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THE GODKIN LECTURES AT
HARVARD UNIVERSITY
1944-1945

THE ROAD TO HIGH EMPLOYMENT

LONDON : HUMPHREY MILFORD
OXFORD UNIVERSITY PRESS

THE ROAD TO HIGH EMPLOYMENT

Administrative Controls in a Free Economy

By

DOUGLAS BERRY COPLAND

*Professor of Economics at the University of Melbourne
Economic Consultant to the Prime Minister of Australia*

1941-1945



HARVARD UNIVERSITY PRESS
Cambridge, Massachusetts

1945

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PRINTED IN THE UNITED STATES OF AMERICA

EDWIN LAWRENCE GODKIN

1831-1902

Edwin Lawrence Godkin, editor of *The Nation* and the *New York Evening Post*, was born in Ireland of English stock, and took his degree at Queen's College, Belfast, in 1851. He published a *History of Hungary* and was associated with the *London Daily News* and the *Belfast Northern Whig* before coming to America in 1856. Here his letters to the *Daily News* on American public affairs attracted attention and prepared him for the task he assumed in 1865 as first editor of *The Nation*, to which he gave a scholarly quality, a breadth of view, and a moral tone that brought it recognition as one of the best weeklies in the English-speaking world. In 1881 *The Nation* became the weekly edition of the *New York Evening Post* of which Godkin was made editor in chief in 1883. From that time until his retirement in 1900 he exercised an influence on public opinion out of all proportion to the circulation of his paper. Editors throughout the country, whether in sympathy with his views or not, watched for his editorials on all important issues. He was exceptionally well read in economics, history, and political theory, believed wholeheartedly in democracy, owed allegiance to no person or party, and was vigorous and fearless in expression. In 1903, by a gift to Harvard University, his friends established "The Godkin Lectures on the Essentials of Free Government and the Duties of the Citizen" in appreciation of his long and disinterested service to the country of his adoption and in the hope of stimulating that spirit of independent thought and devotion to the public service which characterized his career.

PREFACE

THESE LECTURES do not attempt to cover the whole field of the subject with which they deal. They have the limitations and perhaps the virtues of lectures in that they present a central thesis. The level of employment in a free society has become a topic of wide popular interest but it is for the experts to endeavor to clarify the issues involved. In particular it is essential that the fundamental conflict between freedom and security should be kept in the foreground of discussion, and that the difficult administrative questions should be squarely faced. I have had some experience of administration of economic policy in a democracy and it is because of this that I approach the subject with some caution. I hope, however, that the thesis presented will not be considered lacking in the courage and imagination that the discussion of so important a topic demands.

I have to thank in particular my assistants Mr. C. L. S. Hewitt and Mr. R. I. Downing for help in preparing the text, and my old friend and colleague Professor J. B. Condliffe for seeing the book through the press. I have received much encouragement from Professor J. H. Williams and his colleagues at Harvard and I express my grateful appreciation to them.

Douglas Copland

February 20, 1945

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THE ROAD TO HIGH EMPLOYMENT

I

THE EXPERIENCE OF THE WAR AND PRE-WAR TRENDS

IN 1936 I had the honor of delivering a paper before the Harvard Tercentenary Conference of Arts and Sciences.¹ In that paper I attempted to set out my views as to the place of private enterprise in the economy of a capitalistic state and the extent to which state control was necessary. I see no reason to alter the fundamental thesis developed in that paper. The following quotation is therefore relevant as a text for the argument to be developed in these lectures.

The function of the entrepreneur must continue to be performed in any community that desires to make progress. The qualities of imagination, leadership, and adventure necessary for great constructive work were exercised by the entrepreneur under free capitalism. During a large part of the nineteenth century he was left free in most countries to pursue his objective of maximum profit without serious interference by the state. This was true especially of the United States, where even in the post-war period (1919–1929) capitalism flourished and its virtues were extolled as never before in the history of man. Then came the great depression to expose the grave defects of an economic order that had no solution for economic fluctuations, and no means of ameliorating the bur-

¹ "The State and the Entrepreneur," published in *Authority and the Individual* (Cambridge: Harvard University Press, 1937).

dens of depression. Capitalism under the control of the entrepreneur guided mainly by considerations of maximum profit is now completely discredited. It does not give economic security to the masses of the people; it does not provide the administrative machinery whereby increased technical efficiency is transformed easily into a generally higher standard of living; it does not furnish society with the social institutions required to meet the strains imposed by economic fluctuations and rapid technical progress; it does not provide the increasing range of free or collective goods that enter more and more into the standard of living. Countries have been able to absorb the shocks of depression and improved technique in inverse proportion to their dominance by the capitalistic entrepreneur. The contrast between the experiences of the United States and Australia in the depression is significant. Australia got out of the depression quickly by taking unorthodox action through state and banking control; the United States got deeper into the depression by holding firmly to an orthodox course. This, I admit, is a sweeping generalization that requires close examination of the differing circumstances of the two countries. I point the contrast to emphasize a fundamental fact in recent economic evolution—namely, the increasing need for state action if capitalism is to continue to yield its best fruits.

In 1936 there were some signs of economic recovery in the free world but the extent and duration of the recovery were both disappointing, even to those who had been loudest in their advocacy of governmental assistance to promote recovery. The United States in particular was plunged back into its doubts and difficulties concerning both the working of a free capitalistic structure and the extent to which economic controls could afford real assistance. When the European war broke out, there were from ten to twelve millions unemployed in the United States. The position was little better in England, the

European countries that still had some semblance of democratic institutions, and the free dominions of the British Commonwealth.²

I can well recall steps which were under discussion in Australia late in 1938 and during the early part of 1939 to protect the economy against the gathering forces of depression. Had it not been for the war the decade which opened in 1930 with one of the greatest depressions in history would have ended in another depression, perhaps not of the same severity but sufficiently disturbing to cause men everywhere to doubt the capacity of the free world to provide social security and to maintain prosperity at a high level.

In the light of the experience of the last five years, this may seem an exaggerated statement. A businessman remarked to me shortly after I arrived in this country in October last that the war had shown what the business world in America could do if business were given a real chance. It is quite true that the business and industrial leaders of the United States have rendered magnificent service in the past three years. They have shown what the economy of the United States can do when it is geared up to full

² In 1939 at the outbreak of war, the percentages of working population unemployed in some leading democratic countries were very disturbing. They were as follows: Australia 9.6; Belgium 18.8; Canada 14.1; Czechoslovakia 9.1; United Kingdom 10.3; Netherlands 21.8; Norway 18.3; Sweden 10.0; United States 17.0. A full-scale depression was under way in the free world with all its economic losses and social disturbance. In sheer loss of production these figures of unemployment were alarming. They are still more disturbing when the cumulative effects on man's hopes and aspirations in a free society are considered. It is unthinkable that the world should return to this state of affairs.

production. It would be a mistake, however, to attribute this to free enterprise alone. It was the response of industry in America to the challenge of the enemy powers, and it was backed by a firm ninety billion dollar order from the United States government with, moreover, practical guarantees against the risk of new investment required to produce new goods demanded for the war. The correct interpretation to be placed upon the remarkable achievements of American industry during the war is its ready response to a working partnership between government and industry. The same is true of other countries where there is less basic conflict between the government and industry.³ In Great Britain and Australia social legislation and some measure of government control of industry had long been an established practice, but it was still in the experimental stage before the war, and a working partnership between government and industry to maintain a high level of employment and a satisfactory measure of economic security had not been established. Experiments made in this direction during the thirties were hampered by the contraction of international investment and the consequent restrictions on international trade. Experiments designed to promote

³ In Australia the expansion of government expenditure for war and the rise in export prices quickly absorbed the unemployed resources, and by the beginning of 1941 the country was facing a manpower shortage.

Export prices rose by 17.5 per cent in the first year of the war, and war expenditure was £56m, or about 7.5 per cent of national income at the outbreak of war. This was sufficient to generate forces of expansion, and national income rose from £788m in 1938-39 to £887m in 1939-40. By the beginning of 1941 it was running at the rate of more than £900m.

recovery were conducted in a restrictive atmosphere, and the critics were too much inclined to find fault with the experiments and too little inclined to consider the tremendous obstacles to the success of these experiments caused by the malaise that had come over the world economy. Nevertheless, there are a few significant trends in the pre-war experience which throw light on the problem of economic control and the reconciliation of private enterprise with the ultimate interests of the community.

First, there is a better and more widespread understanding of the working of the economic system not only by economists themselves, but also by the leaders of the main sections of the community and by officials who play so important a part in determining as well as administering economic policy. A fundamental reorientation of ideas in a society is always a protracted affair, and it is not remarkable that the shock of the depression of the early thirties took a decade to cause people in general to reconsider their ideas about economic policy. The task is by no means complete as yet, but it had gone sufficiently far in most British communities and in some continental communities to justify the view that a new policy can be worked out when peace comes again.

Secondly, there was the challenge of the totalitarian world, which had succeeded at a lower standard of living in giving reasonable economic security, although at the expense of freedom. The critics of the free world could and did point to authoritarianism as an indication that the economic system could be controlled to give greater security and better living standards to the mass of the people. It is no answer

to these critics to say that they ignored the loss of freedom in the authoritarian state and that they themselves would be the first to object vigorously to the adoption of totalitarian methods in their own communities. The free world cannot ignore the experiences of Germany, Italy, Russia, and Japan in the ten years before the war. Against great difficulties these countries all had expanding economies with full employment. The free world has to meet this challenge by reconciling the aspirations of the people for a rising level of prosperity and economic security with their inherent rights to the democratic freedoms.

Thirdly, in two important directions in the democratic world in the decade before the war, significant experiments were being made. First, there was the attempt to expand public investment in order to impart stability to an economy that was suffering from underdevelopment of private investment. In the second place, through unemployment, health, and sickness insurance, through increasing provisions for education and public health, and through the modern instruments of progressive taxation, a greater equality of income was being attained and greater emphasis was being placed upon sustaining a reasonable level of consumption for people in the lower income ranges. This was, of course, far less effective than it would have been had it not been for the persistence of unemployment at a high level. Both of these movements in favor of expanding public investment and promoting greater equality of incomes were still in their experimental stage. In face of the obstacles

caused by a contracting world economy, they had not been as effective in promoting economic stability as their sponsors had hoped. One is, however, entitled to ask what the state of the world would have been in the thirties without these measures of amelioration.

Fourthly, the widespread experience of the statutory corporation and the public utility company had shown that government enterprise could be highly successful in some spheres. Examples such as the British Broadcasting Commission, the London Passenger Transport Board, the Tennessee Valley Authority, the State Electricity Commission in Victoria indicate the possibility of reconciling independence of management, efficiency, and financial success with political expediency. There were failures in this field, but then there were failures also in private enterprise, whether in the joint-stock company or corporation, or in the proprietary enterprise. These examples of public corporations set up by governments under a charter which guarantees independent management may have as great an influence on the economy of the future as did the principle of the limited-liability joint-stock company in the nineteenth century. The statutory corporation has practically all the advantages of the joint-stock company in the public utility field plus the added advantage that its very structure and the source from which it derives its authority guarantee that it is working in the public interest.

Finally, we have to remember that in spite of the claims that the world before the war, or at least before the great depression of the early thirties, was

a world of free enterprise, that in fact governments were exercising an increasing responsibility for investment. An expanding economy is impossible without investment. In the nineteenth century, when the fruits of the industrial revolution were being reaped on the expanding physical frontiers of America and the ever increasing volume of international investment by Britain, no one doubted the capacity of the economy to give a rising level of prosperity, though there were periods of acute distress caused by economic fluctuations. With a rising standard of living, the economic system could afford more and more to provide not only luxuries for private consumption but also capital goods and services which would not normally return direct dividends to the private investor. In all countries that enjoyed a rising standard of living, there was an increasing flow of what may be called collective goods and services. These I have defined elsewhere as such things as education, public health services, roads, better housing for the poor, libraries, parks and playgrounds, museums and picture galleries.⁴ The world is richer by the provision of these services; yet they could not be provided by private enterprise, though they may well be the results of the increased national incomes brought about by successful private investment in the things which do yield dividends. The provision of these collective goods and services requires an increasing volume of public investment, and the tendency in all countries should be for the proportion of public to private investment to increase. Even in the United States be-

⁴ "The State and the Entrepreneur," *Authority and the Individual*, p. 22.

fore the war, public investment was from 20 to 25 per cent of total investment.⁵

If one reflects upon the trend of consumption in a community with a high and rising standard of living, it becomes obvious that an organized community should encourage the diversion of resources to the provision of such goods and services. Their increasing use by the people is itself an encouragement to a still higher standard of living and a guarantee that the growing riches of the world will be used to enrich the life of the people. A community which fails to make a choice between diverting its resources from increasing the number and magnificence of luxury hotels to the comfort and efficiency of its schools and hospitals, or between increasing the supply of chewing gum as compared with promoting the consumption of milk, is failing to use its riches for the lasting

⁵ In 1928-29 public investment in Australia was £50.7m, and total investment £224.8m. Public investment was, therefore, about 22.5 per cent of total investment. For the average of the five pre-war years, 1933-34 to 1937-38, the proportion of public investment to private investment had fallen to a little more than 15 per cent. The figures are given in Lecture III.

It is doubtful whether such a low proportion of public investment was sufficient to meet the capital needs of the Australian economy where public authorities are much more directly responsible for the finance of public utilities than in most other economic systems.

That this level of public investment was not sufficient may be assumed from the record of unemployment which was higher than normal over the whole decade of the thirties. For the years 1935-1939 the average trade-union percentage was over 11 per cent, though in the last three years it had fallen to 9.2 per cent on the average.

The whole period was one of transition of an economy largely dependent on overseas borrowing for public investment in the twenties to an economy that relied on internal borrowing for its public investment.

benefit of its own people. It can make such a choice only by deliberately setting aside an increasing proportion of its income to encourage the production and use of goods and services which cannot be supplied by private enterprise because they do not return immediate dividends in cash. But the problem goes deeper than this. As indicated already, an expanding economy is one in which there are no limits to the opportunities for investment and to the increase in consumption. If it be true, as I believe it is, that the higher standard of living must increase the emphasis upon the provision and consumption of what I call "collective goods and services," then it equally follows that modern communities must increase the proportion of public to total investment as well as the proportion of the consumption of collective goods and services to their total disposable incomes. If this analysis be true, an increase in volume of public investment is the direct result of greater riches and not, as some of the critics imagine, a sign of decadence.

Objections are made that this development of public investment represents an interference with the free play of consumer's choice. That is not so. It is rather a condition in which the state gives recognition to the demands of its citizen-consumers, a demand which cannot be made effective by each of them acting separately. It is in a similar manner that the state in wartime organizes consumption on the basis of the choice of all its citizens of goods for the waging of war; or, during a depression, gives effect to the consumer's desire to reallocate a portion of the total output to those without spending power.

This is a formidable array of arguments in favor of planning an economic society towards defined social ends. To support them we have the experience of the war, which gave all the free world a definite and agreed objective for the first time in twenty years. This fact has to be borne in mind when considering the lessons of the war on economic policy. It would be a cardinal error to assume that the experience of the war can be repeated in more normal times. For one thing the objective will not be so clear nor so universally supported. Moreover, people were prepared to accept direction and guidance and even increasing restrictions upon their freedom in order to attain the maximum war effort. But making due allowance for these special conditions, the lesson of the war is unmistakable in its demonstration that, given a clear and generally accepted objective, we can erect an economic structure far superior to that we knew during the dark days of the thirties. The war has shown that the free world is capable of a phenomenal and undreamed of expansion of employment and production and a highly successful direction of production towards desired ends. It may be said that this was achieved only by establishing a wide range of economic controls which were restrictive of free enterprise. But the truth of that contention depends upon the magnitude of the war effort. In the early days of the war, the "phony war" as it was appropriately named by an American, that was certainly not true. The controls then were few and mild in their incidence, and every democracy in the initial stages of its war effort set about employing its unused resources, and using its resources already employed

with greater efficiency. The effect was to increase national income, to raise living standards, to increase profits and restore the profitability of many an investment that had been regarded virtually as unpayable or a dead loss. Most democracies were able to build up a war effort of 20 to 25 per cent of their rising national incomes without any real sacrifices for the vast majority of their people. On the contrary real incomes were higher at first. Thus in Australia between 1938-39 and 1940-41, national income rose from about £790m to £956m with war costs at £171m. Allowing for changes in prices and for the large part of war expenditure paid in taxation, this left a balance in favor of the average recipient of income. It was only when the war effort was stepped up and resources had to be diverted from production for civilian purposes that the real costs of war on consumers' spending power began to be felt.⁶

⁶ The significance of this should not be misunderstood. Modern warfare is so dependent on machines and equipment that an initial period of preparation by way of establishing factories and equipping them, training civilians as well as personnel of the armed forces, building camps, hospitals, and administrative centers, improving transport, etc., is needed. This is a sort of gestation period of investment during which only a limited part of the resources of any country can be profitably devoted to war preparation. Australia did this job well, though it was not understood by many who wanted greater evidence of war activity at a time when no responsible government could disclose its plans. After the gestation period the capital equipment was available for production and more people were then required. An expansion of the armed forces was also then appropriate, and this was stepped up still further under the threat of invasion. The expansion of the war effort that inevitably came in Australia early in 1941 required a diversion of resources, and it was then that the controls began to be rigid and in some cases restrictive of enterprise as designed for peacetimes. If we take a narrow definition of a war effort as

Up to this point, where a net diversion of resources was not necessary, all the democratic communities were experiencing some of the benefits of a period of expansion. They were in fact using their resources to full capacity according to a definite plan and the real incomes of the majority of the people were rising. This is the first and most important lesson our war experience has for our post-war economic policy.

Consider this in more specific terms. First, there was a definite stepping up of demand, and this is the key to the economic problem. It has been called by the advocates of a full employment policy—"socializing demand."⁷ Its real significance is that

being that part of a country's labor force that is diverted to war purposes and would be available for production of civilian goods and services were it not for war, then Australia has 49 per cent of her employed labor in the war effort. This does not include people who, for example, are producing food for our own armed forces and would normally in peacetime be producing such food. If we included those and others of their kind, the percentage would rise to over 70 per cent. But even the figure of 49 per cent is likely to be misleading as to the net burden of war. The 49 per cent amounts in all to 1,650,000 men and women in the armed forces and in war industry so defined, but towards this total we have to count 250,000 unemployed before the war; some 250,000 now employed who were not normally in profitable employment before the war (mostly women) or who would have retired from industry or would not have entered it at so early an age; and a natural increase of working population of 150,000. This leaves approximately 1,000,000 net as the working force that had to be directed to the war effort and is the real measure of sacrifice. It was this direction that required the use of the so-called restrictive controls.

⁷ Sir William Beveridge, *Full Employment in a Free Society* (New York: W. W. Norton & Co., 1945). "The policy of full employment outlined here is a policy of socializing demand rather than production. It attacks directly the central weakness of the

under the compelling necessity of war the community set up a demand for the full employment of its resources. In this it was supported by the financiers and the people alike, without regard to any inhibitions concerning the supply of money. The war required the full use of resources; there were unemployed resources available and they were put to work. The government drew on temporary working capital for its means of payment, its expenditure created demand and also caused direct income payments to be made to people not hitherto in receipt of regular income. The expenditure of these incomes generated additional demand and incomes on the principle of the multiplier, and within a relatively short period (about eighteen months) all the slack of unemployment had been taken up. The higher national income generated in the process created a greater field for tax revenues and a greater volume of savings for government loans, and no inflationary finance was required. In the first two years of war Australia financed practically the whole of the war cost from revenue or from public loans.⁸

The myth of insufficient finance which had so dogged the footsteps of those who had advocated expansion in pre-war times was thus exploded. With

unplanned market economy of the past—failure to generate steady effective demand for its own products" (pp. 190–191). This passage and others from the same book below are quoted by permission of the publisher.

⁸The rise in prices of about 12.5 per cent was held in check by price control and was due mainly to higher landed costs of imported goods, the rise in prices of some home produced goods, mostly exportable goods and raw materials that had been depressed before the war, and the adjustment of wages to the cost of living which had been a regular practice under Australian wage control for twenty years.

it went the equally malignant influence of the myth of inevitability, of fluctuations and unemployment. But we must be careful not to claim too much for this experience. There were three factors which were not present in pre-war days. First, the war brought a general world-wide expansion with a rise in Australian export prices and a satisfactory correction of the balance of payments. Secondly, there was control of investment, though not very severe at first. This meant that new ventures not directly related to the war were frowned upon or actually prohibited; and, therefore, that resources were more freely available for war purposes. Had investment remained entirely free the expansion to full employment would have been more rapid, but with a war effort of lower magnitude. The rate of expansion might then have caused a greater rise in prices and more elements of friction and minor disequilibria in the structure. Thirdly, there was the operation of price control which promoted a much more orderly expansion period than would otherwise have been possible.

In interpreting the significance of these favorable factors for post-war policy, it is necessary to remind ourselves that after the transition period the problem will not be one of expansion, but one of preventing contraction.⁹ We have to hold the position we have won under war conditions, not to make

⁹ For some time immediately after the war there will be a heavy demand for investment, both public and private, to make up arrears in capital expenditure due to the war. One of the first war controls in Australia was the control of investment. This meant that many private projects of capital expenditure were deferred while, under public investment, there was an interruption to the normal state expenditure on public works projects.

new advances, the approaches to which were made more difficult by our inhibitions concerning the role of money and the dangers of inflation. As for the effects of world conditions on a dependent economy like Australia, the whole argument only reinforces the case for a world policy on the basis of our early war experience. That will be the subject for treatment in a later lecture.

But the illustration of a typical self-generating period of expansion is not the only lesson of the war economy. In all democracies the emphasis has been upon the mobilization of resources, and this has involved some controls of a restrictionist character. But that, I repeat, is only because we have not only had to mobilize all our resources, but we have also had to divert some from their normal use to war purposes. The two problems are quite distinct, and we shall only stultify ourselves if we think of mobilizing resources in peacetime in any other terms than maintaining full economic activity. This is not restrictionist. This is the expansion on which freedom

Because of rationing of consumption during the war, there will also be arrears of demand for consumption goods to be made up. Thus, for some time, demand for both capital and consumption goods will be high, probably in excess of physical resources to meet it. The proportion of capital expenditure to total expenditure may have to be higher than normal, and that will create a special problem of control during the period of adjusting the economy to normal peace conditions from war activity.

This will be the transition period, and there should be no difficulty in maintaining demand at the level to employ all resources, though there may well be some special problems of transferring particular resources from their wartime use to the conditions of peace. It will be after the transition period that the problem of preventing a contraction of demand and of full employment of resources will arise.

has thrived so much in the past. But the war has taught all democracies a great deal about the use of resources. In particular we have that new instrument of administration—the *man-power budget*.¹⁰ This is the consequence of the excess of demand over supply. In the days of high unemployment there was an alleged surplus of man power, and no one thought of drawing up a man-power budget to see how we could make the best use of our working force. The financial budget was our chief concern then, and it was a Frankenstein monster that devoured most of our efforts to improve conditions. We approach economic policy in wartime through a man-power budget, through an analysis of real resources, and assume quite rightly that we can fit our financial requirements into the disposition of man power, and not man-power requirements into the limits imposed by a financial budget. I believe that this technique can

¹⁰ The analysis of the total man power, its distribution among different occupations during the war, and the possibility of training labor for different occupations have been familiar features of labor policy in all the democracies during the war. The measures adopted have been associated with a direction and control of man power that will be neither necessary nor desirable after the war when compulsory powers will be abandoned in regard to civilian work.

But the experience gained by the deliberate action taken to employ all labor resources for specific resources, and to train labor where necessary, will be valuable in post-war conditions.

It will be possible to assess the surplus or deficiency of man power in any given conditions, and not only to adjust total demand accordingly but also to influence the nature of demand for particular types of labor while offering training for occupations in which shortages exist or are in prospect.

The man-power budget will, therefore, remain an instrument of administration in the free conditions of the post-war economic system.

be used in a free society to assist materially in giving economic security to people, just as it has been used in the controlled war economy to guarantee national security.

Arising out of these two fundamental developments in the war economy—expansion to full economic capacity and the man-power budget—new emphasis has been placed upon national income and its constituent elements. Studies of national income were developing vigorously over the twenty years before the war, and the more detailed information now available in most countries has made it possible for governments to use statistics of national income with greater confidence. In Britain since 1942 the Chancellor's annual budget statement gives much valuable material on national income, savings, investment, consumption, etc. The United States has also broken new ground by the inclusion in the President's budget message of a table giving national income and war expenditure, and adding a more detailed appendix of the constituent items of national income and expenditure.¹¹ The use of national income statistics in wartime breaks new ground. As Meade and Stone say:

As the Chancellor of the Exchequer has shown in recent budget speeches, these estimates (of national income and expenditure) have formed one of the chief bases in the formulation of the general lines of the community's economic and financial policy in war-time. Such estimates show,

¹¹ See *An Analysis of the Sources of War Finance and an Estimate of National Income and Expenditure in 1938, 1940 and 1941*, Cmd. April 1942 and subsequent years; and the *Budget of the United States Government for the Fiscal Year Ending June 30, 1946* (Washington: U. S. Government Printing Office, 1945).

for example, how rapidly the total income of the community is rising or falling; how the income is divided among wages, salaries, profits, rents, etc.; how income is spent, paid in taxes or saved by individuals; how national expenditure is divided among such objects as expenditure for personal consumption, expenditure for government purposes, expenditure for new capital equipment in this country or the acquisition of capital abroad. These figures cover, in fact, all the broad aspects of the whole community's housekeeping; *and it is for this reason that they will continue to play an important part in the post-war world.*¹²

This is not the place to make a detailed study of constituent elements of national income and national expenditure and how they have changed under war conditions; but what clearly emerges from war experience is that national income itself depends upon total demand made up of (1) consumers' expenditure upon goods and services; (2) expenditure by government and public bodies upon goods and services; (3) private and public investment, and (4) net investment overseas. The war has moreover shown that the aggregate of these four items can be controlled, though some of the individual items are not capable of real control by government action. If, however, aggregate demand is maintained by stabilizing aggregate expenditure, as contemplated in the British White Paper on *Employment Policy*, it should

A convenient and lucid exposition of the meaning and significance of these statistics is to be found in a booklet by J. E. Meade and Richard Stone, *National Income and Expenditure* (Oxford University Press). For the United States the National Bureau of Economic Research and the United States Department of Commerce have published detailed information upon national income and expenditure in recent years.

¹² Meade and Stone, *National Income and Expenditure*, p. 3. Italics mine.

be possible to avoid the destructive fluctuations in economic activity that marked the rise of modern capitalism over the past century and threatened its existence in the pre-war decade.¹³ There is now general acceptance in the United States of the doctrine that a high national income must be sustained if reasonably full employment is to be maintained and the awkward adjustments of changing money values to be averted. Thus the Committee for Economic Development in its sponsored publications assumes the need for a national income of \$140m after the war. Whether this be true or not, and whether there is agreement on the means to attain the objective or not, is not of significance in this connection. The important fact is that so influential a group of en-

¹³ See *Employment Policy*, presented by the Minister of Reconstruction to Parliament, May 1944 (Cmd. 6527, H.M.S. Office, London). In parts IV and V the paper makes an analysis of sources of income and what measures can be taken to keep the aggregate stable. "The Government," says the document, "is prepared to accept in future the responsibility for taking action at the earliest stage to arrest a threatened slump." There is ample evidence of this doctrine in past experience. Thus in England money income in the depression of 1929 to 1932 declined by only 15 per cent and this was only slightly more than the fall in prices. In Australia the depression was more severe and money income declined by about 30 per cent. In both countries the decline would have been much more severe had it not been for monetary policy and the maintenance of some government expenditure. In the United States, on the other hand, the fall in money income was over 50 per cent and it had not recovered by 1939 to its 1929 level. I have described the Australian policy fully in *Australia and the World Crisis* (Cambridge University Press, 1934). In retrospect it is now clear that the heroic measures then taken would have been more healing in their effect if government expenditure had not been allowed to fall so severely. But it is easy to be wise after the event, and to forget the political and economic stresses under which policy is formulated in such a crisis.

trepreneurs should sponsor this approach to the post-war problem. It helps to reinforce the argument that national income is taking a more central place in the formulation of economic policy, and there is much more active discussion now on the means of attaining a high and stable level of national income.

Many other significant factors of wartime experience could be mentioned to emphasize the important change that is taking place in economic policy. One further illustration of great importance will be mentioned. The necessities of war gave the advocates of a more balanced diet their grand opportunity, and they have used it with good effect. It was essential that shipping space in the import of food should be saved and that the agricultural resources of Great Britain should be used to the best advantage. The story is contained in an illuminating publication by the veteran advocate of better nutrition for Britain, Sir John Orr,¹⁴ from whom I quote the following:

The war has forced us to adopt a food policy based on the nutritional needs of the people. Soldiers and munition workers have to be maintained in the highest possible state of fighting and working efficiency, and for the maintenance of the morale of the nation, the people has to be as well fed as possible. In Britain these objectives were attained in a manner which reflects the highest credit on the Ministry of Food and the Ministry of Agriculture. Estimates were made of the minimum nutritional requirements of the whole nation. Then a scheme was designed to provide the foodstuffs which would most nearly meet these requirements with the minimum man-hours of labour and the minimum shipping space. Then

¹⁴ *Food and the People*, in the series *Target for Tomorrow*, No. III (London: Pilot Press Ltd., 1943), quoted by permission of the publisher.

the available food was distributed in accordance with physiological needs, special measures being taken to ensure that the higher needs of mothers and children and of heavy workers would be met. There has not been sufficient in the national larder to bring the diet of the people up to the standard for full health, but, since poverty no longer prevents any family from getting its just share of the foodstuffs available, the poorest part of the population is actually better fed, from the point of view of health, than it was before the war. The consumption of milk in working-class families has increased by about 20 per cent, the biggest increase being by mothers and children. The consumption of potatoes and vegetables has increased by about 25 per cent. Then the change-over from white bread to national bread, rich in vitamins, has further improved the diet. Two of the nutrients which were known to be deficient in pre-war diets were calcium and vitamin B₁. A dietary survey done in Scotland shows that in working-class families the intake of the former has increased by about 25 per cent and of the latter by about 40 per cent.

Deliberate planning was necessary to achieve this change in diet, and it has undoubtedly resulted in an improvement in the health of the British people, even under the strain of war. Sir John Orr answers the question of what were the methods by which this result was achieved with the following statement: "In essence, they are for redistributing purchasing power from those who have more than enough for the necessities of life to those who have less than enough. Three methods are adopted: incomes are levelled, prices are kept down and various special arrangements are made for directing supplies to those who most need them." This simple statement covers a wide range of government action including bulk purchasing of essential foods, heavy subsidies to keep prices down, free distribution of

milk, special allowances of the essential "protective" foods to those whose need was greatest, and the spread of factory canteens. It is not suggested that all these methods will be required in the more spacious days of peace, but full employment and direct planning of a more balanced diet for all classes of the people can be achieved only by some measure of government action. It is not to be contemplated that this great and successful experiment should be destroyed by the shortsighted sweeping away of all control as was the case after the last war.

The recommendations of the World Food Conference of May-June 1943 for setting up a world food organization and for securing a pledge from governments "to collaborate in raising levels of nutrition and standards of living of their peoples" offer some hope that action on desired lines will be taken. If this is one of the lessons of the war it will make for economic expansion in the world after the war.

The burdens of World War II have been much greater than those of World War I and the disturbances to the economy of the democracies much more severe. Yet no one can compare the economic policy pursued in these two great wars without being struck by the greater efficiency of the plans made in World War II. Why is this? Partly because the struggle is more intense and partly because the democracies have become far more efficient in managing their economic systems under the disturbed conditions of war. I have endeavored elsewhere to state the basic conditions of success in mobilizing the resources of a modern community for war.¹⁵ The

¹⁵ *Towards Total War* (Sydney: Angus and Robertson, 1942).

range and vigor of wartime controls are in direct proportion to the magnitude of the war effort. Without controls and central planning a vigorous war effort is impossible. It is true that these controls have interfered with the free choice of entrepreneurs, primary producers, and wage earners for the time being, and it would be a great mistake to assume that the controls will be either necessary or desirable in the world after the war. But it would be equally a mistake to destroy them before an orderly retreat from a war to a peace economy has been made,¹⁹ or to ignore the obvious lessons of war experience in maintaining total demand and income. The challenge before free societies in the future is to reconcile the insistence of the peoples on security of employment and a high standard of living with the equally important objective of political and economic freedom. This is a challenge for the planners and the advocates of private enterprise alike, and it is the greatest economic problem democracy has faced. Whether the challenge can be successfully met is the central problem for consideration in these lectures.

¹⁹ On this point I refer to my paper "The Change-Over to Peace" published in the *Proceedings of the Australian Institute of Political Science*, January 1944 (Angus and Robertson, Sydney).

II

THE ROLE OF PRIVATE ENTERPRISE

THERE ARE few economic problems on which the public mind is more confused than it is concerning the part that has been played by private enterprise in economic development. Even in expert economic discussions there is much misunderstanding on the historical role of private enterprise in economic development. The fact is that there never has been an economic system wholly based upon private enterprise. The United States in the heyday of its development in the nineteenth century probably reached closer to the pure system of private enterprise than any other economic system, while the British economy in the nineteenth century was more fully based upon private enterprise than at any time in the history of Great Britain. We are apt to overlook the fact that it was only toward the close of the eighteenth century that private enterprise achieved full scope and independent action. Writers who think that the doctrine of the "Manchester School" represents the main stream of British economic thought are quite wrong. Thus Mr. John Chamberlain, in his introduction to the American edition of Professor F. A. Hayek's widely read book, *The Road to Serfdom*, remarks, "In some respects Hayek is more 'English' than the modern English. He belongs, with modifications, to the great Manchester line, not to

the school of the Webbs." It will be difficult to clear away this widespread impression that the so-called "Manchester line" is representative of British enterprise throughout history and justifies the arguments of those who contend that interference with the basic precepts of the "Manchester School" is bound to end in economic and social disturbances, if not in disaster. Yet there are no precedents in British history for this worship of the "Manchester School," and the greater part of the nineteenth century was taken up by efforts to secure legislation that would correct the excesses of individualism. It was a long and bitter struggle, and the delay in imposing the necessary restraints on rapacious entrepreneurs permitted human suffering on a scale that is not creditable to British leadership, nor in the best tradition of British social development. It is time we recognized the excesses of the "Manchester School" and considered its teaching in relation to the main stream of British social development.

On the other hand, there are many people who seek to get the best of both worlds by assuming that totalitarian results can be achieved without the discipline and restraints that go with it. It is reported that an interjector in the British House of Commons recently remarked during a discussion on demobilization: "Why is it that when we have a victory we fire men, but when the Russians have a victory they fire guns?" The answer is obvious. In Russia men are transferred by the state, under compulsory service, from peace to war, and will again be transferred in the opposite direction from war to peace under the same powers. In the freer economy of Britain the

transfer from war to peace will not be done on the basis of compulsion. Men will be discharged from their wartime activities based upon military or industrial conscription and given the right to a free choice of work after the war. The interjector would, in fact, be very upset if the men were not "fired," but held by the state for service after the war, just as they were held during the war. It is necessarily much more difficult to deal with the problem of demobilization in a free society than it is in a totalitarian society. It is similarly more difficult to ensure stability of an economy based largely upon private enterprise than it is of an economy in which private enterprise plays a very limited part. The order and discipline of the latter is its distinguishing feature, and most men brought up in the democratic tradition will prefer to retain their freedom with some of its disadvantages rather than to have a closely regulated and disciplined life under the domination of state action in economic affairs. They might have security in these circumstances but it is sometimes difficult to reconcile security with freedom. As Shakespeare has it, "Security is mortal's chiefest enemy." Let those communities who like to have discipline extol the virtues of totalitarian methods, but don't let democratic leaders in a free society make the mistake of assuming too readily that the supreme direction by the state of economic affairs can be attained without much damage to things that they value more than they value material goods or economic security.

The problem before the capitalistic democracies is to pilot their way on a course set between the two

extremes of undue emphasis on the virtues of free enterprise on the one hand and undue emphasis upon the virtues of state control on the other. We can best approach this question by considering the principal argument that has been advanced in favor of private enterprise. The basic assumption was that individuals, whether employers or employed, farmers or financiers, making independent decisions among themselves and between their different sections, would build up an ideal productive economy in which reward would be proportional to effort. Each individual in making a choice based upon his own interests would, in relation to the impact of all other similar independent decisions, be making a decision in the common interests of all. The assumption was that all demand and supply factors were perfectly elastic and, therefore, would be automatically adjusted to basic changes in conditions affecting demand and supply. With perfect elasticity of demand and supply, every individual would carry his output to a level which was the optimum, both from his point of view and from the point of view of society as a whole. Similarly, the reward to each individual would be based upon his marginal productivity, and distribution of income would be according to the real value of each individual's contribution to national output. It was a very neat picture and useful as a model to understand the working of the economic system. Had the system worked according to this model, most of the controversy regarding the virtues and defects of private enterprise would never have taken place. But the fact is that the system never has worked in this ideal way. Ignorance, inequality of

opportunity and of economic power, irrational judgments as to the future, monopolistic tendencies, and sectional pressures have all combined to distort the trend of economic organization farther and farther away from the ideal picture as found in the economic literature of the latter nineteenth century. The picture never was true; in the inter-war period it became a travesty of the truth. The pre-war economic world was one of mass unemployment and distressed farmers; of imperfect competition and monopolistic tendencies, leading to gross inequalities of wealth and income; of increasing resistance to change by all sections of the community building up defensive organizations; and worst of all, of a gradual contraction of enterprise in a world that did not understand the riches that lay at its door as a result of improved scientific techniques. So far from this promoting individualism, and building a society fundamentally based upon individual freedom of choice, the whole tendency was in the direction of group or sectional control and of the suppression of the individual. It was mass production with its tendency to emphasize group interests, and not any tendency toward socialism, that was crushing the individual.

It might be well to consider for a moment a few of the more obvious symptoms of this tendency to elevate the group or the mass at the expense of the individual. It was seen in all free economies, at whatever stage of development they were in at the time, in the marked tendency toward monopolistic practices. British industry was perhaps in the most advanced stage of ossification, but that was because British industry was on the defensive in a changing

world. The disclosures in the thirties of the practices of American industry during the "swan song" of so-called free capitalism in the twenties showed to what extent entrepreneurs had become skilled in securing monopoly profit; and, as every student has been taught, monopoly profit is secured by controlling output and not by allowing output to respond to demand. The abuse of advertising, principally by sellers of proprietary lines, was another practice which interfered seriously with the free choice of the consumer, kept up prices, and maintained the services of people in industry, and which could only be regarded as economic at its ruling level of activity on the standards of its own propaganda. Interlocking financial arrangements were made so that related industries could be run according to a predetermined pattern and free entry by competitors rendered more and more difficult. I have referred elsewhere to the hierarchy of financiers that is found in all modern industrial cities. It might also be likened to a caste system with the important difference that the way is open every now and then for some especially enterprising person to burst through the barriers. Nevertheless, it was becoming increasingly difficult in pre-war days to become established in the hierarchy, and to an increasing extent it was this hierarchy that determined financial enterprise.¹

In agriculture as in industry the resistance to change was steadily being strengthened. It reached its height in the erection of tariffs, quotas, exchange controls, etc., in the European countries to keep out

¹ See the arguments in "The State and the Entrepreneur," in *Authority and the Individual* on this and other matters.

the cheaper products of the commercial farming of the new countries. Yet these new countries were developed by nineteenth-century capitalism on the assumption of relatively free movement of goods and relatively free movement of the factors of production. Another manifestation of the lack of flexibility of the structure was the growing proportion of fixed interest-bearing debt as compared with equity debt. In the financing of public utilities (bond issues) by government and local authorities, the fixed interest-bearing security was the predominant instrument. Too little attention has been given to the invention of the equity-debt principle in the joint-stock company and its automatic adjustment of debt burden to changing economic prosperity. As the fixed interest-bearing debt became more important, and it was even increasing in importance through bond issues for public utilities in the so-called free economy of the United States, the burden of fixed interest charges was another influence promoting rigidity in the structure.

It is not necessary to multiply these examples. They are quoted to demonstrate the fact that the economy of private enterprise was undergoing devastating changes and before the war was far removed from the individualistic self-adjusting mechanism of the textbooks. Adam Smith is frequently quoted by advocates of private enterprise, many of whom have probably never read him. Adam Smith was a most acute observer of the trend in economic organization in his own day. Perhaps it would not be unreasonable to say that he could write another *Wealth of Nations* as a protest to the monopolistic and other

practices promoting rigidity in the economy of today, just as he wrote his great work partly as a protest against similar practices 170 years ago. We need a little perspective on these matters if we are to approach this problem with any hope of getting an agreed solution. It is by far the most important problem before the democracies. It should be taken out of its setting in "the folklore of capitalism" and considered primarily as an intellectual problem in the light of the real trends of economic organization, and the basic features of an economy of mass production that will give maximum output and reasonable justice in the distribution of that output.

Obviously, we cannot in the modern world seek to return to an individualistic economy. The developments of mass production preclude any consideration of individualism in the old sense. It elevates the importance of groups and offers opportunities for economic power to pass into the hands of such groups. The openings for anti-social practices in the so-called free economy are to be greater than ever. If we mean by a free economy one in which government control is reduced to the bare minimum, then the exploitation of mass production will elevate certain groups to positions of great power. The economic organization would in fact be neither free nor individualistic. Its best description would be a sort of economic feudalism. The modern community has no option but to seek to curb the powers of its economic barons in whatever class of society they may be found. The question is, however, how far the control has to go and what are the real benefits to be derived from maintaining private enterprise

over as wide a field of economic endeavor as possible.

There is no fundamental challenge to private enterprise in most democracies today. This is particularly true of the English-speaking democracies. Even the advocates of nationalization of industry limit their proposals to a few industries in the public utility and power field. The rights of men to own property in the means of production, to invest for the improvement and expansion of those means of production and to manage that property in the interests of the community are not challenged anywhere in the English-speaking world on a scale that should cause real disturbances to the entrepreneur. Where they are challenged, as for example in coal mining or possibly the land in England, it is owing to the long historical process by which the system of private ownership has become so ossified as to render it incapable of developing the property so as to yield the best fruits for the community. Nationalization would mean payment to existing owners at current values and the future management of the industry by a government agency. As mentioned in the first lecture, the development of the public corporation, or, as it is better named, the statutory corporation, has given to the state an instrument comparable to the joint-stock company in private enterprise. The manager of a joint-stock company may be regarded as a salaried officer employed by a group to manage and develop its affairs. Similarly the manager of a statutory corporation is a salaried officer employed by the government to manage a section of its affairs. It may be argued that the choice of man-

agers would not be as good under government control, or that there will be more interference with his management, or that his staff will be less free to show their enterprise than the staff of a joint-stock company. This is a question on which there will long continue to be differences of opinion, and I can only give my own judgment based upon a fairly intimate knowledge of the operations of public corporations and joint-stock companies in Australia. There is no ground for assuming that the government will choose less able men to be managers or that the managers themselves will be less devoted to their task. The devotion to duty of responsible officials in government-owned industries is, I think, as high as, if not higher than, that of officials in private industries. As regards interference in management, the tendency has been to make the managers of the statutory corporations more and more independent of politics. In my own state of Victoria we have the State Electricity Commission as a governmental agency competing in the city of Melbourne with the Metropolitan Gas Company, a joint-stock company. It would be absurd for anyone to contend that one is more efficient than the other because of their totally different ownership. What impresses the observer is the remarkable likeness between the methods of management in the two cases. It is true that private enterprise succeeded in influencing the state government to stop the Electricity Commission from trading in electrical equipment. Such is our devotion to private enterprise in a community which supposedly has socialistic tendencies. The Metropolitan Gas Company, which works under a charter from the state, is

subject to no such inhibitions and I should not like to have to give a judgment as to whether this has in fact given the Gas Company a competitive advantage over the Electricity Commission. The point is, however, that political interference usually "loads the dice" against the state instrumentality in favor of private enterprise.

But this question of public versus private ownership is not the main issue in the complex of problems raised by the future of private enterprise. Over the main areas of production, transport, distribution, and finance, there is no great body of organized political opinion demanding government ownership in preference to private ownership; nor is there any considerable body of expert opinion. The principle questions at issue are (1) whether private enterprise will always act through competition in the public interest; (2) whether even if it does, private enterprise can give stability of employment and avoid periodic depressions; (3) whether the secular trend of investments and consumption under private enterprise is sufficient to employ all resources available at a rising standard of living; and (4) whether some central planning and guidance are required if private enterprise is to yield its best fruits. These are perfectly legitimate questions. No one should be entitled to own and operate any part of the resources of a community if his actions do not meet satisfactorily the tests implied in these questions. There is a story of an industrial magnate who said to a president of the United States with whom he was on friendly terms: "You know you and I should not be embroiled in public controversy over the operation of that

company. I'll send my attorney down to see your attorney and we'll get the matter fixed up." The president's answer was: "But my attorney represents a sovereign state." It was a very proper rebuke, but the assumption behind the magnate's proposal dies hard. The right of the state to set minimum standards for industrial and financial operations is strongly contested at every step as being a blow at private enterprise. This is not universally true, but it is so widespread a point of view as to cause the disinterested observer to wonder whether many entrepreneurs have a clear understanding of their fundamental rights and obligations. As for public ownership as a solution of any problem, it would never occur to entrepreneurs that it might have some merits. Thus it was reported from Great Britain that in recent discussions of the ultimate disposition of factories and goods owned by the government, it did not occur to the advocates of private enterprise that it might be proper for the government to hold and operate some of the property it had built up.

The contribution of private enterprise to economic development is not in question. The fact that its existence is not under challenge should settle beyond doubt that the majority of people prefer private to public enterprise over the main field of economic endeavour.² The initiative, courage, vigor, efficiency, capacity to take risk, and spirit of adventure of pri-

² In Great Britain, the United States, and Australia official statements from the highest source have affirmed the intention of governments to rely mainly on private enterprise for economic development after the war.

vate enterprise are all essential to progress in any society. The rewards for these qualities must be expected to be high, but it is a *non sequitur* to contend that the functions will always be carried out in the public interest or even that the entrepreneur will thrive if left alone. I remarked in my paper at the Tercentenary: "Nothing is more striking in the modern world than the contrast between the entrepreneur's devotion to the material benefits of scientific progress and his distrust of improved methods of social administration. The one appeals to his idea of progress; the other offends his sense of freedom."³ This is not quite as correct an observation today as it was in 1936. The war has shown what can be done by a free society when it establishes a working partnership between the government and private enterprise. It has also shown that methods of social administration can be improved even under the strain of war. Thus in both the United Kingdom and Australia a great experiment in social insurance and family endowment is being put into operation. If the level of economic activity can be maintained in the post-war world this fundamental reform will not prove a costly burden on enterprise but is likely on the contrary to improve the efficiency of the people and raise their moral well-being. It took the shock of a war to launch it on the scale required.

Even in wartime with all its restrictive controls, including price control on a scale never before essayed, the entrepreneur was able to show much of his old fire, to draw upon those qualities of vigour and

³ "The State and the Entrepreneur," p. 7.

enterprise which have been his distinctive contributions to progress. I am not arguing for a continuance of the controls or even suggesting that the controls make any great contribution to eliciting the magnificent response the democracies got from private enterprise. It was the unity of purpose between government and private enterprise and the pressure and assistance by the government to use resources to the full that gave the entrepreneur his opportunity. In spite of high taxation he has on the whole improved his position during the war. This is markedly true of the United States where net income after corporate tax liabilities rose from \$4.2 billions in 1939 to \$8.9 billions in 1944.⁴

It is an interesting reflection that the depression of 1929 to 1933 in the United States of America was actually a greater burden on the United States than the war effort of Britain has been on Britain in the years 1938 to 1943. This is a startling thought. Despite the heroic measures taken by Britain to build up the greatest war effort in proportion to resources ever undertaken by a free society, the sacrifice of the standard of living (including all investment and government services) amounted to 32 per cent of her 1938 standard of living, whereas the United States in the depression was foregoing in 1933 no less than 36 per cent of her pre-depression standard of living. In Britain during the war, total government expenditure increased from £837 million in 1938 to £5187 million in 1943. If the latter be converted to 1938 prices, the increase is from 16 per cent of

⁴ Appendix 10 of the *Budget of the United States Government* (Washington: Gov't Printing Office, 1945).

1938 national income to over 70 per cent of 1938 national income. The effect was to generate full economic activity, while measures of control and taxation ensured a more equitable distribution of goods and services than in 1938. In the United States in the depression, government expenditure was practically unchanged, unemployment reached record levels, distribution was less equitable than before, and widespread suffering followed.⁵

It is well worth while examining this problem in more detail. The comparison is based upon the analysis of national income and expenditure contained in Meade and Stone's book already referred to. We are concerned in the comparison with movements in real national income and must use price indexes to make adjustments. These price indexes include the effects of the higher indirect taxes, so we have to take national income at market prices. I set out below the five items necessary for the comparison, and give on the right hand column the corresponding items in Meade and Stone.⁶

⁵ There are, of course, many pitfalls in such a comparison and net burden on a community of any experience is very difficult to measure. It is quite certain, however, that the net cost of the war to the United States and Canada is far less than was the net cost of the depression. That may even be true also of Australia, though the war burden is proportionately greater there and approaches British standards. The depression was severe in Australia, though its edge was blunted by some of the policy measures adopted, and recovery was stimulated more rapidly and more completely than in America. In physical standards the war is probably costing Britain more than the depression cost her, but in the life of the spirit it is an ennobling experience, as any visitor to Britain can testify. This is more than can be said of any depression whether in Britain, the United States, or Australia.

⁶ Table on their page 24.

<i>Items of Income and Expenditure</i>	<i>Meade and Stone (corresponding items)</i>
1. Personal expenditure on consumption	7. Personal expenditure on current goods and services
2. Private net investment at home and government and net investment overseas	9. + 10. (Same titles)
3. Private consumption and investment at home, and government and private investment overseas (1 + 2)	No corresponding item.
4. Government expenditure on goods and services	8. Expenditure by public authorities on goods and services
5. Net national income at market prices (3 + 4)	12. + 11. Net national income with indirect taxes not deducted

The figures with which we start are taken from Meade and Stone, p. 24, adjusted as above.

NET NATIONAL INCOME AT MARKET PRICES

<i>Item</i>	<i>United Kingdom</i>		<i>United States</i>	
	£m		\$ billion	
	1938	1943	1929	1933
1. Personal expenditure on consumption	4138	5049	73	43.5
2. Net investment at home and overseas	<u>250</u>	<u>- 781</u>	<u>9</u>	<u>- 4.5</u>
3. Private consumption, and investment at home and overseas	4388	4268	82	39.0
4. Government expenditure on goods and services	<u>837</u>	<u>5187</u>	<u>10</u>	<u>8.5</u>
5. Net national income at market prices	<u><u>5225</u></u>	<u><u>9455</u></u>	<u><u>92</u></u>	<u><u>47.5</u></u>

We have now to deflate the 1943 figures for the United Kingdom, to eliminate the price increase, and to inflate the 1933 figures for the United States to eliminate the price fall. The procedure is:

United Kingdom: See *Economist*, May 6, 1944, p. 606. In effect, assume a 54 per cent price increase for consumption goods and services, and a 35 per cent price increase for government and investment goods and services. The adjusted figures would then be:

<i>Item</i>	1943 (at 1938 prices)
1. Private consumption	£ 3270 m
2. Investment at home and overseas	— £ 580 m
4. Government expenditure	£ 3840 m

United States: On p. 28, Meade and Stone say: "Of the decline of rather more than one half in the American national income in money terms during these years (1929–1933), approximately one-quarter may be explained by a fall in the general level of prices, leaving rather more than one-third to be explained by a reduction in output." One-quarter of the drop from 92 to 47.5 is assumed due to price fall. Therefore, 11.1 must be added back to get output at 1929 prices. To items 1, 2, and 4, add respectively 10.4, — 1.4, and 2.1. This gives the table as corrected on page 44. No attempt has been made to calculate an absolute basis for comparison by correcting for population and for the price and exchange differentials in the respective periods. The relative comparison of the percentage decline in living standards is sufficient to prove my point that the depression cost America more than the war cost Britain.

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NET NATIONAL INCOME AT BASE PERIOD PRICES

Item	United Kingdom		United States	
	£m		\$ billion	
	1938	1943	1929	1933
1. Personal expenditure on consumption	4138	3270	73	53.9
2. Net investment at home and overseas	<u>250</u>	<u>- 580</u>	<u>9</u>	<u>- 5.9</u>
3. Private consumption, and investment at home and overseas	4388	2690	82	48.0
4. Government expenditure on goods and services	<u>837</u>	<u>3840</u>	<u>10</u>	<u>10.6</u>
5. Net national income at base period market prices	<u>5225</u>	<u>6530</u>	<u>92</u>	<u>58.6</u>

Alternatively, the figures may be expressed as relatives of the base period net national income in each case:

REAL NET NATIONAL INCOME IN THE UNITED KINGDOM (1938 AND 1943) AND IN THE UNITED STATES (1929 AND 1933) (Base Period Net National Income = 100)

Item	United Kingdom			United States		
	1938	1943	Move- ment	1929	1933	Move- ment
1. Personal expenditure on consumption	79	63	- 16	79	59	- 20
2. Net investment at home and overseas	<u>5</u>	<u>- 11</u>	<u>- 16</u>	<u>10</u>	<u>- 6</u>	<u>- 16</u>
3. Private consumption, and investment at home and overseas	84	52	- 32	89	53	- 36
4. Government expenditure on goods and services	<u>16</u>	<u>73</u>	<u>+ 57</u>	<u>11</u>	<u>11</u>	<u>---</u>
5. Real net national income	<u>100</u>	<u>125</u>	<u>+ 25</u>	<u>100</u>	<u>64</u>	<u>- 36</u>

It will be seen that Britain, in the fifth year of the most expensive war in history, the burden of which is, to Britain, higher than in any other of the United Nations (except possibly Russia, and in that case comparison is difficult, because the civilian standard of living was in any case very low before the war), is suffering less sacrifice of private consumption than was imposed on America in the depression of the thirties.

In relative terms, Britain in 1943 had foregone 32 per cent of her pre-war standard of living (including all investment and government services—or 40 per cent of her private consumption and investment) in order to achieve a war effort to which she devoted an extra 57 per cent of her pre-war national income. The United States in 1933 had to forego 36 per cent of her pre-war standard of living (including all investment and government services—or 41 per cent of her private consumption and investment) in order to undergo the rigors of industrial depression, and provide a breathing space for American private enterprise to rediscover its enterprise.⁷

The significant difference in the two situations is

⁷ But the results are unmistakable. It may be said that Britain will enter the post-war world with great handicaps because of her loss of overseas investment, shipping, and export trade during the war, and that her recovery to pre-war standards will be difficult, if not impossible, of attainment. That may be true, and it is a most regrettable situation. But it is not more regrettable than the impotence of the great American democracy in the face of a much less dangerous enemy. America had not recovered her living standards at the outbreak of the war. In a decade she not only denied herself the fruits of progress, but also went down to lower living standards in a world that was constantly being startled by new inventions and labor-saving devices.

revealed in the last two lines of the tables. In the period concerned, government expenditure in the United Kingdom rose from 16 per cent to 73 per cent of the 1938 net national income, giving a net national income rising by 25 per cent, and thus ensuring full employment and a reasonably equitable distribution of available goods and services. In the United States in the period concerned, government expenditure rose only negligibly from its level of 11 per cent of 1929 net national income, so that net national income fell by 36 per cent, thus allowing colossal unemployment, great inequity in distribution of available goods and services, and widespread suffering and distress.

Clearly, these facts establish the need for a reconsideration of the relations of private enterprise and government action in normal times. It would be fallacious to argue entirely from war experience. Conditions are different both as to unity of objective and readiness to accept control, but the contrast between war experience and depression experience is so marked as to justify the conclusion that private enterprise will flourish more and not less if the government itself accepts a greater responsibility for the smooth and efficient working of the economic system. People who take the shortsighted view that this will interfere with private enterprise or contract or even destroy its sphere of operation are on quite a wrong scent. On the contrary, the acceptance of such a responsibility by the government is the best guarantee private enterprise can be given that it will have the opportunity to flourish. For the greater the total demand for goods and services, the greater

is the scope for private enterprise. But action by the government to stimulate activity cannot be one-way traffic. If that is the responsibility of the government, it must equally be the responsibility of private enterprise to work in the public interest; and we have seen that under modern conditions of mass production, financial control, and high-pressure salesmanship this is not necessarily the case.

To return to the questions raised earlier in this lecture, the first one concerning private enterprise working in the public interest has already been answered. Some supervision of monopolistic and other anti-social practices is necessary, and there is ample evidence in all democracies that governments, sometimes unwillingly, have found it necessary to set limits to the independent action of the entrepreneur. These limits range from the old factory legislation to the more modern controls over financial management as determined by company laws and supervision of stock-exchange transactions. Much attention has also been given in some countries, notably the United States, to monopolistic practices, and much more attention will have to be given to these practices in England and other democracies, if the defensive mechanism built up in some industries is to be prevented from having an anti-social influence. The British Government has recently referred in an official document to the tendency towards industrial agreements and combines, both national and international, and while recognizing that such agreements and combines may not be in the public interest, it enunciated the following important principle: "The Government will therefore seek power to inform

themselves of the extent and effect of restrictive agreements, and of the activities of combines; and to take appropriate action to check practices which may bring advantages to sectional producing interests but work to the detriment of the country as a whole.”⁸ The policy framed within this declaration cannot be regarded as damaging to private enterprise. On the contrary it can only have the effect of restoring the free competitive spirit which is the main claim of private enterprise to fame.⁹

⁸ *Employment Policy* (London: H.M.S. Office, 1944). This declaration of policy has been reinforced by the rejection by the Board of Trade of the Cotton Board Committee's proposals for a regime of self-government in the cotton trade with price-fixing powers. Mr. Hugh Dalton, President of the Board of Trade, in rejecting the plan, supported as it was by employers and trade unions and indicating a highly dangerous drift to the corporate state, made the following illuminating comment on such arrangements: “There are grave dangers in such minimum price arrangements, which may easily lead to restriction rather than expansion of output, and to the perpetuation of inefficient and old-fashioned methods at the expense of more efficient and up-to-date firms. Moreover, for some time to come, the British cotton industry should be able to sell without difficulty, and at good prices, all it can produce. In the home market, the practical problem will be to enforce, not minimum but maximum prices, so as to prevent inflation. Likewise, in overseas markets, the need will be not for minimum prices, but for a certain discretion on the part of exporters. Our prices must not be so high as to lose in future years the goodwill of our overseas customers.” Quoted from the *Economist*, September 30, 1944.

⁹ On this point I cannot do better than quote from a speech by Lord McGowan, Chairman of Imperial Chemical Industries Ltd., to the Cardiff Business Club on March 28, 1944: “But let us make no mistake, Free Enterprise is on its trial. If we believe in Free Enterprise then we should accept the challenge and welcome the opportunities the future will give us to show its merits. There have been complaints recently of the unenterprise of Free Enterprise. I think there is something in the criticism. It is up to us to destroy its force by our actions; to show that we are alive

Turning now to our second question related to economic fluctuations, it is established beyond all possible doubt that there is an inherent tendency in so-called free enterprise to periodic booms and depressions. That is true even in times of great expansion when private investment is very active over the long period. This problem has received more attention from economists in the last twenty-five years than perhaps any other single problem. For a time it was thought that appropriate banking and financial action within the structure of private enterprise itself would provide a sufficient corrective, and there are still economists who hold that view. But they are small in number and still smaller in influence. The turning point in economic discussion on this problem was the publication in 1936 of Keynes's *The General Theory of Employment, Interest, and Money* with its emphasis upon total demand as the generating influence. It is this work that has inspired so much in the studies of national income and expenditure directed to show the fundamental conditions of maintaining stability and avoiding periodic depressions with their attendant financial disturbances and human suffering.¹⁰ One has but to

to what is expected of us." And again in the same speech: "Free Enterprise, while retaining the profit motive both as an incentive and as a test of efficiency, must not allow that motive to operate solely in narrow sectional interests. . . ." Earlier in a speech at Glasgow Lord McGowan had categorically stated that Free Enterprise could not prevent periodic depression without the assistance of the Government.

¹⁰ On this point see the illuminating passage in the British White Paper on *Employment Policy* dealing with "the constituent parts of total expenditure." For convenience they may be mentioned again—private consumption expenditure, public expenditure

read the published statements and reports of any Corporation or firm in free enterprise to see how each deals with its own particular problems and its own

on current services, private investment expenditure, public investment expenditure, and the foreign balance. That was the first time official recognition had been given to this approach to the problem of short term economic stability, and the document contains the following implied declaration of policy: "The methods which the Government propose to adopt to maintain total expenditure are described in Chapter V." But recent messages of the President to Congress (the State of the Nation and the Budget Message) have similar implications for the United States, and there is a table in Appendix 10 of the Budget under the title "The Government's Budget and the Nation's Budget." The summary of this table is as follows:

(Figures in billions)

	1939	1944
<i>Consumers</i>		
Income after taxes	\$67.3	\$132.8
Expenditures	61.7	92.0
Savings	+ 5.6	+ 35.8
<i>Business</i>		
Undistributed profits and reserves	8.3	12.3
Capital expenditure	10.9	2.6
Net balance	- 2.6	+ 9.7
<i>State and Local Gov't</i>		
Receipts	8.9	10.4
Payments	9.1	8.8
Net Balance	- 0.2	+ 1.6
<i>Federal Gov't</i>		
Receipts	6.5	47.9
Payments	9.3	95.0
Net balance	- 2.8	- 47.1

Total receipts and expenditure balance in each year, and the table brings out the enormous influence federal government expenditures had in 1944.

responsibilities relating solely to its place as a unit within a community. When it is affected by some failure of demand and its profits decline, the reaction is immediately to secure its position and not to restore fundamentally new conditions of total demand. The responsibilities of private enterprise are not communal in the widest sense as are those of the state. Even on the broadest viewpoint an individual entrepreneur regards only those consumers who are employees of his firm as his responsibility.

Thus, the creation of the C.E.D. recently in the United States is a recognition by business that their best interests are met by attending to the needs of the community as a whole. The C.E.D. however must work in coöperation with representatives of consumers, employees, and farmers if the community's difficulties are to be met. In recognition of this it is the state which can most efficiently accept this responsibility for effective demand, and so safeguard the production of enterprise and the consumption of the community. There is no escape from the conclusion that government action on a well coördinated plan will be necessary in the future if these periodic depressions are to be avoided.

We come now to the question whether private enterprise can give long-term full employment of resources. I have given reasons in the first lecture for the view that it cannot. Briefly the argument is that the higher standard of living possible in modern capitalistic communities has shifted the emphasis on economic development from the basic needs to semi-luxuries or luxury goods. This has not provided sufficient scope for investment to maintain a total volume

of construction sufficient to absorb the greater amount of savings that are accumulated as incomes rise. It may be argued that "the frontier of investment" has contracted, not only in the physical sense of a country like the United States that has no new areas to be opened up, but also in the economic sense that the goods in which investment will return dividends to private enterprise are becoming a smaller and smaller proportion of total goods that can be produced with the modern technical equipment. We have to think of "a social frontier of investment" in which with proper organization and administration it will be possible to absorb all the resources available for investment in producing what I have called "collective goods." These are capital goods which the people can enjoy in common, but which cannot be regarded as in any sense suitable for private investment. The frontier has no limits except the wealth and capacity of the community, its capacity not only to produce but also to enjoy the fruits thereof with imagination and courage. After all it was Adam Smith who declared that the objective of production was consumption. What the world of today lacks more than anything else is capacity to consume, not capacity to produce. There is no doubt that the democracies would have been better off if during the thirties they had organized public investment, even for the less noble purpose of producing munitions and weapons of war. That would have increased national debts, and for that reason alone would have been regarded as uneconomic. I shall deal with this problem later. Here it is only necessary to remark that a community which puts idle resources to work

can hardly be poorer than one which allows resources to be idle, despite the higher national debt of the former course.¹¹

The reduction in the frontier of investment has been accompanied by a complementary movement in the level of savings. As the incomes of the community, including those earned by corporations, became more unequal, the total demand for consumable goods relative to total income decreases; i.e., the

¹¹ Investment on the social frontier is not the only problem to be considered, as I shall show in a later lecture. The argument here is that insofar as employment of resources depends upon expansion of investment, we have in modern communities to tackle this problem of the social frontier in investment. But it would be unwise to create a position in which we were constructing great capital equipment while the people were languishing because of underconsumption. A recent book on early Australia—Eleanor Dark's *The Timeless Land*—offers a good illustration of an economy in which too much emphasis was placed on public investment. Governor Philip continued to construct public works at times when even food supplies were in danger of running out, and the little community was facing starvation. On the question of the place of public investment in the American Economy I have outlined my views in "The Middle Way in American Industry," *Yale Review* (June 1937), from which I quote an extract.

"But we cannot talk of liquidating a public works' program as though it were peculiarly a depression need. True, it is important to increase expenditure on such projects in a depression, but the modern capitalistic system cannot be maintained without a generally increasing volume of public works. The objection that this increases the public debt or keeps taxation at a high level is essentially a short-sighted view. Improved technique and efficiency in industry must be translated into a higher standard of living, and a higher standard of living in the modern urbanized world does not consist merely of more motor cars, more talkies, or more cosmetics. It consists also of the increasing range of collective goods that make for good living as well as high living, and cannot be produced and sold for profit. The community can afford more and more of these goods; the economic system requires investment in them to maintain its own cumulative expansion."

volume of savings is increasing. Consequently the effect upon national income or on the total number of persons who can obtain employment from a given unit of investment is lessened. The greater savings by the high-income receivers who are constantly increasing will reduce the numbers of people who can earn income, unless investment moves in proportion to savings.

The rate of investment must in these circumstances be increased; this has not been done by private enterprise and must be undertaken by the state for the benefit of the whole community.¹²

The argument advanced here leaves no doubt that the answer to the fourth question on central planning must be in the affirmative. Much scorn and ridicule have been poured out on the planners as visionaries, theorists, socialists, etc., and no doubt some of them deserve a rebuke for their muddled thinking and ill-considered plans. But a world that is fed on so much muddled thinking from publicists and leaders of pressure groups need not become alarmed about the inevitable excesses of enthusiasts for some new doctrine. People don't want to have their lives planned for them by anyone, and there will probably be a violent reaction against wartime controls when the victory is won. The case for liquidating these controls over the transition period from

¹² The argument here assumes no fundamental change in distribution. There is little doubt that a more equal distribution of income and a more steady flow of income from year to year will alter the total volume of saving relative to income. Some of the more important points in the relationship between savings and changes in the amount and distribution of income are briefly examined in an appendix to this lecture.

war economy to peace economy is overwhelming, and the greater the burden of this war on any economic system and the longer its duration, the more need will there be for a transition period of orderly retreat from the war economy. But that problem is not at issue in this argument. I am referring to long-term central planning of the economic system, not to detailed and rigid controls designed for dealing with the crisis of total war.

This long-term central planning will be designed to permit private enterprise to flourish in a large area of production, exchange and distribution in a free society with a high and stable level of employment. It is only in such a society that people will feel free in the sense in which the word freedom is used in the Atlantic Charter. No one suggests that the authors of the Atlantic Charter aimed at the suppression of freedom of enterprise. On the contrary they were seeking a means of creating faith among free peoples that a system of free enterprise could satisfy the hopes and aspirations of people. "Freedom from want" can only be guaranteed in a society that provides a high level of employment for its people. The nature and degree of planning will be indicated by the discussion in Lecture III on Social and Economic Objectives and stated more specifically in the final lecture. It is only necessary to state here that it will not impose a rigid and detailed control of entrepreneurs. Such a control would be inconsistent with the system of private enterprise.

APPENDIX

SPECIAL NOTE ON SAVINGS

In Lecture II reference is made to an observed tendency in most modern communities for private investment to fall short of the volume of savings. The effect of this is not only to reduce the amount of direct demand for production, but also seriously to reduce the secondary increases in national income that would otherwise be generated by an original unit of new investment.

An extremely wealthy community under private enterprise will have a large capital investment, indicating the possession of modern and efficient technical capital. Its capacity to produce will, therefore, be high per unit of capital and labor used. The question to be considered is whether its capacity to continue to expand its technical capital, that is, to maintain a high and expanding level of private investment, is sufficient to ensure an expanding economy.

It will have to do this if it is to keep up its national income and employment. With high productivity, under modern conditions of mass production, the tendency is for incomes—including the incomes of corporations—to be unequally distributed, despite the effects of high taxation in normal times. With a high level of income and such a distribution, savings will be high. If these savings are not invested total national expenditure will not be kept up, and therefore the demand for labor and resources will not be kept up. National income will, therefore, fall from its high level until such time as the process of active investment is restored.

In spite of its riches, and the prospects of greater riches, the community in these circumstances might actually become poorer. It is conceivable, as Keynes showed in the famous banana saga, that the community could impoverish itself. In fact it never does, because the process

of private investment is eventually restored to a point where at least a substantial proportion of the labor and resources of the community are employed. It is, however, a clumsy and rather inadequate way of dealing with the problem. What is required is an adjustment of the community's investment habits to its propensity to save.

. Beveridge states clearly the need for this adjustment and says, "Saving may be desirable from the point of view of the individual who saves, in order to ensure to him the means of spending and of independence later. Apart from this merit of securing independence, saving in itself has no social virtue. The social virtue of saving by one person depends on there being someone else who wishes to spend the savings."¹³ Individual saving will enrich the community, if the savings are used in active investment. It is not that the people in a community should save less, but rather that the organization of investment should be such that savings are put to active use. Individuals withdraw spending when they save. Unless some one somewhere in the economic system takes up this slack in spending by the process of active investment there is a reduction in total national expenditure and therefore in the volume of employment. We cannot assume that savings will be automatically invested and more attention has to be given to the process by which savings are accumulated and transferred into investment.

In recent years some technical surveys have been made of the relationship between savings and income.¹⁴

¹³ Beveridge, p. 95.

¹⁴ Marvin Hoffenberg, assisted by Mabel S. Lewis, "Estimates of National Output, Distributed Income, Consumer Spending, Saving and Capital Formation," *Review of Economic Statistics* (May 1943); *Consumer Expenditures in the United States: Estimates for 1935-36* (U. S. Government Printing Office: National Resources Committee, 1939); Mordecai Ezekiel, "Statistical Investigations of Saving Consumption and Investment," *American Economic Review* (March-June 1942).

It is not necessary here to review in detail the methods adopted in these reviews. Ezekiel¹⁵ examined the functional relationship of saving and national income from monthly data on saving and quarterly totals of national income. These disclosed a close correspondence between the two series. Proceeding with his analysis he ascertained that the data conformed most closely to the hypothesis that the difference between saving in years of rising and falling income is a function of the amount of change in income from the preceding year to that year. As he says, "with higher and higher incomes the additional amount of saving per billion of additional income showed a slight but distinct increase."

This he confirms in a table based on data for years 1921-1940.

Level of gross national income (billions)	Corresponding level of saving with national income unchanging from year to year (trend constant at 1939 end)	<i>Amount</i> (billions)	<i>Per cent of total</i>
45		5.75	12.8
55		7.75	14.1
65		10.20	15.7
75		12.80	17.2
85		16.00	18.8

The National Resources Board in their examination based on the year 1935-36 reported a similar conclusion.¹⁶

Discussing increases of \$10 billion in total income with 1935-36 conditions otherwise unchanged, they say that "here is clearly brought out the large share of the increases in income which go to savings. . . . *Further-*

¹⁵ Ezekiel, "Statistical Investigations" (Part I, March), pp. 32 ff.

¹⁶ *Consumer Expenditures*, p. 167.

more, savings claim an increasing share of each successive \$10 billion increases: 26 percent as income moves from \$50 billion to \$60 billion; 28 percent as it increases to \$70 billion; and 30 percent as it advances to \$80 billion" (italics mine).

This latter survey has also an interesting analysis of the distribution of aggregate savings by income classes. This shows quite clearly that the high income classes accumulate most of the consumer savings of the nation. Thus in the pattern of family spending by American families in 1935-36, a bare 1 per cent of incomes of 1250 to \$1500 is set aside for savings, rising to more than 50 per cent on the average for incomes of \$20,000 and over.

These surveys disclose the important effect on total savings of both an increase in the total level of national income and in the redistribution of incomes upwards—symptoms of the development of most economies for many years past.

But as already stated, this progressive rise in savings is itself a cause of instability within the economy and contains factors for which there must be compensation if this improvement in standards is to be maintained. This rise in the volume of savings that would normally follow from an expansionist policy provides an ample offset to additional investment which need not be represented by the forced savings of an inflationary movement.

It is in recognition of this increased propensity to save that action should be stimulated by the state to spend on collective goods some of the accumulated wealth which could not be spent in sufficient quantity by individuals to achieve the desired consumption goods. This spending may be of two types:

1. On consumer goods.
2. On investment goods.

In the first category will be found the improved social programs of most societies; in the second those collective goods of which I speak elsewhere. Despite the progress of some sections of our community it will be a very long period before the level of national income will become stabilized. With a given redistribution of incomes, savings in total will be less; consequently the planning of the investment required to maintain this position of equilibrium will be less difficult.

III

SOCIAL AND ECONOMIC OBJECTIVES

IN DEFINING the purpose that we want an economic system to serve, it is perhaps desirable first to consider again the interests of the individual as an entrepreneur or worker and the interests of the community as a whole. The individual has to consider his position relative to the position of others in the community. That is the very essence of the system of private enterprise which it is desired to sustain, but yet at the same time, to submit to certain general tests of performance. Hitherto it has been assumed that the individual in striving to improve his own position would at the same time be serving the best interests of the community in all respects. If we apply this doctrine to an entrepreneur facing a period of contraction of trade, it can be shown that the individual's attempt to defend his own position may well be harmful to the community as a whole. The classical case is where factors of production are elastic and in a contracting market will automatically accept lower rewards. Thus a deflation of wages in a contracting market would lower the costs of production of the entrepreneur, just as would special economy measures that he might take with respect to other items of his expenditure. If he got in ahead of his competitors, he would be able to fight a successful rearguard action, but his very success would

force others to pursue the same course and this could only lead to a general deflation or reduction in total expenditure and therefore to a reduction in employment.

The same analysis can be applied to the wage earner who seeks to hold his job in a contracting market by undercutting his mates. In both cases it might well save the individuals from the worst features of the contracting market but it only serves to promote a general recession for the community as a whole. This would cause national income¹ to fall, and apart from increasing the volume of unemployment it would disorganize the nation's budget. Taxation or government revenue like the net profits of a business responds quickly to changes in total national income. If then the government adopted the same principles as the individual and went in for wholesale economies, the position would only be still further aggravated. One could imagine the community being thrown into complete disorganization by such cumulative processes. In practice, however, this does not happen because sooner or later entrepreneurs who are able to command the necessary capital launch out again on an enterprise under conditions of low costs and this reverses the process. It has been assumed in the past that this tendency to periodic contraction and expansion was inevitable, and that it was a sort of compensatory principle in the economic world. The real costs to the community of accepting this as inevitable were not fully realized until it became clear in the depression of the thirties,

¹ I use the words "national income" to mean the money value of income unless otherwise specified.

if not before, that the process of recovery was not automatic. Contraction was not followed by a sufficient expansion to take up all the slack, and every country had a much greater volume of unemployment than it could really afford in terms of economic cost or social progress. Sir William Beveridge has shown that the average level of unemployment in Great Britain before the war was 14 per cent. In Australia also it was 14 per cent.

In these circumstances it is idle to pretend that the interests of the individual in protecting himself against the contraction phase of an economic cycle² or in seeking to profit by the expansion phase were in conformity with the community's interests. On this point the following observations are relevant:

(1) We have seen that at some stage in the process the entrepreneur would step out boldly and resume his normal function of active investment. He was able to do this because he had so managed his affairs as to have capital at his disposal at the right time, and he had the judgment and courage to act at the right time. But it was folly for the state to follow in the wake of the entrepreneur when it did not lack the capital and should not lack the courage.³ The

² Keynes has shown all too clearly the effect of "the race for liquidity" by entrepreneurs on the level of enterprise, income, and employment. The very effort of the individual to safeguard his own interests precipitates the crisis which he fears is impending.

³ The tendency of public investment to follow closely in the wake of private investment is brought out very clearly in the following table relating to Australia. The figures for public investment do not include the deficits which had the effect during the depression of maintaining income and expenditure at a higher level than would otherwise have been the case. The table brings out however the close correlation that exists between total investment

state was the guardian of the interests of the community, the entrepreneur was the guardian of his own interests. The state has a greater responsibility and should be prepared to take a greater risk. If it acted in the opposite direction to that indicated by the general trend of business, it would assume quite a financial responsibility for maintaining expenditure. But that would be for the benefit of the whole people, and if there were costs involved, these costs would be spread over the whole community. It is obvious that in this matter the interests of the community as a whole are directly opposed to the interests of any one individual.

(2) The question as to whether real costs would be borne by the state if it were to take compensatory action on the line suggested should now be considered. The problem is one of balancing the total costs of unemployment and financial disturbance to

and national income, and indicates the unfortunate effects on the level of economic activity of the government pursuing a policy of investment in accordance with movements of private investment.

Year	Investment by Public Authorities	Private Invest- ment	Total Invest- ment	National Income
	£m	£m	£m	£m
1928-29	50.7	174.1	224.8	734
1929-30	40.3	154.4	185.7	694
1930-31	20.3	59.0	79.3	526
1931-32	12.8	53.2	66.0	491
1932-33	15.0	72.0	87.0	514
1933-34	18.5	90.5	109.0	573
1934-35	23.1	117.5	140.6	596
1935-36	26.0	143.9	169.9	669
1936-37	27.9	172.2	200.1	739
1937-38	29.8	187.6	217.4	779

the community caused by economic fluctuations against the errors the state may make in launching projects that may prove uneconomic on the application of sound financial tests. I think it can be argued with conviction that any state that endeavored to select projects of expenditure that would benefit the people as a whole could not impose on the people costs as great as those imposed by the state following the course of economic fluctuations in its own financial policy.

(3) It may be contended that the state by taking compensatory action might be left in the field of investment permanently at a higher level than would otherwise be likely, and that such investment would be less profitable to the community than private investment. That is a possibility, and apart altogether from the problem of fluctuations. There are plenty of examples of public investment that have involved heavy financial losses,⁴ but the assumption here is that the state will compete with private enterprise in capital investment. That is not the case in the argument I am presenting. If the general level of public investment rises, on my thesis it would be owing to the failure of private investment to employ

⁴ The best exposition of this tendency for Australia is to be found in Eggleston's *State Socialism in Victoria* (London: P. S. King & Son, Ltd., 1932) which is a searching examination of the errors made by an unduly optimistic view of public investment in what might be regarded as commercial ventures. Though the ventures themselves did not return interest on the capital invested, no investor lost any of his investment because the burden was spread over the total government budget. The experience gained by these and other ventures in economic development by Australian governments should provide a basis on which to avoid the more obvious mistakes in the future.

all resources even in its most active periods. I have given reasons in the first two lectures for arguing that this will be the case in the future in communities with a high and rising standard of living.

(4) It has been assumed that the state will have command of financial resources to enable it not only to maintain its normal expenditure in a period of contraction, but also to increase that expenditure if it so desires. This was not the case in the days when the state was dependent upon the money market or private banking institutions for its finances. This is no longer true even where central banks are private institutions, as is the case in Great Britain. The state no longer considers that the central bank is entitled to refuse it credit for expenditure which it regards as essential. It is not suggested that the central bank should meet without question all the requests of the government, that its voice should not be heard as to the desirability of embarking upon expenditure designed to maintain the high level of activity. The government may be taking an unduly pessimistic view of the position, and no responsible person acting on behalf of a government would deny the right of a bank to present an opposite point of view. The decision, however, would have to rest with the government, and it could not be denied financial support. There is thus no argument today for inaction on the part of governments because of inability to obtain financial resources.

All this suggests that the responsibility is on modern governments to decide what general social and economic objectives they desire their economic systems to conform to. The limiting factor will, of course, be productivity and the standard of living. A mere

pious declaration on the part of the government that it will raise the standard of living will not achieve the result. There is no reason, however, why it should not set out to achieve the following results:

- (1) Stable employment at a high level.
- (2) A more equitable distribution of the products of industry.
- (3) A rising standard of living.
- (4) A wide scope for private enterprise within the framework of social control.
- (5) The maintenance of a vigorous system of private enterprise.

The objectives are broadly consistent with the policy enunciated for Great Britain by Sir William Beveridge and those who support him in his campaign for general economic and social reform, and I quote him as follows:

The guiding principle is that of social priorities—of putting first things first. Different societies or the same society at different times may take different views of what comes first, that is to say, of what are the most urgent needs. On the view taken in this Report, the most urgent tasks in Britain, once war is over, are, on the one hand, the making of a common attack on the giant social evils of Want, Disease, Ignorance and Squalor, and on the other hand, the re-equipping of British industry, whether in private or public hands, with new and better machinery to ensure a steady increase in the standard of life; industry for this purpose includes agriculture. It is to these tasks that the productive resources of the nation should first be directed, as they become disengaged from total war.⁵

In considering the objectives enunciated above, it will be appropriate to discuss the position of the different sections of the community, namely, workers,

⁵ *Full Employment in a Free Society*, p. 31.

farmers, and entrepreneurs, and then to consider the position of the government. Dealing first with the position of the worker, the question arises as to what is meant by a stable level of employment with work for all. On the definition of this so many other things depend, as to the degree and rigidity of planning and control required and the difficulties of reconciling order with freedom. Some of the advocates of full employment, as the doctrine has now come to be known, are inclined to seek for perfection in this most complex problem and to ignore the difficulties created by their perfect solution. The common definition is more jobs than there are workers to fill the jobs. The advocates of this view, it is true, make an allowance for what may be called frictional unemployment due to the lack of mobility of labor to move from one job to another. It also allows for any seasonal unemployment which occurs in different degrees in different industries, according to the incidence of climatic conditions or varying demand at different times of the year for the products of the industry. Full employment does not mean that there will be no unemployment. In the view presented that there will be more jobs open than people seeking jobs, unemployment would be reduced to the bare minimum of frictional and seasonal unemployment. In a bill submitted to the United States Congress by Mr. Murray, the following definition is given:

The term "full employment" means a condition in which the number of persons able to work, lacking work, and seeking work, shall be no greater than the number of unfilled opportunities to work, at locally prevailing wages and working conditions for the type of job available, and not below mini-

imum standards required by law, and in which the amount of frictional unemployment, including seasonal and technological unemployment, and other transitional and temporary unemployment, is no greater than the minimum needed to preserve adequate flexibility in the economy.

This definition is less ambitious than that of what may be called "the perfectionist school," and coincides with the definition implied, though not stated, in the British White Paper on *Employment Policy*. It also coincides with the *Report of the Technical Committee of the National Resources Planning Board on Security, Work and Relief Policies in the United States* which suggests an unemployment of from 5 to 8 per cent. With the large labor force in the United States this might leave the number of unemployed as high as three millions. If the same standard were applied to Britain the number of unemployed would be approximately 900,000. With its smaller area and greater mobility of labor, the British ratio might well be lower, but it does not seem profitable at this stage to go in for a precise definition as to what level of unemployment would be regarded as being consistent with the idea of full employment. To bring America back from ten to twelve millions of unemployed before the war to three millions would be a signal achievement and would have a profound effect upon the whole world. Nothing is to be gained by overstating the case for full employment and creating difficulties in administration before there is agreement as to the methods to be adopted to maintain a high level of economic activity. The first step is to establish the fundamental principle that it is within the competence of a com-

munity to control its level of unemployment. There is ample scope in social security measures to ensure the welfare of the smaller numbers of unemployed during the period of experimentation. It may be that eventually the community will be able to get beyond the levels postulated by some of the authorities, even Sir William Beveridge himself. But in this complex question of social reform affecting as it does the whole political structure of the community, it would be absurd to lay down hard and fast rules and to insist upon the observance of these rules at all costs. The economist has had a signal victory in the attention that governments are now giving to this problem of full employment. There is no need for him to overstate his case or to create obstacles in the minds of those who might otherwise support him. The fact is that the world will be an infinitely better place if the first object of the employment policy is to reduce the pre-war volume of unemployment by two-thirds or three-quarters of its amount. That may still leave some people seeking work and not able to find it. If it does, it will be easy to step up the program in the light of the experience gained in the first general attacks on the problem. We do not know in any case to what low limits we can reduce frictional and seasonal unemployment until we have experimented with the mobility of labor under the new conditions.

Let us consider for a moment some of the implications of a policy of full employment defined in the manner of the "perfectionists"—more jobs constantly than people applying for jobs. The economy of such a community would be constantly out of equilibrium

and would need to be checked by some permanent controls on wages, profits, and prices. Sir William Beveridge and his colleagues are aware of this, but I cannot resist the conclusion that they are not fully aware of all the implications of such a condition of affairs. The statement from the *London Times* which Sir William quotes, with its nostalgic assertion that "the first function of unemployment . . . is that it maintains the authority of master over man," may be dismissed as irrelevant to the problem. It is not the authority of master over man that matters, but the obligation of both to the community. With full employment both will benefit, and both may weaken in their sense of responsibility. To go swiftly from the conditions of pre-war years to a condition of full-fledged prosperity—in perpetuity—is probably more than even the British genius for politics can cope with. Sir William has some qualms about this, but says rather naïvely for one who has so intimate a knowledge of industrial conditions in England: "Full employment does not mean that men will have no motive to retain their present jobs; full employment does not mean that everyone has security in his present job even if he behaves well in it; still less does it mean that he has security if he behaves badly. Full employment means only that, if a man loses one job, he has a chance of finding another."⁶ It is true that the man if dismissed may not get unemployment benefit, but who is to decide that the conditions of his dismissal are such that he will be debarred from getting unemployment benefit? And what a fruitful source of strife industrial disputes over the rights of

⁶ *Full Employment in a Free Society*, p. 197.

dismissed employees to benefits will be? It is true as the learned author says that "workmen have no love for idlers," but they have less love for their employers, and they will not readily accept the right of the employer to brand their mates as idlers by dismissing them and depriving them of unemployment benefit. The adoption of such a code by universities or government service would bring about some startling changes.

Sir William is on the right note when he says that "the essence of civilization is that men should come to be led more by hope and ambition and example than led by fear." In a society with the risk of unemployment reduced to a minimum, not a negative risk as the perfectionist school desires, the element of fear will be reduced also to a minimum, particularly if the unemployed benefit is automatically available for a period. The right to be unemployed under such conditions is not far removed from the right to leisure which all modern communities can afford in a greater measure than they realize. We cannot weaken the incentive of competition for work without supplanting it with some form of discipline, which would probably be much more repugnant to organized labor than a relatively small amount of unemployment.

What of the employer? Would he be prepared to risk the prospect of industrial strife by dismissing a "loafer"? Would he not prefer to retain him and load his costs on a high turnover or even to compete with other employers by offering more for labor? This point is met by first suggesting that organized labor "will evolve, in its own manner, the machinery by

which a better co-ordinated wage policy can be carried through." I have a great respect for the leaders of organized labor and particularly for what they have done in restraining their members during the crisis of war, but I think that is asking too much of them as a continuous policy in peacetime. Secondly, it is proposed that wage problems should be settled by arbitration. Australia has had a wide and valuable experience of arbitration, and it has worked well in determining minimum wages. But this problem involves a determination of maximum wages above which neither employer nor employee should go for fear of causing "a vicious spiral of wages and prices." It is said that the primary responsibility for avoiding this will rest on those who conduct the bargaining on behalf of labor. But in a short market for labor some employers will be prepared, as they have been during the war, to pay more, and they will be able to do this despite the third suggestion made in Beveridge's treatment that prices be kept stable. The incidence of demand and turnover and of technical improvements in industry will vary greatly. Some employers will find their position deteriorating with economic change, while others will experience improvement, sometimes fortuitously. A policy of stable prices would not preclude variations in individual prices according to these changes, but speaking as one with some experience of administering price control I should not like to assume responsibility for making decisions that would meet this position. What is really needed in this connection is profit control, and that in normal times requires neat judgments as to efficiency that are probably beyond the capacity of

any individual or tribunal. There is, I am convinced, no escape from the conclusion that the degree of control over wages, profits, and prices required by this search after perfection will impose much more far-reaching government regulation of industry than is compatible with the working of free enterprise.⁷

There is so much to be gained by the policy of "full employment" that it is quite unnecessary at this stage to overstate the case. That employers would benefit by a policy of full employment on the lines suggested where the level of unemployment as a first step was reduced by two-thirds or three-quarters of its pre-war volume is beyond question. Their increased turnover would give them greater profits, but where competition prevailed the higher turnover

⁷ In Par. 292, Beveridge makes some remarkable statements as to the operation of price control under full employment. First its need is greatest with regard to goods and services entering into the cost of living of the ordinary citizen, and with regard to essential goods that are temporarily in short supply. For luxuries the need is less pressing. Therefore it does not need to cover "the whole range of goods and services currently produced." With a free labor market the employers in luxury goods will in these circumstances be able to offer and to pay higher wages and to get a greater command over the more efficient labor. The position should be the reverse, so that the more efficient labor will produce the more essential goods at the lowest possible cost. This compromise on price control confining it to certain goods is a reprehensible practice in wartime. It would be still worse in peacetime, when the freedom of labor movement would give employers and employed an open opportunity in the non-controlled goods to take anti-social action. As for the suggestion that "when concentrated in this fashion, the problem of price control presents no insuperable administrative difficulties," I can only say that no man with any experience of price control would accept responsibility for administering such a policy, especially in a society where full employment offered him opportunities of utilizing his talents on a more hopeful quest.

would lead to lower prices. Where competition did not prevail some tribunal to investigate restrictive practices would check the tendency to benefit unduly by the policy.⁸ If this were associated with some form of high-profits tax in preference to the normal corporation tax, the community would share with the entrepreneur the benefits of the policy.

Clearly the entrepreneur stands to gain by a policy that will keep up the volume of activity. The average level of unemployment in the twenty years before the war in Australia was 14 per cent while in 1931-33 it was nearly 30 per cent. If 9 or 10 per cent had been eliminated by appropriate action in those years, the income of Australia would have been up by a similar amount. This would have added not less than £60m per annum to income and general turnover for the whole of that period. The results in other countries would be no less striking. Business responds readily to increased turnover, and the level of profit rises more than in proportion to the change in turnover. This would not operate if income were not stable, but there is little doubt that given greater stability the entrepreneur would have greater opportunities for the exercise of those qualities of initiative, imagination, and courage which are his special contribution

⁸ Many plans have been suggested for dealing with the problem of monopolistic practices, but there are two that seem practicable. First, restrictive practices could be made illegal, but any trader or group of traders given the right to appeal to some judicial tribunal for recognition of certain practices. At the other extreme is the proposal to appoint a tribunal that will investigate restrictive practices and recommend action to the government. The first is the more rigorous course, the second perhaps the more likely to be adopted. It will obviously be very slow in its action in checking restrictive practices.

to economic progress. As an American writer has put it, "Private industry can and will do the job of production. It is the responsibility of the government to do its part to ensure a sustained demand."⁹

Turning now to the position of the farmer, there is little doubt that he has suffered more than any other group from the instability of the modern economic structure. Over the fifteen years before the war, farmers' incomes suffered, first because of the cyclical fluctuations in general spending power, and secondly because of a long-term trend adverse to them. In every country in the world the farmers were in a state of revolt because of the insecurity of their earnings, the incidence of fixed obligations, and the poor prospects of any expansion of their operations. Many illustrations can be given from the records of farm income over the years before the war, but it will suffice to give the figures for the output of primary production in Australia from 1928-29 to 1938-39. The figures are as follows:

<i>Year</i>	<i>£m</i>
1928-29	207.6
1930-31	129.4
1931-32	141.4
1932-33	142.9
1933-34	170.5
1934-35	158.2
1935-36	187.5
1936-37	215.2
1937-38	214.4
1938-39	184.9

⁹ Alvin Hansen, "The Postwar Economy," *Postwar Economic Problems*, edited by Seymour Harris (New York-London: McGraw-Hill, 1943) p. 14.

This gives the global picture for primary production, and the fluctuations are clearly inconsistent with reasonable security of income or stability of farming enterprise. The fluctuations in individual commodities are even more striking. Thus the pastoral output fell from £84.9m in 1928–29 to £43.0m in 1931–32. The highest figure in the thirties for pastoral output was £84.4m in 1936–37 but the figure had receded again to £63.8m in 1938–39. The fluctuations in farm income in the United States during the last fifteen years were even more violent, despite the attempts made under the Agricultural Adjustment Act to give stability to farmers. The United States, in common with every other agricultural country, was compelled to take defensive measures to protect the farmers in a contracting world. The Ottawa Conference of 1932 was an attempt on the part of the British Empire to shelter its producers from the blasts of the world depression, no doubt quite a legitimate attempt in the circumstances, but nevertheless primarily an instrument of defense. In 1933 the World Economic Conference was discussing policies of restriction to adjust supplies of raw materials and foodstuffs to the reduced demand. The primary producers of the world were in fact faced with the normal cyclical fluctuations and in addition a severe long-period trend towards reduced markets.

It is little wonder that they rebelled against conditions which threatened to overwhelm them. The greater the effort they put forth the less was their net income. They were faced with heavy fixed charges, and in seeking to meet their obligations their inevitable tendency was to increase production in a

falling market, a striking example of a group being steadily ruined by the effort of each of its members to compete with all the others to safeguard his own position. According to the dictates of classical theory, as sponsored by the advocates of private enterprise today, there should have been a reduction in the output with the elimination of inefficient producers. It is true that this movement was not given full sway because of assistance rendered to farmers by governments in some countries. Thus in Australia a total amount of assistance to primary producers of nearly £4m was given in 1931-32 and by 1934-35 it had risen to nearly £5m. But even where the assistance was not on a considerable scale in the early and most difficult years of the depression, as in the United States and Canada, there was little movement from the land but a great deal of suffering and despair. Moreover, it was by no means clear that the world's output of the principal raw materials and foodstuffs produced on the land could not have been consumed, if a policy of expansion had been adopted in place of the policy of contraction that was in operation. Farming is, moreover, much more than a commercial enterprise; it is a means of livelihood around which center the hopes and aspirations of families and communities. They will not normally abandon their farms, even when the position looks almost hopeless, and if we took a record of the depression and recovery in farm income we would probably find that the instinct of the farmer to battle on is more often right than the advice of those who from their Olympian heights tell him to get out into some other occupation. He could, of course, in Australia become a wage

earner where he would have his income guaranteed to him on a certain minimum standard if he could get work. Of what value is the advice to the normal depressed farmer to leave the land and return to the city to compete with experienced workers in a buyer's labor market, demonstrated by the fact that the average level of unemployment was 14 per cent? Surely an intelligent world can do something better than this for the farmer whose whole way of life is at stake.

Most countries are now attempting to find a solution of this problem through guaranteed prices to the farmer. This is a product partly of the pre-war agitation by farmers and partly of wartime experience. I shall deal with the administrative problems involved in this in the final lecture. Here it is only necessary to say that it should not be beyond the resources or the administrative capacity of modern democracies to provide some floor to the prices of primary products and to the incomes of primary producers insofar as these incomes depend upon the level of prices. It may be held that this is placing the farmer in a more secure position than any other group in the community, but he has a sufficient sense of insecurity on account of variation in weather and the incidence of pests and disease to give him scope for great enterprise against natural hazards.

What risks would governments take in providing a floor to the prices of primary products? The answer to that question depends largely upon the standard of living and nutrition level of their peoples. Reference has already been made in Lecture I to the improved nutrition of the people of Britain during the

war and to the beginning that was made at the World Food Conference in 1943 in a concerted effort to lift the level of nutrition. Sir John Orr in his booklet on *Food and the People* refers to increases in production of the "protective foods" that would be required above pre-war standards, if the nutrition level of the people of Britain were raised to the recognized standard. He mentions the following increases:

Milk	65%
Eggs	60%
Fruit	70%
Vegetables	60%
Meat	25%

In the United States the increases required in the output of the protective foods would be even more striking if the whole population were fed on proper health standards. Forty million more acres of food and feeding stuff crops would need to be grown, increases in fruit and vegetable output of 75 per cent would be necessary, of milk by 40 per cent, and of eggs by nearly 23 per cent.¹⁰ If this is true of Britain and the United States, how much more true is it of most countries in the world? An expansionist policy that would give reasonable security of income to people and promote a steady rise in the standard of living may actually create food shortages in place of the surpluses which have troubled the world over recent years. But this requires much better planning of the standard of diet as well as the development of a broad expansionist policy. The laissez-faire stand of

¹⁰ This would not be a net expansion in agricultural production. Some decline in cotton, wheat, and other agricultural products would be necessary in the post-war adjustment in the United States.

pre-war times failed to secure an adequate diet for all the people even in highly developed countries. Without proper guidance as to the best dietary standard and with the contracting world of prewar days, the intervention of governments in agricultural policy was largely designed to restrict output. This was one of the most damaging features of pre-war economic policy. It was barren of hope for the people as well as for the farmers, consigning the one permanently to a deficient dietary standard and the other to the despair of unstable income and restricted enterprise. A policy of expansion will reverse all this, and as regards the production and transport of food will have important indirect benefits on the world economy.

So far it has been shown that the worker, the entrepreneur, and the farmer will all improve their positions under the policy of economic expansion designed to promote a high level of employment and activity. What will be the position of those whose responsibility it has been in the past to finance enterprise—the banks, the insurance companies, trustee companies, pastoral and land finance companies, and the whole range of enterprise associated with the provision of long-term and working capital for industries and for the land? To some the intervention of the state in investment signifies a contraction of the sphere of influence of this group of financial institutions. A moment's reflection will show that this is not so; that, on the contrary, these institutions will have a more active field in which to operate with less risks to their activities. It is not proposed that the state should take over the operations of industry, farming, or distribution, still less finance these

operations. The proposal is that the state should maintain total national expenditure at a level that will keep all the factors of production in full employment. It will do this partly by public investment in fields which private enterprise would not normally enter, and partly by other measures which will be dealt with in Lecture IV. None of these will interfere with the operations of the normal financing of enterprise. But the total effect of the activity of the state will be to maintain a more stable level of output for industry as a whole, thereby reducing the risks inherent in financing production and distribution subject to violent changes in output. There will, however, be one important difference. The government will require working capital if it is always to be in a position of maintaining the total volume of national expenditure. Provision of long-term capital should not cause any difficulties because the high level of national income would keep up savings to the point at which sufficient capital from these savings will be available to finance government operations.¹¹

It is true that financial institutions may question the desirability of investing in government securities, but what other form of fixed interest bearing security is open to them if they are in the position of trust such as an insurance company or a trustee company?

¹¹ The effect of this on the size of the public debt and its burden on the economy requires a separate consideration. I propose to deal with this matter in Lecture IV and am anticipating the conclusion to be given there that a public debt created for the purpose of public investment as expounded in these lectures is no real burden, but on the contrary, like the capital subscribed for a joint-stock company or corporation to expand its activities, it is a real benefit.

They may invest in mortgages and land or even in public utility bonds, but I think it is relevant to point out that the risks of these two latter forms of investment are much greater than the risk of investing in government securities.

It is, however, with regard to short-term working capital that real difficulties may arise in reconciling the traditional ideas of private finance with the needs of the government in the new system. With the recurrence of depressions and booms, wide variation took place in working capital supplied to industry. The financial institutions at times were restrictive in their attitude to the needs of industry, while at other times they were ready to make advances because the money market was easy. There is little doubt that these variations in the supply of working capital were in part the result of the economic fluctuations and in part the cause of them. Variations in working capital for industry and private enterprise in general will be far less serious under the new conditions postulated here. It will be the government that will take the risk of maintaining stability of economic activity, and the government's demand for working capital may vary. It is always a matter of concern to private finance when it observes an increase in treasury bills or other instruments of short-term finance to governments. Yet if the government is to assume the responsibility suggested here, in which a higher level of total working capital for governments may be necessary, much greater fluctuations in the amount will have to be contemplated. I see no reason why this problem should create any more difficulty than the quite substantial fluctuations in working capital sup-

plied to industry under the old conditions. In both cases the ultimate source of the variation in working capital was a contraction or expansion of credit, and this will be precisely the position under the new conditions. The only difference will be that the government is ultimately in a position to obtain from the banking system an increase in working capital even though the system may consider the increase unjustified.

It has been shown that a policy of expansion must be of great benefit to the main economic groups in a system of free enterprise as it had developed before the war. Unquestionably, it would greatly improve stability of employment and security of income for all groups. It is equally true that it would provide for a rising standard of living. The reason for this is that full employment would mean greater production and a higher and more stable general level of consumption. The question of what sort of projects could be developed under public investment is a relevant consideration here, but sufficient indication of that has already been given. The problem will be further discussed in the last lecture, but the scope for improvement in the world's supply of collective goods is almost unlimited, while there are also great economic ventures beyond the resources of private enterprise which can be tackled by governments, sometimes even on an international scale. The list of both sorts of projects would include irrigation, land settlement, power, navigation, and soil-conservation plans in some of the great river basins on the lines of T.V.A.; roads and in some cases both airways and railways, sewerage and water systems, electric power schemes,

health and education buildings, cultural centers, museums, and libraries. Even in well-developed countries like the United States and England the scope is enormous for a people prepared to tackle the problem with courage and imagination, undeterred by the inhibitions imposed on community effort by nineteenth-century individualism.

With so much to be done it is natural to dwell on the place of investment in the plan. That can, however, be overstated. Stability of income will greatly increase consumption, especially by the depressed peoples and by the lower-income groups in countries with a relatively high standard of living. Social security plans based upon insurance against sickness, unemployment, accident, and old age are one means of promoting a more equitable distribution of national output and raising consumption levels. Improved housing for the people as a whole with some form of "assistance" by way of reduced rents for lower income groups is another avenue for raising living standards through more equitable distribution. It will be open to the state to finance these measures and its general expenditure by the modern instrument of progressive taxation. No doubt expenditure on health, education, and nutrition can be profitably stepped up. With a high level of economic activity national income will be high and rising, and government revenues will, for any given level of taxation, be more buoyant than they were under the conditions prevailing before the war. It requires no elaborate analysis of revenue to prove this; the lessons of the depression are eloquent on the effects of a fall in national income in causing a collapse of govern-

ment revenues.¹² It is equally true that in times of expanding national incomes government revenues benefit more than in proportion to the increase in income as a whole. The experience of the state governments in the United States and Australia during the war offer convincing proof of this tendency.

So far the whole problem has been considered in relation to a "closed economy." The impact of external conditions has been ignored. But, of course, in the world of trade and finance it cannot be ignored. The question must then be considered as to whether the economic and social objective is to be altered, because the impact of outside conditions may cause embarrassment to a country that is pursuing a high-employment policy in a world not so dedicated to the ideal. If national income is sustained in country A by the policy suggested in this discussion, and the outside world is not offering any increased demand for the country's exports, there will be no compensating factor available to country A because of its increased imports. For it must be assumed that it will have increased imports. It will then be, especially if, like Australia, it is a dependent economy, embarrassed by a net debit on its balance of payments for interest and other service payments. If this position is long continued at the higher level of imports the balance of payments will be continuously adverse, and country A will soon lose its overseas balances. On the old dispensation this would precipitate financial difficulties and force a deflationary policy.

¹² My study of the Australian depression in *Australia and the World Crisis* gives ample information on this if it were needed. See especially Lecture III, Part 2.

What is country A to do in these circumstances? It has the following courses to choose among.

(1) It can abandon its expansionist policy and maintain its parity with the international monetary standard. This is the traditional policy, and if it could be assumed that country A has to make this choice only once some arguments could be adduced in favor of choosing that heroic course. It would have to reduce its money incomes and costs to the level that enabled it to adjust its balance of payments by reducing the volume of its imports and increasing the volume of exports at lower prices. Theoretically country A could then go along with its expansionist policy at the new level of money incomes and costs. But this assumes that other countries competing with country A will not reduce their export prices, and that surely is a doubtful assumption. Meanwhile, the whole level of activity in the outside world and the price level in general might have changed, and country A may find either that it has to embark upon another step in deflation, or that its heroic measures had turned out to be unnecessary. In any case it has been shown that deflation is a major operation if it is to be a comprehensive measure of policy, and one that no country should embark upon without a full understanding of the issues involved. I have described the Australian policy in 1929–1933 at length in *Australia and the World Crisis*. No one who lived through that crisis would recommend the repetition of that policy as a major measure more than twice in a century! This course has, I think, to be rejected. It is preferable to follow the advice of Lord Keynes in his speech in the House of Lords when he declared

that Britain was determined not to allow her economic policy again to be determined primarily by a strict adherence to a fixed parity with an international monetary standard in all circumstances.¹³

(2) Country A can impose restrictions on imports or ration its consumption of imported goods through a continuance of consumer rationing on wartime plans. This savors of the pre-war policy of trade restrictions which were so damaging to world trade. Moreover, country A may find that the outside world or some members of it may impose restrictions on its exports. Then there is the possibility of the restrictions being used as a means of protecting less economic production in country A. For these reasons this course is also to be rejected, except possibly for minor adjustments over a short period. Where it is thought that the disequilibrium is likely to be short-lived, deferred expenditure on imports is a possible

¹³ Speaking in the House of Lords on the International Monetary Fund on the 23rd of May, 1944, Lord Keynes made the following statement, as to the nature of the International Monetary System embodied in the proposal for an International Monetary Plan, which was later adopted at the Bretton Woods Conference: "The plan introduces . . . an epoch-making innovation in an international instrument, the object of which is to lay down sound and orthodox principles. For instead of maintaining the principle that the internal value of a national currency should conform to a prescribed *de jure* external value, it provides that its external value should be altered if necessary so as to conform to whatever *de facto* internal value results from domestic policies, which themselves shall be immune from criticism by the Fund. Indeed, it is made the duty of the Fund to approve changes which will have this effect. That is why I say that these proposals are the exact opposite of the gold standard. They lay down by international agreement the essence of the new doctrine, far removed from the old orthodoxy. If they do so in terms as inoffensive as possible to the former faith, need we complain?"

course of action, but for any major adjustment measures to restrict imports create more problems than they solve.

(3) The third course of action is to alter the parity of exchange with the international standard. This course is likely to be misunderstood, to be labelled inflationary, and to connote some degree of financial instability. But these fears are a survival of the days when strict adherence to the gold standard was the first article of faith in financial and economic policy. "A fundamental disequilibrium," to quote a phrase that has been given international recognition by the Bretton Woods Conference, may be corrected most satisfactorily by a variation of the exchange rate. As regards a country like Australia I have set out the reasons for this at length in *Australia and the World Crisis* (Lecture V), and I do not need to repeat them here. It avoids the worst and most distressing features of deflation, it keeps trade free of special restrictions and quotas, and provides the quickest and least disturbing method of making a fundamental adjustment. It is not a course, however, to be lightly embarked upon, and the provisions of the Bretton Woods agreement do not permit of an easy recourse to it.¹⁴

¹⁴ Immediately before the War Australia had a level of unemployment of about 10 per cent. In a recent lecture on "Problems of a High Employment Policy" (the Joseph Fisher Lecture in the University of Adelaide), Dr. H. C. Coombs argues that a net increase in government loan expenditure of £10m in Australia in 1938-39 would have increased total national income by £63m at the prevailing level of prices. Although some increased taxation would be necessary, he assumes that private investment would rise from £97m to £115m, an increase of approximately 15 per cent. His increase in public investment is from £34m to

This problem may not arise in an acute form if the leading countries of the world combine to pursue a policy of high employment and continue to work out the bases of international collaboration on the lines planned at recent international conferences. The prospect of restoring reasonable freedom to world trade and exchange will be much greater in a background of general prosperity than it was in pre-war conditions. That is why Australia has been pressing

£44m and the increase in the expenditure from revenue would be from £88m to £114m. The following shows the general picture he gives of expenditure and investment in the two cases:

NATIONAL EXPENDITURE AND INVESTMENT IN AUSTRALIA,
1938-39

	<i>Actual</i>	<i>High Employment</i>
	£ m	£ m
Private expenditure on consumers' goods and services	638	665
Private expenditure on investment goods	97	115
Net expenditure in Australia from overseas	20	2
Public expenditure in goods and services		
from revenue	88	114
from loan	34	44
Unemployment resources	63	—
Maximum production	<u>940</u>	<u>940</u>

The most disturbing feature is the effect on the overseas position. In 1938-39 overseas disinvestment was actually £27m. With the high employment policy imports would rise from £125m to £141m, while freight costs would increase from £16m to £17m, giving a total increase in debits of £17m. The change on the credit side would be limited to a fall of £1m in exports, making the total increase in net debits £18m. This would give an overseas disinvestment of £45m. Obviously Australia could not afford to continue with such a position for long and she would have had, sooner or later, to decide on one of three courses mentioned here, if she were to maintain her full-employment policy.

the doctrine of full employment for discussion on the international level and urging that the nations should pledge themselves to pursue a policy designed to maintain a high level of economic activity within their own territories.

IV

EQUILIBRIUM IN A CONTROLLED ECONOMY

IT WOULD be wrong to assume that the title of this lecture implies controlling the economy in the sense in which we have adopted control during the war, or even in the sense in which certain features of economic control were operating in some European countries before the war. A controlled economy in the sense in which I am using the term does not mean an economy in which individual actions of entrepreneurs are to be subjected to detailed regulation. If the doctrine of full employment is pressed to the limit of demand by what I have called "the perfectionist school," the economy would have to be subjected to a much more detailed regulation than is consistent with free enterprise. One of the objectives set down for the economic system is that it should, in the free world, provide ample scope for the operation of private enterprise in a background of social control. The problem that confronts us in this final lecture is to consider whether it is possible to get the economy to work in the desired way with certain measures of social control and at the same time to leave wide scope for the operation of private enterprise.

It is essential that the economy should be in equilibrium if it is to perform its real function. I shall, therefore, set out the conditions of equilibrium. For

this purpose I repeat the definition already given in the paper I read at the conference of the Institute of Political Science in Canberra in January 1944. The conditions of equilibrium according to this definition were as follows:

(1) That aggregate demand in terms of money does not exceed available supplies at the current prices, and that the level of prices is reasonably stable.

(2) That spending power is so distributed that the demands of each member of the community can be made effective on a reasonably equitable basis.

(3) That the factors of production are sufficiently mobile to permit progress and change.

(4) That the price structure is not distorted by the influence of monopoly.¹

Under the individualistic principles of nineteenth-century economic theory, it was assumed that these conditions of equilibrium would be automatically established by the free movement of resources in response to changes in demand. There is sufficient evidence in the experience of the last thirty years to show that resources are not sufficiently elastic to bring about this equilibrium under the free play of the forces of the market. The stickiness of all resources, including capital in most countries, resulted in equi-

¹ These conditions refer of course to long-term equilibrium and in this lecture I am concerned with the long-term problem after the transition from war economy to peace economy has been made. The problem of control in the transition period will be quite different, as I have shown in the paper referred to, from the problems of control in the long run. We could not speak about a free economy if we had to contemplate the continuance in perpetuity of the controls that will be necessary in the transition period.

librium being attained only with a large and growing amount of unemployed resources.

In the economic system postulated in this discussion, certain measures of control will be necessary to maintain equilibrium. Some of these controls are already in operation in most democracies, perhaps more fully in Australia than elsewhere. The modifications of these controls required to maintain an economy based upon a higher level of employment are not so great as most people have imagined. The principal controls will be as follows: ²

- (1) Control of total national expenditure.
- (2) The provision of social security and the promotion of a more equitable distribution of the national income.
- (3) Financial policy.
- (4) Wages policy.
- (5) The foreign balance.

² I propose to deal only with the general framework of control. To cover this whole ground it would be necessary to write a treatise. In particular, I am omitting detailed reference to such controls as monopoly and restrictive practices; nutrition and its effects upon international trade in basic foodstuffs and the prosperity of the farmer; the treatment of special regions affected by long-term shifts in the demand for their products; the improvement in housing conditions and its influence on health and efficiency and general economic activity; and the difficult problems associated with the administration of guaranteed prices for primary producers. Some of these problems have been referred to in earlier lectures and the position they will occupy in the general policy has been indicated. Thus control of monopoly is necessary if the basis of free competition in a world of mass production is to be restored. It would be futile to attempt to prevent agreements among producers, but the onus should be on them to prove that the agreements are in the public interest and not on the state to initiate investigations and eliminate practices it has not specifically ap-

1. *Control of total national expenditure.* The first step in the new plan for maintaining an active economy is to maintain total expenditure at the desired level, to employ all the resources without major fluctuations in the price level. To do this it is necessary to examine the make-up of total national expenditure. The best model for this is given in the British White Paper on *Employment Policy*. Expenditure creates demand for resources, and if expenditure is not maintained, demand for resources will fall off and some will be unemployed. In the long run if the general level of money incomes is lowered, they could all be employed at the new and lower level of monetary demand. In order to simplify the picture it will be assumed that the policy is being carried out in cooperation among a group of nations so that the com-

proved. Such a measure of control could not be confined to industry and commerce. It will be found to be necessary in respect of farming and labor organizations, and is necessary if we are to avoid developments that will lead to establishing the corporate state with its inherent tendency to totalitarianism. In the general outline of controls given in this lecture no restriction is placed upon the entrepreneur except those which are designed to prevent him from taking restrictive measures himself. The planning required to carry out a policy of high employment and to maintain economic equilibrium does not, as some of the critics and advocates of full employment alike argue, involve detailed control over the economic functions of thousands of individuals. Most people will be aware of central planning only in that it will give them reasonable stability of output and activity in a world that was formerly most unstable and demanded great energy and foresight on their part to avoid the hazards of instability. Much of the basic machinery for control existed in Australia before the war, and it is to the successful working of that machinery, and not to the detailed and restrictive measures during the war, that we must look for our administrative agencies.

plications caused by long-term fluctuations in the foreign balance will not be serious.³

Following the classification in the British White Paper, we have to consider five main components of total national expenditure as follows:

- (1) Private consumption expenditure.
- (2) Public expenditure on current services.
- (3) Private investment expenditure.
- (4) Public investment expenditure.
- (5) The foreign balance.

The last mentioned refers to the difference between total payments made abroad an account of imports, interest payments, etc., and total payments received from abroad on account of exports, interest receipts, etc. If the total payments are less than the total receipts, the community gets an addition to its total

³ Two warnings should be borne in mind at this point. The maintenance of money income at a stable figure does not necessarily mean that real income will be held stable. It may rise or fall. If advantage is taken of the increased productivity due to modern technique in industry, real income should rise. If, however, the efficiency of the entrepreneur and of labor declines under the conditions of greater security brought about by the policy of maintaining expenditure, real income might fall. If again in maintaining total expenditure the government embarks upon totally uneconomic projects which do not promote a higher level of living and improved efficiency among the people, real income may fall. If again through industrial change the community loses a valuable export industry, and the expenditure planned to make up the loss of this income does not establish an equally valuable new export industry, or home product that successfully competes with imports, real income will certainly fall. We should not be confused, therefore, between the maintenance of total expenditure and the resulting movement in real income that may follow from any particular policy pursued. The question in fact is not so much one of maintaining total expenditure, which after all is not such a difficult job, as of the type of project which will be embarked upon to keep up the level of total expenditure.

national expenditure. Conversely, national expenditure would be lowered by an excess of payments over receipts. I propose to assume for the moment that the foreign balance is a constant factor and to consider, under section five below, the complications that arise when it fluctuates.⁴

Turning now to the other four components of national expenditure, we have to consider to what extent they can be controlled individually or in the aggregate. The first one, private consumption, can be reasonably and accurately forecast for any given level of national income. It can also be influenced by fiscal policy on the part of the government. Thus the measures taken to provide social security, nutrition subsidies, health and educational benefits, and cheap housing for people in the lower income groups would

⁴ This assumption is based upon the view that nations should act in concert to maintain total expenditure. If they do, the total volume of international trade will be greater than would otherwise be the case because each nation will have a higher national expenditure. It will distribute this national expenditure between imports and locally produced goods on much the same ratio as in the past, so that total demand for imports will rise along with total demand for home products. I am aware that some modification of this generalization may be required because of conditions that are always at work in a changing world to alter the ratio of imports to home-produced goods consumed by any country. But this is a refinement which does not interfere with the general argument now being advanced. The fact is that there is a high degree of correlation between national income and imports. The best way to increase world trade is for a group of nations to decide among themselves to take all reasonable measures to maintain a high level of national expenditure. The demand for imports will then be maintained at a higher level and that, of course, means the demand for exports. As with every other economic problem the tendency is for each country to act like every individual in the community and to consider that its major objective in all circumstances is to seek by all means to increase exports. That,

all tend to promote a more equitable distribution of income and to raise the level of consumption, if that course is desired. These measures, however, could not have a decisive influence on total expenditure bringing it up to any level desired. Public expenditure on current services is also capable of accurate forecast and of variation within certain limits. This variation, however, is subject to the effect of taxation upon private expenditure or saving in cases where it is necessary to vary the incidence of taxation in order to increase public expenditure on current services. We have seen that saving will tend to increase, the greater the inequality in the distribution of income and the greater the fluctuations in total income. If stability of total income is achieved and a more equitable distribution brought about through fiscal policy and through wages policy, the total volume of savings in relation to national income will be reduced. Since savings is that part of income which is not spent in consumption of goods and services, or paid in taxa-

however, will not increase the total volume of world trade if the demand for imports as a whole is not raised; that is, if total national expenditure is not maintained. Thus, the best attack on the problem of restoring world trade is to look to the power of countries to purchase primary imports. If that is looked after, the exports will look after themselves.

The above statement regarding the effect of the foreign balances on national expenditure is confined to movements originating in imports and exports or other elements in the balance of payments. Thus a change in relative prices of imports would be such a movement, not necessarily related to internal policy, but obviously it is impossible to isolate the foreign balance from other factors causing changes in national expenditure. It is quite likely that an increase in national expenditure brought about by internal policy would be associated with an increase in payments relative to receipts in the foreign balance.

tion, it may be anticipated that the total expenditure on consumption will be greater in an economy with a stable level of national income and a more equitable distribution of that income than has been the experience of the past. Therefore, by fiscal policy and by maintaining stability of income, the government can affect the ratio of savings to total income much more easily than the rate of interest did at a time when it was believed that the proper instrument of control was through the rate of interest and conditions in the money market. We shall see that this is even more true of the level of investment.

One special ingredient of income in a country like Australia can be rendered more stable than in the past by government action. I refer to the income of farmers. If the policy of guaranteeing certain minimum prices of farm products is adopted, fluctuations in farmers' incomes will be greatly reduced. It is not necessary to go into details as to the significance of this in promoting stability of income and stability of private consumption. It will undoubtedly have an important effect in maintaining private consumption at a more stable level as well as at a higher level.⁵ The administrative problems in guaranteeing lower

⁵ The United States, Canada, and Great Britain have all made commitments to guarantee leading farm prices for a short period after the war. In the case of the United States and Canada, the guarantee is based upon legislation, whereas in England it has taken the form of an announcement by the Minister for Agriculture. The British proposal is to consider the prices appropriate to costs from year to year, and it is the intention of the government to make an annual review of costs, and of sample farmers accounts. Further, the government apparently intends to use its price control to direct the development of agriculture into animal husbandry, in accordance with the government's nutrition policy.

limits to the prices of primary products are by no means simple. If, however, action is taken on an international plan and is supported by concerted action to raise nutrition standards, the problem should not present overwhelming difficulties in the immediate future. The minimum prices will have to be determined on a moderate level at which the more efficient producers could operate without incurring heavy losses. This would be a stimulus to efficiency and would discourage the maintenance in production over long periods of the less efficient producers. Since employment activity was being maintained at a high level, the less efficient producers would not need to fear the consequences of abandoning their farming operations in favor of some other activity for which they might be better fitted. It may be argued that the political power of primary producers is so great that they would secure minimum prices above reasonable levels. But the effects upon their economy of a high level of employment and rising nutrition standards with increasing demands for their products would reverse the trends of the last twenty years and render less essential the pressure which they have found it necessary to exert in order to get their reasonable demands met. Australia has had the experience of thirty years of determining minimum wages. In that case the government is not responsible for meeting the extra costs of a rise in the minimum wages and the problem is, therefore, not strictly analogous. Moreover, the minimum wage is rather a more simple concept than minimum prices of primary products. Nevertheless, it should be possible to establish a tribunal whose job it would be to determine mini-

minimum prices of primary products on standards laid down by Parliament. It is better to tackle the problem this way than to work on any set formula, or possibly it would be better to leave the problem to be determined by the government after recommendation from some authority. The minimum price would have to be varied according to changes in productivity and in the emphasis which the government desired to place upon the production of different products. This is basically what the British had in mind in the guarantees they have offered for the next four years. They hope through prices to influence the relative production of different products.⁶

As regards private investment, it would be unwise to exercise too rigid a control. Its level can be estimated with reasonable accuracy, and by proper coördination between the government and private

⁶ The New Zealand government in 1936 set out to provide guaranteed prices for certain basic primary products. A colleague (Professor J. B. Condliffe) once described New Zealand as "a remote farm." It was an apt description, for the whole economy of New Zealand is based upon a few primary products. In a world in which the prices of these products fluctuated violently, New Zealand had a rather unstable economy. For many years the problem of giving stability to the New Zealand economy was largely a problem of giving stability to farm incomes. The government's experiment in 1936 was an attempt to solve this problem. There was some very ill-informed opposition to the proposal, and this and other measures created a difficult financial position for New Zealand because of the flight of capital. But if we consider the problem New Zealand had to face, the effort to stabilize farm prices should have been welcomed both inside and outside of the country. I have set out my views on this in an article in the supplement to the *Economic Record*, 1939. The only valid criticism that can be made was the level at which the guaranteed prices were fixed, and it is by no means certain that in the long run they would have been too high.

enterprise its amount can be influenced without repressive control. Some advocates of full employment lightheartedly propose to control private investment.⁷

Fluctuations in private enterprise have in the past been a product as well as a cause of general industrial fluctuations. Under the conditions postulated here, there would be greater stability of income and expenditure and this would itself reduce the fluctuations in private investment. If, however, there was a tendency for private investment to expand too rapidly and to compromise the government in its plans for maintaining a basic level of public investment, a proper course would be to damp down the rate of private investment for the time being. This could be done by a Capital Issues Board on similar lines to that which operated in Australia during the war. The board would be informed on the general level of income and expenditure and of the government's desire to keep private investment within certain limits. The board would also be a convenient

⁷ Beveridge, *Full Employment in a Free Society*. The Investment Board there proposed would have to make neat decisions which are really outside the scope of any board which does not accept responsibility for the actual expenditure. All investment control during the war in all countries has been negative in character. Thus the Capital Issues Board in Australia set out during the war to prevent new investment in projects that were not directly related to the war. This was a means of diverting resources to war. This problem should not arise in normal peacetimes unless the government is not able to obtain sufficient resources to carry out the projects it has in mind. If it had to delay some of these projects, probably less damage would be done to the society as a whole by leaving private enterprise relatively free than by establishing social priorities and subjecting private investment to repressive control. This may be necessary in the transition period after the war, but it would not be required to meet the requirements of economic development under normal peacetime conditions.

means by which coöperation could be established between private enterprise and the government, and it might not be necessary at any time to impose a check by regulation. That should be the objective. The government's policy could in part be implemented through the banking system. In Australia the trading or commercial banks operate their lending policy within the limits determined by the Commonwealth Bank. If they were not effective, some restriction of private investment would then be necessary. We have to face this fact but in actual practice recourse to a restrictive measure of this kind would rarely be necessary. Since that in fact would be the only measure of control required over private investment, I see no reason why the entrepreneur should fear that a policy of high employment would interfere unduly with his freedom. This method of damping down private investment would be much more effective than the old method through the money market, the rate of interest, and the banking system. It would, moreover, involve few administrative problems.

The last main component in total expenditure is public investment. This is an element of expenditure over which the government has complete control, and it is in this element that the most interesting developments in economic policy have taken place during the war. As indicated in the first lecture, studies of national income and national expenditure made in most countries have led to the practice of considering the financial budget and general economic policy in the light of total national income and national expenditure. After all other methods have

been examined for maintaining total expenditure, the government is able to increase or decrease total expenditure by varying the amount of its own expenditure, whether on current account or on capital account. In the past the tendency has been for government expenditure on both accounts to vary directly with the variations in the general level of economic activity as determined by private investment, private consumption, and movements in the foreign balance. The policy of the government in these circumstances tends rather to aggravate the position than to correct it. In the light of war experience with its emphasis upon mobilization of resources and the man-power budget, it is now clear that the appropriate policy for the government to pursue is almost the direct opposite of traditional policy.⁸

⁸ This is a rough generalization as to the position. During the thirties, however, tentative and experimental steps were being taken in many places, particularly in the United States, to correct the underemployment of resources by government spending, "deficit finance" as it is unfortunately called in America. The experiment, however, was carried out on a limited scale despite the public criticism of the amount of the deficit, and it was associated with a great many other measures that raised acute controversy and created opposition in business circles. I am not suggesting that on reflection most of the measures taken under what came to be known as the New Deal will not in retrospect be found to have been constructive and beneficial to the permanent working of the American economy, but for the time being they created uncertainty and possibly aggravated the unwillingness of entrepreneurs to restore private investment on the scale required. On the other hand, it must be remembered that no great field of construction which has characterized big expansionist movements in the American economy in the past appeared to be open to private investment, and there is little ground for the belief that had the government given private enterprise a free hand the position would have been any better. But this is one of the unresolved controversies in which no prudent person will commit himself. The term "deficit finance"

What will be required in the future will be a continuance of the wartime policy of assessing the level of total expenditure at which resources will be reasonably fully employed and ensuring that that level of expenditure will be maintained in a fairly stable condition. To do this a certain measure of central planning at a high level will be required. This planning is now going on in London, in Washington, in Ottawa, and in Canberra, and no doubt in other democracies. It is a planning for war under which the most economical use of resources is the objective. Because this requires the diversion of resources from normal uses to war purposes, as well as the employment of all hitherto unused resources, many measures of control of a restrictive nature have been found to be necessary during the war. These measures will not be necessary in peacetime to achieve reasonably full employment of resources at a stable level. What, however, will be required is the preparation of regular plans by which total expenditure will be kept at a level appropriate to the employment of the resources of the community. The machinery already exists for doing this in the striking work that is being done in the preparation of estimates of national income and expenditure. It is not necessary to go

is as I say unfortunate. It is absurd to think that a great constructive enterprise like T.V.A. should be financed out of what is called deficit finance. Although not fully completed, T.V.A. is now paying full interest on its capital of nearly eight hundred million dollars and paying off its debt at a rate probably in excess of the depreciation and obsolescence of its assets, and in excess of a rate appropriate to the working of the modern economy, in which as we have seen the propensity to save tends to exceed the willingness to invest.

over this ground again but merely to reaffirm the view that this work represents a very great advance in the application of economic theory to economic practice. The simplest account of it is to be found in Meade and Stone, *National Income and National Expenditure*, to which attention is again drawn.

These estimates of national income and national expenditure will form the basis of future policy. That they should be accurate and independent of the exigencies of politics is a matter of first-class importance. On the other hand, it would be pretentious on the part of the economic expert to claim a specially privileged position regarding the making of policy. It is not his function to make policy, but the facts which his modern technique of investigation can disclose regarding national income and national expenditure should form a basis for policy making. The practice has developed in England for the Chancellor of the Exchequer to publish annually in his budget statement a statistical appendix setting out the principal facts as to national income and national expenditure in relation to financial policy. It is appropriate that these facts should be made public, and the continuance of a central group of experts to investigate continuously movements in national income and expenditure with the annual publication of their findings would be all that is required. It is highly desirable that the experts themselves should be independent of any spending department and even of the treasury itself. Policy as to government finance could then be made in the light of the views of the departments and of the facts disclosed by the investigations of the experts.

Central planning of this type is very different from the bogey in the minds of many advocates of private enterprise that the "planners" propose to take over direction of the whole economy. That is quite unnecessary and quite undesirable. A further step in planning would, however, be essential to the plan. This has relation mainly to the projects upon which government spending should be launched. In regard to this it is first important to note that there is a definite limit to which government spending can be automatically varied to fill what is known as the "deflationary gap" caused by the failure of other components of total expenditure to make up total demand to the desired amount on a given level of public expenditure.⁹

I have advanced strong arguments in favor of the view that in all modern communities with a rising standard of living, the volume of public investment should in any event be maintained at a relatively high level. This is important even from the administrative point of view. To assume as some do that "public works" are to be considered only as a means of offsetting the deficiency in expenditure on other accounts is to ignore the fundamental position of public investment in a modern economy and to overlook the serious administrative difficulties of making

⁹ The "deflationary gap" may be defined as the deficiency in total expenditure required to employ resources at the desired level. It is due usually to a reduction in private investment and to a deficiency in the foreign balance which normally sets in motion reductions in the other items. The objective of government policy will be to check the forces initiating a deflationary gap, and if all other measures fail, to attempt to offset it by an appropriate movement of public expenditure both investment, and current goods and services.

big changes in the volume of public investment. The projects which should be developed by public investment normally require elaborate preparation and take a longer period to complete than would be necessary merely for filling up a temporary gap in total expenditure. A steady stream of public investment at a fairly high level is appropriate to the working of the whole economy and essential for the proper administration of public expenditure. With this base and the machinery available for developing and administering public expenditure, it would be easy to have some short-term plans in arrears which could be drawn upon to fill up the deflationary gap. In these circumstances, moreover, the gap itself would be smaller and the economy would be kept in balance in part by the prevention of an unduly strong upward swing in private investment, as argued above.

To carry this out, however, a modern democracy requires special administrative machinery. This is particularly true of a federal system, where responsibility is divided between the federal government and the state governments. Even in a unitary state like Great Britain, division between central authority and local authority necessitates special action if full use is to be made of local agencies that have in the past been responsible for public expenditure, both on current account and on capital account. Unfortunately states or provinces in a federal system were not originally designed with an eye to regional areas. Even if they had been, the altered conditions and the larger scale on which enterprise can now be developed would have rendered the state or province inappropriate in many cases as the body through

which development might take place. To meet this situation special authorities, such as the T.V.A. in America or the Murray River Commission in Australia, might be necessary. Normally, it has happened that the state or local authority has been the original agency through which public action has been taken for economic and social development. It is desirable that this local autonomy should be retained, but that the activities of the local authorities themselves should be coördinated under some central agency sponsored by the central government.

In Australia the administrative machinery for this purpose already exists and can be used with slight modifications to meet the needs of the new situation. The Australian Loan Council is a body unique in modern federal systems.¹⁰ It is the function of the Loan Council to authorize all borrowings by Australian governments, federal and state, except borrowings by the federal government for defense purposes. Normally, it is the practice for the states and the Commonwealth to submit their proposed borrowing plans to the Loan Council, which decides upon the total amount of borrowing in each year and the allocation of that amount among the several governments. During the war some important developments have taken place in the arrangements between the states and the Commonwealth regarding Public Works. In 1940 it was agreed to appoint a Coördinator-General of Public Works, whose job it was to

¹⁰ I have described the constitution and importance of this body in *Australia in the World Crisis* and in "Problems of Federal Finance and Federal Grants in Australia," *Quarterly Journal of Economics*, IV (May 1937), 497.

survey projects for capital expenditure and to consider and report to the Loan Council upon the extent to which these projects could be postponed during the war. The result has been that capital expenditure, for other than defense purposes by state and federal governments, has been reduced to the minimum.¹¹

The work of the Coördinator of Public Works was one of damping down capital expenditure during the war. In the process, however, he acquired an extensive knowledge of the projects which state and local bodies desired to embark upon, and he also established a commendable respect for his office. This was not easy to do because he was, in fact, independent of all governments, and his reports to the Loan Council were designed to present a balanced view of the needs of each government in relation to the needs of the country as a whole. It will be possible to continue this office of Coördinator of Public Works after the war and to give it a much more positive function.

Two other developments of wartime machinery will assist in this process; first, the establishment of a Public Works Council, consisting of ministers representing the Commonwealth and states, will enable a more effective and balanced planning of capital

¹¹ As regards capital expenditure by local bodies, such as cities and municipalities, the Capital Issues Board exercised authority during the war. It had, however, become an established practice for the state governments to submit with their loan programs estimates of the proposed expenditure by local bodies. This expenditure, though legally outside the powers of the Loan Council, was in fact, by agreement between the Commonwealth and the states, brought under annual review by the Loan Council.

expenditure by government to be developed. Secondly, the needs of defense in early 1942 led to the establishment of the Allied Works Council, designed to build certain urgent defense works. This gave the Commonwealth itself greater experience in public works expenditure than before, and placed at its disposal an efficient and experienced planning agency. By amalgamating the remnant of the Allied Works Council with the Office of Coördinator of Public Works, an efficient secretariat for the Public Works Council is available, and the Coördinator will be in a position to advise the Council and through it the Loan Council of the nature and amount of capital expenditure which the Commonwealth and states may undertake in any year. This machinery is capable of very important developments. It can be used to relate the total capital expenditure by the governments to the general level of economic activity. It can maintain sound capital expenditure at a given level, and it can have in reserve certain capital projects upon which to draw if it is necessary to increase total public expenditure.

A similar machinery does not exist in the other federal systems. In the United States the problem would be much more complicated because of the larger number of states and the different responsibilities which the states have accepted in the past for expenditure on capital account. It is clear, however, that the establishment of some machinery for handling capital expenditure on government account on a more scientific plan is an urgent necessity in the United States, as it is in other federal systems.

2. *Social security and the distribution of income.*

From the space the discussion of national expenditure has occupied, it may safely be concluded that the control of national expenditure is the most important single control required to develop an economy on the lines suggested in this treatment. It would, however, be a mistake to assume that it is the only avenue of control. Every community has found it necessary, over the past four decades, to increase the proportion of national income spent on certain goods and services which would not normally be provided by private enterprise. This includes the expenditure on health and education, social justice, etc. This has been supplemented, however, by another type of expenditure which enables people in general to purchase more of the goods and services that private enterprise is capable of producing than they would otherwise purchase. I refer to the expenditure on social insurance of all kinds: health, accident, unemployment, and old age; to maternity allowances and family endowment; and to improved housing conditions in the lower income groups. There have been great increases in this latter group of expenditures over the past decade, even in wartime in some countries. Thus Britain has produced her great plan of social security in wartime, while Australia developed both the family allowances and a social security plan also during wartime.¹²

¹² These developments were long overdue in Australia. For twenty years little was done to build upon the early provision for pensions and maternity allowances and in some cases other forms of security payments. Australia, in fact, in the twenty years between the two wars, lagged behind most of the democracies, and just prior to the war an attempt to put into operation a national insurance plan was unsuccessful.

It cannot, however, be said that the increase in expenditures on education and health, including nutrition, had kept pace with the increasing productivity and wealth of modern democracies. The enthusiasm at present for social security measures should not be allowed to supplant the equally important provision for an expanding and improved health and education service in modern democracies. It may be argued that the community cannot afford provision for social security and the other payments on social service on the scales contemplated in some of the reforms proposed during the war, and in others planned for development after the war. The capacity of a community to make provision for social services and social security depends upon the level of its national income and its tax system. It is not surprising that during the ten years before the war difficulties were being experienced in maintaining expenditure on social services, let alone increasing that expenditure. We have seen that large proportions of resources were idle in most modern communities, and that the free world was suffering from the illusion that the only way of meeting its economic problems was to proceed on a policy of restrictions of production. With high employment in an expanding world, this position will be reversed. National income will increase year by year because of increasing population and improved efficiency. Tax revenues will therefore be much more buoyant under these conditions than they were in the more difficult pre-war days. Whereas, at that time, in most states in Australia they were hampered by the prospect of deficits, they are today mostly enjoying surpluses in their accounts.

This is owing in part to the heavy railway traffic caused by the war, but also to the increase in national income which has yielded expanding revenues. This is true of all state and local authorities in countries which have had an expansion of activity and a rise in national income under war conditions. In an illuminating appendix to Sir William Beveridge's *Full Employment in a Free Society*, Dr. N. Kaldor shows that in Britain the cost of financing a full-employment policy under post-war conditions with increases in provision for social security and social services will not involve any serious increase in taxation over the pre-war period. He says:

In spite of the considerably higher post-war expenditure, the 1938 tax system would be consistent with a *smaller* deficit in 1948 than it was in the actual situation in 1938. In order to eliminate the deficit, the average rates of taxes would have to be raised by 6 per cent—which means an income tax of 5s. 10d. (instead of 5s. 6d.) in the £, if all taxes were raised proportionately.

The other main determinant of the ability to get the costs of increasing provision for social services is the tax system. It would be erroneous to assume that the level of taxation has little or no effect on enterprise. The existing wartime rates in most democracies require the payment of a large percentage of each additional £100 earned after a certain level of income has been reached. These rates would be a deterrent to enterprise under normal conditions, but it is not suggested that the policy of high employment and of making greater provision for social services would require such high levels of taxation in the world after the war. On the other hand, it would

be idle to pretend that the program of social expenditure contemplated by most democracies does not involve the maintenance of taxation at pre-war rates. If the argument presented in these lectures is sound, there is every reason why such taxation should be continued. It involves transfers of income and, in the process, it undoubtedly stimulates the general level of consumption.

This is not only a means of promoting a more equitable distribution of the products of industry and of increasing the prospects of a high level of economic activity, but it also offers some means whereby governmental expenditure can be adjusted to maintain stability of national income and employment. One method of doing this would be to determine taxation rates at the level that would be required to meet obligations if reasonably full activity were in operation. Should the level of activity fall below the prescribed goal, rates of taxation would not be increased. The government would incur a deficit on current account and maintain its total expenditure by drawing on short- or long-term credits. It may be argued that better still the government should reduce the rates in such circumstances and incur an even greater deficit. On the other side, the government might vary some of its payments according to the state of economic activity. Thus, increased insurance benefits might be paid when unemployment is above a certain level or increased food allowances under nutrition plans might be made, or again increases in the purchases of commodities by the government, to be stored if necessary, might be made. Some of these measures are contained in the

British White Paper on *Employment Policy*, which remarks: "The government believes that in the past the power of public expenditure, skillfully applied to check the onset of a depression, has been underestimated." I should add that this reference is in the section dealing with Capital Expenditure (paragraph 66), but it may equally be applied to the White Paper's proposals on consumption expenditure on government account.

In a financial policy of this nature, attention should be concentrated on the budgetary position over a period of years, rather than the budgetary position year by year. Such a practice would involve some dangers. A government could always make out a case for a budget deficit. I have already suggested, however, that the capital expenditure of the government should be varied in accordance with reliable estimates as to the need to maintain total national expenditure and the total national income. The same technique would have to be applied in respect of taxation policy and government expenditure on current account. It should be possible to work out the procedure in such a way as to provide safeguards against any tendency to maintain deficits beyond the amounts required or the period during which they are required. In this respect, as has already been argued, as regards capital expenditure, the Australian Loan Council offers satisfactory machinery for applying the necessary checks under the federal system in Australia.

3. *Financial policy.* In the previous section I have discussed some of the measures that the state might take to adapt its financial policy to a national plan

of maintaining high employment. As regards current expenditure, the state is not in a position to make great contributions to the correction of instability in total national expenditure. The amount of conveniently adjustable payments by the government, or charges by the government, would not—in any case—be a large proportion of national income. Nevertheless, in this, as in other matters in economics, it is not the magnitude of any individual movement that has to be considered but the aggregate effect of a number of movements. To the extent at which variations in payments by the government—or in charges imposed by the government—can be made, they should be used to offset fluctuations in total national expenditure and national income from other causes.

The chief instrument at the disposal of the state will, however, be investment or public expenditure on capital account. The thesis presented in these lectures is that in the economy of the future this type of investment should, generally speaking, be stepped up. From the administrative point of view, as well as from the needs of the position, it is desirable that a minimum level of public investment should be contemplated. It will not then be necessary to make great variations in the amount of public investment to offset variations in total expenditure caused by changes in the volume of private investment. There are three reasons for this: first, the maintenance of a minimum volume of public investment will reduce the impact of variations in private investment upon the national income. Secondly, the measures taken by the state to promote greater

equality of distribution, to stabilize farm incomes, and to vary both payments and changes on current account will all have the effect of maintaining greater stability of consumption. Thirdly, it is suggested that these measures regarding public finance should be accompanied by close liaison work with private enterprise, so that an undue expansion of private investment will not be permitted. If necessary, as a last resort, some form of capital-issues control would limit the tendency of private investment to rapid expansion in periods of buoyancy. The total effect of these measures would, it is submitted, greatly lessen the inherent tendency of the economy to fluctuations. Some adjustment of public investment to the residual fluctuations, after all other measures have been taken, would doubtless still be necessary. The argument that the public investment program as a whole should be designed mainly to make up the gap in private investment ignores the importance of public investment in the economy of a modern community. Moreover, it places a government in an altogether wrong position as being the passive agent. The government would never have the initiative; it would be a follower at the heels of others. In this position it could never safeguard the community from fluctuations inherent in the system of private enterprise. It would, in fact, be given an impossible job and would constantly be criticized for its failure.

If the government has a basic level of public investment, it can embark upon long-term and well-planned projects, and it can maintain an organization that will ensure reasonable efficiency in the program. At the same time, it would be able to plan

some works to be held in reserve for periods of slackness in private investment and for regions which may be experiencing a decline in output. Such "reserve" works projects require planning of a high order. In the past the mistake of improvising works projects has impaired the success of public-works plans designed to offset the effects on economic prosperity of a decline in private investment.

The public investment policy enunciated in this discussion will require a steady increase in national debt, and this aspect of the problem has given rise to much fear as to the ultimate effects of the plan. In the pre-war economy of Australia, the proportion of total investment to national income was something between 16 per cent and 17.5 per cent. This meant that the community was seeking to increase its capital assets at a rate that would involve the use of this percentage of its total resources from year to year. Much of this was done through private enterprise, and it is popularly supposed that when investment and development take place through private enterprise the community is creating only assets and not liabilities or debts. On the other hand, if the community goes in for a program of public investment, the popular impression is that it is creating debts and not assets. Both views are, of course, extravagant and mistaken. All private investment is not successful. If it were, any community which set aside 16 per cent of its national income to build up its capital assets would soon reach a fantastic level of wealth. Much private investment is, in the very nature of things, unsuccessful simply because even the best entrepreneurs are never 100 per cent right

in their forecasts. It would be interesting to compare over a period of time the proportion of private investment that was successful and the average rate of return received on the whole capital outlay.

When we turn to public investment the emphasis is on the process of debt creation, although all private investment creates debts. But it is assumed too often in public investment that assets are not created against the outlay. The reason for this is that some of the assets are, by their nature, non-revenue producing, and the debt created in their construction has to be serviced in respect of interest and sinking fund from the public revenues. A steadily rising annual interest bill is the nightmare of students of public finance. The annual interest bill on the total public debts of the Australian governments before the war was approximately £60m, and this amounted to about 7.5 per cent of national income.¹³

If this ratio of interest payments to national income is maintained, there is little ground for the argument that the public debt is an increasing burden upon the community. If, however, the resources of the community, diverted to public investment, do

¹³ Up to 1929, Australia was a heavy borrower overseas for its public investment program. Since that time, no new loans have been raised overseas. Some have been repaid, while the process of conversion has substantially reduced the rate of interest. An external debt has to be regarded with much more caution as to its ultimate burden than an internal debt. Since, however, Australia's external debt has been reduced over the last fifteen years, and no further overseas borrowings on public account are contemplated, I do not propose to complicate the discussion by referring here to the essential differences between the burden of external and internal public debts. We can consider the problem purely as an internal debt.

not yield either revenue-producing assets or collective goods that will raise standards of health and efficiency, the ratio may well fall and the debt would then become an increasing burden on the community. Within certain limits the problem is, therefore, not so much one of the amount of the annual investment but the projects to which the investment would be devoted. It is necessary to bear in mind that the amount of the investment will be determined by the anticipated average deficiency in private investment to keep all the resources of the community in reasonably full employment. I have given reasons already for arguing that in a community with a high and rising standard of living there is considerable scope for public investment on a wide range of collective goods which are beyond the scope of private investment but which will produce real assets for the community.

Assuming that care is taken to concentrate public investment on projects that will build up the assets of the community, we might consider for a moment what the rate is at which the public debt could be increased without raising the proportion of interest to national income. With a pre-war national income of £800m, the interest burden in Australia was £60m, or 7.5 per cent. When the war is over, and provided a general fall in world prices does not take place, national income may settle at about £1500m. At what rate might this be expected to increase with reasonably stable prices? We may assume a steady rise in general economic efficiency and an increase in population which would justify an expectation of a 2 per cent rise per annum in national income. This

would mean national income increasing at the rate of £30m per annum or a little higher as time goes on. Of this £30m, we could allot 7.5 per cent, or £2.25m, for interest on the public debt. If the rate of interest is about 3 per cent on the average, for short-term and long-term loans, the amount of debt that could be created in any one year would be £75m. The pre-war loan expenditure was actually £34m, and according to an estimate by Dr. Coombs, already mentioned, a loan expenditure of £44m would have given full employment in 1938-39. I think it may be assumed that the amount of £75m which we might regard as the upper limit for the purposes of this argument would be within the sum required, even after allowance is made for higher prices and higher income.¹⁴

¹⁴ I have taken the rate of interest of 3 per cent for this calculation. The world has just reached the end of a relatively short troublesome period in which rates of interest were unduly high. In a recent article in the *Economic Journal*, Mr. F. V. Morgan shows that the average yield on the British consols between 1919-1921 was 5.1 per cent, whereas for the whole of the period from 1849-1909 the average rate was 3 per cent. In Australia, at the end of the last war, we were borrowing at as high as 6 per cent, but in this war the greater part of the long-term loans have been raised at 3.25 per cent, with short-term at 2.5 per cent. The rate is tending to fall. The lower rates in the latter half of the nineteenth century were held in the face of great expansion of investment with probably less opportunities to save than operate today. There is no reason why we should not contemplate even lower rates than those now prevailing or than the average of the period 1849-1909. Mr. Morgan concludes with the suggestion that long-term rates might settle at 2.5 per cent. With lower rates, the capital devoted to public investment could be still further raised without increasing the proportion of interest account to national income. But if we contemplate, as appears reasonable, a greater ratio of public investment to total investment in the future than in the past, we could argue that the proportion of interest on the public debt to national income could actually rise.

Looked at in this way, traditional fears about an increase in public debt should be dispelled. With a higher and more stable national income, the total amount of savings will be greater and sufficient funds should be available to invest in the public loans required for maintaining the desired level of public investment. We do not, however, know enough about the effects of greater stability of national income on the volume of savings. It may well be that they will tend to fall, but that only means that the level of consumption will be relatively higher. It would follow that the total resources of the community used in the production of goods and services for consumption purposes would be higher, and the amount of investment required to maintain a high level of employment would be lower.

4. *Wages policy.* In Lecture III the argument was advanced that in a society with more jobs than there was labor to fill the jobs, there would be a constant tendency for wages and costs to rise. That is admitted by those who define "full employment" in that extreme sense. On the other hand, a reserve of labor cannot be justified on the ground that it will prevent wages from rising and solve the problem of industrial discipline at the expense of labor. We want the fullest employment that is consistent with administrative practice and the maintenance of freedom in industry for both employer and employed. There are many problems to be considered at this point, but I propose to limit my discussion to two major issues; namely, the general rate of wages and the mobility of labor.

On the first problem of the general rate of wages, most democratic countries were moving before the

war to some form of collective bargaining with a declared minimum wage for all unskilled labor and margins for skill. In this field the Australian and New Zealand practice with legal tribunals was perhaps the most advanced. It will suffice to refer briefly to the Australian system.¹⁵

Three features began to emerge in the years between the two wars—the declaration of the minimum wage; the automatic adjustment of that wage to changes in the cost of living quarterly; and the definition of margins for skill, hours of labor, and working conditions. It was, however, in respect of the declaration of the minimum wage and its adjustment to changes in the cost of living that the most interesting developments for our purpose took place. The Arbitration Court had established the practice of making a major review periodically of the basic wage in the light of the general economic prosperity of the country. Thus in 1931 it ordered a general fall in wages of 10 per cent, in addition to the adjustment to the fall in the cost of living.¹⁶

In 1937 it adopted the opposite course of ordering

¹⁵ I confine this brief account to the federal machinery as it developed over the thirty years before the war in the proceedings of the Commonwealth Court of Conciliation and Arbitration. The six states had arbitration courts or wages boards which operated to fix a basic wage for certain industries in their own states, but the tendency was for the Commonwealth Court to take precedence over the state courts. In some cases, however, state tribunals fixed higher rates and provided for annual reviews. Organized labor tended to favor the state tribunals in these cases. The whole machinery is described in the *Commonwealth Year Book* published annually by the Commonwealth Statistician Government Printer, Canberra.

¹⁶ The circumstances are described in *Australia and the World Crisis* (Cambridge University Press, 1934).

“a prosperity loading” of 6 per cent per week in the minimum wage on account of the higher estimated general level of prosperity of industry. These decisions refer to minimum wages, and there is no reason why the Court should not make its review more frequently, so that under conditions of high employment the minimum wage would be kept at a level that would ensure improved technique passing into higher rewards to labor. Such a review would provide an indication to both employer and employee of the Court’s view of the capacity of industry to pay. It would not be illegal to pay more, but lower rates would be ruled out. This would not solve the problem of “wage and income inflation” if labor were in short supply, but it would establish a traditional basic rate around which bargaining could take place. The principle of adjusting the basic rate each quarter to changes in the cost of living as measured by the statistician’s index of retail prices could be continued as a guarantee to labor that it would not suffer by a rise in prices between the periodic revisions of the general basic rate. This system has worked well in Australia—as well as any other system of collective bargaining, with the added advantage that it provides machinery for a general review of wages in the light of changing prosperity.

As regards mobility of labor it is most desirable to remove as far as possible all difficulties in the way of wage earners changing their places of residence in response to improved opportunities for employment and long-term changes in the demand for the products of certain areas or certain industries. The machinery for doing this is well enough known in theory but

not greatly developed in practice in any country under pre-war conditions. There is the provision of labor exchanges but this should be coördinated with training for skilled occupations according to estimates of demand; with vocational guidance; and, above all, with the provision of travelling facilities for the family and their personal effects and of suitable living accommodation in the new environment. If, as has been argued, we are to learn anything from the administration of labor problems during the war, we should continue the preparation of a man-power budget, so that we shall know what resources of man power are available, whether they are fully employed, whether they are adequately trained, whether they are distributed on the most economical geographical plan. In wartime certain powers of compulsion have been exercised to achieve the full and most economical use of labor resources. Compulsion cannot, and should not, be exercised after the war, but there is open to a sympathetic administration a wide range of social measures that will greatly increase the mobility of labor.¹⁷

¹⁷ It should not be overlooked that the mobility of industry is in some cases more important than mobility of labor. In Great Britain this is a special problem where for twenty years before the war the distressed areas (now to be called more appropriately development areas) baffled all efforts to solve their problem of surplus labor. Whole communities were threatened with continuous poverty at a time when other areas, e.g. the London area, were highly prosperous. To promote mobility of labor and increase still further the aggregation of population in the great urban area of London would create more social problems than would be solved by transfers of labor. It is transfers of industry that are needed in this case, and not transfers of labor. The problem will not be rendered more difficult by the adoption of a policy of high employment. On the contrary, it will be easier to take the necessary measures in

This brief discussion serves to emphasize the importance of collective bargaining and a general minimum standard of wages. Much can be said in criticism of the working of the Australian machinery and of the existence of industrial disputes in some industries in spite of the obligation to observe the conditions laid down by the Arbitration Court. But the Court does provide machinery for the periodical fixation of a basic minimum wage on the estimated capacity of industry to pay. Such a procedure may be foreign to the practices of Australian industry, but there is a well marked tendency in American industry to use collective bargaining in some form. Its more widespread use, particularly if it were associated with fixation of minimum standards for each main region, would facilitate the working of a high employment policy.

5. *The foreign balance.* At the close of Lecture III I gave reasons for favoring the adoption of currency depreciation by a country that pursued a policy of high employment in a world that was not adopting a similar policy. It is not necessary to go over that ground again. There is no doubt that in such cir-

a background of greater prosperity. Critics of a high employment policy may argue that the policy will not necessarily improve the position in South Wales, but it will to the extent that it raises national income and increases the demand for the products of South Wales. The extra measures required to take industry to South Wales would have to be applied to that area in any case, whatever general policy was adopted. Still, the point serves to emphasize that there are many special regional problems that will not be solved on general lines, and this is true also of Australia where it would be most unwise to allow the coastal cities to grow in a haphazard way at the expense of a better social distribution of population in the country towns.

cumstances a country that did not experience some rise in its export prices would suffer a loss of foreign balances. But if the leading countries of the world were engaged in a similar policy this problem would not arise. It is for this reason that a policy of "full employment" on an international basis should be contemplated. This is why Australia has advocated the adoption of such a policy as part of any general international economic policy. This aspect of the problem merits special attention.

For any country we have seen that a rising level of national income means a rising demand for imports as well as for home-produced goods. There is in fact a close correlation between imports and national income for any country, even though that country may have a high tariff. It is because of this that any country alone may experience difficulties in its international balance of payments if it is pursuing a policy of expansion while the outside world is not. If, however, the leading countries of the world are pursuing the same policy of expansion the general demand for imports will rise. That only means that the general demand for exports will go up, and the level of international trade will rise. No country will then experience any special difficulty in its international balances on account of the policy of expansion, though it may have some difficulty on account of a long-term shift in the demand for its exports. The policy of high employment will not solve the problems of individual disturbances in balances of payments caused by major changes in the demand for basic commodities of international commerce, but it will ensure a generally higher volume of inter-

national trade and a higher level of export prices. It will give a background of economic prosperity in which closer economic coöperation will be possible. With higher national income and spending power the demand for locally produced goods in each country will reach high levels. This is a favorable atmosphere in which to reduce tariffs and to make international commitments. If unemployment is high and spending power low, no government can afford to take risks associated with tariff reductions, commodity agreements, and stable exchange plans. There is much misunderstanding on this point. It has been held that Australia in pressing for a full employment policy is acting the part of a "little Australia," determined to proceed with purely nationalist plans and to ignore wider considerations of international coöperation. It may well be true that some Australians will blow hot on full employment and cold on international economic policy, but it would be a great mistake to assume that the Australian advocacy of full employment on an international scale is in any way designed to discourage the discussion of other economic plans such as food and nutrition,¹⁸ mone-

¹⁸ Nutrition and food policy have been pressed upon international conferences by Australian representatives for over ten years now. It was an Australian who urged that nutrition and agricultural policy should be associated as a method of increasing world trade on a basis that the people would understand. The case is the same with regard to employment policy. If the people of the world are urged to coöperate in international economic policy on a basis of full employment some progress can be expected. This is the more likely if plans are worked out internally by each nation for maintaining a high level of employment. It is contended that each nation is pledged to maintain full employment, but it is one thing to make a pledge of this kind as part of a general policy and quite another thing to devise ahead the specific plans for carrying

tary stability, investment, commodity agreements, and tariff reform.

The measure that is common to all plans on the international scale is full employment. Whether discussions center round tariffs, monetary stability, or commodity prices, the objective is high and stable activity. That each of the measures individually will add to the level of economic activity is true, but it is not true that all the measures of external policy combined will give full employment. If the argument in these lectures is sound each country must take internal measures to ensure full employment, and it is this fact that makes it so desirable for the nations as a whole to exchange views and to have a complete understanding of the place and limitations of international action in securing full employment. To proceed with international plans on the assumption that they can bring the remedy, or even that they can be carried out in a world where unemployment is high, would only mislead people. True, the policy of full employment raises domestic issues of great importance, but so do the other measures like tariffs, commodity prices, and stability of exchange. There is no reason why the whole range of measures required for an employment policy should not fall within the scope of an international conference, even though the issues involved will concern matters of domestic policy that are still the subject of great political controversy.

it out. Moreover, the public imagination of people would be captured by a discussion on the international level of methods of obtaining full employment in which the external and internal measures could be placed in their proper perspective.

The argument for this can be restated as follows. Full employment depends upon internal demand for goods and services, and this in turn depends upon five factors of which the foreign balance is one. Measures taken to stimulate international trade and to give currency and exchange stability will help to increase demand.¹⁹ But they won't increase demand over all its components on a level sufficient to give the desired result. It is necessary to take direct measures of internal policy that will promote consumption and investment. If these measures are taken we can expect a rise in national income, and this in turn will increase consumption of both imported and home-produced goods. The level of imports will rise, and if the policy is pursued by a number of countries the world demand for imports will rise. This means that the level of world exports will also rise, so that the foreign balance is added to the other factors as an

¹⁹ Stimulating international trade is usually thought to relate to increasing exports, and each country will do all that is possible to expand its own exports. But the object of production is consumption and the expression of a high standard of living is a rising level of consumption. Countries should therefore be concerned with expanding consumption, and this means higher imports as well as more purchases of home-produced goods. If imports increase for any number of countries exports must also increase. The quickest way to increase exports is to raise the demand for imports, but this requires action on an international level and is again a reason for discussing full employment on that level. The motto might well be: Look after imports and exports will look after themselves. If I had a choice between a reduction in the American tariff, or that of any country with high spending power, and an assured high level of economic activity, I would have no hesitation in choosing the latter. We might get the tariff down later, but a reduction in the tariff would not give anything like the stimulus to world activity that a full-employment policy in the United States would; but there should be no need to make such a choice.

agency of expansion. In a world of expanding trade we can proceed more confidently with detailed plans for currency and exchange stability, international investment, commodity prices, and tariff adjustment.²⁰

The key to expansion will be found in the association of internal and external measures designed to maintain high domestic activity. For this reason the statement by the President of the United States in his budget message of February 1945 is of great significance. I cannot do better than close these lectures with the quotation, and express the hope that the United States will give leadership to the world of free peoples in promoting economic expansion and rising living standards:

Full employment after the war is not only a matter of immediate self-interest, but also a part of our stake in world stability, and prosperity. Other countries are anxiously awaiting the development of our policy and will be more willing to make international commitments if they are assured of high post-war employment in the United States. They are fully aware that international coöperation cannot succeed unless the United States is prosperous.

²⁰ It would be quite unfair to refuse to recognize that some of these measures have already reached a position in international discussions that indicates a willingness on the part of the leading nations to recognize the difficulties of "dependent economies." This is especially true of the Bretton Woods Agreement on the Monetary Fund which safeguards the rights of any country to proceed with a policy of expansion in a world that may refuse to act similarly. This is a movement in the right direction, and the advocates of full employment would do well to recognize the position. They don't help their case by discounting measures that others are willing to concede in special agreements.

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