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SOCIALISM IN THE SIXTIES

Out of Stagnation

A POLICY FOR GROWTH

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FOUR SHILLINGS AND SIXPENCE

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I. Introduction

THE ABOLITION OF ECONOMICS

SHOULD Socialists be concerned about Britain's slow rate of economic growth? I believe that they should; and deeply. The most obvious and immediate reason for thinking so is that there is so much to do, so much that anyone can see who cares for the quality of our national life without even digging below the surface: mean housing, ancient hospitals, under-staffed schools, derelict city centres, all now drooping in a lengthening queue, and a whole new world of widespread cultural and leisure activity awaiting release from commercial purse strings. It may be that we could achieve more of this than we now do, if we were to reorder our priorities, to stop wasting resources on deterrents or detergents, or advertising, or conspicuous consumption, or expense accounts. Let us then do so; we could achieve more still if we had more growth as well. But behind these immediate objectives there lies (for me) the belief that growth is the most formidable engine of equality. This is not simply because of the progressive tax system. It is the notion that between a man with £5,000 a year and a man with £10,000 a year the sense of inequality is much less than it is between men with £500 and £1,000[1] In the latter case the sense of inequality is sharpened by deprivation to a much greater extent than in the former, and the fact that the difference is more obvious to all makes it easier for the distinction of income to harden into a distinction of status.

Those Socialists who prefer to base their beliefs on ancient writ may recollect the passage in 'News from Nowhere' in which the author, in his dream of the future, goes into a shop to buy himself a pipe, and is amazed to find that he is invited to take any one that he likes without payment. It is through economic growth that we may hope to transform this Socialist dream into reality, not merely for ourselves, but for all the world. In William Morris's dream the problem of production has been solved. The age of the economists and the calculators is past; and the glory of the price system is departed for ever. This is the particular vision which, at the deepest level, inspires my own concern with economic growth. The object of Socialism is the abolition of economics.

Between an existing situation and an ideal, the path is not necessarily one of steady improvement. In the sphere of consumption, while complete abundance may be best, more can mean worse. This will quickly be pointed out by those Socialist writers who have skilfully turned 'affluence' into a dirty word, who complain vaguely of 'capitalist values', and who regard the growth of car ownership in particular as the beginning of corruption. I have no sympathy with the concept of Socialism as a kind of holy poverty in which material desires are somehow assuaged by the contemplation of publicly owned assets. At the same time, it would be foolish to ignore the possibility that certain paths of growth could require the sacrifice of other Socialist objectives, such as a more equal distribution of property and the spending of a greater proportion of the national income for social pur-

[1] This point is, of course, Crosland's; see his 'Future of Socialism.'

poses. If, for example, it could be convincingly shown (as it has not been) that the main impediment to more rapid growth was the effect on incentives of the present degree of redistributive taxation, we should then be faced, as Socialists, with an awkward choice. But to my mind the policy which I shall outline contains enough promise of raising the rate of growth of output per man to justify the assertion that the moment for such a choice has not arrived.

If growth is an important agent of social equality, and is not inimical to other socialist objectives, it also has a certain advantage over orthodox socialist measures. For orthodox socialist measures require the existence of radical governments; and these are a historical rarity. A high rate of growth, once created, is more likely to be self-sustaining, and thus to survive the end of the radical government, which, perhaps, has been required to initiate it. Contrasted with the occasional excitement of the bouts of socialist legislation which the electorate will permit from time to time, the gains from rapid growth will be more steady and less interrupted. This is not said to belittle the importance of orthodox socialist measures, but to urge the claim of rapid growth, as an agent of equality and the source of social spending, to be included in that category.

The Competitive Position

Apart from specifically Socialist reasons for being concerned about economic growth, there is another important reason which is not particularly Socialist, but which has to be reckoned with by Socialists as well as everyone else. This is that if output per man rises more slowly in this country than it does in others, then, unless real wages also rise at a correspondingly slower rate, our competitive position in world trade will steadily worsen as our prices are forced relatively upwards. In so far as this causes our balance of payments to worsen, we shall be compelled periodically to correct it by measures which lower our standard of living absolutely—for this is the effect of whatever method of correction we use. Some economists hold the view that a relatively slow rate of growth will, on the contrary be favourable to the balance of payments. They believe that a country with a relatively slow growth of income will generate a slow growth of demands for imports, and experience a fast growth of demand for its exports from the faster-growing economies abroad. This takes an excessively static view of the determination of demand; for surely the faster-growing countries would increasingly channel their faster-rising import demands towards the relatively cheapening source of supply. The optimistic view is unlikely to be justified for an economy which operates in a competitive world. In any case it is not a solid enough base on which to sit back content when there is a strong risk of worse things happening. Against these we have to be on guard. We are not an island; every country's growth diminishes us.

2. Why have we been Growing so Slowly?

MUCH attention has been paid to the fact that this country has been spending a relatively small proportion of its annual product on investment, on the replacement and extension of its capital equipment. If this

were the key, the door should have been swinging open fast in the last few years, since the proportion has steadily risen from 14 per cent in 1954 to 17½ per cent in 1961.[1] But this considerable investment effort has had no perceptible effect on the growth rate of output per man. In any case the proportion spent on investment is not a very relevant statistic. It will naturally be smaller for countries like the U.K. whose labour force is expanding slowly. For such countries have each year a smaller number of additional workers waiting to be rigged out (as it were) with the standard set of tools. More relevant than the proportion of the national income invested is the *growth of capital per man*.

This is shown in column (2) of Table I below for a number of Western countries, Canada and the United States, Column (1) shows for contrast the growth of Gross National Product per employee. Both columns measure the average annual rate of growth during the decade of 1950-60, for each country, calculated in real terms; that is, having corrected the raw figures for price increases. The contrast between columns (1) and (2) is indicated by the ratio in column (3), about which more will be said later.

TABLE 1
1950-1960
Annual average rate of growth of:

	(1) G.N.P. per employee	(2) Capital stock per employee	(3) (1) ÷ (2)
Western Germany	5.0	4.6	1.09
France	3.9	3.0	1.30
Netherlands	3.6	3.5	1.03
Sweden	3.3	1.7	1.93
Norway	3.1	4.9	0.63
Belgium	2.4	2.6	0.92
U.K.	2.1	2.9	0.72
U.S.A.	1.9	2.8	0.60
Canada	1.9	4.2	0.45

The countries are listed in decreasing order of growth of G.N.P. per employee.

Note on the Statistics.

The figures of G.N.P. and Capital Stock, from which the above growth rates are derived, are in *real* terms, i.e. corrected for price changes.

The rates of growth of the capital stock are based on:

(1) estimates of the capital stock in a particular year by various authors: see Income and Wealth Series VIII, published by the International Association for Research in Income and Wealth, and in particular the summary survey pp. 1-34; and

(2) estimates of net fixed capital formation at constant prices taken from the national income statistics of the various countries and applied to (1) to give a continuous series throughout the decade.

The capital stock includes in principle all durable goods in public and private enterprises *except*: military installations; forests, land and livestock; stocks of raw materials and of semi-finished and finished goods; and consumer goods, durable and non-durable, in the hands of consumers. Limitations of the statistics prevent exact adherence to this principle.

[1] The percentages represent Gross Fixed Investment of all kinds divided by Gross National Product, both measured at Factor Cost.

From an examination of these figures, the following points stand out:

1. The disparity between ourselves and the fastest movers is much less marked in column (2) than it is in column (1); for example, our rate of growth of output per employee has been only two-fifths of Germany's, but our rate of growth of capital per employee has been two-thirds of hers. On the latter measure we are still among the slowest growers, but we are not nearly so far behind. Column (1) is still the more interesting measure, since the effort of accumulating capital is not made for its own sake, but for its yield in terms of output. But column (2) takes at any rate some of the steam out of the argument of insufficient investment.

2. Our rate of growth of capital per employee has been very nearly the same as that of France, whose rate of growth of output per employee has been almost twice as high; and has been six-sevenths of that of the Netherlands, whose rate of growth of output per employee has been more than one-and-a-half times as high. The envy with which we frequently regard the performance of these countries must be fixed, not on the investment effort that they have achieved, but on the results that they have obtained from it.

3. Canada has achieved a low rate of growth per output per employee in spite of a very high rate of growth of capital per employee; and Norway, although she has raised capital per employee at a faster rate than any other country in the Table, has realised only a moderate growth rate of output per employee. By contrast, Sweden has achieved a rate of growth of output per employee which has been one-and-a-half times ours, with a rate of growth of capital per employee only 60 per cent of ours.

These facts which emerge from Table I dispose of the idea that there is any simple correlation between the rate of capital accumulation and the rate of growth of output per man, such as would lead us to prescribe bigger doses of investment as the fundamental cure for our lethargic performance under the latter head.[1]

Those who hanker after correlations are more likely to find satisfaction by looking at column (3) of Table I, which shows, for each country, the ratio of the growth rate of output per employee to that of capital per employee. If all capital and all products were homogeneous, i.e., if there were only one type of capital goods producing one type of product in all the countries listed, one could interpret column (3) as showing the percentage increment of the product achieved annually over the decade for every one per cent increment of the capital installed to produce it, or what economists would call 'the relative marginal efficiency of capital'. Since our economy is not like Robinson Crusoe's (except perhaps in its tendency to recruit coloured labour), it is only with a good deal of licence that we can refer to the figures of column (3) as indicative of the relative 'effectiveness' of capital formation in the different countries. (Fellow economists, please note the inverted commas). But seizing the opportunity of licence, we observe that the ratios are all high for the fast-growing German, French and Dutch economies—their capital formation has been relatively 'effective'

[1] Certain exceptions are considered later concerning investment in education and replacement investment—see section (5).

—while for the slow-growing British, U.S. and Canadian economies the ratios have all been low. The contrast is blurred a little by the intermediate cases of Belgium, Norway and Sweden, but it is quite striking, nevertheless. In particular, it appears that with the same rate of growth of capital per employee as we actually achieved during the decade, but with the 'effectiveness' of that of the French,[1] we should have realised very nearly the French rate of growth of output per man. Though still short of the German, this would scarcely have been worth complaining about.

Thus, it seems to me that the first thing to be explored is why we have not had more out of the growth of capital per employee than we have achieved. Impediments to capital formation itself appear to have been surprisingly weak, and are less likely to be found playing a restraining role in the present than in the future, when the underlying conditions of a more rapid rate of expansion of output have been created. Indeed, a situation in which the growth of capital has been outstripping that of output can breed a slump; for it creates a presumption that over large areas of the economy the fruits of capital investment are not being reaped, or in other words that the average productivity of capital is falling. Signs that this is the case have been multiplying in our economy in the last few years; for example, the appearance of idle capacity in an increasing number of industries, particularly steel and consumer durables, and the widespread tendency for the rate of profit on capital to fall. No one would wish to see the rate of growth of capital reduced in the face of this situation, although this may be the natural reaction of businessmen and there are already signs that it may be happening. But it does mean that we should be putting the wrong foot forward, with the risk of falling flat on our faces, if we were to adopt a growth policy which began with a programme of accelerated investment. The moment for this is not yet. The immediate, and increasingly urgent, problem is why the increased capital stock that we have managed to install has not given us a bigger increase of output than it has.[2]

[1] That is, 2.9 (column (2), U.K.) multiplied by 1.30 (column (3), France) equals 3.77, or only 0.13 below the French rate of growth of output per employee (column (1)).

[2] This footnote is addressed primarily to economists, who will suspect the excessively aggregative nature of the facts adduced above. It is possible that the tendency for the growth of capital per employee to run ahead of the growth of output per employee (the tendency which I have dubbed the 'ineffectiveness' of investment) might disappear if the figures were disaggregated and considered industry by industry. In other words, 'ineffectiveness' might prove a statistical illusion. For example, the aggregated result set out above could have emerged if it had been the case that those industries whose technique of production necessarily involved a high capital/output ratio were also those which had been most rapidly expanding. Thus each single industry could have achieved 'effective' capital formation (at least in the sense of maintaining the average productivity of its capital), while the result for the economy as a whole appeared 'ineffective' because of the different expansion rates of its component industries. The verification of such a hypothesis would involve a substantial statistical effort which I cannot undertake; but I strongly suspect that it would not be borne out. It seems generally agreed that 'structural' effects of this sort explain only a small part of the lag in British progress as far as output per man is concerned. It would be surprising if the opposite were the case where output per unit of capital is concerned.

3. A Theory of 'Ineffectiveness'

THE key to this seems to me to lie in the relatively slow growth in the United Kingdom of the population of working age, and in the inadequacy of our adaptation to this particular feature of our situation. How does this key fit? In 1954 there began the great post-war investment boom, which has sustained its impetus almost to the present time and raised the share of the national income invested from 14 per cent to 17½ per cent. Initiated in the mood of post-Korean optimism, intoxicated with Butlerian visions of doubling the standard of living in twenty-five years, and practically stimulated by the introduction of investment allowances, it set in motion the tolerably rapid rate of growth of capital per employee to which we have already drawn attention. Now in general a process of capital expansion can be expected to have two effects. Partly, in so far as it is motivated by the prospect of expanding markets it will require a complementary expansion of the labour force. If one is installing and bringing into production 10 per cent more machines of a certain type, one will need 10 per cent more labour. But usually the advance of technical knowledge allows one to do with less than a proportionate increase of the labour force; the investment will be to some extent labour-saving. Plainly the need for this latter, labour-saving element to be present in a marked degree existed in the British economy in the 'fifties; for while the population of working age was increasing at an annual rate of only 0.1 per cent, the capital stock was increasing at over 3 per cent. But suppose that the investment done had, for some reason, failed to be a kind which allowed for the saving of labour on this scale. Then, if businessmen expected sufficient demand to employ their expanded capital to the full, the effect would be to generate a growth of the demand for complementary labour which would outrun the growth of the normal supply.

There has certainly been the persistent pressure on the labour supply that one would expect in such circumstances. Up to 1952 it can adequately be explained by the abnormally heavy demand for goods and services in general in the immediate post-war period (due to pent-up consumption and investment wants postponed during the war itself, and to the export drive) and by its reappearance at the time of the Korean rearmament effort. But the strain has continued throughout the period of more normal demand for goods and services since 1953. The O.E.E.C. Report on the Problem of Rising Prices takes the view that Britain is one of the countries in which the scarcity of labour has been greatest between 1955 and 1959[1]; and the scarcity has been reflected in the low national unemployment percentage, in the tendency of total employment to rise more rapidly than the population of working age, in the unshakeable persistence of overtime working, in the steady stream of immigrants, and in the strong pressure for wage increases. There have, of course, been variations in the intensity of these phenomena, which may be partly explicable in terms of variations in the demand for goods and services (e.g. in 1954/5 and 1958/9); but the underlying strength and persistence of the demand for labour has been such that it must be attributed to other factors. At the same time as labour

[1] See p. 125 of this Report (May, 1961).

has continued to be scarce, complaints of lack of capital capacity have been dwindling, and have more recently given way to indications of its under-utilisation. The first signs of this, appearing towards the end of 1957, were smothered in the 1959 boom, but it has been confirmed by an increasing number of reports from industry in the last year or two, and has reflected itself in the falling tendency of the rate of profit on capital.[1]

What this picture strongly suggests is a lack of harmony between the relative rates of growth of capital and labour. But how does this lack of harmony account for the 'ineffectiveness' of our investment, which has been the most obvious feature of our poor growth of output per man? The connecting link is the disposition of those in control of economic policy to tackle the scarcity of labour, and the wage inflation which either did or was held to result from it, by means of measures to restrain the demand for goods and services in general. This disposition sprang in part from a simple failure of comprehension. It did not occur to the authorities (nor, one should add, to many of their critics) that there might be an excess of demand over supply in the labour market without there being simultaneous excess demand in the market for goods and services.[2] But the determination of the authorities to slam the latter, without asking whether it was there that the inflationary pressure originated, was strengthened by a particular feature of the second half of the 'fifties. This was the necessity of maintaining confidence in sterling, given that, in pursuit of their policy of restoring the convertibility of sterling and its importance as an international currency, they were dismantling exchange controls and therewith an alternative means of defence against loss of gold reserves due to fluctuations of foreign confidence. This greatly increased the urgency of wielding the only weapon which they had left themselves, namely, action against the general level of demand for goods and services. But even in the absence of the confidence factor, they would have been driven to use this weapon owing to their distaste for, and consequent failure to equip themselves with, anything more selective and discriminating. At any rate, restraint on the growth of demand—mainly through credit policy, but periodically supplemented by hire-purchase restrictions—became the dominant policy of the later 'fifties. Consequently, output, being held back through the fear of wage inflation in conditions of labour scarcity, was prevented from growing at a rate commensurate with the fairly satisfactory growth of capital which was being achieved. Hence the 'ineffectiveness' of our investment effort, as illustrated

[1] See the *Economist*, 21st April, 1962, 'Profits: a Ten-Year-Look.' According to the *Economist's* figures, based on company reports, the average gross return on capital employed has declined from 20.4 per cent. at the end of 1951 to 15.1 per cent. in the first quarter of 1962. The downward trend was broken only during 1954-55 and 1959-60. Gross return is profit after providing for depreciation divided by net assets. Dividend rates have been better maintained because of the reduction in the standard rate of income tax; and total dividends have, of course, greatly increased because so has the stock of capital.

[2] This is a tribute to the captivating elegance of classical 'general equilibrium' models of the economic system, in which impulses are transmitted like quicksilver from one market to another. Things have got worse since Keynes observed that 'practical men . . . are often the slaves of some defunct economist.' So it seems are many extant economists also.

by Table I, and the disappointing growth of output per man to which it is the key.

If this account were correct, we would also expect to have seen the share of wages and salaries in the national income tending to rise. This will happen, by definition, if the rate of increase of money wage rates is large compared to the combined effect of the rate of growth of output per man and the rate of increase of product prices.[1] We have suggested that, because capital accumulation has been insufficiently labour-saving, there has been an underlying scarcity of labour; and from this we would expect to find, over a number of years, a tendency for money wages to rise comparatively rapidly. At the same time we have shown how demand restrictions, responding to this, have slowed the growth of output per man. Thus as far as its first two components are concerned, the share of wages and salaries in the national income should have been rising. But what about the rise of prices? These reacted to wages through the cost-inflation mechanism of course, but their role has mainly been a passive one. Once the heat of the 1954/5 boom had subsided and except for a brief period in 1959, there was little sign of excessive demand for goods and services operating independently to push prices up, and their effort to keep pace was struggling increasingly against the need to keep capacity employed. With wages and salaries the pace-makers, and output per man and prices handicapped as described, we should have seen the former's share of the national income rising in the latter years of the 'fifties; and this is exactly what has tended to happen.[2] It is a tendency which should have surprised some economists, who hold that a rising share of investment will be associated with a rising share of profits, on the grounds that it is from profits that the savings to finance investment mainly come. But it is not surprising if our account of the influences at work is correct.

Differing Rates of Growth

The vital element, then, in our explanation of the poor British record of growth in the 'fifties is the supposition that there has been a damaging disharmony between the rates of growth in the supply of the two factors of production, labour and capital. The natural growth of the former has been less than the rapid growth which the latter has demanded; the resulting pressure of demand for labour has led to counter measures taking the form of restricted demand for goods and services; and so the expected fruits of capital expansion have not been gathered. This has been the underlying system of reactions. From time to time, as one would expect, the stripped-down version presented here has been overlaid by the effects of other influences at work. For example, it seems likely that in recent years the wage-price spiral has acquired some momentum of its own, in addition to

[1] This proposition is logically impeccable only in the case of a single firm producing one product with one type of labour. For the case of the whole economy, it is complicated by the process of aggregating diverse goods and labour of different skills. The reader should be warned, but not frightened, by this.

[2] The share of income from employment in the gross national product rose from 64.3 per cent. in 1954 to 67.7 per cent. in 1960.

the effect of labour shortage. The functioning of the system has also been complicated by variations in the strength of its component parts. For example, sometimes (as in 1954/5) the demand for goods and services has surged up strongly enough to justify attributing the tightness of the labour market to that as much as anything else, and sometimes strongly enough to absorb available capacity for a while. Again, sometimes (as in 1958 and now) the restraint which the authorities have placed on the demand for goods and services has lain long enough to make an impression on the demand for labour. But the permanent and fundamental defect of the growth mechanism in Britain in the last decade has been the maladjustment between a slow growth of the labour force and a much more rapid growth of the capital stock.[1]

From this we could draw the timorous conclusion that, given the slow growth of the labour force, the growth of capital should be reduced to harmonise with it. At the present time there is a distinct danger that this may happen of its own accord, as the falling profitability of capital, reflecting the fact that output has been held back from rising in line with it, gradually saps the confidence of business. If the retreat from optimistic expectations becomes a rout, a new and highly dangerous element will be introduced into the situation, capable of playing havoc with the prospects of maintaining the present rate of growth, let alone increasing it. But apart from this it seems absurd to waste the ability which the economy has shown it possesses to accumulate capital at a reasonably rapid rate, an ability reflected in the remarkable growth of personal savings. The right and bold conclusion to draw is that the rates of growth of capital and labour must be harmonised by ensuring that investment that we do in future is of a significantly more labour-saving kind than we have done in the past.

But before the implications of this are drawn, there is an important loose end to tie up. When we say that investment has not been labour-saving enough, we are not reporting something we have actually observed to be the case; we are setting down a hypothesis. The hypothesis springs to mind because it seems to be consistent with certain dominant facts of our experience. Any hypothesis like ours must expect the question: "Has it actually been so?' This is a question which it would be very difficult to answer, and I cannot hope to do so. But at least there must be some consideration of the weaker question: 'Why should it have been so?' Having inferred the existence of a shortcoming in the nature of our capital investment, can we account for it?

It is not at all easy to do so. But the mystery is not quite as deep as it might seem. What has to be explained is the failure of British industry to invest in a sufficiently labour-saving way. This could mean that we have not done as well as other countries have in this connection. If this were

[1] It may be said that in the last year what has caused the authorities to hold back expansion has been not so much their fear that the shortage of labour would recur (though this has played a part) as their anxiety about the expansion of exports. From my explanation of the 'ineffectiveness' of our capital formation reasons follow why exports should have been slow to expand. These are treated in Section (7), p. 35.

true, it would certainly be mysterious; for even if it were proved that we had fallen behind as innovators because of inattention to basic research or higher education (as is often suggested), it would be surprising if we had not benefitted from the rapid international transmission of ideas among so competitive a group of economies as those of Western Europe and the United States. Not a few countries have grown by imitation, and some of them, like Japan, have grown exceedingly fast. However, this is not the issue. When we inferred from the foregoing analysis that our investment had been insufficiently labour-saving, we meant that it had not been sufficiently so to offset the relatively slow growth of our population of working age. Even if we had in no way fallen behind other countries in the application of labour-saving techniques, we would still have fallen behind what was demanded by this particular feature of our situation. What we have failed to do is to be ahead of other countries to the extent that this country and its slow population growth requires.[1]

This is regrettable, but not necessarily surprising. Historically we have long been accustomed to a relatively slow rate of growth of output per man.[2] We must have bounded rapidly ahead in the first half of the nineteenth century, since when we have continued on a relatively gentle curve with many countries catching us up and some overtaking us. This suggests that the pace of capital accumulation has also been comparatively gentle. Then after 1954 it suddenly quickened, while the population of working age continued its leisurely growth.[3] It is not altogether surprising that there should have been a time-lag before the country became aware of the changed relationship between the growth rates of its two factors of production, and of the implications which the change held for its technology.

At the same time it is doubtful whether, even if business had become rapidly aware of Britain's special need for labour-saving investment, conditions were favourable to undertaking it. The conditions that would have been necessary for this are ones in which capital is cheap and plentiful, and labour scarce and expensive. Of these the latter has generally been present in the second half of the 'fifties and since, though sometimes moderated by the effects of demand restrictions. But, except for firms able to raise money by issuing shares on the stock exchange, capital has been expensive and subject to interruption, owing to the devotion of the authorities to monetary policy, in particular for the purpose of buttressing the status of sterling as an international currency. Faced with circumstances in which there are both difficulties in obtaining capital and difficulties in obtaining labour, firms anxious to grow will probably find the latter less absolute.

[1] The French, whose growth record we all admire, have also experienced a slow growth of the population of working age, but without evidently suffering from it. They have, however, been able to take advantage of a previous maldistribution of the labour force, attracting people into their growing sectors of industry who had been under-employed elsewhere, e.g. in agriculture.

[2] See the article by D. Paige, 'Economic Growth; the Last Hundred Years,' *National Institute Economic Review*, July, 1961.

[3] The growth of the population of working age probably over-estimates the growth of the available labour supply in the last decade, owing to the increasing tendency to stay on at school or seek higher education.

For in the labour market it is quite conventional to bid labour away from other firms, whereas this is unheard of in the distribution of bank credit. This line of argument, however, runs up against the objection that, whatever one might have expected of the conditions of the period, they evidently did not prevent the carrying out of a substantial programme of capital accumulation in general. This Table I has shown and our earlier argument has relied upon. Can we now argue that conditions which have not inhibited capital investment in general have nevertheless inhibited capital investment for the particular purpose of replacing labour?

I do not think that it is implausible to suggest this. Capital projects have various objectives and can be expected to respond to differing motives. Labour-saving investment involves a change in the method of production which means using more capital and less labour to produce a given output, and whose justification will depend on a comparison of their costs or what their costs are thought likely to be in the future. Where there is little to choose between the factors as regards their cost, and both are equally hard to get, the motive for emphasising labour-saving investment is weak. But simultaneously there may be strong motives for investment to expand capacity, in the face of which the cost of capital is a minor deterrent and failure to find ways and means of overcoming a shortage of it will run the severe risk of having to turn away customers unsupplied. This was certainly the case in 1954, and the desire to expand capacity provided most of the energy for the investment boom.[1] Thus we have lived through a situation in which the motive to extend the capital stock has been strong despite the cost and uncertain availability of capital funds, while because of these same things the motive to make investment particularly labour-saving has been weak. To put the point slightly differently, if capital funds had been

[1] It may be asked whether this motive, justified in 1954, can explain why the growth of investment has been so prolonged, maintaining itself almost to the present time through a period of decreasing utilisation of capacity. This can be explained by two factors:

(a) One effect of recurrent credit restrictions may have been to cause the later stages of investment plans originally conceived in 1954 and shortly after, to be postponed, and so stretched out over later years. The decision to *cancel* part of an integrated investment programme can be very costly. The effect of credit restrictions in causing the postponement of investment plans was probably reinforced by increasing pressure for higher dividends in the later 'fifties and the effect of this on internal sources of capital from undistributed profits;

(b) competitive expansion of capacity. Once competitors are known to be expanding, an independent motive enters with increasing strength into investment planning—the desire to keep in as good a position as they to snap up any new customers that may offer or to match any sales promotion drives that they make. Thus a firm may feel justified in planning a certain expansion of its own capacity, even though it recognises that the plans of the industry as a whole are likely to run ahead of probable demand. The motor industry (not only in this country) is a case in point.

Thus the capacity-expansion motive could be expected to go on working out its effects for some years after the investment boom to which it originally gave rise.

cheaper and more plentiful, I do not think that the investment done would have been greater, but I do think that it would have been more labour saving.

'Indivisible' Costs

Another reason for thinking that the conditions of the later 'fifties in Britain have been unfavourable to the required emphasis on investment of a labour-saving kind can be found in the work of a Belgian economist interested in the comparatively slow growth of his own economy.[1] The suggestion is that capital-intensive investments, or projects intended to make a major change in the method of production replacing labour by capital, will generally be of a 'lumpy' or 'indivisible' kind. That is to say, they will require the installation of capital equipment in large units, representing a substantial financial commitment on the part of the business. Consequently a significant proportion of its costs will be transferred from the category of variable costs (wages) into that of fixed or 'overhead' costs (depreciation and obsolescence, and interest charges) from which it is less easy for the firm to disengage itself.[2] Conditions in which the future is cloudy and uncertain, in which recurrent restrictions on demand permit no confidence on the part of the businessman that the equipment will yield a steady revenue to match the costs to which it commits him, will clearly be inimical to investment of this kind. It must have been discouraged in Britain's stop-start economy of the late 'fifties. Moreover, quite apart from the uncertainty of the outlook, the slowness of growth itself has added discouragement. For if demand is growing slowly the reabsorption of the displaced labour will be more difficult, and the prospect of trouble over redundancy may frighten the businessman away from this type of investment. Also, over-commitment is less risky when growth is fast. Thus we discover another of the vicious circles which are always cropping up in economics; growth has been slow because investment has been insufficiently labour saving, and investment has been insufficiently labour saving because growth has been slow.

Saving Labour

These arguments support, although they do not substantiate, the contention that economic conditions in Britain in the late 'fifties were actively hostile to investment of the kind which was particularly needed. They can only be substantiated by a detailed study of actual investment decisions which were taken; and this cannot be undertaken here. The main conclusion of our analysis, however, does not depend on them. Even if one is not persuaded by them and remains mystified concerning *why* investment was insufficiently labour saving, our basic contention stands—that a greater effort to economise in the use of our scarcest and slowest-growing resource,

[1] A. Lamfalussy, Investment and Growth in Mature Economies. There are a number of other suggestions in this intriguing book whose factual relevance to the U.K. economy deserves investigation.

[2] Are not byegones forever byegones? Not if the firm sees itself as staying in business or growing (i.e. having to replace or extend its capital).

our labour power,[1] was the really vital condition in the 'fifties for achieving a rate of growth of output commensurate with the rate of growth of capital. For the sixties there is no obvious reason why we should not be capable of accumulating capital at the same rate; for recent experience confirms that savings ride high on the rising tide of affluence. At the moment the doubt that casts the longest shadow is whether business can sustain its *willingness* to accumulate capital, given the disappointing returns. Indeed there is a risk of its falling rapidly away; risks on other fronts are well worth taking to forestall this. But assuming that the willingness to invest can be preserved, the growth of output and of output per man that it promises can only be had so long as we ensure that the investment demands a slower growth of complementary labour than in the past and thus one for which the normal growth of our population can provide. Otherwise we are back to the old sequence of wage inflation, restricted demand, and under-utilisation of capacity.

Before we go on to work out the detailed implications of this general principle of policy, it should be emphasised that what it asks for is that Britain should adapt her policy to her own peculiar circumstances. Of these the most marked is her slow population growth. Possibly this is becoming faster now. But what has surely accelerated is the growth of capital, and we have not succeeded in absorbing it. It is not as if there were a lot of labour-saving possibilities lying around, which investment planners in this country have failed to pick up and their opposite numbers in Western Europe have quickly seized. It is rather that we have not made the special effort to develop such possibilities that was warranted by our own circumstances. Our discontent with our growth record began when we compared it with that of other countries, but it will not be removed simply by asking ourselves what we have not done that they have done. The study of French planning, or Swedish wage policy, or other such developments, is interesting and important; but it must not obscure the fact that we have a special problem to overcome, which ideas evolved in other conditions may not be sufficient to solve. If we are to save our position in Europe, it will have to be by our exertions rather than her example.

4. What not to do

IN turning from analysis to policy, the first thing to do is to carry out a post mortem on Selwyn Lloyd and see that his policies are well and truly nailed down into their coffin. Heartily sick of them as the country was when he was dismissed, the danger that he may walk again, with the

[1] These words are written at a time when redundancy has been increasingly in the news, and may be read with a wry face by anyone suffering from this. My argument that there has been an *underlying* scarcity of labour does not require that we should always be able to observe it, or that we should never be able to observe its opposite. The argument is that there has been a cause-effect sequence running: scarcity of labour—wage inflation (or fear of it)—demand restriction. After the demand restriction stage we could very well expect to find redundancies cropping up. Put another way, the argument is that if the level of demand were raised till redundancy disappeared (apart from special cases like the railways), and nothing else were done, we should soon find ourselves observing all the signs of labour scarcity.

added authority of a wronged man justified, is serious, unless it is clearly seen that they were also wrongly based. They must not only be damned but also discredited. If our analysis is right, they were fundamentally wrong because, like the Red Queen, they flew to an indiscriminate chopping off of heads. They read the signs of labour shortage, but interpreted them without differentiation as indicating that the demand for final products also was excessive, ignoring the fact that, to a steadily increasing degree, this failed to be confirmed by a concomitant shortage of capital capacity. Thus restrictions on the demand for goods and services were applied, which assuming them sufficient to remove the excess demand for labour, were bound to prevent the economy from realising the full potential of its investment. So output per man grew more slowly than capital per man, and the latter failed to fructify in the pockets of the people.

It might be claimed that Selwyn Lloyd's term at the Exchequer did produce an idea of the kind required, a measure which would attack the particular shortage which was dominant, namely the Payroll Tax.[1] This defence would add that the instruments of economic control available to the Chancellor proviously—credit control, hire purchase regulations, annual tax changes, and the ultimate authority over the capital investment programmes of the nationalised industries—were none of them at all well adapted to differentiating between demand for products and demand for labour, and that Selwyn Lloyd should go down to history with the credit of having introduced one that would do this. Yet this particular episode of his Chancellorship reveals the most significant evidence of all of his failure to direct his policies at the right objective. For in his exposition of the new device it was quite clear that he saw it as yet another means by which he could restrain demand for the final product. To this it was of doubtful relevance; but this is not the point. The tragedy is that, when a tool was thrust into his hand which might have done what was needed, his preoccupation with the demand for goods and services was such that he did not even see what it was for.

The 'Paish Thesis'

The same sort of failure of comprehension is found in the well-known 'Paish thesis', which stresses the importance of running the economy with a certain margin of unused capacity as a condition of growth without inflation. This is scarcely surprising, as Professor Paish is thought to have had some influence on Conservative Chancellors. Yet at the same time it is surprising, because in his work he specifically distinguishes between the proportion of capital and the proportion of the labour force employed, and provides estimates of each. The idea is that there are certain 'safe' levels for these proportions, such that inflation rapidly follows their being exceeded. For Professor Paish 'makes the assumption, which appears to have considerable statistical confirmation, that, at any rate in conditions of near-full employment, the most important factor in determining the rate of rise in

[1] This was proposed in the 1961 Budget, to be applied at a rate of up to 4s. per employee per week. Subsequently it was dropped.

money incomes is the proportion of productive capacity currently employed'.[1] Of the 'safe' proportions he says: 'It does not seem possible to put the necessary margin of unused capacity at less than 5 per cent, which roughly corresponds to 2 per cent of unemployment, and it may well have been higher, though probably not very much higher. We may probably put it somewhere within the range of 5 to 7 per cent, corresponding to between 2 and $2\frac{1}{2}$ per cent of unemployment'.[2]

The closer demand presses on the economy's capacity to produce, the greater is the risk of rising wages and prices. This element of the 'Paish thesis' can hardly be denied. What is wrong with it, for the circumstances of Britain since the middle 'fifties, is that it totally ignores the relation between the two percentages, of unemployment and of capacity utilisation. They are supposed to 'correspond' in some way. But how? Suppose we start from 2 per cent unemployment and 5 per cent unused capacity, and aim to maintain these proportions. To maintain the percentage of unemployment, the number of jobs must expand at the same rate as the labour force, which in our case is rather slow. At the same time the advance of technology is steadily achieving economies in the use of labour, so that if the number of jobs is to expand at the same rate as the labour force, capital will have to accumulate at a faster rate. This sets the required rate of growth of demand, since any other rate will change the degree of utilisation of capacity. The required growth rates of capital and demand, consistent with maintaining unemployment at the 2 per cent level, will be greater, the greater the extent to which advances in technology are labour saving. But suppose that at the same time the economy shows itself capable of saving and accumulating capital at an even faster rate. Then the degree of utilisation of capacity will not be maintained at the 5 per cent level. It will in fact decline. From Paish's point of view this will be 'safe', in that it avoids generating inflationary pressure. But it must eventually check the willingness of business to make use of the available savings in further accumulation, and thus lead to their being wasted, as well as to the defeat of the original aim through the cumulative impact of deflation on the percentage of unemployment.[3]

This situation, in which the growth of the labour force and the rate at which opportunities occur for labour-saving investment are together too slow for the growth of capital achieved, is exactly that which, according to our analysis, has been present in the United Kingdom since 1954. Plainly it cannot be met by playing about with demand and hoping to hit on some rate of expansion of it which will simultaneously preserve 'safe' levels of unemployment and capacity utilisation. Moreover, the attempt to do so leads to an exaggerated view of what the 'safe' margin of unused capacity is. Professor Paish singles out the year and a half from the beginning of

[1] Paish, F. W., *Studies in an Inflationary Economy,* p. 310. We refer in the next section to the statistical confirmation which he claims. What it appears to confirm, however, is not so much the power of the ' proportion of productive capacity currently employed to influence the growth of money incomes, as that of the proportion of *labour* unemployed to influence the growth of *money wages.*

[2] *Op. cit.,* p. 327.

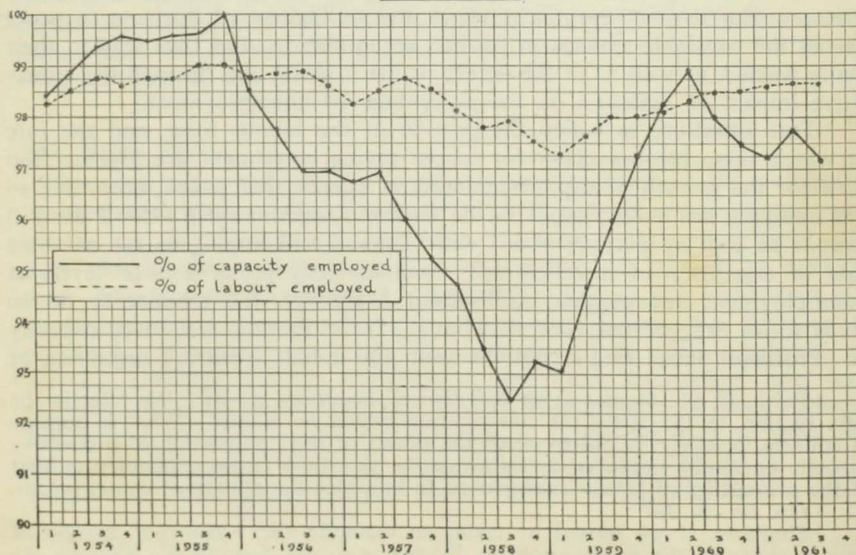
[3] Similarly, if we started by trying to maintain the 5 per cent. margin of unused capacity, the result would be increasing excess demand for labour.

1958 to the middle of 1959 as the only one since the war in which there has been long-term price equilibrium. From his estimate that capacity utilisation was somewhat below 95 per cent during that period, he concludes that this is the 'safe' maximum. But the reason why capacity utilisation was then as low as that was that demand was restrained in response to the underlying labour shortage. If this shortage could have been relieved by increasing the labour-saving potential of investment, the demand restrictions would have been unnecessary and capacity could have been more fully utilised without strain. In the long term, therefore, when the disparity between the growth rates of labour and capital is corrected, the 'safe' margin of unused capacity would not be as large as in 1958-9.

Unemployment Levels

In the conditions that we have had, the practical effect of the 'Paish thesis' is that policy becomes preoccupied with the defence of one of the sacred percentages, that of unemployment, since it is this that the underlying shortage of labour is always seeking to press down. It can be prevented from actually doing so, if enough effort is made to hold back the expansion of demand. But this cannot be done without creating a weakness elsewhere in the form of under utilisation of capacity, thus endangering

CHART I



the other percentage.[1] The maintenance of both cannot be achieved by regulating demand alone. More radical measures are required in order to balance the growth of the economy.

Demand Expansion

From what we have said, it is clear that there also falls into the category of 'what not to do' the idea that a long-term solution can be found by pinning our colours to demand expansion. Given the fundamental maladjustment of capital formation to the slow growth of the labour force, a more rapid expansion of the demand for goods and services would improve the utilisation of capacity, only to be defeated by the recrudescence of labour shortage on a scale which could not be simply ignored. Once the fundamental maladjustment has been cured, of course, the way will be cleared for demand to expand more rapidly than in the past decade, so that we realise all that we are offered by our potential for saving and accumulation of capital. But we must take the cure before we can enjoy its results. Nevertheless it is important that at the present juncture we should take a bit of a risk in this direction for the sake of preventing things from getting worse. There is now a serious danger that the under-utilisation of capacity has reached a stage at which it is sapping the expectations of business about the future. As reflected in business investment plans, these expectations have continued optimistic for surprisingly long. If they now change, as they have been known to do with remarkable suddenness, we stand liable not only to lose the rate of growth of capacity which we want in the long run, but also to plunge into a genuine slump. The recent signs of hesitancy in the investment plans of business are a warning which should not be ignored.

[1] The working of this effect should have been spotted by Paish from his own figures, but for a bit of graphmanship in plotting them. Observing the range of fluctuation of the percentages of capital in use to be greater than that of the percentages of labour employed, he plots them on separate scales, which give to each movement of the employment percentage a weight of five times as great as the weight given to each movement of the percentage of capital in use. (Paish, *op. cit.*, chart III, p. 324). When both are plotted on the same scale, the relation of the percentages is that shown in our Chart I (p. 16). This clearly shows that when demand restrictions have been such as to make a moderate dent in the employment percentage (from the end of 1955 to the middle of 1958), the degree of capacity utilisation has been substantially lowered; and that when they have been such as to keep the employment percentage stable or slightly rising (from the 3rd quarter of 1960 to the end of the series), capacity utilisation has also been declining. (The earliest part of the period, from the beginning of 1954 to the end of 1955, is different, because it is a period of transition to the more rapid growth of capital subsequently achieved, and during it there was certainly excess demand for goods in general). These results are exactly what would be expected from our analysis with its insistence on the fundamental lack of adjustment of the rate of capital formation to the growth of the labour force. Paish himself remarks that the employment percentage tends to be held up by employers hoarding labour. But employers have developed this habit precisely because they have recognised, better than economists have, that labour has become our scarcest resource. What they have not yet done is to draw the conclusion that investment has not been labour-saving enough to overcome it. Nor are they likely to if Paishite demand restraint continues much longer.

Some immediate stimulus to demand, though not a long-term solution to our growth problem, is worth it to avoid the risk of worse.

5. Outlines of Policy

SECTION (3) concluded that for a more rapid rate of growth of output per man we must concentrate on adjusting ourselves to the peculiarities of the British situation. Chief among these is the wide gap between the slow rate of growth of our population of working age and the tolerably rapid rate of growth of our stock of capital. The bridge between the two is the degree to which investment is labour-saving; and the extension of this bridge should be the dominant aim of a policy for faster growth. We now pick out the particular fields for action which are indicated for a policy dominated by this general aim. It does not follow, of course, that the need for action in them hinges upon accepting the particular diagnosis of section (3). Many of them would find their place in anybody's prescription.

Science and Technology

First, the field of science and technology. It is difficult to see what policy measures could give our technology a labour-saving twist. The best approach is to create the conditions for more rapid technological advance in general, and stimulate business to demand of it innovations of a more labour-saving kind. With regard to one of the major conditions of more rapid technological advance, the supply of qualified manpower, things are beginning to move, but not fast enough. The government's Committee on Scientific Manpower concluded in August, 1961, that 'the overall supply and demand for qualified manpower will not be very much out of balance at the end of the first five years of the decade 1960/70'.[1] But their calculations have almost certainly underestimated the demand, being based on enquiries from industry in 1960, the end of a decade of slow growth and a time when decreasing utilisation of capacity was probably inducing a cautious view about capital expansion in the 'sixties. Moreover, the demand should increase beyond the Committee's reckoning to the extent that we succeed in swinging investment in a more capital intensive, labour-saving direction.[2] According to the F.B.I.,[3] the number of qualified research and development staff in 254 firms answering their enquiry, had increased by 52 per cent between 1946 and 1950. This is an annual rate of increase of 8 per cent, which is well in excess of that of 6 per cent which the Committee

[1] 'The Long-Term Demand for Scientific Manpower,' Cmnd. 1490, para. 75. Qualified manpower includes all with degrees or Dip. Techs., and those with H.N.D. or H.N.C.s (' only a proportion ') who gain admittance to professional institutions.

[2] This is not a paradox. Highly-trained manpower is really capital, since to a large extent its skill has been created by teaching in the past, just as a machine has been created by labour in the past. The Committee says that it 'had ground for assuming that technological " break-throughs " as such within a large industry would not normally involve those industries in taking on significant additional resources of (qualified ?) manpower.' It would be interesting to know the grounds for this rather surprising assumption.

[3] F.B.I. (1950/51), *Research and Development in British Industry*, Table 7. and Cmd. 1490, Table 9.

thought would be enough between 1959 and 1970. Even the balance which the Committee foresees depends upon the fulfilment of the universities' plans for 170,000 students by 1971/2, which are now set back by the Government's refusal to face the financial implications of them. Nevertheless, as far as the growth of numbers is concerned, the task is to accelerate something which has at last acquired momentum. What really needs the nation's shoulder behind it is the task of discovering and developing the latent abilities of our people. It was the Crowther Report which most dramatically confronted us with our failure here in the famous survey which revealed that 'half of the National Service recruits to the Army who were rated in the two highest ability groups had left school at fifteen', thus illustrating the Report's conclusion that 'the country is a long way from tapping all the available supply of talent by present methods'.[1] But the failure is confirmed by other evidence: 'There are, for example, more than three men undergraduates for every girl undergraduate. There are more than two male undergraduates from the top two social classes for every one from the manual working class—while in the population as a whole the ratio of these classes is one to three. There is no evidence to show that girls are less able than boys, and there is a great deal of evidence that there are many very able children of working-class parents who are not getting higher education at the moment'.[2] Not all of this lost ability would flow into science and technology, but if the quality as well as the size of the intake into these fields is to be raised, it is clear that educational reform will have to reach well down the age-groups. The task is all the greater because no socialist can treat the educational system simply as a gigantic talent scout, and the extension of opportunities to talent will have to be carried out within the context of improved education for all.

Although any expenditure on education which increases the numbers and skill of the country's qualified manpower is an investment in a very real sense, the statistics of investment include only the physical assets of the educational system. But these will have to be in the van of educational improvement, and here we need to qualify something we said earlier. Although spending a higher proportion of the national income on investment in general is not a cure for our lagging growth, we must expect to spend a higher proportion on educational investment, as well as on education in general.

Channels of Communication

Apart from the need to provide the necessary numbers and raise the quality of our scientific manpower, we must also keep clear the channels of communication between their work and the needs of the economy. It could be that some blockage here accounts for part of our failure to adapt our capital formation to the slow growth of the working population.

[1] Report of the Central Advisory Committee on Education; 15 to 18, para. 202.

[2] *Investment for National Survival*, a report written at the invitation of the N.U.T. by an independent committee under the chairmanship of Sir Charles Morris, 1961.

Such a blockage could be expected to arise from our native love of putting people into classes. If we insist that technologists are not scientists, and that technicians are not technologists, and enshrine the distinctions in the institutional set up of higher education, we shall certainly diminish the speed with which technology adapts itself to the new fields opened up by research and, in the other direction, the speed with which problems of technology make the necessity felt for new departures in pure research. No one should be so foolish as to interpret this as suggesting that science should be 'directed towards some specified, materially useful end.'[1] What it does suggest is that ideas which might be materially useful should be rapidly transmitted, rapidly received, and adaptably applied. This requires that the training of technologists should be less dedicated to the handing on of traditional skills, and should have a higher content of formal education in scientific principles and method. But the channel of communication which most needs opening up is that between scientists and management. It is not clear that this is a matter of having more scientifically qualified people in managerial positions. From their enquiries, published in 1957, Carter and Williams concluded: 'If scientists hold senior positions in management, or are directors, there seems a moderate probability that the firm will be found to be technically progressive; but the cause-effect relationship is not certain, and firms can achieve considerable technical progress with no scientists or technologists in leading positions'.[2] On the other hand, if our investment is to be adapted in the way required by the slow growth of the working population, we shall need managers who are not merely receptive to technical change, but are capable of influencing it; and this argues for a greater weight of scientists in management. But rather than simply drafting scientists into the boardroom, the major necessity is to create a disciplined and comprehensive type of management training at university level. The elements of such a training would be drawn from the history of technology, the principles of economics, and the study of industrial relations, together with a pervasive emphasis on the habit of quantitative thinking. Its object would be to turn out managers not only equipped and inclined to measure their problems, but also able to understand the relationship between the technical, economic and human sides of the management function.[3] The

[1] J. Jewkes, *How Much Science*, Presidential Address to Section F of the British Association, 1959 (*Economic Journal*, March, 1960, p. 14). Professor Jewkes fears that this may be a result of the recent boosting of science, and solemnly warns us: 'In " seeking to sell science to the Establishment " scientists may also sell themselves to the Establishment.' Is it the Oxford academic life that accounts for such nervousness? Or is it this that we mean by 'conservatism'?

[2] *Industry and Technical Progress*, a report written on behalf of the Science and Industry Committee appointed by the Royal Society of Arts, the British Association, and the Nuffield Foundation, p. 190.

[3] No doubt a certain flair continues to be an indispensable ingredient of successful management. But unaided by training it is nowadays decreasingly effective. The limitations of simply drafting scientists into managerial positions seems likely to be vividly illustrated by the experience of Dr. Beeching with British Railways, though it may be that his concentration on the technical and economic (and neglect of the human) problems of the railways stems from his brief from the government.

increasing complexity of this function demands a disciplined approach based upon an integrated conception of it; and thus equipped, managers would be better placed both to influence and to exploit the contribution of science to industry.[1]

The importance of better-trained management is greater the less one is convinced by the reasons given earlier to explain the failure of our investment to be sufficiently labour saving. While these reasons—the high cost of capital, the uncertainty over its availability, and the more generalised uncertainty of the economic outlook which discouraged commitment to capital-intensive innovations—carry some force, they do not leave one altogether satisfied. The inadequate adaptation of our investment to the slow growth of our labour force remains something of a puzzle; and this suggests that the fault may lie, not only in the objective situation in which managers have worked, but in themselves. In spite of the shortage of labour, which has been obvious enough, they may simply have failed to take the opportunities to adapt which did exist. As we have pointed out, ideas are not confined by frontiers; and really determined management might well have imported labour-saving ideas on a bigger scale. Whether this is so or not, an improvement of the quality and in particular the adaptability of management is very important. Of the economic advantages of the loss of empire, the greatest may be the release of able men from government to industry. But the reservoir of potential talent is deeper than that; and, what is important from a socialist point of view, by making strenuous efforts to tap it, we can both increase the supply of high-grade managers and avoid doing so by offering higher pre-or post-tax incomes and thus retreating from equality.

Scale of Research

The scale of research in industry is something of which one instinctively wants to ask whether it should not be larger. But there is not much basis for suggesting that it should. It is true that, on an industry by industry analysis, there is an observable association in the U.K. and the U.S.A. between the proportion of its net output which an industry devotes to research and its rate of growth. But this does not imply any particular causal relationship between the two ; and on the national scale it is noticeable that there has been little difference between the growth rates of out-

[1] Such a course might well be at postgraduate level, with provision for completion in a shorter time by graduates in engineering or economics. In Oxford, where a preliminary skirmish has just taken place, resistance would be intense. It would take its stand on the view that there are certain subjects 'proper' for a university to teach, among which management (even in the wider sense suggested above) would not fall. How to recognise a 'proper' subject is not usually made clear, and I suspect that the adjective is tautologically defined as 'what Oxford recognises.' Often the words 'liberal and humane' are used, but they are not usually defined either. It is stupid to imagine that what is proper for university study can be defined by subject. It is not a matter of subject at all, but of the manner in which it is studied. The manner of university study is critical and disciplined, aiming at the formulation of general principles and carefully examining their specific validity. I hope that this will be recognised in the new universities.

put per man in the U.K. and the U.S.A. during the 'fifties, in spite of the fact that the average large firm in the U.S.A. spent five times as much on research as the average large firm in the U.K.[1] Carter and Williams assure us that 'industrial research and development are growing rapidly . . . and they will yield greater rewards in the future'.[2] In general it is best to allow industry to be the judge of the right scale of its research, and to concentrate on improving its judgment by providing it with managers who have 'light of science in their eyes.' But there are two exceptions to this. First there are the particular cases where an industry has obviously judged wrongly. The leading example of this is ship-building, which has been specifically criticised by the Department of Scientific and Industrial Research for not spending enough on research. The Department should be strengthened to do more probing of backward industries. It should also be given funds to publicise cases where research (not only that carried out under its auspices) has led to spectacular saving of resources.[3] But since the greatest importance attaches to technical advances which economise in the use of labour, the D.S.I.R. should make the encouragement of these a special objective of its policy. The second exception stems from the fact that there may be inventions which, if developed, will have a general applicability in a wide range of industries, but are not important enough to any one industry for it to undertake the effort of development itself. These fall into the special province of the National Research Development Corporation, which was established to concern itself with inventions insufficiently exploited as well as with those resulting from public research. The N.R.D.C. must be adequately provided for; the current level of its expenditure, at £1 million in 1959/60, seems very small.

Obsolescence

With technical progress, as with management, the rate at which the new get in is conditioned by the rate at which the old retire. When a new technique appears, it has to be embodied in new capital equipment; and the rate at which opportunities occur to replace old by new depends on the normal length of life of capital assets. If this is short, a large proportion of the country's stock of capital falls due for renewal each year, and the average age of capital equipment in use is low.[4] Of course there is nothing absolute about the life-span of a particular piece of equipment. If technical advance throws up a new type whose operating costs are sufficiently below those of the old type in use, it will pay to scrap it before its normal life

[1] C. Freeman, *Research and Development: a Comparison between British and American Industry, National Institute Economic Review*, May, 1962. The association referred to is between research expenditure and output, not output per man; but output and output per man are also associated.

[2] *Op. cit.*, p. 189.

[3] Some examples are given in a lecture to the Manchester Statistical Society by Sir Harry Melville, the head of D.S.I.R. (see *Financial Times*, 26th March, 1962).

[4] A low average age of capital is, of course, an incidental advantage of a high rate of growth of the capital stock, and a reason why success may breed success. But the rate of growth of the capital stock cannot be stepped up simply for this reason; it must take account of the growth and cost of other factors.

has expired. But the hold of accounting conventions and of Inland Revenue depreciation allowances is strong enough to make managers look primarily to the end of the normal life-span as the appropriate time to replace old by new. Hence the importance of what is regarded as normal to the speed at which technical advance becomes effective.

There is a great deal of evidence of the continued existence of too much old equipment in British industry. A constant theme of the Reports of the Anglo-American Productivity Council (set up by the Labour government just after the war) was that the best British plants in the industries studied were comparable with the best American, but that the worst British were far behind. The same thing is noticed in their particular field by Carter and Williams, who say: 'British industry is not universally backwards in scientific matters, but is uneven in its development, with a great range from the best to the worst firms'.[1] The shipbuilding industry, for instance, criticised itself through a committee of nine chosen by itself from its top management levels. The committee visited a number of European shipyards and concluded that 'only a few . . . were superior to the best of their British counterparts. But the least progressive British shipyards also created a less favourable impression than any of the comparable foreign yards'.[2] Then there is the McGraw-Hill survey of machine tools in use in the U.K. which found 65 per cent to be more than ten years old and thus beyond the commonly accepted age for obsolescence.[3] Finally, in so far as the normal life of equipment is determined by what is agreed with the Inland Revenue, British industry suffers under a considerable disadvantage compared to its competitors. The average tax life of industrial equipment is 5 years in Sweden, 8 years in Belgium, 10 years in Canada, France, West Germany, Italy and the Netherlands, 16 years in Japan—and in Britain 27 years.[4]

Rapid Replacement

More rapid replacement is vitally needed, and makes a second qualification to our view that investing a higher proportion of the national income will not solve our growth problem. For part of the solution must certainly be to keep our capital stock more up to date by turning it over more rapidly, and turning it over more rapidly will involve allocating a higher proportion of the national income to depreciation and replacement. To encourage this, the normal tax life of industrial equipment should be lowered at least down to the ten-year average which prevails in most of the Common Market

[1] *Op. cit.*, p. 189.

[2] See report in the *Financial Times*, 21st March, 1962.

[3] *Ibid.*, 20th November, 1961.

[4] *The Times*, 13th February, 1962. The figures were produced by the American Secretary of the Treasury, Mr. Dillon, for the Joint Committee on Internal Revenue Taxation, to support his own reforms in this field. It should be added that, as regards the proportion of the initial cost of equipment which can be written off during the *first year* of its life, Britain is second only to Japan; but as regards the first two years, she drops down to fifth, and as regards the first five to bottom again.

countries, and the tax life of other types of asset should be adjusted accordingly. And this should not be done at the expense of the comparatively large proportion of the initial cost which our tax system now allows to be written off in the first year. The giving of generous initial allowances is important because it confers a differential advantage on the firms which are growing fastest.[1] The need to do these things at once is underlined by the fact that the Americans are also now revising their depreciation provisions in order to 'place American industry on a substantially equal footing with its foreign competitors' (Mr. Dillon). But the overhaul of this part of our tax system should also be conducted with a view to introducing a more far-reaching reform, whereby firms would be allowed to decide for themselves the rate at which they write off their assets and provide for their replacement. This would force them to keep a continual watch on their assets, liberate them from conventional notions about their normal life, and concentrate their attention instead on the more relevant question of how profitable they are compared with more modern types which have become available. A bold departure like this is needed to counter the strength of the national addiction to the preservation of ancient monuments.

So far we have concentrated on the rate at which technical progress occurs and becomes effective. By the policies suggested it will not be directly harnessed to the labour-saving requirement which stands out so clearly from the contrast between the rate of capital accumulation and the slow growth of the labour force, except in so far as bodies like D.S.I.R. concerned with research and development are persuaded to accept this as a major plank in their policy. Of course all technical progress helps because it means that a given amount can be produced with less labour as well as with less capital. But the particular twist in a labour-saving direction that we must give to technical progress is best administered indirectly by making industry want it. We now turn to ways of doing this.

Persuasion

First, persuasion. The opportunity for this already exists in the practice whereby the government reviews the investment programmes of the nationalised industries. In future these reviews should particularly press the question how carefully, in drawing up the programmes, labour-saving techniques were examined. The government must press the question on itself as well, since administration would probably yield substantial returns to such techniques. Much criticism has been levelled at investment planning in the nationalised industries, and there is even a school of thought which gives weight to

[1] The advantage takes the form of postponement of tax liability. The initial allowance reduces the liability in the first year. The liability will be felt by the static firm at a later date in the life of the asset, but when that date arrives, the growing firm will be receiving the initial allowance on further additions to its assets. For a firm which is *continually* growing, the liability is postponed indefinitely.

alleged failures there as a cause of our slow growth.[1] But if what is important is the extent to which investment is labour saving, there is no evidence that the nationalised industries have a worse record than any others, and some that they have a better. The investment of the National Coal Board, for example, has been heavily labour saving. Investment in electricity could hardly be more so, except by going over more rapidly to nuclear power (thus dispensing with labour-intensive coal); and the Atomic Energy Authority has pressed ahead with this rather faster than many thought justified by the current comparison of costs. Transport is a jungle of planning mistakes, mostly rooted in the lack of a comprehensive scheme of integration; failure to exploit labour-saving investment possibilities may be tangled up in here, but it is hard to identify with any certainty. As far as private industry is concerned, one of the most important tasks of N.E.D.C. is to build up for itself a position of prestige and influence from which it can make its views felt quite independently of any sanctions it may wield. And one thing that it must particularly get across is the special importance of labour-saving investment. In this it may well succeed. Cynics who dismiss the possibilities of persuasion are as far from the realities of power as the idealists who overrate them. But it is bound to be some time before it is working effectively.

Payroll Tax

So a more immediate stimulus is needed. If investment is insufficiently labour saving on the national scale, then growth on the national scale will be checked; but the likelihood that its own growth may be checked is less obvious to the individual firm. It may feel confident that it can poach labour from others, or work more overtime, and in an inflationary climate not be too worried about putting itself at a cost disadvantage. No doubt the scarcity of labour would ultimately make itself felt by the individual firm via general wage inflation, which would give the corrective twist to investment and make it more labour saving. But it would be hazardous to wait for this. Instead, the corrective twist should be given straight away by means of an effective payroll tax. The rate of up to 4/- per employee per week at which Selwyn Lloyd originally intended to apply this is much too

[1] These failures mostly involve waste of capital, e.g. capacity in transport and electricity has to be of a size to meet the peak demand on the system, and if the peak were spread over the day, smaller capacity could serve a given daily demand. But since neither industry has a pricing policy which encourages demand to distribute itself more evenly, larger capacity has to be installed than otherwise. This argument, though simplified, is perfectly correct, and it is important that nationalised industries should have pricing policies which make for efficient use of capital, old and new. But I do not think that the argument explains the 'ineffectiveness' of our investment, pointed out earlier as the most striking fact about our growth record. Assume that nationalised industries have a normal ratio of capital to output which is higher than it ought to be, but that they do nothing about it and use it in their investment planning. Then we would expect to find capital and output still growing together. The inefficient use of capital would not explain the 'ineffective' investment observed. If the nationalised industries began to turn over to better pricing policies, there would be a period of transition during which output would be observed rising faster than capital (investment would be more 'effective'); but this would end once the new pricing policies had become universal.

small; the figure should be more like 10/-. This attacks the problem on one side; and it needs to be supported from the other by cheapening and stabilising the supply of credit. For the fact that credit has been both expensive and repeatedly squeezed has got in the way of establishing that clear contrast between the costs of labour-intensive and capital-intensive methods which was needed in the peculiar circumstances of the British economy to twist investment in the right direction.

Cheap Credit

This immediately raises two difficulties. First is the defence of sterling, which has always been foremost among the reasons brought forward to justify a tight credit policy. This is dealt with in section (7). The second is that, if we are to keep credit cheap and stable, we have to avoid using monetary policy to control demand. It will then be asked: 'How do we control it?' Presumably by increasing and decreasing taxation in particular by use of the new 'regulator' which gives the Chancellor power to vary rates of purchase tax between budgets. But if we are going to hit demand more often with this, even though we hit it less often with the monetary weapon, shall we not still be very far from creating the conditions of steady expansion, of minimal uncertainty, in which business will be prepared to look far into the future and commit itself to substantial capital-intensive, labour-saving investment? In other words, does it help to keep credit cheap and plentiful if we then have to interfere with demand in some other way? It certainly does. First, the aim of the policy we are outlining is to remove the disharmony which has led in the past to perpetual interference with demand. If we succeed, there will be much less for the 'regulator' to do than monetary policy has had to do in the past. But success will not be had unless conditions exist, and are seen by business to be set for some time ahead, in which there is a marked contrast between the costliness of labour and the cheapness of capital. The general policy will not prevent all fluctuations in demand. But experience suggests that what can be most predictably influenced is the demand for consumption goods, either via taxes on income or directly through purchase and similar taxes. If, when demand fluctuates, we concentrate our attention on these, we shall achieve a steadier and smoother control than could ever be expected from the dramatic 'package deals' of monetary policy. For the very reason why these piled higher Bank Rate, restricted credit, calls on special deposits, letters to bank chairmen, stiffer hire-purchase terms, and cuts in public investment all on top of each other, was that no one had any idea how effective any one of them would be in curtailing demand; so the only way of making sure was to try the lot.[1]

[1] This emphasis on operating against consumption, since it would involve more frequent use of indirect taxes, raises the question whether it would not be regressive. It should not be, so long as the government plays the game and uses the 'regulator' as a *regulator*, and does not yield to the temptation of consolidating any increase in indirect taxes resulting from it into the general level of indirect taxation. Selwyn Lloyd did a great disservice to his own regulator by yielding to this temptation in the 1962 budget. There is no reason why a more frequent *variation* of indirect taxes should not be compatible with a reduced dependence on them in the long run, as measured by their share of total revenue. To reduce the latter should certainly be an object of policy, though it has no special relevance to our argument here.

The Mobility of Labour

In addition to creating the conditions in which investment will become more labour saving, we should also aim to increase the supply and mobility of labour. The Immigration Act—a revolting example of the alacrity with which the Tories are willing to explain the worst kinds of popular prejudice in order to pass themselves off as the people's friends—should be repealed, for sound economic reasons as well as those of common humanity. At the same time it should be recognised in the labour movement that the opening of our frontiers to immigration from Western Europe is an argument for joining the Common Market, not against it. For if immigration raises the rate of growth of the labour force closer towards harmony with the rate of capital accumulation, there will be no reason why demand should not expand at a rate much closer to the latter. Since demand and real income can be expected to move together, this will mean that the growth of real income per head can increase towards the growth of capital per head. The need to improve the mobility of labour requires a much more vigorous effort to overcome the housing shortage, and in particular to ensure that a pool of rentable accommodation is always available in growing industrial centres. If local authorities need to be persuaded of this by bigger subsidies, the economic returns from these will amply justify them.

Redundancy

Next, a major effort is needed to deal with the fear of redundancy. But first, at the risk of a repetition, let us get the problem in the right perspective. We have said that the main cause of our slow growth has been the persistent, underlying shortage of labour. Policy should therefore be directed to removing this shortage.[1] This does not mean creating a surplus; and if our policy measures are seen to be having this effect, they must be withdrawn while the analysis supporting them is re-examined. Nor are they meant to pose any kind of choice between a high level of employment and a high rate of increase of real wages, such as someone might imagine there to be who thought that unemployment had some magically incentive effect. Their aim is to raise the rate of growth of real wages, while maintaining unemployment within the lower part of the range 1.5 to 2.0 per cent.

The choice that is posed is the following. If we do nothing about the shortage, there will be repeated attempts to bottle it up by holding back demand until it does disappear. So the shortage of labour will be eliminated anyway, and with risk of worse to come; for the fact that demand is now expanding less rapidly than the capital stock will set the stage for a slump. But if we tackle the shortage of labour at its source, nothing need stop demand from rising more rapidly to create new jobs in place of those which labour-saving investment has destroyed—and a faster growth of real wages into the bargain. Clearly this is what it is in labour's interest to choose. But at the same time we cannot expect people whose livelihood is threatened by labour-saving techniques to be content with the assurance that the bread

[1] The suggestion that it might actually be exploited for the sake of raising labour's share in the national income is considered in section (6).

which they are forced to cast upon the waters will return to them after many days. So it will; but meanwhile, shall they be told to eat cake? It is easy to raise the cry of 'Luddites!', but in their circumstances most of us would have been Luddites too. Faster growth with social justice demands that generous compensation for redundancy become the general rule throughout the economy.[1] In getting this provided there is a strong case for a state subsidy. Many people would oppose this, at any rate for private industry, on the grounds that it ought to recognise and carry its social responsibility. While the principle has a strong appeal, the trouble is that it is not the firms which pay out under redundancy schemes that receive the benefit of them, but the growing firms to which the labour is more quickly transferred. There is also a more widely diffused benefit to society as a whole in that the loss of output due to the transfer is smaller. It is not only fair that some of the cost of compensating for redundancy should be placed on the beneficiaries, but it is also likely to accelerate the acceptance of schemes for it throughout the private sector. Obviously, however, the beneficiaries can only be made to contribute indirectly. For this purpose, schemes accepted by workers and management and approved by the Ministry of Labour should qualify for state aid, and this aid should be a charge on the revenue from the payroll tax. This would uphold in a general sense the principle that industry should look after its own.

Distressed Areas

Finally there are the particular cases which do not fit the general picture. We would not expect the existence of an underlying labour shortage to be quickly recognised on Merseyside or in South Wales, in central Scotland or on the north-east coast. In these districts the growth of capital has not outrun the labour force, and unemployment has been well above the national average. The application here of a payroll tax and other measures leading to economy in the use of labour will create special problems; and these problems will be the more severe in so far as the districts depend heavily on industries of the older and more labour-intensive kind. Again it must be remembered that some of the edge will be taken off their difficulties by the faster rate of growth on the national scale which our general policy will make possible. But the problem of localised unemployment has proved an intractable one in all conditions, and will remain. The introduction of a stiff payroll tax could provide a new and powerful means of influencing the regional distribution of industry, namely by exempting firms in the development areas. This would derogate from its main purpose; if firms could avoid it by moving, they would not need to do so by making their investment more labour saving. But in the short run they might be contributing just as much to the possibility of more rapid expansion. For if the growth of capital can be concentrated in areas where it presses less heavily on the labour supply, the shortage of labour will be less acutely felt, and the rate of growth of demand can be edged up closer to the growth of capacity without the risk of wage-inflation and a wage-price spiral. The fact that the firms might be less efficiently located in the development areas would be offset by the faster rate of growth that would be nationally

possible. In the long run the payroll tax must be applied to make investment more labour saving; but if exemption from it in the short run can ease the problem of localised unemployment, an important objection to it will be removed.

6. Wages Policy and the Distribution of Income

THE next thing to consider is the relevance of a national wages policy; that is, of having some device or other to ensure that the growth of wages is not simply the resultant of collective bargaining, but is made consistent with the national interest in avoiding inflationary price trends or other difficulties. If this meant that workers yielded to persuasion and accepted a growth of wages smaller than they would otherwise have got, in conditions of labour shortage, it would relieve one of the symptoms of the shortage and temporarily remove the case for resorting to restraint of demand.[1] But it is very unlikely that it could endure in the teeth of the market situation, as is surely demonstrated by previous experiments with wage restraint.[2] Indeed, looked on as a panacea, it would actually work against a lasting solution, since it would blunt one of the incentives to invest in a labour-saving way.

At this point it will be asked whether, having tackled at its source and overcome the underlying shortage of labour, we shall have thereby removed the danger of inflation stemming from wage claims. This brings us to the vexed question of the extent to which wage inflation in the latter part of the 'fifties has been attributable to the pressure of demand for labour, and of the extent to which it has been self-generated. It is the latter possibility, that of 'wage-push' inflation, that is uppermost in the minds of the greatest enthusiasts for a wages policy. That there should be a connection between the rate of increase of money wages and the pressure of demand for labour is something which is suggested by common sense. It was first illustrated by A. W. Phillips,[3] from historical statistics extending some way back. This drew the reasonable criticism that things might have been changing since 1862, when the figures began. Subsequently the relationship has been systematically investigated by R. G. Lipsey,[4] and by J. C. R. Dow and L. A.

[1] This would require them not merely not to press for wage increases, but to decline the offers which employers would make, attempting to bid labour away from each other. Wage inflation does not come only from the side of the wage-earners.

[2] Conceivably it might endure for some time under a Tory government which resolutely proclaimed to the Unions: 'restrain wages, or we will deflate till your market power is broken.' Rumblings of such thunder have been heard from Tory Chancellors from time to time, but usually just before their political careers have run into trouble. I doubt whether a Tory government would risk taking the bit between its teeth to this extent. It would be clearly inconceivable (and highly undesirable) for a Labour government to do so.

[3] Economica, November, 1958, *The Relation between Unemployment and the Rate of Change of Money Wage Rates in the U.K. 1862-1957.*

[4] Economica, February, 1960, *A Further Analysis.*

Dicks-Mireau[1] for the period since the war. It has also been critically examined by Kenneth Knowles and C. B. Winsten.[2] From this controversy I would conclude:

(a) that the relation between the rate of change of wages and the demand for labour is not a tight one. Thus it would be foolish to believe that moderate variations in the level of unemployment could be relied upon with any accuracy to control the pace of wage inflation;

(b) but at the same time a period of some years over which a shortage of labour has persisted can reliably be expected to be one of relatively marked wage inflation;

(c) nevertheless wages appear to have an independent movement of their own, even when there is no excess demand for labour, and no recent price rises, to push them up. In the 'fifties this independent increase averaged between 3 per cent and 4 per cent a year, or rather more than would have been expected on account of the growth of productivity.

Exactly what this independent movement of wages is due to needs further investigation. The temptation is to ascribe it to the one important influence left out of the statistical calculations, on the grounds that it cannot be measured; namely the energy and strength of Trade Union pressure. However this may be, it is clear enough that, having succeeded in adjusting ourselves to the slow growth of our labour force and thus removed the cause of persistent labour shortage, we shall not be able to expect to find ourselves delivered also from self-generated wage inflation. From this shrill voices may preach deliverance by pressing down the level of employment.[3] But those who have ceased to believe in human sacrifice must find some other way; and it is through a wages policy that they are seeking it.

Wages Policy and Growth

But what is its relevance to growth? Some people, while prepared to agree that inflation is a social nuisance which should be avoided if possible, would argue that the first priority is growth, and that if a wages policy does not contribute directly to this, and even more if its enforcement weakens the will of labour to co-operate in other policies required for growth (such as the acceptance of more labour-saving methods), then too much effort should not be wasted on it. This is a misguided view. Although, as we have argued above, no wages policy by itself can remove the fundamental barrier to growth, it remains true that the lack of it can impose another one. Once we have achieved the necessary harmony between the slow growth of the labour force and the growth of the capital stock, and demand is again expanding at the rate allowed by full utilisation of the

[1] Journal of the Royal Statistical Society, 1959, *The Determinants of Wage Inflation: U.K. 1946-56* (Dow and Dicks-Mireaux); Oxford Economic Papers, October, 1961, *The Inter-relationship between Cost and Price Changes 1946-59; a Study of Inflation in Post-war Britain* (Dicks-Mireaux).

[2] Bulletin of Oxford University Institute of Statistics, 1959.

[3] Although they vary in their predictions about the percentage of unemployment required, they are not necessarily false prophets. What they preach, if carried out on the scale required and sustained for long enough, would do the trick. The point is that we prefer to try something more humane.

latter, an independent upward movement of wages and prices of the sort we have had would still be liable to provoke counter measures in the form of restraints on demand. To dismiss this as typical Tory restrictionism is beside the point; we quite often have to live with Tory governments. And in any case it is not clear that a Labour government would be able or willing to face the consequences of alternative action. Thus growth policy and wages policy are not really divisible, independent policies to be taken or left separately. While the restoration of rapid growth does not hinge upon wages policy, its maintenance will.

Does this mean that there is no urgency about getting a wages policy into operation? That it can perfectly well await the massive deliberation which is such an admirable and exhausting feature of the labour movement? In hustling on with the establishment of NIC, the government was clearly seizing the chance to score a tactical advantage over the T.U.C., by revealing how scantily it has clothed itself with ideas on the matter; and George Woodcock was unwise to show himself so rattled by this manoeuvre. But making all allowance for the political factor, it still has to be admitted that a wages policy is a matter of urgency. This is because the expansion of demand cannot await the time when it would really be appropriate. We have argued above that, if the rate of growth of demand is speeded up before the disharmony between the growth rates of labour and capital is being rectified, we shall risk a renewed shortage of labour and the demand-inhibiting reaction of the past; but that we must now take that risk to prevent the expectations of business turning sour on its under-utilised capacity. To minimise that risk, to ensure that the immediate pressure on the supply of labour is contained without generating the inflationary effects which will play into restrictionist hands, a wages policy is vital. It is vital for another reason also, and that is the present vulnerability of the economy to lapses of foreign confidence in sterling. This is something which we must reduce as part of our long-term policy for growth. But in the short run, however much we may dislike it, it cannot be ignored. Foreign speculators are remarkably ignorant about the fundamental sources of strength of an economy; and if expansion designed to sustain the rate of capital formation is seen to have inflationary effects, they will be tempted to liquidate their sterling holdings, so that the loss of gold compels the government to bring expansion to an end. The sting in the tail of our great international currency has to be respected in the short run, though we may hope to draw it in the long.

Thus a wages policy is indispensable both now and in the future, though not sufficient for, nor even much help towards, restoring the conditions for rapid growth. In so far as the disharmony between the growth rates of capital and the labour force is removed, it will be easier also to succeed with a wages policy, since it will not be asked to battle against the tide of a persistent shortage of labour. What form such a policy might take, and how it is to be brought into operation, will be better written about by others. But even from an ivory tower it can be seen that some ground will have to be given on both sides. In the first place the unions will have to stop pretending that collective bargaining is like some mysterious

religious observance, in which only the participating initiates have anything to say. To hold that outside bodies should not interfere because they are ignorant of what goes on is as irrelevant as it would be to say that no one can express views on road safety who does not understand how an internal combustion engine works. The idea that wage claims should be decided on 'the merits of the case' must be broadened to include the question whether, through their inflationary impact, they will slash the real value of other successful claims. We cannot add up the merits of the dockers' case until we have asked whether it will lower the real wages of miners.[1]

The Cost of Living

On the other side the government must retreat from the position that wage claims based on a rise in the cost of living should be disregarded. This amounts to saying that people are not justified in asking for more pay to restore their living standards to what they were before. In an economy with a normal expectation of growth in real wages year by year, this is an extreme position to take. Again, in industries which have fallen markedly behind in productivity, it may be that a cut in real wages is the only alternative to redundancy. But in such cases there is no reason why the workers should not, if they prefer it, choose to maintain real wages and risk redundancy; indeed, from the national point of view they will be doing a greater service, by accelerating the decline of a relatively inefficient industry. No wages policy can hope to succeed if it denies the right, in normal times, to maintain existing standards.

All Incomes Included

Nor can it do so unless two other conditions are fulfilled. The first is that NIC should firmly gather within its purview all forms of income. The government's attitude seems to be: 'let us concentrate our attention on wages; we can always do something about profits, if need be'. Who can be expected to buy that one? The technique of NIC will presumably be to analyse, publicise, and criticise; but it must be allowed to perfect and develop it not only on wages and salaries, but also on profits, dividends and rents.[2] Nor should it be prevented from examining the effect of capital gains on the distribution of real purchasing power. It needs a government directive to make this unequivocally clear. In the second place, it must be made less suspect by means of emphasising more effectively its key place in a sustained policy of more rapid growth, once the conditions for it have been created. We have said that it cannot itself create these conditions. But once they are again present, we shall not want to be forced off the

[1] Since writing this, the terms of reference of N.I.C. have been made known (see *Economist*, November 10th, 1962), and evidently prevent it from commenting on wage claims while negotiations are going on, unless both sides agree. This means that the merits of the case being negotiated will continue to be restrictively interpreted. But it is going too far to say, as the *Economist* characteristically does, that this means that 'the whole idea of a coherent national incomes policy has been abandoned.' Even if it had been, no Labour government can afford to be without one.

[2] Under its terms of reference, published since this was written, it is allowed to say whether it thinks profits are too high.

higher growth rate which will then be possible by measures restraining the growth of demand. And such measures, unless we are prepared for the transition to a very different type of regime, will become necessary if money incomes try to rise independently at a rate in excess of the growth of productivity. In the long run, to realise all that this growth of productivity has to offer, money incomes must control themselves.

The Consequences of Militancy

Is the antithesis between restraining the growth of demand and restraining the growth of wages an inescapable one? To a 'militant' it would certainly not appear so. Let us trace the consequences of adopting a 'militant' approach. The 'militant' would welcome the underlying shortage of labour which we have diagnosed, as a strong tactical position from which further to force up the share of wages in the national income. He would reckon that it could be strengthened even more by lifting restraints on demand, and allowing it to grow at the same rate as capacity. If inflationary wage increases followed (as they surely would with an uncorrected labour shortage, and might well do without it), they could be prevented from raising prices by means of price control. The system of price control would either have to be comprehensive, or, if partial, require to be accompanied by rationing of the price-controlled goods. For if the prices of some goods only were controlled, demand would be diverted towards them and become excessive. Could not more then be produced? Not willingly, because it would not be profitable to do so ; hence businesses would have to be directed, and supplied with directed labour. To avoid this a comprehensive system would be necessary, and the necessity might be heroically borne. But the matter would not end there. As the share of wages continued to rise, and profit margins were further eroded, the life blood of capitalism would begin to run dry. Capital would try to flee abroad, and would presumably be checked by applying exchange control with the necessary severity. This done, businesses would gradually begin to close down, as there would be insufficient profit to induce them to replace their worn-out assets. To avert this, the state would have to take them over and private ownership of the means of production would be slowly extinguished. This would be welcome to the 'militant'; but the interesting question is what would happen then. Would it be possible to stabilise the share of wages at the higher percentage reached after such an effort of 'militancy'? There would be two obstacles to this. First, the higher share of wages would be almost certain to mean that a higher proportion of the social product was being consumed, so that the capitalistic rate of accumulation could not be sustained. Secondly, the higher share of wages, especially if it also meant a higher share for the lowest paid within the wages sector, would mean that the yield of the progressive tax system would be relatively smaller than if capitalism had been kept alive. Since the state-owned economy which has succeeded it will be no less anxious to accumulate capital and provide public services, it will have to reserve resources for these purposes. This must lead back both to a reduced share for wages, effected probably by turnover taxes

which raise the selling prices of goods and services, and to firm resistance to increasing it. Dizzy with success, the 'militants' find themselves knocked on the head.

All this is said only partly for the purpose of highlighting the difficulties of 'militancy' as a practical policy. Dedicated 'militants' will swallow them whole, although I should strain at them myself. The point is rather that the distribution of the national income is not just a problem of capitalism. If wages, in real terms, rise faster than output per man, thus raising their share of the national income, difficulties are created for any kind of economy, except one which is ready to throw the rate of its capital accumulation and the adequacy of its public services to the winds. And these difficulties will outlast any shift, however large, from private to public ownership of the means of production. So for anyone who does not want to see the growth of demand held below what the growth of our productive resources can supply, dislike of capitalism is no excuse for avoiding commitment to a wages policy. Whatever the nature of the economic system, 'militancy' is barren, except for the important function of ensuring that non-wage incomes obey the same canons of self restraint.

Distribution of Income

Finally, we have to consider the effect on the distribution of the national income of the sort of policy that we have outlined in sections (3) and (5) for a more rapid growth of output per man. We have argued that one of the symptoms of the underlying causes of our slow rate of growth of output per man has been the tendency of the share of wages and salaries in the national income to rise. This has resulted from the fact that the persistent shortage of labour has given a strong lift to wage rates, while the ensuing restraints on the demand for goods and services have held the growth of output per man below that of capital per man, causing diminishing utilisation of capacity and a falling rate of profit. It follows that if we correct the shortage of labour, by harmonising the growth of capital with the slow growth of the labour force, we must expect this gain in the share of wages and salaries to be cancelled. Anyone who wants to condemn this as a regressive step must remember the following. In the first place, the combination of circumstances which has led to the increased share of wages and salaries will certainly, if left alone, be self cancelling. In particular the diminishing utilisation of capacity threatens the level of investment, and through that the level of employment, and through that the power of wages to sustain their rate of growth. Secondly, the policy which we propose, with its heavy emphasis on the need for a more pronounced labour-saving element in our investment, is intended to allow full and uninterrupted utilisation of our growing capital stock. Thus with output per man growing faster than before, at a rate approaching instead of falling below that of the growth of capital per man, it will become possible to realise a sustained growth of real wages which offers labour far more, even over a few years, than could be dragged from a competitive struggle with profits.

Real Wages

The future of real wages lies in the growth of the social product rather than in its distribution. But having set the economy on to a higher growth path, we ought also to be looking for means of improving distribution which are compatible with staying on it. One of the greatest obstacles to a higher share for wages—and for lower-income groups generally, including, for example, pensioners—has always been the fear that it would reduce the proportion of the national income saved and therefore available for capital accumulation; for the higher the income, the higher is the proportion of it which is saved. This obstacle can be overcome if wage earners can be helped to save more.[1] As an objective of socialist policy, this must be given high priority. Recent investigations have told us much more about the motives for saving and the forms that it takes, in different income groups and different personal circumstances. At the same time the opportunities are becoming wider and more varied. Not all of these are socially desirable; for example, uninformed dabbling in stocks and shares by small investors can have disturbing effects well beyond the boundaries of the Stock Exchange, and tied pension schemes can weaken a man's power to say Boo to his boss. It is high time that the left evolved a coherent policy for the encouragement of all socially desirable forms of saving by wage earners. For this is one of the most important means of shifting the distribution of income in their favour, without compromising the rate of capital formation on which their future standard of living chiefly depends.

7. Growth in a World Setting

Economically we are not an island; nor can we hope to make ourselves one. Tired as one is of being reminded of it, it remains a fact—and therefore the more irritating. To what extent does it condition the sort of programme outlined earlier in this pamphlet for more rapid growth? The answer to this needs another pamphlet; what follows is an outline sketch of it.

The doctrine is widely proclaimed that exports are the key to expansion. Taken by itself this is obvious nonsense. There is no reason why the key should be exports any more than imports; and no insurance that, if the necessary balance[2] between them is successfully maintained, the door will

[1] Mr. A. E. Jasay (*Paying Ourselves More Money*, Westminster Bank Review, May, 1962) argues that labour may have to trade some loss of its relative share of the national income for more rapid progress towards affluence. My argument leads to the same conclusion, but for different reasons. I do not think, as he does, that more rapid growth depends on investing a higher proportion of the national income, but (at any rate in the first instance) on realising the full potential yield of the investment we are achieving. It is in correcting the disharmony which has prevented this that, according to my argument, the share of wages and salaries must be expected to fall from its present (and non-maintainable) level.

[2] 'Balance' does not imply equality between them, but whatever excess of exports over imports is needed to provide for aid to under-developed countries (e.g. the Labour Party's official $1\frac{1}{2}$ per cent. of national income) and for reducing our net external indebtedness.

not still be barred by difficulties with the capital account. But the doctrine appears to have the authority of O.E.C.D., and has carried weight with the government in the last year or so as a reason for delaying expansion. O.E.C.D. has actually committed itself to the view that the U.K. should raise the ratio of exports to total output to a permanently higher level.'[1] We should not be influenced by any such ratio-mongering. It is true that during the 'fifties as a whole the Gross Domestic Product grew faster than exports; but between 1954 and the end of the decade exports grew slightly faster.[2] It is again true that during the last three years of the decade imports took to rising very rapidly and outpaced the growth of exports. But whether the higher ratio of imports to national income which resulted is to be taken as a permanent feature of our situation, calling for steps to achieve a permanent increase in the ratio of exports, is doubtful. If it could be shown that the higher propensity to import was due to the removal of controls, interpreted as a transition to a permanent era of freer trade, there would be a case for adjusting our export ratio accordingly. But from the detailed study by the National Institute of Economic Research,[3] it seems that this is only a minor part of the explanation. The major part is held to be lack of competitiveness of British *manufactures* (the class of imports which has increased most markedly), a failure made the more startling by the fact that it occurred on home ground. What its correction would imply is a fall in the ratio of imports to national income, not a rise in the ratio of exports. But whatever set the sights of O.E.C.D. on this misguided objective, it is dangerous for the U.K. to increase the vulnerability of its economy by depending more heavily on foreign trade. Sometimes the risk may be worth taking; if, for example, by specialising on certain goods and exploiting a particular advantage in producing them, we can import more of certain other goods than we could get by making them ourselves. But without good reason, to raise the degree to which the level and growth of our national income depends upon events outside our control, is asking for trouble—as should be obvious to anyone who has read the economic history in the 'fifties.

Exports and Expansion

But the proposition that exports are the key to expansion might be interpreted in a milder and more acceptable way. It might mean that more rapid growth can only be sustained if it is led by the growth of exports. As the economy's capacity to produce expands, as the labour force grows and the capital stock increases, demand must also expand to absorb it. But as demand expands so will imports, and the growth process may have to be checked for the sake of the balance of payments. Exports, however, have the particular virtue that they can provide the

[1] Economic Survey of U.K., March, 1962.

[2] Measured by volume; visible exports only.

[3] *National Institute Economic Review*, May, 1961. See also Sir Roy Harrod (*Financial Times*, November 27th, 1961), who agrees that the increase of imports at the end of the 'fifties was out of line with what could be expected in the long run, although he does not echo the National Institute's explanation of it.

necessary demand at the same time as benefiting the balance of payments. So if exports are the leading sector in the growth process, there is always a cushion to prevent the demand required for the full employment of capacity from rubbing against the balance of payments. This is reasonable enough, but not very helpful. It is like a driver in congested traffic who says, 'I could move faster, if only the car in front of me would move faster.' It is a bit more reasonable than saying, 'if only I were to move faster, the car in front would move faster,' but in solving the problem it gets us nowhere. For the means by which exports can be expanded more rapidly are not likely to be found independently of those which will cause a greater rate of growth of output per man generally. If we can achieve that, there are some grounds for hoping that exports will not lag behind. Another National Institute enquiry, among ninety engineering firms of varying sizes, found that those which had expanded their output most rapidly had also expanded their exports most.[1] By itself this is a small piece of evidence, but it confirms the impression often given by business men when they pronounce on the matter, that they have in mind some optimum ratio of exports to total output and like to keep to it. If this is so, then anything which helps their output to expand, within the limits of their capacity, will help their exports also. Certainly if output is low, it will be more difficult for them to absorb the particular overheads involved in cultivating foreign markets. Obviously any measures by which exports *can* be independently pushed ahead are worth exploring. N.E.D.C. is particularly well placed to take a hand here; and serious consideration should be given to the suggestion by Mr. Wernly[2] for a new semi-public organisation to take over the foreign trade functions of the multiplicity of bodies (Board of Trade, Foreign Embassies, Trade Associations, Chambers of Commerce, and so on), among which export promotion is now confusedly dispersed. But the main prescription for success in exports is to keep our eyes on creating a more healthy rate of growth of output per man throughout the economy. There are better ways of helping a child to grow than stretching its neck.

Will the growth policy which we have outlined make our exports more competitive and—what is just as important—our imports less competitive? A higher rate of growth of output per man will not achieve this, if wage rates rise faster too. In the later 'fifties our competitiveness was being squeezed from both these directions. But if we correct the disharmony as proposed, we shall simultaneously relax both the downward pressure on output per man and the upward pressure on wage rates. This double-pronged attack should enable us to move successfully against competitors both in our home market and abroad. The problem will still remain, of course, of preventing wages and other incomes from spontaneously trying to forge ahead of output per man, but one problem is less than two.

[1] *National Institute Economic Review*, January, 1961. It is also noticeable that on the national scale our exports seem to expand most when output generally is expanding.

[2] *The Times*, February 2nd and 3rd, 1961.

An International Currency

Or rather two problems are less than three. For this brings us to the most serious impediment of all to achieving faster growth, and one which (except on a very long view) we cannot expect to dissolve as faster growth is achieved. This is put in our way by the fact that sterling is an international currency whose status we are trying to maintain on a very narrow margin of reserves. Because overseas countries hold balances in sterling, which they can require us to convert into gold, very much greater than the gold we possess, we are wide open to the influence of fluctuations in their international transactions and have only a thin cushion against temporary fluctuations in our own. If, for example, India runs into a deficit (as in 1957), or if plans of industry to raise the level of stocks coincide, or if the government makes a minor misjudgment in the control of demand, the gold reserves are not enough to absorb these influences—the point of *having* reserves of this useless metal being that they should—until they can be diagnosed and rectified. Rapid action has to be taken to check the loss of reserves, in case other sterling holders should become nervous, withdraw their balances, and drain the reserves far more than the original influences justified. During the 'fifties the action which the government favoured was to raise Bank Rate and other interest rates in consequence and to restrict credit, with the object of restraining the growth of home demand in the hope that this would hold down imports and drive exports abroad. Thus the defence of sterling has been an independent cause of our failure to make our investment ' effective '; and the hope of doing so by turning it in a labour-saving direction will be frustrated unless we can remove the necessity for a high cost of capital and the uncertainty engendered in industry by perpetual interference with demand. Because of what we have said earlier, a solution of our sterling problem is not a sufficient condition of this, but it is a highly necessary one.

No rapid and radical solution is possible. We cannot opt out of having an international currency, as we might out of having military bases abroad or keeping an independent deterrent. After all, the sterling balances held by other countries are theirs, not ours. To repudiate them, to default on our debts, would be unthinkable. To block them would not be much better, and might severely upset the development plans of the many under-developed Commonwealth countries which hold them. To declare them inconvertible—that is, to allow them to be used only for buying goods from the United Kingdom or from other countries (if any could be found) which would accept sterling in payment without demanding gold in exchange—might seem to have more justification in that it was the Tories' policy of extending convertibility which did so much to increase the vulnerability of our economy to temporary and speculative movements across the exchanges. But it is one thing to say that convertibility should not have been extended so quickly, and quite another to say that rights given should be taken away. Nor could this be done without damaging the Commonwealth and particularly the poorer members of it. We could hardly expect them to be soothed by being told that there were British goods which would do them just as well as the European or American goods which

we were stopping them from getting—even if we could step up our production to supply them. The damage would be greater than this, however; a gaping hole would be blown in the world financial system. Countries which had held a substantial amount of sterling in their reserves, relying on its convertibility to make it generally acceptable in transactions with other countries, would find themselves suddenly uncovered; and a scramble for gold would begin whose consequences would be disastrously deflationary.

Reducing the Danger

Thus we have to live with our international currency, and it will be potentially dangerous for some time to come. Although they will not remove it, there are some steps which we should take to reduce the danger somewhat. First, when the revival of our competitive power has restored the surplus of exports over imports to the £300 million required for aid to under-developed countries, the prior charge on any further surpluses that accrue must be the accumulation of foreign currency reserves,[1] or for second-best the liquidation of short-term sterling debt. These purposes must be given clear priority over further aid or more overseas investment or quicker dismantling of tariffs.[2] Secondly, we must firmly resist pressure from the city for further relaxations of exchange control, unless it is quite clear that they will not worsen the threat of volatile foreign money in London which hovers over our gold reserves. Such relaxations will be claimed as enabling the City to attract more foreign business and add to the country's overseas earnings; but since they began to be made, the dividends have been poor. Thirdly, when interest rates have come down to a more reasonable level, we should offer the opportunity to holders of sterling balances to fund them by converting into longer-term stock. The price, a higher rate of interest than we would otherwise have had to pay, will be worth the advantage of having them in stock which it is difficult for them to liquidate in a hurry. Fourthly, since some of the under-developed countries plainly regard part of their sterling balances not as reserves to be held but as capital to be spent in the course of their development plans, we should attempt to negotiate with them an orderly programme of withdrawal, so that they will not add to the pressure on sterling in an unforeseen way at awkward moments.

These are long-term and slow-acting means of reducing the danger arising from the low ratio of our international reserves to our international liabilities. In the shorter term, must we simply reconcile ourselves to

[1] Not necessarily *gold* reserves, since co-operation with the U.S. monetary authorities, now in similar difficulties to ours, may require us to hold dollars rather than convert them into gold. This is obviously in our interest if they will do the same for sterling. Nor do I suggest that we should aim for a regular surplus of any given size for this purpose. This must vary with the state of the world economy and be determined opportunistically. Attempts to run large surpluses, which we do not 'put back' by investing abroad, are deflationary to the rest of the world.

[2] If we are inside E.E.C., of course, our freedom will be limited. But we may be able to limit the pace at which capital movements are freed, and resist undue acceleration of the time-table for tariff reduction.

having our programme of more rapid growth harassed and hampered because of temporary or externally-induced fluctuations in our balance of payments? This is a matter of finding means to absorb them which do not impinge on the level of internal demand. For even if we can drop monetary policy as the main regulator, the current policy set-up would require internal demand to bear the brunt through some other means. What can we do instead?

Exchange Rates

We could, if necessary, allow the exchange rate to fall. There are obvious objections to doing this at all often, and it is best in principle to reserve this remedy for deeper-seated trouble with the trade balance, such as if our prices had got seriously out of line with those of other countries. It would rob the holders of sterling of part of the purchasing power of their balances—though not, of course, over British goods—and many of them could ill afford that. Since sterling is an international currency, devaluing it is bound to risk widespread speculative repercussions, as those who failed to see what was coming determine not to be caught again next time. At the present time the repercussions would not be confined to sterling; they would certainly include fears that the dollar too might tumble. Irrational and unjustified as such fears might be, we have to avoid provoking them, not merely for the sake of good relations with the United States (which we need on the monetary front for the defence of sterling), but because lack of confidence in both of the major currencies would precipitate a scramble fcr the world's supplies of gold, in which the winners would be those who lost least in the ensuing slump.

Direct Controls

Thus the logic begins to point towards a return to direct controls on imports and a stiffening of exchange controls on capital transactions. Any sane man will wince at this, and not merely because of the problem of administering them. Much is made of this by civil servants temperamentally disinclined to doing so, but there are genuine and awkward difficulties. The major deterrent, however, to the use of import restrictions under present conditions is that they would have to be so severe. In the days when the Sterling Area was a going concern, the import restrictions called for at a time of pressure on sterling would be imposed not only by the U.K. but also by the other members of the Area. This co-operation in restraint was possible because the Sterling Area countries had a privileged access to the gold reserves; they were free to convert their sterling into gold or dollars when the rest of the world (outside the Dollar Area) was not. And it had the great advantage that for every product whose import a member of the Area restricted, some substitute within the Area might be found. As the Tories extended convertibility rights to all countries, to 'restore the status of sterling as an international currency,' the privileged position of the Sterling Area countries disappeared and with it the basis for co-operation. Consequently if we want to defend sterling to-day by

means of import restrictions, we must impose them on ourselves alone.[1] And since there are many things which we import for which it is hard to find substitutes at home, this means either that the scope for them is smaller or that their severity will have to be greater than in the past. Nevertheless they would have to be accepted if they were the only alternative to meeting balance of payments difficulties by the growth-inhibiting policies of the Tory 'fifties.

The Monetary System

At the present time, however, we are not compelled to accept that they are. There is now a chance of reform in the international monetary system, which could result in relieving us of some of the burden of our international currency. A new mood of co-operation and some practical measures have emerged from the demi-monde of Central Bankers towards checking and absorbing speculative movements across the exchanges. The International Monetary Fund has turned itself into a more effective lubricant of the mechanism for offsetting temporary disturbances in its members' balances of payments, and its Managing Director has gone on record that deflation is the greater danger now facing the world. Of particular significance is the fact that the disappearance of the post-war strength of the dollar has brought the Americans into the camp of those who have an interest in reform, although they do not like to say so, for fear that others may then question their determination and ability to maintain the dollar's rate of exchange. Resistance to reform, and particularly to reform of the radical kind which would involve superseding the gold-exchange standard in favour of some kind of managed international money, is strong among European bankers whose reserve position has improved immensely in recent years. But all in all the balance of forces is favourable enough to justify our giving priority now to the pursuit of reform. The chance of obtaining any significant degree of reform would undoubtedly be prejudiced if we were to resort to import restrictions and severer exchange control, though possibly it might be aided if we left no doubt that these things were in the back of our mind and could be brought to the front by failure. Not only would they prejudice the chance of reform; they would also diminish the current willingness of other countries and of the International Monetary Fund to assist us when sterling is in difficulties.

So the logic which appears to point towards direct controls, as means for insulating a programme of more rapid growth from external disturbances, need not be accepted as immediately compelling. Instead we should forward in every way we can the campaign to alleviate the strain on the two key currencies, sterling and the dollar, so that speculation and temporary fluctuations in our balance of payments can safely be absorbed by

[1] A few years ago I argued (*The Listener*, January, 1958) that this Sterling Area co-operation might be able to be revived, largely on the grounds that the policies which we might otherwise be compelled to adopt (deflation or devaluation) would be even more damaging for the other Sterling Area countries than co-operative import restriction would. I still think that this is true, but that the other Sterling Area countries will only be brought to see it in conditions which threaten a severe world slump.

varying our reserves and prevented from upsetting the balance of internal expansion. In this campaign the particular line of attack is less important than the ultimate objective. Every economist carries a plan in his knapsack, and each of them is likely to be so much better than the present situation that too much time should not be wasted discussing their rival merits. In any case nothing should be allowed to delay the adoption of a soundly-based programme of growth, such as we have outlined. For since it aims to remove the basic disharmony in our economy, which has generated inflation, hampered the growth of productivity, and lowered our competitive power, it ought itself to contribute to greater confidence in sterling and thus ease its own passage.

The Common Market

Finally a word about the Common Market. To my mind the strongest economic argument against joining has been that we would lose independence in our foreign economic policy. Whatever is exactly meant by the clause in the Treaty of Rome which requires the signatories to regard their exchange rates as a matter of common concern, we should plainly lose room to manoeuvre this weapon. And direct controls would become useless because they could not be applied to a vital sector of our foreign trade. If these were needed in order to maintain steady growth, uninterrupted by the external disturbances to which we were particularly liable on account of the over-extended international position of sterling, then we should stay out unless other arguments for going in were strong. There are other arguments for going in; but in the past they have never seemed to me to have the strength to prevail. Now, however, I am not so sure. For in the first place there is little hope of getting a group of countries, such as the old Sterling Area, with whom we could co-operate in the application of controls. And in the second place it now seems worthwhile to seek a solution along multilateral lines of a problem which has ceased to be merely a British one. This is not to say that a solution of the key currency problem will be brought nearer by our joining the Common Market. We may have pleasant dreams of calling in the strong reserve position of the Six to redress the balance of our own; but to them this would be more like a nightmare. The point is rather that a solution of our own liquidity problem no longer requires us to stay out.[1]

8. The Role of 'Planning'

HITHERTO we have said little about the part to be played in a programme of more rapid growth by planning in general and by N.E.D.C. in particular. How can they help?

[1] Since writing the above there has been published the E.E.C. Commission's Action Programme on planning and monetary policy. The part of this which deals with monetary policy recognises the principle of mutual assistance between members, in which sterling might find useful support; but to make the form, extent and conditions of this satisfactory would probably require a struggle. Dr. Erhard's hostility to the Action Programme was mainly due to its endorsement of planning. While this hostility was ill-conceived and regrettable, it does not necessarily extend to the proposals on monetary policy.

Some think very little, on the grounds that N.E.D.C. is clearly neither intended nor equipped to do any 'real socialist planning'. The criticism is just, if 'real socialist planning' is intended to mean something which would be recognised by planners in Eastern Europe and the Soviet Union, namely an integrated system of production decisions defining the allocation of labour, capital and materials between producing units and embodying directives and incentives to get them where they should be. There is no point in discussing the adaptation of such a system to the U.K., not merely because the opportunity is unlikely to arise for applying it, but rather because in most of the countries which do apply it, it is beginning to have a very old-fashioned look. When an economy is very backward or under siege, the planner's task is not difficult, since it is carried out against a background of general shortage. The major particular shortages stand out sharply for his special attention. The question whether there is too much of this and too little of that does not arise; there is too little of everything, and more of almost anything is a success. But as the standard of living rises, the range of what people want to have widens and their tastes become more variable. The planner's targets are less likely to be right, since people will be varying their choices; and because he no longer has the safety valve of a general shortage, which can be opened to absorb any surpluses resulting from his unavoidable mistakes, he must adapt the mechanism of his planning system to strengthen the link between production and demand. As the communist countries move out of backwardness and siege conditions, a great deal of discussion is centering round this problem.

In the pure theory of a private enterprise economy, the link between production and demand is provided by profit; if there is too little of something, the profit to be made by producing it rises and induces businessmen to do so. The lubricant of profit is sometimes too heavy, often clogged by other elements in the system (such as the dominance of salaried management), and capable of flowing in the wrong direction (as when monopolies are powerful). But if not fully effective, it is indispensable. Many socialists, however, to whom the bureaucratic apparatus of Soviet planning would be repugnant, claim that the economy should be shifted from a basis of production for profit to one of production for use; and they refuse to regard N.E.D.C. as a piece of genuine planning because it is clearly not set to do this. It must be recognised that the antithesis between production for profit and production for use is entirely false. This should be suspected by anyone who has asked himself: 'What is the test of what is of use?' If he were a planner in a backward or siege economy a number of 'useful' things would leap to his eye at once. In an economy on the verge of affluence, where choices are open and variable, no simple test is available. Thus production for profit and production for use cannot be alternative ends, towards which different criteria will carry us concerning what is to be produced, when, where and how. Profit, in fact, as a test of whether people want particular things, is a relevant and important test to apply in the process of deciding what should be produced. The error of laissez faire is not that it uses this test, but that it would like to make it exclusive, failing to realise (or deliberately failing to notice) that it is often insufficient, or to recognise society's

moral right to supersede it by other tests which it may evolve of what is socially desirable. Yet if planners are denied the use of this test, in an economy whose real income is as high as ours, it will be as if we have provided them with offices, desks and secretaries, but nothing to write with.

There are of course many ways in which the role of profit in determining what shall be produced requires to be qualified. They fall into two main classes. First there are the cases where profit leads to a production decision which is inefficient from the point of view of society as a whole, either because it does not accurately take into account all the social costs and benefits involved, or because market conditions allow more to be extracted from the buyers than the goods cost to produce. Secondly there are the cases where, taking full account of social costs and benefits, we prefer some other production decision—for example, that education should be provided regardless not merely of ability but also of willingness to pay. The purpose of planning is to arrive at rational production decisions in these two sets of cases. In this it is clear that N.E.D.C. possesses limited opportunities. In the first place much is already done in other ways. The government itself provides a mass of goods and services free or for less than they cost. The redistributive element in taxation helps to make ability to pay a more accurate indicator of personal wants. Nationalised industries accept notions of providing a 'public service', which they allow to influence their pricing and investment policies. Legislation against restrictive practices by business aims to improve the competitive mechanism which rewards those who succeed in anticipating people's wants and penalises those who fail. All these, except the last, are now under attack; but whichever way the trend is, N.E.D.C. has no power to influence it. In the second place, where the profit criterion yields distorted production decisions, their correction will usually require fiscal or regulatory devices (subsidies, taxes, licences) which N.E.D.C. may usefully and authoritatively suggest, but is neither empowered nor equipped to operate. And in the third place, where the weighing of costs and benefits is to be superseded altogther in favour of other social objectives, an unrepresentative body like N.E.D.C. can have nothing to say at all.

Thus, although the false antithesis between production for profit and production for use only draws a red herring across the argument, it is true that to describe what N.E.D.C. can do as 'planning' is, like the title of King of Kings, which is enjoyed by the Shah of Persia, somewhat of an exaggeration of its powers. What then can it contribute to the achievement of a more rapid rate of growth?

Indicative Planning

First, it can contribute something by developing the technique which is described by the rather self-contradictory phrase 'indicative planning'. This involves confronting knowledge of the independently formulated production plans of industry with knowledge of the quantitative relationships between supplies and outputs in each, and using this confrontation to pinpoint the inconsistencies that seem likely to arise. The attempt to remove these statistical inconsistencies will then yield a set of targets which, though

unenforceable, will indicate to the various industries that their plans may have been too optimistic or too pessimistic when viewed in the light of the economy as a whole. They may still prefer to back their own judgment rather than N.E.D.C.'s; but the rest of us can be happier about this if they have been forced to think twice about it. Quantitative forecasting in economics is in its infancy, and will demand a good deal of inspired guesswork from N.E.D.C.'s professional staff. But from continuous statistical exercises it should be possible to identify major distortions in the growth process, such as the disharmony between the growth rates of capital and the labour force, which has been at the bottom of our troubles in recent years.

Targets

Secondly, the publication of a set of targets is of particular importance in that it suggests a commitment to a certain rate of growth. To establish a commitment, however, needs more than numbers on a printed page; and the most important part of N.E.D C.'s work will be the studies that it is undertaking of the obstacles that may lie in the path of faster growth. To establish confidence that a steady rate of growth will be maintained is vital to creating the conditions for the necessary shift of investment in a labour-saving direction. For the major changes in methods of production which will be necessary themselves involve a substantial commitment of capital by industry which will not be likely to occur unless uncertainty is reduced to the feasible minimum and businessmen can look ahead to a clear horizon. To get industry thinking in terms of a steady rate of growth is more important in the first instance than getting it to envisage a faster rate; indeed, the latter should follow the strengthening of confidence in a steady rate, in so far as this creates the conditions for the adoption of major labour-saving innovations. When N.E.D.C. was first established. many people put their faith in its evolving a technique of planning by incantation, of talking up the rate of growth by declaring an optimistic intention to which industries would accommodate themselves for fear of being left behind. Its published intention to think in terms of 4 per cent per annum seems to reflect the influence of this school of thought. Such incantation can work, as Hugh Dalton found in 1946 when he talked the rate of interest down to below $2\frac{1}{2}$ per cent; but as Hugh Dalton found in 1947, it is not enough to maintain the achievement in the teeth of the objective circumstances. A certain judicious optimism is the best spirit in which to approach the problem of stimulating growth; but it is more important to establish that the rate can be maintained. And this will partly depend on the success with which N.E.D.C. can identify the obstacles which lie in the way.

Thirdly, the effectiveness of N.E.D.C. will greatly depend upon the relations which it can develop with the management both of private industry and of public enterprises. In time it may wish to evolve formal techniques of consultation, and no doubt it will have to grapple with the problem of equipping itself with teeth to sink into the fleshy rumps which sit heavily on the boards of certain backward industries. But it will always have to

rely a great deal on sheer prodding; and the influence which it can exert in this way will depend on the closeness of the informal contacts which it can develop.

Fourthly, N.E.D.C. should develop a special effort in certain sectors where the conditions offer the chance of planning in a more positive sense; that is, of a joint industry-N.E.D.C. adoption and pursuance of definite targets for production. The contribution that N.E.D.C. would make to such a co-operative venture would be the statistical services that it could offer in connection with production programming, and the fact that it would bring the industry concerned closer to the ear of government. A good sector to start with would be that of exports, not only on the grounds of their special importance, but because in many fields they tend to come from the minority of large firms in the industry, rather than being dispersed throughout it. This is not to suggest that the habit of exporting should not be extended as widely as possible; and probably a concerted attack on the export problem by the leaders of the industry in co-operation with N.E.D.C. would help to bring the others in. Other sectors of industry with a high degree of concentration also present favourable fields for such experiments in more positive planning (though steel already has its own), and will be the more amenable to the extent that public policy intends to deal firmly with monopolies. But in choosing where to experiment, N.E D.C. should also have regard to the likelihood of success; for in its early years it needs more than anything else to establish its position in the economy by demonstrating that it can actually achieve something tangible.

Fifthly, N.E.D.C. should keep a permanent watch for the distortions which arise when social and private costs diverge and the competitive search for profit yields a defective allocation of resources. In a congested island, with many large productive units, and a substantial public sector in which the relation between costs of production and prices charged is a good deal looser than it is in much of the private sector, competition is often bound to determine inefficiently how much of what should be produced and where. As we have said, N.E.D.C. has no power to correct these distortions, but it should continually concern itself with identifying them. A watchdog that barks, even if it never bites, is better than none at all. Here again there are particular sectors which need immediate attention, such as the transport system as a whole, the supply of energy as a whole, and the location of industry.

But although there is much that N.E.D.C. can do to show the way to faster growth, and to enlist the co-operation of industry in following it, the ultimate test is the willingness of the government to commit itself to priority for such a policy. And commitment means not merely establishing the conditions under which the growth of the capital stock can both be maintained and be adapted in the labour-saving manner required. It also means defending them. And the defences will remain weak so long as we continue to exhaust ourselves in uninhibited struggles for higher money incomes and in maintaining the international status of sterling. If we want to enjoy the green pastures of a povertyless society, we must expel the sacred cows which are trampling them underfoot.

Postscript, January, 1963.

Since this pamphlet was first written, unemployment has risen, the threat of depression has grown more serious, and the new Chancellor, in his ' little budget ' of November, has tried to do something about it. This does not lead me to revise the foregoing analysis. Some may think it odd to be recommending the introduction of more labour-saving techniques at a time when unemployment is increasing, and is becoming a general and not only a regional phenomenon. To dispel this impression, I will risk boring the reader by repeating the main features of my analysis. I contend:

(1) that by the standards of our own past we have had since 1953 a relatively rapid rate of growth of our national stock of capital equipment;

(2) that no similar increase has occurred (or can be expected to occur) in the growth rate of our potential labour-force;

(3) that since we have not adapted ourselves to this new situation in our economy, by investing in an adequately labour-saving way, there has been a persistent shortage of the labour needed to operate our growing stock of capital;

(4) that the shortage of labour has led to government restrictions on the demand for goods and services;

(5) that in so far as the growth of demand has thus been held down to the rate which is consistent with the growth of the labour force and the avoidance of excessive demand for labour, it has inevitably fallen short of the rate which would keep the growing stock of capital equipment fully occupied.

The end result of this process is the situation in which we now find ourselves, with capital more than adequate for current levels of demand in a growing number of industries, further investment being discouraged, and, as the effects of this spread, men also being laid off. The possibility of this happening is suggested on page 17.

For the future, the problem is complicated in the short term by the recent worsening of the economic climate, but for the long term does not differ from what I have outlined. The first thing that is required is to recreate the confidence which will persuade businessmen not to cancel investment plans and precipitate a classic slump involving 6-10 per cent. unemployment. Mr. Maudling's measures to inject purchasing power into the economy are oddly chosen for this purpose. Some broadly-based stimulant to demand would have been preferable to special favour—in the form of reduced purchase tax on cars—for an industry which does not particularly deserve it, combined with an incentive to invest offered to businessmen who are becoming increasingly conscious of the ineffectiveness of much of their investment in the past decade. To stimulate investment without a broad enough injection of purchasing power to ensure that it will pay is like strengthening the roof of a building whose foundations are about to collapse.

Once confidence has been restored and a collapse of investment has

been averted, the long-term task begins which I have outlined in section (5) above. One of the measures suggested there is now part of the Chancellor's intentions; namely, to reduce the working life of capital equipment for tax purposes. He has also added something of his own by giving especially generous treatment to buildings and plant for research. But the suggestion that businesses should be allowed to choose their own rates of depreciation, he has rejected. The timid reasons which he gave for rejecting it are not encouraging.

We have to adapt ourselves to the facts of our economic situation. We have to reconcile the slow growth of our labour-force with the accelerated growth of capital which we are able to achieve. To bridge the gap we must invest in a more labour-saving way. What is particularly important is that we should not be frightened off this vital task by the present unemployment. The present unemployment is the result of measures stemming from our *failure* to invest in an adequately labour-saving way. If we can overcome this failure, then incomes and the demand for goods and services can rise more rapidly without creating a shortage of labour; because demand is rising more rapidly, the growth of capital will be justified; and because the growth of capital will be justified, we shall emerge from the heavy shadows of depression into the invigorating sunlight of sustained growth.

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