A change of the highest consequence is taking place in the attitude of the trade unions in overseas countries toward the question of productive efficiency. The beginnings of this change—insofar as it applies to the trade unions in Britain*—were noted and commented upon in these columns over twelve months ago. Since that time a great deal of additional evidence has come to hand of the strong momentum which this movement is gathering, not only in Britain but in the countries throughout Western Europe.

That this revolution—for it is nothing less than that—in trade union philosophy will eventually have its impact on Australian trade unionism is certain; but what is important from the point of view of the trade unions themselves as well as of the Australian community is that the impact should come sooner rather than later, that the trade unions here should make it their business to keep abreast of and not lag behind the major new development in ideas and policy taking place among their overseas counterparts.

What is the nature of this movement and why is it occurring?

* See article "Triumph or Disaster" in January/February, 1949 "Review."
A PRIME OBJECTIVE

It is simply that the trade unions are now beginning to make increased production and the raising of standards of industrial efficiency the prime objective of their activities. This represents a fundamental break away from deeply ingrained trade union notions and traditional conceptions of trade union policy.

From their beginnings the unions have directed the major part of their energies to obtaining for their members a larger share of what is produced. Only in a secondary and minor sense have they been concerned with enlarging the amount of wealth available for distribution, and many of their activities have in fact militated against the achievement of the highest levels of production. But a new and momentous change in the trade union attitude to production is occurring. It is excellently, and rather dramatically, summed up in the opening paragraphs of a report by a team of British trade unionists who visited the United States late last year to investigate the role of American unions in increasing productivity.

"British trade unionism, to repeat what almost amounts nowadays to a platitude is standing on the threshold of a new social, economic and industrial order—a situation which has been created in part by the trade unions themselves. The way has been long and arduous but "mass" and "hard core" unemployment and social insecurity, characteristics of social injustice, have, we hope, disappeared for good. But what lies beyond this threshold of Labour Movement achievement? . . . By and large the answer has been found. It is to seek a rising standard of life for all, achieved through increasing industrial productivity or output per manhour. This then is the real problem confronting trade unions: to find ways and means of increasing productivity—a problem concerned mainly with industrial policy and action as distinct from the political pressure to achieve full employment and economic stability."

*The italics in this quotation are ours.
WHY THE CHANGE?

To what is this change of attitude to be attributed? Basically to the fact that the scope for improving the workers’ standards of living through further division of the existing fruits of production is now so confined as to be almost nonexistent. The weight of inescapable economic fact, driven home by economists, statisticians and even by labour politicians, seems to have convinced the unions—or at least their leaders—that there is now no prospect of raising living standards through a further sharing-up of available wealth. The lemon has just about been sucked dry. Therefore, progress to a better standard of life for the mass of the people depends now on higher and more efficient production. The hard ultimate logic of economics can no longer be escaped.

There are other reasons. In the past one of the great obstacles to positive action by the unions to promote production has been the fear of unemployment and of the worker “working himself out of a job.” This fear was particularly potent in the thirties as a consequence of the Great Depression; and while no one would pretend that it has completely vanished, it has undoubtedly been rendered much weaker by the continuation of full employment in most countries since the end of the war, and by the far-reaching steps that have been taken in recent years to provide greater economic security for the masses of the people. Finally—and this is especially evident in Western Europe—there is the effect of the economic conditions left by the war. To the peoples of the old world, the economic aftermath of the war has brought home how much their economic welfare depends upon their ability to produce and export a sufficient volume of goods at competitive prices to pay for the imports essential to their standards of life and the maintenance of employment. These countries have been forced to consider every possible means of expanding the production of their industries. This was, in the first place, a matter of sheer economic survival, but it is now
being widely realised that the best insurance against unemployment in the future is the achievement of a higher standard of productive efficiency in the present.

Thus, in his report for 1950, the Director-General of the International Labour Office, was led to say: “In these circumstances, a trend of the greatest significance can be discerned in a number of countries . . . . a tendency can be observed for the attitude of cautious reserve often adopted by trade unions in the past towards measures to increase the productivity of labour to give way to a new attitude of positive and vigorous support for and co-operation in such measures . . .”

THE EVIDENCE

Where is the evidence of this tendency?

In the United Kingdom, the Trades Union Congress has set up a special Production Committee and has given a strong lead to its member unions in support of the Government's policy of increasing production. In its 1949 Report the Congress stated: “The Trade Union Movement is participating in, and has everything to gain from encouraging, a national drive to increase industrial efficiency and production.” The trade unions are represented on the National Production Advisory Council on Industry, the Committee on Industrial Productivity, and the Anglo-American Council on Productivity. The General Council of the T.U.C. recommended recently that a review should be undertaken within each industry with a view to extending systems of payments by results over the widest possible range. Finally, there is the important report of the team of British trade union officials who visited the United States last year.*

In Sweden, an agreement concluded between the central organisations of employers and workers provides for the establishment of joint committees for the different sections of industry to undertake time and motion studies. The unions in

* This report is of such unique importance that we have included a summary of its main findings as an appendix to this article. See Page 129.
Sweden have also taken the unprecedented course of insisting on the provision of fiscal incentives for industry to plough back its profits into improved equipment. They argued that in this way industry could be made more efficient, and that if improved efficiency resulted in higher profits they would see that their members got their fair share. The unions also supported the widespread application of piece-work, which now applies to more than half of all Swedish industry.

In Denmark, in December, 1949, the Government appointed a Joint Production Committee with the purpose of promoting industrial efficiency.

In the countries behind "the iron curtain" it is recognised that the central task of the trade unions is to find ways of increasing production. In these countries, notably in Bulgaria, Czechoslovakia, Hungary and in Poland, systems of payments by results are becoming almost universal.*

Here, then, is a convincing weight of evidence of the remarkable change taking place in the traditional attitude of the trade unions toward production.

TRADE UNIONS IN THE U.S.

In the United States, no such positive changes are to be discerned, primarily because trade union policy in that country has, broadly speaking, always been based on the central idea that improvement in the workers' standards can come only from improvements in productivity. Committee after committee, representing British industries, which have visited the United States in recent years under the sponsorship of the Anglo-American Council on Productivity, have commented on the universal acceptance of productivity as the essential driving force in American industrial life, and on the extent to which this acceptance permeates the approach of workers as well as of employers and managers. In America, as the Report of the team of British unionists makes clear, the trade

unions do not resist the introduction of new and better machinery and mechanical aids to production; on the contrary they welcome, and indeed demand, the application of the most modern and efficient methods. Where the standards of efficiency of a particular company are lagging behind those of other companies in the same field, the unions themselves insist on the management taking steps to raise efficiency. American unions do not object to time studies, but through their own trained officials reserve the right to check the findings of managements. American unions accept the competitive economic system because they regard competition as the best means of ensuring high standards of efficiency and a rapid pace of industrial progress from which they can benefit.

As a result of its experiences in the United States, the team of British trade unionists has made a number of recommendations to fit the unions for their new role of positive participation in the improvement of industrial efficiency. Among the most important are that the unions should establish production engineering departments and train production engineers to protect and further the interests of their members; that they should seek to increase productive efficiency by a greater use of mechanical aids and by the application of time and motion studies; and that they should cease opposition to the introduction of modern machinery and methods, and fit themselves to give technical assistance to firms whose profit margins are falling so as to threaten wage rates and employment. We have already noted the support given by the Trades Union Congress to the widest practicable application of wage arrangements based on payment by results.

EFFECT ON AUSTRALIA

What effect is all this having on the attitude and policy of the trade union movement in Australia? Are the trade unions in this country preparing to adjust their ideas and policies to the new economic and social conditions of the middle
twentieth century, or do they intend to persist with a philosophy which has been rendered irrelevant and obstructive by the passage of time? Are they preparing to address themselves positively and conscientiously to the great task of raising productive efficiency and speeding up economic progress? Or are they determined on continuing to devote their main energies to the objective of economic security—a goal already largely achieved—or to further raising money wages and shortening hours of work—objectives which, even if gained, can now make no worthwhile contribution to improving the standards of life of their members? Are they, in other words, ready to fall into step with their counterparts in other countries, or are they going to allow themselves to drag ignominiously behind in the great forward march taking place?

There is only one answer to these questions which should be made by the trade unions, whether they look at the matter from the standpoint of the interests of their own members or of the wider community of which they are part.

It is most vital that the A.C.T.U. should now be preparing to give a lead to its affiliated unions such as that being given by the Trades Union Congress in Great Britain. The A.C.T.U. might well set up a special committee to study the ways in which the trade union movement can contribute to greater production and higher efficiency. It could organise a campaign of education to urge upon its member unions the need for supporting all reasonable measures to improve efficiency. It might follow the example of the Trades Union Congress in Britain and the trade unions in other countries by reversing its long-standing attitude to incentive payments and supporting the widest effective adoption of wage arrangements based on payment by results. A more positive approach to the introduction and use of labour-saving devices, and to all unjustifiable union practices which restrict production, is also required. The attitude, frequently expressed in recent years, that productive efficiency is solely the task of manage-
ment and one with which the trade unions have little or no concern is no longer tenable. The opportunity is now here and circumstances are now ripe for the unions to play a courageous and constructive role in the great task of raising production and building a new standard of life for their members.

AN UNEQUIVOCAL STATEMENT REQUIRED

An unequivocal statement of its attitude to production, in the light of what is occurring abroad, is now the clear responsibility of the trade union movement in this country.

In saying this, we do not wish to pretend that the main responsibility for advancing the efficiency of Australian industries does not still rest with management and employers. That must, in the nature of things industrial, always be so. Nor is it suggested that employers and management are, without exception, as conscientious and effective as they might be in the discharge of this duty, and that there is no room for improvement in managerial methods. But when this is conceded, it still remains true that the trade unions have now a magnificent opportunity, and a great responsibility, for doing everything they reasonably can to assist, and even to inspire, management to carry out its task with the maximum of efficiency.

If they fail to rise to the occasion they will be letting not only themselves down, but the nation as well.

★ ★ ★
The Report of a Team of British Trade Union Officials Who Investigated the Role of Unions in Increasing Productivity in the United States of America

On 21st July this year, a report which marked a milestone in British trade union history emerged from the headquarters of the Trades Union Congress. It represented the findings of a team of trade union officials sent to the United States to study the part played by American trade unions in achieving and maintaining a high rate of industrial productivity, and to consider whether a similar role might be undertaken by British trade unions in an effort to raise British productivity. The delegation studied at first hand the reasons for the American predominance in production and it pulls no punches when telling the story to fellow trade unionists. No issues are dodged because of their political implications and unpalatable truths are frankly recognised.

In view of the unique nature and significance of this report we have reproduced here certain extracts by kind permission of the British Trades Union Congress.

AMERICAN UNIONS AND PRODUCTIVITY.

Competitive Economic System.
1. Americans accept the competitive economic system—it ensures a high rate of economic expansion and a high standard of living. Unions rely on competition to increase purchasing power by keeping consumer prices down, but oppose attempts to promote competitive efficiency at the expense of wage rates.

2. The attitude of American trade unions to company profits is typical of their acceptance of a capitalist economy. High profits, at least in competitive industries, are not regarded as immoral or a social evil; indeed they give proof of solvency and assured employment. Usually high profits are considered a sign of efficiency and relatively high output per manhour. The unions have tended to regard comment on employers’ profits as outside their province and have campaigned against them only when feeling they were not getting a fair share.

3. So long as American capitalism continues to “deliver the goods” in the form of a rising standard of living—and American trade unions believe in results rather than theories—there is little possibility of the idea of a carefully defined programme of social and economic planning gaining many adherents.

4. Nevertheless, it is doubtful if competition would be accepted without question in all circumstances as the answer to every social and industrial problem. The assistance given to agriculture, for instance, is recognition of the value of government intervention. Also a re-emerg-
ene of mass unemployment or a falling standard of living would stimulate a trade union demand for remedial measures by the government, perhaps on the lines of the Tennessee Valley scheme.

**Management and Productivity.**

5. Competition forces management to set the pace of productivity and less efficient concerns are spurred on by the trade unions. Unions drive the best bargain they can with the most efficient and profitable company in an industry and then bargain with other companies to obtain similar wage or piece rates. By helping to improve average industrial efficiency, unions are assured of correspondingly higher wage rates and earnings.

6. Although trade unions on the whole rely on management to increase productivity, a number of unions have already gone some considerable way towards acquiring the facilities for co-operating fully in many phases of managerial functions. Production engineers are employed and management engineering departments established to obtain experience in time studies and other “scientific” management techniques, and to train union officials to deal satisfactorily with production problems on the shop floor.

7. If a company protests that it cannot meet a wage claim, unions will point out that better production methods would enable them to reduce costs sufficiently to pay the claim. In this way unions disseminate production “know how.” From information and experiences gained in previous negotiations, they can suggest methods and machinery used by the highly efficient companies to improve efficiency in a plant. The pressure exerted by unions in this fashion can be much more effective than the information gained by management from their technical associations and trade journals.

**Mechanization.**

8. Except in a few very isolated cases there was nothing to suggest that Americans work harder than their opposite numbers in Britain. It was apparent, as has been stressed by previous British productivity teams, that owing to the greater use of machinery, mechanical handling and lifting equipment, and various other factors, the American operatives’ work is more effective.

9. The attitude of union leaders to the introduction of new machinery and labour-saving methods indicates an appreciation of the social advantages of a dynamic industrial pattern. Whilst the idea of security of employment at all costs is not unknown, the absence of any serious opposition to labour-saving machinery is undoubtedly a major contribution, if only a passive one, to increasing productivity. The pride of operatives in using modern machinery was very noticeable in all the factories visited. The maintenance of this attitude is dependent upon an ever-expanding economy, i.e., that redundant operatives will be reabsorbed in another part of the plant or will soon get a job elsewhere as new production is created to meet new demands.

10. Individual fear of redundancy arising out of the introduction of new machinery is frequently offset by a generally established rule of seniority—“last in first out.” This suggests that the high rate of American productivity is not attributable to fear of unemployment. The seniority rule may penalize young and able work people, but it limits nepotism and favouritism and ensures employment for operatives who might have difficulties getting jobs elsewhere owing to their age.

**Recommendations to British Trade Unions.**

11. The need in industry for decisive trade union action in which unions must
accept their responsibilities as well as claim their rights is perfectly clear. A rising standard of living can only be obtained from labour-saving machinery and technical processes and working skill. As trade unions want the standard of living to rise continually they cannot justify opposition to the installation of new or modernised machinery.

12. Where managements are progressive and seeking to use "scientific management" techniques in a reasonable manner to step up production, unions should be prepared to co-operate. Where managements are not sufficiently enterprising and progressive, are unwilling to step up efficiency or extend markets through lower prices, then unions must press them to do so. Union members must recognise that the use of "scientific management" techniques, however unscientific, is inevitable and necessary in industry today, and that determination to prevent abuses and where possible control "scientific management" is a necessary function of modern trade unionism.

13. A wage policy in which earnings are related to output and factory efficiency is the most obvious one for unions to pursue.

14. Considerable emphasis is placed on the need to encourage labour mobility and flexibility—it is becoming increasingly recognised that full employment means that there are more jobs than workers, rather than providing the redundant with jobs at the same locality.
The intention of the Attlee Government to proceed with the nationalisation of the British Steel Industry makes this analysis of Socialism timely and important.

SOCIALIST ECONOMICS

There is so much confusion in the public mind—and not least in the minds of socialist supporters themselves—about the central meaning and ultimate objective of socialism, that any new exposition of socialist doctrine, which contributes something to clarification, is to be welcomed. The latest essay in this direction is a small book, "Socialist Economics," whose author, G. D. H. Cole, is probably entitled to the ranking of No. 1 among top socialist writers. "Socialist Economics" was written in response to a special request of the Fabian Society, and in view of this and of the almost unrivalled position of the author in the intellectual side of the socialist movement, it may be taken as a uniquely authoritative exposition of what socialism means.

G. D. H. Cole, at present Professor of Social and Political Theory at Oxford University, was only 17 years of age when he joined the Labour Party. In 1918, when still under thirty, he became the chief research officer of the party and, on many occasions, he served British Labour Governments in an advisory capacity. He was foundation secretary of the Fabian Research Bureau and from 1939 to 1946 chairman of the Fabian Society. Professor Cole is an extraordinarily prolific writer on socialism and on the history and problems of the labour movement.

There has been a tendency in recent months for many socialists to suggest that socialism means little more than the nationalisation of a few large private monopolies plus a mild and gradual expansion of social services.* Whether this tendency signifies a sincere change of heart, or a shrewd trimming of the sails to the prevailing winds of public opinion (with the hope that the winds will become more favourable later on) is question for debate. However, the impression thus conveyed certainly does not accord with the traditional explanations of socialism—differ in details though they do—offered in the main socialist texts; and it is far removed indeed from the interpretation of socialism given in G. D. H. Cole's important book.

Free Enterprise—Three Basic Features.

To appreciate what socialism (as described in Professor Cole's book) would involve, it is of help to recall the essential features of the system of private enterprise which still largely prevails in the democratic English-speaking nations. There are three:

First, the production of goods and services is predominantly organised and carried out by people acting in a private capacity and not by governments or their agents;

second, the mechanism of prices and costs by which producer and producer, and producer and consumer are brought together is predominantly free, and not directly determined and controlled by governments; third, the distribution of production among the members of the community is based predominantly on the contribution of the individual rather than upon his need.

These three features are, of course, subject to important qualifications. Thus, while the great part of production is left to individuals acting in a private capacity, a not insignificant part is carried out directly by the state; while the price and cost market is predominantly free, important sections are directly or indirectly controlled by governments;

*Something like this impression is conveyed in Bertrand Russell's article in "The Argus" of the 2nd August, 1950.
while the share of the individual in the national product is determined in the main by his contribution, the state through steeply progressive taxation and large-scale social services makes a strong and necessary concession to need.

Socialism and Production.

In the socialist system of G. D. H. Cole all this is to undergo a revolutionary transformation. The state itself is to become the main producer, and the field of production left to private enterprise is to be subject to strict control. "The State must itself become an investor, and therewith an owner of capital assets: not necessarily, the sole owner, but an investor and owner on a considerable scale, not only in a limited group of 'public service' industries, but over a wide field, covering every major type of capital development"; and: "The Keynesian apparatus for maintaining economic equilibrium at a high level will not work unless the state . . . owns and controls a large part of the apparatus of production . . . 'The public sector' of industry must be large enough to set the tone for the rest, leaving private industry to operate within a framework of public enterprise rather than the other way around." This hardly accords with the conception—in fact it is a direct refutation of it—of socialism as the nationalisation of a few large monopolies. Moreover, even the attenuated "private sector" remaining is no longer to be free enterprise in the sense that those who direct it will be able to use their own discretion and judgment in directing their businesses. "If a private business seeks to expand, except at a modest rate, it will have to secure the approval of the planning authorities." Profits are to be strictly controlled through price regulation and taxation.

Socialism and the Market.

So much for socialism and production! What of socialism and the market mechanism?

The free market will be abolished and the whole price system will be regulated by the state. Price fixing, according to Professor Cole, will not be done on any arbitrary basis, but will be related to costs of production. If prices were fixed arbitrarily, says the author, there could be no real freedom of choice for the consumer, for the government and not the people would, in that case, determine the pattern of consumption and thus production. Professor Cole places great emphasis on the need for preserving the right of the consumer to decide for himself what he wants. Thus he attempts to answer one of the main criticisms of his opponents, namely, that under socialism the planners will in effect tell the people what they should have. "The planners' task in relation to production will be to ensure that, as far as possible, the pattern of supply corresponds to the consumers' willingness to pay." The planners, just as businessmen do, will attempt to estimate demand and adjust their production programmes to it.

The state, then, will on the one hand be constantly striving to estimate the demands of consumer, and on the other will fix the prices at which goods are sold, not arbitrarily, but on costs of production. But how will costs of production be determined? By the state, of course! The incomes going to all sections of the community and payable for the use of all factors of production will be fixed by the planners—wages, salaries, professional fees, rent, interest and profit. (All land, incidentally, will be nationalised and the state will determine the rents to be paid for its use.)

Here the author is involved in a peculiar contradiction; for while he denies that prices will be fixed arbitrarily, he admits that costs of production, to which prices will be hitched, will themselves, of necessity, be determined more or less arbitrarily. "These payments (i.e., for the factors of production—land, labour,
capital, etc.) will be in a sense arbitrary, in that the planning authorities will be regulating them in order to promote ends which are regarded as socially desirable, and will not be merely following, in a neutral spirit the dictates of any set of supposed economic laws."

"The price system of a socialist economy will rest . . . on a structure of costs embodying socially determined valuations of the rewards due to the various producers. . . . The making of these valuations will be a task of social judgment." "Social desirability," "social determinations," "social judgment!"—what do these abstractions mean, and what practical help can they be expected to afford in determining the structure of income payments, costs and prices? One man's view of what is "socially desirable" will differ from the next; in fact the wide disparity of views which exist on this question is at the very root of the political differences and of political party divisions in the modern democracies. Indeed, it is safe to say that no two groups of people would think exactly alike on this question—the palpable differences among socialist thinkers themselves are sufficient evidence of that.

Despite Professor Cole's concern for avoiding arbitrary judgments and for preserving the personal choices and preferences of the consumer, the whole structure of incomes, costs and prices becomes, in practice, dependent on the subjective whims, prejudices and beliefs of a few planners, and not on countless transactions made in the light of the hard objective standards imposed by the market. Let us take a simple example! A businessman employs two men for administrative work, one of whom he agrees to pay £2,000 a year, the other £1,000. He arrives at this decision on the basis of what he considers the two men are worth to his business, that is on what the business can afford to pay. This is in turn broadly determined by the market prospects of his products. It is true that in making his decision he has in mind the salaries generally paid in other businesses for the type of work he expects the men to do, but in the last analysis the broad limit of what it is economical for a business to pay for this class of work is set by the market, that is by the consumer. How would these salaries be determined in a socialist society? According to G. D. H. Cole they would be set by the planners, not upon the ultimate criterion of the market at all, but on "social desirability" and by "social judgment"—whatever these abstractions may mean. In actuality the decisions would depend inevitably on the personal ideas and views of the planners unhampered by any economic considerations of the market.

Socialism and the Distribution of Income.

What of the distribution of income? Since the state would be fixing broadly the payments made to all those contributing to production, it will in effect be determining directly and precisely how the total national income is to be distributed. On what broad principle will these determinations be made? On the principle of the nearest practicable approach to equality! The author makes a reluctant concession to the need of incentives, but in numerous sentences he reveals his strong pre-disposition toward equal incomes for all, regardless of the quantity or quality of the contribution made by the participants. Deviations from equality, he says, require particular justification on grounds either of need or of social utility. There is no mention of contribution. "I have made it clear . . . that I know of no magic formula whereby fairness in these matters can be measured, except that there is always a strong presumption in favour of the nearest approach to sheer equality that is compatible with high output and public sentiment."
What is the picture of socialism which emerges from all this?

It is a picture, surely, of the complete and unqualified regimentation of the entire economic and social life of the community by government planners. A large part—obviously G. D. H. Cole considers the great part—of production would be directly owned and run by the state. That section remaining to private individuals would be subject in every phase of its activities—investment, costs, prices, profits, location—to minute control by government officials. All incomes would be fixed within rigid limits by the planners. There would be no nook or cranny of the economic and social mechanism into which the state would not poke its inquisitive nose and stretch its interfering hand. Every major decision of economic and industrial policy would be taken by government officials, and while, in theory, it would be open to the private citizen or private organisation to influence those decisions, what real weight would they carry where the balance of power and authority was so heavily loaded against them. It is a picture of what G. D. H. Cole in one of his earlier writings has described, and incidentally condemned, as "the omnicompetent, omnivorous, omniscient, and omnipresent state."

A Question of Power.

If it were possible to find a sufficient supply of planners gifted with superhuman intelligence, benevolence and wisdom such a system might be made to work. Even then it is highly questionable whether it would be a desirable system; for what scope or encouragement could there be for the individual person to work out his own destiny and to shape the course of his own career, where practically every significant decision he might wish to take on his own behalf would be subject to the approval (or disapproval) of a state official?

Democracy, it is well to remember, is in the last analysis a question of power, and every great movement toward democracy has been one of curbing the arbitrary and overweening powers either of the state itself or of private individuals or groups, and to widen the scope of individual choice and decision, and thus of individual freedom. Socialists, themselves, notably Bertrand Russell, have appreciated this, but they do not seem to appreciate the consequences to which their proposals would lead.* The socialism of Professor Cole would clearly entail a grand centralisation of power in the hands of the state, and a corresponding curtailment of the power of the individual citizen. The question of whether, in an economic sense, socialism would be efficient or inefficient is of relatively minor importance beside the supreme question of its consequences to political and personal freedom.

Let us try to bring this down to earth by a few practical examples. Where there are many private employers to choose between, one can disagree or fall out with one's employer without necessarily jeopardising one's whole career; but could any individual afford to disagree with the state, where the state was very nearly the one big employer? One can argue about one's salary or conditions of employment with the private employer, but it might not be so easy, or indeed so wise, to argue with the state. Could any private businessman afford to fall out with the state, where overriding economic power was in the hands of the state, and where, with a stroke of the pen, a government official could injure or cut off the source of his livelihood? One can have a difference with one's bank manager when there are other banks a few doors down the street eager for custom; but

*"The aim of democracy is to secure as nearly as possible an even distribution of ultimate power." (Bertrand Russell in article in "The Argus," 2nd August, 1950.)
if one wants good treatment from the one socialist bank, it might be discreet to watch your step. The consumer can refuse to take the products or accept the prices of a business where there are alternative sources of supply; but how could he refuse the products of the state, or argue about their prices, when there are no alternative sources of supply available? How could the trade unions exert any real influence on conditions of employment or the level of wages when the state was the main employer, and when any alteration of wages might seriously upset the balance of the economic plan devised, after such infinite labours, by the state planners?

It is only because there are alternative ways of doing what one wants under free enterprise—even though they may be limited—that we have avoided building a race of obsequious "yes men." But cut off those alternatives and we might soon find that the moral fibre of the people was in danger of serious degeneration.

Efficiency.

And, quite apart from its effects on political freedom and personal character, there still remains the great question of the efficiency of the socialist system. As a basic principle of socialism, Professor Cole calls for the establishment of a minimum living income for every person—a principle with which most non-socialists would agree and one which is being given increasing recognition in all the democracies today. But he then makes the significant admission that "the level of minimum income a society can afford depends on its total productivity." It follows that a large part of the case for socialism must rest on whether it will prove to be more efficient and productive than an economic system based preponderantly on free private enterprise.

If experience had any say in this matter then the case against socialism and for private enterprise would seem to have been established beyond all dispute by the United States, which, by general consent, is the most productive society the world has known. And as one eminent economist in Britain, Lionel Robbins, said: "I confess I find it more than a little paradoxical that at the present day we are continually told that in order to obtain American standards of efficiency we must go over to wholesale collectivism." But experience seems to weigh little with the socialists and their whole case for efficiency under socialism is largely drawn from abstract reasoning conducted in the seclusion of ivory towers rather than from the hard facts of observed experience.

A great part of Professor Cole's argument for socialism derives from his repeated claim that socialism will more fully satisfy the demands of the consumer than the present system does. He says, for instance: "The aim of the planners will be to respond to the consumers' demands by taking every opportunity to increase the efficiency and thus lower the unit costs of production." This is, of course, nothing more than pure assertion of what he hopes the planners will do, or perhaps what he himself would do if he were a planner. But why will the planners be alert "to take every opportunity" to increase efficiency? Where is the kick if they fail or neglect to avail themselves of the opportunities? Because all production is fixed according to an overall plan there is no real competition, either direct, or, indeed, indirect by way of substitutes. And there is no immediate compulsion on the planners to drive for efficiency. They can't be put out of business because of inefficiency. Moreover, if they are efficient, how do they stand to gain in a personal sense? In a society in which there is so strong a predisposition toward equality of incomes, where will there be the incentive to strive for greater efficiency? Admittedly Professor Cole concedes the need for adequate—
but not more than adequate—incentives. But what are adequate incentives? If the top planners err on the side of "inadequacy," then presumably the production managers will lapse into inefficiency.

And what is to be the test of efficiency where the state runs production? The test of efficiency in private enterprise is the ability to make a profit—or to avoid a loss—in competition with other producers. This is a compelling one; and, although by no means fully operative in private enterprise, it does prevail over a large section of business. In the small private business, failure to make a profit may not only endanger the business and savings of the proprietors, but their very livelihood. In the large public company the very suspicion of failure will lead to unsettling post-mortems between the managers and the Board of Directors and the Board of Directors and the shareholders. The socialists have not yet shown, and Professor Cole does not show, what is to substitute for these compulsions and incentives.

Professor Cole argues the case for efficiency under socialism from a further standpoint. He claims that the planners will be less likely to misjudge demand than the private business, because in planning production they will be more fully informed of what is going on in other parts of the economy. But is it not likely that the planners will be somewhat more careless, somewhat less meticulous, in their attempts to estimate demand than the private businessman, where a miscalculation can have dire consequences for his business? There is no compulsion on the planners to be correct in their predictions. If they make an error of judgment, where is the penalty? They are hardly likely to lose their jobs or even to lose money. Mr. Strachey still flourishes as a senior Cabinet Minister in the British Government despite the colossal fiasco of the African groundnuts scheme. But when Charles Luckman, appointed President of the American branch of the great British combine of Lever & Unilever Ltd. in 1946, turned a profit into a loss, he found himself on the labour market. As Professor Cole himself says: "If the planners mistakenly expect an expanding demand which does not accrue even at a reduced price, that is just too bad."*

Responsibility for Mistakes.

Moreover, even if penalties could be imposed, how would the responsibility for mistakes be nailed at the right door? It is notoriously easy "to pass the buck" in government departments, but no amount of "passing the buck" in a private business will serve to turn a loss, due to a miscalculation, into a profit. A business loss is its own penalty. The stick is never far away from the businessman's back and, generally speaking, it induces a wariness, an intentness, and a driving energy on his part far greater than can humanly be expected of a government official working under entirely different conditions.

A Race of Supermen.

Professor Cole asks a great deal of his planners. They are to decide what is to be produced in what quantities after, of course, having ascertained what the public wants—by no means an easy task when you come to consider the myriad different products and the vast number of variations of the same product which are bought by the consumer; they are to decide directly what proportion of the national production is to be devoted to investment or capital goods, and what proportion to consumption goods (itself, it may be noted, a serious infringement of the consumers' freedom of choice); they are to fix prices throughout the market; they are to decide how much each contributor to production is to be

*The italics are ours.
paid in accordance with "notions of social justice and expediency" (whose notions; and what proportion of "justice" and what proportion of "expediency")? To quote Professor Cole: "They will be asking themselves, wherever the need for judgment arises, what the consequences of acting in this or that way are likely to be, and adopting the solution which, in all the circumstances, seems best calculated to promote the general welfare . . . they will be responding to as well as moulding a structure of actual and prospective consumers' demand which it will be their principal function to satisfy as fully as the available resources allow. But they will have to do their own weighing of claim against claim, and of future needs against present demands. They will not be in a position to disregard the need of incentives in order to press the claims of equality to the limit, or to ignore the state of opinion about the standards of income appropriate to different callings; but it will be their function, in the light of commonsense and democratic intention, to weigh these considerations in the balance and to propose accommodations between conflicting objectives and attitudes."

One might comment that a great deal more than commonsense and good intentions will be needed. The planners who are to carry out this gigantic assignment effectively will need knowledge and comprehension far above those allotted to the common run of men. They will need, indeed, to be a race of supermen.

Perhaps even Professor Cole is appalled by what he is asking his planners to do; perhaps he has a lingering doubt himself whether it is not just a little too much, for in one place he writes: "In all the foregoing I have of course had in mind not some board of supermen entitled to impose their judgment on society . . . ."

Professor Cole's conception of the fully functioning socialist society is sheer economic fantasy. But to argue a case against socialism is not, it should be remembered, to establish the perfection of the present economic system. The existing system has to its credit great practical achievements, and many good features which we should, at all costs, preserve. It possesses on the other hand, as any unbiased observer will concede, some features capable of improvement. The task of correcting these faults is one that should be pursued vigorously and unremittingly—for this is the surest form of protection that can be taken against the establishment of the ultimate futility and calamity of the socialist state.
AUSTRALIA AND THE
"DOLLAR GAP"

The negotiations successfully concluded by the Prime Minister for a loan of $100m. from the International Bank for Reconstruction and Development have been widely applauded. The loan, together with the prospect of a further $150m. within the near future, will enable Australia to obtain vital equipment—especially for large-scale developmental and industrial projects—which is at present unobtainable from the soft currency areas. The dollar loan can therefore be justified as an important step toward developing Australia's productive capacity and thus assisting the economic absorption of the great flow of migrants. It has also been claimed that the loan will help to counter inflation, but its immediate influence in this direction is likely to be insignificant.

Interest and capital repayments on the loan, which will commence in 1956, will amount in the first instance to $7,356,000 a year. This amount will, of course, substantially increase if the expected additional loan of $150m. eventuates, and we must anticipate that the burden of servicing the newly acquired dollar debt will in due course be of the order of $15m. to $20m. a year.

This is by no means a negligible amount; it would represent about 15% of Australia's total dollar exports on the basis of the average of the last three financial years. The task of repayment will, however, be greatly simplified if by 1956 the sterling-dollar gap has been bridged and sterling is again freely convertible into dollars—assuming, of course, that world demand for Australian exports is well maintained. In that event Australia would be able to finance repayment of the loan out of its earnings of sterling.

Australia has always been a large debtor on dollar account, but before the war we were generally able to buy our full dollar requirements by using our earnings of sterling to cover the deficit on direct dollar trading. Notwithstanding the dollar loan we will be compelled to continue restrictions on dollar purchases until multilateral trade has been restored and sterling is again a freely convertible currency. The solution of the Australian dollar problem and the removal of restrictions on dollar imports therefore depend entirely on the solution of the dollar shortage of the whole sterling area.

It is therefore of some interest, in connection with the dollar loan, to examine the Australian balance of payments with the dollar countries and the relationship of our own dollar problem to that of the world dollar shortage.

* * * * *

For the three pre-war years, 1936/7 to 1938/9, Australia had an adverse balance of commodity trade (excluding gold) with the U.S.A. and Canada amounting on average to $70m. a year. This, together with dollar expenditure on "invisible" items such as freight, insurance, tourist expenditure, film remittances, dividend and interest payments, entailed a total dollar deficit of the order of $120m. The size of this deficit did not matter very much for under the pre-war system of multilateral trading our main concern was not to balance our account with each individual country, but to achieve an overall balance. So long as sterling was freely convertible into dollars there was virtually no dollar problem as far as Australia was concerned;
but with a serious deterioration in the ability of the sterling area to meet its dollar commitments during the war and postwar period all this has been changed.

The free exchange of sterling for dollars has been suspended—except for a temporary relaxation in 1947 to meet the terms imposed by the American loan to the United Kingdom. This action resulted in a tremendous drain on the dollar reserves of the sterling area, and very severe economies were re-imposed in all sterling countries. Australia was forced to introduce extensive restrictions on dollar purchases—petrol, newsprint, motor chassis, cotton and textiles—which aimed at cutting our total dollar imports by 20%. Restrictions were also imposed on items such as films and travel and special efforts were made to boost our exports to the dollar areas. With the sharp drop in the dollar reserves of the sterling area in 1949, further heavy economies were made at the time of devaluation.

The success of this policy can be gauged from the following table:

<table>
<thead>
<tr>
<th></th>
<th>U.S. $ million</th>
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<tbody>
<tr>
<td></td>
<td>1946/47</td>
</tr>
<tr>
<td>Freight on imports</td>
<td>-35.4</td>
</tr>
<tr>
<td>Insurance on imports</td>
<td>-2.5</td>
</tr>
<tr>
<td>Expenditure by Australian travellers</td>
<td>-4.8</td>
</tr>
<tr>
<td>Expenses of Australian companies in N. America</td>
<td>-1.2</td>
</tr>
<tr>
<td>Film remittances</td>
<td>-6.6</td>
</tr>
<tr>
<td>Profits and dividends remitted</td>
<td>-7.4</td>
</tr>
<tr>
<td>Undistributed income accruing to North American companies</td>
<td>(a)</td>
</tr>
<tr>
<td>Public authority interest payments</td>
<td>-10.7</td>
</tr>
<tr>
<td>Lend-lease settlement and purchase of U.S. surpluses</td>
<td>-20.0</td>
</tr>
<tr>
<td>Other miscellaneous debits</td>
<td>-20.6</td>
</tr>
<tr>
<td>Miscellaneous credits</td>
<td>34.7</td>
</tr>
<tr>
<td>Invisible balance with the Dollar Area</td>
<td>-75</td>
</tr>
<tr>
<td>Trade Balance with the Dollar Area</td>
<td>-15</td>
</tr>
<tr>
<td>BALANCE ON CURRENT ACCOUNT</td>
<td>-90</td>
</tr>
<tr>
<td>CAPITAL ACCOUNT</td>
<td></td>
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<tr>
<td>Increase in debt of public authorities</td>
<td>-1</td>
</tr>
<tr>
<td>Identified private capital inflow (including undistributed income)</td>
<td>(a)</td>
</tr>
<tr>
<td>Errors &amp; omissions (mainly capital movements)</td>
<td>35(a)</td>
</tr>
<tr>
<td>BALANCE ON CAPITAL ACCOUNT</td>
<td>34</td>
</tr>
<tr>
<td>EXCESS OF DOLLAR DEBITS OVER DOLLAR CREDITS</td>
<td>-56</td>
</tr>
<tr>
<td>DOLLAR FINANCING</td>
<td></td>
</tr>
<tr>
<td>Gold Sales to United Kingdom</td>
<td>-30</td>
</tr>
<tr>
<td>Estimated dollar drawings from Sterling Area Dollar Pool</td>
<td>54</td>
</tr>
<tr>
<td>Decline in dollar balances</td>
<td>2</td>
</tr>
<tr>
<td>TOTAL</td>
<td>56</td>
</tr>
</tbody>
</table>

(a) No estimate is available for identified private capital inflow in 1946/47. Undistributed income is excluded from both current and capital account and other private capital inflow is included in the item Errors and Omissions.

It is anticipated that the invisible balance on current account for 1949/50 will be within $5-10m. of that for 1948/9. On capital account two local government loans amounting to $9m. were repaid in 1949/50, but no information is yet available regarding private capital movements.
As Australia sold about the same amount of gold to the United Kingdom as in 1948/9 and drew $20m. from the International Monetary Fund, the movement in our dollar balance was again negligible. The great proportion of our current earnings of dollars are derived from exports of wool, other primary products and metals. Out of £59m. (Aust.) received from exports to Canada and United States in 1949/50, wool contributed £45m. Other exports include dried fruits £2m. and raw sugar £1m. to Canada; and sheep skins £2m., rabbit skins £1½m., pearl shell £4m., pig lead £1m., ores and concentrates £1½m. to the United States. Australia also exported £1½m. worth of foodstuffs to Canada and the United States, consisting mainly of sausage casings, frozen rabbits and lobster tails.

Although Australia's adverse balance of trade with the dollar area has been brought back to fairly manageable proportions through import economies we still have a large expenditure on non-trade items and, on present indications, can seldom expect to balance our account with North America out of our own resources. We will still depend on the account being balanced by the sterling area as a whole and the correction of the chronic world dollar shortage.

**World Dollar Shortage.**

Why has the world been so short of dollars?

There are several reasons, all arising directly from the war itself. The ability of the European countries to produce goods for export was disastrously impaired by the large-scale destruction of their productive capacity during the war. Great plants were wiped out, transport systems destroyed and dislocated, shipping and docking facilities severely damaged and agricultural lands laid waste. In the early years after the war it was a sheer physical impossibility for the countries of Western Europe to produce goods for export on the scale required to maintain reasonable standards of living and to reconstruct their battered industrial machines for peace-time purposes. This problem was of course aggravated by the fact that the economies of these countries had been totally turned to the production of munitions and goods essential for the war, and the process of reconversion to peace production was necessarily slow and difficult.

There were other reasons. Before the war European investments in the dollar countries were a large source of dollar income, but during the war a big proportion of these investments had been sold in order to obtain funds to finance the purchase of munitions and essential war supplies. In addition, shipping, which had been an important dollar earner before the war, had been drastically reduced by the war and could not be rapidly rebuilt.

The dollar income from shipping and investments in the years before the war was sufficient to pay for about 30% of the total dollar requirements of the European countries. This meant that only 70% of their imports from the U.S. had to be covered by exports to the United States. But by 1947 this position had been radically transformed; and the consequence of the loss of dollar earnings from shipping and investments is that Western Europe now has to earn a much larger proportion of her total dollar requirements by the direct export of goods to the United States. In 1947 the Western European countries were able to earn from exports and other sources only 40% of the dollars needed to pay for their imports. The remaining 60% was provided by United States Government Aid, by further liquidation of assets held in the United States, and by sales of gold.

Moreover, superimposed upon this deterioration of their dollar-earning capacity was the fact that the war made these countries dependent on U.S. production...
to rebuild and reconver their economies for the purposes of peace. Thus: "The rest of the world became more than ever before dependent upon American resources and was less than ever before able to pay for its imports from the United States."

Since the end of the war the dollar exports of the countries of Western Europe have fallen a long way short of the amount necessary to pay for even their minimum requirements from the United States. The gap has been bridged in part by American loans—notably the Anglo-American loan of 1946—and, since 1948, by assistance under the European Recovery Programme (widely known as "Marshall Aid") which consists in the main of free grants-in-aid.

Prospects of the Marshall Plan.

Since 1948 the Marshall Plan has been the chief means of bridging the gap. The basic intention of the Marshall Plan was to provide the countries of Western Europe with the time, materials and equipment needed to reconstruct their economies and increase their production, and thus their dollar exports, to the point where a resumption of normal trading relationships would be possible. When the Marshall Plan was launched, it was hoped that by 1952 these countries might be in a position "to pay their way" by their own efforts and without the continuance of extraordinary assistance from the United States. Before the position was obscured by the Korean War, it was generally accepted that this objective was unlikely to be attained. (The Korean war has greatly increased United States purchases of strategic materials and has temporarily relieved the acute nature of Europe's dollar deficit.)

Spectacular progress has been achieved in all the European countries since the commencement of Marshall Aid in 1948. Indeed, Paul Hoffman, the head of the European Co-operation Administration went so far as to say early this year: "The recovery of industrial production, built almost literally from the ashes of World War II, has been a near miracle."

The 1949 Crisis and Devaluation.

The ground gained, however, has not been easily won, nor without temporary reverses of a serious kind. In 1949 the dollar deficit of the sterling area countries increased rapidly and the gold and dollar reserves of the United Kingdom began to dwindle alarmingly. This situation led directly to the devaluation of the £ sterling in September, 1949, from the previous rate of $4.03 to the £ to the current rate of $2.80 to the £. Part of the cause of the drain on the U.K. dollar reserves was the slight economic recession which took place in the United States itself and which continued throughout 1949. The effect of the recession was to reduce United States purchases from (and thus the dollar earnings of) Europe and the rest of the world. The events of 1949 serve to show the great extent to which a continuance of the improvement in the dollar position of the last few years, and indeed an eventual solution of the dollar problem, are dependent upon the maintenance of high-level business activity in the United States.

Ultimate Closing of the Dollar Gap.

Notwithstanding the temporary relief being provided by the impetus to expanding defence expenditure arising from the Korean war, the long-term difficulties must still be overcome. How will the gap eventually be bridged? Probably by a combination of methods! A great deal of hope is being placed on the expansion of overseas investment by private investors in America. Reports published by the National Association of Manufacturers of the U.S. suggest that by 1952...
American private capital will probably be prepared to go abroad in large amounts, and that possibly $2 billions a year will be available for this purpose. This would obviously make a very material contribution to the solution of the problem, but, if it is to be realised, positive steps will have to be taken to create conditions attractive to private investors. The essential conditions are that American capital invested abroad should be free from the fear of expropriation and from excessive rates of taxation, and that proceeds of investments should be readily convertible into dollars.

In the long run, the solution of the dollar problem will demand that the United States accept the need for greatly increased imports from the rest of the world. This will become all the more necessary as interest and capital repayments of overseas loans become due and as expanding investments of private capital have to be serviced by the payment of dividends. If the overseas dollar account is to be balanced the United States will, in fact, have to become a "net importer." This is inherent in her position as a creditor nation and there seems no escape from it.

Are the American people ready to accept the implications of this position? The signs are not altogether unpromising. The groundwork for a revolution in American opinion is being laid by the educational work of Paul Hoffman and the organisation which he heads, and by articles in leading American papers and periodicals. But perhaps the most striking manifestation of a change of opinion is to be found in a report entitled "The Foreign Trade Gap," prepared for and published by the traditionally high-protectionist National Association of Manufacturers. This report published last year, categorically states the necessity for the United States to develop eventually an "import surplus"—in other words to import more than she exports.

The success of all plans for the solution of the dollar problem is conditional upon the avoidance of economic depression within the United States itself. A serious depression in the United States would deal a heavy blow at economic stability throughout the world, and would constitute a severe setback to hopes of overcoming the dollar shortage and the restoration of sterling convertibility.
LORD KEYNES AND PREVENTION OF DEPRESSION

This article has been contributed, by special arrangement, exclusively to "Review," by Dudley Dillard, Professor of Economics at the University of Maryland, U.S.A. Professor Dillard received the degree of Doctor of Philosophy in 1940 from the University of California for which he wrote a treatise dealing with Lord Keynes' most famous work: "The General Theory of Employment, Interest, and Money." Later Professor Dillard published a book on "The Economics of John Maynard Keynes" in which he attempted to clarify for the general reader the meaning and argument underlying the extremely complicated body of economic doctrine which Keynes evolved. In this difficult task he succeeded better than most writers who have attempted it. It was because of our own appreciation of the high merits of this book that we invited Professor Dillard to contribute this article dealing with the essential features of the ideas of Keynes.

Lord Keynes is the outstanding figure in economics of the 20th century. His influence, both on abstract economic theory and on practical government policy, transcends and over-shadows that of all others. The judgment of a prominent contemporary economist, R. F. Harrod, is no exaggeration: "Few men in history," says Harrod, "have had so great an influence as Keynes in moving the minds of men on social and economic questions."

Keynes' views have given rise to innumerable disputes. Was this pre-eminent figure a socialist? Or was he an advocate of the preservation of individual enterprise? Did he believe in detailed government planning and control? Or was his advocacy of increased government intervention limited to influencing, by broad directions, the climate in which free business enterprise is carried on?

Professor Dillard's article helps us to answer these questions and makes clear the essentials of Keynes' thought. Free from economic jargon and from difficult theoretical abstractions comprehensible only to the specialist, it is capable of being understood by the intelligent citizen interested in the central questions of modern economic and political policy. No one unable to claim some general familiarity with the work and ideas of Lord Keynes can hope to appreciate the main political and economic currents of the modern world. We are, therefore, pleased to have the opportunity of presenting Professor Dillard's article to our readers and feel that, in Australia, it will help to satisfy a long-felt and overdue need.

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A popular parlour and newspaper game in the United States during 1950 has been to name the outstanding performer in various fields of activity during the first half of the twentieth century. Charlie Chaplin, for example, has received the award in motion pictures. To my knowledge, no official or semi-official judgment has been rendered in economics, but if such an award were to be made, it is safe to predict that John Maynard (Lord) Keynes would be the winner by a wide margin. In a recent scholarly volume surveying contemporary economics, Keynes' name appears more than twice as many times as that of any other economist. Keynes' most famous book, The General Theory of Employment, Interest, and Money, published in 1936, has been the source of more discussion than any other volume in the history of economic thought in a comparable period after publication. This book already ranks along with the work of Adam Smith, David Ricardo, John Stuart Mill, Karl Marx and Alfred Marshall, as one of the greatest classics of economic literature. Keynes dominates what has come to be known as the "New Economics" in much the same manner as Einstein dominates the "New Physics."

During the past fifteen years there has arisen a new body of economic doctrine which represents nothing less than a revolution in economic thought. Although Keynes is by no means the sole contributor to this new doctrine, he stands unchallenged as its chief architect. Textbooks on the principles of economics are being rewritten to take account of the "Keynesian Revolution." The most important impact of the New Economics, however, is neither in technical economic theory nor in the classroom, but in new departures which it calls for in public policy. The great depression of the thirties and the great war of the forties precipitated the acceptance of new economic policies. Some of the better-known measures which bear the personal imprint of Keynes are the various white papers on unemployment policy, the International Monetary Fund, the International Bank for Reconstruction and Development, and, probably most important of all, new fiscal and monetary policies.

How are we to account for the pre-eminent position of Lord Keynes among his contemporaries? Personality and intellectual genius were factors. The crux of the answer lies, however, in Keynes' unique ability to combine economic analysis on a high level of abstraction with penetrating insight into practical policy. This combination of qualities has characterized great economists in the past. In the hands of Adam Smith and Ricardo the highly abstract classical economic theory was essentially an argument for a policy of laissez-faire. The dominant position of the classical tradition, which was the ruling doctrine for more than one hundred and fifty years, now seems to have come to an end with the work of Keynes. He repudiates more effectively than anyone else the theoretical foundations of laissez-faire. On the positive side he formulates a system of theory which demonstrates the need for positive social action in order to reconcile private interest with public welfare.

The Old Economics in Relation to the New.

Although Keynes breaks with the traditional economics, he argues not so much that it is wrong as that it is irrelevant to the main problems which confront modern industrial society. The classical theory, says Keynes, is a special case which is "misleading and disastrous if we attempt to apply it to the facts of experience." In the Old Economics the presumption is that social control is not essential to the general welfare; in the New Economics the presumption is that social control is essential to the general welfare. The difference is sufficient to constitute a virtual revolution in economic theory and policy.
When Keynes wrote his *General Theory* in 1936, unemployment was the chief economic problem confronting capitalist nations. His main criticism of the existing body of theory was its inability to deal realistically with fluctuations in employment and national income. The attempts which had been made within the framework of existing theory came generally to the conclusion that unemployment was caused by interferences with the natural forces of free competition in the labour market. Wages were too high, and the market was not free to make the necessary adjustments, it was asserted. The existence of wage levels too high to allow full employment was plausibly explained in terms of the recent growth of strong trade unions and protective social legislation providing for minimum wages and liberal unemployment benefits. The Old Economics looked upon collective bargaining by labour and political action by governments as violations of the sacred principles of laissez-faire. Unemployed men who tramped the streets looking for work had only themselves to blame for their unhappy plight. The solution suggested by the classical theory was simple: Since unemployment is caused by wages being too high, the remedy is lower wages. This line of reasoning could hardly have been convincing to the unemployed workers or to the general public. That the economists took it seriously, however, is clearly indicated by the work of the greatest living exponent of classical theory, Professor Pigou of Cambridge, a colleague of Keynes at King’s College, who argued in his *Theory of Unemployment* (1933) that the remedy for unemployment was a general all-round reduction in wage rates.

Keynes objected strongly to this line of reasoning. He pointed to the obvious fact that millions of unemployed persons were willing to work for less than the going money wage rates, but could not find jobs at any price. The fault, according to Keynes, lay in a general deficiency of demand. A theory of unemployment must account for the deficiency of demand, and a programme for increasing employment must focus on the problem of enlarging the volume of effective demand.

**Keynes’ Theory of Effective Demand.**

In non-technical terms Keynes’ theory of effective demand may be stated as follows: People are employed either in producing goods to be currently consumed (consumption) or in producing capital goods (investment). Those who are employed producing consumption goods do not spend enough of their incomes to maintain the demand for the goods they produce. They save part of their incomes. Hence the demand for consumers’ goods must be supplemented by expenditures out of income derived from investment goods activity.

If we visualize consumption output as production from existing factories and investment output as construction of new factories, the essential point of Keynes’ theory is that full use cannot be made of existing factories unless new factories are always being built. If no new factories were built, those previously employed in construction work would lose their jobs. These workers would have less money with which to buy the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing unemployment among those previously employed in existing factories. These unemployed workers in turn would have less money to spend for the products of existing factories, causing employment in existing factories. The essential point in the theory of effective demand is that investment activity results in the disbursement of income, most of which will be spent for consumers’ goods, without
bringing on to the market any current consumers' goods to be sold. The expenditure of income derived from investment activity fills the gap between income received and the expenditure made out of that income for consumption goods. Another way of putting it is to say that investment is necessary as an offset to saving, which is the excess of income over what is spent for consumption.

The Role of Investment.

Employment depends on the volume of effective demand, and the volume of effective demand depends on expenditure for consumption and expenditure for investment. Expenditure for consumption varies in a regular manner with changes in income, such that when income increases, consumption will increase, but by less than income. If more men are put to work, incomes will increase and expenditure for consumption may be expected to increase in a fairly regular and predictable manner. But an increase in income does not, according to Keynes' theory, bear any regular or predictable relation to investment expenditure. Because investment expenditure does not increase when income increases, there is no reason to expect that the gap between income and consumption expenditure will be filled, and, unless it is filled, the increases in employment and income cannot be sustained. When there has been no increase in investment demand (expenditure), entrepreneurs who temporarily expand output will suffer losses because the new (consumption) demand will be less than the value of the output. Entrepreneurs will be led by these losses to return to the former, and lower, level of employment and output. The significant conclusion is that employment cannot increase unless investment increases. If investment does increase, then employment may be expected to increase. Reduced to somewhat over-simplified terms, Keynes' theory is that employment depends on the volume of investment.

The next significant question then becomes: What determines the volume of investment? An adequate answer to this question would necessarily involve detailed technical discussion. Only the broad outlines of the analysis can be indicated here. The inability of private enterprise to provide continuous full employment arises from a failure of the demand for investment to be sufficient to fill the gap between income and consumption expenditure at full employment. How does Keynes account for the lack of sufficient investment? In advanced industrial societies most private investment takes the form of capital assets which are expected to yield a return over a period extending some years into the future. The inducement to invest depends, therefore, upon the investor's estimate of what is going to happen to his prospective investment in the future. Now the outstanding characteristic of the future, at least so far as economic life is concerned, is that we know very little about it. Estimates concerning the future are at best vague and uncertain, and can hardly be reduced to a rational, scientific basis. Estimates which are made are not as a rule held with much confidence by those who make them. There is a tendency for investors, lacking confidence in their own judgment, to rely upon the judgment of others, who likewise lack confidence in their own estimates of the future. Reliance upon the judgment of others gives some basis, a conventional basis, for action, but it does not remove the basic uncertainty. It does mean that investors tend to think alike at any one time. The resulting mass psychology finds its highest institutionalized form in the stock exchanges. When conventional beliefs turn out to be poorly founded, as they surely will in many cases, there ensues a sweeping revision of estimates and a loss of confidence. A deep pessimism enshrouds the investment market, bringing with it a sharp fall in the volume of new investment and therefore in employment.
Public Investment and Fiscal Policy.

In a severe depression characterized by extreme pessimism it probably will be impossible to stimulate private investment on a scale sufficient to provide a tolerable level of employment. In the event private investment is inadequate, Keynes advocated public investment on a scale sufficient to lift the economy out of depression. The type of public investment is, generally speaking, less important than its volume, although it is naturally preferable to direct public investment toward projects of the greatest social utility. The primary purpose of whatever investment is made is to distribute income, the expenditure of which will stimulate private enterprise to produce more consumers' goods. The cumulative effect of investment upon income, described above, will tend to yield a multiple increase in national income. For example, an increase in public investment of one million pounds may result in a rise in national income of three million pounds. In this case, government investment would have distributed enough new income to cause private enterprise to increase the output of consumers' goods by two million pounds. Keynes always viewed public investment as an aid to private enterprise and not as a substitute for it.

In order to have income-generating effects, government spending must be new spending and not merely a substitution for private expenditure. In depression, therefore, spending should be loan-financed rather than tax-financed, since it is generally valid to assume that income taken away from the public in the form of taxes would have been spent if left in private hands, whereas money borrowed, especially from banks, will normally represent a net addition to total spending. The desirability of unbalanced government budgets in times of depression now appears to be widely accepted by liberal statesmen as well as by the great majority of economists. Liberal business groups like the Committee for Economic Development in the United States seem willing to accept this type of programme. Conservative groups like the United States National Association of Manufacturers do not accept it. The extent to which public opinion has moved in the direction of the new philosophy of deficit-financing, better termed income-generating expenditures, is perhaps indicated by the mid-year economic report of President Truman in 1949, when he said it would be foolish in the face of the then increasing unemployment and falling national income to take money away from people in the form of taxes in order to balance the federal budget. The old idea that government budgets should be balanced every year is related to the laissez-faire philosophy that government should be as inconspicuous as possible in economic affairs.

In recent years increasing stress has been placed on fiscal policy as a means for keeping the economy from falling into a depression rather than as a means for pulling the economy out of a depression. It seems fair to say that fiscal and monetary policies are the only, or at least the main, defences against depression which the United States, and I think other countries could be included, has to-day that it did not have before 1929. How strong these defences really are no one knows because they have not yet been tested.

A minority opinion advocates interest-free financing of public investment in depression. Such a policy would enable large outlays to be made by the government without adding to the size of the interest-bearing public debt. However, this view does not appear to be gaining many new supporters, and it would involve some special difficulties in a country like the United States, where the central bank (the Federal Reserve Banks) are not owned by the government. The Keynesian idea that interest rates on securities of all
types should be low has gained support among professional economists, and is understandably popular with Treasury officials.

Keynes emphasized the role of low interest rates as a means for stimulating private investment. He believed the monetary authority should have the power to push interest rates down to hitherto unprecedented low levels. Here the task is two-fold. First interest rates should be lowered, and second they should be kept down in order to convince the investing public they will remain permanently low. The second task is really part of the first because a major obstacle in lowering interest rates is the anticipation that they may rise again. This is particularly true of the long-term rate of interest. The low level of interest rates achieved in Great Britain, the United States, and other countries during the past two decades accords with Keynes' recommendations. However, Keynes' view that interest rates have a considerable influence on the volume of private investment is not generally accepted.

Inflation Policies.

Keynes' policy recommendations were not confined to depression measures. He also made important contributions to the theory and policy appropriate for inflation. For inflationary situations such as usually exist in wartime, he favoured indirect monetary and fiscal controls rather than direct controls such as price ceilings and administrative rationing. The most important of his wartime suggestions for Great Britain was a plan of forced saving or deferred pay, a plan which was partially adopted by the British Treasury during the war. Keynes argued that taxation and voluntary saving would be inadequate to finance a major war without inflation; and that therefore current consumer demand should be further curtailed by extra deductions from employees' paychecks. The income withheld during the war as an anti-inflationary measure was to be paid after the war as an anti-depression measure. In circumstances which are potentially inflationary appeals for voluntary saving as a preventive of inflation are not likely to be effective unless the would-be savers are convinced that saving will be general. There is, however, no way to assure that saving will be participated in by all except by making it compulsory. That is what Keynes' plan was intended to do. Keynes pointed to wartime inflation as another example where unrestrained self-interest
is inconsistent with community welfare, and therefore requires social control. Furthermore, he pointed out, forced saving is consistent with the maximum freedom of individual consumer choice, in contrast with a comprehensive system of rationing and price control. The latter can work equitably only on the assumption that consumers have more or less the same tastes, an assumption which may be valid for some commodities like sugar, but cannot be valid for commodities in general. Keynes did not overlook the need for some price control and administrative rationing, but he viewed them as supplementary to fiscal policy in the fight against inflation. The versatility of Keynes' general system of theory was demonstrated by the fact that the same general framework could be used to analyse inflation and unemployment.

Wage Policy.

It has already been noted that Keynes opposed attempts to remedy unemployment through cutting wages. Since employment depends on the demand for consumption plus the demand for investment, wage policy can affect employment only to the extent that it influences one or both of these sources of effective demand. Keynes did not deny that wage cuts might have some indirect tendency to increase employment. His main point was the practical one that whatever might be achieved through wage policy could be done better through monetary and fiscal policy. Keynes also rejected what may be called the trade-unionist argument that the way out of depression is to increase wage rates. In the main, he contended that higher money wages would be offset by higher prices and would leave real wages and real effective demand about as they were before the wage rise. A survey of professional opinion would, I think, reveal that Keynes' views concerning wage policy are now generally accepted by economists. The pre-General Theory notion of the classical economists that unemployment can be remedied by cutting wages is certainly no longer accepted by economists or public policy makers. In present-day discussions of wage policy, stress is placed on the need for short-run stability of money wages and prices, with flexibility introduced through monetary and fiscal measures.

The foregoing discussion of wages refers to the short run in which productivity of labour is assumed not to change. In the longer run, increases in productivity permit real wages to increase. An increase in real wages may come about either in the form of higher money wages with constant prices, or in the form of constant money wages with lower prices. Of these two alternatives, Keynes preferred the former.

Keynes on Socialism and Capitalism.

The question is sometimes asked whether or not Keynes was a socialist? Clearly he was not a socialist, at least in any generally accepted meaning of that term. His efforts at reform were directed toward the preservation of capitalism and economic individualism. In politics Keynes was an outspoken member of the Liberal Party, and disliked the philosophies of both the Labour and Conservative Parties. He believed government ownership of the means of production to be both unnecessary and undesirable. Keynes was quite
hostile to Marx and Marxism. He referred to Marx's *Capital* as "an obsolete textbook which I know to be not only scientifically erroneous but without interest or application to the modern world." On the occasion of a visit to the Soviet Union in 1925 Keynes was impressed, on the one hand, with the economic inefficiency of Communism and, on the other hand, by the strength of Communism as a type of religious faith.

Equality of wealth and income is a fundamental tenet of socialism. Keynes believed there was social and psychological justification for significant inequalities of wealth and income, but not for such large disparities as exist in capitalist society. His theory of employment led him to the conclusion that greater equality would contribute to the maintenance of higher levels of employment and to a more rapid growth of capital. People with low incomes tend to spend for consumption a larger proportion of their income than do people with high incomes. Therefore a redistribution of income from high to low income groups would increase the community's propensity to consume, which in turn would increase employment and national income. Out of the enlarged national income the community would save and invest more than before. The larger investment represents a greater accumulation of capital. This argument reverses the traditional or classical economics, which justified inequality of income and wealth as a necessary condition of progress on the ground that most saving and investing is done by the wealthy out of their surplus income. This classical argument like much else in classical economics would be valid under conditions of full employment, but it is not valid if one assumes, as Keynes did, that the characteristic condition of capitalism is one of less than full employment.

Keynes also believed that the wealthier a capitalist community becomes, regardless of the degree of inequality, the more difficult it is to maintain a satisfactory level of employment. He says: "Moreover the richer the community, the wider will tend to be the gap between its actual and its potential production; and therefore the more obvious and outrageous the defects of the economic system." A poor community will have little difficulty employing all its resources because it will tend to spend on consumption a large proportion of its total income. Only a small gap needs to be filled by investment. A wealthy community, on the other hand, will have great difficulty maintaining full employment because the gap between income and consumption will be large. Its investment outlets must be great if there are to be enough jobs for all. The very fact that the community is rich in accumulated capital assets weakens the inducement to invest because every new investment must compete with an already large supply of old investments. This version of the paradox of poverty in the midst of potential plenty is strikingly similar to the socialist view that capitalism is characterized in its historical development by a growing discrepancy between its capacity to produce and its capacity to consume. Karl Marx thought that the increasing productivity characteristic of large-scale technology would lead to depressions and wars of increasing intensity until finally capitalism would collapse. There is no lack of historical evidence to support this
view, and whatever one may think of it or of the evidence, it is one of the fundamental premises which leads Communist nations to anticipate certain victory in the struggle for power against capitalism. In socialist theory, at least in Marx’s version of it, the ultimate determining forces of history are economic rather than military or political.

There are, however, important differences between Keynes and Marx. Keynes attributed the contradictions associated with the deficiency of effective demand to laissez-faire capitalism and not to capitalism as such. In the long run he believed the answer to the capitalist dilemma lay in the elimination of capitalism’s worst faults rather than in the elimination of private ownership of the means of production. Capitalism’s special faults are associated with its monetary and financial institutions, with speculation, and with rentierism. Keynes’ general position can best be characterized as that of a critic of financial capitalism and a defender of industrial capitalism. Acceptance of the positive measures advocated by him would mean the end of laissez-faire capitalism, but would preserve the advantages of private enterprise and economic individualism. Keynes believed that the worst enemies of capitalism were those who, refusing to admit its faults, were unwilling to do what was necessary to save it.