

EXCESS DEMAND AND INVESTMENT IN THE UNITED KINGDOM.

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By excess demand I mean the current excess of private disposable income, after the deduction of voluntary saving, over the target figure for the supply of consumption goods at current prices, and that piled-up demand for war-time arrears of semi-durable goods and maintenance of equipment which is backed by savings in liquid form.

In the United Kingdom, where the market economy is cabined and confined by price control, rationing, materials priorities, import control, and exhortations to export, the effect of excess demand is threefold. It leads to an emptying of the industrial pipe-lines, to a short-fall of investment, and to a failure to achieve export targets. The failure to achieve export targets leads in turn to a ruinous rate of borrowing abroad or to a reduction in essential imports. Furthermore, in such an economy there is no automatic mechanism to ensure a reversal of this trend, and without a reduction of excess demand there is danger of a cumulative run-down of the economy. For measures to limit imports directly and to increase exports by stricter and more efficient allocation of materials will, in themselves, increase excess demand, and the consequent increase in the inflationary pressure will tend to bring a failure of export plans through a partial breakdown of materials allocations, (evasions, bottlenecks and so on) and/or through a rise in the cost of exports. Detailed controls can never cover efficiently all cases, or be responsive to changing needs, while the efficiency of more general controls depends on the strength of the profit opportunities working against them. Thus the greater the inflationary pressure the less efficient the controls, and hence the greater the leakage of resources and the rise in costs due to shortages. In addition, excess demand creates an artificial but serious labour shortage. In the hope that controls can be overcome or that they will soon be relaxed, or in the knowledge that increased costs can be passed on, employers take on men even when they cannot employ them productively, and the existence of piled-up saving makes this possible. Now when export targets are raised, efforts are made to attract labour into the export industries by higher wages or better conditions. Where these efforts are successful other industries become "undermanned," even industries making essential goods for the home market, and a new inducement to raise wages or better conditions is created. So it is that wage costs go on rising even when workers as a whole do not use their strong powers of bargaining.

The continued failure to achieve export targets, because of excess demand or because of the maintenance of a type of planning which cannot operate when harried by excess demand, must in the end lead

to a reduction of imports which will make it unnecessary to set any export targets other than for "personnel." In some way the relation between imports and exports must be made to appear in consumers' spending plans. If an excess of imports, not matched by intended borrowing abroad, is not made to lead to a reduced money claim on resources for home consumption, and in some cases to a reduction in costs, there is no mechanism to correct the shortage of exports. This mechanism must continue to be lacking while excess demand goes unchecked, and can only be supplied by an appropriate monetary policy. Such a monetary policy cannot be supplied so long as the budgetary problem is conceived in terms of "ordinary revenue and expenditure," particularly, as will be seen later, when the current concepts of "ordinary" are so extraordinary. Direct controls and monetary controls must be seen as complementary—neither will work without the other. However, at the moment (I write before the budget), we are suffering from the hangover of the past—from the pre-war objection to "financial Bourbons"—and this hangover is so potent that it plays havoc with the current conception of "Democratic planning" (Cmd. 7046). While we still in large measure rely on the market system, there is nothing specifically democratic about asking people to do voluntarily what is against their profit-interest. The Government has not only the power but also the responsibility to control the volume of money and credits, but in the absence of a monetary policy consistent with direct controls and targets, if exporters yield to Government exhortation they might well involve themselves in bankruptcy as costs rise in the face of a reduction of goods available for consumption at home. Church meetings may, as the master of Balliol teaches, have been a vital foundation of British democracy, but even the Churches never applied literally the teaching about the rich man and Heaven.

From that sketch of the background-principles I proceed to the details of the problem. The war effort of the United Kingdom cost her about a quarter of her national wealth. A large part of that loss was reflected in the reduction of overseas investments by £1,000 million and an increase of the debt abroad from £760 million to £3,500 million in June 1945. As exports had been reduced to only 30% of the pre-war level, and as capital equipment was run down, it was necessary to seek overseas loans to make recovery possible. Taking into account the U.S. and Canadian credits, the United Kingdom's capital position in relation to the rest of the world is, as compared with 1938, worse by roughly £6,000 million. The magnitude of the loss is illustrated by the fact that for a 1938 level of imports and terms of trade, exports would need to be 40% greater. Furthermore, part of the internal debt, the Sterling Balances, has so far involved repayment at such a rate as to put a great strain on British resources at this stage. In 1947, e.g., Sterling Balances were reduced by £165 million.

A summary of the items in the Balance of Payments for 1947 will indicate the sort of problem with which the U.K. is faced. As compared with 1938 :—(i) The surplus of imports over exports increased from £302 million to £449 million. These monetary totals hide the fact that there has been a fall in the quantity of imports and an increase in the quantity of exports. The greater rise in import than in export prices involved an addition of £250 million to the cost of imports in 1947. This movement in the terms of trade involves of course a further downward pressure on the possible level of consumption. (ii) Government expenditure overseas has increased from £16 million to £211 million. This figure

includes £80 million for military expenditure, £62 million for U.N.R.R.A. and advances to devastated countries, and £79 million as the cost of Germany. We may expect a substantial reduction in these items for 1948, and the estimate of the *Economic Survey for 1948* is that for the first half of the year expenditure will be at the rate of £140 million a year. (iii) Net income from overseas dropped from £175 million to £51 million. Changes in this item are likely to be unfavourable. (iv) A large body of miscellaneous receipts and payments has changed from a surplus of £100 million to a deficit of £20 million. The principal items here include the overseas transactions of British oil companies, insurance, expenses and upkeep of British enterprises abroad, business travel, and allowances for errors and omissions on current account. This item is likely to show a large deficit this year.

The international deficit on income account was thus £675 million, but gold and dollar losses were £1,023 million. The difference is explained by the fact that £151 million was invested in the Sterling area and a further £55 million elsewhere, while £142 million net was drawn off Sterling balances in London. All these sums were taken in gold and dollars from the reserves of the U.K. At the beginning of 1948 reserves were about £680 million, and at the present rate of loss these reserves will be exhausted by mid-1949. Indeed, with the present rate of loss, and assuming Marshall aid at the rate of £250 million per annum, the reserves will not last beyond 1950. This loss of reserves cuts directly at the basis of recovery—the import of food and raw materials—and without a sharp reversal of present trends there cannot be recovery, but only decline.

The figures I have just quoted make allowance for, or rather are based on, the present import and export policy. Taking the estimates in *The Economic Survey for 1948*, we find that if imports continued at the same level as planned for the first half of this year they would amount to £1,670 million in 1948. For exports and re-exports the targets have been set at £1,500 million, while the estimated deficit on invisibles is £80 million. This gives an over-all deficit of £250 million. But the U.K. deficit in the dollar area for the first half of 1948 is expected to be at the rate of £300 million a year with an additional Sterling area dollar deficit of £150 million. This means a loss of reserves for the first half of 1948 at the rate of £450 million a year. The rate of drain so far has been greater than this.

In the absence of Marshall aid the U.K. would be forced to reduce imports from the Western Hemisphere, and that would mean the collapse of full employment. To quote from the *Economic Survey*: “Our programmed imports of materials from the dollar countries form about a quarter of all our imports of materials. Cuts designed to save a half of the dollar imports which is the least that could make sufficient contribution to the maintenance of the Sterling area reserves, would reduce our total raw material imports by about one-eighth. Since, however, only a limited range of materials are affected, the supplies of these would be reduced by about one-fifth.” (Par. 49) I cannot follow these proportions—so far as I can see a quarter and an eighth should be a third and a sixth—but the broad result is independent of fine calculation. And as raw materials form but a third of imports from the Western Hemisphere it is clear that if dollar imports were halved the main saving would fall on food and feeding-stuffs which form roughly one half of imports from the Western Hemisphere. Put in this way it is clear that Marshall aid will not justify any attempt to raise the level of consumption in the U.K. For even with Marshall aid, unless exports exceed present

targets, reserves will be depleted at a dangerous rate. Thus unless Marshall aid is used to reduce the unfavourable balance of the Sterling area with the Western Hemisphere the basis for recovery will not be laid, and valuable time may be lost in getting a re-orientation of trade policy—away from the uncertain and, in the event, inaccessible waters of multi-lateralism. It should be noted, too, that if Marshall aid includes allocations of luxuries it will not forestall some reduction in essential imports.

Just as an attack on excess demand at home is a pre-condition of the successful use of direct controls, so is it a pre-condition, but not a substitute for, the successful use of direct controls over foreign trade. So long as the world's currencies are not readily interchangeable it is impossible for the U.K. to achieve a satisfactory balance of payments with the Western Hemisphere, and the world's currencies will not be freely convertible so long as there is a world shortage of dollars. In 1947 the U.S. favourable balance of payments on current account was \$11,000 million. This was met by U.S. loans and grants of \$7,000 million and by the liquidation of foreign gold and dollar reserves to the extent of \$4,000 million. As these reserves can be used but once, the proposed Marshall aid of \$5,300 million seems to be too small to solve the current dollar problem. There is now little to nourish the optimism concerning the potential supply and demand of dollars that was evinced during the discussions leading to the setting up of the International Monetary Fund. Then it was customary, in view of the positive correlation between imports and industrial production in the U.S., to rely on full employment in the U.S. as the solvent of the dollar problem, and on the scarce currency clause (Article VII) of the Monetary Fund as the sanction against a dollar scarcity due to possible American unemployment. In the case of the first it is instructive to compare Lord Keynes's estimate (*Economic Journal*, June, 1946), of the U.S. imports of goods \$6 to \$8 billion and exports \$10 billion, with the actual figures for 1947 of \$5½ billion (and the actual quantity smaller than in 1946), and \$14½ billion respectively. (*Survey of Current Business, U.S. Department of Commerce, February, 1948*, pp. S 20 and 21). Further it is now obvious that the "scarce currency" clause was rated too highly. A currency can only become scarce in the Fund when other countries use their quotas to purchase the currency in question from the Fund in exchange for their own currencies, but as there are strict limits to the amount and rate of this exchange, a currency of which there is at the start a large amount in the Fund can be scarce only after the lapse of a period of time. The importance of this period of time is indicated by the fact that U.S. dollars cannot be scarce in the Fund for some considerable time to come.

To the extent that optimism about the supply of U.S. dollars is reduced, the strength of the case for the American free enterprise conception of world trade and for the original U.K. export targets as 175 per cent. of 1938 is undermined. Already in fact the U.K. Government appears to be relying on a sort of long term plan based on a level of imports at 75 per cent. of the 1938 level and on a consequent expansion of import substitutes. But an expansion of world trade is in the interests of the U.K., and the extent of that expansion depends on a change in U.S. policy with reference to its tariffs, tied loans, and protection of raw material substitutes, and on the action of deficit countries to increase their productivity. It is in that light that we should look at investment in the U.K.

Owing to the failure to achieve export targets and to the unfavourable movement in the terms of trade investment programmes have been

pruned. For 1948 gross investment in fixed capital is estimated in the *Economic Survey* at £1,420 million. It is also estimated that a further £380 million will arise from an increase in "stocks and industrial work in progress as output increases," and from a rise in costs. (Cmd. 7344, par. 183). This figure for gross investment represents about 18 per cent. of the estimated gross national product. The significance of this estimate can be seen from the Combined Capital Account, 1946-8 (Table XXV Cmd. 7344, £ million at current prices).

Sums set aside	Provisional		Estimated 1948	Capital Formation	Provisional		Estimated 1948
	1946	1947			1946	1947	
Depreciation allowances ..	600	650	700	Gross capital formation at home	1,350	1,900	1,800
Saving of public authorities ..	-410	-30	275	Less net borrowing abroad ..	-380	-675	-250
Private saving ..	780	605	575				
Total sums set aside	970	1,225	1,550	Total capital formation ..	970	1,225	1,550

In the light of what I have said earlier, the figure for capital formation in 1948 can be seen to depend on the achievement of export targets, Marshall aid, and, given £275 million saving by public authorities, on private saving of £575 million. Without the first two imports cannot be maintained at a level sufficient to maintain full employment or to achieve the planned increase in stocks and industrial work in progress. Without private saving of £575 million the difficulties of achieving investment and export targets will be insuperable.

To arrive at net investment a deduction must be made for depreciation. This suggests that net investment should be put at £1,100 million. But this figure for net investment is purely nominal, as the figure for depreciation is calculated from income tax allowances which are based on the original cost of the depreciating assets. The estimate given in the *Economic Survey* for the annual wear and tear of capital at current costs of production is £900 million. When we add an allowance for the repairs and maintenance of the equipment of public authorities there is no danger of understating the size of net capital formation in deducting £1,000 million from the gross figure, leaving net investment at £800 million. In 1938 net investment was £320 million. Now if for safety we halve the most doubtful item in the investment estimates, namely the increase in stocks and work in progress, and make allowance for the change in prices, the 1948 figure becomes approximately equal to that of 1938. Yet capital equipment before the war was adjusted to a rate of unemployment of 10 per cent. while during the war damage and postponements more than offset improvements, and as the result of the war it is necessary to export a higher percentage of production. *It is clear that the investment programme is set alarmingly low, and even more alarming that the end-1948 rate is lower than the rate for 1948 as a whole.*

As the achievement of even this rate will depend on maintaining imports and on preventing a direct disappearance of resources from investment at the bidding of excess demand, I turn now to current excess demand. Mr. Dalton was recently reported as saying that the City of London ought to erect a statue of the Chancellor who had

produced a record Budget surplus, and he has claimed (*New Statesman and Nation*, March 13, 1948), that chiefly because of an ever growing revenue surplus the floating debt has been reduced by over £500 million in the last 12 months. The Budget "surplus" of £658 million for 1947/8, however, results from a curious and misleading accounting convention. Included in "ordinary" revenue are such items as Miscellaneous Receipts (£230 million), which, as "clawings back" of money issued to Government departments in earlier years but left unspent, are no more than inter-departmental transfers, and £193 million from the sale of surplus war stores, but excluded from "ordinary" expenditure are war damage payments, E.P.T. repayments, and post-war tax credits (£364 million), as well as loans for housing and other local authority purposes. In fact the so-called Budget surplus was less than extra Budget expenditure, and for the explanation of the reduction in the floating debt we must look to the American and Canadian credits. The sale of dollars to importers in exchange for sterling brings revenue to the Exchequer and without the sale of borrowed dollars the reduction in the floating debt would have been negligible. The general position is brought out clearly by the balance sheet for public authorities as a whole.

REVENUE AND EXPENDITURE OF PUBLIC AUTHORITIES. (£ million).

(Source : Cmd. 7344)

	1947	1948		1947	1948	
Direct Taxes ..	1,765	1,825	Current Expenditure on Goods and Ser- vices Subsidies National Debt Interest Social Security Payts. Other Surplus on Income Account ..	2,150	2,050	
Indirect Taxes ..	1,855	1,975		430	400	
Income from Pro- perty, Trading, etc.	75	65		545	540	
				450	475	
				150	125	
				-30	275	
Total Revenue on Income Account	3,695	3,865		Total expenditure on Income Account	3,695	3,865
Surplus on Income Account ..	-30	275		War-damage Pay- ments, E.P.T. repayments .. Post-war credits .. Other Surplus available for Investment ..	280	150
Sale of Surplus War Stores	190	50			50	50
			50		50	
			-220		75	
Total Revenue on Capital Transfer Account ..	160	325	Total Expenditure on Capital Trans- fer Account ..	160	325	

It would be amusing, if it were not so serious, that a Government which has assumed responsibility for planning the economy as a whole, for developing the basic industries, and for providing the community with a stable monetary system, still presents its Budget in a form which implies that it has no such responsibilities. The figures for 1948 are taken from the *Economic Survey*, and are, of course, provisional. It is a pity that I had to write this paper so soon before the Budget, but the

discussion can proceed from a more accurate knowledge. It will be noticed that for 1948 there is an assumed increased yield of taxation by £180 million, and a fall of expenditure on income account by £100 million, making possible a surplus on Income Account of £275 million. It is this surplus which, in conjunction with depreciation allowances of £700 million, and an overseas deficit of £250 million, leads to the estimate of £575 million as the necessary private saving. Any reduction in the saving of public authorities would make the necessary level of saving greater. The possibility of getting saving of the order supposed can be considered only in the knowledge of the estimates for National Resources and Expenditure. (Cmd. 7344, Table XXII, £ million at current prices).

Resources	Provisional		Esti- mated 1948	Expenditure	Provisional		Esti- mated 1948
	1946	1947			1946	1947	
National Income of the U.K. . .	8,200	8,600	9,000	Domestic Expen- diture on goods and services at market prices . .			
Borrowing from abroad, etc. . .	380	675	250	Personal ..	6,750	7,300	7,675
				Government	2,330	2,150	2,050
				Net Invest.	750	1,250	1,100
				Total ..	9,830	10,700	10,825
				Subsidies ..	360	430	400
				Less Indirect Taxes ..	1,610	1,855	1,975
Total resources available for use at home	8,580	9,275	9,250	Total resources available for use at home	8,580	9,275	9,250

At first glance the most surprising feature of the estimate for 1948 is the increase of £375 million in personal consumption. For total resources available for use at home are to be down by £25 million and one of the justifications given for the pruning of investment is that "the overall resources, including man-power, needed to build up the export and import saving industries, could be secured only by reductions in investment as well as in consumption." (Cmd. 7344, par. 176). Now as estimates are given at current prices, allowance must be made for some increases in wage rates and import prices, which are already higher than in 1947. Let us assume that borrowing £250 million abroad does make it possible to keep up the planned level of imports. Then, as 1947 was the year of the coal crisis, and as there has been some improvement in equipment, it is reasonable to assume an increase in productivity. The assumption of a 3 per cent. rise in the factor price of goods and a 2 per cent. rise in productivity puts the National Income for 1948 rather higher than the estimate given in the *Economic Survey*. On the other hand, after imputing to personal consumption the whole of the increase in indirect taxation and assuming the same rise in factor prices, the addition to the personal consumption over 1947 is still less than in the official estimate. In other words, if the assumption of a 3 per cent. price rise is correct, there is provision for a slight rise, and not a fall, in consumption.

In contradistinction to 1947, when personal consumption rose to 71 per cent. of the National Income instead of to 66½ per cent. as planned, in 1948

personal consumption cannot as in 1947 be stretched by a deficit abroad on current account 93 per cent. greater than is planned. For this year the attempt to stretch consumption would necessarily be defeated by a fall in imports. Let us turn therefore to saving out of current income. Private saving is the sum of personal saving, undistributed profits, and additions to companies' tax reserves. In 1947 these were respectively £625 million, £220 million, and minus £240 million, while the estimates for 1948, or target in the case of the first, are £450 million, £225 million, and minus £100 million. It may seem that as personal savings were £625 million in 1947 a target of £450 million out of a higher National Income should not be difficult of achievement. But the saving realised last year was by no means all voluntary. A large part of it was forced out by queues, delays, and restrictions, and by the inflationary influence of the attempt to avoid forced saving, which in raising money income raised the level of money saving. But the cost of that forced saving was a fall in exports and in investment and a large increase in borrowing abroad and it is just this cost, at the 1947 rate, which is now unpayable.

In 1938 personal savings were $3\frac{1}{2}$ per cent. of personal disposable income, but personal savings of £450 millions this year would constitute $5\frac{1}{2}$ per cent. of personal disposable income. Now the real level of consumption as such would not tend to push a higher proportion of personal disposable income into savings. Indeed though in terms of common prices consumption per head is now approximately the same as in 1938, consumers are certain that they are now worse off, and if the goods consumers most want were freely available personal savings might well be negative since people wish to spend war savings on goods they then did without. If then £450 million is to be saved it will be so only because of a successful appeal to people's sense of duty combined with policies which make it more difficult or more expensive to buy. While rising prices remorselessly reduce the value of savings, no effective appeal can be made to people's sense of duty, for an appeal of that type must be solidly grounded in self interest. But the savings are needed to stop the fall in the value of savings. Is there a solution to this problem?

In 1947 a large proportion of personal saving was forced—less than £350 million, e.g., found its way into National Savings and the purchase of New Issues. Will it be possible in 1948 to force savings of, say, £350 million without a pressure on the controls? As the direct controls—rationing, docketing, materials allocation, "agreed" percentages for exports and so on—are not proof against inflationary pressure they must be supplemented in some way. They can be supplemented in three ways:

First, by increasing purchase tax. Properly arranged, this additional purchase tax could be such as to leave the estimates for personal consumption and the yield of indirect taxation unaltered. That is to say, the purchase tax would achieve not more revenue but more saving. Purchase tax at this level would be unpopular, but the effect of saving less than £450 million would be still more unpopular, and in general, people are happier with a grievance against the Government than with a genuine misery.

Second, by using subsidies to prevent the spiral of rising import prices and wages. The direct controls, and the export targets in particular, need to be buttressed by an attack on one of the causes of rising costs. As import prices are still rising such a policy is almost certain to involve a higher expenditure on subsidies than that shown in the estimates, and to that extent will involve, if Government expenditure is not cut else-

where, raising the target for personal saving as a proportion of personal disposable income, either indirectly through an increase in direct taxation, or directly by increasing the target figure for saving. From the standpoint of stabilising the value of savings, it may seem that stabilising the price level of necessities gives with one hand what it takes away with the other in purchase tax. But the conscious decision to have two price levels, one for strict necessities and one for goods not wholly essential, and the explanation of this decision as necessary medicine for present ills, cannot produce the same disincentives to save as creeping inflation. A pre-requisite to restoring faith in the virtue of thrift is to stop the present drift in economic affairs, and the pre-condition of a standstill agreement over wages would appear to be the stabilisation of the price of necessities.

Third, by immobilizing or destroying piled-up demand. Even if through purchase tax the piled-up demand is kept off the market for consumption goods this year, it does not follow that it can do no harm. For it partly consists of a piled-up demand for capital goods which is additional to the demand allowed for this year. The damage that is done by this piled-up demand is, first, that the leakage of materials through the control leads both to the use of materials in relatively unimportant projects and to a reduction in efficiency through shortages and holdups which would not otherwise have taken place, and, second, that the difficulties of bringing about a re-distribution of manpower are magnified. Piled-up demand as a whole can be put, very roughly, at between £5,000 million and £3,000 million, according as it is estimated from the surplus of actual saving over pre-war rates or by adding to the deficiency of consumption since 1938 as judged by 1938 consumption, an estimate for the insufficient replacement of fixed and working capital due to the war. Now the possibility of a collapse of the piled-up demand depends on the form of savings. Unfortunately, a large portion is in a completely liquid form. The average currency circulation with the public is £400 million greater than it would have been if it had risen only in proportion to the rise in net national expenditure at market prices, while bank deposits are £1,000 million greater than they would have been on the same reckoning. However, I will not discuss the best way of controlling expenditure out of capital, and instead I will take the liberty of referring you to J. R. Hicks's discussion in *Lloyds Bank Review* for July, 1947.

I have argued that we are suffering from a hangover of the past in that the fear of monetary restriction which was created by the vastly different condition of the past—conditions different in respect both of investment outlets and Banking institutions—has blocked the creation of a monetary policy appropriate in the present. The effects of living in the past have affected far more things than monetary policy, for in public affairs the formulation of policy always lags behind, and then outlasts, the contemporary situation. In concluding I will take two examples.

It was painfully obvious between the wars that the pricing mechanism in the competitive system cannot ensure full employment, for, to mention the most obvious deficiency, saving is not sufficiently responsive to changes in investment. Although the effect of this lack of response can be either inflationary or deflationary it was natural during the 'thirties to stress the deflationary dangers. As a result, theories were elaborated on the assumption of insufficient private investment, and public instruction took the form of demonstrating and re-iterating the need for a "gap-filling" Government investment policy. Now that there is an obvious inflationary pressure the easiest way to adapt the pre-war advice is to

substitute the term "gap-creating" for "gap-filling." But when the main problem is not that of setting men to work to use existing equipment but of creating equipment so that imports and work can be maintained, only harm can result from a pre-disposition to place the stress on investment as *the* flexible factor in planning. We cannot reasonably expect "Keynes" to be happy standing on his head.

The stress on investment as the flexible element in planning has of course been a very recent development. Before the crises in coal and the Balance of Payments investment targets were often extravagant. In building in particular the target was absurd. But building was an obvious line of activity for the State in a full-employment policy as conceived before and during the war. Here was an opportunity for a continuing State investment which would not only provide a stable core of employment but also meet the claims of social justice for low-cost housing. Now, since during the war planning proceeded very largely in terms of man-power budgets, the obvious way to proceed was to attract a particular (and round) number of workers into building by better conditions and promises of a permanently expanded building programme. We can see here the hangover from two pasts. From the depression, and not from the war, comes the implicit assumption that there is always room for social-justice investment. From the war comes the idea of physical planning. We have here as good an example as any of the inherent contradictions in the present approach. The indispensable conditions of planning through man-power allocations are (i) the strict direction of labour, and (ii) a central allocation of materials. But both these conditions are incompatible with the concept of "democratic planning" in a semi-market economy in peace time. The conflict could be lessened by an appropriate monetary policy but it could not be abolished. The effect of inherent contradictions in policy is that "accidents" and "bad luck" and "self-seeking" hold up recovery. That is to say, plans fail.

DISCUSSION ON MR. WILLIAMS' PAPER.

Mr. J. C. M. Eason : I join in congratulating Mr. Williams on the excellence of his paper and especially upon its clear expression and good delivery.

While, however, I can follow his line of argument I do not know enough of the figures in the background to understand what alternative methods might have been adopted for his estimates and, therefore, will not attempt any criticism.

There is indeed one exception I would make, and that is regarding his suggestion that the item for borrowing overseas might be a flexible factor in his calculations. Is that correct? Can the British count upon compliant creditors? Further, if they can should they adopt such a policy? This approach is too reminiscent of the spendthrift living beyond his means, or the trader approaching bankruptcy to have my approval.

The last paragraph of his paper was written as Keynes would say "on a somewhat lower level of understanding than the rest." There are one or two points upon which I wish to comment:

The Budget contains a plan but it is not necessarily rigid. The inherent contradiction between it and the economic tables of Mr. Williams may derive from the Chancellor's hope that the British people will in

fact be sufficiently stern and austere in their habits and inflexible in their savings' propensity to render full control unnecessary; but if plans fail through a breakdown of self control in a democracy then the planners must proceed to stiffen their controls up to the hilt, once they have been committed to a policy of full employment at all costs they will pursue it, and that, I think, is behind the speech made by Dr. Dalton.

An appropriate monetary policy might not abolish all the contradictions but would make them bearable: the fact of the matter is that there are inherent antinomies, contradictions, anomalies and dilemmas in all economic operations and they will exist plan or no plan.

The President (Dr. Geary) said that the very interesting paper which they had heard this evening was a work on economics not on statistics (though it dealt largely with figures), and it was none the worse for that. He (the President) would like to raise the question of what he might term the *status* of the figures for 1948, or for the more remote future, variously described as "estimates," "targets," "programming." He (the President) had spent a quarter of a century in trying to ascertain reasonably accurate economic statistics for the recent and remote past, and he had, in consequence, a profound respect for statistics if only because they were so hard to come by. According to the modern fashion, it appeared to be far easier to produce figures—he did not call them statistics—for the future than for the past, though, of course, statistics of the past were utilised in their preparation. Were these figures for the future to be regarded as prophecies? Clearly, no; in Great Britain, the man-power and balance of payments targets for 1947 were considerably falsified in the event, not only in detail but in aggregate. In Ireland, where the economy was much less subject to control than in Great Britain, this programming or target approach was even more hazardous. Nonetheless, it seemed impossible to avoid it, since it would be required under our E.R.P. commitments.

He would be glad to hear Mr. Williams's view on this important point. He (the President) could assure Mr. Williams that statistical theory had not yet reached the point in which economic forecasts of the near future could be made from present statistical levels within even wide limits of error. Perhaps the answer was that the object of programming for the future was to ensure that the figures quoted were economically consistent. In other words, the figures were performing the useful function of clarifying abstract thought.

Post-Budget Addendum. By MR. WILLIAMS.

The Budget and the publication of *National Income and Expenditure of the United Kingdom, 1947* (Cmd. 7371), make it necessary to alter some of the detail and comment of this paper.

(1) The Chancellor of the Exchequer stated in the Budget speech that his new task is not merely to balance the Budget but to match resources to needs, so that "the Budget must be complementary to, and in some sense part of, the national economic plan." He budgetted for a surplus of £300 million over both ordinary and capital expenditure as the amount needed, after allowing for reduced overseas borrowing, to stem inflationary tendencies. This new *policy* pushes my "financial Bourbons" comment into the past tense, but as no provision is made to peg the price level of necessities through subsidies or to immobilize piled-up demand how effective will this surplus be? As an aid in thinking out the probable effects of the Budget, I will make new "estimates" for personal saving and National Income and Expenditure in 1948. These will differ

appreciably from the *Economic Survey* "estimates." (2) In 1947 (Cmd. 7371) depreciation allowances, undistributed profits, and gross capital formation were greater, and personal savings and the reduction in tax reserves smaller, than was anticipated in the *Economic Survey*. Following first the method in the *Economic Survey* for 1948 I assume that depreciation rises by the same amount in 1948 as in 1947, that undistributed profits rise by one half as much in 1948 as in 1947, and that changes in tax reserves are minus £100 million. As the *Economic Survey* underestimated the rise in prices I raise their estimate of gross capital formation to £1,900 million. This gives a figure of £1,075 for net investment as compared with the estimate of £1,100 million in the *Economic Survey*. I have calculated that the saving of public authorities will now be £500 million in 1948, so that the required amount of personal saving on the above assumptions is not £450 million but £75 million.

COMBINED CAPITAL ACCOUNT

(£ Million at Current Prices).

Sums Set Aside	1947	(1948)	Capital Formation	1947	(1948)
Depreciation ..	775	825	Gross capital formation at home ..	2,020	1,900
Saving of Public Authorities ..	-135	500	Less borrowing abroad ..	675	250
Undistributed profits ..	320	350			
Changes in tax reserves ..	-60	-100			
Personal saving ..	445	75			
Total sums set aside	1,345	1,650	Total capital formation ..	1,345	1,650

On the assumption that personal saving in 1948 is £75 million a National Income for 1948 can now be estimated from the tax rates and expected yields as given in the *Financial Statement*, 1948-9. This method should enable us to see the broad implications of the Budget estimates within the framework of the economic plan as a whole, of which estimates for capital formation and overseas borrowing form part.

By adding together personal expenditure at market prices and personal saving we find that in 1947 personal disposable income was £7,866 million. As the relevant taxation paid was £1,287 million personal income was £9,153 in 1947. In the *Financial Statement* (1948-9) it is calculated that at 1947-8 rates of tax, income tax would yield an increase of £200 million in 1948-9. As calculated from the standard rate the implied increase in personal income is £500 million, so making personal income 5 per cent greater than in 1947-8. Using this percentage increase for 1948, personal income becomes £9,653 million. Income tax is calculated to yield £100 million more this financial year than last, so that to be on the safe side I deduct £1,375 for taxes in 1948 as compared with £1,287 million in 1947. This gives personal disposable income of £8,278. Thus, with personal saving at £75 million, personal expenditure at market prices would be £8,200. Add to this estimates for (i) Government expenditure on goods and services, (ii) net capital formation at home and (iii) subsidies, and then deduct indirect taxes and the planned rate of borrowing abroad. The result is the assumed National Income which, based on the assumptions that personal saving is £75 million and that £250 million is borrowed abroad, and on rough calculations, from financial

years, of Government expenditure and expected tax yields in a calendar year, is not a forecast. The calculation is intended only as an aid in thinking out the probable effects of the Budget within the general economic plan as announced, and as an aid in judging the consistency of the various parts of the "economic plan."

NATIONAL RESOURCES AND EXPENDITURE

(£ Million at Current Prices).

Resources	1946	1947	(1948)	Expenditure	1946	1947	(1948)
National Income of the U.K.	8,100	8,770	9,445	Expenditure on goods and services at market prices :			
Borrowing abroad, etc.	380	675	250	Personal	6,739	7,421	8,200
				Government ..	2,473	2,168	1,900
				Net Investment ..	530	1,245	1,075
					9,742	10,834	11,175
				Add Subsidies ...	327	442	400
				Deduct indirect tax	1,599	1,831	1,880
Total resources available for use at home	8,480	9,445	9,695	Total resources available for use at home	8,480	9,445	9,695

It will be noticed that the rise in the National Income assumed for 1948 is practically the same as the actual rise in 1947, but that the rise in personal expenditure is about £100 million greater than the rise in 1947, despite the fact that indirect taxation is shown as rising by £50 million in 1948 as compared with a rise of £230 million in 1947. Expressed in percentages, the assumed rise of National Income in 1948 is 8 per cent. and the rise in personal expenditure 10 per cent. What does this mean in real terms ?

Any increase in efficiency which is matched by a corresponding increase in money payments to factors of production will act to keep prices stable, while any increase in payments to factors as a whole without an increase in efficiency will push prices up. Now suppose that there is a 5 per cent. rise in prices due to the latter. Then allowing for that rise in prices, the reduction in subsidies, and the increase in indirect taxation, the implied increase in real consumption is 4 per cent. In judging whether that is possible we have to take into account the reductions in Government expenditure and investment on the one hand and, the supplies of raw materials and the planned increase in exports on the other.

For simplicity, assume that a reduction of £1 in Government expenditure and investment makes possible a reduction of £1 in the import surplus or an increase of £1 in personal consumption. Then, at the prices assumed for 1948, Government expenditure and investment are £438 million less than in 1947, while the increase in exports necessary to reduce overseas borrowing to £250 million is roughly £300 million. The difference between these two, £138 million, is, with the assumptions made, the amount available to increase consumption. But the amount needed for a 4 per cent. rise is £320 million. This means that in addition to the transference assumed there must be an increase in production for consumption of roughly 2½ per cent.

The major short-term possibility for an increase in efficiency is to combine less men with the same raw materials. This means that to increase production more raw materials will be needed. But raw material imports are to be at best about the same as in 1947, so that the chance of increasing production 3 per cent. is dependent on exports and personal consumption being less raw material using than Government expenditure and investment. I have no direct evidence on this point, but there is some indirect evidence. First, according to the *Economic Survey* the condition of achieving the necessary export targets is a release from investment projects of certain materials, notably steel. Second, although in 1947 industrial production increased 9 per cent., the increase was accounted for by demobilization and transfers from munitions, and during this period imports of raw materials rose about 25 per cent.

In view of this indirect evidence, and the fact that in assuming a £ for £ change between investment and Government expenditure on the one hand, and exports and consumption on the other, I have ignored the problems of transference and adaptation, I conclude that personal consumption, given a 5 per cent. rise in prices and borrowing abroad of only £250 million, must be less than £8,200 million. That is to say, the lack of goods would force personal saving to be higher than £75 million. But this will mean that personal income cannot be as high as £9,653 million.

Suppose that personal saving is £325 million, (to get which sum, incidentally, would involve pressure on the controls), and that in consequence undistributed profits fall by £250 million, i.e., that profits fall by £250 million but dividends are maintained. Then personal expenditure and National Income would both be £250 million less than shown in the table, and with a 5 per cent. price rise personal consumption would be 1 per cent. greater than in 1947. This means too that with undistributed profits £250 million lower, the amount of personal saving required for capital formation of £1,650 becomes not £75 million but £325 million. To take £250 million out of undistributed profits, however, is to assume an extreme of frictionless adjustment, and I have done so simply because it is the simplest adjustment to envisage. In fact the reduction of profits, below that level first assumed, by £250 million would inevitably affect the willingness and ability of firms to maintain the postulated increase in factor prices—dividends as well as salaries and wages and prices of materials. That is why personal income cannot be as high as I first postulated. There is nothing strange about this. One of the main purposes of an anti-inflationary policy is to stop firms granting increases in wages, etc., simply because they know that, in an inflationary situation, they can pass on the increased costs. But another implication of the present Budget within the general economic plan is that unless the rise in the rates of payment to factors is less than (very roughly) 5 per cent., there will be unemployment due to firms' unwillingness or inability to employ as many men as before. Indeed, assuming that there is no increase in productivity but that the £1 for £1 change between Government expenditure and consumption production is valid, and given the very small fluctuation in the year by year share of the National Income going to wages, the maximum rise in wage rates consistent with full employment is less than 2 per cent. If it is less than 2 per cent., then, for the reasons argued in my paper, the prospects of reaching export targets will be better than they have been hitherto. However, the upward pressure on prices always outlasts the conditions that caused it, so that, quite apart from a continuing, though reduced,

pressure on controls, there will probably be difficult problems of adjustment in rate of pay later this year, and although, given the announced plan, these adjustments, as well as in the level of employment in particular industries, must be faced if we are to get rid of the artificial shortage of manpower and so on, the real test of the intentions of the Chancellor will not come till then. Will there be sufficient voluntary restraint, and foresight, e.g., on the part of the Unions now to prevent the need for lowering wage rates later? Doubtless their foresight would be greater if subsidies had not in real terms been tailed off. But if, lacking nourishment, their foresight is deficient will unemployment due to excessive payments to factors—excessive in relation to export targets and the conditions of “Democratic Planning”—be taken as a sign that Budget policy is *causing* unemployment? If so my haste in pushing my “financial Bourbons” comment into the past tense will have proved excessive.