaller firms. The Industrial and Commercial Finance Corporation was created at the end of the war with the latter object in view; and although it has not been in existence long enough to prove its mettle, it may yet fulfil an important function. This type of organisation is not, of course, entirely new; there were pre-war experiments along somewhat similar lines, and there should still be scope in this field for other enterprising finance companies, such as the Charterhouse Investment Trust.

In another way the state can help — or cease to hinder — by changing its taxation policy. Before the war the Inland Revenue permitted only very modest allowances for depreciation each year which implied a long period of amortisation. For example, the Working Party on the Boot and Shoe Industry [1] complained that firms were allowed to write off only 2 per cent of the value of factory buildings each year and even this was an improvement on pre-war — a fact which should be kept in mind when industry is condemned on the ground that its factories are often old-fashioned. In presenting his budget for 1949-50, Sir Stafford Cripps announced a further increase in the initial allowance when new capital has been purchased, a highly desirable change. For the time being the gain can be regarded as no more than an offset to the inadequacy of depreciation allowances which are based on original costs. Ultimately, moreover, the objective should be a substantial cut in the rate of tax. It requires great courage, especially on the part of the small firm, to borrow money when it is known that, at the present level of taxation, a very long period must elapse before enough can be saved out of profits to redeem a debt, which always increases the risk of bankruptcy.

Monopoly and Enterprise

When sufficient information has been collected, it will be possible for a firm to work out, on the lines indicated above, whether new methods of production are likely to be economical or not. In this way, some serious errors can be avoided but a completely accurate statement of possibilities need not of course be sought. At best, the figures can only be estimates, and no-one can say precisely how a different technique will work in practice. Furthermore, the level of future demand is always somewhat uncertain and increases the margin of error on any calculations of what is likely to prove economic. In the end a risk must be taken and it is one of

[1] P. 13.

the main functions of the business man to take such risks.

The difficulty in these matters is to preserve some kind of balance between the extravagance of the technicians and the excessive caution of the accountants. Although the danger of madcap schemes has been stressed, it is probably true on the whole to say that the bias should be in favour of change when a firm is faced with genuine uncertainty. If the approach is too cautious, the psychological consequences are likely to be unfortunate and may result in the long run in a chronic timidity and an aversion to new ventures. Conservative habits may lead ultimately to the neglect of new methods which, even on the most sober accounting basis, would appear economical. After all, the range of technical possibilities does not appear, as though by magic, before the managers. Imagination is required and is more likely to be found in the stimulating atmosphere of a venturesome firm than in one which always plumps for safety.

The importance of competition and the danger of monopoly now become apparent. If each firm in an industry is standing on its own feet and competing with the others, the more efficient are likely to force the pace. If newcomers have a reasonable chance of entering an industry, those already there will be kept on their toes. Some managers are always liable to view the possibilities before them in an irrational manner and to neglect new methods even when these would increase their profits as well as benefit society, but if the number of autonomous units is large, the danger is much reduced. Competition may act as a spur to progress, whereas the reward of monopoly may be not so much high profits as " an easy life ".

At one time the law courts were opposed to monopoly; but the attitude of the judges changed and the courts, far from penalising, were prepared to enforce monopolistic agreements before the war. With the law in this condition, some new statute was required, and the Monopolies and Restrictive Practices Act is a somewhat uncertain step in the right direction.

It may be objected that any policy of this kind is likely to prove a failure, and the experience of the U.S.A. is usually cited as proof of this statement. In fact, however, the U.S. anti-monopoly policy has been by no means without effect; it has not checked the growth of the large firm but it has done something to discourage restrictive agreements between different firms — which the British law courts have actually enforced. Moreover, it must be emphasised that until recently there was nothing like sufficient staff to enforce the American Acts. It is undoubtedly the case that " gentlemen's agreements " of one kind or another will persist, but it would be entirely wrong to suppose that there is a persistent bias in private industry in favour of restriction. There are plenty of efficient firms which wish to expand and are prepared to compete in order to do so.[1] If the text-book discussions of anti-monopoly policy give the impression sometimes that the state will have to fight against the tide, it is a useful corrective to read accounts of the historical attempts to organise industries which are full of complaints about the bias in favour of " disorderly " competition. The task of enforcing the policy might certainly prove too difficult if nothing could be done to prevent periodic deflations of great severity. For example, the slump of the 'thirties made a large part of existing capacity appear to be excessive and it was very natural that employers should have tried to combine. (For similar reasons the trade unions have long since devised all kinds of job-safeguarding rules which are restrictive in their effect.) It need scarcely be said that such methods were inadequate; the real solution lay with the state, which should have tried to maintain total monetary

[1] The frequent failure to appreciate this point may explain the belief that when a cartel fixes prices, it will always do so at a level which will permit the most inefficient firms to maintain their position in safety and comfort. Such a policy would not suit the more efficient firms and it will not be followed unless they have no power to influence decisions — which is most unlikely. The main object in fixing prices may be the prevention of " cut-throat " competition which would damage everyone, even the consumers.

demand. If this can be done in future, competition is likely to be stronger; for it is a well-known fact that monopolistic agreements tend to lapse when the flow of purchasing power is sufficient to keep most industries busy.

Little can be said here about the more specific prohibitions which might form part of a policy directed against the abuse of monopolistic power; only the following examples will be given.

(1) Perhaps the worst arrangement is that by which a cartel, *i.e.* an association of independent firms, allocates production quotas among its members. Fortunately there were only a few instances before the war, and the state itself was responsible for the most important of them.[1] To say that such practices are always wrong would be as doctrinaire as to deny any possible use under any circumstances for the analogous techniques of physical planning. Since, however, the danger of abuse is so great, all schemes of this kind should be declared illegal unless special permission has been given.

(2) Producers may form such close arrangements with distributors as to deny outlets to new competitors. It is suggested that agreements for exclusive trading should be prohibited unless they were specially sanctioned for other reasons, as they might be in the motor-car industry. It is true that some permanent link between the manufacturer and the distributor is often an advantage to the consumer, and even if exclusive agreements were outlawed, loyalty rebates might be permitted as a compromise. These rebates, however, should not be allowed to exceed a statutory maximum percentage of price.

(3) The regulations with regard to patents have often been denounced as restrictive, but the Swan Committee could

[1] The quota system enforced by the Coal Mines Acts may have done a little good in some respects but it was undoubtedly responsible for retarding the development of the more efficient pits. Thus great divergences were maintained between the productive performances of different mines, and the average was held down in this way just as much as by the slow rate of mechanisation.

find no evidence of abuse. If, nevertheless, it is felt that the danger of abuse is there, the appropriate remedy is a change in the law. The new Patents and Designs Bill, which has been introduced since the war, should meet the need.

(4) The American consumer can obtain much better advice about the qualities of different goods than the British consumer, who lives in a country where the law of libel is so ferocious that it is almost impossible to say anything. Many of the claims made in advertisements are undoubtedly misleading, and there should be some body, presumably sponsored by the state, which could advise consumers.

Measures such as these may be desirable, but at the present time by far the most important means of restoring competition and freeing the market is to abandon physical planning as soon as possible. The allocation of raw materials, etc., by means of controls is similar in its effects to the imposition of a vast cartel over almost the whole of industry. Indeed it is much worse, not only because it covers far more of industry than any cartel agreement for the distribution of quotas ever did in the past, but also because the quotas are so much more rigid. If, in one of the few industries which were organised in that way before the war, some firm produced more than its quota, it paid a fine; or it could avoid the fine by purchasing part of the quota of a firm which did not want to produce the full amount. Thus a kind of tax was imposed on the efficient firm; but although this was deplorable, it was not so restrictive as the rigid allocations made today by the state which cannot be increased except by illegal — and very expensive — means.

Physical planning also encourages the formation of private monopolies. The programme for an industry must be worked out by the Government in consultation with the industry in question. This was the procedure during the war and the same procedure is followed today. The

" industry " means the principal firms or the trade association, for it is altogether impossible to consult all the firms concerned. Furthermore, when it comes to allocations, the big firms often fare best, and the small concerns have to manage somehow as well as they can. The directors of the big firms have access to Ministers and senior officials and can in this way secure revisions and adjustments which the small business man, who would have difficulty in getting past the hall-porter in a big Ministry, need not expect.[1] Newcomers are prevented from entering an industry far more effectively than in the much-criticised " monopolistic " economy of pre-war years, and enterprise suffers accordingly. For these reasons, physical planning is bound to foster monopoly, as was clearly recognised by the Committee on Trusts in 1919.[2] The use of such methods has begun to make the United Kingdom look like a corporative state, and it is no consolation that some groups of big business men — who profess to dislike planning in theory — are by no means averse to such corporative developments as far as their own industries are concerned.

If the operation of the price mechanism is marred by the occasional abuse of monopolistic power, it is no remedy, but only an aggravation, to resort to physical planning.

The Problem of the Large Firm

According to one view, any attempt to facilitate competition is bound to fail because industry is now dominated by a few large firms which cannot be broken up without losing the economies of large-scale production. This objection

[1] It is not suggested, of course, that the Ministers and officials are biased; the big business men who see them can often present an honest and reasonable case. The trouble is that thousands of other business men can never see them at all but are at the mercy of minor officials who work according to inflexible regulations. The Trade Association may, of course, be a great help in presenting the case of the smaller firms; but it cannot deal in detail with the thousands of individual problems which would be solved on the market in a free economy.

[2] Cmd. 9236, para. 4.

holds with regard to some industries, but in general it is a gross exaggeration. In 1935 there were over 250,000 firms in the industries covered by the Census of Production and to these must be added the firms in the distributive trades, agriculture, etc. These figures are highly relevant in considering the chances of becoming one's own boss in the modern British economy; but in order to indicate the importance of large firms reference must be made to their share of total output or total employment. Mr. H. Leak and Mr. A. Maizels have made a detailed study of the information obtained in the Census of Production of 1935 and have tried to indicate "the degree of concentration" in each industry and in the census trades as a whole. No unambiguous index can be devised, but they have taken as a rough indicator the proportion of the labour force employed in the three largest "units", where "a unit" is defined as a single firm or a group of firms owned or controlled by a single company and employing 500 persons or more. ("Control" means the ownership of more than half the capital or voting power in a firm.) As one would expect, the answer varies a great deal from one industry to another; and their conclusions, which relate to 249 trades and subdivisions, may be summarised as follows:

Degree of Concentration in Different Trades	Employment in these Trades as a Percentage of the Total
Under 10	39·9
10–20	13·8
20–30	11·6
30–40	11·3
40–50	8·2
50–60	4·9
60–70	2·3
70–80	3·3
80–90	4·3
Over 90	0·4
	100·0

The weighted average of " the degree of concentration " is 26 per cent. That is a substantial figure, but it is far less than one would expect from the highly-coloured statements of the more doctrinaire Socialists which suggest that the large firms are of altogether overwhelming importance. Only 0·4 per cent of the labour force was in trades where the three big units employed over 90 per cent of the total; only about 6 per cent was in trades where the degree of concentration was above 75 per cent. Almost two-fifths worked in occupation where there was very little concentration and over a half in those where it was under 20 per cent.

An index of " concentration ", such as that calculated by Messrs. Leak and Maizels, is not an adequate index of " the degree of monopoly ". On the one hand, it takes no account of cartel arrangements between independent concerns; and, on the other hand, it does not indicate the extent to which the three largest units may compete amongst themselves. It is therefore of interest to turn to another inquiry carried out on somewhat different lines by Professor Arthur Lewis and described in a pamphlet on " Monopoly " published by the Fabian Society. He divides industries into three groups: those where the number of firms are small and their size large; those where both number and size are small; and those where there is a large number of firms. More signs of monopoly would be natural in the first group and in fact two-thirds of the numbers employed within it (or one-fifth of the total labour force) was employed by concerns with " monopoly power ". In the third group, on the other hand, which employed 57 per cent of the labour force, there was very little trace of monopoly. If the weighted average of the three is taken it works out at 29 per cent for industry as a whole. Of course the allocation of trades between the monopolised and competitive categories is bound to be somewhat arbitrary, for it is all a question of judgement and degree; but it is fair to conclude that between two-thirds and three-quarters of the workers in the

trades covered by the Census of Production were employed in competitive industries before the war. A policy directed against cartels could increase this proportion appreciably, and it may be assumed, I think, that the fraction of the labour force left over in the difficult categories is under one-fifth. In these industries the large size of the firm and the small number of undertakings required to meet demand create an *apparent* bias in favour of monopoly, although it must be repeated that the three largest firms may compete with each other, and may face competition from multi-product firms in other " industries ".

It may be held that although concentration had not proceeded so very far before the war, it is a continuing process and the importance of the big concern is likely to grow apace. This may prove to be so, but there is altogether insufficient evidence to justify any definite prediction that it must occur. On the contrary, the information available for the United States indicates that the trend in favour of size may have been checked by more recent technological reasons. There was some growth in the average size of firms over the inter-war period, but this was due almost entirely to the relative expansion of certain industries where the firms were larger than the average. Within each industry, on the other hand, there was little indication that firms were growing larger ; indeed in a good many cases average size declined. It is also worth noting that the merger movement, which seemed at one time to threaten the survival of the independent producer, was of little importance after 1929. The data are not satisfactory enough to justify detailed conclusions, but at all events there is no reason to predict that the big firm is bound to sweep all before it.

The economies of large-scale production are usually exaggerated beyond all reason in popular discussions.[1] It is true enough that costs fall for a time in most cases as output

[1] Cf., *e g.*, S. R. Dennison, " The Problem of Bigness ", *Cambridge Review*, No. 2.

is expanded, but beyond a certain point no further economies can be achieved ;[1] and at this point there may still be a substantial number of firms in the industry. The Working Party Reports did not advocate big amalgamations and huge factories for any of the industries covered. Even in the motor-car industry there is a sufficiently large total output to justify enough firms to preserve competition ; the main trouble has been the production of too many types by each individual concern and, above all, the failure to standardise components.

Some of the industrial giants have grown up because they have used their financial strength to expand, not necessarily with any sinister object in mind, but because they wanted to find scope for the investment of their savings in an industry with which they were familiar. These large firms should not be thought of as though they were simply enormous factories where production is concentrated to secure the economies of scale. They consist as a rule of a large number of factories, and managerial decisions have to be delegated to preserve efficiency. For example, the General Motors Corporation not only obliges its constituents, such as Fisher Body Division, to keep separate accounts, but allows them to buy parts outside the organisation, if they can do so more cheaply. Unless, indeed, some such arrangement is made, serious loss may result to the firm ; and since this is the case it would seem that some, at least, of the big units could be broken up if this were thought desirable. I.C.I., which consists of a very large number of concerns, could be dissolved into a number of smaller groupings without losing any of the gains of mass-production at the factory level ; although in this case, where scientific research is so important, a great deal might well be sacrificed in other respects by doing so.

[1] Cf an article by J. M. Blair of the Federal Trade Commission on the question : " Does Large Scale Enterprise Result in Lower Costs ? " *Papers and Proceedings of the Sixteenth Annual Meeting of the American Economic Association.* Also, " The Structure of Industry ", Temporary National Economic Committee, Monograph No. 27.

When a large concern in a dominating position must be accepted as inevitable, what is the right policy to follow? First, and least important, is the danger that unduly high prices may be charged. Few firms are in so secure a position as to try to exploit the market unduly, and most would not wish to do so in any case. So far as I am aware, no serious student of the subject regards abnormal profits as the most important aspect of the problem, and most would probably agree with the author of the Fabian pamphlet from which we have quoted when he says: "Whatever may be the case in other countries, most monopolies in the U.K. can be absolved of any charge of extortionate prices and profits". To this we may add that in one other country, at least, extortionate profits can be of only negligible quantitative importance. In the U.S.A. the profits of all corporations amounted to only 3 per cent of total incomes over the 'thirties. When it is recalled that a very large part of these profits was received by firms in competitive industries, and when allowance is also made for the fact that the monopolistic firms were entitled to reasonable profits themselves, the part which can be attributed to exploitation must be very small indeed — a trivial fraction of 1 per cent. Nevertheless, it seems proper that the state should have the right to investigate the accounts when a firm is in a very strong position, and the publication of the results would in itself be a deterrent to the abuse of power. In some cases it may even be appropriate for the state to fix maximum prices and thus extend the traditional policy which was applied to public utilities and railways. But the number of cases where this is likely to be necessary will be small.[1]

There is no real danger that monopolists will get away

[1] Those who are familiar with the academic literature will observe that I have made no reference to the proposition that price should be equal to short-run marginal costs. The omission seems proper in a book which tries to discuss practical affairs. Cf., however, my article entitled, "Private Enterprise and the Theory of Value", *Manchester School*, May 1948.

with profits which are an outrageous proportion of the nation's income; but there may be some danger that they will take things easy because they feel so secure. Thus we come back to the fundamental problem of ensuring that managers are kept on their toes, and in some cases domestic competition may not be strong enough to meet the need. There is no certainty, of course, that slothfulness will result; the large firms may be very vigorous and enterprising and when this is the case, there is little reason to complain about their monopolistic position. It is doubtful whether anyone would care to make a serious charge under this heading against, say, I.C.I. or Courtaulds! And since this is so, the claim that all monopolies should be nationalised can be dismissed as doctrinaire nonsense. But as a general safeguard it is always possible to subject even the large monopoly to strong competition by permitting its rivals overseas to sell on the British market. A real free-trade policy is out of the question; but in the not too distant future there could, perhaps, be less restriction of the import of goods which compete with those produced by what may, it is feared, become a slothful monopoly.

Above all, it is necessary to emphasise the importance of studying the whole problem from the point of view of a dynamic rather than a static economy. Nearly all the theoretical books [1] are sadly at fault in this respect, and much confusion has resulted from the attempt to apply their doctrines in discussing the real world. Technical progress is always changing the composition of output, challenging the position of established firms and providing opportunities for new men, with drive and ideas, to enter industry. If one's viewpoint is static, one may feel that the big firms are permanently entrenched; but it is instructive to ask where these big firms were twenty-five years ago. How

[1] The works of Professor Joseph Schumpeter constitute a notable exception. Cf., *e.g.*, *Capitalism, Socialism and Democracy*, chapter viii. More recently, Mr. P. W. S. Andrews has made a realistic and balanced survey of the problem in his *Manufacturing Business*.

many of them were small struggling concerns? How many were in existence at all? A host of new products has come on to the market — motor-cars, radios, artificial fibres, refrigerators and so on indefinitely — and has transformed the whole industrial structure. The process of concentration in the railway industry reached its peak in the 'twenties, but already the lorries were there to challenge the power of the Big Four. It is against this background that the problems of monopoly and industrial organisation should be judged, and because we have not second-sight and cannot therefore say what new technical developments lie ahead, that is no reason to suppose that the economy will lack in the future the competitive stimulus which they provide.

The facts set out above give little support to the fashionable Marxian theory that this is the age of monopoly capitalism. If any label of this kind is to be used — and all labels are misleading — it would be more appropriate to say that this is the era of the labour unions. The workers are much more closely organised than the employers, and their unions exercise much greater political power than associations of employers in this country or in the U.S.A. It is probable that the day-to-day restrictive practices of the unions are a good deal more important than those of the capitalists; and it is undoubtedly the case that there have been no instances of unpatriotic action by employers at a time of crisis to compare with those of which the dockers, in particular, have been guilty on more than one occasion in recent years. It is therefore somewhat odd that the peccadilloes of the employers can be denounced in very strong language without incurring a charge of bias; but any plain speaking about the incomparably more important misdeeds of organised labour, even when these are clearly performed at the behest of foreign agents, is liable to be dubbed reactionary propaganda. Apparently a conditioned reflex has been developed in our minds and we are scarcely aware of the fact.

Nationalisation is no Remedy

Nationalisation provides no solution to the problems discussed in the preceding sections; on the contrary, it is almost certain in every case to make matters worse.

The public corporations enjoy a degree of monopolistic power far beyond the dreams of any private firm. It may be held that this does not matter because the managers of such organisations will think only of " the public good " with minds which are free from any spot of sectional interest. If this were true it would imply that the corporations could be relied upon to adopt an attitude very different from that of the Government departments, although the latter have their Ministers who go to Cabinet meetings where general economic policy is discussed. Once more it must be repeated that the Ministry of Agriculture is concerned above all with agriculture, the War Office is concerned with the army, and so on; their attitude is essentially departmental and on the whole it is right that this should be so. If they — or the managers of public corporations — neglect their own peculiar interests because of their nebulous views about the " public good ", confusion is likely to result. It is better that each person in an executive position should be encouraged to get on with his own job and to defend the interests of his own ministry, corporation or firm. At all events, whether one likes it or not, it is clear that the big corporations view matters in much the same way as the big private monopolies. The former have no profit motive in the narrow sense and this, as we shall see in the next paragraph, is a disadvantage; but there is the same desire for power and prestige as before.

The private firm is at least subject to the discipline of the balance-sheet; but it is doubtful whether the public corporation will be, or indeed can be, subjected to control in quite the same way. It is true that the socialised industries are supposed to cover their costs, but that rule can scarcely be applied inflexibly year by year in industries, such as the iron and steel industry, which are subject to

unavoidable fluctuations in demand. If the rule is relaxed too much, slackness may result; if a stern attempt is made to insist upon its observance, this will discourage the taking of risks. In a private firm, on the other hand, profits fluctuate sharply and thus provide a needed buffer when circumstances change; but, at the same time, the anxiety of the directors to make profits, and the more ultimate danger of complete bankruptcy, mean that the obligation to cover costs cannot be disregarded in the end. In the latter case, there are both flexibility and an incentive to do well. In the former case, where there is no "equity interest", it is difficult to see how both requirements can be met, as some socialist economists have begun to realise.

Some private industries have been severely criticised in the past on the ground that their cartel organisation involved price-fixing and market-sharing, but it can scarcely be claimed that nationalisation removes this evil. The great corporations are charged with covering costs, but only for each industry as a whole;[1] there is no presumption at all that the units within each industry will be required to stand on their own feet to any greater extent than in the most cartellised industry. On the contrary, costs and receipts are likely to be pooled to an extent never known before and the whole price structure rigged in order to avoid disturbance. The railways will presumably benefit at the expense of the road industry, the inefficient mines will be carried indefinitely by the more efficient, and so on.

The principal reason for regarding with apprehension the dominating monopolistic power of some large firms is the possibility that management may grow slack without the stimulus of competition. With public ownership such fears are intensified rather than calmed. The impregnable position of the public corporation is such that the management need

[1] An exception has been made in the case of the gas industry where each of the twelve Area Boards is required to cover its costs independently. Even in this case, however, costs and receipts may be pooled within each area.

have little fear of newcomers or of private firms left in the industry. It is true that in the case of the iron and steel industry the Labour Party has been defeated by the extraordinary complexity of its connections with other industries, and in some sectors public concerns are to operate alongside private companies. But nothing can be more certain than that the state will not allow itself to be challenged in any sector where its own interests are substantial. Its private rivals, as soon as they become dangerous, may be nationalised in the same way as the motor transport industry has been nationalised to prevent it from threatening the publicly owned railways. Or if the rivals escape nationalisation, they will at least discover that their efficiency has become a " public problem " which requires for its solution such a dose of " co-ordination " as to render them harmless ever after. In general it is a great defect of publicly owned concerns that there will be strong political opposition to their bankruptcy and dissolution. What would have happened if the stage-coaches had been owned by the state and indignant M.P.s had protested continuously against the losses they were making as a result of " unco-ordinated " rail competition ?

It is not, of course, inevitable that a public corporation will rest on its oars because every serious rival is sunk as soon as it appears. Nor is it inevitable that the large private monopoly will do so. But one of the main arguments put forward in defence of socialisation is the claim that when a firm enjoys monopoly power it should be in public ownership, and it is likely to be an empty claim, unless there is good reason to believe that the new corporation will be more on its toes all the time than the private firm it has taken over. I doubt whether anyone would seriously advance so extraordinary a proposition with regard to I.C.I., which has been mentioned as a possible victim, or with regard to Courtaulds or Unilever. Even those who can swallow such a suggestion would have difficulty in showing that it

provided a firm foundation for an entire social and political philosophy.

I do not think that anyone who had an opportunity of observing events at the time will contradict the statement that the Labour Government had no clear idea in 1945 of how to run the industries which it was determined to nationalise. The socialist literature on the subject was little help to them in this respect, for although it contained much criticism of private industries — some of it pertinent enough — the sections on nationalisation said very little of substance. There was occasionally some detail about the organisation of the public corporations — a committee here and a chairman there — but no real analysis of the problems of economic operation was to be found. Nor has the position been much improved since then, if one may judge from the deplorable standard of Ministerial speeches during the debate on the Steel Bill.[1] Although I am opposed to nationalisation on political grounds, because it will weaken the basis of democracy if carried too far, I am fully prepared to admit in principle that, if attention is confined to economic considerations alone, there may sometimes be a case for taking over some industry. The case may be there but so far it has not been stated; and the more I cast about for any substantial reasons for such action the more I am at a loss to find them. In this I am not alone, and it is only right to express dismay at the prospect of a great party embarking upon a series of experiments which may affect our whole social life, without being able to offer anything which approaches to a coherent explanation of what it is trying to do.

[1] For a quietly devastating criticism of Ministerial vagueness see D. N. Chester's "Note on the Price Policy Indicated by the Nationalization Acts", *Oxford Economic Papers*, January 1950.

CHAPTER 10

INFLATION, CONTROLS AND THE FOUR-YEAR PLAN

In an economy regulated by the price mechanism, the allocation of resources between different uses is largely determined by the pull of monetary demands; and the merits of this procedure have been stressed in earlier pages. In such an economy, money is indispensable both as a medium of exchange and as a common denominator in which the values of heterogeneous goods can be set against their heterogeneous costs. But if the total volume of monetary outlay is too great, then the operation of the price mechanism may prove so unsatisfactory, whether from the point of view of efficiency or equity, that direct controls, administered by the state, may be desirable in spite of the attendant ills which their use involves.

Types of Inflation

It may be well at the outset to distinguish between the two ways in which inflation can be engendered:

(*a*) Inflation may result from excessive monetary expenditure, now sometimes described by the convenient cliché — "Too much money chasing too few goods". (See the Appendix on the Inflationary Gap.)

(*b*) The second type of inflation may be labelled a cost-price inflation. With full employment there is always a strong pressure in most industries for higher wages which, if conceded, will tend to raise prices. Furthermore, wages may be raised in expanding industries in order to attract

labour; and since trade unions are unlikely to sanction correspondingly lower wages in contracting industries, the average is slowly pushed up. Alternatively, the upward movement may start with rising prices for imported goods, and wages may follow rather than lead; more expensive imports may raise the cost of living, and demands for higher wages, leading in turn to still higher prices, may follow.

Inflation of both kinds was apparent during the war, and the interconnections between the two were so close as to make it impossible to estimate the relative importance of each. Nevertheless, the conceptual distinction is important, even in dealing with the war, and is essential in discussing peace-time problems. For although the first type of inflation may be removed, the second is likely to be a permanent feature of a " full-employment " economy.

Taxation and the Inflationary Gap

At the time of writing the inflationary gap seems to be fairly small. Whether it will remain small will depend very largely upon the validity of the usual assumption that the world is in a period of transition from war to peace. With the last conflict only a little way behind, the mental bias in favour of such a view is well-nigh irresistible; but with the passage of time, it has become unpleasantly clear that the facts are against it. It is more probable that we are in transition from one war to another, and the democratic Powers are faced once more with the terrible choice between fighting and surrendering. Even if war is avoided, this will only be because the West has built up a sufficiently overwhelming military strength to deter the Russian imperialists. In either event, the burden of armaments is bound to be heavy, and it is somewhat unrealistic to discuss present difficulties on the assumption that one is dealing with a peace-time economy. In view of Russian policy, prudence would

seem to recommend a more substantial defence programme,[1] especially in the U.S.A., which would allow the democratic Powers to prevent further encroachments in Asia as well as in Europe. Yet heavy armament expenditure may perpetuate inflation and require the retention of controls during a long period of " armed peace ". It is a bitter thought that in this way the militarists in the East, even if they do not conquer us, can make us shape our affairs according to their own mould.

As always, the democracies can be expected to do little and to do it too late. Increased expenditure on defence may not therefore be so heavy as to force our economy back on a war footing for some time, but it will be sufficiently substantial to render imperative the utmost economy in other directions.

The uncertainty with regard to military expenditure makes prediction virtually impossible, but if it were not for the possibility of an increase in this item, it would be reasonable to assume that the acute inflationary phase was over. That does not imply that the position is satisfactory. If some sort of balance has been almost achieved this has been possible only by maintaining taxation at a level which has an adverse effect on enterprise and efficiency. At the present time, 7s. 6d. is taken away by the tax-collector out of every pound

[1] There is every reason to suppose that even without any increase in the resources devoted to defence, British security could be enhanced by a more efficient use of what is already available. In general, the Labour Government has behaved as though it were under the curse of predestination. When it assumed office its members were intimidated by the Service Departments and bewildered by problems which they had tended, with the exception of Mr. Bevin, to neglect and despise. Hence the muddle over demobilisation and the disposal of surplus stores. The Government could have been assailed even more vigorously at the time, but some Tories felt that moderation was advisable because the Labour Party was likely to revert in time to its more traditional attitude, cut the Services too severely and simply disregard their needs from lack of interest. This, of course, is what has happened.

As for the U.S.A., defence expenditure on goods and services amounted to merely 5 per cent of the gross national output in 1949, and the increase contemplated for 1950 is small.

of private income, which is 3s. more than in 1938 and only 6d. less than in 1944 when the war effort was at its peak. The United Kingdom is the most heavily taxed country in the world, and while Sir Stafford Cripps is certainly right in maintaining that the burden must be borne so long as the other items in the national accounts are unchanged, the possibility of making such changes deserves close consideration. Furthermore, although the worst of the inflation may be over, the gap has not been completely closed. Some further reduction in total monetary expenditure is necessary and it should be achieved, not by a further increase in taxation, but by a cut in Government expenditure.

In deciding how far to go in applying a deflationary policy, it is salutary to reflect that the estimates of future expenditure may be wrong, and all kinds of unforeseeable events may upset a too precarious balance. A country with a serious balance-of-payments problem should try to insure against such risks of renewed inflation by deflating slightly more than would appear to be strictly necessary if the statistical estimates of future developments were not subject to a margin of error.

Finally, it is necessary to refer once more to the distinction between the two types of inflation made above. With regard to the second of these types — the cost-price inflation — it may not be true to say that the most acute phase is over, and all kinds of ominous developments may lie ahead. Some reference is made to such dangers in the present chapter, but the main discussion is to be found in the concluding section of the chapter on the British Balance of Payments.

Possible Economies

The high level of gross domestic investment [1] (£2300 million in 1949, according to plan) is one reason for desiring

[1] By " investment " is meant not the purchase of securities but the production of capital goods such as houses, factories and equipment. Both public and private expenditures are included in the figure above.

a substantial budget surplus. It may be claimed that investment has become a fetish and that productivity could be raised just as much by further restricting the expenditure on capital goods which would permit the abandonment of some remaining controls and would make possible a cut in direct taxation. This view is quite tenable and the weighing of the pros and cons presents a nice problem in practical judgement. It would certainly be a mistake to suppose that we can follow Soviet policy in these matters; for the U.S.S.R. has reduced consumption in favour of investment mainly by the use of indirect taxes, and has thus avoided to a large extent the evil consequences of high direct taxation in the form of smaller rewards for work and enterprise. With our greater regard for equity, such methods are not possible here.

If any cuts were to be made, it would probably be unwise to allow them to fall on investment in manufacturing industry as a whole, where only £450 million gross — or perhaps £200 to £250 million net after allowing for depreciation — was to be spent in 1949. Out of a total national product of about £11,000 million this does not appear to be an excessive amount for a country which must make substantial structural changes and must try, if it can, to raise the level of output per head by introducing new techniques. But it might well be possible to make some cuts elsewhere, for example in the expenditure on construction and plant for the nationalised industries, shipping and the social services which was planned to reach the disproportionately large sum of £680 million (gross). After all, a reduction of only £150 million in the budget surplus would be the equivalent of a shilling in the pound on the income tax; a cut of £200 million would be equal to the total amount of income tax paid out of wages in 1948, with all the discouraging effects which are so well known.

Apart from the expenditure on the nationalised industries, the state takes goods and services to the value of about £2000

million for its own use; it gives transfer incomes of £1300 million which are not a reward for current production but which compete for the goods and services available with those which are; finally, it grants subsidies at a cost of over £500 million. There can be little doubt that substantial economies could be made by a Government which was less wasteful in its administration, and it should also be possible to make some changes in the ill-conceived health service. On the other hand, it would be unwise to suggest that social security transfer payments, which amount to £500 million and consist largely of old-age pensions and family allowances, could be reduced. After all, it is a basic principle of Conservative as well as Labour policy that reasonable benefits should be paid to the old and to the casualties of economic life; only the Communists, who approve presumably of the abolition of unemployment pay and the stern treatment of the old in the U.S.S.R., could dispute this principle. The food subsidies are much less defensible and should never have been allowed to reach their present staggering figure; as Sir Stafford Cripps has observed, prices have "got out of all relationship with realities". But the harm has been done, and it will be difficult enough to prevent further increases, let alone make a substantial cut, without provoking more political opposition than any Government will care to face.

No attempt will be made here to examine the statistics in detail or to suggest the magnitudes of the possible economies. But it seems reasonably safe to assume that as much as £500 million could be saved by cutting both investment and state expenditure which amount together to over £6000 million;[1] and if even half that sum were devoted to the reduction of direct taxation it would be well worth while. To hope for much more would probably be foolish.

[1] The suggested figure of £500 million is in addition to the cuts announced by Mr. Attlee in the Autumn of 1949. Mr. Attlee's cuts were merely designed to check a resurgence of inflation, whereas the purpose of the cuts suggested above is to permit a reduction in taxation.

We have burdened ourselves with a heavy weight of communal expenditure and for years to come we shall have to endure the consequences. Perhaps it is possible to envisage a world where this would not matter; people would work for the fun of it and no-one would complain. But the world is not like this; and since personal consumption provides a special stimulus and satisfaction which communal consumption, however admirable in other ways, seems to lack, it is unfortunate that we should have chosen just this period in the country's history to embark upon so many ambitious schemes.

In general, it is a great mistake to give so much away free — free, that is to say, to the citizen as consumer, although the services are by no means free to the citizen as a taxpayer. Such a policy fosters extravagance on the part of both the recipients and those who administer the schemes. The principle of the shilling charge for all prescriptions should be widely extended and a larger contribution levied in such cases as the provision of spectacles, false teeth, hospital services and school books. The poor should not, of course, be expected to pay, but the number of those who are really poor is small. In 1948, the nation spent £1700 million on drink, tobacco and entertainments, a sum which was equal to four-fifths its expenditure on food. (It was also equal to ten times the net unearned incomes of the payers of surtax.) Most of this enormous expenditure was made by the working class, and it is therefore absurd to pretend that the workers must suffer frightful hardships if they are expected to contribute a little directly towards the cost of the health services and to pay slightly higher prices for food.

In any case, we have long since passed the stage when welfare schemes can be regarded primarily as a means of redistributing income between the rich and the working class. The workers themselves are heavily taxed, and the main effect of elaborate welfare schemes is to offer them something free at the expense of compelling them to do

without other things which they may prefer. The paternal attitude of the Government may, or may not, result in a better composition of outlay; but whatever is thought about that, it must be admitted that such a policy may affect people's willingness to work, especially if marginal earnings are heavily taxed, with repercussions which may, in the end, jeopardise the welfare state itself. Social welfare may ultimately be damaged, not enhanced, if the Government behaves like a fussy governess in these matters. In saying this, I do not wish for a moment to denigrate the fine ideals of the welfare state; but it is possible to move too fast, especially at a time of economic crisis.

According to a sobering article in the *Economist* [1] it will take about a quarter of a century to reduce taxation of all kinds to 5s. in the pound even if (*a*) productivity increases at 2½ per cent per annum as assumed in the Four-Year Plan and (*b*) Government expenditure does not rise above its present level. Unless there is some change in policy, this is the prospect before us for the next couple of decades — even if a large defence programme should prove to be unnecessary. As production per head increases, the country may be able to edge its way slowly out of its difficulties; but the weight of taxation in itself will slow down the rate of progress. Productivity must be accorded the leading role in any drama of recovery; yet it is not being given a reasonable chance to play its part.

The Dilemma in the Four-Year Plan

No-one can complain that the authors of the Four-Year Plan have set their sights too low.

> "Broadly speaking, this Programme provides for an expansion of output in manufacturing, mining, agriculture, building and public utilities taken together as a whole to a level of one-third above pre-war and, despite a constant

[1] March 19, 1949.

or slightly declining force, to increase manufacturing output by a quarter in the five years from 1947 to a level about 40 per cent above 1938." [1]

The expansion is certainly ambitious but it is also necessary. It need not be deemed beyond our powers, but it will only be fulfilled in conditions favourable to initiative and enterprise.

The White Paper is, indeed, a paradoxical document, and its paragraphs indirectly suggest, although they do not openly state, the dilemma with which the country appears to be faced. On the one hand, the Government sets out its " Plan " for the development of the economy over the next few years. The various industries are to expand in varying specified degrees; additions to capital are to be made at a certain rate and will be distributed in such and such a way; and so on. These programmes may be regarded as unsatisfactory in some respects; but even if they are accepted, some means must be found of enforcing them. The obvious answer is the continued use of controls, but it is a poor one. " Controls over production," say the authors of the document, " however exercised, undoubtedly restrain initiative and enterprise." The Plan depends not only on such negative measures as the prevention of extravagant imports and the like; it depends also on an increase in productivity on which it would be rash to count if there were still a barbed-wire entanglement of controls. Hence the apparent dilemma.

A detailed survey of these complicated matters is out of the question, but an attempt can be made to discuss some of the more general topics:

(1) How can the total volume of investment be held within reasonable limits and inflation prevented if controls are abolished?

[1] Cmd. 7572 (1948). The purpose of the Plan is " to achieve as soon as possible and maintain a satisfactory level of economic activity without extraordinary outside assistance ".

(2) How can the composition of investment be related to social priorities?
(3) Will it still be necessary to ration foodstuffs if the inflation has been brought under control?
(4) How can export targets be enforced?
(5) Is it true that so long as imports must be controlled directly by the state, their internal allocation must also be determined by controls?

The Control of Total Investment

It may be stated at once that an elaborate network of controls is unnecessary to restrict the volume of total investment. By and large, the iron and steel control and the regulation of building permits should suffice. Some investment might escape the net, but it would scarcely be of sufficient importance to warrant the use of scores of other controls and the employment of thousands of man-years in their enforcement. This reliance upon a couple of key controls would simplify enormously the task of administration and would be a great boon to the business man; but enterprise would still suffer to some extent from the doling out, according to more or less arbitrary rules of thumb, of supplies of steel and of building permits. There is, therefore, a strong case for investigating the other methods of preventing excessive investment.

When savings are inadequate in relation to the demand for capital goods, high rates of interest may appear to be appropriate, and the regulation in this way of the cost of borrowing was a central feature of orthodox monetary policy. The brakes were not always applied with sufficient firmness or speed to be fully effective, but the principle was there; the modern policy of keeping charges deliberately low during an inflationary period must be regarded as a major breach with the past. The arguments in favour of the cheap-money policy are familiar. It was felt that only intolerably high rates of interest would do the trick after

the war, and this would add appreciably to the burden of the national debt. Since a thorough-going dear-money policy was out of the question and controls appeared to be necessary in any case for other reasons, it was held that there was little point in raising interest rates at all.[1] (Dr. Dalton, indeed, managed for a time to reduce them during the phase of ultra-cheap money with some unfortunate consequences.[2]) In any case many firms held large cash reserves after the war and might not have been readily deflected by high rates alone from any course they wished to follow.

Whatever views may have been held on the position after the war, it is probable that the more recent tendency towards dearer money has helped to mitigate the inflation. The danger of excessive expenditure on investment is anyhow appreciably less and firms no longer hold such large reserves, with the result that a moderate increase in the cost of borrowing ought to be more effective than it would have been two or three years ago. Expenditure on consumption out of capital will be penalised and positive savings encouraged, which will reduce correspondingly the size of the budget surplus required to check inflation. The only disadvantage is a possible increase in the cost of the national debt, and this is, I think, often exaggerated.

Excessive investment might also be discouraged if it were possible to impose an indirect tax on capital goods, which would be analogous to dearer money, with the obvious difference that the cost of the national debt would not be

[1] This argument ignored the fact that a higher rate of interest would have made it less attractive to use scarce savings for very long-term projects. Cheap money has tended to distort the time-shape of investment.

[2] For discussion of this experiment the reader is referred to an article by F. Paish entitled " Cheap Money ", *Economica*, August 1947. Dr. Dalton's policy not only made borrowing cheaper but gave a bonus to anyone who wished to realise his capital whether for consumption or for business expenditure. Thus he put a greater strain on the controls which were already weakened very seriously by the abandonment of the main controls over man-power. Furthermore, while investors lost heavily when the policy was abandoned, the speculators did well out of it. Mr. Paish's comment is : " If Dr. Dalton was the rentier's enemy, he was much more the speculator's friend ".

increased. It is not easy to see how such a tax could be devised, but fortunately a similar effect could be achieved by the selective use of direct taxation. The principle of selection has been applied to the Profits Tax which falls more heavily on distributed profits (25 per cent) than on profits which are saved (10 per cent). That in itself is no reason why this otherwise unsatisfactory tax should be retained; for a similar element of discrimination could be introduced into the income tax, and the Profits Tax does not, in any case, discriminate to the right extent.

The income tax might therefore be modified in the following way:

(1) Dividends would be taxed at source at the usual standard rate of income tax, but no additional deduction should be made and the Profits Tax should be abolished. (If it is felt that unearned incomes are taxed too lightly — a doubtful proposition — income tax and surtax should be revised; but there is no reason to penalise the shareholder while the bond-holder and the landlord escape.)

(2) Undistributed profits should be divided in the proportion in which the firm has (*a*) added to its reserves and (*b*) purchased capital goods. The latter part would be taxed more severely than the former if there were inflation. Indeed the saving of funds which were not currently used should be let off lightly (say 6s. 8d. in the pound),[1] while profits spent on capital extensions should bear a weightier charge (say 9s.).

The proposal for a selective income tax must not be regarded as evidence of any hostility towards investment! It is put forward rather as a means of dealing with the *alleged* danger of a vast and inflationary increase in the expenditure on capital goods if controls were abandoned. The technique of selection might well be retained as a permanent feature

[1] The generally admitted inadequacy of the allowances for depreciation, as sanctioned by the Inland Revenue, provides an additional reason for a low rate.

of the income tax, and could be used in the opposite way in times of deflation to encourage both investment and the distribution of dividends, and to discourage additions to reserves. Although more complex, it offers a number of advantages over the present system of income tax. When there is only a single rate of tax one is always confronted with some kind of dilemma. In inflationary conditions, a high rate seems appropriate as a means of reducing consumption and withdrawing funds which might otherwise be used for investment; but a high rate leaves business with a very meagre reward for the risks it must bear, and anyhow, in so far as the tax is paid out of what would otherwise have been saved and set aside, the inflationary pressure is not reduced at all. Conversely, when monetary expenditure is tending to decline below what is needed to maintain a high level of employment, lower rates of income tax are appropriate; but again one is faced with the difficulty that a substantial part of the additional funds left behind by the tax-collector may not be put to any current use. The arrangement proposed would mitigate these difficulties.

This section may be concluded by repeating that very few direct controls are required to prevent an excessive volume of expenditure on capital goods, and the regulation of such expenditure would be very much easier if the somewhat neglected financial measures were employed. Indeed by using the latter more fully, it might prove possible to remove the remaining controls altogether unless they were required for some other purpose. Whether the control of new issues of securities would still be needed is also highly doubtful.

The Composition of Investment

One other purpose which controls are meant to serve is that of ensuring that the composition of investment is right and in accord with " social priorities ". " Social priorities " should certainly be observed, but the use of the term is too often question-begging and conveys the impression that

without the direct intervention of the state only the most haphazard allocation of expenditure would result. Yet business men do not invest for fun ; they invest because they anticipate a sufficiently strong demand from home consumers and from foreign purchasers to warrant the risking of capital by the purchase of factories and equipment. It is not, in fact, immediately obvious that the response of private firms will be in some way less satisfactory than the plans imposed from the centre. Some further analysis is required and to sharpen the issue it will be assumed that the total volume of investment has been restricted to the level consistent with the prevention of inflation. The only task is to ensure that capital outlay takes the " right " forms.

That private investment tends to reflect anticipated consumers' demand will not be regarded as an argument in its favour by the die-hard planner, in whose eyes all consumers are dolts who cannot tell what is good for them and whose wishes should count for nothing. There is a strong suggestion of totalitarianism in many of the arguments in favour of investment control, and they must be discounted accordingly. Nevertheless, the fact remains that it may be necessary, in an economy which is as badly placed as ours, to interfere, however reluctantly, with consumers' freedom. Let us try to put the argument as strongly as possible. Consumers do not understand the collective consequences of their actions, harmless though they may be when judged in isolation. At the present time, their tastes would warrant increased investment in luxury cinemas and greyhound tracks ; private firms, if permitted, would respond accordingly. Nor is this all. The ease with which different firms can finance new investment will depend upon all kinds of circumstances, many of them irrelevant from the point of view of ensuring that " priorities ", even as given by the anticipation of sales, will be observed. A large combine which wants to build another " fun-fair " may be able to get capital, whereas a new and struggling concern, whose owner

has devised some promising product for export, may have difficulty in raising the funds it needs.

It must be admitted at once that some direct controls and prohibitions are needed to deal with projects which are of little national importance at a time such as this. The building of large houses, cinemas, greyhound tracks and the like should be prohibited altogether, or permitted only by special licence; and the law should be enforced by means of drastic penalties. But examples of this kind, which feature so largely in the propaganda in favour of physical planning, are of minor importance and can be coped with easily enough. It is the allocation of investment between uses all of which are defensible which raises more serious difficulties. The procedure of physical planning is to allocate the resources required not only as between uses but even as between firms, and we have dealt with the consequences in previous chapters — the delays, the waste of man-power, the almost insuperable obstacles to the newcomer, the handicaps imposed on the more efficient firms which are prevented from using their financial strength in order to expand. The small but promising firm may be at a disadvantage under the price mechanism, as mentioned above, but it is certainly not helped by planning. Indeed, there is a strong tendency for the whole approach to be static. Not only large firms but large and obvious types of output are unduly favoured, and too much attention is usually given to the " staple industries ", although the export trade is likely to consist less and less of such goods as cotton and more of a miscellaneous range of products.[1] Moreover, if

[1] Cf. *The Times*, leading article October 16, 1948. " Apart from the basic industries, those in the development areas, and the textile industries, it is probable that others are on balance unable even fully to meet their bare replacement needs. . . . Inevitably, if the basic industry programmes and public buildings are continued on their present scale, while consumption is at least maintained, the resources available for the re-equipment of the general range of intermediate and finishing industries will not be enough to safeguard the country's industrial and economic future."

one views these matters historically, one is impressed by the number of new goods which are always over the horizon and concealed from contemporary observers. It is useless to try to predict what is coming, but it is essential to provide freedom and scope for such new developments. This country must continue to be a pioneer, and it will go ill with it if it has to wait until the official committees, which allocate resources, are convinced by the work of unregulated genius overseas that the projects are sound. If progress is permitted, it will certainly not be costless. Many projects which private business men are prepared to back would appear to be indefensible before the event if judged by the sober rules of the accountant; many will certainly prove to have been wrong after the event and capital will have been wasted. But it is by taking such risks and incurring such losses that large advances are made. It is scarcely plausible to suppose that Henry Ford or William Morris could have done what they did if their investment projects had been regulated by civil servants.

If private investment may be wrongly directed, state-controlled investment is by no means immune from such dangers. It is not at all clear that private investment, as regulated by anticipated demand, will imply a worse allocation of resources as between different industries than will planned investment. It is reasonably clear that the allocation will be better as between firms within each industry; and that is an important consideration. To say this is not to imply that an extreme *laisser-faire* position should be adopted. There is scope for co-operation between the state and industry — not the close co-operation of the controller and the big firm or the trade association, but a form of mutual assistance which may nevertheless be most beneficial. The country is faced with the need to adjust its industrial structure both rapidly and substantially in view of the terrible deterioration in its balance of payments since 1939. The future is uncertain and no-one can foresee what exactly is required; but capital goods last for a long time and the

resources available for their production are narrowly limited. The nation must give its hostages to fortune, and it is likely to fare better if differing opinions are given due weight. In its Four-Year Plan, the Labour Government set down views about the future in a way which should be some rough guide to private firms. Imports are not expected to rise much above the present level, and business men can assume with good reason that the country will have to aim at greater self-sufficiency than before the war, even if trade is subsequently regulated entirely by means of the price mechanism, including the rate of exchange. The White Paper, however, goes beyond this and indicates the proportions in which investment should be distributed between different industries, a rather more dubious step. It is true that the latter statement, although more liable to error, may also be regarded as valuable advice. The experts of the civil service have devoted a good deal of time and thought to these matters, and business should welcome any expression of opinion which they are prepared to make — provided no-one tries to pretend that the experts, whether inside or outside Whitehall, are necessarily right. In short, the Government may provide a general intelligence service on economic affairs, and if it stops at that no harm is done.

It is a different matter if the Government tries to enforce its views by allocating resources industry by industry and firm by firm. Apart from the inflexibility already stressed, it may be unwise to ride roughshod over the private managements which possess, after all, a great deal of detailed knowledge; and it is certainly dangerous, from a political point of view, for the Government to work out detailed plans in conjunction with " the leaders of industry " — the corporative technique. Even in the socialised industries, the Government would do well to leave a good deal to autonomous managers.

In any case it is by no means clear how the more elaborate plans can be enforced. When there is a strong pent-up

demand for capital goods, the state can try to determine the relative sizes of the different outlet streams by means of controls. But if investment demand is no longer excessive, such negative means of regulation may prove to be of little avail. Unless the private pattern, as determined by the decisions of thousands of managers, should prove to be roughly the same as the Government's plan, it will be found that, while the controls are restricting investment of some types, there is less private demand for others than the controls would permit and the plan prescribe. Even the managers of socialised industries may be reluctant to act according to the plan if they are also under an obligation to cover costs out of receipts.

It is suggested that this conclusion may be of some practical importance. There are, indeed, three alternatives:

(1) The state may draw up its investment programme and try to enforce it by means of controls. But such a policy not only implies that Whitehall knows best; it also presupposes chronic inflation without which such negative devices as controls will prove ineffective.
(2) When inflation has been conquered the state may do no more than express its views as to future needs and thus provide an intelligence service to private industry.
(3) The state may intervene to a greater extent than is suggested in (2) by the use of indirect taxes and subsidies.

From a moderate and realistic point of view, a combination of (2) and (3) seems to provide the proper policy for a democratic country after the worse arrears of the war have been made good. The use of direct controls may be necessary for some time after a war in order to keep investment within reasonable limits, and they can also be used to determine the composition of investment according to what is regarded as the appropriate pattern. The controls needed for this purpose, however, should be few in number, and the bewildering array maintained for several years in the United Kingdom

could not be justified with reference to investment policy. Subsequently, as inflation is gradually eliminated, direct controls will become increasingly ineffective, and the whole theory of " planned investment ", which has been enunciated with such *éclat* as one of the great new achievements of " progressive " economics, must be regarded as dangerously superficial. The theory is essentially restrictionist; and the practical means employed are only negative ones which will be of little avail unless a permanent and deliberately engendered inflation is accepted as a corollary. If the state feels that there is too little investment in some lines it must give subsidies; elsewhere, it must impose indirect taxes. The extent to which such intervention should be carried will be a matter of opinion; there would certainly be difficulties in trying to carry it very far. But the important point to stress is that such methods are consistent with the delegation, by means of the price mechanism, of all detailed decisions to the men on the spot.

The Rationing of Food

As the inflationary pressure is gradually reduced and consumers' expenditure brought into a more appropriate relationship with the value of goods available at existing prices, supply is likely to exceed demand for some commodities while it still falls short in the case of others. There are strong indications that this has begun to occur already at the time of writing. Prices will tend to fall in some cases and it must be emphasised that they should be allowed to rise in others. For by gradually abandoning price control, a powerful impetus will be given to the change in the composition of output which is required.

Foodstuffs, however, must be treated as a special case. Even if there is no general inflation, the prices at which demand would be equated to supply on a free market may be deemed too high on grounds of equity; and so long as this is so, rationing must continue. Moreover, higher prices

in this case would not have much effect in increasing supplies. The home producer already receives much more than the consumer pays, and the supply of imported foods will depend on other factors. The continued rationing of a few goods for a certain period might therefore be appropriate, even if general inflation had gone. Of course, supplies may increase very appreciably, if import prices fall and exports are maintained; we are concerned here with analysis, not prediction.

In the event, the answer will depend not only upon supplies but also upon the policy with regard to food subsidies. It is improbable, of course, that the complete abolition of subsidies, say, in 1948, would have raised all prices sufficiently to ensure equilibrium for every kind of foodstuff. For example, if the subsidies on bacon, tea, cheese and sugar had been removed at the end of 1948 each consumer would have had to pay only an extra 5½d. a week [1] on these commodities, and it is difficult to believe that with only this increase in prices there would have been enough to go round. Thus some rationing might still be necessary even if subsidies were removed — unless still greater increases in prices were contemplated. But the policy with regard to subsidies is nevertheless of great relevance. If prices were stabilised indefinitely in face of rising money incomes, then a larger increase in supplies would be needed to ensure equilibrium without rationing. The human appetite, though limited, is substantial and the scope for waste is very large.

In concluding this section it must be observed that the rationing of part of the food supplies, however irritating, is far less undesirable than the detailed regulation of industry by the state. It is the industrial controls which are the major handicap in attempting to increase efficiency.

Export Targets and Shortages

If the inflation is properly under control, consumers' outlay may not be excessive in general, but too much expenditure

[1] The *Economist*, February 19, 1949.

may be directed towards particular goods to the detriment of the export drive. Thus the regulation of total consumers' outlay may be too crude a method to be adequate, and more selective measures may be urged. The market for motor-cars provides the most striking example ; without an export target for the industry an excessively large proportion of output might be sold at home with a consequent loss of precious foreign exchange.

Such objections hold, in the main, during a period of transition and do not support the view that controls must be maintained indefinitely. As arrears are made good the position will be eased ; and if there is reason to suppose that demand will remain permanently at a high level, productive capacity should be gradually enlarged until it suffices to supply both the home and the foreign market without any centrally determined export targets. Even in the meanwhile, it is not clear that elaborate commodity controls are required to enforce the targets. At the present time, a firm which disregards its target can be penalised, in theory, by a reduction in its supplies of raw materials ; but it is doubtful whether this sanction is of great practical importance. When the idea of targets was first discussed, I think it was generally recognised that their observance would depend in the main upon moral suasion. Whatever the theory may be, it is rarely feasible to cut down the raw materials of an offender and throw his employees out of work ; prosecutions in the courts are likely to provide a better practical alternative in spite of the fact that a fine is a less serious punishment than the temporary reduction of a quota. Moreover, the pulls exerted by the domestic market can be appreciably weakened by the use of purchase tax. With regard to motor-cars, the tax has, of course, been far too low for years. It is absurd that second-hand cars should fetch more than new ones and that profiteers — including some specially favoured doctors — should make gains which ought to go into public revenue. The covenant prohibiting resale for a year and all the

elaborate attempts to enforce it make a virtue out of queueing in a case where it is inappropriate. This is equalitarianism gone mad.

It may be concluded that even if most direct controls were relaxed, it might still be desirable to prepare export targets for some industries, which would be enforced by means of moral pressure, backed by the threat of prosecution. In some cases a few simple prohibitions might be added. (For example, it might be ruled, as at present, that no high quality decorated china should be sold on the home market and any manufacturer or merchant guilty of doing so should be haled before the magistrates.) Undesirable leakages would undoubtedly take place, perhaps to a greater extent than at the present time, but in all probability the loss would be outweighed by the gains resulting from the increased efficiency throughout the economy which the abolition of direct controls would permit.

Import Controls and Domestic Controls

The reason for maintaining import controls is the belief that demand at ruling prices would otherwise exceed the supply which the country could afford to purchase. Now these prices depend partly upon the external value of the pound and have therefore been affected by depreciation. The prices of imports have been raised in terms of sterling and are now closer to the equilibrium prices which would equate supply and demand. In theory, it would be possible to continue to adjust import prices in this way, if necessary by further depreciation, until a general equilibrium had been reached and import controls were no longer necessary. But such a procedure would be attended by other disadvantages; in particular, it would probably reduce receipts from exports. In choosing the external parity of a currency, a large number of considerations must be taken into account and there is no certainty that at the parity which seems on balance most appropriate, import prices will be at a

level which makes control unnecessary.

It is true that the comments on depreciation in most text-books are not altogether relevant to the current problem; for it is usually assumed that the change in parity has been made by a country which is not already employing import controls. The possibility of a substantial decline in imports is then discussed and is held to be small in the case of the United Kingdom, whose imports consist so largely of essential foodstuffs and raw materials. A somewhat different approach is required, however, in discussing our more immediate needs. Imports have already been cut to the bone and further reductions would not be desirable in any case. Any improvement in the balance of payments resulting from depreciation will be due exclusively to greater exports, and the effect of depreciation on the demand for imports should be studied rather from the point of view of achieving more flexibility by removing import controls. The danger of such a removal would be a possible increase in imports in spite of higher prices, because at the previous prices demand was very greatly in excess of supply and might remain in excess, though to a lesser extent, after depreciation.

At the present time there is a sufficient supply of imported raw materials to maintain full employment and to provide enough food for a dull but adequate diet. Subsequently, the increase in domestic production will strengthen the position and ensure that most demands, which are so urgent as to be largely insensitive to moderate changes in prices, can be met even if imports do not rise much above 85 per cent of pre-war. In such circumstances, a large part of any additional imports which might be demanded if controls were relaxed would be in the nature of semi-luxuries; and from this follows the most important conclusion that the prospective purchasers would, in all probability, be somewhat deterred by the higher prices due to depreciation.

As always, the method of approach must be cautious and

empirical. If it is observed that the incidental consequence of a measure of depreciation, carried out primarily with regard to export markets, is a rise in import prices which makes some controls inoperative, these controls should be abolished. This condition may not be satisfied with regard to some important commodities until self-sufficiency has been further increased and until some of the more urgent demands for semi-durable goods have been met. But with the passage of time the higher prices will have a more deterrent effect; and since this is so, it is not necessary to assume that the control of imports must be a permanent feature of the British economy.

Whatever may be thought of such possibilities, the fact remains that import controls are in force at the moment and some at least are likely to remain for a time. So long as this is the case, the domestic prices which would equate supply and demand on a free market will exceed the actual import prices of some important goods; and for this reason it may appear necessary to ration out the supplies by means of internal controls among the various claimants. Thus it may seem that the domestic economy will have to be regulated while the control of imports continues — a conclusion which, if it is true, is bitter and depressing; to keep down imports we shall have to perpetuate a system which keeps down productivity! It may be that what can be gained in the former respect will be more than offset by what is lost in the latter.

Fortunately there are other alternatives. First of all, when the state is the purchaser of the imports, it need not sell them at the prices at which it buys them; it can sell them at higher prices, which will equate supply and demand, and the surplus may be added to public revenue. Should such higher prices be regarded as inappropriate, some different reason must be adduced other than the existence of import controls. Presumably the prices of imported food would not be allowed to rise to this extent; food imports are,

in fact, still sold at less than the cost of obtaining them, not more. But if there were a case for granting subsidies it would remain unaffected even if import prices were high enough to equate supply and demand, without the use of import controls. Similar considerations apply in the case of imported raw materials, such as soft-woods, which are still subject to control. If the domestic position is such that their allocation can be best determined by prices, they can be sold for what they will fetch. The determining factor is not the control of imports, but rather the general state of health of the internal economy and the special internal considerations which may apply in the case of some very scarce commodities.

Goods which are privately imported could also be sold freely; but in this case the difference between domestic prices and import prices would go into the pockets of private traders, not into the Exchequer. If the margin were large, undesirable profiteering would result, but its prevention would not require price control and allocations. The proper procedure would be to sell official import licences to the importers and thus secure the surplus profits for the Exchequer.[1]

A scheme of this kind could be applied in a variety of ways with corresponding differences in the degree of supervision maintained by the state. The licences might confer the right to import anything up to the value inserted on them

[1] A proposal to this effect has been made by Professor James Meade, former head of the Economic Section of the Cabinet Offices, in his book *Planning and the Price Mechanism*. The more traditional remedy would be a tariff, or an increase in an existing tariff, but in this case the reactions of other countries might be so hostile as to make it impossible. Oddly enough, the Charter of the International Trade Organisation, which is designed to foster liberal methods in world trade, makes it easier to use direct import controls than tariffs, although the latter are more "liberal". The sale of import licences might also be regarded as contrary to the Charter, but if so, this would be anomalous in the extreme. If the control of imports is permitted as an exception to the general rule, it would surely be absurd to insist the controls should be so employed as to have the most anti-liberal repercussions on the internal economy.

— say, £10,000 worth of whatever goods the purchaser might desire. Or the licences might be divided into different categories, some for the import of iron ore, others for the import of wood, and so on. The latter arrangement might be considered preferable for a time, with the former, which is more liberal, as a subsequent objective. In either case, it should not be particularly difficult to administer the scheme; it would, indeed, be a great simplification as compared with present methods, which involve the detailed scrutiny of demand and the doling out of individual licences to both importers and domestic users according to more or less inflexible rules. There would also be far less danger of corruption. Thus there is a strong case for the sale of licences which will become stronger still if Government purchases overseas tend to decline — as they should — and private merchants are allowed to render their expert services on a wider scale.

So much by way of a general discussion of controls. More definite and detailed suggestions as to the speed with which those still in force can be withdrawn, can scarcely be attempted here. The exact timing is bound to be a tricky matter and the Government has released far too little information to provide a satisfactory basis for informed comment. At all events, it is reassuring to reflect that it is so largely a question of timing. The economic needs of the country should not call for the indefinite use of such crude and wasteful devices as the allocation of important raw materials to every industry and firm.

CHAPTER II

UNEMPLOYMENT AND SOCIALISM

THE full employment of labour is possible only if an adequate supply of raw materials is available. By and large this condition seems to have been fulfilled in the past and the lack of jobs was due to other causes; but in post-war Britain, the position may be different. The one spell of heavy unemployment so far experienced was due not to the so-called "inherent contradictions of capitalism", which have received so much attention from some members of the Labour Party, but to the shortage of coal in the spring of 1947 which resulted from "inherent contradictions" of a different kind. Fortunately the crisis was of short duration but more ominous dangers lie ahead. The principal threat to the level of employment is likely to be an insufficient supply of imports rather than any inadequate monetary expenditure at home, which has been accorded perhaps too much emphasis in most of the recent publications on the prevention of unemployment. If it had not been for American loans and gifts there would have been serious unemployment in the United Kingdom over the past few years.

It is still necessary to emphasise these points because of the persistent tendency to regard the balance of payments as merely something which concerns the City, a tiresome financial complication which should not be allowed to prevent a Socialist Government from carrying out its progressive plans. But the fact that the figures in the balance of pay-

ments are necessarily expressed in terms of money should not obscure the basic issue, which is, indeed, quite simple. The United Kingdom is heavily dependent upon imports of food, and the bulk of her raw materials, apart from coal, must be obtained overseas. These supplies will not be forthcoming unless we offer other countries the goods they want in return. It is therefore indisputable that a high level of employment can be maintained only if the export drive proves successful. This is so not because we need to find overseas markets for surplus supplies which cannot be absorbed at home; Communist dogma only serves to confuse the issue. The reason why we need to export is because we need to import.

Some of the problems associated with the balance of payments are discussed in the next chapter. These problems need not be deemed insoluble, but there is no guarantee of success;[1] and since this is so, it may not be feasible in the event to maintain full employment. To say this does not imply that the workers must be sacrificed to some old-fashioned theory of financial orthodoxy; it implies that, whether as a result of our own failures or as a result of unfavourable developments overseas, it may prove quite impossible to obtain sufficient raw materials to keep everyone busy. It is not suggested, of course, that pessimistic anticipations are necessarily the more realistic; but it is appropriate to note, at the beginning of a chapter on employment policy, that such grave dangers may lie ahead.

Unemployment may, of course, be the result of a number of other causes apart from a shortage of raw materials, and it is with these other types of unemployment that this chapter

[1] It would be possible, of course, to balance the international accounts by making a sufficiently drastic cut in imports. That, however, is not what is meant by "solving the balance-of-payments problem". A "solution" implies that overseas sales will bring in at least enough foreign exchange to buy the food required to prevent a fall in nutritional standards and to buy enough raw materials to meet the needs of industry at "full" employment.

is primarily concerned. The remedial measures are briefly reviewed, and it is suggested that they should prove reasonably successful. But the threat of international insolvency will continue to menace the economy, and whatever action is proposed as a means of dealing with other difficulties must be reconciled with the needs of Britain's foreign trade.

The Need for Flexibility

What makes economic statesmanship so difficult is the conflict between different objectives, each of them highly desirable in itself. Nowhere is this unpleasant fact more strikingly illustrated than in the study of employment policy.

Paradoxically, the supply of imports which is essential for full employment will not be obtained if " full employment " is allowed to become a fetish. A " full employment policy " must not be taken to mean perpetual security of employment in a given firm or even in a given industry; if such an interpretation is placed upon it, the whole economy will be petrified, and the increased efficiency, upon which so much emphasis is rightly placed, will lie beyond our reach. It has been pointed out often enough that there is some conflict between security and progress, but the truth is worse than that. If it were merely a question of choosing between the relative advantages of complete security of employment, and material progress, the question would be an open one and different views might be held; but the unkind facts of economic life permit no real scope for a reflective and philosophical choice of this kind. The extreme interpretation of " full employment " to mean security in a given job must be rejected out of hand because it is self-contradictory. An economy organised according to this rigid principle would stagnate, and a stagnant economy would not be able to cope with the balance-of-payments difficulties confronting the United Kingdom at the present time; it would soon find itself short of the imports of raw

materials upon which the level of employment itself depends. Thus far greater unemployment would result from the attempt to keep employment unduly stable, and in the event far less security would be enjoyed if the search for it resulted in rigidity and stagnation.

This may appear to be a hard doctrine, but it is not so much the doctrine as the facts which are hard. The hardness, moreover, can be exaggerated. A certain amount of unemployment is unavoidable in any dynamic economy, but its magnitude need be much less than that which was experienced during the inter-war years. To make this clear the causes of unemployment, other than a shortage of raw materials, may be briefly enumerated:

(1) *Seasonal unemployment*, whether open or concealed, is to some extent unavoidable.

(2) *Frictional unemployment* is the temporary idleness of workers who are changing their jobs, whether voluntarily or because their previous employers are reducing their staffs. (If one-eighth of the labour force were out of work for four weeks in the year, this would result in about 1 per cent of unemployment.)

(3) *Structural unemployment* tends to be concentrated in a few industries and often in a few areas. It must be expected among the workers attached to an industry which is being gradually superseded in a technically progressive economy; more serious is the danger of structural unemployment in the export trades and the industries making capital goods, which are subject to marked and partly unavoidable fluctuations. Some time may elapse before displaced workers find alternative occupations; and it will be appreciated, therefore, that the structural and frictional varieties are similar in nature. The difference between them is one of degree.

(4) *Monetary unemployment* is due to inadequate monetary expenditure, *i.e.* to deflation. Most industries tend to be

affected, though not in the same degree, and all would be helped if expenditure, whether private or public, could be increased.

(5) *Concealed unemployment* is the characteristic of an over-planned economy where labour is allocated to each occupation by the state. Such allocations, as we have seen in Chapter 4, are bound to be rough and inaccurate with the result that some enterprises will have too much labour and some too little. Furthermore, there will be plenty of square pegs pushed into round holes.

Concealed unemployment is also likely to occur in conditions of acute shortage and inflation when some concerns, both private and public, will try to hold on to more labour than they can employ at the moment because they have an eye to the future.

Some attempt can now be made to discuss the magnitude of unemployment which must be regarded as an irreducible minimum. A free economy which controls inflation should be able to reduce the last category — concealed unemployment — to small dimensions. The means of preventing the fourth type, which results from deflation, will be discussed in the next section; but we may anticipate by saying that serious deflation can be prevented in spite of the fact that some mistakes are bound to be made. The first three types remain. Of these, seasonal unemployment need not be very heavy and frictional unemployment should not be large. Structural unemployment presents greater difficulties, but once more there is no reason to suppose that enormous numbers will be without work provided both the state and the trade unions adopt reasonable policies.

In *Full Employment in a Free Society* Lord Beveridge suggested that the irreducible minimum might be put at 3 per cent. That is no more than a guess, but it is reasonable to conclude that the order of magnitude is right. A much more gloomy conclusion would certainly be unavoidable if

the statements about the inter-war years which have become the stock-in-trade of the Socialist politicians were true. The notion that it was then more customary to be out of work than to have a job has acquired surprising currency, but it is not based on any study of the facts. If Lord Beveridge's 3 per cent is accepted, then it can be said that there was on the average about 11 per cent of "unnecessary unemployment" between 1921 and 1938. In other words, the economy was about 90 per cent efficient and did not fall below 80 per cent efficiency even in the bad years. If this was the record of a period when there was no serious attempt by the Government to adopt an employment policy, it is surely not too much to hope that when such a policy is enforced, the fraction unemployed should be of a very modest size — somewhere, perhaps, between 2 and 5 per cent on the average, subject to the important proviso that imports are available — although it might rise appreciably for short spells if the economy were faced with the need for sudden adjustments on a large scale. This small proportion unemployed may be regarded as the unavoidable cost of economic development. For the reasons given, any attempt to aim at more than this might defeat its own object.

It cannot be denied that some individuals are bound to suffer a certain amount of hardship. A skilled man may find that his skill is no longer required, and he will have to turn to something else. Some workers and their families may be obliged to leave their homes in order to obtain a suitable opening for the bread-winner. And so on. Economic progress is always bound to hurt someone, and perhaps one may be so unfashionable as to spare a little sympathy for the small business man or shareholder who loses his capital. But an economy so vulnerably placed as ours must move forward and we must put up with these hardships. A country dependent on foreign trade cannot stand still and yet survive; and that is all there is to it. Fortunately the hardship will be lessened by improved social security schemes and,

above all, it should be possible to prevent the prolonged unemployment, year after year, of an unfortunate minority in a depressed area. That was in my view the worst feature of unemployment before the war — much worse than the material loss. I do not believe that it need be regarded as unavoidable.

There is one final proviso which must be made. At a high level of employment there is a natural tendency for trade unions to demand higher money wages. If wages rise more rapidly than productivity, prices will be raised in turn; but trade unions take a sectional view and their leaders at the factory level have had their heads crammed with fallacious economics.

A wage-price inflation is therefore only too probable, and it has been suggested that employment must be held at a sufficiently low level to prevent this from occurring. The suggestion, it need not be said, has been denounced as outrageously reactionary, but a real difficulty cannot be solved by attaching rude labels to those who raise it. Basically it is not a choice between more employment with a wage-inflation or less employment without one. The first alternative may be possible for a time, but it is bound to result in the end in self-contradiction and defeat. For if wages rise much more rapidly than productivity, the balance of payments will become so adverse as to cause unemployment through a shortage of raw materials. Employment can only be maintained indefinitely just short of the level at which inflation begins, and it is for organised labour to determine whether the level will be high or low.

Deflation and Unemployment

If the inter-war years were made bleak by recurrent deflations, there was much welcome if belated progress in diagnosing the cause of the trouble. It has become fashionable to talk about the Keynesian Revolution in economic thought, and if the adjective is slightly misleading — for

Keynes was only the most distinguished of a large number of pioneers — the noun implies no exaggeration. The old-fashioned theories, which prescribed budgetary economy as the right specific for every deflation, have been knocked to pieces, and the "Treasury View" was officially abandoned by Mr. Churchill's Coalition Government in 1944. At the same time, the more extreme Socialists have been much discomforted by the development of a moderate economic philosophy which indicates that a more stable form of capitalism, with a high level of employment, can be regarded as a practicable and desirable alternative to the pervasive state regulation which they are wont to prescribe.

The subject is oppressively large for summary treatment, but fortunately so much has been written about it in recent years [1] that it is only necessary to recapitulate the more important points. In doing so I shall refer periodically to the White Paper on Employment Policy [2] of 1944 in which the Coalition Government accepted "as one of their primary aims and responsibilities the maintenance of a high and stable level of employment". This was the first occasion on which any such pronouncement had been made, and it must be emphasised that the Government which did so was representative of all three parties. Although the White Paper has been criticised on a number of grounds, it remains the only comprehensive statement of official policy which has appeared so far, and it must still be regarded as a state document of the greatest practical importance.

The alternation of booms and slumps is largely caused

[1] One of the most useful volumes is that published by the League of Nations under the title *Stability in the Post-War World*. See also *Prosperity and Depression*, by Haberler; *Full Employment in a Free Society*, by Beveridge; *The Conquest of Unemployment*, by Morgan; *Fiscal Policy and Business Cycles*, by Hansen; *The New Economics*, edited by S. E. Harris. The author has tried to discuss these matters at greater length in *Fluctuations in Income and Employment* and in an article entitled "A Reconsideration of the Theory of Effective Demand", *Economica*, November 1947.

[2] Cmd. 6527.

by fluctuations in the demand for capital goods, and by way of example we shall refer to the experience of the U.S.A. towards the end of the 'twenties. After a great period of activity in the building industry, the demand for new houses was temporarily sated and their production began to decline. A number of other industries had also made very large additions to their real capital — notably the motor-car industry — and although the demand for their products was still strong, the new plant and equipment were semi-durable and could sustain a constant flow of output for some time with little expenditure on replacement. In order to maintain reasonable stability in total national production, resources should have been diverted to the production of consumers' goods, and expenditure on consumption should have increased as expenditure on investment declined. A switch-over of this kind would have been difficult in any economy, but under *laisser-faire* the mechanism by which such compensatory changes can be engendered is deplorably weak. As output declined in the industries which made capital goods, the fall in the personal incomes of those attached to these industries resulted in less expenditure on consumption, not more. The industries producing goods for the consumer were also depressed, with yet further unfavourable repercussions on the demand for new capital. Thus there began a cumulative downward movement which soon involved the whole economy.[1]

There is every reason to suppose that similar difficulties will be encountered in the future in the U.S.A. and elsewhere as the intense demand for capital goods is gradually satisfied. Moreover, fluctuations in foreign trade, which are beyond the

[1] It need scarcely be said that the last paragraph is not intended to provide a proper explanation of anything so complex as the great American depression. The list of factors which have been omitted is formidable enough — the agricultural depression, the weakness of the banking system, the international complications, the Wall Street collapse and so on. For a fuller discussion cf., *e.g.*, *Fluctuations in Income and Employment*, Part II.

control of any single country, may precipitate a slump unless some compensatory policy is adopted. A fall in exports relatively to imports is analogous to a decline in home investment and will have a deflationary effect. (See Appendix on the Inflationary Gap.) For the United Kingdom in particular, overseas developments are of major importance and she has sometimes imported her depressions from abroad.

After this brief diagnosis, the familiar features of an employment policy may be recapitulated. It will be assumed, in what follows, that the nation is free to adopt whatever domestic measures seem appropriate without finding itself short of the foreign exchange required to purchase its imports. When one considers the problem of maintaining employment in the U.S.A. this assumption does not appear so unrealistic as to be lacking in interest. The additional difficulties before the United Kingdom will not be discussed here, but the policies outlined below can be regarded as appropriate even for us unless the balance of payments is so unfavourable that all hope of maintaining a high level of employment must be abandoned.

The Prevention of Mass Unemployment

It is foolish to suppose that investment can be stabilised completely, and such stability would in any case be undesirable in a progressive economy. But some important steps can be taken to prevent a sharp and catastrophic decline in total monetary expenditure ; and these consist, in the main, of the reversal of policies previously required to control inflation. If the cost of borrowing has been raised, it should now be lowered. If a selective system of income tax has been introduced, it should now be employed to encourage capital expenditure and penalise the accumulation of reserves. Experience suggests that cheap money may not always suffice because, even at very low rates, the demand for funds may be inadequate ; but a selective income tax might prove a most

powerful instrument of control.[1] Undistributed profits would be divided as before in the proportion in which the firm had (*a*) added to its real capital and (*b*) increased its financial reserves. The rate of tax levied on the former might be very low indeed, and a reduction from 9s. or so in the pound to, say, 2s. 6d. or even less, would surely provide a strong inducement to embark upon new capital projects. No conceivable lowering of interest rates could have a comparable effect. The actual assessment of the income tax could be made only after the event; but the Government could announce its intentions as soon as it felt reasonably sure that a slump was impending, and the anticipation of subsequent tax relief should call forth additional investment.

In a more direct way, the state can help by embarking upon new schemes of public investment (roads, schools, town planning and the like). The White Paper on Employment Policy lays considerable stress upon a compensatory policy of this kind, although it does not attempt to conceal the difficulties. Such projects cannot be started on a large scale without delay; nor, once started, can they be stopped immediately should industrial investment revive. There is, in any case, a limit to the volume of public investment which can be considered desirable. So much may be conceded without implying that the anti-cyclical control of such expenditure will be of little avail. On the contrary, it should be a great help, in particular to the construction trades which are liable to sharp fluctuations. The slumps of the past would have been less severe if the state had not frequently curtailed its own investment expenditure at the very time when private outlay had also contracted.

Although it may not be possible to prevent some decline in total investment, it should at least be within the power of the state to check a sympathetic decline in consumption with

[1] The White Paper on Employment Policy hinted at the possibility of granting tax rebates but did not discuss a selective tax (para. 61). (For accounting reasons it would be necessary to define net investment as the value of gross investment *less* depreciation *allowances*.)

cumulative consequences throughout the whole economy. If personal incomes are tending to fall as production and employment decline in the industries producing capital goods, taxes can be lowered and the total of net personal incomes maintained at a reasonably high level. Fortunately, taxation can be reduced quite quickly should the need arise. Indirect taxes may be slashed at once by means of an Emergency Finance Act with an immediate and substantial effect on consumption. A mere 3d. off a pint of beer would leave £60 million more in people's pockets. P.A.Y.E. is so cumbersome that a lower income tax would not take effect immediately, although the announcement of a lower rate, perhaps with retrospective remissions, would have a stimulating effect. Furthermore, the Government will have at its disposal one important, if abnormal, means of sustaining consumption at least during the first deflation of the future. At the present time, the public holds post-war credits to the value of hundreds of millions [1] and the Government can start repayment at once when consumers' demand needs a stimulus. Indeed, as the White Paper suggested (para. 72), there may be a case for reintroducing the system of the credits at a much later stage as a permanent means of providing the public with certificates during the boom period which can be cashed when deflationary tendencies appear. In these ways consumers' outlay can be stimulated, and counter-cyclical changes in its volume may be regarded as a very logical method of coping with the variations in the need for capital goods. If resources were more mobile, still greater reliance could be placed upon it, and the composition of output could be adjusted accordingly. In fact, labour is not so completely mobile and capital equipment is often specific; it is for these reasons that resort must also be had to such measures as the special encouragement of private investment and expenditure on public works of one kind

[1] The figure was almost £670 million on March 31, 1948, according to the Director of Statistics, Inland Revenue.

and another, even although an increased supply of consumer goods might well be thought more desirable.

At all events, the belief that we shall be crushed by an unavoidable deflationary pressure unless capitalism is abolished is without foundation. With taxation running at, say, £3000 million as compared with net investment of, say, £1200 million, it will be within the power of the Government to offset any decline in the latter which can possibly occur. Any deflation can be stopped and, for that matter, an inflation can be substituted readily enough! The practical test is to decide just how much should be done to preserve a tolerable stability in total monetary outlay without rushing from one extreme to the other.

It is one thing to set down on paper the main features of an employment policy, but a very different matter to put them into effect. The nation's experience of manpower budgeting, both during and since the war, should suffice to safeguard us from any facile optimism about such matters. Time is required for the collection of the statistics which serve as a guide to policy, and more time must elapse before they can be interpreted with reasonable confidence — witness the position in the U.S.A. at the end of 1948. Before the committees have deliberated and reached their conclusions a couple of months or more may have passed, and there will be a further delay before the new policies can be implemented. Only experience can tell whether, in the event, too much or too little has been done. There is no way out of these difficulties under capitalism or socialism and we must reconcile ourselves to the fact that brief spells of deflation cannot be avoided. The only alternative is to maintain total expenditure at such a high level that there is chronic inflation, with the fluctuations in investment merely affecting its intensity. But that can scarcely be regarded as a solution! It would so disrupt the export trade and reduce the supply of imported raw materials that unemployment of a different kind would soon appear.

Mild periodic deflation may be deemed inevitable, but that in itself is no reason for despair unless one insists on perfectionist standards. For it should at least be possible to avoid prolonged deflation of the pre-war variety and to prevent altogether any profound depression due to inadequate monetary outlay. What is at issue is 2 or 3 per cent more unemployment for short periods, not an extra 15 or 20 per cent for a matter of years.

There are a number of ways in which the Government can develop a fairly elaborate mechanism of forecasting future trends. In particular, it can accumulate a good deal of information about projected capital outlay at home which should be of great value in guiding its decisions. The White Paper suggested that all local authorities should be required to prepare their programmes for buildings, roads and the like for five years ahead which would then be submitted to the Central Government. The plans would be flexible and subject to constant revision, but they would at least serve as an important indication of what was on foot. Presumably this is now being done on an even more ambitious scale under the new legislation for town and country planning. In general, the Government can make reasonable forecasts of building activity, and information about projected private investment in equipment can also be obtained, at least from the larger firms. The general trend of domestic investment need not be shrouded in impenetrable mystery, and the central planners can prepare in advance to stimulate it or to increase consumption by means of lower taxes and the payment of deferred credits. In drawing up such schemes there will naturally be a strong case for benefiting the consumer who has been hard-pinched during the present inflationary phase. The Government should, and presumably will, reduce the burden of taxation as the need for a large capital programme declines and, in so far as events can be foreseen, smooth adjustments will be possible.

The possibility of some sharp and unforeseeable declines

in private domestic investment cannot, however, be excluded even in the United Kingdom, let alone the U.S.A.; but so far as this country is concerned, the main source of danger must always be the export trades. In this case the collapse may occur with alarming speed, as the result, say, of depression overseas, and will subject the new techniques of employment policy to the most severe test they are likely to undergo. Speedy action may be required to prevent a general deflation developing, and there is much to be said for the institution of some kind of automatic arrangement which will provide at least some support to the market while the more powerful remedies are under deliberation. It was with these difficulties in mind that the Coalition Government suggested the linking of social security contributions with the volume of unemployment. When the statistics recorded a rise in the number out of work, the amount required as contributions would fall at once without awaiting the outcome of committee decisions. Although the possible changes in contributions in the example given in the White Paper were so meagre as to be of little importance, the scheme itself might prove of value if more impressive alterations were made. Even without such adjustments in contributions, the payment of unemployment benefit is, of itself, of some value in sustaining demand.

If taxation is to be reduced and Government expenditure increased as a means of preventing deflation, budget surpluses will be reduced and even deficits may appear from time to time. Everyone is agreed on this point; but some concern has been expressed lest the deficits in the bad years should exceed the surpluses in the good ones, and thus cause a gradual increase in the national debt. The White Paper admitted the need for deficits, but it was laid down that "the policies proposed . . . certainly do not contemplate any departure from the principle that the Budget must be balanced over a longer period". The controversy which has centred round this point is of little immediate interest

or value. In the past the main cyclical swings have been of about eight to ten years' duration between peak and peak, and without special foresight of the events of the next twenty-five to fifty years it is impossible to tell whether there will be such a strong deflationary pressure as to require larger deficits than surpluses.[1] For practical purposes it is enough to say that the Government should take whatever action is required to sustain demand without any serious inhibitions about the national debt. To begin with, any deficits which are likely to be required for years to come will scarcely make a large addition to a debt which already stands at £25,000 million; and if their financing is handled with skill, practically no increase in interest charges should be involved. By running a deficit when private investment has declined, the state would not be depriving industry of scarce savings; nor would it be appropriate to encourage increased thrift by the offer of Government bonds on which substantial interest was paid. The Government would be halting a decline in total monetary outlay, and it should, therefore, finance its deficits by direct borrowing at negligible charges from the banks.[2]

There may be many obstacles to a full-employment policy of which a shortage of foreign exchange is likely to be the chief. But the problem of financing deficits is not one of them, and there is reason to regret the timidity with which this matter has been approached in most of the literature,

[1] Cf. Hansen, *op. cit.*; Beveridge, *op. cit.*; Terborgh, *The Bogey of Economic Maturity*, and a review of the latter by the author in the *Economic Journal* for September 1947. If there were good reason to fear such deflation there would also be other measures which might be adopted apart from deficit financing.

[2] As a technical footnote, it may be suggested that the funds should be obtained by an issue of Treasury Deposit Receipts, which the banks must accept, if required to do so, and which are not negotiable. The banks would not be in a position to complain even if interest payments on T.D.R.'s were negligible; their receipts and profits would at least be greater than if deflation were allowed to develop. There should be no question of printing large numbers of new bank-notes. What is required is not a rise in total expenditure but the prevention of a collapse.

including Lord Beveridge's *Full Employment in a Free Society.*

Structural Unemployment

Even if it were possible to stabilise the *total* volume of internal investment — and that is far too much to expect — *some* of the industries producing capital goods would still suffer from depression when the post-war boom drew to its close. Shipbuilding is an obvious example, and ultimately the building industry itself will have to be reduced in size when the great housing programme has been largely completed. We must, therefore, anticipate a certain amount of structural unemployment among the workers attached to trades such as these, and they will not be the only ones subjected to such misfortunes. Fluctuations in exports may throw substantial numbers out of work from time to time; and others may find themselves on the dole as technical developments and changing consumers' demand undermine the prosperity of their industries. The measures discussed in the previous section should prevent a decline in some industries from having a serious effect on the others according to the familiar trade-cycle pattern. But the prevention of a cumulative decline in monetary expenditure will not in itself be an adequate cure for unemployment in the particular industries initially affected. Additional measures must therefore be adopted.

In considering remedial action, it is necessary to distinguish between structural recessions which are expected to be very temporary affairs and those of a more permanent, or at all events a more prolonged, nature.

In the former case, a transfer of workers to other industries will not be particularly desirable in view of the time required for its accomplishment and the difficulty of reversing the procedure at an early date. No doubt the employers themselves will attempt to retain a large proportion of their workers and " short time " or production for

stock will help. But there is a limit to what private firms can be expected to do and, as the White Paper suggested, the Government should intervene. If the state is in the habit of purchasing some part of the output of these industries — for example, clothing for the services — it can give large orders at such a time and add to its stores. It may do more than this and accumulate stores which it does not require for its own use with the intention of selling them again. Internal " buffer stocks " of this kind may serve a useful purpose but, in general, a subsidy per unit of output, designed to stimulate current sales at home or abroad, should, I think, be preferred. The subsidy could be direct or, in some cases, it could take a more elaborate form after the model of the Stamp Plans adopted by some States in the U.S.A. towards the end of the 'thirties.[1] These plans were designed to divert additional expenditure on consumption towards foodstuffs and cotton goods. Special blue stamps worth 50 cents were given free by the authorities and could be exchanged for the surplus commodities. In order, however, to ensure that these grants did not merely result in a proportionate decline in ordinary expenditure on the goods in question, the free blue stamps could be obtained only by purchasing a dollar's worth of orange stamps which could also be used only to obtain the goods in surplus supply. (This safeguard might not, of course, have been effective, but in the event the psychological reactions appear to have been favourable.) No doubt a number of variants could be devised.

When the decline in the industry is expected to be permanent, or to last for several years, a transfer of workers should take place. Even in this case, measures of the kind described above may well be adopted as a means of easing the shock; but there is a grave danger that what should only be temporary support may be continued indefinitely and thus retard the adjustments required of a dynamic

[1] See the Report of the Secretary of Agriculture for 1940, pp. 51-4.

economy. The belief that "full employment" means complete security in a particular job has become so widespread that any Government which resorts to subsidies will have great difficulty in getting rid of them, unless there is a natural revival in the industry. If there were no pressure-groups of workers and employers, an employment policy could be conceived on bolder lines but, as it is, caution is indicated. In practice, of course, it is never possible to foresee with accuracy how temporary or how permanent a decline in demand is going to be; but it may be well to restrict the granting of subsidies to those cases where there is a strong presumption in favour of early recovery.

The White Paper discusses at some length the means by which the transfer of workers can be facilitated — training schemes in industry and in Government centres, houses to let in the reception areas, resettlement allowances and the like. The proposals are generously conceived and designed to reduce to the minimum the hardship imposed on the individual worker and his family. They should be of great assistance in facilitating the necessary adjustments; but, in a free economy, the state cannot do everything, and much will depend on the enterprise of the workers themselves and the attitude of the trade unions. The latter, in particular, have too often created unnecessary obstacles to movement by restricting the number of new entrants whom they will receive and by imposing prolonged and highly artificial periods of apprenticeship. These attitudes were explicable enough in an economy where deflation and widespread unemployment were so familiar an experience; but they will be out of place in a country which is attempting to implement an employment policy.

Geographical transfers are much more painful and may be more costly than transfers from one industry to another within the same small area. If, in some cases, the workers must move, in others it will be more appropriate to bring the work to them. For this reason the White Paper advocated

" a balanced industrial development in areas which have in the past been unduly dependent on industries specially vulnerable to unemployment ". The Labour Government (1945) tried to implement this recommendation by passing the Distribution of Industry Act and by its subsequent efforts, under the terms of the Act, to favour the building of new factories in the Development Areas. The Government was often criticised, perhaps rightly, on the ground that it was trying to do too much at the wrong time ; but, in principle, the policy can scarcely be challenged. During the post-war years, when it has been necessary in any case to regulate building directly by means of licensing, the use of controls to encourage the erection of factories in the Development Areas has been appropriate. But, if the stick has been used, it has also been necessary to offer carrots in the form of subsidies of one kind and another ; and it is, indeed, right that this should be so. For if a factory is to be erected on a less economical site, some item representing the loss should appear somewhere, and an open subsidy will help to keep the accounts straight. Subsequently, when the first phase of reconstruction is over, still more reliance will have to be placed upon the positive inducements rather than the negative restraints in order to encourage any further diversification which may be deemed desirable.

This section may be concluded by emphasising that the problem of structural unemployment will be far less acute if the general level of activity is well maintained throughout the greater part of the country. If there was heavy unemployment in South Wales in the 'thirties, there were substantial numbers without jobs even in the more prosperous areas. In such circumstances the greater mobility of workers would not have sufficed and a more comprehensive financial policy, designed to increase total national expenditure, was required. If total demand is well maintained in the future, this will be more than half the battle even with regard to structural unemployment.

The Irrelevance of Socialism

Unemployment under capitalism is usually attributed by Socialists to the fact that " production is for profit, not for use ". In a fully planned and socialised economy, so it is argued, such waste and suffering would be readily avoided ; without planning and socialism the blight will remain. As propaganda such statements are of immense value, but it may be doubted whether they are of much significance from any other point of view.

Some years ago it was fashionable to suggest that expenditure on investment at home should be controlled in some way by a Board and its flow maintained at a steady rate. There are a number of limitations to a policy of this kind, but the one which received almost exclusive attention was the possible weakness of the Board in attempting to enforce its will on private business. In view of such difficulties it was concluded that the socialisation of the major industries would help, because so much investment would then be carried out by the state itself. That such arguments, although plausible, are superficial, may be seen from a consideration of post-war events. For reasons of stability, it would have been desirable to restrict investment to very modest amounts after the war, but the investment goods themselves were urgently needed. The socialised industries have not been the most backward in seeking to replace and improve their real capital, and expenditure on housing, which constitutes a substantial part of total investment, is largely under state control. Private industrial investment itself is subject to the permission of the controllers but it has been allowed to add its contribution to the excessive volume of monetary expenditure. In short, the Government has been obliged to consider the country's more general requirements and has not been able to act as though stability were the only objective. Investment has, indeed, been restricted — perhaps too much in private manufacturing industry — but it is clear that in the post-war decade the

nation will make a very substantial addition to its capital stock; thereafter it may not be possible to maintain investment at the same proportion of national income.

The period after a great war provides a particularly striking example of such difficulties, but the problem cannot be dismissed as merely exceptional. Investment goods are semi-durable and can render service for considerable time. If substantial additions have been made to the nation's capital stock, one must anticipate a slack period in the industries producing capital goods, which will be followed by subsequent spurts as batches of equipment and buildings fall due for replacement. The whole process is made very much more complicated by technical progress, the rise of great new industries and changes in tastes at home and abroad; but without attempting any more sophisticated analysis a practical conclusion of great importance may be drawn. Even if it should prove possible, by means of compensatory policies, to prevent major cyclical fluctuations in the total national output of goods and services, some important industries which produce semi-durable goods, such as housing and ships, will experience cyclical fluctuations of their own. We may have occasion to reflect on this point over the next few years. If the demand for new ships falls off and unemployment appears, this will be adduced as an argument in favour of socialising the industry. Yet — if one may ask a question which is so rarely answered — what difference would socialisation make? Is it proposed to launch unwanted ships? Or are they to be sold at so much less than cost that there will be a demand for them? The second alternative amounts to the granting of a subsidy which could also be given to the industry if it were in private hands.

State ownership or control will not affect the position materially — unless, indeed, it is proposed to disregard some of the nation's more urgent requirements for such goods at some periods, while continuing to produce them, even if they are not needed, at others. That would be a curious

interpretation of " socialist production for use ". Of course it would all be much easier for capitalism and socialism if there were never any wars, but one has to deal with the world as it is, not with theoretical models.

The stabilisation of output in each industry, or even in the capital-goods industries as a group, is inconsistent with any reasonable interpretation of " production for use ". Something can certainly be done, as we have seen, to mitigate the severity of the fluctuations by means of subsidies, tax remissions and the timing of public investment in roads and the like. What is by no means apparent is the nature of the almost miraculous change which public ownership is to bring about. The Labour Government has paid some tribute to the desirability of balancing accounts by laying it down that each socialised industry will attempt to cover its costs. If the managers of the new corporations are to be given a chance of fulfilling this injunction, they must not be ordered to increase their capital without regard to the financial position when an increase may be inappropriate from the point of view of the industry in question. Even apart from new investment, they must not be required to maintain current production at a loss in face of falling demand merely because this would be an easy way of sustaining employment. It is true that the managers need not be expected to cover costs in every single year without exception for that would be too inflexible an arrangement ; some elasticity is required corresponding to that which is provided by profits in private industry. But if the covering of costs is to mean anything, the socialised industries must not be simply pushed around in the interests of some more general policy. Otherwise the accounts will be useless as a guide to the allocation of resources and will not serve as a check against managerial inefficiency.

The importance of such considerations may be acknowledged, but it may be objected that unemployment is a high price to pay for the fruits of sound accounting. The

objection is valid but there is a solution. If the state wishes to support production in a certain line, it should offer a subsidy per unit of output or a remission of taxation ; and such measures must not be regarded as merely an artificial tinkering with the accounts. The offer of some definite financial assistance, as proposed here, is a very different matter from giving the managers *carte blanche* by telling them to go on producing in the interests of stability whatever the accounting record may say. In the latter case, the managers will be in a similar position to business men on cost-plus contracts, with all that that implies. The former method is unquestionably the right one, and it is just the same as that which was proposed in earlier sections for a capitalist economy. Admittedly the suggestion was made subject to the qualification that unless great care were exercised, the granting of subsidies might be used too extensively and prevent desirable structural adjustments. The same qualification holds with regard to socialised undertakings, but in practice the danger of abuse will be considerably greater. Prolonged subsidies to a number of private industries might even provoke opposition ; but publicly owned concerns might be supported indefinitely because it would be more difficult politically for the state to face the indignation of the trade unions if a desirable readjustment led to some temporary unemployment. State-owned industries will not be expected to behave like that !

In addition to its attempts to reduce the instability of investment, the Government of the socialist country will have to prepare a more general financial plan. As under private enterprise, one objective is to maintain a high level of employment, but this can only be reconciled with the rulings of sound accounting if total monetary expenditure is sufficient to buy what is being produced at prices which, by and large, will cover costs. (Some firms and industries should make losses and contract, while others expand ; that is not inconsistent with the idea of a stable total outlay.)

If both inflation and deflation are to be avoided, it will be necessary to use the budget in the way discussed in previous paragraphs; and once more there is no fundamental difference between a socialist economy and a capitalist one, in which an employment policy has been adopted.

It may be claimed that the administrative problem will be easier under socialism, so that there will still be an important difference of degree, if not of kind. If all industry, so it is argued, is state-owned, then the state can foretell exactly how much is going to be spent on capital goods and how much industry is going to save. Even if this were true, personal savings and their response to changes in taxation would remain a source of some uncertainty so long as any remnant of freedom was allowed; above all, the future of exports would continue to be very much a matter of speculation. But it is not plausible, in any case, to suggest that the socialist planners can discover exactly how much expenditure on capital will take place at home. In an economy where there are thousands of undertakings, there must be a margin of uncertainty so long as any discretion is left to the managers. Only by adopting a policy of extreme centralisation, which took investment decisions out of the hands of the managers, could exact forecasts be made; and such a policy would involve new administrative difficulties of a most serious kind and result in all the waste and inefficiency of a more rigorous physical planning than any we have so far experienced. Of course it is true that the Government can obtain information about the major investment projects in a more decentralised socialist economy — but, once more, the same is true under capitalism. Any differences in the adequacy of the information obtained are likely to be slight as compared with the more chronic uncertainties of the export trade which either type of economy will have to face.

The immobility of workers will present similar difficulties under socialism as it does under capitalism. At least this is true so long as socialism makes any claim to be democratic;

it must be admitted, however, that communism offers some special advantages in these respects. To begin with, in a totalitarian state the trade unions would be under complete central control and would not be allowed to keep out new arrivals from a depressed industry. Moreover, workers would be conscripted and forcibly moved from one occupation to another when this seemed desirable, although such methods create concealed unemployment and are not as efficient as they seem. Furthermore, the abolition of unemployment pay in 1930 has put the unemployed Russian worker under a more powerful compulsion to find a new job than that experienced by his British comrade whose dole, even before the war, was worth more than the average Russian wage. In taking this step the Soviet Government declared that unemployment had been banished from its confines, and it is certainly true that mass unemployment, due to inadequate monetary expenditure, was prevented in the U.S.S.R., as it could have been prevented without revolutionary changes in the capitalist countries.[1] But structural and frictional unemployment can in no wise be avoided entirely in any progressive economy, where some factories and industries must reduce the numbers on their pay rolls if others are to find the additional hands they require. Indeed, the large turn-over of labour in the U.S.S.R. has attracted much attention and must have been accompanied by a certain amount of idleness, although it has been contrary to the " party-line " to collect the statistics. Such unemployment is likely, however, to be of short duration in a country where the unemployed receive no assistance and are liable to be conscripted if they do not find work of some kind, however uncongenial, with little delay.

[1] If the U.S.S.R. escaped the world depression she did not escape a more grievous infliction in the form of a famine which killed several million people. The famine was largely due to the confusion caused by the First Five-Year Plan.

CHAPTER 12

THE BRITISH BALANCE OF PAYMENTS

FOR generations the position of the United Kingdom as a Great Power has depended upon her foreign trade. Imports of food from overseas, which accounted for about two-thirds of her total supplies before the war, made it possible to maintain a large population at a relatively high nutritional standard in a small island. Imports of raw materials provided industry with about nine-tenths of its total requirements, apart from coal, in the early 'thirties.[1] We lacked natural resources but fortunately we possessed a skilled labour force, a vast accumulation of capital and much wisdom and experience in the management of production and the organisation of exchange. As a result of international specialisation both this country and its neighbours benefited greatly from these British assets, and it is surely a tribute to private enterprise and the price mechanism that an arrangement, so complex and mutually advantageous, was possible. The mistakes and the losses, the crises and the clash of policies normally attract far more attention than the solid gains, and perhaps rightly so, for it is the ailments which require diagnosis and remedy. When, however, our history is viewed in perspective the remarkable nature of the unplanned achievement leaves one deeply impressed and not ungrateful for the benefits conferred upon us by the " invisible hand ".

The gains were great but there was, of course, no guarantee that they would continue for ever. The United Kingdom accounted for roughly one-third of world manu-

[1] See H. S. Booker, *The Problem of Britain's Overseas Trade*, p. 30.

facturing output in 1870, but for only about one-tenth in 1938; and it was apparent that the peculiar advantages which constituted her strength might lose much of their importance in a world which was becoming steadily more industrialised. Even before the outbreak of war, the trade position was growing difficult. We were living on capital and might have been forced to make heavier drawings if there had been any marked accentuation of the tendency, apparent in the later 'thirties, for the terms of trade to become less favourable. All this was true and there were no grounds for easy complacency; but there are also no grounds for the argument sometimes encountered today to the effect that the present crisis is little more than the natural development of pre-war trends. If international specialisation had put the United Kingdom in a somewhat exposed position, private enterprise had provided her with a substantial nest-egg against the rainy day which might lie ahead. It has been estimated that British overseas investments — apart from reserves of gold and foreign currencies — amounted to some £4000 million in 1938, and it would have been possible to live on capital for a very long time at the pre-war rate. This country had advanced its neighbours the resources they needed on credit, and now that so many of them were reaching maturity, it was not necessarily unsound policy to allow some repayment of their debts. The rate at which the United Kingdom was consuming her capital might, it is true, have increased steadily, even if peace had been preserved, and a gradual adjustment of the British economy was clearly needed. Such an adjustment was indeed in progress during the inter-war years, and although there were obvious danger signs — in particular many of the rising industries were not sufficiently concerned with the export market and were, therefore, an imperfect substitute for the old declining staples — it is difficult to believe that there would have been any balance-of-payments crisis but for the two great wars. The United Kingdom, which had been

the " workshop of the world " in the nineteenth century, could no longer maintain her unique position and was bound to modify her economic structure as industries grew up overseas ; but it has been her great misfortune that the rate of change required of her has been so much accelerated by two great wars in one generation. The consequences of the first would have strained to the utmost the resilience of any economy whether planned or unplanned, socialist or capitalist. Subsequently, the drastic decline in the overseas demand for coal and cotton, which together made up one-third of our exports of commodities in 1913, was bound to dislocate the economy, create unemployment and injure the balance of payments. But we had still large assets and could at least have continued to pay our way and to buy what we required on foreign markets. The Second World War has been far more disastrous in its effects, for it has run away with so much capital that we are now obliged to carry out, in a matter of a few years, the vast reorganisation which might otherwise have been achieved in a more leisurely manner over a quarter of a century.

The bitter losses of the Second World War have been grimly recorded in so many White Papers that only a bare recital is necessary here. Apart from physical destruction and the neglected maintenance of industrial equipment, Britain's international capital account deteriorated to the extent of £4200 million. To this must be added the loss of reserves, the further sales of investments and the heavy borrowing from the United States of America and Canada to enable us to survive during the dislocation of the post-war years. So far the war and its aftermath have cost us about £6000 million in terms of lost assets and increased debts. Even when allowance has been made for changes in the value of money it remains true to say that we have been forced by German aggression to throw away in a mere six years what had been accumulated by the toil and thrift of past generations.

It is true that the war would not have cost anything like so much if Britain had been the rapacious imperialist Power which Russian agents and American innocents have always held her to be. The Empire was supposed to be governed despotically in the interests of the mother country and, if so, might have been obliged to give up what was required in the way of supplies and man-power without receiving anything in return. Even Egypt and Eire might have been forced to contribute something, and it would not have been surprising if all the countries within the British sphere of influence had found themselves in debt to their protector at the end of the war. In fact, the reverse was true; it was the United Kingdom which owed India £1100 million, the Colonies and Mandates £650 million, Egypt £400 million and Eire £179 million. Apparently there is something wrong with the usual statements about British imperialism! Although that arch-imperialist, Mr. Churchill, was Prime Minister, the overseas financial arrangements were not merely fair to other countries but erred dangerously on the side of generosity. For this, of course, we received no credit at all and were still abused with as much unreasoning vehemence as though we were behaving like Nazis or Communists. The unfortunate Europeans, who were "liberated" by the Red Army and subsequently witnessed so much of their possessions disappear across the Russian frontier, could give some instructive lectures on the real nature of imperialism to the nationalists in British territories and to the gullible American readers of Colonel McCormick's newspapers.[1]

A Russian policy would certainly have been too ruthless

[1] The comments about British imperialism are so monstrously unfair that it may be instructive to make another comparison. Both Russia and Britain were embarrassed by separatist movements in their territories during the war. When the war was over, the Kremlin meted out ferocious punishment and thousands of people were deported from the Ukraine and the Caucasus. The British Government, for its part, far from punishing the Indian nationalists, gave them independence. Even the "Tory imperialists" did not suggest that Nehru and his colleagues should be shot and all their more active supporters condemned to deportation and forced labour!

for the British conscience, and I do not wish to imply that the sterling debt incurred during the war was entirely indefensible. But it was at least twice as big as it would have been if (*a*) the financial agreements had been more reasonable, and (*b*) value for money had been received. Sir John Anderson, for example, should have revised the terms of the agreement with India, as he was fully entitled to do, because the strategic assumptions on which it was based had been made inappropriate by Japan's entry into the war. Or, to take another example, our indebtedness to Egypt was translated into sterling at the old parity in spite of the fact that the purchasing power of Egyptian currency had been greatly reduced by a steep inflation. Many more examples could be quoted from war-time experience, and unfortunately this topic is of more than historical interest. For the same weakness in financial matters has been apparent since 1945. The extraordinarily generous treatment accorded to the ungrateful Palestinians is a case in point; and more recently it has become clear that the sterling balances are being repaid far too quickly. It has always been recognised in principle that these debts should not be treated as ordinary commercial obligations and that their redemption must be very slow until the United Kingdom has regained a strong financial position. Yet in the first half of 1949, repayments were at an annual rate of over £200 million. That is to say, although there was only a small deficit on the total British balance of payments, nothing was received in return for £200 million worth of the goods and services sent overseas; herein lies an important explanation of the crisis which led to the devaluation of the pound. Before his death, Lord Keynes protested vigorously against the folly of " playing the part of Lady Bountiful with the bailiffs at the door ". (I quote from memory.) By his death, the nation lost one of the few people who might have put a stop to such folly.

The present economic position of the United Kingdom can only be understood if, in listing the causes of her

difficulties, a high place is given to the loss of effective Treasury control since 1939. One of the most important tasks which a new Government should set itself is the reform of this great Department of State, which has now fallen on such evil days. Its staff should be substantially increased, especially at the administrative level, for this is a rare Department which is not too large. It should be charged with scrutinising in much more detail the estimates of the spending departments and, above all, it should be required to keep a much tighter control over our external accounts.[1] Unfortunately, however, such reforms have no ideological appeal. A Labour Government would rather socialise the iron and steel industry than remove inefficiency in the performance of those functions which are the proper prerogative of the state. A Conservative Chancellor, for his part, might well display much the same weakness as his officials. After all, Mr. Amery was Secretary of State for India during the years when India was allowed to build up such an enormous credit at our expense, and Sir John Anderson was Chancellor.

Socialism and Foreign Trade

Apart from the repayment of debts, the loss of net income from investments overseas has called for a drastic readjustment in the British balance of payments. In 1939, about a fifth of total imports was paid for in this way; in 1948, only 3 per cent. For this and for other reasons, it is estimated that we shall have to export half as much again as we did before the war in order to obtain even four-fifths of pre-war imports. At least this volume of imports will be needed if anything like a tolerable standard of life is to be maintained, because it will still be necessary to import half the food supplies and nearly all the raw materials, apart from coal.

[1] To swing to the opposite extreme and become too niggardly, especially in dealing with the Colonies, would also, of course, be a sign of weakness.

These imports will not be obtained unless the country can offer exports in return at competitive prices. It is sometimes argued that the export drive would present no difficulties in a socialised world; other countries need British goods and would take them gladly if affairs were conducted in a more rational manner. Such arguments are foolish. There is never any difficulty in disposing of British goods—after all, they can be given away; but there may be great difficulty in exchanging them for the kind of goods which are needed in return. The countries which have such supplies to offer will not favour an exchange unless the terms are at least as advantageous as could be obtained by dealing elsewhere or by producing the goods themselves. Thus the need for ensuring that British exports were competitive would remain even in a socialist world. Much popular socialist propaganda seems to imply that in such a world other countries, many of which were poorer than Britain, would be so well disposed towards her that they would supply her with all she wanted without looking for good value in return; the British comrades would then need to exert themselves still less for still shorter hours and would receive ever-increasing real wages and enjoy ever-expanding social services!

If the discussion is conducted on a more serious plane, it is clear that the main effect of socialisation on foreign trade will be indirect. It will change the internal economy and unfortunately the change is likely to be for the worse, because nationalised undertakings, whatever other merits they may possess, seem to be lacking in just those qualities of enterprise and inventiveness which are so important to the development of a healthy export trade. In general, it is safe to assume that a socialised economy will be a good deal less flexible and responsive than one in which private firms are given a fair chance to show what they can do. These propositions are scarcely controversial, and since they have, in any case, been discussed elsewhere, the argument need not be elaborated here.

The effect of socialisation will, of course, be direct in so far as the business of buying and selling abroad is taken over by the state. Here, too, the dangers are grave and the prospect of any substantial net advantage dubious. It is true that a Ministry can engage in bulk buying, but it is doubtful whether much is gained thereby. A private firm can often economise by purchasing large quantities because small parcels are more costly to handle and transport; but such economies are exhausted when the purchases are still a small proportion of total British requirements for any important imported commodity. A Ministry can also enter into long-term contracts; but so can private firms, and such contracts were customary before the war. The length of the contracts has probably been increased since the state began to trade, which was a great advantage when world prices were rising but is now becoming a disadvantage when prices are falling; it is clearly impossible to say whether greater length will bring net gain or loss on the average over a period, and in either event the result will be largely accidental.

It is often argued in favour of bulk purchases for long periods that there is more security for the duration of the contracts. This is true; but the periods of security are punctuated by periods of extreme insecurity when the old contracts are expiring and the new ones are being negotiated. The terms on which it will be possible to obtain a vital part of the nation's supplies will remain uncertain for a time while the negotiations are in progress; and when the outcome is known, it may require sudden and highly inconvenient changes in the course of trade. These difficulties are markedly less acute when a state monopoly in one country is dealing with a number of private traders in another country; if, however, state trading has become general, vast public monopolies will confront each other, and the exchange of goods will be determined by toughness and bargaining power. Every agreement will involve political prestige, and all kinds of other issues apart from the

agreement itself will be dragged in. The recent negotiations between the United Kingdom and the Argentine provide a striking example of all the dangers mentioned above, and it is no answer to say that all would have been well if the Argentine Government had consisted of more helpful and considerate people. Some Governments will always be tough and ruthless; so will some traders for that matter, but this will be far less important when there are a substantial number of them on each side competing with each other. Furthermore, the conflicts of interest between countries which buy and countries which sell will become more open and bitter when enormous quantities of each commodity are involved, and it is a case of " take it or leave it ".

Although bulk purchases by the state may at times confer important advantages, these are likely to be outweighed by the disadvantages mentioned above. The dangers are particularly great in the case of the United Kingdom, whose negotiators too often lack the ruthlessness necessary to make a good bargain. It is paradoxical that many " progressives " should profess admiration for the trading methods of Dr. Schacht, although it is apparent that his successes were possible only because of his fiercely nationalistic attitude and his immunity from moral scruples. It is true that this country has used similar methods in a more generous way, and in the most abstract theory all countries might behave very well — just as all might disarm. In practice, if there is one method of conducting affairs which tends to emphasise nationalistic considerations and to put temptation in the way of every unscrupulous Government, it is state trading. A country such as the United Kingdom, where the instinct of national self-preservation has become so atrophied, is likely to fare ill in such a struggle. Of course she may always get a fair deal from the U.S.A. and from some of the Commonwealth nations; but even her friends may grow exasperated when they see that their own generosity is matched by successful rapacity elsewhere which British negotiators,

nurtured in the internationalistic traditions of the pre-war university, are unable to resist.

If there is nothing more than " wishful-thinking " behind the claim that socialisation will solve the problem of the British balance of payments, there is more sentiment than sense behind the suggestion that all difficulties could be avoided easily enough by relying more fully on the sterling area. Admittedly, there may be scope for much closer co-operation with the Dominions, and the possibility of achieving a customs union with some of them deserves to be explored. Everything which is economically feasible should also be done to develop the Colonies; there is no dispute on that point. Great firmness should be shown in rebutting American complaints about imperial development when such complaints are clearly unreasonable, as they often are, in view of the policies adopted by the U.S.A. herself (*e.g.* with regard to Cuban sugar).[1] All this is common ground; but the fact remains that the sterling area, which does not even include Canada, must remain heavily dependent upon supplies from outside. Much has been written on such matters, but apart from two articles by Mr. G. D. A. MacDougall,[2] I know of no serious attempt to examine quantitatively what is essentially a quantitative problem. Mr. MacDougall's conclusions are pessimistic; unfortunately it is quite clear that a self-sufficient sterling bloc with a high standard of living is out of the question. It is true that we should be forced to rely to a much greater extent upon sterling supplies if the dollar problem should prove otherwise insoluble, because, for example, the Americans refused to facilitate a more satisfactory outcome by a substantial lowering of their tariff. There may, in the event, be no

[1] It should be noted that although the International Trade Charter is hostile to large preferences in tariffs, it does not prevent the establishment of customs unions. After all, Imperial Preference was a half-hearted affair at best; a customs union with some of the Dominions would be more like the real thing.

[2] *Economic Journal*, March 1946, and *Oxford Economic Papers*, January 1949.

other course open to us, and the Americans will have themselves to blame if their exports decline very sharply. But the adverse effect on the U.S.A. would be far less than the loss which the sterling area itself would suffer; without substantial supplies from the dollar area, the British standard of living is bound to undergo a severe decline.

In any case, it would be foolish to suppose that the existence of the sterling area obviates the need to make British exports competitive with dollar supplies. After all, the sterling countries will want some kind of value for their money, unless they are browbeaten into submission; and a democratic government will always be loth to embark upon the systematic exploitation of dependent areas. (It will be recalled that the Tory " imperialists " of the inter-war years allowed a nominally dependent Government of India to sanction developments which gravely damaged the Lancashire cotton industry; while at the present time, American cars are not unknown in the Colonies. It would be easy to multiply the examples.) Indeed, some of the most enthusiastic imperialists are so far from wishing to exploit the empire that they might well exploit the mother country. Mr. Amery, for example, has no fault to find with the policy which gave India sterling balances worth £1100 million and seems quite unperturbed by the cost in terms of goods and services which repayment must involve.[1] Clearly it is not to the Tories but to the Communist imperialists we must look if the empire is to pay the greatest possible tribute. Provided they had sufficient military power, the Communists would presumably follow Russian policy and " integrate " the economies of the overseas territories with that of the United Kingdom by means of a " master plan ". The development of the Colonies would be strictly determined by the needs of the home country; they would be forced to give up as much as possible, and anything they received in return would be conceded only because it was reckoned to be a

[1] Cf., *e g., The Awakening.*

good investment from the point of view of England. Any colonial patriot who protested would find that he had become a " reactionary deviationist ", and he would undergo an informative process of " re-education " in a forced labour camp. Such policies may certainly be expected in view of the way in which Russia has treated both her own territories and the European countries behind the Iron Curtain which are under her sway. But that is scarcely a suitable model for a democratic Britain.

Free Trade and the Export Drive

It is something of a paradox that in this age of planning the international solvency of the United Kingdom should depend so much upon the possibility of achieving greater freedom in international trade. Yet this is the case for a number of reasons. The United Kingdom must increase her exports to at least 150 per cent of pre-war ; if, however, the volume of world trade in manufactures does not rise above its pre-war level, she will be able to achieve this target only by capturing and holding 30 per cent of the total as compared with 20 per cent in 1937 — a Herculean task. Yet a comparatively small increase in the volume of world trade in manufactures relatively to world consumption would transform the position. Before the war the proportion was about 10 per cent ; our exports therefore amounted to a mere 2 per cent of world consumption. If it were possible to raise world exports to 15 per cent of consumption, Britain's export target could be achieved even if her share of trade remained unchanged. She would then be supplying only 3 per cent of pre-war consumption, which does not seem a hopelessly large proportion.[1] Moreover, if trade is reasonably free, the spread of industrialisation will be far less harmful ; the international division of labour will be more economical and the old countries will have a reasonable

[1] Cf. G. D. A. MacDougall, " Britain's Foreign Trade Problem ", *Economic Journal*, March 1947.

opportunity to profit from their superiority in certain lines.

For similar reasons, convertible currencies and multilateral trade are highly desirable from the point of view of British exports; protective, bilateral and discriminatory policies elsewhere may well defeat all efforts. There is, however, a possible conflict here between different British objectives; for the United Kingdom may wish to resort to such practices herself in order to restrict imports to the level she can afford and in order to buy them from some areas rather than others. A compromise is necessary; and if retaliation and beggar-my-neighbour policies are to be avoided, some carefully prepared rules-of-the-game, to which all important countries subscribe, are highly desirable. An enlightened, and on the whole reasonably successful, attempt was made to devise such rules at the international conferences held at Bretton Woods, London, Geneva and Havana. In a small book, which is primarily concerned with domestic policy, a review of these highly technical matters cannot be attempted; but it may be said that although the agreements suffer from a number of defects, they represent a great advance as compared with the pre-war arrangements. Completely free trade is out of the question; but, if the agreements are carried out, international commerce will be liberated from many of its present shackles. Deficit countries will be permitted, however, to use protective devices in certain circumstances, in particular during the post-war period while they set their houses in order, and during any crisis which may occur as the result of a severe slump in some important trading country.

In spite of these agreements, greater freedom in world trade may remain an almost unattainable ideal unless the scarcity of dollars becomes less acute. So long as dollars are in desperately short supply, each country will be anxious not only to discriminate against dollar imports but also to protect itself in its dealings with third countries lest it should find itself burdened with debts which have to be redeemed

in dollars or gold. For this reason there is great reluctance to make currencies freely convertible, and the restrictions imposed as national safeguards actually intensify the world shortage of dollars by reducing the volume of multilateral trade. Thus there is a vicious circle to be broken, and the U.S.A. has earned more gratitude than she has received by her attempt to do so through the provision of Marshall Aid. Her obligations do not end here; there is still the American tariff to be surmounted and there is still the danger of an American slump. But among the other measures previously required was a revision of international prices designed to discourage the purchase of dollar supplies and to encourage the purchase of supplies from non-dollar areas. Depreciation was one way of bringing about such a revision and its implications will be discussed in the next section.

Competitive Exports and the Dollar Scarcity

It is officially estimated — or rather officially hoped — that productivity will increase by 2½ per cent per annum over the next few years; and it is generally agreed that great efforts will be necessary to bring this about. Yet an increase of this magnitude, even if it were achieved, might not suffice to lower the price of British exports to a substantial extent and might even fail to lower them at all. For lower costs may be offset by higher wage-rates and, to judge by recent experience, a rise of 2½ per cent in the latter is scarcely impossible. In this constant race between wages and productivity, productivity may win ultimately; but with the most sanguine assumptions it is still inconceivable that greater efficiency will bring prices down by an adequate amount. A rise of 2½ per cent in output per head, even if it were not offset at all by increased money costs, would be too slow to meet the needs of the export drive when the sellers' market had disappeared.

Since British exports can scarcely be made sufficiently competitive by increasing productivity — although this is by

far the most desirable method — it has been necessary to adopt the more painful remedy of depreciating the pound. The consideration of this step can only be extremely brief in the present context, and many highly technical issues must be ignored; it will be possible to do no more than touch upon the more important implications.

Depreciation will reduce the amount of foreign exchange obtained for each unit of exports, and total receipts from exports will therefore be lowered, not raised, unless the physical volume of sales goes up in proportion to the decline in export prices. Whether or not increased sales will be possible will depend upon the responsiveness of foreign markets to lower British prices and upon Britain's ability to provide the additional goods. It would have been foolish to depreciate the pound during the war or even immediately after the war; British sales overseas were limited, not by high British prices, but by the volume of supplies which could be provided. Thus so long as it was possible to sell all that was available a lower value for the pound would have involved the country in pointless loss; but those conditions now appear to have passed.

With such considerations in mind, it may be asked whether depreciation is likely to solve the dollar problem. Unfortunately no unequivocal answer can be given. To begin with, it is clear that dollars may be scarce for two main reasons:

(1) The nations outside the dollar area may need to live for a time beyond their incomes until the more urgent needs of reconstruction have been met. To quote from the Report of the International Monetary Fund for 1948: "The countries which have been devastated by the war cannot be expected to balance their international payments at once, and no exchange depreciation, however severe, would achieve such a balance at a tolerable level of imports".

(2) Dollars may remain scarce after production has largely recovered because the additional goods which are now available are too expensive, at the ruling rates of exchange, to compete with U.S. goods, whether inside the U.S.A. itself or in other markets. This reason for scarcity may be fairly termed artificial and a readjustment of exchange rates regarded as an appropriate remedy.

The first reason for scarcity has probably been the more important since the end of the war, but the significance of the second has increased markedly over the years 1948 and 1949. There is no reason why both causes should not be present to some extent at the same time, and it is still true that Western Europe could not solve its problems entirely by means of depreciation. A sufficient volume of goods could scarcely be provided until more time had elapsed for structural adjustments, and an immediate reduction in dollar imports by the amount needed to close the gap would have disastrous results. Hence the need for Marshall Aid. All this may be undeniable; but the fact remains that Europe should earn what dollars it can, and to this end depreciation will be a help provided the domestic position in the European countries has improved sufficiently to permit a substantial increase in exports.

Depreciation may assist in various ways, but it is by no means certain that it will result in a satisfactorily large increase in direct sales to the U.S.A. Admittedly the possibility of achieving such an increase is often dismissed too abruptly and for the wrong reasons. In particular, it should not be concluded that because the U.S.A. is a great manufacturing country, her people can derive no benefit from the import of manufactures. Nor is the pessimistic argument made unassailable by pointing out that most manufactured goods can be produced with fewer man-hours in the U.S.A. Goods are exchanged, not in terms of man-hours, but in terms of prices; and higher U.S. money-wages, as converted

at the rate of exchange after depreciation, may offset the effect on prices of superior productivity. This does not imply, of course, that the U.S.A. will suffer from an unfair disadvantage as a result of the depreciation of other countries' currencies; her standard of life will be raised, not lowered, if she buys in the cheapest markets and thus imports those goods in the production of which her superiority is least marked. Nor is it true that the increased volume of U.S. imports necessary to solve the European dollar problem would so flood her market with goods as to precipitate an unavoidable slump; the total dollar deficit of the sterling area, including the United Kingdom, amounted to less than 1 per cent of U.S. consumption in the first half of 1949. Furthermore, since the required increase in imports would constitute such a small proportion of total supplies, American purchasers might be expected to respond to the lower prices made possible by depreciation.

The real difficulties lie elsewhere and they are undeniably formidable. The American tariff is the most obvious one; in the case of many commodities it is so high that an impossibly large depreciation of the exporters' currencies would be necessary to make their goods competitive. No doubt the American public would gain from lower tariffs, but the possible gain is not so obviously large as to create a strong pressure against the vested interests behind the tariffs. (For the same reason, the spread of industrialisation elsewhere is likely to damage British trade in practice, if not in theory. The only hope is a series of mutually beneficial international agreements for the reduction of tariffs.) In such circumstances, it is fortunate for the rest of the world that the U.S. Administration should have declared its support for Cordell Hull's policy of greater freedom in world trade. If progress has been slow so far in dealing with the U.S. tariff, it is at least something that the U.S.A. cannot make an extensive use of quotas without abandoning completely the policies previously supported at a number of recent conferences. Furthermore,

it is significant that some groups of American business men have come to doubt the wisdom of a high tariff — if one may judge from statements made by their organisations. A change in attitude is, of course, long overdue for reasons of enlightened self-interest. If the tariff remains high, the U.S.A. will be able to maintain the volume of her exports only by giving part of them away, as she is doing at the moment in the form of Marshall Aid. If the tariff remains and Marshall Aid comes to an end, other countries will have no choice but to cut down their dollar imports with the utmost severity; the consequences will be most unpleasant for them, but the U.S.A. will also suffer both economically and politically. In some American industries the effect will be particularly adverse, and if there are vested interests behind the tariff, there are also vested interests in favour of freer trade.

Private restrictive practices are a further obstacle in addition to the tariff and may deny importers the necessary retail outlets for their goods; whether the anti-trust legislation will be used effectively to prevent such action remains to be seen. The American consumers themselves may show some resistance to increased purchases, especially in those lines where the proportion of required imports to consumption is much higher than the average figure for total quantities; favourable prices may overcome this conservatism, and it is probably not so important in any case as the fact that many Americans — perhaps the majority — have little chance of buying imported manufactures for the familiar reason that the marketing methods of the importers are so poor. The final difficulty to note is the danger of a U.S. depression; if this should occur, all attempts to increase sales to America would probably be frustrated, and it seems inevitable that other countries would be dragged into sympathetic depression, unless the U.S. Government decided to maintain dollar exports at all costs by offering still larger gifts to foreigners.

Whether there will in fact be any substantial increase in the value of sales to the U.S.A. as a result of depreciation and other measures is anyone's guess. Given time, the position may become easier as exporters learn more about their job and, given time, the U.S. tariff may be reduced. Provided there is no heavy deflation in the States there may be some ground for optimism, but that is about as far as anyone can go. Fortunately, however, the effects of depreciation will not be confined to U.S. purchases. Perhaps more important will be the tendency for U.S. exports to decline relatively to the exports of other countries, including Britain, which have depreciated. In this way the world demand for dollars will be reduced and the general deficit gradually eliminated. To revert to the argument developed in an earlier paragraph, a scarcity of dollars which persisted after post-war reconstruction had been completed would be artificial. It would indicate that at ruling exchange rates U.S. goods were too cheap, and parities should be adjusted to obtain some kind of equilibrium. It remains to be seen whether the recent changes in exchange rates will suffice to prevent an artificial dollar scarcity of this kind ; at all events, some such change was clearly appropriate in order to reduce the attractiveness of dollar purchases and to encourage non-dollar countries to buy more from one another. The benefits resulting from such developments will not, however, accrue to anything like the full extent until there is greater convertibility of currencies — that is to say, until the price mechanism is allowed to operate more freely. The problem of convertibility is too technical, however, to be discussed in short space and must be set aside, together with the other highly important problem of increasing international investment.

Enough has been said about the difficulties. In the event, the adjustment of exchange rates may do little good and there may be no further progress in removing the barriers to world trade. If so, it will be clear that a large population

can no longer be supported in these small islands at a tolerable standard of life, and Britain's days as a Great Power will be over. For there is no other way out, and it does not help in the least to pretend that there is. To recognise this unpleasant fact and to reject the illusions of both the Socialists and the sentimental imperialists should not be regarded as an admission of defeat, any more than was the War Cabinet's realistic appreciation of the state of the defences in 1940. There is still a fighting chance. Many of the most crucial issues can only be settled internationally and not by Britain alone; but Britain can take the initiative more boldly in international negotiations, and above all, she can set her internal affairs in order.

At such a time of crisis it is most undesirable that the country should be governed by a group of tired Ministers advised by a group of tired civil servants. (I refer, of course, to the higher-grade civil servants who are as much overworked as the clerical grades are often under-worked.) It is all the more unfortunate when such exhaustion has been partly unnecessary and has been caused by much overelaborate planning and pointless nationalisation. It is surely an unflattering comment on Mr. Attlee's sense of proportion that at such a time he should be so interested in the Iron and Steel Act and the Parliament Act and so determined to push through his doctrinaire policy, even at the cost of making everyone concerned still more tired and still more incapable of showing the imagination and vigour which are so badly needed to save the country from complete disaster. Even those who believe that the nationalisation of the iron and steel industry will benefit the country in the long run cannot pretend that it will contribute at all towards the solution of our present difficulties. It may therefore be thought surprising that the Labour leaders should display such stubbornness, the more so in view of the severe moral standards by which they are wont to judge their opponents.

One of the first of the real tasks is, of course, to raise productivity. In an earlier paragraph it was argued that no practicable increase in productivity would lower prices sufficiently to maintain sales on a buyers' market, and for this reason depreciation seemed appropriate. That will not, I hope, be taken to imply any indifference towards the importance of raising productivity! The hardship involved in achieving solvency will be all the less if output per head can be increased; indeed it is possible that the additional exports and the additional substitutes for imports could be provided with little decline in the standard of living, if a serious attempt were made to produce as much as possible in a reasonable day's work instead of aiming at a mediocre norm. Increased productivity, even if it does not lower domestic costs in terms of money, is clearly essential if an adequate flow of exports is to be provided and full advantage taken of the benefits of depreciation.

If productivity is important, so is flexibility. It is not merely a question of producing more per head on the average over industry as a whole — the objective usually stressed — but of adjusting the composition of output in order to produce the right things. This statement may be regarded as so true as to verge on the platitudinous, but the implications for the welfare state may be resisted in practice. As we have seen in Chapter 11, some structural unemployment is unavoidable but it will lead to much discontent. In such circumstances, the Labour spokesmen, intent on propaganda, are rendering a poor service to the nation and even, in the long run, to their party, by attempting to increase the confusion between temporary idleness of this kind and mass unemployment. One of the principal reasons for advocating flexibility, even at the cost of a little unemployment, is because a fossilised British economy would shortly experience real mass unemployment on a very heavy scale; it would be unable to buy the imports needed to keep people at work.

Depreciation and the Wage-inflation

There is no painless way of achieving solvency in the balance of payments. But the pain is likely to be less if the value of exports is increased by means of depreciation than it would be if the deficit were closed by means of a drastic curtailment of imports. Unfortunately, however, depreciation operates in such a way as to provoke strong opposition to the adjustments required. It raises the prices of imports, and whereas people will submit with great humility to the hardships imposed by direct controls, they tend to be extremely sensitive even to minor hardships when brought about by higher prices. They seem to act as though they preferred a smaller volume of imports at stable prices to a higher volume at higher prices. Thus the trade unions will put up with severe cuts administered by the controllers, but they may tend to react against depreciation by demanding higher wages.

It is too early to say whether the advantages of depreciation will be lost as the result of a wage-inflation. At all events it is sound policy to try to cushion the effect on the cost of living by using any stocks which may be available and to try to postpone the granting of wage increases. It is extremely important to gain time. The quantitative importance of the rise in the cost of living is likely to be small and will be all the less if sufficient time has elapsed to permit an increase in productivity. People will grow accustomed to the new state of affairs and their demands for compensating increases in money incomes will grow less insistent. The danger is a rapid succession of increases in prices and wages after depreciation, and this perhaps can be avoided. It does not seem unduly optimistic, therefore, to suggest that a substantial part of the gains from depreciation will be retained at least for a time in spite of the pressure for higher wages.

There may be strong demands for more pay for reasons other than the effect of depreciation on the cost of living. In conditions of full employment, organised labour is in a

strong position to press its demands, and the country may therefore suffer from a gradual wage-price inflation which will disrupt the export trade. It must not be supposed that depreciation can provide a satisfactory solution to this problem; successive changes in the external value of the pound would be required which would have a seriously adverse effect on international trade.

It is perfectly natural, of course, that workers should want better wages, and it is one of the principal objectives of economic policy to satisfy their legitimate demands. But a wage-inflation in excess of productivity will defeat its own object. Prices will follow wages and the disastrous consequences for the balance of payments will leave the workers worse off than before. The right way is to increase output per man; it will then be possible to raise *wage-rates* without harming the economy. What is so paradoxical is that hundreds of thousands of workers could begin immediately to take home larger wage-packets every week even if *wage-rates* remained unchanged. They could do so by producing a little more and thus increasing their *earnings* which are partly based on piece-work. No great exertions or Stakhanovite heroics are needed — merely the abandonment of restrictive practices which set the conventional " stint " well below what is comfortably possible. If the piece-workers behaved in this way, it would also be feasible to increase the pay of the complementary time-workers.

The trade-union leaders have had at least some success so far in their attempts to slow down the wage-inflation; but they have made little progress in securing the abolition of restrictive practices. (Indeed it is not altogether clear that they have tried very hard.) It may well be that these leaders will be less successful in future in preventing wages from rising steadily, especially if there is a Conservative Government and it is no longer possible to warn the workers against the danger of sabotaging the Labour Movement. The fact that the appeal is usually made in this way seems to imply

that the workers have no wider, patriotic loyalties, and although this is unrealistic as well as unflattering, it is probable that the trade-union leaders would act in a much more irresponsible way, even at the expense of their country, with the Tories in power.

It may therefore be necessary to contemplate the use of stronger measures if the attempt to reach international solvency is not to be frustrated by a wage-inflation. Two lines of policy are possible. The first is to the old-fashioned method of restricting the amount of credit in the country. In recent years the Bank of England has docilely printed more and more money as the cost-price inflation pushed up the nominal monetary value of output. Under the gold standard this would not have happened; and although the operation of the gold standard was somewhat harsh and arbitrary, it at least imposed some kind of discipline on the economy. Most people, including most of those who are opposed to socialism and physical planning, are agreed that the country should be able to manage its monetary affairs in a more delicate and scientific manner. So it should, granted a rational and self-restrained attitude on the part of everyone concerned — but that is a somewhat discouraging proviso. Needless to say, a return to the gold standard is out of the question; but a dangerous inflation of money-wages could perhaps be checked by the adoption of some analogous arrangement which would limit the creation of money.[1] The Bank of England would then cease to provide a continuous stream of funds; and if the existing supply of money proved too small to finance the same physical output after costs had risen in terms of money, output would have to decline and some workers would lose their jobs. This growth of unemployment might then induce organised labour to adopt a more reasonable attitude. This would be a most regrettable

[1] It is interesting to note that a proposal to this effect has been made by Sir Hubert Henderson in a recent article: "The Function of Exchange Rates", *Oxford Economic Papers*, January 1949.

policy, but it is no answer to denounce it as reactionary and leave the basic problem unsolved. If productivity lags behind and money-wages rise too fast, the country will be faced with ruin. A disciplinary policy administered by means of credit control would be severe, but it would be preferable to the widespread unemployment which must be regarded as the inescapable outcome of inflation in a country dependent upon foreign trade.

A policy of this kind might prove impracticable because of the political opposition it would encounter. Should this be the case, democratic methods would have failed and the ensuing period of extreme crisis and international insolvency could be terminated only by the adoption of a more totalitarian policy. Whether the Government which adopted such a policy was described as " Right " or " Left " would be of little interest to the workers; for the extreme parties on each side have far more in common with each other than with the moderate groups in the middle. In either event, labour would be disciplined in much the same way as it is disciplined in the U.S.S.R. The general level of wages would be controlled by the state, and the trade unions would become completely subservient executive organs. The wage-inflation would be stopped and the restrictive practices of organised labour would be regarded as a conspiracy against the state. Anyone who protested and tried to organise a strike or a " go-slow " movement would find himself arrested on a charge of criminal conspiracy and, if Russian practice were followed, he would be sentenced to penal servitude or shot.

It would be unreasonable to blame economists because they cannot provide an easy solution to this problem. No elaborate training is required to see that wages should not rise more quickly than productivity, and if people prove incapable of self-discipline under democratic government, there is no pleasant remedy to be found in economics. Nor is there much temptation nowadays to suppose that public ownership affords a solution; the nationalised industries

have scarcely been immune from such troubles. The real issue is whether democracy can survive in a highly vulnerable economy when so much power is in the hands of the organised workers. There is certainly no reason to despair, but it is unfortunate that the common sense of decent working people should have been so much corroded and eaten away by years of socialist propaganda, and it is even more unfortunate that senior Socialists, like Dr. Dalton and Mr. Bevan, should still be so actively engaged on this task of destruction. The Communist saboteurs, who will do their utmost to make matters worse, have a solution of their own which they would apply to the deluded workers if they succeeded in capturing power. But it is the solution of the whip. The fact that a few capitalists had been expropriated and arrested would scarcely be regarded by the proletariat as a lasting compensation for the severities of a Soviet labour code.

Conclusion

CHAPTER 13

THE PROSPECTS FOR PRIVATE ENTERPRISE

If the social and political structure were determined by economic forces in the manner described by Karl Marx, there would be little reason to feel concern about the future of private enterprise. For his theory of economic determinism seems to imply a rationality in the course of events which ensures that institutions are adapted in a way appropriate, in some sense, to the needs of the time. Human beings themselves may not be rational and may, indeed, fail completely to understand what is happening; but since the course of history is determined, in any case, not by ideas as to what is desirable but by more impersonal forces, the fallibility of human judgement is of only minor importance. Broadly speaking, that appears to be the theory, and if it were true a capitalist economy with a moderate degree of state intervention could be regarded as " determined " for as long ahead as could be foreseen. Admittedly an unreformed capitalism would not survive for long in the post-war world; in particular, heavy unemployment has caused so much suffering and resentment as to necessitate some change in the economic system. But if any serious attempt at diagnosis is made, it will be seen that such reforms do not require the abolition of private enterprise. On rational grounds, what is needed to prevent mass unemployment of the *pre-war* kind is a vigorous policy of financial stabilisation, combined with special measures to encourage the mobility of labour and to modify the location of industry.

Similarly, the mitigation of inequality will not be achieved by nationalisation but rather by the continued use of progressive taxation. Even with regard to foreign trade, the most difficult of the post-war problems, socialisation will be no help at all but a serious hindrance, because of its adverse effect on industrial efficiency and flexibility. Whether industry is socialised or not, it may be impossible to procure the imports necessary to maintain the standard of living and the level of employment — if only because the success of the export drive cannot be ensured by this country alone. But the danger of failure will be all the greater if the British economy is sluggish and insensitive, as it is only too likely to be if private enterprise has been abolished.

Without attempting to summarise further the conclusions of the preceding chapters, we may say that a rational response to economic needs would involve more state intervention than before the war, but not the socialisation of industry or the physical planning of output over the greater part of the economy. On the contrary, the private firm and the price mechanism should be preserved because they can make such a large positive contribution to economic development; a reformed capitalism should be regarded not as a makeshift contraption but rather as the most progressive form of economic organisation. If greater stability is desirable, so are enterprise and risk-bearing and the flexibility which can be achieved only by decentralising authority to the man on the spot. It is not merely a question of propping up a capitalist economy, and the issue can therefore be confused by suggesting that, since the principal evils of the past can be largely removed, a convenient political compromise is possible. Private enterprise should be retained and strongly defended in view of its high all-round performance, not because, with a bit of tinkering, it will do well enough and save trouble.

Since this is so, economic determinism should not lead to socialism. Unfortunately, however, the theory of determinism is itself a strange mixture of realism and mysticism.

It is perfectly true that the " objective " factors, such as changing industrial techniques, exert a major influence on social development, and if this observation falls somewhat short of originality, Marx was at least original in the emphasis he placed upon it. Without any question, he stressed the point too much, but it can be argued in his defence that it was necessary to correct a bias in the opposite direction and to criticise the view that society could be reorganised according to abstract ideas alone which might have little relation to reality. So far so good. The error lies in supposing that the ultimate response to changing conditions will necessarily be the right one; for this implies a kind of Economic Providence whose existence is not apparent except to the eye of faith. It is here that the " human factor ", so inadequately treated by Marx, becomes important; the objective needs may be misconceived and the various policies misunderstood. Even if, in the end, the action taken proves successful in removing a specific evil, it may be that some alternative policy would have proved equally successful for the immediate purpose and would have been more satisfactory in its wider implications. There is no law of nature to prevent a country from jumping out of the frying-pan into the fire by resorting to communism as a cure for cyclical unemployment. The cure may work fairly well but it will be far worse than the disease; it is, I believe, a sober statement of fact that the working class would be better off even in an unreformed capitalist economy, which was subject to cyclical fluctuations, than it would be under the heel of a communist dictatorship. There is, of course, a third alternative. Such unemployment could be reduced if the major countries were to adopt what is often described as a Keynesian policy, and in this way reasonable security might be achieved without the sacrifice of equity which communism implies. The third alternative is the more desirable, but because of irrationality and ignorance it may not be adopted.

Marx believed that the coming of socialism was inevitable; but if private enterprise is swept away this will be the consequence, not of economic necessity, but of the force of ideas which Marx so much underrated. Ironically enough, the ideas will be largely those of Marx himself, but not entirely so; and in examining the irrational beliefs which make for socialism it is appropriate to begin with the defenders of private enterprise rather than with its enemies. A reformed capitalism would meet the needs of our time much better than socialism; but there is no guarantee that it will be reformed in time, and the danger of suicidal conservatism is particularly apparent in the U.S.A.[1] As we have seen in Chapter 11, the measures necessary to prevent severe deflation and the mass unemployment which follows from it are fundamentally similar whether property is publicly or privately owned. But whereas a socialist Government could be relied upon to prepare some kind of financial plan, a "capitalist" Government might fail to do so. There would be no necessity for such a failure, and it is now most improbable that the British Conservative Party would be guilty of it. In the U.S.A., however, there is a strong body of opinion which is so unenlightened in its self-interest as to favour extreme *laisser-faire* and to view with abhorrence even the use of a budget deficit as a means of sustaining monetary demand in bad times. It may be that the majority of the electorate would support more progressive measures, but the exponents of "orthodox" finance are powerful in Congress, and when due allowance is made for the defects of the American constitution, they seem capable of doing almost as much damage to private enterprise, however unwittingly, as the Communists elsewhere can hope to do, wittingly. If mass unemployment is allowed to reappear in the capitalist economies and to persist for long periods, then the political reaction in favour of socialism may be decisive

[1] If the reforms had come more quickly in the United Kingdom itself, there would be less danger of totalitarian policies today.

in many places. It is true that such an outcome may be improbable within the U.S.A. itself, where socialism has scarcely begun to take root; it is more likely that the pressure of public opinion will, in the end, defeat the conservatives before the American socialists have come into power. But the interim consequences for the rest of the world may be a serious crisis, a further loss of faith in capitalism and a general resurgence of socialism.

The socialist movement may also gain some strength from the discontent caused by those failures of economic policy which may be described as genuinely unavoidable. The technique of maintaining monetary stability has been devised within recent years and a good deal of experience and experimentation will be needed before its potentialities can be realised to the full. Moreover, no skill can ever be so complete as to cope with all the unforeseeable possibilities of the future, and fairly serious mistakes may well be made. From a rational viewpoint, the consequent hardships and disappointments should be borne with some resignation, because there is in fact no better alternative. In the event, however, the failures will no doubt be attributed quite unfairly to private enterprise and an unpleasant reality contrasted most unreasonably with a theoretical and idealised version of socialism.

The scales are weighted against private enterprise for another reason. Progress has been remarkable in the past and may be rapid in the future, when judged by realistic standards; but it has not been and will not be so spectacular as to satisfy Utopian cravings. The defenders of private enterprise are fully aware of this and it has been one of the merits of the Conservative Party in the past that it has not attempted to win support by making wildly extravagant promises. The more responsible leaders of the Labour Party may also be acquitted of any folly of this kind; but in studying the attitude of the Left it is necessary to appreciate that many of its members are neurotics, who find in a

fanatical political faith some kind of solace for their personal needs. Of course it would be naïve to regard all extremists in this way; in order to understand the behaviour of, say, the French Communists, it must be recognised that many of them are simply would-be commissars on the make, who are as free from Utopian neurosis as anyone can possibly be. The neurotic element, however, is frequently apparent, and although it may have a number of causes, the need for some kind of faith is probably the most important.

Old-fashioned rationalists attacked supernatural faith with considerable success; but the result was simply to leave human existence unexplained and to create a dangerous spiritual vacuum. It was unwise to suppose that because these problems are insoluble by any ordinary process of reasoning, they can therefore be ignored; and it was not particularly sensible to expect a calm and rational attitude on the part of human beings whose lives are bound to end in a startlingly irrational manner. Without some kind of faith many people would feel that life was intolerable; and if the higher religions of the past have been partially abandoned, crude materialistic superstitions have been devised to take their place. In some countries religion has occasionally been " the opium of the people " which served to keep them quiet and docile under the rule of their masters. In the modern world, however, what is far more remarkable is the extent to which socialism has become the opium of those who are without a supernatural religion.

It is true that some people feel the need for a faith much more acutely than others; yet no-one can succeed altogether in ignoring the great problems of human existence, and there is no point in trying to pretend that an interest in these matters is in itself neurotic. The Freudians would have us believe that it is all due to sexual maladjustment, as though one aspect of life were more important than life as a whole; this is mere intellectual escapism. The Marxists claim that the interest is merely bourgeois, a claim which would be

grossly insulting to the workers if it were not so manifestly false as to be merely silly. Metaphysical curiosity is perfectly natural, and to some the importance of a belief, which gives at least an apparent meaning to life, seems to overshadow everything else. Perhaps everyone should accept the advice of the rationalists, abandon all vain questioning and " cultivate his garden ". But we are concerned here not with what people ought to do but with what they will do in practice; and it is an observed fact that " gardening " will not suffice.

It is true that no religion of social progress can ever be a substitute for a supernatural faith; all the important questions are left unanswered. But the irrelevance of worldly religions seems merely to add to the enthusiasm of their devotees and to lend an indignant fanaticism to their professions of belief. This must, I think, be accepted as a fact by the student of economics and politics; whether or not he himself has any supernatural faith is beside the point. Even if it is held that all faiths of the latter variety are no more than superstitions, it ought still to be recognised that a superstition may calm the human mind and that, without such comfort, neuroses may develop of so serious a kind that society is always liable to be diverted from rational courses by irrational political religions.

Although Marx contrasted his so-called " scientific socialism " with Utopian socialism, the difference was one of detail. He emphasised that the brave new world could not be created merely by the force of ideas, but he held that it would be brought about inexorably by the laws of economic development. This, of course, was not a scientific statement in the ordinary sense of the term. It was a dogmatic statement of faith, the substitution of a long-worded prophecy for a mere hope, but it was not science. It is also significant that Marx devoted very little space to a description of the new and happy society he predicted, and he was no doubt wise to leave everything rather vague. Life would be unbearably dull in all the Utopias so far described in detail, and

the struggle for their achievement is far more attractive than their realisation could ever be. Not that there is much danger of reaching the goal! The one thing which can be predicted with reasonable certainty about economic development is that the pace will be slow — slow, that is to say, if one's idea of speed is such that the progress of the past two centuries is regarded as trivial and unimportant.

In the light of these considerations, the qualities requisite for a successful social religion may be summarised. First, there should be some Utopian objective. Second, it is desirable to introduce an element of determinism which leads the faithful to believe that their goal is not only attainable but also that its attainment is inevitable. They may fight better if they think that " history is on their side "; and simply because they fight better, history will tend to be on their side. Third, the final state should be left vague lest the faithful grow bored or incredulous and begin to ask whether the struggle is worth while. Because it is a fight for so indefinite an objective, attention should be concentrated on the fight itself. For this reason it is important to exaggerate the evils of contemporary society out of all recognition and to denounce opponents as vile reactionaries who are not fit to live. Fourth, great stress should be laid upon the importance of loyalty to " the party ", not only for the obvious tactical reasons, but also because such loyalty may partially satisfy some cheap psychological needs. It is very pleasant, no doubt, to rely upon " authority ", and it may be a great comfort to feel that the virtue of party membership can outweigh the failures of personal life. To be on the right side is to be " saved ".

The Communist religion satisfies these requirements remarkably well, and it is also well suited to modern minds because its mysticism is wrongly labelled "science". It has no beauty of symbolism but it has an economic liturgy and that is what appeals to many modern minds — which are too dull for poetry and too lazy for real economics. Moreover, the

doctrine of the class-war makes a strong traditional appeal by dividing the world into the elect and the damned; and the issue is not confused by any "nonsense" about loving one's enemies.

> "The early socialists", writes Sir Alexander Gray,[1] "had been inspired by a large-hearted love; the gospel of Marx is a gospel of hatred and envy and malevolence, setting the class struggle in the centre of things, and appealing to all the ignoble passions."

Such an appeal is likely, perhaps, to meet with a more immediate practical response than any appeal to philanthropy.

It is only by studying the emotional and neurotic aspects of the Marxian religion that the reasons for its strength can be understood. This strength would, indeed, be inexplicable if rationality were an essential quality; for there is very little of the Marxian doctrine which can stand the test of intellectual scrutiny. It is because of his emphasis on economics that Marx is supposed to be a great thinker — mainly by those who have read neither his economics nor anyone else's. In fact, his economic analysis, which depends upon a labour theory of value, has long since been discredited, and his predictions have been falsified repeatedly by the events. From the point of view of the scholar, Marx's views must be judged historically and in that sense they are interesting. But the three large opaque volumes of *Das Kapital* contain little that is of value to the modern world, and it is merely absurd to put Marx in a higher intellectual category than Ricardo or John Stuart Mill. From the point of view of the political agitator, however, he looks much more attractive, and that unfortunately is what matters most. To adapt a phrase of Peacock's, Marx has done "enough mischief to be called a great man".

By contrast, a belief in private enterprise, however sincere, scarcely meets the needs of those who want some

[1] *The Development of Economic Doctrine*, p. 329.

worldly faith as a means of sublimating their desire for metaphysical certainty. It is true that a capitalist economy has more to offer than one which is socialised, and it is emphatically the case that communism represents, on balance, no progress at all but a long step backwards. But the outcome will depend in part upon emotional appeal and in this respect capitalism is poorly endowed. It has no " infallible " scriptures to compare with the works of Marx; the conclusions are tentative and the policies experimental. It implies much decentralisation and therefore requires a degree of self-restraint and modesty on the part of politicians and social theorists. It offers no worldly heaven as a compensation for the loss of belief in a heaven after death. For those who are uneducated and superstitious, capitalism is also unsatisfactory. It has no " holy pictures " of its leaders which can be hung in every worker's home. Its prophets have not been deified like Marx, Engels and Lenin. It has no shrines, and people do not go on pilgrimage to the birthplace of Adam Smith — which, no doubt by some oversight, has not been covered with a dome of coloured glass supported by marble pillars, like the birthplace of Marshal Stalin ! A form of economic organisation which has developed gradually in a largely unplanned way has a weaker imaginative appeal than one which has been created by revolutionaries. Because of its nature, the achievements of private enterprise have been due to the work of countless unknown individuals. They have done as much as — indeed far more than — those who worked out the Five-Year Plans; but in their case no Plan was announced beforehand with bombast and rhetoric, and the achievements themselves have not been lauded by an obedient party press.

If people are not entirely rational in their political attitudes, they are not entirely irrational, and it may be suggested that they will see through all this Marxian nonsense before it is too late. Herein lies our principal hope; but everything will depend upon the stage which has been reached when their eyes begin to open. In spite of con-

tinuous propaganda, the inhabitants of the satellite states probably suffer from far fewer illusions about the benefits of Marxism than do the people of the free world; and I imagine that the Communists in Poland or Czechoslovakia or Hungary would receive short shrift if the workers were free to act as they pleased. But although the people may have begun to realise the truth, they also realise that the Red Army is not far away. Even in Russia itself, there must be a great deal of disillusionment — not about the greatness of Russia which will be defended to the death, but about the new ruling class. The mass executions and the deportation of millions of people in the 'thirties indicate that, at least in Stalin's opinion, there was a substantial opposition to his policies at that time. More recently, fresh evidence of unrest may be inferred from the suspicious attitude adopted towards ex-servicemen who have seen a little of the world outside the U.S.S.R., and from the indecent haste with which nearly all the great Soviet generals have been pushed into obscurity. What would happen if there were free elections in Russia is anyone's guess, but the most relevant fact is that there are no such elections. A police state is a tough nut to crack, and machine-guns provide a convincing answer to second thoughts.

In Mr. Koestler's remarkable novel, *Darkness at Noon*, there is an old Communist who goes to Russia on his release from prison in his own country, where he has suffered for many years for his beliefs. On reaching the promised land, he is promptly arrested and imprisoned once more, and his bewildered mind breaks under the strain. As he sits in his cell he mutters again and again: "I was put in the wrong train". When Mr. Koestler created this character he may have had in mind the German Communists who fled to Russia before the war in order to escape Nazi persecution, only to find themselves in Soviet concentration camps. They "took the wrong train" and their fate should serve as a terrible warning to the Western Communists and Fellow-

Travellers who would like to see us all travel in the same direction. No doubt these Germans saw the truth at last but there was very little they could do about it. It is true that some of them did manage to make a return journey in the physical sense, for they were handed over to the Gestapo by their Soviet captors during the period of the Russo-German alliance, and were thus given an opportunity of studying, from the angle of political prisoners, the old question as to whether or not there is any difference between fascism and communism. Unfortunately, whatever second thoughts they may have had about their former political and economic beliefs can have been of little practical significance to themselves or anyone else.[1]

So much for communism. A similar religious element is apparent in the policy of socialisation by democratic means, but in this case the danger is much less. The Utopian claims may be discredited and disillusionment follow after a few instalments of nationalisation; and so long as Parliamentary government survives, the opposition of the majority can be given effective expression. It seems likely, indeed, that this is what will happen in the United Kingdom. Nationalisation has worked few wonders so far; and to the ordinary consumer or employee its benefits have been difficult to discern. In an attempt to evade the unpleasant truth, some incorrigibles have begun to draw a mysterious distinction between "nationalisation" and "socialisation"; while admitting the disappointing results of the former, they continue to make a religion out of the latter.[2] But the workers are not complete fools and such hair-splitting will scarcely convince them in the long run.

[1] Meanwhile some of their former comrades had taken a different train. They had travelled to the reactionary England of Baldwin and Chamberlain; and while their old comrade Frau Neumann was on her way from a concentration camp in Kazakstan to Ravensbruck, they were living in some comfort and attempting to undermine the war effort of their tolerant hosts in the interests of Soviet foreign policy.

[2] Perhaps what is wanted is more co-operation between the workers and the management. If so, this can also be provided in private industry.

The polls of public opinion suggest that the bulk of the electorate is opposed to further socialisation; even in 1945 there was no majority in favour of it. The Labour Party did not obtain half the votes, and even those who voted for it did so, in many cases, for reasons other than a belief in socialism. The party was supported because it was expected to be more successful than its rival in providing houses, maintaining employment and the like, and because it was believed — quite wrongly — that Mr. Attlee would demobilise more quickly than Mr. Churchill. Above all, people were sick of the Tories and wanted a change — a very proper attitude in a democracy. But there was no evidence to suggest that the Labour Party won the election as the result of any general enthusiasm for its programme of nationalisation [1], and it is difficult to take seriously the claim of its leaders that they have been carrying out "the mandate of the people". Parties are supported for a variety of reasons and it is necessary to take the good with the bad. Thus the Labour Party may be successful in the future and may push ahead with socialisation, although only a small, if strident, minority is really opposed to private enterprise. The same may happen with regard to other issues, whatever party is in power, but in this case there is reason to feel particularly disturbed about the working of the Parliamentary system. It will be so difficult to restore private enterprise to the

But if what is demanded is "workers' control", the reply has been given by Marshal Stalin himself:

"The workers persistently complain. 'There is no master in the works; there is no system.' We cannot any longer tolerate that our factories should be transformed from productive organisms into Parliaments." Quoted by a Communist writer, Mr. M. Dobb, in his *Soviet Planning and Labour in Peace and War*, p. 84.

Although Communists sometimes support syndicalist tendencies, this is merely a political ruse which ought to deceive no-one. Syndicalism was denounced in the strongest terms by Lenin as well as by Stalin; and managerial discipline is much stronger in the U.S.S.R. than in the capitalist countries. (Cf., *e.g.*, the Labour Law of 1940 which condemns absentees to six months' compulsory labour.)

[1] This has been still more true of the election of Feb. 1950. There is now no trace of a mandate for further nationalisation.

industries whence it has been banished, and permanent public ownership will have so profound an effect on the social and political structure, that it should not be undertaken unless it is clear that an overwhelming majority of the electorate is in favour of a far-reaching change of the kind implied. Unfortunately the Labour leaders have not been deterred by scruples of this kind and they may get away with it once more in the future. But at some stage, nationalisation may become a major issue at an election, and if this occurs, its supporters are likely to suffer a resounding defeat. Certainly it is most improbable that any of the positive achievements of the nationalised industries will win electoral support, and the main hope of the Socialists must be the coincidence of a Conservative administration with an acute balance-of-payments crisis which might lead to a strong, if wholly irrational, outcry against private enterprise as such.

In speculating on these matters, the future policy of the Labour Party itself is an intriguing puzzle. The Right-Wing section appears to be fully aware of the electoral dangers of an ambitious policy of socialisation; and in any case, the more experienced and intellectually competent members of the party are well aware that such a programme would be extremely difficult to implement at a time when the country had more important things to deal with. Some would be opposed to a great extension of public ownership even on principle. They joined the party in the first instance because they felt it would be more active than a Baldwin or Chamberlain administration in curing mass unemployment, improving the social services and so on — and who will say that they were wrong?[1] They would have joined the Liberals, in all probability, if there had been any chance of a Liberal Government, but they knew that there was none. These moderates will now be allied with those who, like Sir

[1] The author himself joined the Fabian Society for these reasons and subsequently left it when he became aware that a radical, as distinct from a socialist, policy was regarded unfavourably.

Stafford Cripps, were once extremely doctrinaire, but have now modified their views after five years of hard practical education. At the other extreme are the fanatical Socialists, who are a menace both to the political stability of their country and to the future of their own party. What a strange party it is! The Conservative Party is often criticised on the ground that it has no policy, but the broad outlines of its policy are clear enough, if far too infrequently stated by its members. It is rather the policy of the Labour Party which is so uncertain, and it will continue to be so while it contains such an extraordinary diversity of views. It is no exaggeration to say that its own Right Wing has more in common with the Tories and the Liberals than it has with its own Left Wing, and the party's future will be largely determined by an internal struggle for power. Will it feel obliged to present a list of candidates for socialisation in every election programme? Will it continue to whittle away at private enterprise, if it gets the chance, until very little is left? Or will it soon call a halt to nationalisation, deal more reasonably with the profit motive, and put into practice some of the encouraging remarks about competition which are contained in that characteristically inconsistent document, *Labour Believes in Britain*? It is significant that these questions would be answered differently by different groups within the Party.

The Liberals are probably right when they claim that the majority of the British people are liberal in outlook. By a strange paradox, however, their party is of minor political importance, and since the Labour Party, although it contains a strong liberal element, is so divided and confused, it is the Conservatives who must be regarded as the principal defenders of the liberal tradition. Unfortunately they do not always give the impression of being the most stalwart of champions.

Although the Conservatives are supposed to represent the interests of the well-to-do, their bark is far worse than their

bite. Conservative Governments have in fact increased greatly the progressive character of the tax-structure, and no future administration which they may form will be able to enlarge the share of the rich to the point where it becomes a large proportion of the total. This statement can be made with assurance for two reasons. First of all, the distribution of gross incomes even before taxation is far less unequal than is usually supposed. Second, state expenditure is so large and will remain so large, even after all possible economies have been made, that progressive taxation will be essential under any Government, except a Communist one, if the bill is to be paid at all. Without doubt the Tories would distribute the benefits of any possible reduction in taxation over all income groups, instead of giving as much as possible to the workers; but in this they would probably be right. Profits, in particular, ought to be taxed less heavily if risky enterprises of the kind so badly needed are to be undertaken on a sufficient scale. On the expenditure side, it is worth recalling that Mr. Churchill's Coalition accepted practically all the recommendations in the Beveridge Report on the social services, although it did so with such characteristic political incompetence as to receive little credit for its action and practically none for its own proposals, which were actually to be more costly than those made by Lord Beveridge himself. The new educational policy, which has as one of its objectives a greater equality of opportunity, was also conceived by the Coalition Government, and it was Mr. Butler who introduced the Bill.

With regard to the inequality in the ownership of capital, which is far more marked than the inequality of income, the Conservatives would probably slow up a little the process of eliminating the large fortunes by reducing death duties as soon as this became financially possible. But it will not be financially possible to make any large changes for a long time to come, and for political reasons, the Tories would not, in any case, dare to propose an abrupt departure from

the progressive policy which they themselves have carried out in the past. This is something but it is not enough. It is a remarkable fact that in discussing Conservative policy with regard to such matters, it is natural to begin by asking what the propertied classes will be prompted to do on the assumption of almost complete selfishness. The next step is to consider whether or not, if their own interests conflict with those of the rest of the people, they are likely to get away with it; and the answer is, I believe, remarkably encouraging for a variety of reasons at the present time. But their whole approach gives the impression of being either grudging or patronising, and this is most unfortunate both for themselves and for the capitalist democracy which they defend. Part of the trouble is due, of course, to the traditional failure of the Conservatives to present even their most progressive policies in a way which appeals to the imagination; but there is more to it than that. If the party could permit itself to take a larger sip of the equalitarian idealism in which some of its opponents are wont to drown themselves, it would recognise and emphasise that very large inherited properties are morally wrong as well as being merely doomed in practice. Of course it would be folly to expect any party to behave in a completely altruistic way with no regard to self-interest, and this is as true of the rising commissar as it is of the business man. But it is unduly cynical to exclude altogether the possibility of more philanthropic motives.

For that matter the self-interest of the propertied classes should prompt them to attack the very large estates. The vast majority of the class consists of people with quite modest estates, and their position can be defended, as we have seen in earlier chapters, on objective grounds. It is only a very small group at the top which deserves to be seriously attacked, and it will be ironical if the smaller capitalists jeopardise their position by attempting to defend privileges which they do not themselves enjoy. I have tried to show above that a property-owning democracy is the best

objective which the country can choose and I have also conceded that its achievement can only be gradual. I am fully aware that levelling up is far more important than levelling down and that high death duties may have bad incidental effects, in particular because thriftiness is discouraged. But the Conservatives, who are always suspect and should be more careful, are far too wont to stress the snags, and it is time they recognised that the idea of a property-owning democracy will catch the imagination only if it is presented with more equalitarian enthusiasm. Whether the ordinary property owner who supports the party is himself an idealist, or merely an astute egotist, he should be prepared to proclaim that large inherited estates are undesirable in principle.

The Conservatives have been blamed, with some justice, for the heavy unemployment of the inter-war years, although it is worth recalling that it was a Labour Government which first intensified the deflationary pressure by its fiscal policy after 1929. Both the Socialists and the Tories were handicapped throughout this period by the lack of technical knowledge and the slow development of economic thought in the past. It is long since time to abandon the superficial Marxian view that whatever happens is due to class-interest and " the logic of the system " ; and it is surely extraordinary that so many educated people, who would never dream of introducing such arguments in attempting, for example, to explain why cancer has not been cured, should find them wholly convincing as an explanation of social ills, as though there were nothing " technical " about, say, monetary management. Business does not benefit from depression, which reduces profits more than any other constituent in the national income, and the mere existence of private business does not mean that deep depressions are unavoidable. Even the disastrous return to the gold standard at a high parity in 1925 was taken on the advice of financial experts, and it is absurd to suggest that there was class-interest behind a

policy which did so much to lower profits as well as to swell the ranks of the unemployed. Subsequently, a great deal of experience has been acquired in the technique of financial planning, and the statement of future policy in the White Paper on Employment Policy marks a major breach with the past. This document was unsatisfactory in many respects but too much attention should not be devoted to the details. Without question, the new ideas have been largely accepted by the Tories: the practice of relating the budget to estimates of national output and expenditure will scarcely be abandoned by any subsequent Government, whether of the Right or the Left; and the measures necessary to mitigate structural unemployment will also be carried out.

Conservative policy seems reasonably satisfactory in all these respects and is, indeed, remarkably similar to Labour policy. If that were all there were to be said, the main reason for supporting the Conservatives would be a belief that the Tory leaders were more competent administrators. Views will differ on that point; but apart from defence — which may be so important as to settle the issue — it would be difficult to make out an overwhelming Conservative case on this score. It is a different matter, however, when the remaining considerations are taken into account. A principal merit of the Tories is that they would put a stop to the policy of nationalisation which is so undesirable economically and so dangerous politically. With the inflationary gap no longer grave, they would also be able to dispense with many of the remaining industrial controls and thus free the market. The Labour Party could do the same, of course, but it is confused by its hatred of the profit motive and its doctrinaire belief in the desirability of physical planning and controls. It cannot be doubted that Conservatives would permit much greater scope for enterprise and initiative.

The Conservatives are often criticised on the ground that they are too inclined to foster monopolistic practices. The more extreme charges under this heading may be dismissed

out of hand, but the fact remains that a Conservative Government, even if it did not sponsor such practices, might not be particularly active in trying to eradicate them. To what extent is this important?

It has been conceded already in Chapter 9 that some of the charges made against monopoly are exaggerated and that some of the remedies proposed would make matters worse. In particular, we have already rejected the notion that an industry ought to be socialised if the economies of large-scale production are such as to place one or two firms in a strong monopolistic position. It is also clear that even private cartels may be far less harmful than public monopolies if only because there will always be enough efficient firms, with a strong desire to compete, to ensure that the monopolistic power of the cartel will be less than that of the full-blown public corporation. Politically the danger is also less because the industrial grouping will represent some division of power which, if it does not result in democracy, may at least set some limit to the authority of the Central Government. (After all, it was the barons, not the people, who wrested Magna Carta from a reluctant monarch.) Above all, a policy of sponsoring or permitting cartels is preferable to one of nationalisation because its reversal by a subsequent Government would be far easier than the restoration of private enterprise to industries which had been taken over by the state.

It is necessary, moreover, to resist the usual academic temptation of applying ideal standards. A Labour Government might do more to restrain the employers' monopolies, but its opposition to private enterprise in general might be so bitter that it would fail to understand the problems with which it was dealing. A quiescent Conservative Government might do little or nothing to improve the situation, but a Monopoly Commission, staffed by doctrinaire Socialists and supported by doctrinaire Labour Ministers, would be capable of doing untold harm. It is also fair to add that a

Labour Government could not be expected to show much vigour in preventing the trade unions from enforcing restrictive practices. Not that the Conservatives, for their part, would dare to interfere with the unions. Thus, whereas the monopolistic employers might escape to some extent if one Party were in power, the trade unions would escape whatever the complexion of the Government — unless, of course, the Communists had seized control, when the independence of the unions would be abruptly terminated.

The prospects for private enterprise will depend very largely upon the outcome of a struggle for power within each of the main political parties. If the more sensible members of the Labour Party can consolidate and extend their power at the expense of the doctrinaire Socialists, a true Labour Party may yet emerge which will attempt to improve the lot of the common man by whatever methods seem to be appropriate. As for the Conservatives, it is not, I suppose, altogether out of the question that some new Disraeli may yet express with vigour and clarity the idealism which undoubtedly exists behind the hard veneer of social snobbery.

It may be objected that if both parties were to accept a liberal policy of the kind which so many politically frustrated people would gladly support, there would be no further point in the party system. Such arguments, however, reveal a serious failure to understand the basic conditions for successful democratic government. Apart from the fact that there would always be differences of emphasis on major points of principle, marked differences might be expected in the attitudes adopted by the two parties towards the specific problems of the day. A large part of the work of government has nothing to do with the application of ideologies — a fact which is too often ignored by academic theorists. An administration may be judged by its success in finding particular remedies for particular problems, and the rotation of parties provides a sanction for inefficiency, a way of changing personnel and a safeguard against the

abuses which always tend to appear when a single party, such as the Communists in Russia or the Nazis in Germany, has a monopoly of power. The parties need not be separated by great ideological differences. On the contrary, such differences will make it impossible in the end to operate a Parliamentary system ; as we have seen in the first chapter, their existence in the United Kingdom, even at the present time, gives cause for grave concern. As some of the great philosophers of democracy were wont to emphasise, it is an essential condition of success that the main parties in a democracy should be in agreement on those fundamental issues which affect the whole basis of society and should confine their disagreements — which may certainly be sharp and bitter — to other matters.

Such agreement on fundamentals may not be so far beyond our reach as the pessimists suggest. It is undoubtedly apparent over a very large part of the electorate and it can be discerned as between the more responsible wings of the two major parties, although each is handicapped by its own extremists. It would be vastly strengthened if those who believe in a progressive policy for private enterprise could conquer their exaggerated inferiority complex with regard to the past, overcome their irrational sense of defeat and cease to be apologetic when they ought to be aggressive. It is true that a belief of this kind cannot be made into a " religion ", and this can be a serious handicap in the political struggle, where crude emotional force is often more important than technical competence or moral worth. The economic case for a progressive capitalism is based on empirical investigation and rational inquiry. It is a strong case, but it does not leave those who accept it with an optimistic conviction that " history " is inevitably on their side, whatever human beings may do. By contrast, the Marxists, like Lawrence's Arabs, know " only truth and untruth, belief and unbelief, without our hesitating retinue of finer shades ". Their minds uninhibited by scientific

habits of thought, they can press forward with confidence, irrationally certain of success. Thus it happens sometimes that

> " The best lack all conviction, while the worst
> Are full of passionate intensity."

Herein lies the strength of the totalitarians; but the determinism of their religion which fortifies them so long as they are gaining ground, may prove a source of weakness if they should suffer a severe reverse. If they can be resisted with steadiness and courage, their belief in a predestined victory, which somehow constantly eludes them, may wane with great suddenness, and self-assurance may give place to despair. " Confidence in victory ", writes Professor Toynbee in discussing these matters, " at last proved Goliath's bane when the long series of successful combats was broken and terminated by his encounter with David." There is great comfort in such reflections, and there would be more if the defenders of private enterprise and democracy were better endowed with some of the qualities to which David owed his success.

APPENDIX

THE INFLATIONARY GAP

INFLATION is often described by saying that there is "too much money chasing too few goods", and it is customary to supplement this convenient cliché with others about "the stream of money" and "the stream of goods". Unfortunately, the official statistics are not presented in such a way as to make these two streams easily discernible and the nature of the problem may, perhaps, be elucidated more readily if the arrangement of the figures is changed. This I have tried to do in Table 1 overleaf.

The figures for 1948 have been derived from the White Paper on the National Income and Expenditure of the United Kingdom for 1946–48 (Cmd. 7649). Those for 1949 come from the Economic Survey (Cmd. 7647). Some of the estimates may need to be revised in the near future, but that is of minor importance in the present context where the main purpose of the table is to indicate a possible method of analysing the data.

The table begins with the value of goods and services produced at home which is necessarily equal to their cost and therefore to the sum of incomes earned in home production. If all these incomes were spent currently, whether on consumption goods or capital goods, and if no expenditure were possible except out of funds thus earned in production, then costs would be exactly covered by receipts and the economy would be in monetary equilibrium. (In technical language, Say's Law would apply.) In fact, however, there are a number of complications as shown in the table.

To begin with the goods stream. First of all, it is necessary to add a figure for imports of goods and services and to deduct exports. This indicates the way in which the supply of goods available is increased or decreased as a result of foreign trade.

TABLE I

Goods Stream	£ million		Money Stream	£ million	
	1948	1949		1948	1949
(1) Value of goods and services produced at home	10,460	10,850	(8) Incomes earned in domestic production	10,460	10,850
Add:			*Add:*		
(2) Imports of goods and services *less* exports	160	50	(9) Net income on overseas investments	40	50
(3) Indirect taxes *less* subsidies	1,650	1,670	(10) Transfer incomes not earned in production	1,263	1,320
(4) Goods and services for domestic use valued at market prices	12,270	12,570	*Deduct:* (11) Government income from property *less* losses	131	130
Deduct:			(12) Total of gross private incomes before taxation	11,632	12,090
(5) Goods and services used by the state	1,914	2,040			
(6) Gross capital formation	2,352	2,330			
			Deduct:		
			(13) Provision for depreciation	825	900
			(14) Direct taxes	1,997	2,160
			(15) Business savings and additions to tax reserves	710	620
			(16) Total of personal incomes	8,100	8,410
			Deduct:		
			(17) Personal savings and additions to tax reserves	96	210
(7) Available for consumption	8,004	8,200	(18) Expenditure on consumption	8,004	8,200

The next step, which involves the addition of indirect taxes, may appear more obscure. The object of the whole calculation is to see whether monetary expenditure is likely to exceed or fall short of the monetary value of supplies valued at market prices. These prices are raised above costs of production by indirect taxes, which means that more purchasing power will be absorbed in the purchase of a given quantity of goods than would be the case if no such taxes were imposed. Conversely, subsidies must be deducted. It will be seen, therefore, that indirect taxes are disinflationary, in the sense that they help to close a gap between expenditure and the value of supplies; conversely, subsidies are inflationary. (It is one of the complications of policy that what may be required for stability in this context may conflict with what is desirable in order to prevent a wage-inflation. For the latter purpose, it is subsidies which are disinflationary and indirect taxes which are inflationary.)

Line (4) indicates the total value of goods and services available for domestic use and valued at market prices. The next two steps are straightforward. Deductions are made for the quantities of goods used by the state and for gross investment. What is left is the value of goods and services available for consumption.

The other side of the table shows how incomes are now increased and now decreased. It is necessary to add net income on overseas investments and all transfer incomes (social security payments, war pensions, interest on the national debt, etc.). These incomes (lines (9) and (10)) have not been earned in return for any current contribution to production.

In line (11), the Government's net income from property, which is analogous to a tax, is taken away and the remainder (line (12)) is the total of all private incomes whether earned in production or received as transfers. From this are deducted depreciation allowances, direct taxation, business savings and additions to the tax reserves of business concerns; and the amount left is personal disposable income after taxation (line (16)). When an allowance has been made for personal savings and additions to tax reserves of persons, a figure for expenditure on consumption is obtained (line 18)).

It will be seen that the amount available for consumption is equal in each year to the expenditure on consumption, and

this may be taken to mean no inflationary gap. Unfortunately, it is not as straightforward as that. The figures for 1948 are historical estimates made after the event; and, apart from statistical inaccuracies, no gap will ever appear in calculations of this kind because the quantities will always be forced into alignment by some kind of unintentional adjustment. Prices may rise and people will then be unable to buy as much, in real terms, as they are trying to do because their money has depreciated in their hands; this is open inflation. Or inflation may be suppressed by means of price controls, rationing and similar measures designed to restrict purchases and to force people to save; in this case there will be a piling up of private monetary reserves and much grumbling about the shortage of goods. In either event, however, a historical gap can never be estimated from the figures for national income and output and its existence can only be deduced from other statistics. (Indices of prices are useful, although their evidence may be ambiguous when there is price-control and prices are allowed to rise only with rising wage-rates or rising import prices. The record of changes in the volume of money and in its velocity of circulation are of considerable value and further guidance may be obtained from statistics of stocks and reports about the availability of supplies in the shops.)

The statistics for 1949 are different in nature. These estimates have been made before the event and an inflationary or deflationary gap may be forecast in such circumstances. If such a gap appeared on the basis of plans and estimates made at the beginning of a period, and if nothing were done as an act of deliberate policy to close it, a whole series of forced and often undesirable adjustments could be anticipated. In fact the accounts for 1949 are in balance because the Government believes, rightly or wrongly, that it has taken whatever action is needed to ensure that this will be so.

With the aid of these figures, some aspects of fiscal policy for 1949 may be noted. Supplies produced at home in 1949 are expected to be greater by about £400 million than in 1948. But this is to be offset to the extent of £110 million by the fall in the import surplus and to the extent of £126 million by the increased demands of the state. After taking account of some minor adjustments, it appears that only half the increase in production (£200 million) will be available for consumption. But

on the other side of the accounts, incomes will have gone up by the full amount of the rise in output (£400 million); and at the same time transfer payments are expected to rise by about £60 million. If no other items were changed, an inflationary gap of £260 million could be anticipated. The import surplus might then increase, investment might be reduced by a running down of stocks, and so on. In fact, the Government has planned to cope with the situation by raising more in direct taxation and by inserting a larger figure for personal savings, which may be no more than a pious hope. At all events, Sir Stafford Cripps was clearly justified in refusing to increase subsidies in such circumstances. Such an increase would have reduced still further the market value of the goods available, *i.e.* item (3) in Table 1 would have been smaller and so, therefore, would have been line (7).

An alternative arrangement of these figures for 1949 is given below. (The figures in brackets refer to the numbering of the items in Table 1.)

TABLE 2

Savings	£m	*Investment*	£m.
Personal savings and additions to tax reserves (17)	210	Gross capital formation at home (6)	2330
Business savings and additions to tax reserves (15)	620	Foreign investment (2 *less* 9)	nil
Depreciation allowances (13)	900		
Surpluses of public authorities on current account (3 + 11 + 14 *less* 5 + 10)	600		
	2330		2330

The surpluses of public authorities will provide the finance needed for investment in various ways. Part will be expended as a capital transfer to private account (E.P.T. refunds, War Damage Compensation, etc.). Part will be used to repay the national debt and funds will thus flow into the stock exchange. Part may be left idle in the banks, which will help to offset the inflationary consequences of any rise either in the quantity of money or in its velocity of circulation which may occur in order to meet the needs of the private sector. At least this is what

should happen if the plan is carried out. Our object has been to indicate the nature of the problem as it appeared at the beginning of 1949 and to elucidate the proposed solution. Realisation is another matter.

In the preceding paragraphs the emphasis has been on inflation, but the same technique of analysis can, of course, be used in dealing with deflation.

THE END

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