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# SOCIETY AND ENTERPRISE

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# SOCIETY AND ENTERPRISE

*By*

A. T. K. GRANT

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*Toute leur vie estoit employée non par lois, statuts, ou règles ; mais selon leur vouloir et franc arbitre. Se levoient du lict quand bon leur sembloit ; buvoient, mangeoient, travailloient, dormoient, quand le desir leur venoit. Nul ne les esveilloit, nul ne les parforçoit ni à boire, ni à manger, ni à faire chose aultre quelconque. Ainsi l'avoit establi Gargantua. En leur règle n'estoit que ceste clause :*

**FAY CE QUE VOULDRAS**

—*François Rabelais : Gargantua, lvii.*



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# SOCIETY AND ENTERPRISE

## CHAPTER I

### THE MATERIAL FOUNDATIONS

#### I

A DETACHED observer—surveying humanity and its vicissitudes in the post-War years—might be aware of a series of apparent contradictions. Human society is fragile, enjoying a feverish prosperity at one moment, the next almost sick unto death ; human society is tough-fibred, and emerges from wars and economic collapse almost unscathed. The world is old, and the present is the culmination of centuries of development ; the world is new, for most of the technical devices which so obviously shape the present, from the steam engine onwards, have been introduced within a hundred years. Our economic activities are exceedingly complex in that all that each one of us does is to perform one minute portion of a productive process over and over again, the work of each individual being dovetailed in with that of others ; our economic activities

are exceedingly simple, since they harmonize spontaneously and almost blindly without conscious co-ordination or regulation.

These apparent contradictions can be resolved, but the observer, having resolved them to his satisfaction, perhaps might go on to ponder over the two most striking economic features which emerge, the complexity of the modern world and its newness, and to discover a further paradox, that something so elaborate should be so young. The present study aims, first, at bringing out the significance of that very elaborate machinery by which we satisfy an extensive range of daily wants, second, at suggesting that industrial civilization as we know it has been in existence for so short a time and has grown up so quickly that it may soon change out of recognition, and lastly, at laying emphasis on the importance of recognizing the highly complex nature of the machinery which many of us wish consciously to control in the future. It is a theme of this book, that if the idealism of the present day is not to be embittered with disappointment, if the dissatisfaction with things as they are and the urge towards things as they might be is not to prove fruitless, we must devote attention, not to sweeping ideas, but to technicalities and apparent trifles. The provision of goods and services in a specialized society is far more

than a simple matter and a broad issue, and any remodelling of society must take account of innumerable facts which, outwardly often insignificant, may yet turn out to be vital.

## 2

First, the complexity of modern economic society. While our talents are specialized, our needs and desires cover a multitude of objects, so that an individual helps to produce a great deal of one thing, but needs a little of many things.

The variety of our wants is an accepted matter of fact, and no one would have it otherwise. The individual spends his money income (that is, uses his claim on the output of goods and services of the community) to secure his share of the things for which he wishes—food and shelter, clothing, amenities like tobacco and drink, amusements, travelling expenses, perhaps schooling for his children, other things. But of all these he can only have a certain amount since they are limited in quantity, as is his income. He is faced with a choice, and will prefer some things to others ; and further, he will try to proportion the amount he buys of each so that he has them in quantities which will give him the greatest satisfaction. He may

need two new shirts, but feels it a waste of money to get a third, so he will spend his money on something else. He will get different things in varying proportions, so as to secure "as good value as possible". And "value" in this case means "value to him", and is nothing inherent in the objects which are bought. An extra shirt has little attraction for a man who has just bought enough shirts to last him for months ahead. We prefer some things to others and when we have enough of the things we like most we go on to second choices and so on down the scale. We balance the things we get in such a way as to get the most out of them.

On the other side of the picture, labour is specialized. An individual is normally engaged in doing one job, and that job probably represents only a very small part in the process of production of one particular type of article. A man may be a bricklayer, doing a minute portion of the work of building a house, or a clerk, helping the productive machine without actually touching the products he provides. Aptitudes and training have made him proficient at the particular type of work, and he cannot easily turn to any other. Quite certainly he will not be providing for himself more than the most minute fraction of the range of goods and services of which he is in need.

The question arises, how are the two sides of the account brought together in the economic system, so that things are produced in the proportions in which they are demanded? How does the "world as consumer" meet the "world as producer" on an equal footing?

It is worth stressing the significance of this question. The indiscriminate production of boots and beet-root, of ships and sealing-wax and crowns, of toys and hospitals, would be of little use to mankind; the important thing is to preserve balance between the output of these and other goods so that they appear roughly in the proportions in which people will want to buy them. In other words, it is essential that we distribute our efforts at producing over a wide range of commodities, and do not just make those commodities that our fancies as producers might dictate.

In the absence of any outside co-ordinating authority (such, for example, as the war-time rationing system) production and consumption are brought together through the working of the price system in a relatively free market. If there is a shortage in the supply of any particular article for which there is a big demand, the price tends to rise. If there is an excess in the supply, the price falls. Price movements affect both producer and consumer; the consumer is discouraged and the

producer encouraged when prices rise ; the consumer is encouraged and the producer discouraged when the price falls. Prices determine profits, and the profit motive is always tending to attract people towards the production of those things which bring in the biggest returns and to drive them away from productive activities which involve loss.

A qualification must be added at this stage. In the real world, prices—especially the prices of goods in shops—are often insensitive ; they move only at long intervals and under special circumstances. In this case the indicator of whether supply is outstripping or falling short of demand is not the price but the tendency of stocks to accumulate or decrease. The producer who finds that there is a limit to what he can sell at a given price knows that if he produces more than that either he must lower his price or be unable to dispose of his product. Again, a producer may find that at a given price orders outstrip supplies ; if he does not raise the price he will have to refuse orders and see the waiting list grow. In these circumstances he will have every inducement to extend production, and his field will prove an attractive one for competitors.

The mere fact of producers trying to start business on those lines where profits are high and to avoid the lines where losses may be

incurred is all the time tending towards a levelling of remuneration in different industries. The business man has certain costs to meet in the producing of his wares ; the difference between these costs and the price he receives constitute his remuneration. Thus the constant flow of new production towards profits and away from losses tends to restore proportion in the supply of goods and services, and where there is irregularity, this force making for a levelling out of producers' remuneration is coming into play to reduce it.

The same principles govern the flow of labour between occupations. The workman tends to go where he can get the highest wages, or the greatest continuous employment, or the most congenial occupation, and his final choice will be influenced by all these motives. On the whole, wage variations tend to be much less than those of the prices of goods ; with fairly rigid wage rates it is the volume of unemployment attached to each industry which acts as indicator. Thus labour flows from one direction to another with a certain tendency (though not always very powerful) for the pay for equal work in different industries to be equalized.

In this way the working of the price system is such as to bring about readjustments between millions of individual consumers and millions

of producers so that desires are satisfied Robinson Crusoe alone on his island would have to decide what he wanted and then would have to make it; in a world of specialized individuals the price system brings about an unconscious but automatic readjustment between wants and productive powers. The economic world goes round under a system of free enterprise because a man tries to get as much as he can of the things he wants. By selling his labour as dearly as possible he tries to get as big a claim as he can on the total output of goods and services; by his choice between different objects he directs the nature of that flow and incidentally his own remuneration in different occupations as contrasted with each other. So much for the economic theory of capitalist society; to what extent does it throw light on facts?

If we attempt to apply this framework of underlying principles to the real world, we find that, while broadly true, in certain respects it must be qualified, and it is limited in its significance. Thus, while the general principles apply, they are all the time overlaid by various tendencies which prevent them being true except "in the long run"; the short-run effects may be different to what we would expect.

It is based, for example, on the assumption of a free market both for goods and for labour.

Clearly there can never be a market completely free, while inevitably labour is fairly immobile. We have innumerable shops to choose from, but we can never know everything that is in them ; our choice depends on a limited range of knowledge, and to that extent the market is restricted. And the case of consumers' choice is the strongest from the point of view of the theory, for it is here that competition undoubtedly does work most freely. In regard to production, quite apart from questions of real monopoly, the firm which is established has natural advantages as against a new-comer ; it will have reserves behind it to fight a campaign ; it will have a connection and goodwill to give it strength. All this goes to restrict competition among producers even when there is room for it, and in addition it must not be overlooked that the establishing of a productive process is a long and expensive business. Factories cannot be built overnight ; the risks involved are considerable. Thus competition among producers is often limited. When we come to workmen the same thing is true ; operatives cannot move freely from one occupation to another, or from one locality to another. In regard to some skilled trades it can even be said that under normal circumstances the most that will happen is that the flow of new entrants into industry will tend to be deflected.

Nevertheless, it still remains true, if underlying conditions are taken into account, that it is the desire of individuals to get as much as they can of the things they want which shapes production and the directions in which it moves. The response may not be immediate, but the motive force is there and is always having some influence, even if it is almost imperceptible. Broadly speaking, it is fair to say that supply is constantly being proportioned to demand, although at any given moment there are a number of maladjustments and misproportions.

This argument, it will be noticed, depends on a hypothesis of deliberate and conscious choice; such an assumption is merely that of rationality, or, to put it at the lowest level, of a certain amount of method in our madness. Any man is free to follow philanthropic impulses, or to prefer fresh air to higher wages; the only assumption is that his action is a matter of deliberate choice and not of accident. To a very limited extent this assumption is unfair, but—since it will be undisputed that most of our purposes are the result of choice, however imperfect from any given standard—the force of the argument remains more or less undiminished.

There is, however, a much more far-reaching criticism which leads on from this. The assumption so far is that of individual choice,

but the decisions which govern society are not the decisions of individuals alone, but also of individuals collectively. The price of a drug will be affected, for example, by the fact that people, though buying the drug, vote for a Government which tries to suppress its sale. The interests of a man as an individual and of the same man as a member of society can come into conflict. It hardly seems possible to explain what one might call collective choice (the decisions of society as such) in terms of an aggregate of individual choices alone. It is not even fair to discuss the clash of the two as an example of irrational choice; for each of us may be perfectly logical in choosing one thing for himself and another for society as a whole if we think on balance that we shall succeed in doing a thing which others will be prevented from doing, and it will be to our advantage.

But the whole problem becomes clearer if we realize the very rigid limitations of the whole conception of individuals earning as much money as possible and spending it as they think best, and so bringing producer and consumer into touch with each other. The neat abstraction—everybody getting what their work is worth to other people, and buying those things with the proceeds which seem worth most to them—falls completely to pieces

if any attempt is made to use it as the basis of a complete and self-contained explanation of the economic world as it is. People's incomes are not what they earn. People do not start level. What counts is not what you need, but what you desire and can pay for. The whole phenomenon of property comes upon the scene, and the tragic fact that it is not what you want but what you have that matters.

Thus the relationship between producer and consumer through free enterprise and a free market is only in terms of the money claims of which the consumer is in possession ; there is no relationship to " needs ", " wants ", or any such specifically human criterion. The profit mechanism helps to bring about a balance in a given environment. If the environment is so changed—perhaps through a collective choice—that it gives more people an opportunity of satisfying their desires on a wider scale, then the price mechanism will tend to secure a corresponding readjustment in production. The imposition of a new tax—a decision of the community as such, and not of an individual—will alter particular prices as well as changing, perhaps, the general environment.

Thus, to sum up to the present point, there is always a tendency for what is produced to be proportioned to what is consumed through the price system, and prices are ultimately the

expression of the relative preferences of individuals ; these preferences are expressed not in terms of what people want but of what they have, and bear no relation to needs or capacities ; the distribution of property—this element of “ has ”—depends on the existing environment, which in its turn is constantly being affected also by decisions of society as such, decisions which have some direct effect on individual prices quite apart from their indirect effect in diverting income from one direction to another. This leads on to a double conclusion : first, that the price system is neither moral nor immoral but non-moral, since it has no bearing on questions of social equity whatever ; and, second, that it is of significance because even in the most perfect society it would still be necessary to relate supply and demand.

## 3

So much for what has been called the “ complexity ” of modern economic society, a subject which will have to be examined further when the lay-out of the economic organism is discussed. The other distinctive feature, mentioned at the beginning of this chapter, is its newness.

For the economic historian the beginning of the Industrial Revolution is to be found in the early part of the eighteenth century. From

the practical point of view its effects date from the post-Napoleonic period. In 1824 the *Tyne Mercury* was asking, "What person would ever think of paying anything to be conveyed from Hexham to Newcastle in something like a coal-waggon, upon a dreary waggon-way, and to be dragged for the greater part of the distance by a roaring steam engine." <sup>1</sup> The Stockton and Darlington, the first railway line to carry passengers, was opened in 1825; the Reform Bill of 1832 is the symbol of political change; the big increase in population which so troubled Malthus is in the main a nineteenth-century affair, for during the previous century the population had been more or less stationary.

It is only later that beginnings are replaced by achievement. If we want to see modern England taking shape we must wait till after the boom in railway construction and the unification of the country, which is a surprisingly recent development.

## RAILWAYS

Mileage open in United Kingdom on 31st December of certain years (1842 onwards).

1842 .	1,857	1880 .	17,933
1845 .	2,441	1885 .	19,169
1850 .	6,621	1890 .	20,073
1855 .	8,280	1895 .	21,174
1860 .	10,433	1900 .	21,855
1865 .	13,289	1905 .	22,847
1870 .	15,537	1910 .	23,387
1875 .	16,658		

[Source: *Statistical Abstract of the United Kingdom.*]

<sup>1</sup> R. M. C. Anderson, *The Roads of England*, p. 202.

The year 1837 saw the last coach between London and Birmingham, 1843 between London and Bristol, and 1847 the last between London and Plymouth. By 1850 (the year following was to see that Great Exhibition of which the Crystal Palace is the memorial) there was a substantial railway system,<sup>1</sup> and perhaps we may take that date as the beginning of a more or less familiar Britain. Even then it was only modern Britain, and not yet the beginning of the "modern world", an affair of ocean liners, transcontinental railways, and latterly excessive cereal crops. Modern Britain is not a hundred years old, and the modern world is even younger.

The choice of railways as a symbol of development is deliberate: they represent mechanical invention and the development of the technique of machine making, the fruit of saving, the wider markets made available to manufacturers, increased mobility, and that bringing nearer of distant places which was to result in a unified world economy; above all things they represent the application of artificial power to human needs. The vital distinction between the modern world and the world which preceded it is that we have steam, gas, electricity, and the internal combustion engine, where our

<sup>1</sup> See Anderson, *op. cit.*, p. 205, for a map; even then there was no through line to Scotland.

forefathers could only harness wind and water. Without the discovery of power there could have been no Industrial Revolution, and the great majority of the new inventions would have been useless.

But the significant thing is not merely the spate of new inventions, but the rapidity with which they were introduced and embodied in the form of capital—the surprising way in which railways, factories, and steamships sprang into existence almost overnight. The explanation of this is to be found in the answer to a double question—why did people want to buy factories and steamboats instead of food and amusement, and how did they have the money to pay for them ?

The clue lies in the environment of the day. The new inventions brought with them enormous profits—and these profits were left to those who got them and were not taxed away or otherwise dissipated. Economic findings were keepings. There was a ruthless devil - take - the - hindmost atmosphere ; the interests of the past and of the present had to give way to those of the future ; there was no one to slow down the pace of change, and the handloom weaver during the century—unlike the English wheat farmer to-day—had no government to protect him, and brutishly he went to the wall.

The individual business man's attitude—if one may generalize in this way—was one of self-help, and the making of the most of his opportunities. James Nasmyth, who owns a machine-making business, is explaining himself and his methods to a Commission :—

“ . . . One of the results of these mechanical improvements is, that where one automaton machine was going on with its work, and would occupy six or eight hours to complete it, now, instead of the man standing still, you give him another machine to look after. I had an instance in my own works where I gave a labourer a machine to bore the cylinders for steam-engines. In the first instance he had only one machine, and after the cylinder was put into the boring machine he had to stand with his hands at his back perhaps reading an old newspaper or a new newspaper as the case may be, and then putting a drop of oil now and then ; he had such a surplus of time on his hands that I thought proper to give him another boring machine, and it ended by my giving him six, and with every additional machine I gave him a shilling a week extra. . . .

“(Mr. Harrison.) With regard to the man whom you subsequently employed upon six machines, what were his wages when he had one ?—16s.

“ He was worth sixteen shillings to you ?—Yes.

“ Probably more, I mean that the profits derived from the man's labour were worth say 20s.—Yes.

“ When you put him upon six machines his profits to you were therefore 6*l.* a week ?—Yes.

“ And he received 20s.—Yes, I was very niggardly in giving him only 2*l.* a week, but it is quite possible to spoil a man like that by giving him too much

at once. . . . I was the employer and he was the employed, and we were dealing together to our perfect mutual satisfaction."

Nor was Nasmyth himself the man to spend his large profits on his own amusement. The frugality which he imposed upon others he had exercised himself.

"(Lord Elcho.) You talked of the wages that you first got when you came to London being 15*s.* a week, and you say that you saved considerably upon that. May I ask how much you could save out of 15*s.* a week?—I saved 3*s.* a week, and I got a little apparatus made to cook my dinner, which I have at home now.

"You invented a little apparatus for that purpose, did you not?—There was no invention about it at all; it was so simple. It was heated by an oil lamp below the pan, like what they cook children's food with in the nursery now. It cost me a half-penny a day for oil.

"You put your dinner into that apparatus, did you not, when you went out at breakfast time, and it was so calculated that when you came home you found your dinner cooked?—Yes. I indulged in leg of beef. By walking across from Lambeth to Farringdon Market I could get it at 2½*d.* a pound instead of 3½*d.*, and it was stewed to perfection by my apparatus.

"That little pot you show, do you not, as the foundation of your fortune?—Yes, that it was the spirit of self denial and love of true independence that did that."<sup>1</sup>

<sup>1</sup> *Tenth Report* of the Commissioners appointed to Inquire into the Organization and Rules of Trade Unions and Other Associations: together with Minutes of Evidence, 1868.

Indeed, self-denial, "true independence," freedom from taxation and cheaply paid labour were the foundations of many fortunes, and certainly explain the very rapid industrial development of the last century. The ideals of thrift and abstinence, invoked perhaps to justify low wages in the case of operatives, influenced equally strongly the factory owners themselves; profits were put back into the business, and so the new technique swept over the country.

Behind all this was a philosophy—or at least a current set of ideas. The significance of the conception of *laissez-faire* must not be forgotten. Had the State run welfare services at considerable expense to relieve the hardships of those who suffered most from the change, had large fortunes been taxed heavily in order to redistribute the benefits of material advance, had the State used artificial methods to raise wages to a higher level—in short, had it done anything substantial to preserve a semblance of equity in the way that benefits were distributed—the process of building up productive power would to that extent have been slowed down and material development delayed. Material advance in the narrower sense and the diffusion of welfare throughout society were in the scales against each other, and the scales were weighted heavily in favour of material

advance. The benefits arising for society were to some extent to be deferred so that they might become greater with time as productive capacity increased; and so the philosophy of *laissez-faire* did for the industrialization of nineteenth-century Britain what propaganda and national planning is doing for the industrialization of Soviet Russia.

The philosophical case for free enterprise and the right to do as one would with one's own must trace its origin to the mingling of several streams of thought, but to a large extent it is a protest against abuses and anachronisms. In the sphere of political economy the plea for free enterprise is not unqualified in the works of most of the leading thinkers, and it is only in books designed for popular consumption that the dogma of *laissez-faire* is to be found in its most undiluted form. "More harm than good is likely to be done"—this is Archbishop Whately,<sup>1</sup> in his *Easy Lessons for Young People*, distributed about 1850 by the Society for Promoting Christian Knowledge—"by almost any interference of Government with men's money transactions, whether letting and leasing, or buying and selling of any kind." True liberty is "that every man should be left free to dispose of his own property, his own time, and strength,

<sup>1</sup> Quoted by J. M. Keynes, *The End of Laissez-faire*, pp. 23-4.

and skill, in whatever way he himself may think fit, provided he does no wrong to his neighbours.”

But it is not the theories of the more reputable economists, or even the pronouncements of their second-hand interpreters, which provide the most startling illustration of the doctrines of *laissez-faire*; it is the imposing list of opponents of Factory Acts and similar ameliorative measures in Parliament. Lord Shaftesbury<sup>1</sup> mentions as opponents Peel, O’Connell, Bright, Cobden, and Gladstone (though in fairness it must be said that Gladstone came round later, and probably some of the others modified their views). Here is Bright in 1855 blustering against a Bill which may interfere with him by making him rail off his machinery and by sending inspectors to see that he does it.

“Why are we mill owners to be selected as subject to interference? Why is a Scotchman to be sent to see how I work my people, while the farmer, and the carpenter, and the builder, and the tailor is left with ordinary responsibilities of law and public opinion? . . . I have advised my partners, if this Machinery Bill passes, to set the example of turning the key on the doors of our mills, and to throw on the legislators the responsibility of feeding the millions whom they will not allow us to employ with a profit.”<sup>2</sup>

<sup>1</sup> A. V. Dicey, *Law and Public Opinion in England*, pp. 234-5.

<sup>2</sup> Dicey, *loc. cit.*

Thus freedom of enterprise, large profits, inequality of income, "thrift," low taxation, and an absence of Government interference made possible the huge accumulation of capital which changed the face of England with the coming of steam power. In due course British capital flowed abroad and helped on the process of change in the rest of the world. There had been several bursts of foreign investment between the end of the Napoleonic Wars and the middle of the nineteenth century, and investments had been made in Europe, in the United States, and in the newly recognized South American Republics. Bursts of lending had been punctuated by patches of bankruptcy and default. By 1850 British overseas investment had almost reached £250 million. "All the authorities agree that by 1875 the total of British holdings overseas had reached round about £1,200,000,000 at the least, and that in the early seventies foreign investment was proceeding at the rate of not much less than £40,000,000 a year, actually reaching over £56,000,000 in the boom year of 1872. . . . European, Colonial, American and Indian Government and railway loans were widely quoted and dealt in on the London stock exchange." <sup>1</sup>

And after the Civil War there were golden

<sup>1</sup> G. D. H. Cole, *British Trade and Industry*, pp. 62-3.

opportunities in the United States. "The glittering accounts of our prolific soil and the immense area of our pasture lands"—this is a Congressman from Pennsylvania, quoted by Charles and Mary Beard—"soon caught the eye of European capitalists. And our railroad companies with a thrifty purpose of their own stimulated the interest already aroused by free excursions in well-stocked palace cars, by which noblemen and other men of wealth saw the bounteousness of our prairies through the sparkle of champagne and the delicate smoke of pure Havana; and the enormous returns which foreign investors received from their American cattle ranches still further inflamed the cupidity of their countrymen and many others sought these rich fields of gain." The efforts of American railroad leaders to attract foreign capital to the prairies seem to have been eminently successful, especially among members of the British aristocracy. "By 1884, approximately twenty million acres had passed into alien hands. Lord Dunmore had one hundred thousand acres; Lord Dunraven had sixty thousand; the Duke of Sutherland, who owned so much of Scotland, had nearly half a million acres of American soil; an English syndicate, headed by the Marquis of Tweeddale, had more than a million and a half; two English syndicates over seven

millions in Texas alone ; and a German concern more than a million acres." <sup>1</sup>

Free enterprise was enlarging the world.

## 4

Thus freedom of choice, freedom of enterprise (which for Great Britain in due course covered external as well as internal free trade), and a political environment which allowed to the winners their rewards, made for the extraordinary rapidity with which an economic system based on the use of artificial power came into being. Generally speaking, this is true of most countries though it applies with especial force to the pioneer, Great Britain, and to the United States ; in Prussia, however, and later in the new Germany, shortage of capital and military considerations compelled the State to take a more active interest in the developments that were going on, and to a lesser degree this is true also of France. In Germany especially, as the century wears on, there is a conscious effort at national economic development ; Germany is a late-comer, and the methods of letting things be and waiting for the results are not enough. But, making some allowance for this, the generalization about free enterprise holds good.

The question arises : what were the

<sup>1</sup> C. A. and M. R. Beard, *The Rise of American Civilization*, 1930 edition, chap. xix, pp. 150-1.

advantages and disadvantages of this economic freedom, this weighting of everything in favour of the entrepreneur ?

The answer—if the question may be answered in terms of Great Britain alone—is not clear cut, and depends partly whether we take the standpoint of the present, or of those contemporary with the changes that were going on. But, given the particular circumstances of the earlier half of the nineteenth century, the advantages probably outweigh the disadvantages. The sufferings of displaced craftsmen, such as the handloom weavers, were exceptional ; on the whole the factory workers were in many ways better off than they had been before, though at one period the drift of people to the towns tended to overwhelm what organization there was, with the result of insanitary conditions and overcrowding. The rapid increase in population—due mainly to a falling death-rate—also suggests that the condition of workers was improving. Had the rapid increase of population occurred in a Great Britain which was not being transformed and which still remained mainly agricultural, the forebodings of Malthus about over-population might have been much nearer being realized, and the population of this country reduced to the miserable level of the Irish peasantry of the

first half of the nineteenth century. But the most important argument on behalf of a favourable answer is this: that the slowing down of the immediate benefits (and of course some benefit was accruing all the time, even if sometimes it was as meagre as the increase in wages of Nasmyth's machine minder) meant a capacity for much greater production in the future; if the contemporaries of the Industrial Revolution—men and masters alike—to some extent sacrificed themselves, they enlarged the scope for posterity. They had to forego certain advantages, but we have inherited the factories and railways.

This is not to excuse the horrors that Engels has recorded so vividly,<sup>1</sup> and which certainly did not leave contemporary opinion unmoved. But it must not be forgotten that there is no evidence of a fall in the standard of living; on the contrary, the evidence points to a steady rise. What is probably true, however, is that the rise might at the time have been much greater, coupled with a slower development in the long run; it may even be that Britain might have ended up as a counterpart of a Sweden or a Denmark. But this is moving far into the realms of speculation.

Yet the verdict is really immaterial: free enterprise (and a right to its rewards) did

<sup>1</sup> Engels, *Condition of the Working Class in 1844*.

introduce a steam power industrial system in a comparatively short space of time, and the sacrifices of the workmen who received low wages and of the business man himself who thriftily put his profits back into the business have been made. The embodied capital is there for all to see.

But there is a significant distinction. Sacrifices which may be justified to provide for posterity the benefit of a new technique like that of steam power are much harder to defend when the means to new advance are not available on such an overwhelming scale. By all means let us weight everything in favour of the entrepreneur and of change when the change is worth while, but let us also try and distribute the fruits when material advance has fewer striking inducements to offer. Already in the second half of the nineteenth century considerations of equity were beginning to assert themselves strongly against the dogmas of *laissez-faire*. The movement which began with factory legislation and limitation of hours has developed, and death duties and social services now redistribute to some extent the profits of enterprise. But these are clumsy "negative" devices, a sop to social conscience rather than a constructive policy, and are open to criticism from many angles. In particular there is a strong demand for considering the

whole subject from the standpoint of conscious reconstruction so that, with the material problem solved, we should be able to secure a more equitable distribution of the good things of this life. Free enterprise, and all that is usually associated with it, has brought certain advantages. What is to happen if they are not to be lost, but to be exploited to the full? This ultimate question can only be approached through an examination of certain aspects of the economic system as it exists to-day.

## CHAPTER II

# THE ECONOMIC ORGANISM

### I

IT is almost a platitude to point out that in a modern community all men are specialists—equally with the tools they use. As economic organization has progressed it has become more intricate and the division of labour has been pushed farther and farther. Specialization and sub-specialization have become the rule. The old gibe about the expert “learning more and more about less and less till he knows everything about nothing” applies to people engaged in productive work as well, though it is the field of their activity rather than that of their knowledge that has become circumscribed. The mechanized factory, with unskilled or only semi-skilled men repeating the same operation for hour after hour, illustrates the length to which a process of this sort can go.

But specialization is not confined to human beings. It embraces tools as well. The simple tool becomes more elaborate and becomes a machine which can probably only be used for

one purpose. Here as elsewhere the result is to make the output much greater, but the adaptability of machines becomes less and less. A spade or a hammer can be used for many purposes; a steam shovel or a steam hammer for comparatively few. With the specialization of labour there is a specialization of capital.

“Tools” has been used to introduce the conception of capital; capital in fact consists of nothing more than tools and materials and finished goods as yet unsold. A nation’s capital consists of its machines, its roads and buildings and natural resources, the raw materials lying in its warehouses, the half-finished products in its factories and workrooms, the stocks of goods for sale in the shops. The railway engine and the spade, the market gardener’s greenhouse and the electricity pylon, the cheese lying on a shelf in a shop in wait for a customer, and the shelf on which it lies, are all alike capital. They cease to be capital only when they are discarded or bought and consumed.

The various objects in the list do not seem to have much in common, but they are all necessary parts of the productive machine which turns out goods for consumption. Broadly speaking one can distinguish between fixed capital and working capital. Fixed

capital consists of machinery, buildings, and durable objects of that kind. Working capital consists of raw materials and half-finished and finished goods in stock—the goods which increase in value as labour is expended on them and wages are paid out against them. But though a classification of this sort is useful, it cannot be used too rigidly. The distinction between fixed and working capital is one of degree rather than of kind. The raw material which is being worked up into the finished product or the coal which is consumed in the furnace has to be renewed more quickly than are the machines. That is the distinction, though there is an added implication which is significant: the business man is not deeply committed as far as coal and raw materials are concerned because they are expected to last so short a time and because they are constantly being renewed — and in any case they can often be put to other uses. But with fixed capital he has committed himself. If it is unsuitable for its purpose, or if the purpose is unjustified, he will make a heavy loss.

Nor is it easy to draw a satisfactory line between capital and many forms of durable consumers' goods. The piano of the professional musician is capital, and so is the motor car of the commercial traveller; in the

hands of private persons it is not, since it produces no future wealth. But there is an air of sophistry in refusing to call a car driven by a man's own chauffeur for his pleasure capital, but allowing that title to the car if it belongs to the driver and plies for hire. The distinction becomes even less justifiable when we remember that ultimately what the economic machine produces is not goods but satisfactions. All goods are used—directly or indirectly—to render satisfactions, and if we were strictly logical perhaps the most we should feel able to say is that they are less or more remote from the satisfactions they render. The implication is that the more remote they are, the more they are capital, but it is impossible to develop this approach here. It is necessary and convenient to think in terms of fixed and working capital, remembering all the time that these are rough and ready conceptions.

## 2

The accumulation of capital must be preceded by saving. An increase in the power to produce wealth involves an initial accumulation of capital (that is, of tools and materials). A Robinson Crusoe, deciding that his task of getting food for himself would be more successful if he had a knife (capital), determines to

make one for himself. He is faced with a dilemma : he cannot spend time on making a knife unless he devotes less time to getting food ; he must therefore eat less until he has got the knife. Once he has the knife, however, he will be able to get more food and go on getting this increased quantity of food as long as the knife lasts. Thus Crusoe is forced to go without a certain amount of consumable goods in order to make himself the knife ; his compensation is the greater supply of food he will go on enjoying in the future. Reduced consumption in the present is balanced by continuing increased consumption from some future date onwards. This elementary example illustrates very fairly the significance of saving and capital accumulation.

In a community the process is essentially similar. Mr. H. D. Henderson has described it very clearly.

“ The individual . . . foregoes his right to purchase now a quantity of consumers' goods in consideration of the prospect of purchasing a larger quantity of such things in the future. From the standpoint of the whole community, there is a similar postponement of consumption, though it need not commence so soon. The store of consumable goods is what it is : the quantity of goods in *process* of manufacture, which will shortly be coming forward, is also what it is. For some time, therefore, a sudden access of saving

cannot affect the quantity of goods available for consumption; and if, in fact, they should be consumed less rapidly, that will represent an unfortunate defect, not an essential condition of a smoothly working system. The *necessary* consequence comes later. The increased saving will cause labour, materials, land, agents of production generally, to be devoted to distant purposes. Men will be set to work producing durable goods, largely durable instruments of production like ships or railways or factories or plant. If the increased saving is considerable, the labour, materials, etc., required for these purposes will be withdrawn even under our present system, as under a smoothly working system they clearly must be, from the production of other and more immediately consumable things. Hence, some time later, the supplies of consumable things will be diminished, while at a later period still they will be more than correspondingly increased as the result of the assistance of the new durable instruments. That is the essence of saving from the social standpoint. An early future is sacrificed to a more remote future. The aggregate consumable income of the present is unaffected; the aggregate consumable income of the near future is actually diminished; it is not until at least some years later that the aggregate consumable income is increased.”<sup>1</sup>

Thus, to take the example of a fairly primitive community, some members are devoting their energies to making tools and growing corn for seed purposes; the others must supply them

<sup>1</sup> H. D. Henderson, *Supply and Demand*, pp. 126-7.

with the means of living since their activities will produce a return only in the future. Present consumption and future consumption are alternatives: less to-day but more to-morrow; more to-day, less to-morrow. Increasing wealth is dependent on an initial "going without", so that all those processes can be built up which are essential to a better organized technique taking full advantage of specialization. The great growth in wealth producing capacity of the Victorian era was made possible by the abstinence of the Victorian business man—the Nasmyth who put all his money back into his business. It is sometimes said that the standard of living fell rather than rose during the course of the first Five Year Plan in Russia; if this is so, it serves to illustrate the magnitude of the effort, and does not reflect on the conception.

How is this process of capital accumulation secured under free enterprise? We have seen that different things are produced in certain proportions because of individual preferences. Similarly the division between goods for more or less immediate consumption and goods which are to help to produce future goods—or, if we do not like the distinction, into goods more or less remote from the satisfactions they render—is dictated by individual preference, the preference for a *continuing* income in

return for a present payment.<sup>1</sup> The price system works here as it works elsewhere ; it affects the terms on which continuing incomes change hands. If the demand for continuing incomes exceeds the supply, the price in terms of present payment rises ; if the other way about, it falls. Thus the price of an income may be twenty years' purchase. This means that for a payment of £2,000 now one may secure a lasting income of £100 a year. This is the same thing as saying that the rate of interest will be 5 per cent. "Rate of interest" is merely a term which defines the relationship between present payments and continuing incomes. If demand increases, the present price of the continuing income of £100 a year might rise to £2,500, in which case the rate of interest would be 4 per cent. But a 4 per cent yield may not satisfy many people, may seem too small, in which case the purchase price may fall (in the absence of buyers) until the yield is 5 per cent again. Thus the rate of interest indicates the price at which the future exchanges against the present.

The conception of a continuing income pure

<sup>1</sup> It is a mistake to suppose that one saves at one moment in order to spend what one has saved at another—a suggestion implicit in those examples which take as their starting-point a man saving up against old age or a rainy day. Robinson Crusoe cannot turn his spade into food ; all he can do is to look for some one to give him food in exchange for the spade, in which case he has reversed the process of saving as far as he himself is concerned by surrendering his source of continuing income.

and simple is an artificial one. In fact incomes are to be had on various terms and have more or less risk attached, and this is reflected in the yield on the purchase price. The whole network of borrowing and lending between individuals is so bound up with questions of risk and so complicated by the fact that loans are for particular periods, that the real question of the terms on which continuing income is exchanging itself against present payments is obscured. Yet it is on the relative price of the two that the division between more or less remote objects of satisfaction depends. When all is said and done the underlying position is the same as in the case of Robinson Crusoe. Crusoe has to consider whether the reduced consumption which he will undergo to make a spade is worth the increased flow of wealth which the spade will give him. The business man to-day, balancing up a security against a new motor car for himself, considers whether the continuing yield from the security will balance the disadvantage of not having a new car. The rate of interest which he will get is the determining factor. It is the price of capital, and of the future as against the present.

## 3

It has been emphasized that capital itself has become more and more specialized in

character. Raw materials and fixed plant are both capital, and are both necessary for the production of goods. But the world is faced with choice in the type of capital it accumulates, whether it is to increase its supply of raw materials or its supply of factories, for example. One can imagine the one outstripping the other. If there are too many factories and not enough raw materials, the price of raw materials will be high, the factories will be running wastefully and expensively at half pressure, and demand will be choked off until a proper proportion reasserts itself. Alternatively, if there are too many raw materials, their price will fall till production is squeezed from the direction of raw materials into the more elaborate manufacturing processes. And the same is true of different types of fixed capital and of different types of raw material. Over-production in one direction involves a process of low prices and squeezing until production balances demand at a reasonable price and compensatory movements occur elsewhere.

Thus the price system is not merely two dimensional (apportioning different forms of goods and services according to consumers' preferences) but three dimensional; it preserves a balance not only between different types of producers' goods, for example between raw materials to be worked up into finished

goods and the fixed plant that works them up, but also between different types of material and plant. Proportion runs through the economic system.

We are sometimes reminded that "one industry's finished product is another industry's raw material". The output of the paper mill is the raw material of the printer, and the loose sheets of the printer are the raw material of the binder. Almost every finished product passes through the hands of many industries. A bird's-eye view of the industrial structure of a country at any given moment would show innumerable industries all dovetailing one into the other, and goods passing from industry to industry and then to the distributive services which give those goods value equally with the more obvious efforts of the producer, by bringing them to the right place at the right time.

All these industries will have taken time to set up, and all of them will have value only as long as they continue to produce income. Once the ability of a factory to bring in a return has gone because the demand for its products is not enough to justify its remaining open, it becomes valueless—or rather, its value will be dictated by any alternative uses to which it could be put. It may be that this will only be the value of the site and of the scrap. A ship that cannot run at a profit, or

a water mill that will not pay its way, have ceased to be capital.

In a wealthy country money has been sunk in fixed capital to an enormous extent. Mines, farm buildings, factories, railways, roads, business premises, are a nation's capital, and about them two things are significant: first, that they are unadaptable and tend to be able to produce only the types of goods for which they were originally designed; second, that their value solely depends on their income producing capacity and that consequently any shift of demand away from the goods in which plant is specialized means that the owners of that plant have lost their incomes. It will be noticed that the more advanced and developed a country is—that is, the greater the measure of specialization and the complexity of the economic organism—the more irretrievably is money sunk in capital goods, and therefore the greater will be the effect of any sudden change in demand on the relative profitability of different parts of the industrial system. The more modern a nation is in its productive methods, the less will it be able to shift production easily from one direction to another and the greater will be the impact of the forces of change.

### CHAPTER III

## SOCIAL AND ECONOMIC CHANGES

#### I

THE economic organism has been depicted as consisting of co-ordinated industries which dovetail into each other and are duly proportioned to the process of maintaining and increasing the wealth of the community. But this is only an instantaneous picture ; if the position be considered over a period of time the picture becomes infinitely more complicated. Not only are changes of every sort constantly going on, new industries appearing, others decaying, others again changing in significance, but these changes are discontinuous. New inventions do not appear at an even rate. Progress is disturbed by political upheavals, broken by wars. Changes in social structure are less striking but exert an uneven influence. Economic organization is always transforming itself, at some moments more rapidly than at others. New methods, new desires, new governments, new theories—each of these creates opportunities in one direction and reduces them in another. The value of existing capital fluctuates in accordance with its

income producing capacity. The whole structure of economic society is ever modifying itself.

Any attempt to analyse change encounters this difficulty : that no one factor can be isolated and its effects examined without regard to other factors. Itself the result of other forces, much of its importance lies in the further forces on which it works. With each factor reacting with others, the most one can do is to examine general effects and implications. But the result of such an examination must inevitably be meagre, apart from reinforcing the obvious conclusion that the readjustments which the economic organism is always trying to make are on a very extensive scale. The particular changes which may be considered very shortly are changes in population, in taste, in income distribution, in the political situation, in invention and technique, in organization. It need hardly be said that the list does not pretend to be exhaustive (it even omits in the interests of space any discussion of seasonal change), while the classification is merely one of convenience ; it is quite indefensible if it be considered as an attempt to differentiate between different kinds of change.

## 2

Changes in population are an obvious source of new demands and of the falling away of

old demands. The population of a country is composed of individuals of varying ages, and the requirements of these different groups will vary. The needs of children are not those of old people ; men and women want different things. The difference is not one of taste and fancy alone, but of real physical requirement.

With a stationary population (assuming the distribution between the different age groups does not vary to any great extent) the demands for many types of goods and services will remain fairly stable. Every year a certain number of school children will reach school age and will replace those who are leaving. Every year the teachers who retire will be replaced by approximately the same number of teachers fresh from training schools and universities. The demand for new houses will be fairly steady and will be confined (assuming no big change in people's habits) to the replacement of those which have become dilapidated or out of date. The demand for a whole range of goods and services would be fairly steady, year in and year out.

If we assume population increasing at a steady rate, the picture is different, but only slightly so. It is true that every year *more* children will reach school age, *more* class room accommodation will be needed, *more* school teachers will be required and supplied by the

training schools and universities. But as long as the rate of growth is steady the increase will not call for drastic changes. The building industry and the teaching profession alike will organize themselves in order to provide a steadily increasing output. The lines that demand is likely to follow are clearly marked, and there are no disturbing fluctuations.

This applies, of course, to a large number of activities of which building and teaching have only been chosen as conspicuous examples. A sparsely inhabited country which is filling out will need new railways and means of communication as the population pushes its way further and further over virgin territory. The steady demand will not be confined to new houses and new railways, but will extend to streets and street lighting and to public service. There will be a slowly increasing demand for the necessities of life and livelihood. The dangers of maladjustment, should over-development occur in any one direction, are much reduced. If too many schools have been built, in a few years demand will have caught up and all will be well. If there are too many doctors, the supply of new doctors will slowly be reduced, and in any case in a few years the number of patients will have made up the leeway. The absorption of those coming into employment from the schools

each year is relatively a simple matter, since the dangers of wrong specialization in regard either to capital or to human beings is largely transient.

But the picture becomes much more sombre if we assume, after a steady rate of increase, a population that starts decreasing. The demand for fresh houses and fresh teachers will disappear; there will not even be demand for houses to replace all those that are obsolete, or for young teachers to follow the footsteps of all those who have grown too old. Any error will not tend to remedy itself, but will grow more dangerous; there will be a transfer problem in that people trained for one profession may have to be retrained for another, while misapplied capital will be misapplied for all time. The demand for the old staple necessities will fall off proportionately, and luxury goods and luxury services will become relatively more and more important. Inevitably large readjustments will be called for.

This case of a steady increase followed by sudden decrease is admittedly an exaggeration, but the implications of the argument apply to any irregularity in population growth. Population tendencies are seldom regular, and the consequent variation in the demand for particular types of goods is considerable. The greater the changes in population, the

more sweeping are the readjustments called for in the productive structure and in the direction in which the operative, the technician, and the professional man are called on to specialize.

Population changes are not, of course, confined to the total number of people in existence at any given time: the distribution of the different sexes and the different age-groups is important. More men, less women; more old people, fewer children; a larger or a smaller proportion of the population capable of performing work—all such variations have a significance. And population changes are likely to be profound. Experts take the view that in the countries of Western Europe population is likely soon to reach a maximum and then to begin to decline, and it is even suggested that the population of such a rapidly expanding country as Japan will have passed its maximum by 1970. The significance of this for anyone who attempts to forecast the economic future cannot be exaggerated; it will involve changes of the most powerful kind.

## 3

Taste and fashion represent the second source of fluctuating demand.

We have seen that, as a country progresses—

and as population growth slows down—it devotes proportionally less of its energies to producing necessities and more to luxuries. The demand for luxuries is fickle, in contrast to the more stable demand for necessities. Potatoes remain much the same, but taste in clothes alters from season to season in a most erratic manner. With progress the whole range of goods subject to unforeseeable variations in demand increases.

It should hardly be necessary to emphasize the extent to which tastes do change. A comparison of the methods of living of to-day with those of forty years ago should be more than sufficient to point the moral. It is not merely a question of differences of dress and of outward appearance, but goes to the root of things ; to social developments and far-reaching changes in outlook which profoundly affect the economic structure. The demand for bath-rooms and the desire for travel are cases in point, and to these may be added even more obvious examples—tweeds in preference to frock coats, hairdressers in place of hairpins, silk stockings and artificial silk underwear for stockings of black wool and petticoats of flannel. The generations change, and with them the things they prize highly and the things they disdain. The falling-off in liquor consumption is balanced by the increased

demand for other forms of amusement ; money spent on greyhounds and cinemas is largely money saved on beer. Instead of going marketing we expect our goods to be well advertised and delivered at our own front door into the bargain. The amount we read goes up by leaps and bounds. The wireless ousts the piano from the home, and the garage the wallflowers from the garden. The anti-macassar becomes proverbial for the obsolete.

The way in which we use the terms " pre-War " and " post-War " illustrates how great a gulf in outlook may break up a short period of years.

## 4

Next there are changes in the way that incomes are distributed within a community. In different countries and in different periods the distribution of income among sections of the population varies. The few may be getting richer more rapidly than the many, or the gap between the many and the few may be closing up. And so demand is affected, for the desires of millionaires are not those of the majority. Thus if the wealth of the many is increasing faster than that of the very rich, the demand for the more common luxuries will outstrip that for millionaires' goods.

A rough illustration of such changes is provided by the following table <sup>1</sup> :—

HOME-PRODUCED NET INCOME : DIVISION BETWEEN FACTORS OF PRODUCTION

	1911.	1924.	1929.	1931.
Wages . . . . .	773	1,413	1,482	1,376
Salaries . . . . .	215	741	838	808
Rent (land and buildings) . . . . .	200	258	293	313
Profit and Interest . . . . .	624	989	1,106	825
<b>Total . . . . .</b>	<b>1,812</b>	<b>3,401</b>	<b>3,719</b>	<b>3,322</b>
Net Income from Overseas . . . . .	200	185	287	177
Salaries as per cent of whole Home-produced Income . . . . .	11·9	21·8	22·5	24·2
Wages as per cent of whole Home-produced Income . . . . .	42·5	41·5	39·9	41·3

Thus the conspicuous change in the twenty years following 1911 is the increasing proportion of the national income going to salaries, and by implication the increasing demand for goods of a type demanded by salary earners.

5

Many changes can be traced to political considerations. It is hardly necessary to dwell on the fact that a war stimulates a large and sudden demand for armaments and munitions and for raw materials necessary to their production. It is more important to notice that the cutting off of sources of supply creates a need for food-stuffs and for a whole range of specialized goods and services which previously

<sup>1</sup> From Colin Clark, *The National Income*, Table xxv.

could be obtained from quarters now out of reach. How great the changes in industrial organization due to war can be are shown only too vividly in the history of post-War Europe. Home supplies of food-stuffs had to be strengthened and developed as rapidly as possible, while industries sprang into life, devoting their energies solely to producing the material of warfare required by direct combatants. In the case of Great Britain ship-building had to be undertaken on a large scale, and home sources of supply replaced many commodities previously imported. In the meantime a large number of normal industries found themselves starved or insignificant; the resources of the community were above all things devoted to the prosecution of war.

With the Armistice a complete change over began. Replacements of every type had to be made, and industries that had languished during hostilities were suddenly distended to meet a sudden demand that had been accumulating during the previous four years. The swing was liable to go to extremes; the huge war industries were due to disappear; feverish peace activities were trying to meet an enormous but temporary demand. The process of turning swords into ploughshares was in full swing.

But it is not fair to focus undue attention on the effects of wars alone. In peace time the activity of governments is constantly modifying the demand for goods and services. Taxes alter incomes and so affect the amount of money people have to spend. Measures such as tariffs or quotas are constantly influencing people to prefer some goods to others. Every political decision has a greater or smaller effect in stimulating or restraining the forces of change.

## 6

So far the question of change has been considered—except in the case of government action, which tends to affect demand and supply alike—from the demand side. It is now time to turn to changes from the side of supply, emphasizing once again that the distinction drawn between the two is one of convenience alone since there is no logical justification for severing the one from the other.

The most conspicuous examples of changes from the side of supply come from the growth in human knowledge and from new inventions. History from the eighteenth century onwards is full of those new discoveries, technical and scientific, which have made possible productive processes as we know them to-day. The

comparatively recent development of power-driven machinery is fundamental, and even the factory itself is, as human memory goes, almost an innovation ; without these we cannot conceive of a mode of living akin to that with which we are familiar. "Mass production methods" have made available a whole range of articles, expensive to make without the refinements of sub-specialization, to the bulk of the population, and the whole system rests on a well-grounded and progressive technical advance. We live in an industrialized age, and the methods of industrialism owe their origin to discoveries of the human intellect.

It is not only that discovery has enabled things with which the world was already familiar to be produced more easily and in much greater quantities. A whole range of new goods has been added to those on offer to the purchaser. The pace of invention in recent years provides ample testimony to this. Motor cars, wireless, gramophones, artificial silk, air travel—all these are fundamentally affecting the character of people's existence. New discoveries evoke new wants, and enable existing wants to be satisfied for many more people than heretofore.

Nor is this progress confined to the manufacturing industries. The world has witnessed several agricultural revolutions, and of these

the revolution of recent years, due to the introduction of mechanical methods and to the discoveries of biology and of the kindred sciences, is not the least, coupled as it has been with an increasing acceptance of the importance of subsidized research and of subsidized dissemination of information. "With the sickle and the flail, from 35-50 hours of labour were required to harvest and thrash an acre of wheat with a yield of 15 bushels. With the combined harvester three-quarters of an hour of labour is required."<sup>1</sup> Again, "great increases in production have undoubtedly resulted from the advances in agricultural engineering in the newer countries. In the four years 1925-8 production of wheat in the United States averaged 13 per cent more than in the period 1919-1922. But this increase must not be attributed merely to mechanized progress. The great efforts made to diffuse scientific knowledge of soils, crops, fertilizers, live stock, breeding and feeding, and of the defence of crops and animals against pests and diseases have played a large part. No mechanical devices are a substitute for good and scientific farming."<sup>2</sup>

<sup>1</sup> *World Agriculture : An International Survey*. Oxford University Press. Issued under the auspices of the Royal Institute of International Affairs. p. 39. See chap. iii, "Modern Methods," *passim*.

<sup>2</sup> *Op. cit.*, p. 44.

The responsibility of the State for spreading knowledge and for encouraging up-to-date agricultural methods is now generally recognized, and various efforts are made in different countries towards this end. The most spectacular successes are perhaps those connected with improved sugar-cane and rubber production in the Dutch East Indies—spectacular partly because they have had the less happy effect of leading to over-production in sugar and rubber alike. The best known scientific achievement is perhaps that of fixation of nitrogen from the air for the purpose of making fertilizers—a discovery which owes its origin to the needs of Germany during the war and has had the incidental effect of nearly ruining Chile by undermining her position as the world's only important supplier of natural nitrates. Of enormous importance also is the discovery of efficient methods of preservation (for example, canning) and refrigeration. "The nations of the west are now so accustomed to the variety of foods made possible by the development of methods of food preservation that it is hard to realize how comparatively restricted diet was fifty years ago."<sup>1</sup>

The effect of the tremendous stream of discoveries and inventions has been completely to change the quantity and the quality, and

<sup>1</sup> *Op. cit.*, p. 52.

to increase the variety, of goods coming on to the market.

## 7

Change can come about through another form of improvement in productive technique, that of increasing efficiency through re-organization and greater specialization. While such developments—in their most familiar form known as “rationalization”—very often take place in conjunction with the use of improved technical resources, there is no reason why this should always be so. The possibility of concentrating processes in such a way as to secure more economical production is related in the main to the size of the market. Mass production methods only pay as long as there is a large and steady demand for their output. If the demand is small, they cease to be an economy; in a small village the blacksmith will undertake many functions and will not, for example, concentrate on the making of a particular type of screw alone. In contrast, if instead of a village we have a large community in which there is room for specialists, there is little doubt that screws will be produced more efficiently and more cheaply by one man concentrating on their manufacture even though the technical methods at his disposal are much the same as those of a village blacksmith.

The same thing will happen in the case of business ; as a business finds its markets increase it will be able to differentiate its functions more and more and so to perform them more satisfactorily. Similar processes can be concentrated in the same place ; machinery can be run for longer hours ; economies will follow on bulk handling of materials and finished products ; all sorts of innovations can be made use of which pay if the output is large and which could never pay as long as it remained at a low level. The greater the volume the more cheaply can it as a rule be produced and handled. Reorganization and specialization can secure the supply more economically ; this is the principle which underlies many "grouping" movements and rationalization schemes.

## 8

At this stage it may be well to expand the reiterated warning against the danger of simplifying the picture unduly, either by looking on the different influences as working in isolation or by drawing a line between changes from the side of supply and those from the side of demand. The difficulty of distinguishing between particular influences has just been illustrated : when an industry rationalizes itself

it is almost impossible to distinguish the extent to which the advantages are due to improved technique, or to an enlarged market which makes further specialization and the use of this technique profitable. In fact, often enough rationalization has proved a failure; new methods are taken up and fail because the market is not large enough, though had the market been larger they would undoubtedly have proved a tremendous success. The distinctions between changes due to taste or to redistribution of income or to population movements are—if they be analysed—equally arbitrary. They are constantly affecting each other, and one cannot assume “other things being equal” in discussing them; changes in population will not leave the distribution of incomes unaffected; and a change here is likely to mean changes of taste. They are not independent forms of change, but rather different aspects of a process of change which is constantly going on. And the same is true when one considers the position first from the side of supply and then from that of demand. No change in supply leaves demand unaffected, and this applies equally to the converse. The one provokes a reaction from the other side, there being a movement towards a price at which demand and supply will balance each other. While it is useful to consider each side

of the account separately, it must never be forgotten that they are sides of the same account. Thus it is an error to look at an objective "cost of production" of an article, on the assumption that the first and the millionth sample of that article cost approximately the same to produce. Things are scarce because people desire them, and cost of production arises out of people's desire for things and the effort involved in making the required supply available—and from that alone. We get as many things as we can in the proportions which suit us best; there is no independent cost of production and no justification for separating supply and demand. Ultimately values arise out of natural scarcity and human choice.

## 9

In conclusion, the argument of the preceding pages may be illustrated from the changes which have taken place in Great Britain in the ten years 1923–1932 (see tables, pp. 59 and 60).

The following figures—restricted to industries employing more than a hundred thousand—cover over 80 per cent of the whole insured population, plus agricultural workers. They do not, of course, cover 80 per cent of the working population—there are other employments

besides agriculture outside the unemployment insurance scheme.

CHANGES IN NUMBERS EMPLOYED IN DIFFERENT INDUSTRIES,  
1923-1932  
(All Industries over 100,000, and Agriculture)

<i>Industries.</i>	1923.	1932.	<i>Percentage increase or decrease.</i>
<i>Expanding Industries.</i>			
Public Works Contracting, etc.	127,940	290,370	127
Tramway and Omnibus Service	108,240	180,510	67
Electric Cable, Apparatus, Lamps, etc. . . . .	72,120	117,490	63
Distributive Trades . . . .	1,253,980	1,950,240	55
Hotel, Public House, Restau- rant, Boarding-house, Club, etc., Service . . . . .	258,960	381,930	47
Furniture Making, Upholster- ing, etc. . . . .	94,090	133,870	42
Road Transport not separately specified . . . . .	148,900	209,160	40
Local Government . . . . .	241,760	339,790	40
Laundries, Dyeing, and Dry Cleaning . . . . .	106,780	148,530	39
Motor Vehicles, Cycles, and Aircraft . . . . .	191,830	252,080	31
Shipping Service . . . . .	127,240	161,330	27
Hosiery . . . . .	89,880	114,200	27
Professional Services . . . .	108,590	137,160	26
Printing, Publishing, and Book- binding . . . . .	227,920	284,770	25
Metal Industries not separately specified . . . . .	164,760	204,000	24
Food Industries not separately specified . . . . .	96,800	118,770	23
Building . . . . .	716,020	856,910	20
Tailoring . . . . .	186,460	211,660	13
Drink Industries . . . . .	100,290	108,080	8
Commerce, Banking, Insurance, and Finance . . . . .	226,660	243,130	7
Gas, Water, and Electricity Supply Industries . . . . .	173,040	174,210	—
<b>Total . . . . .</b>	<b>4,822,260</b>	<b>6,618,190</b>	<b>37</b>

<i>Industries.</i>	1923.	1932.	<i>Percentage increase or decrease.</i>
<i>Contracting Industries.</i>			
Bread, Biscuits, Cakes, etc. . . . .	159,890	159,250	—
Boots, Shoes, Slippers, and Clogs . . . . .	141,890	137,970	-- 3
Textile Bleaching, Printing, Dyeing, etc. . . . .	114,950	112,090	-- 3
Chemicals . . . . .	104,010	99,120	-- 5
Agriculture . . . . .	892,410	809,100	-- 9
Total Cotton . . . . .	567,650	517,950	-- 9
Dock, Harbour, River, and Canal Service . . . . .	190,870	169,070	-- 11
Dressmaking and Millinery . . . . .	117,160	102,970	-- 12
Woollen and Worsted . . . . .	269,420	233,610	-- 13
Coal Mining . . . . .	1,243,580	1,044,920	-- 16
General Engineering: Engineers' Iron and Steel Founding . . . . .	666,950	551,200	-- 17
Steel Melting and Iron Pudd- ling, Iron and Steel Rolling, and Forging . . . . .	210,960	167,760	-- 21
Railway Service . . . . .	190,210	134,450	-- 29
Shipbuilding and Ship Repair- ing . . . . .	269,970	181,930	-- 33
National Government . . . . .	181,170	121,840	-- 33
Total . . . . .	<u>5,321,090</u>	<u>4,543,230</u>	<u>-- 15</u>

[Calculated from Statistical Abstract, numbers insured in industries, and members employed in agricultural holdings of more than one acre.]

During the ten years the total number rose by just under 10 per cent. Twenty-one industries increased by 37 per cent, and fifteen decreased by 15 per cent. These figures tend to under-estimate the change, since they make no allowance for unemployment, which would be much heavier in the case of the decaying industries.

The evidence of these figures is striking.

The enormous increase in public works reflects road development, the desire for social amenities, and efforts to combat unemployment. Almost all the figures illustrate the growing demand for minor luxuries (for example, the motor industry) and especially for services (the increase in distribution and hotels bears witness to this). On the other side of the picture, we see the demobilization of national government officials (a war-time legacy), failing agriculture, railways suffering from road transport competition, decreasing shipping and the failure of Britain's old export industries—cotton, coal, steel. The old-established industries are disappearing, and yielding place before a more diversified demand.

It is easy to see the broad significance of these figures, with their comment on the way that mankind prefers to use its energies once a certain level of material well-being is reached. The sheer quantity of goods required and consumed does not increase in proportion to our capacity for extracting food-stuffs and materials from nature. Instead, the goods that we use must be made more elaborate. More time must be spent on making them up, and in particular more energy must be devoted to bringing them to the right place at the right time—hence the growth in the numbers of those employed in the distributive

industries. The extra opportunities for satisfying our wants, brought through technical advance, are used by us to demand services instead of goods. Our wants become more and more complex, and we require a diminishing proportion of purely natural resources to satisfy us. Thus the more advanced we become, the more we find satisfaction—rightly and naturally—in an economic process of “taking in one another’s washing”.

## CHAPTER IV

### BUSINESS FLUCTUATIONS

#### I

THE constant ups and downs in business activity which are so characteristic of the era of specialized industrial organization find their origin in the impact of change on fixed and specialized capital. There is a constant interplay of the forces making for new development ; in face of this there is a large quantity of fixed capital ever being added to and ever being replaced. But the rate of addition and the rate of replacement are alike varying ; the value of the capital itself is fluctuating with its income producing capacity, while the actual plant of which it consists remains the same. On top of this it must be remembered that the motive force of business is that of profit. Future development is completely dependent on the anticipated rate of future profits, and the direction in which profits may be found. In these circumstances it is only natural that irregular movements should occur. Given the constant change in human requirements and in productive capacities, it would indeed be surprising if economic advance were a slow

and steady upward movement, unpunctuated by setbacks.

Thus the volume of productive activity is never increasing regularly or even remaining steady for any length of time ; it expands and contracts, and this tendency shows itself in parallel movements in various indices of economic activity. Not only do direct indices of the volume of production itself illustrate the expansion and contraction, but prices also move up and down as depression deepens or prosperity reasserts itself. From several points of view the best indicator of these changes in activity is the volume of unemployment. This is the conspicuous feature which attracts the most attention and brings home most closely the social as well as the economic effects of a dislocation of the productive system.

But increasing unemployment and falling prices are only two of the symptoms of decreasing production. At the beginning and in the earlier stages of a depression stocks of commodities tend to accumulate ; security prices fall sharply and go on falling as the outlook becomes more ominous ; since incomes have been reduced the government finds its revenue failing, and is forced to reduce expenditure and increase taxation. The profits of industry are the first to suffer, but gradually there is an assault on wages and the wage-level

is thrust downwards ; creditors become shy and try to call in their loans ; debtors find it all the more difficult to pay. For a short time there may be a financial panic, or even a series of financial panics.

The international repercussions of the trade cycle are now equally far-reaching, though during the last century national economies were more insulated and the waves of disturbance in consequence spread less rapidly. Panics, exchange restrictions, tariffs, the abandonment of the gold standard, and an enormous drop in the volume of international trade are the monuments of economic collapse. Increased communication, if it has brought the world into closer unity for the enjoyment of prosperity, has also made it more liable to disturbance.

## 2

Generally speaking, the origin of business fluctuations is to be found in the fact that the demand for capital goods—for factories, machines, and railways, for example—is irregular. The stream of new enterprise is not an even one, but tends to proceed by fits and starts. It is only natural that this should be so. If, after several placid years, a new invention of a revolutionary character and of world-wide significance comes to the forefront,

inevitably there are feverish efforts to embody it in the form of capital. Again, when this invention has been fairly widely diffused, the demand for capital goods quite naturally begins to fall away since there is no reason to suppose that a second major invention of approximately the same importance will always be there to take the place of its predecessor. Invention is a discontinuous process.

Nor need these discontinuities be associated with invention alone. They may originate from the other causes of change which have been discussed, such, for example, as changes in the rate of population growth or the occurrence of wars. The events which followed immediately on the Great War illustrate exactly what we might expect to find. We have seen how during the War there was a very large demand for capital of certain kinds. This demand was stimulated not only by the need for machinery to turn out ships and munitions of war, but by the necessity of having plant to enable us to produce at home such necessities as we were no longer able to import on account of hostilities. Not only was there this huge demand for capital goods, but owing to shortage of labour it was quite impossible to satisfy the more normal but less urgent requirements of existing industries. Hence after the War there was a huge "restocking" boom. Worn-

out plant had to be renewed, houses for private people had to be built, stocks of commodities had to be replenished. As a result there was very little unemployment in the boom following on the War.

But the effect of this soon wore out. War demands and renewal demands had been met. The Trade Union unemployment percentage went up with a bound.<sup>1</sup>

Irregularity in the demand for capital goods is further explained when we consider how a small change in consumers' tastes calls for an enormously greater change in the capital-producing industries. This may be illustrated with an example of a type with which economists will be familiar. Let us suppose that shoe factories have £10 millions' worth of plant, and that every year they spend £1 million on renewing one-tenth of this plant which wears out, so that the value of the plant remains the same. Then the makers of shoe machines will themselves be organized to provide this

<sup>1</sup> Pigou, *Industrial Fluctuations*, p. 400.

		<i>Per cent.</i>
1919.	First quarter . . .	2·7
	Second quarter . . .	2·2
	Third quarter . . .	1·9
	Fourth quarter . . .	2·9
1920.	First quarter . . .	1·9
	Second quarter . . .	1·1
	Third quarter . . .	1·7
	Fourth quarter . . .	5·0
1921.	First quarter . . .	8·5
	Second quarter . . .	20·9

£1 million's worth of plant each year. After this has been going on for a fair period, the public suddenly decides that it is going to buy 10 per cent more shoes in future. What happens to the makers of shoe machines?

The effect must be traced through slowly. With the public demanding 10 per cent more shoes the shoe factories decide that they must have 10 per cent more plant. They will want £11 millions' worth of plant instead of £10 millions' worth. So in the one year they order not £1 million's worth of plant but £2 million, i.e. £1 million entirely new plant plus £1 million plant for renewal purposes as before. That is to say, under these conditions a 10 per cent increase in consumers' demand has been followed by the *doubling* of the demand for shoe machines in the one year.

But the story does not end there. Suppose that the demand of the consumers for shoes stabilizes itself at the new level instead of going on increasing. In that case the shoe factories have £11 millions' worth of machinery. The year following they renew the usual tenth, there being no demand for more. One-tenth of £11 million is £1,100,000. Thus on these hypotheses in three successive years the makers of machines have to supply:—

First year	. £1 million worth.
Second year	. £2 million worth.
Third year	. £1,100,000 worth.

And all this occurs because of a 10 per cent irregular increase in demand. The case becomes even more extreme if we assume that after the 10 per cent increase consumers' demand falls right back again to its old level. In that case, if the shoe factories just decide to scrap one-tenth of their oldest machines instead of getting in new ones for renewal purposes, there may be no orders at all for the machine-makers for a whole year.

Now the assumptions behind an example of this sort are quite artificial. In the real world there is an element of give which is omitted for the sake of simplicity and drama. In addition, the makers of the machines would be unlikely to confine their attention to machinery for one industry alone ; for another, they would have some unused plant as a margin against emergencies ; for a third, they could use their plant more intensively and so produce more shoe machines. But there is a further reason still to be remembered : in face of such an overwhelming demand, the makers of shoe machines could raise prices and so even out the demand and space it out more effectively. Nevertheless, even with all these qualifications, the example shows how a small change on the surface may involve tremendous change at the roots, and points to a source of instability. The swings in

profits and in employment among the makers of machines are likely to be big—and here must be sought the origin of business fluctuations.

The fact is that the demand for capital goods spreads from industry to industry. Prosperity in one industry tends to breed prosperity in another, just as depression in one industry means unemployment and a falling off in demand and gradually a spreading of unfavourable conditions throughout the economic system unless countervailing factors assert themselves. It now remains to show how once a downward movement has passed a certain point, it tends to gather momentum.

## 3

Some of the effect of disturbance may be illustrated by an analogy. An isolated community of thirteen men is at work. Ten of these are engaged in producing the normal goods and services for consumption. The other three are maintaining and adding to the stock of capital ; that is to say, they are making tools and growing corn for seed purposes. The three men have been busy because new types of tools have been invented. The other members of the community have been keeping them in

food and drink in return for the tools they have made. But invention begins to fail, and the ten men see no particular sort of tool which they desire. Two of the three men are thrown out of work and made to subsist on the minimum, since they are out of work and on the "dole". Since these two men are now consuming less there is, it is true, more for the remaining employed members of the community; but they find that they are unable to consume this extra supply of food since they have enough already. They cut down the acreage under cultivation, and one of those who is producing consumption goods is unemployed. There is the paradoxical position that there are men unemployed who have to go without because they are doing no work and at the same time a glut of food. This is the familiar paradox "of poverty in the midst of plenty".

The answer to the paradox is simple enough; the two men who stopped making tools should have been put on to try and satisfy entirely new needs for the community in some entirely new line of business, so that they could exchange the products of this for their share of the food-stuffs. Failing the existence of any such new line, one can only assume that the community had reached a stage of general satisfaction, and should have worked less all

round or taken it in turns to have a holiday. But the significance of the tale is in the fact that adjustment to the new conditions will involve a considerable process of adaptation and reorganization.

If we look at the economic system we see something which very approximately parallels the thirteen men of this analogy. A large part of the working population is producing goods for consumption ; the rest of it is producing capital, that is, the more complicated instruments which are the present-day equivalent of tools and seed corn. The consumption goods are bought by people with what they " spend " ; in contrast the capital goods are bought with what people " save ".

And here is the crux of the matter. The individual who sets aside a part of his income does not as a rule start a shop or a factory with it. He may buy securities, or an insurance policy, or deposit the money in a bank. But in the long run it will be borrowed (with bank or insurance company acting as intermediary) by someone who wants to use it for the purpose of extending a business. This man will buy capital goods and so give employment to workmen and organizers who in their turn will buy consumption goods though they are producing capital goods which do not as yet add to the supply of things on the

consumption market. The position may be depicted thus :—

Flow of capital goods --- Intermediaries, ---	Money being " saved "
Banks, etc.	by individuals.
Flow of consumption goods -----	Money being " spent "
	by individuals.

We may assume normal conditions to begin with. In this case the flow of money spent on capital goods may be said to be equal to taking up the supply of these goods, and the same thing of the money spent on consumption goods. Now, suppose that the intermediaries suddenly get frightened and see no obvious opportunity of profitable investment in capital goods. The demand for capital goods falls off, but saving remains the same. There is no inevitable reason why money saved by individuals should be translated into capital goods ; that implies a transaction of a particular type in which money and machines are exchanged against each other. The money lies idle in banks without circulating. It is true that the actual amount of cash and credit outstanding on bank books may be unchanged, but it will circulate more slowly, and it is through circulating rapidly that it provides means of payment on a larger scale. We thus have the position that " saving " is not being translated into " investment ",<sup>1</sup> that is, into a demand for capital goods. In

<sup>1</sup> This use of the terms comes from J. M. Keynes' *Treatise on Money*.

turn this means a falling-off in the wages and salaries paid out by the capital goods industries. In Mr. Keynes's terminology, saving exceeds investment.

The falling-off in wages and salaries leads to a fall in the amount offered against the flow of consumption goods. Either the supply of these goods piles up or else the price falls so that they may be disposed of at the lower level. Production becomes more unprofitable and this, further, lessens the demand for capital goods. A vicious spiral is set up and the downward movement of depression is in full swing.

It is important at this point to stress the effect of the fall in prices once it gets beyond a certain point. The first effect is to cut down profits, since wages and fixed interest payments must be maintained more or less in full. Next, as things get worse wages move downward slightly, but do not compensate for the lessened receipts due to the fall in prices and in turnover. On the other hand, all those receiving fixed incomes in terms of money benefit because they are able to buy everything much more cheaply. Thus those receiving fixed payments gain and those receiving fluctuating payments suffer; in particular creditors gain and business debtors find it much harder to meet their obligations. Un-

certainty and lack of confidence in the future breed more uncertainty and a greater unwillingness to embark on new enterprises. Unemployment goes up by leaps and bounds.

The upward movement, that of recovery, is the exact reverse of this. It begins with a demand for capital goods, a demand which equals and then exceeds saving. More is paid out in the way of wages to those producing for the future. The purchase of consumption goods increases as unemployment is reduced. Prices rise; profits are restored; debts are easier to pay; profits breed more enterprise and in turn more profits, and the upward movement goes from strength to strength until at length a lack of obvious investing opportunities, bad investments which are not properly proportioned to consumers' demand, and other disturbances accumulate till the demand for capital goods falls off again below the level of savings and the down swing begins once more.

So far there has been no explanation of why there should be a turn at the bottom of the depression. As the argument stands at present there is no reason why depression should not go on for ever, which obviously is not the case. Professor Ohlin<sup>1</sup> classifies the forces

<sup>1</sup> League of Nations, *The Course and Phases of the World Economic Depression*, pp. 293-8.

making for recovery under two heads. The first head covers factors making for increased production without necessarily increasing purchasing power in use. The main factor here is that stocks of commodities may be reduced because production is cut down faster than consumption and so, by stopping the fall in prices, may stimulate a feeling of confidence in the profitability of new operations.

But more important are the causes which he classifies under the second head, that of "factors leading to an increase in the total volume of purchasing power in use". The most important of these is an increase in the purchase of capital goods. This will be helped by the fact that the cost of building, installing machines, and so on—that is, of capital goods—will have fallen, while lower rates of interest will enable operations bringing in a smaller return to be undertaken. Further,

"An expansion in investment activity after a period of depression has also sometimes been called forth by new inventions and other forms of technical progress, rendering profitable the adoption of new machines and new methods of production requiring capital investment.

"Moreover, owing to the small amount of new investment during the first part of a depression, a need for certain forms of investment—for instance, in building—develops. This has occurred during most of the major previous depressions.

The more insistent that need, the greater has, as a rule, been the stimulus to invest capital. In other words, the existence during the depression of a reserve of investment requirements has been a factor making for early and rapid recovery. It matters little from this point of view whether the investment is in producers' investment goods or in other investment goods—i.e. durable consumers' goods, such as motor cars, furniture, etc. Naturally, consumers often postpone purchases of the latter class of commodities during the first part of the depression, but the fact that this demand has been merely postponed may lead to an increase in purchases after a time."

The second reason is that there may be a reduction in the proportion of income saved; "such a reduction leads to an increase in the demand for consumers' goods in comparison with the supply of such goods." The fall in the proportion saved might very well be due to the fact that after a time people are forced to put much less aside if they are to maintain anything approaching their previous standard of living, while a large source of saving—the reserves of industrial companies themselves—are especially hit by depression.

The third possible reason is "purchasing power may also be increased through a growth in the demand for credit to buy consumers' goods. This might occur, for instance, if manufacturing industries were forced to pay

higher wages and obtain the means of doing so through increased bank credits". Professor Ohlin was writing before the time of President Roosevelt, or he might not have written "there is no evidence to show that this has ever taken place on a considerable scale". But it is only under certain very limited conditions that this possibility arises. Higher wages might mean more employment.

But of all these reasons the increase in the demand for capital seems to be the most important. Housing, railways, motor cars, roads, electrification—it is round activities of these types that recovery most often centres.

Thus, to sum up, it is significant that any upward or downward movement in economic activity tends to accumulate in strength till it comes into contact with what might be called "real" factors which govern business men's estimates of the desirability of purchasing capital goods. It is important to remember that the process of accumulation so carefully analysed by Mr. Keynes and others is not in itself an explanation of business fluctuations: it is a description of what happens during the process of fluctuation. The original causes of a downward or upward movement are many and different; they culminate in a weight of economic maladjustments and misproportions

which have sapped men's confidence in the future profitability of new enterprise and have so led to a falling-off in the volume of economic activity. There is no reason to suppose that these causes are the same or of approximately equal importance during different depressions.

The present description has not stressed the monetary factor. There is no doubt that mistaken monetary policies can be, and have been, potent causes of maladjustment. Too easy a policy during a boom and too deflationary a policy (in a mistaken attempt to secure liquidity) during the down swing of depression add to the difficulties. Thus banks may encourage the demand for capital goods during some period to excess through easy credit, and may discourage it unduly during slump by charging too much to would-be borrowers or by struggling for undue liquidity. But the power of the banks to control the demand for capital goods and to even out the flow of investment is limited; as we have seen, estimates of the profitability of extending enterprise depend on many other factors over which they have no control. In general business fluctuations must be attributed to the irregular nature of the demand for capital goods and to the many factors which make for irregularity in this demand.

Inevitably an interesting question arises—will business fluctuations become more intense or will they decrease in force as the years go on?

On the whole recent happenings do not in themselves throw very much light on this question. To some extent the Great Depression which began in 1930 is the counterpart of the Great War which began in 1914. It is true that many of the alleged causes of depression arising out of the War itself—debts and reparations, for example—have been unduly stressed. But these elements apart—and there can be little doubt that they must have had some effect—the War still left an overwhelming legacy of dislocation. Markets were disorganized and productive capacities warped; the feverish haste with which all nations set to work to restore themselves in the years following the cessation of hostilities left its mark even on the more satisfactory achievements. But we shall never be able to reach a final conclusion and to say thus far depression was due to the direct and indirect effects of the War, and thus far to the fact that the economic organism was more complex and more susceptible to a sudden malady.

We are therefore driven back to an attempt

to answer this question in terms of the organism itself. There is no doubt that, as capital per head increases and capital and labour alike become more specialized, the effect of any sudden changes will, on the whole, tend to be more devastating. This at least is true unless we take as a hypothesis some machinery, such as does not as yet exist, both for transferring labour and for writing off capital values. If things go on as they are it seems likely that capital and labour alike will become more brittle.

Again, it seems fairly clear that there is no prospect of the forces making for change weakening in the near future. It is just possible that there may be calmer waters ahead once population stabilizes itself, but the passage of the next few years with its variations in population looks like proving difficult. When we remember that the demand will be all the more for luxuries and services and less for necessities or for the older staple forms of capital goods, it is obvious that variations in taste will exercise a much greater influence.

Connected with this is the fact that the transition—for a country like Great Britain at any rate—to an economic organization in which less will be saved and fewer capital goods will be produced, will not be an easy one. There is every probability of a falling-off in

the demand for capital goods in view of the future state of population and of the fact that the many service industries which are especially demanded by refinements of taste do not tend to be highly capitalized. At the very least there should be a falling-off in the demand for fixed capital, but it does not follow that this will be accompanied by a diminution either of individual savings or in the producing capacity of the industries making capital goods. Till saving and productive capacity readjust themselves to the lower level dictated by the possibility of employing new capital profitably, there is every probability of business fluctuation becoming increasingly severe. And in these circumstances it is inevitable that men's thoughts should turn towards seeking a remedy.

## CHAPTER V

### STABILITY AND PROGRESS

#### I

**B**USINESS fluctuations are a disintegrating force both economically and politically, and as a result there has grown up an increasingly strong demand for some form of control over the sequence of boom and slump. This demand for economic stability has taken many forms. Currency manipulation, tariffs, quotas, cartels, price-fixing schemes have all been invoked in an attempt to prevent the drastic restriction of activity with which depression is associated.

Nothing is more natural than that we should seek consciously to control the face of change in the interest of maintaining general well-being at a less intermittent level. No doubt we should all be willing to sacrifice some of our more striking industrial achievements in return for an economic security which guaranteed a reasonable standard of living to wage earner and salary earner, and preserved them from the disastrous breaks registered by mounting figures of unemployment. On the

other hand, the measures which are so often suggested give little hope of achieving any great success. As often as not they concern themselves with symptoms instead of causes, and perhaps in the process aggravate the trouble. All the remedies just mentioned are static remedies. While they might prove palliatives in a given situation, the situation is constantly changing. Any attempt to deal with the ups and downs of business fluctuations must be more dynamic and more far-reaching in character than most of the half-hearted devices for which the publicist clamours and to which the politician is tempted to resort.

Most of these devices suffer from the fact that they definitely come from a "depression" state of mind. An objective observer cannot fail to note the reaction of opinion to circumstances. We are all producers and we are all consumers. In the midst of economic collapse, with financial loss and unemployment the dominating issues, everybody takes the producer's point of view. The producer must be protected from unfair competition: if the competitors are foreigners let there be more tariffs and quotas. If the competitors come from within the country, let us set up some organization which will prevent any new businesses from starting up in an industry already hard-hit. If a tariff or a marketing board

cannot help, let us pay a subsidy out of the public funds to enable us to compete with foreigners who, we take it for granted, are already subsidized. Let us close the Empire to dumped cotton goods, and let us shut our eyes to the fact that if we do so the native is being exploited by being forced to buy one expensive shirt where he might have had two cheap shirts. Business men, politicians, Trade Union leaders, and Press barons join together to inculcate doctrines of this sort into a not unwilling public.

But, of course, we begin to think otherwise as soon as prosperity returns, and the figures of unemployment are reduced to manageable proportions. Once people feel more or less secure in their jobs, they begin to look at the economic system from the angle of the consumer. They see that they have been deprived of various benefits which they might have enjoyed. They are paying more for inferior goods, and they think they would be much better off if the process of specialization were allowed to go a bit further on an international scale. They see that everyone would be richer if only countries specialized in the things they were good at and exchanged these for the products of other countries. The drive for Free Trade gathers force. When everyone tends to be in a job people begin to realize

that it is the consumer who pays and that production might be concentrated to much better advantage.

A disinterested witness might well find these reactions instructive. On the whole the desperate attempts made during depression to transfer unemployment abroad—for that is all that most of these schemes amount to—is the more pathetic and the more dangerous: what one country does, others do also, and in the long run everyone is the loser. But there are dangers also in the too complacent assumptions of prosperity: economists of standing tend to be Free Traders because the advocates of Protection are mainly vested (and often inefficient) interests, but the consolidation of the future and the development of new industries is always a long and complicated business and a tilting of the balance in their favour may be advisable.

## 2

Ultimately stability must be based on a demand for capital goods which does not fluctuate to any great extent. This is not to say that it must remain unchanging, but the change must be reasonably ordered, must try to eliminate the leaps and bounds with which the demand for new capital is associated

under existing conditions. If the analogy may be recalled, the demand for tools must not cease suddenly, so that the tool-makers have nothing to do. Similarly, there is nothing to be said for setting everybody to making tools which in the long run will be too many or useless for their purpose, for that will mean that people will suddenly discover that their tool-buying policy has been a mistake, and for the time being they will stop buying any tools at all, with disastrous results.

The making and buying of tools over a period of time is, even in this simple form, a dynamic process. The static approach is of little help in dealing with the dynamic problem. Yet it may be worth while turning aside to consider how elaborate an argument can be built up on a failure to grasp the significance of the constant process of change. One may take one example, typical of many, but more ably argued than most.

In his book *Reconstruction*,<sup>1</sup> Captain Harold Macmillan shows himself a vigorous and liberal-minded critic of things as they are. He is obviously writing in the shadow of depression and wants positive action. He suggests—his remedy is “planning”—“that two things are necessary for the planning of production

<sup>1</sup> *Reconstruction: A Plea for a National Policy*, by Harold Macmillan, M.P. Macmillan & Co., 1933.

in any national unit. (1) It must be adequately protected, and (2) regulative powers amounting to monopoly must be granted to efficiently organized and integrated national industries. . . . The choice is no longer as between industrial *laissez-faire* and monopoly ; but between trustification and socialization, or, it may be, between orderly capitalism and economic and social disorder." He quotes as examples of planning the Electricity Supply Act, the London Passenger Transport Act, and similar measures. He does not claim these as perfect forms of planned organization but only as useful experiments. He stresses the fact that "the full benefits of Planning cannot be obtained if the policy is only partially applied".

He goes on to admit that the Government itself cannot formulate schemes. "The whole intention of the policy here advanced is to achieve Planning through self-government as an alternative to bureaucracy." Broadly speaking, he would empower an enlightened majority within an industry to control the unenlightened minority who hold up reorganization schemes ; by conferring on this majority this power he would enable them to secure the elimination of redundant plant and so to attain to cheaper and more efficient production through the concentration of activity in the most suitable units.

He draws a picture then of industries "in which disorderly production and competitive selling have been eliminated by the operation of the Industrial Councils" which he would have at the head of each industry.

"Each national industry has achieved a corporate unity; the separate industries in the group, or the sub-sections of each industry, may be under their own management, but their activities will be co-ordinated and directed by the protective supervision of the Council, under whose auspices they come. The market, let us suppose, is being studied scientifically and industry has been organized to ensure that each plant, constructed with a view to its specialized task within the industry, is able to maintain its production at what is called the "efficiency" level. By these means, not only has anarchy been banished from the market but an instrument has been forged by which the economic activities of each section of the nation can be harmonized with the general economic policy of the nation as a whole."

He completes the picture by sketching a Central Economic Council which will co-ordinate the activities of the various Industrial Councils. It will be the business of this Economic Council to maintain equilibrium throughout the system. In fact the task of this Council is the elimination of business fluctuations. How? On this point Captain Macmillan is tantalizingly brief and vague. Quite clearly he is aware that discontinuities

in the demand for capital goods are an important feature of boom and slump movements, but it is hard to believe that he has grasped their significance when we read that "when there are no profitable opportunities for investment" the Economic Council must "find new avenues for the investment of savings, assist and encourage industries which, in their opinion, it would be in the national interest to expand: and if necessary urge the adoption of public works programmes at times when such a policy is necessary to preserve the stability of the market until the balance between savings and investment has been restored". After all, this is *the* main problem which can hardly be cavalierly dismissed with the assurance that "the Economic Council would have at its disposal the expert knowledge and the necessary machinery for its performance". Captain Macmillan deals fluently enough with comparatively unimportant static problems, but as soon as he begins to touch on the one dynamic problem, which obviously must condition the form which effective planning is to take, he is cautious enough to plead that he "makes no pretence of being qualified to write such a book".<sup>1</sup>

<sup>1</sup> And there are several gruesome misconceptions in other parts of the book. On p. 74 is the wild statement that "the retention of the price system is the real dividing line between Socialist and non-Socialist ideas of planning", while chapter vii,

The objection to Captain Macmillan's argument is that he looks backward instead of forward. Above all things he is concerned with those industries which have been prosperous in the past and which he would make prosperous again in the future. There is no reason to assume that those are the industries on which attention should be concentrated. If the Japanese make cotton goods more cheaply than we do it will in the short run mean disturbance ; in the long run it should mean that we should take advantage of the Japanese capacity for making cotton goods and should concentrate on providing ourselves with something else—with a motor car industry, a canning industry, with various services and with goods of a more specialized and elaborate kind. Government influence will be far more useful in building up compensating developments and making the change-over more easy than in trying to maintain the past against all change. Writing under the influence of depression Captain Macmillan sketches drastic measures for dealing with "unregulated competitive imports which may drive down prices,

on "Foreign Trade", is quite incomprehensible except on the assumptions (a) that we always tend to have an unfavourable balance of payments, (b) that, while a reduction of costs is to be encouraged at home, the benefits of reduction of costs by the foreigner should not be allowed to accrue to the British consumer. But this is definitely a book written from the "producer" standpoint.

and therefore wages, in sections of our home industry ”; one might equally well think in terms of labour released and available for performing other tasks because imported goods enable us to supply ourselves more cheaply. At least it is well to remind ourselves that there is another side to the rather lurid picture.

Captain Macmillan has been so busy sketching out organizations for securing greater efficiency that he appears to have lost sight of the whole motive power behind development, which is profit. New developments mean risk and uncertainty. There is no such thing as an “efficiency” level of production taken by itself. The plant may be there but it is valueless if the output is lacking. Only plant plus output is of any use, and the mere establishment of this plant involves a greater or less degree of risk. Who is to bear that risk? Apparently—if industries are to be more or less in a monopoly position—it is to be the industry as a whole. But how is capital to be distributed between new industries and between one industry and another? Who is to bear the risk there? Quite clearly each industry cannot always invest any savings it may make in its own activities. Some industries are growing, some decaying. How is the transfer between industries made? As soon as you get growth,

who is responsible for directing it? By implication it would seem to be Captain Macmillan's Economic Council, but if the Economic Council makes the decision it is still not clear who bears the risk and gets the profit. The public? Other industries? The Economic Council? The two former are not philanthropists. Yet it is indeed difficult to believe that during depression the erection of a few Councils and Committees will turn losses into profits.

Any successful approach to the whole subject must distinguish clearly between problems of organization and those of risk-bearing connected with dynamic development. The most perfect of organizations will not eliminate risk, and should not seek to eliminate risk. There is no doubt that a great deal of very valuable work could be done in the process of helping to reconstruct the depressed industries which have been such a burden on Britain since the war. But in no way should this reconstruction be confused with the whole dynamic problem which underlies economic change. Salvage work will often have its part, but it is to be hoped that we shall get out of the habit of thinking of conscious economic control as being merely a process of reorganizing existing industries in such a way as to save them from themselves through methods of majority rule.

The functions which the industrialist has to fulfil are twofold : on the one hand he has the ordinary task of running a business and of trying to make it pay ; on the other he must risk money in various directions and choose between these directions. In the past these two functions were often combined, but the tendency at present is for them to be separated. The man who manages an enterprise is seldom the man who has taken the financial risk involved in organizing it, and side by side with the efficient organization of industry and the elimination of wasteful competition must come the whole problem of forecasting the direction in which industry will move. Past experience has shown that depressions come to an end because of new industries and new developments ; they do not come to an end because old industries adopt new forms of organization, useful though these may be.

## 3

The approach which has been discussed at some length in the preceding pages is not an isolated one. It is one which is to be found among many members of all existing political parties. From Fascists at one end of the scale to Communists at the other, and among

all shades of opinion in between, there are many who feel that some form of conscious organization and control of economic happenings, some "planning", is necessary. Nothing has been said here to contradict that view; all the argument is that the stress tends in discussion of the type quoted to be laid almost entirely on forms and hardly at all on changing substance. To clear our minds on the whole subject we must consider not merely suitable reshaping of economic organization (allowing ourselves to be duly impressed by the anarchy in the coal, cotton, and steel industries) but the purpose for which we wish to organize the economic system at all.

It must be obvious that most of the current approaches to the problem of economic stability do not envisage it in these terms at all. Stability in these cases means "no more slumps" and little else. Now on closer examination such a conception does not remain a logical and self-satisfying whole. Britain might have been able to avoid the business cycle had she stabilized and maintained the Norman Conquest, or—to take an example only slightly less ridiculous—kept the Industrial Revolution at bay; but this is not what anybody means. Presumably what most people do want is reasonably orderly development, and they are prepared to sacrifice some of the achievements

of a more spectacular sort, if need be, as the price of this. As soon as this objective is put in such terms it ceases to be an objective at all; it becomes a rather loose statement of a want and, whatever it is, it certainly is not a "plan".

It does not, for example, show within what limits economic development may be sacrificed in the interests of order, or order in the interests of the real material advance which economic development ultimately does bring. Nor does it show—if there be several alternative methods of bringing about this development—on what principle the choice should be made. "Stability" by itself is no more a cure for our economic ills than is "being well" a cure for our physical ills, and this sort of "planning" by itself is a cure no more than is "wanting to get well". Captain Macmillan's Industrial Councils and Economic Council are no more a policy for curing the trade cycle than is "the nationalization of the means of production and distribution"; the interesting thing is what you are going to do with your Councils or your nationalized industries when they are in action.

To begin to understand this problem one must think of it in terms of old industries which are constantly dying and new industries which are replacing them, of a store of national tools

and materials, part of which is constantly being used up and being replaced and being added to. We must remember again that most of these tools can only be used for particular purposes, so that once the purpose is gone the tool is useless. Again, tools are owned by individuals, and the men engaged in making tools are dependent on the orders of individuals who can pay for them, and the latter will only buy tools when they can see a good use for them.

The problem of business fluctuations is that of organizing society's tool-buying activities, and this leads straight away into the maze which surrounds all questions of profit and loss, of risk and uncertainty bearing.

CHAPTER VI  
THE REASSERTION OF MORAL  
VALUES

I

AT this stage it may be well to turn aside from the strictly economic argument and to approach the question, what purpose should we like economic society to fulfil? We have seen that the Industrial Revolution made such rapid headway because social organization favoured free economic enterprise and allowed the spoils to go to the winner. This resulted in extreme inequalities of income and in a very high rate of saving to build up the national capital. Industrial development proceeded with great rapidity, and perhaps was justified since the benefits postponed for the moment meant vastly increased benefits in the future. It was, however, suggested that once the exploitation of artificial power had been reasonably developed, justification for such rapid advance would grow less and the problem of the more equitable distribution of the new benefits accruing would become more important. It is worth while examining the implications of this more equitable distribution.

“From each according to his abilities, to each according to his needs”—this is a symbol which has fascinated revolutionaries and reformers alike, and around it in one form or another most Utopias have been built. And undoubtedly it presents a picture which has its attractions. It conjures up a vision of a pool of goods and services on which all may draw without stint whenever they are in need, and would seem to represent the final victory of man over his niggardly surroundings. The conception of each individual doing his utmost in the light of his abilities to add to this pool of goods and services is the inevitable counterpart—man’s victory over himself. But, when all is said and done, as soon as one attempts to linger over the vision it fades away, for the formula does not tell us what to put into the pool.

“From each according to his abilities” is not so very far removed from the every-day world. It is true that through differences of education and social advantage the abilities of some have a much better chance of being developed than those of others, while the range of opportunity is much greater for the chosen few than it is for the many. But this is not in any way an essential feature of the existing system as such. Whatever its imperfections, the system of free enterprise does try to provide a scale of rewards which encourages people to

develop their abilities and use them. It does offer a stimulus to individual effort ; whether an organized social conscience would be more effective is an open question, but on the whole the present system is not ineffective as far as this aspect is concerned. It may even be argued that it is too effective, and too harsh.

The inadequacy of the formula is much more noticeable when we come to the consideration of " needs ". Needs is a negative and limiting term. Sufficient food, clothing, and house-room to keep a man and his family healthy is a very low minimum. Such a definition of " needs " is not very helpful in civilized countries at the present time, in spite of the black spots which a dulled social conscience still allows to remain. But " needs " does not go very far beyond this minimum. We can say, it is true, that there is a " need " for a cure for cancer, but we can hardly apply the term in its strictness to cinemas or even to public libraries, however indispensable they may seem to have become.

In the modern world we are dealing not merely with bare necessities but with options of every kind, with luxuries which from habit and tradition may have become engrained, but which are luxuries nevertheless. Under these circumstances a definition in terms of needs, however much it may apply in an

undeveloped society, is quite beside the point.

The basis of any more moral reconstruction of society must be judged not in terms of the satisfaction of needs but of the range of choices open to individuals. Lives may be stunted without any physical deterioration setting in, and society has not discharged its obligations towards an individual when it has housed him and given him enough to eat. The case against existing society is that it allows a much wider range of choices to some than to others. No man's wealth is infinite, but the rich man can satisfy many more of his desires than can the poor man. If life is a right to more than animal existence, the equitable policy would be to equalize the claims of individuals on the total output of goods and services to such an extent that one is not able to take enormously more from the basket than is another. From the moral standpoint the aim should be a greater equality of income—quite without prejudice to the question, yet to be discussed, as to how far this is possible or desirable on various practical grounds.

## 2

There are certain implications in the above argument which must be examined. The chief of these is the implication of choice.

There is, of course, no absolutely definite proof that choice in itself is desirable. If every body wore a simple uniform manufactured by the State, the whole process of dressing would be infinitely cheaper. No doubt if all the things we consume were standardized we could supply ourselves as a community infinitely more easily and have infinitely more leisure to spare. Further, if we cut out, not necessarily all amenities, but all fads and extravagances, we could be well fed, healthy, and comfortable, and, in addition, enjoy a fair number of standardized amusements and standardized recreations.

Yet such a universal conscription is a thing to which no one but an ascetic could look forward. If there is any meaning in the word "progress" at all, it must lie in its ability to develop personality and to give personality a chance to gain in fullness. A general regimentation directed towards maintaining a certain minimum of material achievement and nothing else would be a disaster. If we want all to share in as wide a range of satisfactions as possible, it is on the assumption that the capacity for experiencing satisfaction does not stand still or grow less.

The implication of this argument is that it is *prima facie* desirable to increase the supply of goods and services as far as is reasonably

possible, and again that this range of goods and services should be as wide and varied as it can be. At the same time the ideal would look to a much better distribution of all these good things of life in terms of income: that is, to a greater equality of income.

Such a suggestion is only approximately satisfying from a logical point of view. Two qualifications must be added at this stage. It is impossible to measure satisfactions which can be bought with a given sum of money. It is obviously ridiculous to assert that people's capacities for satisfaction are equal in any way. One cannot say that the giving of £100 to *X* will add to his pleasure more or less than it would add to the pleasure of *Y*. On the other hand it is not unreasonable to suppose that if *X* is unemployed and *Y* is a millionaire the £100 will do more for *X* than for *Y*. Proposals for equalizing income ultimately rest on a very approximate assumption, but this assumption is perfectly justified as a working hypothesis.

The second qualification is a minor one. There are a large number of what might be described as "communal services" which add to the satisfaction of a large number of people but which do not appear in any one's money income in the narrower sense, and in regard to which the individual has only indirect

choice as a voter. A man does not *buy* his share of the enjoyment which he may get from a walk in Kensington Gardens: he has to pay his taxes, and it is his own affair whether he walks through Kensington Gardens or not. It does not affect the argument that, as far as certain communal services go, direct choice is limited.

## 3

It is an obvious commonplace that inequalities of income do not depend on merit. It is often hard enough to trace any direct connection between merit and incomes received for work done. But the real inequalities of income have little connection with the work that their owners are doing at any given moment, or possibly have ever done in their lives. Professor Irving Fisher<sup>1</sup> has laid it down that the distribution of property “depends on inheritance, constantly modified by thrift, ability, industry, luck and fraud”. This gives fairly enough the significance of differences in wealth. Wealth breeds more wealth, and with the very rich saving becomes an almost automatic process. A man who cannot spend his money puts it in the bank or buys securities, and so it increases as time goes on.

To some extent the taxation policy of the

<sup>1</sup> Quoted by Dalton, *Inequality of Incomes*, p. 274.

State and the rules of inheritance which it enforces tend to break up big fortunes and to put a limit to the rapidity with which they increase as they pass down from generation to generation. In this country a steeply graduated scale of death duties takes a large slice off fortunes as they are handed down. But it cannot be maintained that this process goes very far in bringing about any substantial equalization of wealth, though it probably does a great deal in preventing inequalities increasing.

It is, of course, perfectly possible to limit very severely the amount that a man can leave at his death and to appropriate the surplus. While such a line of action would certainly tend very strongly to reduce inequalities, it is not as simple as appears at first sight in a society organized as is society to-day. The effects would be more far-reaching than is commonly realized. For example, if all that a man had over the value of £10,000 went to the State at his death, the heir of the large landowner would be compelled either to sell his estate or to surrender it to the authorities. As soon as the process of decumulating large fortunes has gone to any lengths there will be no purchasers for the estate, and it will have to be broken up into smaller lots, or there will have to come into being a type of limited company with many shareholders which owns

and operates the estate as a unit, or the State itself will have to turn landowner. All these developments in their turn call for further developments—for a supply of small-scale farmers, or for a new type of landowning company, or for a new Government agency to control national land side by side with privately owned land. Now any or all of these developments may or may not be desirable: the point of the argument is to show that they all follow from a single measure of policy as soon as its significance is analysed.

Undoubtedly it would be possible for the distribution of spending power to be affected through Government action. The taxing machine can be used in very many different ways in order to redistribute income, though it is impossible to describe the whole legal and fiscal framework which has been set up in various countries in the attempt to dissipate fortunes without at the same time reducing the incentives to individuals to build them up. But the implications of any attempt to even out spending power between individuals are very considerable, and will have to be examined further.

## 4

At this stage it may be well to pause and to bring out the significance of some of the

arguments discussed in the preceding chapters. The strands of thought are three.

First, the disastrous ups and downs of business activity, which have been so conspicuous since the War but which are in effect the result of change operating on a minutely specialized economic structure, are an evil which—if not to be altogether eliminated—must be reduced in its incidence. What is wanted is “economic security”, a confidence that conditions will not change so rapidly as to upset the plans and estimates of private individuals, of business men, and of Governments alike. In pursuit of this it is even worth while sacrificing some of the pace of technical advance, and it is certainly worth while making less provision for the future and adding more slowly to the national stock of capital if thereby a reasonable measure of stability is secured.

Second, a reasonable degree of economic progress must be maintained; we want the process of differentiation to go further so that we produce more efficiently; we want to extend the range of choices open to individuals as far as possible, and to maintain and increase existing standards of living and welfare. This goes without saying.

Third, we want some equalization of income and a better distribution of the good things of life. But this must not be at the price of

stagnation or of retrogression. Equal poverty is not to be preferred to inequalities with all enjoying a much higher standard.

It is hardly necessary to point out that to a considerable extent all the above aims are inconsistent. If the aim of equality of income is pursued too drastically, economic progress will be retarded. Again, if we pursue the aim of economic progress as diligently as did our Victorian forefathers it might well mean that business fluctuations would become much sharper instead of growing less. Again, if we try and smooth out business fluctuations, the tendency may be for the pace of material advance to diminish very rapidly. The fact that there is much to be said for each of these aims considered separately tends to disguise the problem of making them consistent. There is no doubt, for example, that Governments at various intervals try to dispel depression or to cut down big fortunes or to promote economic advance without thinking out the effect of one policy on the other. The result is shown in the unhappy futility which is the result of so many well-meaning plans sponsored by Governments.

It does not, of course, matter that to some extent all these aims are inconsistent, provided that people *do* see what is involved. It might almost be said that economics is a science

which studies human beings in the process partly of having their cake and partly of eating it. The important thing is to discover how far these divergent aims can be harmonized and how far they must be qualified. Once this is clear the problem becomes much simpler; it is really complex only when the three aims are kept in water-tight compartments (possibly under the control of different Cabinet Ministers) and pursued quite heedless of their very powerful interactions.

All these may seem truisms, but they are truisms which need emphasis at a time when over-facile conceptions of political and economic problems are current to the extent that they are to-day. There are a multitude of theories of planning and a host of proposals for sweeping reorganization whose authors seem quite oblivious of these divergent threads behind the demand for reconstruction. And yet it is precisely these threads which are so important. For example, the socialization of the means of production, distribution, and exchange is important not in itself but because it might help to forward one or more of the above aims. So much thinking on problems of politics or applied economics stops short on the threshold without attempting to discuss real objectives. And as a result there arise innumerable political muddles (well-meant

efforts that have gone wrong) and a tremendous amount of shoddy thinking which does incalculable harm. We are so busy pretending that we can have our cake and eat it too that we quite forget the real problem, which is to what extent to eat the cake, to what extent to keep it, and how to prevent it getting stale when we do.

Up to this point this book has been covering relatively non-controversial ground. Many will accept in broad outline the analysis which has been directed to bringing out the significance of these three divergent aims—(1) economic security against the effects of sharp business fluctuations, (2) reasonably rapid material advance, and (3) greater equality of income. But it is only fair to issue a warning, that from now on we must enter on much more controversial and much more uncertain ground in attempting to assess how far these aims may be realizable and what the economic future is likely to imply.

The first stage is to examine further the conception of equalizing incomes.

CHAPTER VII  
EQUALIZATION OF INCOME

I

**E**QUALIZATION of income has so far been discussed only very briefly and in strictly general terms. Once one examines the extent to which equalization is possible or desirable from a practical standpoint, the whole subject is much more complicated. To begin with, it is important to recall the distinction between earned and unearned income. This distinction is not always clear-cut in real life, but fundamentally it is of significance because an attempt at securing equality of earnings encounters a different set of difficulties from an attempt at equality of unearned income.

Differences in earnings reflect various factors. To some extent they are conventional, or depend on fortuitous advantages enjoyed by particular sets of men. But for the most part earnings represent the price of labour (whether it be of hand or brain) though this must be qualified with the comment that the prices of relative types of labour are on the whole fairly insensitive to changing conditions and

move only after long intervals and in varying degrees. But one must not forget that from this standpoint earnings are very definitely a part of the price system, in that variations of earnings in different occupations help to secure readjustments between supply and demand by shifting labour from one direction to another—that is, help the community to secure the things it wants in the proportions that it wants them. On the other hand, as we have seen earlier on, wants do not just represent desires, but *desires in terms of income*. Thus we are apparently faced by a dilemma: market prices dictate incomes, and yet incomes dictate market prices. Mr. Maurice Dobb <sup>1</sup>—up against this difficulty—is criticizing a writer in the *Economic Journal* who, he says,

“ would have us believe that in a socialist society the objections to the economic democracy of the market, like those to the democracy of the polls, would lose their force. But this is very far from being the case. Unless there were complete equality of reward, ‘ plural voting ’ would still remain, if diminished; whereas, if equality of reward prevailed, market valuations would *ipso facto* lose their alleged significance, since money costs would have no meaning. If carpenters are scarcer or more costly to train than scavengers, the market will

<sup>1</sup> Dobb, “ The Problems of a Socialist Economy,” *Economic Journal*, December, 1932. See also H. D. Dickinson, “ Price Formation in a Socialist Community,” *Economic Journal*, June, 1933.

place a higher value upon their services, and carpenters will derive a higher income and have greater 'voting power' as consumers. On the side of supply the extra 'costliness' of carpenters will receive expression, but only at the expense of giving carpenters a differential 'pull' as consumers, and hence of vitiating the index of demand. On the other hand, if carpenters and scavengers are to be given equal weight as consumers by assuring them equal incomes, then the extra 'costliness' of carpenters will find no expression in costs of production. Here is the central dilemma. Precisely because consumers are also producers, both 'costs' and 'needs' are precluded from receiving simultaneous expression in the same system of market valuations. Precisely to the extent that market valuations are rendered adequate in one direction they lose their significance in the other. Mr. Dickinson cannot have it both ways."

But Mr. Dickinson can certainly have it both ways provided he refuses to be tempted by Mr. Dobb into a piece of circular reasoning. Mr. Dobb's fallacy is that of taking as hypothesis an irresistible force and an immovable object. If carpenters and scavengers are assured equal incomes then the increased costliness of scavengers will cause the price of scavenging (assuming that scavengers are paid less to begin with) to rise and many costs of production will be affected. With scavenging more expensive, it is possible that the world will call for fewer scavengers and for more of

something else. This will mean that scavengers will be unemployed, and will have to seek employment elsewhere. The relationship between different prices would be upset as costs were increased or reduced by equalization of earnings and in due course an entirely new equilibrium would be approached, disequilibria having shown themselves not in wage changes but in unemployment in some directions and a shortage of labour in others. Admittedly an equalization of income on such lines will mean that many people will have to find new employment—but that hardly seems to be the point which Mr. Dobb puts with such precision.

But, nevertheless, there are many sound reasons for preserving a considerable measure of inequality of earnings, even if it does involve “plural voting”. For one thing, the redirection of labour between different industries would be more effective if the inducement of employment and the fear of unemployment were reinforced by some variation in wages. If activities are to be distributed to the best advantage there is no point in ignoring any useful weapon in a world in which economic changes adjust themselves with difficulty.

But this argument can be extended. There is a strong case for a certain system of rewards and penalties to encourage people to give of their utmost, and differences in earnings do

provide such a system. There is everything to be said for putting a premium on talent and knowledge and perhaps on physical strength, and putting a discount on laziness or unskilled mediocrity. To become a lawyer or a doctor requires much time, patience, and hard work ; to become a jobbing gardener requires considerably less. If you pay your jobbing gardener as much as you do your doctor you may find that people who have the capacity to become doctors take up gardening and do not devote their talents to those occupations which require longer preparation and which are socially necessary. No doubt there are many who would go through with the hard preparation without thought of ultimate gain, but on the whole it seems certain that social considerations would require the tilting of the balance in favour of skilled occupations as against unskilled.

It is only just to point out, however, that this would be merely making a virtue of necessity. It has no special justification on "moral" grounds. There is no abstract reason why the man who is born stupid should be paid less than the man who is born clever ; certainly he is no less worthy than his more fortunate fellow. Nor is there any argument in abstract justice to suggest that the clever man should be paid more to induce him to

exercise his wits. Some differentiation of earnings is definitely desirable, but it is desirable on practical grounds and not on moral considerations.

The same practical considerations can be adduced, for example, in favour of paying judges or important Government officials on a substantial scale. A cynic has pointed out that judges receive large salaries not because they are especially honest but because, being human beings, they must be put out of reach of temptation. The same argument can justifiably be extended to Government officials and others in responsible positions. The view which prevails in many countries, that to serve the Government is an honour and a privilege and therefore is to be paid on a lower scale than less distinguished occupations, only increases the opportunities of corruption. It is a salutary rule, that those who have most opportunity to be dishonest should be paid on a scale which will reduce temptation. Again, it may be added that this is a matter of expediency: there is no moral justification for paying people to be honest.

On the whole differences in earnings are of little importance compared to differences in unearned income, and some differences in earnings would be desirable on practical grounds even in Utopia, assuming that Utopia is

peopled with human beings and not with martyrs or with saints. Society must encourage its members to develop their aptitudes and talents, and its members, being human, need some encouragement. Further, positions of responsibility should involve a higher reward since the dangers of corruption are greatest where those in responsible posts are underpaid.

If we ought to preserve a certain measure of inequality in earned incomes, it would still remain possible to bring the extreme limits of the spread between rich and poor closer together. Statutory regulations and unemployment insurance can do something to raise the earnings of the worst paid kinds of labour; taxation of the higher reaches of earned income can bring down the peaks, though here a certain amount of caution is necessary. There are individuals with co-ordinating business intelligence of a type which is very rare, but who are worth every penny they earn, exceptionally large though their salaries may be. It would be a great social loss if, in the attempt to secure equality, this type of intelligence became rarer still.

Differences in unearned incomes are much harder to defend on grounds of expediency,

and it is such differences which give so unbalanced an appearance to the distribution of wealth in a modern State, and provide the strongest ground for complaint to those who take their stand on moral values in relation to public policy. In 1928—the figures are Mr. Colin Clark's<sup>1</sup>—there were nearly ten thousand people with incomes of £10,000 or more; of these over five hundred had more than £50,000 apiece and 139 had more than £100,000 a year. Only a very slight proportion of this would be earned income; the great bulk of it is clearly unearned. Before the depression corresponding figures for the United States would have yielded infinitely more striking results.

Therefore any serious attempt at levelling out the flow of individual incomes, and consequently the shares in the flow of goods and services, would have to begin by attacking the money pouring in from the passive ownership of property and enterprise. Such a policy is simple enough to envisage: it is a matter of confiscatory taxation. That it will have a sweeping effect on the process of saving and on the building-up of new capital cannot be doubted, but a discussion of this point is best postponed until some preliminary aspects of the redistribution problem have been discussed.

<sup>1</sup> *The National Income*, p. 76.

Redistribution means, as we have seen, redistribution of money claims on the total output of goods and services. This total output does not consist of a mass of general commodities which are interchangeable one for the other. It consists of a flow of specialized goods and of specialized services which tend to be produced in definite proportions in accordance with the demand for them. The fact that they cannot freely be substituted for each other leads to important conclusions which go right against some of the simpler theories of income redistribution. Mr. Colin Clark concludes that

“ even at the present time the equal distribution of the national income, not including income from overseas, and with maintenance of the existing rate of investment, would give an average family income of some £270 per annum to all, including the unemployed. I have gone into this point in detail because it seems to be widely believed that the equal distribution of the present national income would not make any appreciable difference to the condition of the main mass of wage-earners.”<sup>1</sup>

Mr. Clark gives no hint that the usefulness of the change will largely depend on the rapidity with which the supply of goods and services can be modified, and yet it is in the light of this

<sup>1</sup> *Op. cit.*, p. 78.

consideration that the whole proposition to redistribute income must be considered.

The fact is that a sudden redistribution of income will in the short run mean a rise in the price of certain types of goods and services which are especially required by those with small incomes, and the extent to which this will take place will depend on the rate at which production can be switched over from producing what we might call "rich men's goods" to "poor men's goods". The point is so important that it might be worth elaborating in some detail by means of a simplified example.

Let us assume a community which lives on three types of goods, and let us simplify the problem by making further unreal hypotheses—unreal because they are far too clear-cut for real life. The community consumes *A* goods—the necessities of life of which every member has enough. Some members consume also *B* goods; these are the minor luxuries which everybody would want to buy if salaries were evened out to £5 a week all round through equalizing income. Then there are *C* goods, bought by all who have more than £260 a year, but which no one will want once incomes are equalized at the £260 level.

Some benevolent dictator brings in a decree, and instantaneously everybody has £5 a week, no more and no less. There will be no increased

demand for *A* goods—everybody has as much as he wants of these already. The demand for *C* goods will disappear altogether—nobody can afford to buy them. The flow of money will concentrate with increased force on *B* goods. The production of *B* goods cannot be expanded immediately to meet the demand. Up goes the price of *B* goods, and for the moment people are getting the same quantity of *B* goods as before and paying a very much higher price for it. Redistribution of income has served no purpose, and will serve no purpose as long as the supply of *B* goods cannot be increased.

Thus the first effect of a redistribution of income would be to send up the price of the less elementary necessities and of minor luxuries, and it will only be after a time that the industrial structure would be able to adapt itself to the changed nature of the demand with which it is faced.

This raises a further question of significance. Assuming other things equal, what is the rate at which incomes should be equalized in order to avoid undue loss by the community?

The preceding analogy will help to show the lines on which such a question can be approached. It may simplify matters to give proper names to the goods consumed by the imaginary community. Let us take it that

their necessities are all satisfied, and that, under the influence of advertising, they have only one luxury in which they indulge—motoring. Let us further grant them this peculiar trait, that the advertising having been surprisingly successful, they are prepared to acquire and keep an indefinite number of cars apiece, much as the Bank of France is prepared to acquire gold. Let us further assume that as a result of competition there are only two brands of cars left—Rolls Royces (corresponding to *C* goods) and Austin Sevens (corresponding to *B* goods). The long-run effect of redistribution will be to wipe out the demand for Rolls Royces altogether and to increase the demand for Austin Sevens in their place. The question arises at what rate should redistribution occur to prevent the price of Austins going up?

There are several factors to consider here, and they all centre in the adaptability of fixed capital. One thing to be considered would be the rate at which Rolls Royce works could be turned into factories capable of producing Austin cars. Assuming that they are quite useless for that purpose, one must bear in mind the rate at which these works fall into decay and are replaced by new Rolls Royce works. If we assume that there are twenty different plants each of which is pulled down

and rebuilt every twenty years, it is clearly possible to substitute a plant for producing Austins in place of the new Rolls plant once a year so that at the end of twenty years the Rolls plants are all used up and Austin plants have taken their place.

The object of an example of this sort is to bring out one point of significance which is often forgotten—the relationship between the possibility of redistributing income and the rate of obsolescence of capital equipment. It is true, of course, that an arranged example of this sort over-emphasizes this relationship, and is proceeding on a tacit assumption that both the production of expensive luxuries and of working-class goods and services is a highly capitalized affair. But this problem of amortization affects not only specialized capital but also specialized labour. The rate at which labour can be turned over from one occupation to another is—as we have learnt to our cost—very slow and depends far more than we like to admit on the redirection of new entrants into employment than on the transference of those who have become skilled at a trade which eventually turns out to be useless.

It is difficult to decide to what extent the artificial analogy provides a significant comment on real conditions. This would depend on the extent to which changes in the structure

of production were called for by the redirection of purchasing power into the hands of poorer as against richer consumers. But it seems probable that these changes would be very considerable, and the degree of adaptation and reorientation called for, large.

Returning to the analogy, there is one criticism which may perhaps be anticipated. It might be argued that the possibility of desirable change should be related not to the obsolescence of the Rolls plant but to the rate of saving which enables new Austin plant to be built, ignoring the Rolls plant. The analogy avoided this difficulty by the tacit assumption that the only saving going on in the community was that which maintained the stock of capital intact, and that the stock of capital was not being added to. If we assume the community saving positively, it can add to the production of Austins without affecting the production of Rollses. In other words, the income of the community is increasing and all the benefit of this increase is going to the poor : the rich remain where they were. It is when we come to the transfer of purchasing power away from the rich that the relationship with capital obsolescence shows itself. The argument holds good.

The moral would seem to be that in a modern State, even under the most perfect conditions

and assuming all other problems connected with equalization of incomes non-existent, income could not be redistributed without social loss under a considerable period of years, even allowing for the fact that to some extent fixed capital is adaptable. Taking account alone of the immobility of capital and of labour, and of obsolescence, it is difficult to see how such a process could be completed without loss in one form or another under twenty years.

## 3

The arguments that have been put forward are economic in nature, but political in their implications. They are very definitely arguments against drastic change, meaning by drastic change a sudden modification in the existing state of affairs. They can be reinforced by arguments much less theoretical in nature. If you abolish the rich you are going to be faced with the difficulty of finding jobs for those who are out of work, and this finding of jobs will be a lengthy process unless you are going to set them to work digging holes in the ground at a time when nobody wants to buy holes in the ground. The frequency with which economists use the word "readjustment" in discussing contemporary topics should be a warning against expecting the

economic machine to go on functioning under the strain of sudden changes. If we want to secure effective change, and change for the better, it would require an expenditure not merely of forethought but of time. A factory cannot be made in a day, and saving is an unpleasant process in so far as it involves the forfeiture of immediate benefits in favour of benefits to come.

It must be pointed out, however, that the particular arguments put forward are not arguments against abolishing the rich—they are merely reasons which go to show that if you want to abolish the rich you should do so slowly and steadily over a period of years, and that on this ground at any rate there is nothing to be said for doing it in a hurry.

So far the discussion has been carried on merely in terms of static assumptions. It has been pointed out that moral considerations are in favour of an equalization of income and especially of unearned income, and certain economic arguments have been adduced for making this process of equalization—if it is to be undertaken—a protracted and not a sudden one. The next step must be to consider the effect of any such policy on the general flow of economic activity.

## CHAPTER VIII

### PUBLIC POLICY AND PRIVATE PROFIT

#### I

UNEARNED income originates mainly in profits, and profits play an essential part in a system of free enterprise. They are the reward for the successful employment of capital goods, and of success in providing something that is wanted by the general body of consumers, while losses are the result of failure. The man who puts up money for an enterprise is taking a risk, and the greater that this risk may be, the larger will be the reward which he will expect if all goes well. In a changing world constant developments are taking place and, as we have seen in connection with business fluctuations, it is on an adequate flow of new developments that prosperity depends.

The taxation of property in order to equalize income will, once it goes beyond a certain point, affect very severely the inducement to undertake operations which involve risk. People will not be willing to invest in enterprises if the major part of their reward is to be taken from them. Therefore the first effect of an equalizing policy will be to bring about a

slowing down of new capital development and a consequent fall in the volume of economic activity—in short, it will bring on depression which will go on until some inducement arises which will get the flow of capital development going again. If the taxation policy continues, private investors will not have that inducement.

This is the crux of the matter. An active policy, if it in any way interferes with the business man's profits, will induce him to curtail his operations. It does not much matter what form this interference takes if it frightens the business man or snatches his reward away from him. He undertakes risks because if he is successful it is worth his while, and if the fruits of his success are not to be his he will be unwilling to play his part in a process which may involve him in loss. His profits may be affected because his private property is very severely taxed, or because he is threatened with being socialized, or because he is being coerced by the Government into a planned industry—in all these cases the working of free enterprise has been interfered with and the flow of new investment on which the maintenance of existing standards of prosperity depend will slow down.

It is true that some of these policies—especially the one making for a greater equality of income—will also interfere with the capacity

for saving as well, but there is no reason to expect progress to remain steady with capital growing at a lower rate than before. There is very little doubt that a community which is dependent on free enterprise and the profit motive alone is limited in what it can do to bring about equitable readjustments in the interests of national welfare. Unfortunately the argument that excessive expenditure on social services will bring about unemployment is only too true. If the community depends on individuals to bear its economic risks for it, the taxation necessary for extensive social services may very soon interfere with the risk-bearing mechanism and so reduce the amount of economic risk that individuals will be prepared to face.

Mr. J. L. Sykes <sup>1</sup> has discussed this problem in his examination of the finances of the post-War period. "If, in addition to the items usually reckoned in calculating the national dividend, other less tangible and measurable items such as social content and physical and mental welfare of the population as a whole are considered, it is obvious that the reduction of poverty and the raising of the standards of the Poorer achieved by the altered taxing and spending process have added very substantially to this—the more real—national dividend

<sup>1</sup> J. L. Sykes, *British Public Expenditure*, pp. 365-6 and 368.

compared with the pre-war period." But he qualifies this optimistic conclusion by adding "to take the physical and material connotation usually attached to the term, however, it is plain that the same factors going to explain the maintenance of the real dividend serve also largely to explain why it has shown no nearly defined tendency to increase over the period". He further adds, "wage earners, salaried persons, and social service beneficiaries generally have obtained a higher real claim on the national dividend *pari passu* with the reduced real share going to the entrepreneur. In circumstances such as these it can hardly be expected that the dividend stands as much chance of being augmented as of being diminished."

This central difficulty is likely to show itself in the future. Any Government anxious to put forward reforms, to redress inequalities and abuses, will be faced with the necessity of counting the cost very carefully. It cannot allow its heart to rule its head. However flagrant the evils, they can only be dealt with when there is money available; otherwise unemployment is the inevitable result of a policy prepared to sacrifice things that are to things that ought to be. If free enterprise is to continue, the scope of social reconstruction is indeed limited.

Nor is it any answer to throw over the hypothesis of free enterprise light-heartedly. The heart of these problems lies in the necessity of maintaining an adequate flow of goods and services. At present society is organized in a certain way to produce and to consume goods and services, and though it may function only in a somewhat haphazard manner at least the onus is on the supporters of change to show that their reconstruction would provide for an adequate flow not merely in the long run but in the short as well. It does not follow that the volume of goods and services need be maintained at the existing level. A smaller flow but distributed in a more equitable manner may well produce a greater flow of welfare. On the other hand, there may come a point at which the flow of wealth has dwindled to such an extent that no redistribution will be able to maintain the standard of welfare. In short, if we are going to redistribute and reorganize wealth, we must take great care that the supply of goods and services does not fall off abruptly.

All but the most bigoted must admit that there is a real danger that this may happen. Any rapid change-over to a restricted private enterprise—whether it be called Socialism or not—may lead to shock and uncertainty in its initial stages. It may be that such uncertainty

would be quite unjustified—but that is no proof that it will not occur. Past experience suggests that the advance of the State into economic life has not been an unmixed blessing. Any advance towards a consciously organized and “planned” society—even the mere thought of it—will upset the calculations of all those who run the risk of finding themselves organized. This may be sheer stupidity on the part of the business man, but it is none the less likely to cause an upheaval in employment, in production, in the distribution of the necessities and luxuries to which we have grown accustomed. Nor will it be stupidity alone, or the last kick of a dying individualism. As long as economic activity depends on the calculation and expectation of future receipts and costs, the introduction of a new imponderable will upset the basis of all such calculations for the individual business man. It may be wisdom on his part to restrict his activities until he can see more clearly what place is reserved for him in the new society. He cannot be expected to do otherwise when it will be in his own interest to wait and see. The change-over to a more ordered world will probably mean a heavy curtailment in the flow of goods and services for which private enterprise is responsible.

The economic system of to-day provides

for certain functions in a specific manner. Saving, investing, risk-bearing all play their part in economic life. If we are to maintain and extend our capacity for producing wealth, saving must be provided for somehow, and steps must be taken to ensure that this saving is effectively translated into capital goods of a type required by the community. Further, there is the question of technical advance, of new inventions, of necessary changes. Changes involve risk, but the risk is taken because if the change or development is a successful one the rewards are commensurate with the risk. But in the new world, if the development turns out to be an important one for society as a whole, it will be controlled, and the opportunity for exploitation will be restricted. The word "exploitation" has been used deliberately; so far the world has attached so much importance to the introduction of new things that it has rewarded the introducer by allowing him to make what profits he can without regard to the wider interests of the community as such. The world in the past has on the whole shown a preference for economic progress as against economic justice. If this valuation is to be upset and justice preferred, progress cannot be left to itself. Equal starvation is no substitute for unequal wealth.

This does not mean that private enterprise should be left in undisputed possession; it does mean that those responsible for change should be prepared for contingencies and should not refuse to face facts. The fact is that measures, however desirable, for alleviating the conditions of the less happy members of society may—and almost certainly will in many countries—lead to a falling-off in economic activity, and any policy which is to be successful must be prepared to deal with this falling-off in activity. The engineers of a new society must be clear as to how saving, investing, risk-taking are to be provided for, and what part, if any, the profit mechanism is to play. Unless these difficulties are faced there is the probability that the economic mechanism will run down like a clock, ticking slowly and more slowly, and yielding more and more meagre rewards.

Thus the discussion must cover—if we are to examine the possibility of equalizing income, of smoothing out business fluctuations, and of maintaining a reasonable standard of economic advance—the possibility of providing a reinforcement to the flow of goods and services at a time when private enterprise is slowing down.

We have seen that profit is the reward for the bearing of risk in enterprise which inevitably must be uncertain. It will be necessary at this stage to point to the elements contained in the returns which industry brings in over and above costs. There is, first, what might be described as pure interest. This is the continuing income which must be paid in return for the original capital. Were there a complete absence of risk the only other element would be the wages of management—if one can use a general term of this sort to describe the salary paid for organization, a salary which might most easily be included in costs if there was not a variable element in it as well. Since there is risk, however, the element of pure interest is merged in the larger fluctuating element of profits, and these in their turn are the inducement offered to capitalists to invest their money in enterprise. The greater the risk the greater will be the necessity of reward. A debenture holder receives less on his money than an ordinary shareholder because he has first claim on the assets of the company if it is wound up, that is, because his money is safer. The ordinary shareholder, on the other hand, has to bear the brunt of the smallest falling-off in earnings; therefore he gets the benefit of any windfalls that may be going.

It is not proposed to analyse the conception of profit as a reward for risk-bearing in any detail here.<sup>1</sup> A few observations, however, are inevitable. In the first place, risk is associated with specialization. The effect of specialization is to make it very difficult to divert resources from one purpose to another. Once capital has been sunk there may be no opportunity of redeeming it without very considerable, and perhaps total, loss. And capital may be rendered valueless for a number of reasons. It may be that the purpose to which it is devoted is a wrong one, and it may be so devoted owing to the mistaken judgment of those who supported the investment. Thus, if a town already has too many hotels a man who builds a new one without taking account of this may find his hotel running at a loss. But misjudgment on the part of the owner of a hotel may not be the only reason for the hotel's failure. There may be a series of wet summers, and the tourists who normally frequent that type of hotel may be driven away by the weather. Or again, the prospect of political upheavals may frighten tourists away. Or general economic depression may deplete the numbers of those with money to

<sup>1</sup> See *The Review of Economic Studies*, October, 1933, for an analysis of the approach, "Profit in American Economic Theory," by William S. Hopkins. See also "An Essay on Profit", by G. D. H. Cole, in *Economic Tracts for the Times*.

spend. These reasons may be multiplied very considerably.

On the whole it is difficult to classify different kinds of risks. It is tempting to try and split them up into risks which can or cannot be guarded against by a spreading of investments, on the principle that what is lost on the roundabouts can be regained on the swings, but such a classification is not very convincing. Obviously some risks—like weather, or crop failures—can be estimated to some extent, but even then weather is said to go in cycles, and the unexpected success of several consecutive coffee crops ruined the basis of coffee valorization schemes in Brazil, so that it is wise to preserve a certain amount of scepticism on this score. On the other hand wars and depressions cannot be estimated satisfactorily at all; nor can the proportion of failures to successes in business enterprise.

But if risk cannot be guarded against, it is true to say that its distribution, though not eliminating failure, does much to reduce the incidence of loss. The shares of investment trusts will fluctuate up and down with those of business enterprises, but if the trust is well run they will not fluctuate to anything like the same extent. The spreading of risks does much to minimize the dangers of heavy losses.

The interesting question arises, to what extent will risk increase or decrease? To some extent there are forces making for a reduction. One of these is the much greater information available. Another is the limited possibility, discussed above, of estimating the dangers of certain types of disaster—wet weather, for example. Another is improved technique: estimates of costs can be made with a much greater probability of their being adhered to. But against this must be set other factors which outweigh those making for stability. Improved technique may make estimates more accurate, but new inventions make obsolescence more and more a matter of guess-work. Changes in demand become harder to calculate as luxuries form a larger part of the national income and necessities a smaller part of it. The probability that a piece of fixed capital will continue for the time estimated as a wealth-producing agency on a given scale is on the whole growing smaller. It appears on balance that the uncertainties of the future are more and not less imponderable than they were in the past. In the middle of last century British railways were built as if to last for eternity, and in Lancashire looms are still said to be in use which were installed sixty years ago. It is hard to imagine any industry nowadays which would dare to base its calcula-

tions in such a far-reaching manner as did the railway companies or the owners of cotton mills of last century.

Risks, therefore, appear to be increasing, and hence it follows that the reward for risk-bearing will have to increase proportionately so that larger profits compensate for larger losses. Yet the opportunity for these larger profits is not to be found so easily. Profits are greatest when population is increasing rapidly, and when the whole basic conception of life is undergoing rapid change which will provide an insatiable demand for certain types of goods. Yet the momentum of change is on the whole slowing down. The railway engine was much more revolutionary compared to the stage-coach than is the motor car compared to the railway engine ; perhaps in its turn the aeroplane will prove less revolutionary than the motor. The discovery of new forms of power can hardly have such profound effects as did the first discovery of artificial power in a world in which such power was non-existent. As far as rewards for enterprise are concerned the prospect is certainly one of dwindling returns. If this is the case, the risk-bearing process will work less and not more satisfactorily, and any attempt to cut into the rewards of enterprise in the general social interest will become more and not less dangerous.

It now remains to consider the individual who bears the risk. During the previous century, when industry was less highly organized and specialized, money was put in an enterprise by individuals who could control what they were doing. The man who provided the money ran the business.

But the gap between ownership and management has been steadily increasing. This is largely due to the form which modern industry has taken, with its immense and elaborate structure which no individual can oversee. It is due partly to the advantages which the Limited Liability Acts have brought with them. It is due again to the discovery of the technique of spreading risks, a very different technique to that of managing industry. It is due also to the fact that after several generations the individuals who own the money are not those who have made it, and may consequently be quite unsuited to the task of controlling the enterprises in which it is employed.

The effect of these tendencies has been to make for a lack of financial control. The business manager owes allegiance, not to a few individuals who can constantly supervise what he is doing, but to a multitude of shareholders who can register a certain amount of disappoint-

ment or approval, but who can do little else except by changing the management when things go drastically wrong.

For their part the shareholders as a rule take little interest in the business itself. If they think a business is going to do badly they do not stop to ask why this is, but try to get rid of their shares. They have become not merely investors but to some extent speculators and gamblers. Large concerns often seek to distribute their shares among as many people as possible. Often when shares are allotted, allotments are so spread as to favour the applicant for a small number of shares as against the applicant for a large number. The shareholders of large concerns such as Imperial Chemicals Industries or the American Telegraph and Telephone Corporation number tens and hundreds of thousands. Such a dispersion of shares is favoured by a company largely because it helps to build up goodwill, but it also is a comment on the interest which investment of a speculative sort arouses among many classes. The last Wall Street boom was due not merely to the operations of the giants of finance but also of innumerable individuals with comparatively little capital, speculating on margins on the very doubtful assumption that because shares were going up rapidly they would continue to go up.

But the spread of investment only partly takes the form of the purchase of shares by individuals. An enormous amount of saving is employed in the payment of insurance premiums, and though the money is ultimately invested—either in industry or in official issues of one sort or another—the return to the individual is small, the balance going to the institution to compensate for risks which exist even though they are spread. Again, a large part of savings consists of company profits put to reserve. Only a part of these may be employed in extending or maintaining the business of the company which has earned them. The rest is invested in securities, the company behaving very much like an investment trust, switching from one security to another in order to secure capital or income gains, and perhaps doing a little profitable underwriting as a side line. Here the investments may have absolutely no relation to the business in which the company itself is engaged.

The effect of all this is that the gap between the person who puts up the money and the man who makes the decisions has become enormous. There has grown up a new figure—the managing director. He is a paid official of the company which he directs. His salary is fixed at a high level. It is mainly independent of the earnings of the company, and his interest

in the company may be confined to a quite nominal holding of shares in order to comply with articles of the company in which he holds his post.

Nominally the managing director is put in to manage the concern on behalf of the shareholders. But his interests may not be entirely the same as those of his proprietors. The proprietors are interested in one thing and one thing alone, dividends. The managing director has other things to think about ; the reputation of the firm, its general standing, its treatment of its employees, the quality of its work. These desirable objects may often clash with the money-making capacity of the firm, and the sympathies of a good managing director will hardly be only with those who merely want more money. The result is that there is a gradual process going on by which large and important public companies almost inevitably come to regard themselves as servants of the public, and not merely as exploiters of it, charging what the market will bear. Any managing director worth his salt has sufficient pride in his work to try to give the concern he runs a high reputation, rather than to pay out dividends alone. Sometimes, no doubt, the two coincide, but they will not always do so. And it must be remembered that the managing director only typifies the large

managerial staff of which he is the head, all of whom tend to have some consciousness of professional interest in the work in hand. Most people prefer efficiency for its own sake, and not merely efficiency because it pays.

Thus there has been a fairly long process of separation between ownership (and the consequent risk-bearing) and management, and there is no reason to suppose that this tendency will be reversed. The ownership of securities has been diffused on a wide scale among ordinary shareholders who are not now in a position to exercise control. The result has been the growth of a professional managerial class controlling industry. This class is not a risk-bearing class (except in so far as failure means unemployment and success a possibility of securing more favourable employment) and its salaries are usually independent of profits. The functions of risk-bearing and management have become separated, especially where large concerns are involved.

## 4

It has been suggested that any successful advance towards conscious control of our economic activities will involve the State in such closer contact with risk-bearing. It is not, of course, in any way correct to suggest that the State is completely independent of

the risk-bearing process. The polite fiction that it is indifferent to the economic activities of its members, indifferent to profits and losses alike, is more and more clearly being shown to have little relation to facts. Emphatically the State is vitally interested in the welfare of its members, both directly and indirectly. It cannot be otherwise. It wishes to reduce poverty, and it recognizes that poverty presents it with a problem. It has a keen eye for riches because riches provide it with its income, out of which it must deal with the many problems with which it is faced, poverty included. When things go well it can preserve some semblance of detachment since it is able to get its own income easily, while its problems are comparatively small. But even in prosperity, and most certainly in depression, the State is interested in the risk-bearing process. In fact, directly or indirectly, it is involved in giving financial support to industries which would be lost without that financial support.

The most obvious example of such support is that of tariffs. In the ultimate analysis the effect of the general increase in tariff barriers all over the world has been that consumers pay more than they need have done for their goods. A tariff is nothing more than a concealed subsidy to particular industries, and the growth of tariffs is a symptom of the way in which the

State as such is involved in the fortunes of national industries. Tariffs are further reinforced in some cases by subsidies to exporting industries ; here again the State and risk-bearing are entangled.

The State not merely has to pay attention to the fortunes of industries, but also to those of individuals. Unemployment, as we know in Great Britain and have learnt in the United States, is a national and not a local problem. The individual who is suffering from mistaken specialization or from the impact of business fluctuations upon the industry in which he is interested must look to the authorities for support, and the authorities have recognized their duty to provide that support if work is not available. The State, then, is supporting individual specialists through unemployment and relief payments, as it supports particular industries through tariffs and subsidies.

But this does not exhaust the connections. The State is involved even more directly through the provision of official credit facilities of various kinds, facilities which vary a good deal from country to country, and in Great Britain are most conspicuous in connection with export credit schemes for financing overseas trade and with cheap borrowing for certain forms of capital construction. The danger of

such arrangements is that they may tend—especially where commercial credits are concerned—to help the weaker against the stronger competitors, with the result that the effects of competition are minimized at a vital point and readjustments are held up.

But even these arrangements have not proved enough. In Great Britain we have discovered that industry cannot be left to stand alone even with their support ; the State, it is recognized, must be involved still further. But with characteristic British obliqueness such operations are undertaken, not under the auspices of Government, but under those of the Bank of England—nominally an independent body. The thought of a Central Bank being even indirectly concerned in some of the more speculative aspects of industrial financing is refreshingly unorthodox, and yet the Bankers' Industrial Development Co., the Securities Management Trust, and the Lancashire Cotton Corporation bear witness to the elaborate devices adopted to screen the Government from the accusation that after all it may be indulging in operations which should come within the field of private enterprise.

The doctrine that the State has nothing to do with the bearing of economic risk is baseless. It derives from the ideas inherited from last century when profits were large and when

business men were far more interested in preventing the State from taking a share of their profits than in considering the well-being of their less fortunate fellows. But to-day when chances are not as easy to come by as they were, the clamour for State assistance to industry grows apace. Tariffs, subsidies, restrictions, are demanded and received. The State cannot remain deaf to these cries, because the assistance it gives enables some measure of employment to continue which would otherwise disappear. The State can never remain indifferent to business men's losses. If this is the case it may well be asked whether it is giving assistance in the best form possible, and whether, since it has to help to pay for losses, it is not entitled to much greater interest in the profits that are earned.

Certainly defensive measures for the protection of existing capital have little to recommend them as remedies for trade depression. Any revival must come in terms of new investment, and this means stimulating a demand for new capital goods. A demand for new capital goods can only come from entrepreneurs setting up new enterprises or extending existing ones. Current political conventions only allow the State to indulge in investment in a very limited sphere, the sphere of "public works". Public works consist largely of amenities or necessities

run at a loss ; only to a limited extent in regard to certain monopoly services and to some extent working-class houses does remunerative investment come under the heading of " public works ". Outside this, ordinary economic activities are taboo. While the State is expected to run to the assistance of the ordinary producer, it is not allowed to recoup itself by indulging in any form of economic activity outside the very narrow prescribed limits. The State is a salvage State ; it is a negative affair which is expected to remedy evils once they have occurred, but is allowed to play no more active part than this.

It is suggested that such a philosophy and such an outlook is completely out of date ; the British cotton industry and the British coal industry are fitting monuments to it. The truth of the matter is that the only remedies for these debacles are drastic reorganization, on the one hand, and the stimulation of new compensating industries, on the other. But the Government appears debarred from doing either of these things. The decaying industries are sacrosanct ; on the other hand, the authorities may do nothing to satisfy new wants. Steps have been taken to organize the wholesale distribution of electricity, for example ; but the Government cannot take upon itself the task of putting electric light

and heating at low rates into every house, though employment would be created. This would interfere with existing vested interests ; and as a result, though in many places charges are extortionately high, the welfare of consumers and the employment of producers has to wait. Again, an examination of recent tendencies in the changes of demand show an increased desire for middle-class luxuries. Artificial silk, gramophones, wireless, cheap motor cars, canning—these are the industries for whose goods an enormously enhanced demand has appeared. But any plan for closing down cotton mills and for the Government setting up factories to promote the manufacture of speciality goods under the direction of skilled—and if necessary imported—craftsmen would have been stigmatized as an intolerable interference with private enterprise. Yet it remains very clear that the future lies very largely with the commoner and more attractive cheap luxuries, that attractiveness and appearance will count for a good deal, and that mass production methods will probably be inevitable for most of these goods. Yet a Government campaign to produce articles of this kind and to build up a reputation for their production would be ruled out under the existing approach.

Another example. Many countries in the past have derived considerable annual wealth

from a regular tourist industry. Recently a "Come to Britain" movement was inaugurated in the hope that low prices would attract foreigners. Now a successful "Come to Britain" movement demands a large supply of cheap, comfortable, and up-to-date hotels. Were the Government to build such hotels at a number of England's show places, the existing hotel industry would be up in arms. Yet, in spite of the success of the hotel industry as shown by the number employed in it, the general run of British hotels is amazingly primitive. Recently a newly built hotel in London had the almost unique distinction of being able to boast that it had a bathroom for every bedroom at reasonable prices. In tourist centres abroad it is taken for granted that leading hotels are arranged on these lines. It is fairly certain that if the Government, preparatory to a "Come to Britain" campaign, built satisfactory hotels in leading centres, the influx of visitors would be greater, the hotels would be self-supporting, total employment in the hotel industry would be greater, there would be employment in the building industry, and the only sufferers would be the owners of a few of the more primitive of existing hotels who would have been deservedly put out of business.

The stress has been put deliberately on what might be described as the lower and middle

ranges of luxury. The examples chosen are unspectacular. Yet it is suggested that it is precisely in production of this sort and in services that new developments will come. There is no reason to suppose that we shall develop new staple industries analogous to coal-mining, to cheap textiles, or to ship-building. The future would not seem to lie with the satisfaction of that type of want; if it did it would be much simpler and private enterprise could be relied on more satisfactorily to carry out its task. It is in the middle range of luxuries that new developments will come, and it is by stimulating the provision of them that the Government might play a positive instead of merely a negative part. It is in these directions that new investment must be undertaken, but the Government is restricted by convention to the provision of what are classified as "public works".

The preceding argument has related the risk-bearing process to business fluctuations. The ups and downs of business activity are involving the State more and more deeply in the risk-bearing process. Refusal to recognize this fact has led to an unnecessary slowing down and unnecessary dislocation in the past. The only way out would seem to be for the State to play the part of a conscious agency in the financing of the risks of future developments.

Thus the State is involved in the risk-bearing process on account of the losses suffered by private capitalists. The argument for the equalization of income points in exactly the same direction. As we have seen, any policy which aims at bringing about a more equitable distribution of spending power is faced with the enormous inequalities of unearned income. To attack these unearned incomes has been a definite objective of statesmanship during recent years, and inheritance duties, death duties, and the higher rate of income-tax that unearned income has to bear are evidence of this. But this process cannot go to any length on account of its interference with the risk-bearing mechanism. If policies of this sort are to be pursued to a logical conclusion, compensatory influences to stimulate the flow of new investment will be absolutely inevitable if economic society is not to break down.

Thus on all grounds the arguments go to suggest that in the future risk-bearing must be a social rather than a private function. In the past private risk-bearing helped to bring about the very rapid change summed up in the phrase "the Industrial Revolution", but it is unable to deal with the complex processes of an intricate economic organism, or to provide a diffusion of its fruits in a satisfactory manner.

CHAPTER IX  
WHEN THE STATE GOES INTO  
BUSINESS . . .

I

THE demand for conscious control of economic society rests ultimately, we have seen, on three grounds: the desirability of smoothing out business fluctuations, the desirability of maintaining a reasonably rapid material advance, and the desirability of a greater equality of income. These three objectives are admittedly in some measure incompatible, and a balance would have to be struck between them. Further, there is little prospect of any substantial measure of achievement in these directions unless society as a whole is prepared to take a very large measure of responsibility for the whole risk-bearing process. Here there is a parting of the ways, in that any prospect of compromise seems ruled out. The present position is confused. The State has been forced to encroach more and more on the sphere of competitive enterprise while disavowing its intention of doing so. At one moment it is called in to succour existing

industry against possible future competitors ; the next, it is trying to secure for the wage-earner some slight alleviation of his condition through increased social services. Such a condition of affairs may continue for some little time, but it is difficult to see how it can develop in any satisfactory manner. Either the Government will be involved more and more in industry, in which case it will have to approach the whole problem with open eyes, or else it will be forced to curtail its activities, to bias everything once more in favour of the entrepreneur, and to abandon its efforts to build up social welfare in favour of allowing to business profits sufficiently remunerative to justify a development rapid enough to absorb the bulk of the unemployed. Whether the latter is a practical policy remains to be seen. But there is no ground whatever for believing that a middle path can be taken for any length of time. It is a case either of going forward or of going back ; a policy of compromise cannot be prolonged indefinitely. The profit mechanism can be worked by individuals, or it can be worked by society, but it can hardly be worked successfully under a dual monarchy.

In so far as greater social control of the industrial system is being considered, the distinction between management and risk-bearing is vital. Most " plans " for the recon-

struction of economic society look—as does Captain Macmillan—to changes in the way in which industries are organized. Rationalization, improvements in management, supervising boards are to pave the way to a new and lasting prosperity. No doubt some of these schemes are sound ; no doubt organization and management might be overhauled with beneficial results as regards efficiency. But the condition of our cotton and coal industries (which could so obviously do with reorganization) should not blind us to the fact that changes of this sort are only incidental to the main problem to be faced, that of the organization of risk-bearing.

The captains of industry are becoming salaried employees ; they seldom own any substantial share in the ship. This distinction is of significance, for strong though the arguments for the socialization of risk-bearing undoubtedly are, the case for the general centralization of management seems very weak indeed. Great Britain has a highly efficient administrative machine, but industry is less in need of administration than of individual initiative. The force behind economic activities cannot come from “ up above ” ; even now in some of the mammoth concerns which have grown up, organization tends to become dilatory and cumbersome. Any rational reconstruction

would have by some means to provide for more and not less individual initiative. Thus the arguments, while being in favour of risk-bearing by society, are against too rigid a control of economic developments from the centre. Society must play the part of a financier choosing between different ways of investing his money, but it must not seek to impose too rigid a form on the large and unwieldy mass of the economic structure of a modern State. There can be co-ordination and there can be choice, but there cannot and should not be over-centralized control.

Socialist thought has on the whole been moving to some extent towards recognizing this, though it is difficult to say how far this recognition has gone. The word "nationalization" is disappearing, and the word "socialization" has gained an enhanced popularity. But the ideas involved still seem incoherent, and there seems to be undue preoccupation with how managing boards will be set up, and comparatively little attention to the organization of the financing of entirely new activities. Even the demand for taking over the banks seems to be inspired largely by a suspicion of bankers, and there are few indications to suggest that a Socialist Government would do anything very revolutionary with the banks once it had got them. Therein lies the

weakness ; unless the Socialist Government does do something revolutionary in this direction it will find itself prostrate before a rapidly gathering business recession.

Nor do the increasing non-Socialist elements who demand economic reconstruction have ideas any more concrete on this point. The slogan of self-government for industry does not in itself do very much to push forward the conception of individual initiative ; on the whole individuals are more progressive than majorities. But the slogan has not been taken up with this point in mind : it is rather one directed quite rightly against obstreperous minorities in some of our more backward industries. The problem of centralizing risk-bearing and new investment, and decentralizing management, does not seem to have been envisaged.

If the State is to bear the financial responsibility, it would have to put in its important managers and remove them if they were unsuccessful, but the managers, while they were in office, would have to have a wide power of discretion. Only in terms of this sort can any satisfactory progress be envisaged.

Above all it would be vital to preserve a price system working as freely as possible for consumers' goods. The area of choice should not be contracted. There is no case, given the capacities

for production which we enjoy at the present time, for any limitation of the area of choice open to individuals. The desires of individuals should, as far as possible, be made to guide the directions in which production develops. The ultimate problem is that of the man on the desert island who has to choose what he will produce for his own satisfaction. The object of any rational reconstruction of society must be to extend this power of choice effectively to as many as possible. Otherwise reconstruction will cease to have any meaning at all.

An apparent argument in favour of the bearing of risk by society as a whole is that it will enable competition to be eliminated. To some extent this is true ; there is no doubt a good deal of redundant competition which could very well be cut out for the benefit of all concerned. On the other hand, it is a mistake to push this argument too far. In a sense all goods are competing with each other, and the greater the freedom of choice the greater will be the competition. A large number of production units turning out different kinds of articles must be inevitable, but the advantages which socialized risk-bearing would bring would include a much more accurate and detailed knowledge of the limits within which expansion can usefully come in particular directions. It would remove many of the evils connected with

competition, even though society would still be most emphatically a competitive society. If there were fewer grocers competing with each other, the grocer would still compete with the butcher, the cinema with the theatre, the pleasures of going abroad with the joys of staying at home.

This will involve a normal system of charging. The pricing process will be so arranged (outside the sphere of natural monopolies) as to charge what the market will bear, as it is now. In the light of profitability new developments will come and the relative advantages of different forms of future production be judged. This will not exclude the State deciding that for social or other reasons certain types of enterprise are to be specially preferred.<sup>1</sup> But it will assume that in general the State is determined to provide the widest range of choice that is within its power.

So far the whole question has been considered only in terms of consumers' goods. This is only a part—and some would hold a subsidiary part—of any argument covering the ground. Society is engaged not merely in distributing goods to consumers but in accumulating capital to increase the flow of goods in the future. The question arises, in what direction and in

<sup>1</sup> Cf. Maurice Dobb, "The Problems of a Socialist Economy," *Economic Journal*, December, 1933.

accordance with what standards should such capital be specialized.

## 2

If risk-bearing is to become a social function, society will have the last say as to the forms which new investment is to take. It will be faced with a problem of allocating funds in one direction or another. It will also have to decide on what scale provision for the future should be taking place.

It will be remembered that in the analysis of how economic society works, two different functions were distinguished ; that of saving (refraining from expenditure) and that of investment (the use of money for the purchase of capital goods). Stress was laid on the effects of any sweeping differences between these two. Under conditions in which the whole risk-bearing process depended on society as a whole, the amount spent on the purchase of capital goods would be automatically decided. What would happen to the amount " saved " ?

It would be the duty of the State to see that the amount expended on capital goods approximately balanced voluntary savings if these were on a high scale. But *ex hypothesi* there is at work a taxation system so adjusted as to make for equalization of income, and

consequently the opportunities and inducements for large-scale individual saving will be few. This will mean an extremely heavy fall in the total of saving and it will be probable that the new capital extensions which the State would judge necessary would far exceed in value any voluntary savings available. In the circumstances it will have a double task: not merely will it decide on the volume of investment, but it will have through taxation to secure the appropriate abstention from consumption goods, i.e. the appropriate savings. It will thus have to take care of both sides of the account.

This in theory it can do. But a far more difficult question arises—How will it be able to decide in which directions to invest? How will it decide between one enterprise and another? This is an important question to which critics have devoted a good deal of attention, though it probably has not the importance which has sometimes been suggested by certain economists.

Under existing conditions this problem is decided more or less automatically. The entrepreneur about to start a new business can make an estimate of the receipts he hopes to obtain from his prospective market and can then estimate his costs. In estimating costs he will take account of wages, of rents, and especially of the interest he has to pay on his

capital. He will thus be able to reach a decision as to whether certain developments will be profitable or not, and he will be able to decide, in so far as he has an alternative, whether he should use much capital and little labour or little capital and much labour.

The task for society as a whole is a harder one. It has deprived itself of the measure of a rate of interest. It can, it is true, apply some arbitrarily chosen percentage for its calculations, but this hardly meets the case. In place of a rate of interest determined in a market as a basis for calculations, there would seem to be no basis at all. To some extent there would have to be a purely arbitrary choice on the part of the authorities.

The problem simplifies itself to some extent on analysis. There are in fact two separate questions involved, first the total volume of saving available for investment in a given period of time, and, second, the directions in which they are to be used. If the total volume of savings be given, it is perfectly possible to decide in which direction they can be most usefully invested. So much saving with so much labour will produce such and such a yield if used in a given direction. It is a matter of distributing the volume of savings available in the directions in which they give the highest yield.

First, it is important to consider the significance of the fact that the State is to determine the extent to which the capital resources of the community are to be increased in a given period. In the past such a calculation has in effect been determined by what may be roughly described as the free play of the forces of enterprise. At first sight such a solution appears satisfactory, and preferable at any rate to an arbitrary decision on the part of authority. But in fact it depends in its turn very largely on the volume of savings available, and this in its turn depends on the distribution of income. When we look back we see that to some extent the rapid development of Victorian times was a matter of accident—if we may term accidental the existence and maintenance of conditions under which savings are left unimpaired and are not used to any extent to finance the more needy members of the community. In many countries the voluntary level of saving was considered inadequate, and in Germany and elsewhere the State interested itself directly in the financing of such activities as the building of railways. When all is said and done, the rate of saving is not a matter of the wishes of individuals alone (it might just be argued with a show of plausibility that individuals' wishes should be respected) but also of the form which

society has taken. Consequently there is no particular reason for supposing that the total of saving which results from the decisions of individuals has any particular relationship to the rate of saving that is socially desirable.

From this approach, with its emphasis on the fact that there is no particular merit in the volume of saving that appears under conditions of free enterprise, it becomes evident that there is at least no *prima facie* demerit in the volume of saving being determined by the State. The State's decision as to how far the resources should be distributed between satisfying a nearer or a more remote posterity is not likely to be a wild one. It can tell to what extent large capital extensions would or would not be beneficial ; it can at least make a shrewd guess as to the problems with which it will be faced and the desirability of pushing on or slowing up the pace of industrial development. The decision will be arbitrary, but it need not be unreasonable, and certainly it can be more reasonable than the same decision under conditions of free competition.

The second point concerns allocation of the resources available between different industries. Here it is matter of arranging propositions in a rough order of priority, and allocating the resources first to those industries bringing in the highest return and then to ones bringing in a lesser return, in descending order. Such a

procedure would be approximately—though only approximately—effective in securing a fairly reasonable distribution of activities as far as new capital development is concerned.

It may be at this stage not undesirable to anticipate a criticism which might conceivably be urged against an approach on the lines suggested above. How, it might be asked, can costs be formulated if no allowance is to be made for the cost of interest? The answer is that prospective interest is covered in the yield expected after other costs are met. Past interest is immaterial. Once the investment has been made and the building is up the return on the investment has no relation whatever to the original cost of the building or even of the liabilities resting on it. It is worth working the plant, once it is up, as long as there is a positive return on it after allowing for wages, materials, and upkeep. The size of this return will depend on the demand for the goods produced. The calculation of the return on the money invested to begin with is the calculation of the residue; it is not a primary calculation to be taken into account. If the residue is likely to be adequate—in comparison with the residue likely to come from other prospective enterprises—the investment is worth making.

But this argument does require some qualification. If past interest is not a cost, future

interest may be. An enterprise about to be started now will have, in making its calculations, to allow for the fact that at future dates, if it is to be run efficiently, it will need further investment. Whether this further investment will be justified or not will depend on the competing opportunities for investment in the future. This will be an unknown, and consequently the estimate will be to that extent an approximation. It might be pointed out, however, that under existing conditions this is also a very approximate calculation.

But the problem simplifies itself once an attempt is made to see it in proportion. What would be the effect of a miscalculation, of a "mistake"? It would mean merely that the supply of goods and services produced would be at a level lower than it might have been. If the mistake is a really bad one it might mean that certain factories were not worth running at all; if it is a small mistake it will mean that it would have been better to build something other than what has been built, but that nevertheless what has been built is serving a useful purpose. Once we see the significance of this, we are entitled to set against the possibilities of error in calculation in the circumstances postulated, the errors which do arise in the present world owing to the fact that entrepreneurs are acting blindly without

knowledge of each other's intention. Once these two different aspects are put side by side, it definitely appears as if the margin of error is likely to be the larger under conditions of competitive free enterprise. The tragic history of investments in the United States, and even the unhappy result of many investments made in England during the years before the depression,<sup>1</sup> go to show that the working of free enterprise is not a happy one. There are reasons for believing that it will be less happy still in a world in which markets and investment opportunities are likely to decrease. In these circumstances one would aim at a system which combined the greatest obtainable accuracy in calculation with the greatest real knowledge of the position.

## 3

There is a further point which works in favour of the approach which has been outlined. As we have seen, the problem is threefold. First, there is the question of trying to smooth out business fluctuations—a problem which would appear intractable unless we assume some agency able to smooth out the flow of new investment and able and willing to limit its profits and to cut its losses in a way which

<sup>1</sup> See *Macmillan Report*, p. 166, para. 386.

is impossible for the body of private individuals who act as risk-bearers for the community. Second, there is the problem of keeping up a reasonable rate of material development, a problem which does solve itself under existing conditions but would be unlikely to do so if, third, a policy of equalizing income (or, to put it at its mildest, maintaining and extending social services) is pursued. But, if we assume that risk-bearing becomes a social function, the third consideration reacts favourably and not unfavourably upon the first two. The redistribution of income will in itself create easily discernible investment opportunities in that it will "throw back" demand upon existing forms of the cheaper luxury goods. There will be an investment demand which will be specially created through the disappearance of the private risk-bearer with his large fortune. As risk-bearer the State should start under auspicious circumstances: it will in effect be creating for itself its own investment opportunities.

Thus against the very real difficulties of a momentous change must be balanced certain advantages. First, there are the advantages of improved knowledge as against competition working on essentially blind estimates; second, there is the elimination of waste through the greater control over business fluctuations;

and third, there is the fact that a redistribution of income in itself creates a demand which can be met on clearly defined and not on unknown lines.

But perhaps the change is not as revolutionary as it sounds. Of the three objectives discussed only that of equalization of income would be likely to arouse any substantial measure of dissent. And even here the chief objection would seem to be one against calling things by their proper names. Social policy not merely in this country but elsewhere has in fact—though possibly without drawing attention to its significance—been pursuing this aim. Free education, unemployment benefits, health insurance (all subsidies wholly or partially by the State) are a reflection of this. So is taxation policy. The scale of taxation is graduated so as to fall with more than proportionate weight on the largest incomes. Further, it tends to bear more heavily on unearned than on earned income. Lastly, it invariably bears with the greatest weight on fortunes left at death. With increasing force we have been working towards equalization of income without paying due attention to all that the process implies.

And the change has been equally significant in regard to the machinery of risk-bearing. The divorce between ownership and management is becoming more and more striking.

All the bias is in favour of management, as management becomes more specialized while ownership becomes despecialized in the sense that investments are being spread instead of being concentrated. This is under the pressure of circumstances—and it is difficult to see to what ultimate result this may lead other than the spread of the risk-bearing process to society as a whole.

## 4

So far the subject has been attacked without reference to the views put forward by political parties of all colours. An examination of the views which are put forward by prominent men suggests that, while there is dissatisfaction with things as they are, the real implications tend to be forgotten. The doctrines of free competition are at a discount. The comfortable economic philosophy which saw rational men pursuing—in unimpeded fashion—their own personal ends, and arrived at the triumphant conclusion that all these manifold activities made for the good of the whole, has gone by the board. The philosophy of freedom of enterprise—the right to do as one would with one's own—is being condemned on all sides. It must be replaced—by what?

By “a planned society compatible with both

economic and political freedom ”.<sup>1</sup> “ Planning may be defined as the conscious and deliberative co-operative effort of free men and women disciplined by an active social conscience to create for themselves and for their fellows the optimum material environment in which to realize the highest potentialities of spiritual development.”<sup>2</sup> “ The Government must work out in detail and apply a considered plan for the future economic life of the country whereby the best use will be made of natural resources, of the skill and energy of the people, and of the social capital embodied in the houses, factories, schools, etc., in the various parts of the country—the object of the plan being to produce the material basis for the fullest life for all the people of the country.”<sup>3</sup> It is significant that a Liberal and a Conservative, as well as a Socialist, have turned their backs on *laissez-faire* and are looking for an ordered reconstruction which will make us Better as well as Better Off.

Thus the advocates of an ordered reconstruction of society range in this country from supporters of the “ Corporate State ” (whether they call themselves Fascists or not), through more liberal non-Socialist elements and a

<sup>1</sup> Sir Arthur Salter, *The Framework of an Ordered Society* p. 38.

<sup>2</sup> Sir Basil Blackett, *Planned Money*, p. 5.

<sup>3</sup> C. R. Attlee, *Local Government and the Socialist Plan in Problems of a Socialist Government*, p. 188.

democratic element of Socialists, to Communists at the other extreme. They are divided among themselves as well as divided from each other. The ideas they bring, though they include many interesting isolated proposals for change, and a number of generalizations of importance, are deficient in their approach to certain fundamentals—to be specific, in their explanations of how certain aspects of society will be dealt with when the profit motive is hampered or restricted, as it is bound to be under any system of conscious reconstruction. Such a question is fundamental, and until it is answered no real progress is possible. In fairness to those who support proposals for reconstruction, it must be admitted that many of the foremost among them recognize this fact. But perhaps this is not true of some of their more enthusiastic followers.

But—it may be answered—progress is possible, and is being made. Italy, Germany, the United States, even perhaps Great Britain, may be quoted as examples of countries in which a greater or less degree of consciously controlled change is taking place without undue difficulties as regards profits. But this progress which is being made is due to the fact that questions of objective have been answered for the time being at any rate. Italy is planning to give her inhabitants a standard

of living comparable to that of her more up-to-date neighbours. How far Germany knows what she wants to do from the economic standpoint remains to be seen: the political objective is a greater national consciousness in a country lacking in political cohesion; the economic aims seem to be subordinate to this, and are as yet so ill-defined and contradictory that it would be unfair to judge them. The United States has only one object—a restoration of prosperity, and all the rest is subordinate to this. In Great Britain, in spite of the Central Electricity Board, the London Transport Board, the trade agreements, and the Agricultural Marketing Schemes, all attempts at conscious organization have been in the nature of measures designed to deal with particular situations as they arose. It is not for nothing that the phrase “ad hoc” has assumed such a real significance in British administrative thought.

Thus the question of objective has yet to be answered in economic terms by Italy when a given standard of living has been attained, by the United States when she has reached prosperity, by Germany when her political difficulties are overcome, if not before. Once the short-term objective is reached, the long-term question arises. Those who have some way to go have a breathing-space in which

to consider and reconsider long-term questions. For Great Britain there is no such short-term question, and consequently—if there is to be a conscious control of development—no breathing-space. She is not in need of industrialization ; she is not lacking in political cohesion ; there is no opportunity for spectacular measures designed to bring an end to depression. If she is to consider her economic future she must do so in earnest—and in detail. Progressive thought is only too often engaged in arguing the rights and wrongs of the State's encroaching on competitive enterprise, when in fact the issue would appear to have been decided long ago, that the State must encroach whenever competitive enterprise proves itself deficient and whenever competitive enterprise begins to break down. The main problem is that of so managing State encroachment that it does not raise more difficulties than it helps to solve—in fact what we may call “the technique of State encroachment”.

It is the present contention that this problem can only be approached satisfactorily by drawing a rigid distinction between risk-bearing and management, by allowing risk-bearing to become a social function, and by attempting to preserve the greatest freedom in the matter of management.

CHAPTER X  
THE END OF AN EPOCH

I

MODERN economic society is complex, and it is young. The argument which has been developed in the last few chapters is undoubtedly a sweeping one. However strongly we may stress the fact that management and risk-bearing are tending to go further and further apart, and the additional fact that the State is inevitably involved in the economic fortunes of a country, it is impossible to pretend that change on the lines suggested would be other than revolutionary. The argument has been that risk-bearing must ultimately become a social function if progress is to be maintained. Such a change does inevitably involve the transformation of the familiar negative policeman State, sometimes benevolent, often sinister, into an entrepreneur State financing its own economic activity and, though allowing the fullest latitude to the innumerable units through which this activity is exercised, doing something at least to ensure that it is not financing these enterprises merely to compete against each other.

What does all this imply ? In the first place it implies the existence of a much greater devolution of powers in the organization of the State itself. The modern State is a grossly over-centralized body. The attempt to throw responsibility on to the Central Government has led to overworked Ministers, large and efficient Government departments at the centre, and as a rule inefficient local government. In Great Britain, at any rate, the contrast between Whitehall tackling enormous tasks in a heroic manner and local authorities usually failing abysmally whenever they are faced with any task at all out of the ordinary, is startling beyond belief. But it is far too superficial to put this down merely to the superior gifts for government possessed by those in Whitehall, and the infinitely lesser capacities of those who govern elsewhere. At bottom the difficulty is that local government has been, and is, treated as a side-line. The responsibility of the local authorities is reduced to a minimum ; the financing of any developments out of the ordinary through Government grants which help to defray part of the cost breeds a mind whose chief concern must be to keep down the rates rather than to plan a thorough programme of local development which considers the welfare of those dwelling in the locality. It is an inevitable result of the absence

of responsibility. One can give powers of initiative to local authorities, even to some extent one can force them to exercise these powers, but one cannot take away all real initiative and yet expect to retain a drive behind the business of local administration.

The moral of this in regard to any form of economic reorganization is obvious; responsibility must be diffused if efficiency is to be secured. Nothing is to be gained by centralization and by throwing responsibility further and further back. One of the complaints against industry as it is run to-day is not that it is too enterprising but that it is not enterprising enough. The object of taking the risk-bearing process out of the hands of individuals must be to make it possible for industry to be more enterprising and to adopt more experimental lines. The State will be able to stimulate developments at times and in directions which the private financier would be unwilling to face. As risk-bearer it would not only be able to liquidate the failing parts of the economic system much more quickly and thoroughly than happens under existing conditions, but it would be able to adopt a venturesome and forward policy in stimulating new and compensatory developments.

This is one of the most important functions with which it will have to concern itself.

The objection to present-day forms of State intervention in industry is largely based on the fact that this intervention is usually directed towards preserving existing interests. Subsidies are demanded as a rule for failing industries, and are often demanded with success on the ground that to leave the failing industry to itself will cause widespread unemployment, distress, and loss of capital. Yet the more straightforward view of the matter should clearly be that if a big industry is failing—and is likely to go on failing—the resources of the State should be directed to providing alternative and more desirable forms of activity which can absorb those displaced by the old industry. In fact, the State seldom does this, and when it attempts to do so its motives are seldom economic. Anxiety to support a new industry is usually based on grounds of national defence, or else merely takes the form of tariff protection to help a country to become self-contained. Only in the newer countries are there deliberate attempts to build up new industries to compensate for the failing of old ones. The approach is uneconomic in the extreme.

In these circumstances it would appear to be a tremendous innovation to assign to the State the financing of future developments and the determination of at least the broad

lines which they are to take. Certainly the prospect is not a straightforward and simple one. The changes would be on a gigantic scale, calling not merely for a new technique but a new outlook as well. It is not easy to contemplate the transformation of the existing State into one which will number among its functions the bearing of risk.

The difficulties will be heightened by those of transition. It is significant that the most ardent advocates of change are often also those who are least coherent as to how the change should come about. Perhaps Communism should be exempted from a criticism of this sort. For the Communist, capitalist society will collapse of its own weight, and he will bide his time and build anew from the ruins. He is willing to wait upon events; the transformation of the old world into the new without a collapse is a piece of political engineering beyond his ken. He may be right. The task may be impossible. But at least it is worth considering as a piece of political engineering, and not merely as a moral affirmation, and a patient vigil for the hour of collapse. After all, if collapse does come, is it only the capitalist who suffers? Is not the suffering of society as a whole worth trying to avoid?

Few of these who argue most strongly for change have clarified their conception. They

argue for what is, in effect, a considerable measure of reconstruction, but appear to support their arguments with little more than general statements or pleas for specific and isolated reforms. They all tend to look with interest and gratitude towards the Central Electricity Board or the London Transport Board. Many of them have admirable plans for reshaping existing industries which are in a state of confusion. Again, many of them are anxious to build some framework which will eliminate the anomalies of unrestrained and wasteful competition and will allow the introduction of more efficient methods on a much larger scale. A number of these proposals are wholly admirable, and would be an immense improvement on the present state of affairs in the industries with which they are designed to deal.

Yet they all avoid the central issue—how are we to deal with the unknown as distinct from the better handling of the known? No boards will help to deal with problems of this sort. The sort of boards that have been proposed are especially valuable in directing safe monopoly industries, or in transforming risky industries into safer industries under the protection of monopoly; they are not designed to cover entirely fresh ground, and it is in dealing with this task that the present system is breaking down.

The whole approach to this aspect of the problem centres on the question of the bearing of risk. It cannot be answered except in those terms. It is quite possible to get together a committee of experts, to provide them with material, and to get from them an opinion as to the most useful directions in which developments might be pushed forward. It is a very different matter getting any of these recommendations implemented as far as financing is concerned.

Yet of the dangers of transition the chief must be that of indecision. It is so easy to imagine the uncertainties and sources of difficulty with which a Government may be faced when it has such gigantic decisions to make and when it is faced with such a stream of perplexities and innovations. It will have to deal with an enormous amount of detail of a sort with which it is completely unfamiliar. The prospect is a tremendous one, and it may well quail before the task. Unfortunately any hesitation may mean that the whole volume of economic activity begins to dwindle and the economic system starts to run down because the profit motive has been impaired and no compensating influence has been put in its place. Only the strongest and most decided of policies could put the change through successfully.

Would it not be better, it might be asked, in view of the difficulties, to abandon the whole attempt and to get back to some automatic system in which the free play of economic forces brought about adjustments, and in which action and reaction followed automatically ?

This alternative is not without its temptations, but it is important to remember what it implies. It does not mean the maintenance of things as they are. The present position is based on an anomaly, on the two inconsistent assumptions that one can maintain a freely functioning private enterprise and an expensive set of social services and amenities paid for out of taxation side by side. There is no evidence to show that this can be done successfully for any long period of time. The complaint of *laissez-faire* economists against the rigidities of the economic system and against excessive taxation due to Government "extravagance" are perfectly legitimate complaints. Certainly there is no opportunity of extending the social services and amenities above their present level. It is probable that for the economic system to function effectively there would have to be a substantial reduction in taxation, and cuts in the social services might have to be maintained and even extended.

There is no hope of "muddling through" by continuing the present unhappy marriage of *laissez-faire* with State interference of a spasmodic kind. The possibilities of compromise have been exploited to the full, and have been found wanting. There are only two clear and coherent alternatives, either a system in which the risk-bearing of the individual is adequately rewarded, or a system in which the whole process of risk-bearing is taken over by society as a whole.

It is difficult to see how it is conceivable that one could get back to the former state of affairs. The only conditions under which it might be possible would be in a period of extremely rapid development and change comparable to that of the Industrial Revolution. It seems unlikely that such development may come in the near future. From the technical point of view we would appear to be entering on a period of consolidation and stabilization in which new inventions will have much less revolutionary effects on our ways of life. All the opportunities for misdirection of investment will be there, but the compensating influences—the increasing population which will soon justify developments that have proceeded too far, the new discovery which is crying out to be exploited and which will give employment to millions of capital and thousands of men—

are absent. A cutting down of social services and an increase of free enterprise can do nothing to aid the process of consolidation and partial stabilization.

The impossibility of going back effectively is shown by an examination of the reasons why the State is in fact drawn further and further into the economic process. In practice the picture of automatic readjustments taking place and of a steadily increasing standard of welfare is an entirely false one. The State is drawn in because adjustments do not take place, because welfare is not spread, because the advantages do not accrue. The movement towards Protection is a sign of this. Professional economists have in the past largely tended to be Free Traders because they have been impressed with the advantages of the international specialization of productive resources. Yet this international specialization—men have discovered—has its disadvantages, because the country which has specialized to excess will feel the full force of any change which makes its industries unprofitable ; in the attempt to secure for itself an economic security it has to try to diversify its resources by means of protective tariffs and similar arrangements. The picture of all being for the best in the best of all possible worlds under a system of free enterprise is a myth, and because it is

a myth free enterprise is growing more and more restricted. Yet these efforts at controlling the position are bound to fail without a realization of what they imply.

Nor has the working of free enterprise in the past been so very effective. Britain had an enormous lead in the whole process of industrial development, yet the standard of living in this country hardly compares very favourably with that of the Scandinavian countries, countries which were behind us in industrial development and whose natural resources are not equal to ours. Economic developments in Great Britain were very successful in producing a large number of rich men, but when the general standard of living of the people is considered the results are very far from satisfactory. It is painfully obvious that the real benefits of past developments have gone to a minority rather than to the majority.

These observations are confirmed by the experience of the War. It is a striking paradox that, in spite of the enormous efforts deflected from industry to the waging of war, working-class conditions in the post-War period were on the whole better than they had been in pre-War days. It is difficult to account for this phenomenon—improved working-class conditions even when the volume of unemployment is taken into account—except on the assumption

that before the War a much larger proportion of the national wealth might have been secured for the majority of workers in this country with little—if any—increase in unemployment. There can be no more striking commentary on the inability of free enterprise to secure a reasonable standard of living for the workers than this fact of our being able to endure wastage on such an enormous scale and yet to provide a flow of goods and services on an even larger scale for workers better able to extort for themselves an adequate share of the welfare of the community. The advantages of free enterprise are largely a myth ; in their name came opposition to labour regulation, to shorter working hours, to increased income-tax (at a time when income-tax was a matter of pennies rather than of shillings in the pound), to death duties, to unemployment insurance. No doubt the same advantages will be invoked by vested interests against any other change that threatens.

Thus any going back to conditions of freer enterprise seems ruled out. There is no evidence that free enterprise can provide either prosperity or a more satisfactory standard of living. If free enterprise has succeeded in building up capital at a surprising rate, it must not be forgotten that the benefits of these increasing wealth-producing processes have only been

disseminated to a large extent under pressure. The successors of Nasmyth have had to make concessions in the face of organized working-class action and of a Government growing slowly more conscious of its social responsibilities and of the social waste involved in poverty. Free enterprise has been successful enough in providing machines, but it has failed to provide an adequate standard of social existence. It can neither smooth out the effects of business fluctuations, nor provide a reasonable distribution of the good things of this life.

## 3

There is a further and rather more technical argument which points to further dislocation under any substantial measure of *laissez-faire*. It centres round the difference between the rate of interest which the lender expects and the return which the borrower can secure by investing this money in enterprise.

Professor Cassel asked himself the question, why are rates of interest round about four and five per cent instead of being four or five per thousand? He came to the conclusion that the answer must be sought in the length of human life. A five per cent return means that over twenty years a lender will have had

back the equivalent of his original loan and will still have his capital intact. Were the return five per thousand there would be little to be seen within the short space of the lender's life. There would be no real inducement to save. For this reason the length of human life does provide a limit below which interest rates can fall only with the very greatest difficulty.

The suggestion of Professor Cassel is not one which can be proved or disproved. It is a matter of hypothesis, and the most that can be done is to suggest the reasons which make it probable. And *prima facie* it is very probable that the terms on which present payments will be exchanged for continuing incomes, and continuing incomes for present payments, will reflect the desire of individuals to secure what they feel to be an adequate return within their own lifetimes. Five per thousand is not an adequate recompense for foregoing the pleasure of immediate consumption ; five per cent is. Any economic argument which bases itself on the decisions of individuals must, it would seem, allow this contention.

It is not of course argued that a rate of interest lower than that justified by expectation of human life would put an end to the exchange of present payments against continuing incomes. To some extent this would be bound to go on since people would no doubt even be willing

to pay a negative "rate of interest" for the safe keeping of their claims. But this would be a saving of capital in order to spend that capital at some subsequent period within the same lifetime. It would not be saving proper, for saving proper definitely implies the purchase of a continuing income without thought of giving up that income in order to spend the capital again at some subsequent date. From Robinson Crusoe's point of view, putting by some food-stuffs in order that he may eat them when he is ill is a very different thing from making a spade. Crusoe can go hungry in order to lay in a store of food-stuffs against a time when he may need them, or he can go hungry in order to make a spade. At a subsequent date he can eat his food-stuffs, but he cannot eat the spade. On the other hand, the spade will help him to produce more, and the food will not.

It is fair to assume, then, that present payments and continuing income do reflect the expectation of life on the part of individuals. Inevitably comes the question, can one assume that new industry will be able to yield a return which will be above the minimum at which people will be willing to save?

There is no inevitable reason why this should be the case. Human lives are finite, economic systems are not. There is every

reason to expect the yield of new investment gradually to grow less. The demand for a duplication of existing types of activity is likely to grow less with the fall in the rate at which population is growing. The opportunities for using investment to reduce costs and lower the price at which commodities can be produced is largely dependent on increasing markets. There is every indication that the days of an "expanding economic universe" are rapidly coming to an end. The prospects are those of a stable economic universe. It is true that arguments will be urged against this, the old familiar argument that the day is very far distant "when the last Hottentot will live like a millionaire", the argument that there are still plenty of opportunities for using investment to reduce costs. Nevertheless, whether the prospect be near or distant, there is an indication that a time will come when the decreasing return on new investment will make itself felt. And while there is no limit to the potential fall in the return of new investment, the rate of interest on savings will still be affected by the expectation of human life.

Let us ignore for the moment whether this is an immediate possibility, or one which can be safely ruled out for the time being. If the return on new investment falls below the

minimum adequate return in the light of the expectation of human life, what will be the effect on economic activity ?

In the long run the effect would seem to be much less terrifying—the quantity of saving would fall almost to zero but would remain at a level just sufficient to maintain capital and to add to it in so far as opportunities of investment presented themselves at a rate consistent with human expectation. In short, both the rate of interest and the rate of return on new capital would be stabilized at a level coincident with the minimum rate of interest justified in terms of the expectation of life.

On the face of it this would seem an eminently satisfactory result. Yet on closer examination the picture has one or two disquieting features. The bulk of saving is nowadays performed by rich people who are unable to spend their incomes and in fact leave all their income above the level necessary for their normal expenditure to accumulate at compound interest. One can hardly conceive of large incomes being spent almost in full under the conditions postulated. In fact those conditions go to suggest that there will not be any large inequalities of income, but that incomes and leisure will be fairly equitably distributed. Unfortunately it is only too easy to see how this “equalization” can have come about.

As the rate of return drops below the rate that savers are willing to accept there will be a constant tendency on the part of savers to take risks in order to secure a higher return and not to play for safety. There will be a tendency to under-estimate the risk premium and to go for investments which offer large profits if they are successful.

The effect will be quite understandable. It will be infinitely more attractive to take a twenty to one chance on a twenty per cent investment than to take a certain one per cent. Especially will this be the case when the optimism of the company promoter will be there to hide the fact that the chances are only twenty to one. In short, the first stage will definitely be to introduce an element of gambling into the whole process of investment. It is sometimes said that, when all the money spent in the search for gold has been taken into account, the gold supply of the world has been produced at a loss. This tendency will gradually get extended to all forms of investment activity, and the risk premium will be under-estimated. A writer in the *Economic Journal* suggests that even to-day people "dislike the lower rate of interest which a slackening of the need for capital is likely to bring with it, and in consequence endeavour to keep their capital uninvested until more attractive oppor-

tunities are open, or else uncritically devote their savings to enterprises (e.g. gold mining) where the returns seem to be high, largely because they are normally associated with a considerable risk premium. There is some reason to believe that both these influences are, in fact, operative and important, causing incidentally a considerable wastage of capital".<sup>1</sup>

The effects of any such tendencies on an exaggerated scale may be foreseen. Miscalculations of this sort can only make infinitely more intense the oscillations of the economic system. Boom will be followed by deeper and deeper slump till the whole economic structure is shaken to its foundations. Under circumstances such as these the profit motive will never be able to work satisfactorily, and whatever advantages there may be in free enterprise will be lost. Even if we can conceive of society standing the strain sufficiently long to allow for the reduction of saving to a low level through the destruction of large incomes in crisis after crisis, the ultimate goal in itself will be a doubtful one. Would society as a whole like to see all new investment cut down till only those few objects which could yield three per cent were pursued? Would not society as a whole, apart from its members as

<sup>1</sup> A. G. B. Fisher, "Capital and the Growth of Knowledge," *Economic Journal*, September, 1933.

individuals, wish to benefit a more distant posterity by increasing its wealth by adding assets whose yield might be two per cent, or even one per cent? Even under these conditions of perfect stability the desirability of society financing enterprise through taxation suggests itself.

It is difficult to escape the conclusion that, as far as risk-bearing is concerned, individual enterprise has no future.

## 4

The argument of this book has been a concentrated one, and in its details neither easy to express nor easy to follow. It began with stress on the actions and reactions of the economic system through which human beings are able to make those things they want approximately in the proportions in which they want them on account of the price system. It then went on to explain the limitations of this argument in that inequalities of income under existing conditions identifies what people want with what they can pay for. While considerable inequalities of income helped the very rapid accumulation of capital during the last century, the advantages of rapid accumulation are very much more doubtful during a period such as the present, when the world

is not faced with innovations as revolutionary as the first affliction of artificial power. General arguments seem to point to the desirability of diffusing welfare throughout society instead of concentrating on preparing potential welfare for a distant future. Equalizing income should mean in the main equalization of unearned income since there are good reasons for maintaining a considerable spread in the range of earned income.

But as soon as any policy of this nature is pushed very far, certain economic considerations have to be taken into account. Any sudden change in income distribution will not necessarily mean a growth in the total amount of satisfaction given, since the increased purchasing-power of those who receive the money redistributed may be balanced by a rise in the price of those articles on which they spend the money. This consideration—and the corollary involved, that sudden change will involve large and sweeping transfers of specialized labour and capital from one industry to another—suggests that any policy aiming at equalizing income should be pursued slowly and steadily rather than sharply and spasmodically.

Yet such a policy raises far wider issues, since the profit motive on which the working of the system of free enterprise depends, will

be affected. Booms and slumps occur because the flow of new investment is irregular owing to the variations in entrepreneurs' expectations due to the impact of change on fixed and speculative capital. Any official policy which materially reduces entrepreneurs' expectations of profit inevitably involves slump and stagnation. If slumps are to be avoided, if material progress is to be maintained, and if a greater measure of income equality is to be gained, there is no alternative but for society to concern itself directly with the investment process in order to maintain and even out the flow of new investment.

But society is not organized to undertake operations of this sort, since the only forms of "investment" undertaken by the State or by local authorities is in so-called "public works". The change-over would be from a negative State, coming only in case of emergency to the assistance of some of its less happy industries, to a positive State which definitely undertook the financing of economic enterprises. This change is less sweeping than would seem to be the case at first sight once allowance is made for the rapidly increasing gap between ownership and management. In many ways a concentration of management is undesirable, especially as far as undeveloped enterprise is concerned, but the ownership of

new enterprises by the State presents no such objections. Certainly many of the objections to so-called "State control of industry" are objections to management rather than ownership, and rest on a confusion between the two functions. For the rest, a redistribution of income will provide clear-cut opportunities for profitable investment since it will tend to concentrate reward on the lower and middle ranges of luxuries and semi-luxuries.

Such is the argument, suggesting clearly and definitely that any effective form of conscious economic reconstruction must depend on the risk-bearing process becoming a social and not an industrial function. When the desirability of conscious reconstruction is brought into consideration, the argument is reinforced. There is little prospect of the present compromise, under which profits are insufficient to stimulate the investor and social benefits are insufficient to satisfy the legitimate needs of society as a whole, of continuing even in its present form for any length of time. A reversion to something resembling more closely the *laissez-faire* conditions of last century is impracticable, and gives no hope of any successful outcome. We are forced to recognize the inevitability of risk-bearing as a social function.

From the immediate practical standpoint

what does it involve? For one thing, a dropping of the old controversy between deflationists and inflationists as to the relative efficacy of economic salvation through faith or through public works. If depression can be alleviated through the financing of public works at a loss, it can certainly be alleviated more satisfactorily through new developments being financed directly under Government auspices, enterprises which in time should be profit-earning. The first effect of a changed policy would be that the Treasury would have to add to its functions that of an investment syndicate, announcing its willingness to finance new enterprises, weighing up their respective merits, supporting the most promising, deciding scientifically and carefully what amount of money it was prepared to invest during a given period. And gradually, as the private investor began to disappear, the financing of enterprise by Government would spread. The flow of new investment could be regulated, and the opportunities in different directions more accurately assessed.

It is the principle that is vital. Once it be admitted that where private enterprise breaks down it is the duty of the Government to organize new enterprise, to re-employ those who are out of work, and once it be further admitted that these enterprises should be made to

produce those things in which profits are likely to be greatest, that is, those things which people are most likely to want, the rest will follow in course of time. Society will come more and more to depend on State financing ; the State will hold the equity interests and will be able to even out profits and losses ; management will be reasonably diffused ; a policy of equalizing incomes can be pursued without economic set-backs.

The real danger is that we shall be reluctant to face the facts, shall remain clinging to the vain belief that it is quite possible to leave private enterprise to provide employment, while taking the fruits of that enterprise to give to those who are the least fortunately placed. It is an easy belief, and a convenient belief, and if it were true it would save us time and trouble and thought. Nothing could be more idyllic than to know that all we need do is to leave the provision of goods and services to take care of itself, diverting the flow whenever necessary for the benefit of those who are being denied what appears to be a just and proper share. And here lies the pitfall, that we would persuade ourselves that what we would like must necessarily be true.

And there is, unfortunately, evidence that those who are most eager for a conscious

reconstruction of society forget what it must mean. Socialists and non-Socialists alike tend to minimize the task. They concern themselves with the existing forms of economic activity, and would improve it, with a Board here, a reorganization there, and no doubt the Boards and reorganizations might be all to the good. And yet all this is beside the point, for it is not the past that matters, or even the present, but the future. It is on an even and balanced and regulated flow of *new* development that economic well-being depends. Enterprise is in need, not of a nursemaid, but of a midwife.













