John Maynard Keynes
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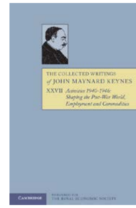

EMPLOYMENT POLICY

Discussions of post-war employment policy began in the course of 1941. While Keynes was in America, the Treasury had preliminary discussions on post-war internal economic problems, but these petered out before his return as other matters were more pressing. However, the Economic Section of the War Cabinet kept up the momentum. As early as February 1941, James Meade, in the first of a long series of memoranda, had turned to the subject. A later memorandum by Meade, dated 8 July 1941 and entitled 'Internal Measures for the Prevention of Unemployment', along with the preliminary Treasury discussions, played a part in the organisation of an inter-departmental Committee on Post-War Internal Economic Problems in October 1941. This Committee was charged with ascertaining what would be the chief internal problems facing post-war economic policy makers, arranging for memoranda to examine these problems and recommending to Ministers the considerations that they should have in mind in framing policy. Meade's July memorandum was one of the first documents circulated to the Committee.

During the early stages of the Committee's work, Keynes himself made a foray into the shape of the post-war world, not for internal Treasury consumption, but as part of a series of BBC broadcasts on post-war planning.

From The Listener, *2 April 1942*

HOW MUCH DOES FINANCE MATTER?

For some weeks at this hour you have enjoyed the day-dreams of planning. But what about the nightmare of finance? I am sure there have been many listeners who have been muttering:

'That's all very well, but how is it to be paid for?'

Let me begin by telling you how I tried to answer an eminent architect who pushed on one side all the grandiose plans to rebuild London with the phrase: 'Where's the money to come from?' 'The money?' I said. 'But surely, Sir John, you don't build houses with money? Do you mean that there won't be enough bricks and mortar and steel and cement?' 'Oh no', he replied, 'of course there will be plenty of all that'. 'Do you mean', I went on, 'that there won't be enough labour? For what will the builders be doing if they are not building houses?' 'Oh no, that's all right', he agreed. 'Then there is only one conclusion. You must be meaning, Sir John, that there won't be enough *architects*'. But there I was trespassing on the boundaries of politeness. So I hurried to add: 'Well, if there are bricks and mortar and steel and concrete and labour and architects, why not assemble all this good material into houses?' But he was, I fear, quite unconvinced. 'What I want to know', he repeated, 'is where the money is coming from'. To answer that would have got him and me into deeper water than I cared for, so I replied rather shabbily: 'The same place it is coming from now'. He might have countered (but he didn't): 'Of course I know that money is not the slightest use whatever. But, all the same, my dear sir, you will find it a devil of a business not to have any'.

A question of pace and preference

Had I given him a good and convincing answer by saying that we build houses with bricks and mortar, not with money? Or was I only teasing him? It all depends what he really had in mind. He might have meant that the burden of the national debt, the heavy taxation, the fact that the banks have lent so much money to the Government and all that, would make it impossible to borrow money to pay the wages of the makers of the raw material, the building labour, and even the architects. Or he might have meant something quite different. He could have pointed out very justly that those who were making houses would have to be supported meanwhile with the means of subsistence. Will the rest of us, after supporting ourselves, have enough margin of output of food and clothing and the like, directly or by foreign trade, to support the builders as well as ourselves whilst they are at work?

In fact was he really talking about money? Or was he talking about resources in general—resources in a wide sense, not merely bricks and cement and architects? If the former, if it was some technical problem of finance that was troubling him, then my answer was good and sufficient. For one thing, he was making the very usual confusion between the problem of finance for an individual and the problem for the community as a whole. Apart from this, no doubt there *is* a technical problem, a problem which we have sometimes bungled in the past, but one which today we understand much more thoroughly. It would be out of place to try to explain it in a few minutes on the air, just as it would be to explain the technical details of bridge-building or the internal combustion engine or the surgery of the thyroid gland. As a technician in these matters I can only affirm that the technical problem of where the *money* for reconstruction is to come from can be solved, and therefore should be solved.

Perhaps I can go a little further than this. The technical problem at the end of this war is likely to be a great deal easier to handle than it was at the end of the last war when we bungled it badly. There are two chief reasons for this. The Treasury is borrowing money at only half the rate of interest paid in the last war, with the result that the interest paid in 1941 on the new debt incurred in this war was actually more than offset by the relief to national resources of not having a large body of unemployed. We cannot expect that the position will be so good as this at the end of the war. Nevertheless if we *keep* good employment when peace comes (which we can and mean to do), even the post-war Budget problem will not be too difficult. And there is another reason also. In 1919 public opinion and political opinion were determined to get back to 1914 by scrapping at the first possible moment many of the controls which were making the technical task easier. I do not notice today the same enthusiasm to get back to 1939. I hope and believe that this time public opinion will give the technicians a fair chance by letting them retain so long as they think necessary many of the controls over the financial machinery which we are finding useful, and indeed essential, today.

What can we afford to spend?

Now let me turn back to the other interpretation of what my friend may have had at the back of his head—the adequacy of our resources in general, even assuming good employment, to allow us to devote a large body of labour to capital works which would bring in no immediate return. Here is a real problem, fundamental yet essentially simple, which it is important for all of us to try to understand. The first task is to make sure that there is enough demand to provide employment for everyone. The second task is to prevent a demand in excess of the physical possibilities of supply, which is the proper meaning of inflation. For the physical possibilities of supply are very far from unlimited. Our building programme must be properly proportioned to the resources which are left *after* we have met our daily needs and have produced enough exports to pay for what we require to import from overseas. Immediately after the war the export industries must have the first claim on our attention. I cannot emphasise that too much. Until we have rebuilt our export trade to its former dimensions, we must be prepared for any reasonable sacrifice in the interests of exports. Success in that field is the clue to success all along the line. After meeting our daily needs by production and by export, we shall find ourselves with a certain surplus of resources and of labour available for capital works of improvement. If there is *insufficient* outlet for this surplus, we have unemployment. If, on the other hand, there is an *excess* demand, we have inflation.

To make sure of good employment we must have ready an ample programme of re-stocking and of development over a wide field, industrial, engineering, transport and agricultural—not merely building. Having prepared our blue-prints, covering the whole field of our requirements and not building alone—and these can be as ambitious and glorious as the minds of our engineers and architects and social planners can conceive—those in charge must then concentrate on the vital task of central management, the *pace* at which the programme is put into operation, neither so slow as to cause unemployment nor so rapid as to cause inflation. The proportion of this surplus which can be allocated to building must depend on the order of our preference between different types of project.

With that analysis in our minds, let us come back to the building and constructional plans. It is extremely difficult to predict accurately in advance the scale and pace on which they can be carried out. In the long run almost anything is possible. Therefore do not be afraid of large and bold schemes. Let our plans be big, significant, but not hasty. Rome was not built in a day. The building of the great architectural monuments of the past was carried out slowly, gradually, over many years, and they drew much of their virtue from being the fruit of slow cogitation ripening under the hand and before the eyes of the designer. The problem of pace can be determined rightly only in the light of the competing programmes in all other directions.

The difficulty of predicting accurately the appropriate pace of the execution of the building programme is extremely tiresome to those concerned. You cannot improvise a building industry suddenly or put part of it into cold storage when it is excessive. Tell those concerned that we shall need a building industry of a million operatives directly employed—well and good, it can be arranged. Tell them that we shall need a million-and-a-half or two million—again well and good. But we must let them have in good time some reasonably accurate idea of the target. For if the building industry is to expand in an orderly fashion, it must have some assurance of continuing employment for the larger labour force.

I myself have no adequate data on which to guess. But if you put me against a wall opposite a firing squad, I should, at the last moment, reply that at the present level of prices and wages we might afford in the early post-war years to spend not less than £600 million a year and not more than £800 million on the output of the building industry as a whole. Please remember that this includes repairs and current painting and decorations and replacements as well as all new construction, not merely on houses but also on factories and all other buildings. That, for what it is worth, is my best guess. It covers the activities of private citizens, of firms and companies, of building societies, as well as of local authorities and the central government. Now these are very large sums. Continued, year by year, over a period of ten years or more, they are enormous. We could double in twenty years all the buildings there now are in the whole country. We can do almost anything we like, *given time*. We must not force the pace—that is necessary warning. In good time we can do it all. But we must work to a long-term programme.

Not all planning is expensive. Take the talk of two months ago about planning the countryside. Nothing costly there. To preserve as the national domain for exercise and recreation and the enjoyment and contemplation of nature the cliffs and coastline of the country, the Highlands, the lakes, the moors and fells and mountains, the downs and woodlands furnished with hostels and camping grounds and easy access—that requires no more than the decision to act. For the community as a whole the expense is insignificant. Or take the question of compensation, which Mr Osborn discussed so clearly and so fairly a fortnight ago. Compensation uses up no resources. It is out of one pocket into another and costs nothing to the community as a whole.

Even the planning of London to give space and air and perspective costs nothing to the nation's resources and need not involve a charge on the Budget. There is heaps of room, enough and more than enough, in a re-planned London. We could get all the accommodation we need if a third of the present built-up area was cleared altogether and left cleared. The blitz has uncovered St Paul's to the eyes of this generation. To leave it so will cost nothing to the community as a whole. To build may be costly. Let us offset that expense by a generous policy, here and there, of *not* building.

Where we are using up resources, do not let us submit to the vile doctrine of the nineteenth century that every enterprise must justify itself in pounds, shillings and pence of cash income, with no other denominator of values but this. I should like to see that war memorials of this tragic struggle take the shape of an enrichment of the civic life of every great centre of population. Why should we not set aside, let us say, £50 millions a year for the next twenty years to add in every substantial city of the realm the dignity of an ancient university or a European capital to our local schools and their surroundings, to our local government and its offices, and above all perhaps, to provide a local centre of refreshment and entertainment with an ample theatre, a concert hall, a dance hall, a gallery, a British restaurant, canteens, cafés and so forth. Assuredly we can afford this and much more. Anything we can actually *do* we can afford. Once done, it is *there*. Nothing can take it from us. We are immeasurably richer than our predecessors. Is it not evident that some sophistry, some fallacy, governs our collective action if we are forced to be so much meaner than they in the embellishments of life?

Yet these must be only the trimmings on the more solid, urgent and necessary outgoings on housing the people, on reconstructing industry and transport and on re-planning the environment of our daily life. Not only shall we come to possess these excellent things. With a big programme carried out at a properly regulated pace we can hope to keep employment good for many years to come. We shall, in very fact, have built our New Jerusalem out of the labour which in our former vain folly we were keeping unused and unhappy in enforced idleness.

As part of the Committee's programme of enquiry, the Treasury prepared a memorandum entitled 'The Post-War Relation between Purchasing Power and Consumer Goods'. This memorandum was largely the work of Sir Hubert Henderson. It spent more space discussing the immediate post-war transitional period and drawing parallels with the position of the United Kingdom between 1919 and 1924 than considering appropriate policy measures, despite the fact that it was deeply pessimistic as to the long-run level of demand. Keynes's role in the preparation of this paper, as later, was largely that of a critic at a late stage, as the following comments indicate.

To SIR HUBERT HENDERSON *and* SIR RICHARD HOPKINS, *8 April 1942*

MEMORANDUM ON THE POST-WAR RELATION BETWEEN PURCHASING POWER AND CONSUMERS' GOODS

I am not at all happy with the new ending provided for this paper from paragraph 25 onwards. If Mr Bevin was to look on this with as jaundiced an eye as on the Clearing Union, he would say, I think, that the author was scared to death lest there might be some date at which the figure of unemployment would fall below three million! It seems to me to be too pessimistic all along the line under the three headings—(*a*) interim unemployment, (*b*) risk of inflation and (*c*) difficulty in maintaining the standard of life.

(*a*) The last sentence of paragraph 25 seems to me too pessimistic, as paragraph 26 really shows. It might be well to emphasise the rapidity with which the problem will be on us this time owing to the release of civil defence workers. On the other hand, if the army is serving in distant theatres of war or if hostilities in some theatres terminate before hostilities in others, the demobilisation of the army proper may be more easily spread over a period than was the case last time. I should much prefer to put the emphasis on the importance of making early provision and fairly cut-and-dried plans for the transition and particularly in those fields where, with adequate preparation, peace-time employment can be provided quickly, and point out that, *unless this is done*, the problems indicated in the present draft will arise.

(*b*) If we manage our affairs properly, I do not believe that the prevention of inflation will be to slow down the process of reabsorption. The process of manufacturers bidding against one another for supplies which are not there was not particularly helpful last time. I should agree, however, that it may be necessary to provide other incentives than the hope of speculative gains, particularly perhaps by underwriting orders,—a subject which I should like to develop. But here again I should like to put the emphasis on the positive side of the matter and say that if we maintain, as we shall have to, control of prices to prevent an undue rise, it will be particularly important to see that manufacturers have markets opened to them promptly and on attractive terms, such as will be likely to stimulate them into reasonably rapid action during the interim period.

(*c*) The passage about the standard of living comes in paragraph 33. I do not at all share the pessimism here expressed. In line 6 I should like to substitute 'short' for 'considerable'. I think the memorandum greatly under-estimates the consequences of full employment and of the improvement in technical production, which will not cease to take place but will in some directions have been even accelerated during the war period. In this connection I call attention to some studies which are being made by the Economic Section. In their provisional studies of the post-war period they are assuming that we can reduce unemployment to 5 per cent and that technical progress between 1938 and 1946 will amount to 10 per cent. Their figures, which have been agreed by Leak, are as follows:

	(*a*) Home production	(*b*) Exports	(*c*) Retained home production	(*d*) Imports	(*e*) Total, (*c*) +(*d*)	(*f*) Total (pre-war = 100)
Pre-war	100	15	85	26	111	100
Post-war	119	22	97	28	125	113

This shows that, even though we have to increase our exports by 50 per cent, with a very small corresponding increase in imports, we can nevertheless afford an increase of standards as compared with pre-war of 13 per cent. It may be that this is too optimistic, that our memorandum is thinking of a date less distant than 1946 and that the Economic Section is assuming that we can attain that volume of exports. Nevertheless, it is going very much to the other extreme to suggest that 'a considerable interval must elapse before it is possible to restore the standard of living to its pre-war level'. At any rate, I should like to utter the warning that we shall be speaking with an entirely different voice from the Economic Section and in terms which would certainly excite Mr Bevin, if he reads so far on in the memorandum. Here, for the third time, I should put the emphasis on the positive side and point out that our capacity to restore our standard of living and raise it in the measure which technical progress should prompt is to an important extent contingent on the satisfactory development of our exports, a programme which we shall have to further by every possible means open to us, orthodox or unorthodox.

I object not less to the latter part of this paragraph. Of course, it is dangerous to exclude any possibility, but this does seem to me to be seriously overdoing it. Similarly, I do not like, for reasons already given, the whole of paragraph 34. The cumulative effect of paragraphs 33 and 34, although worded in polite language, almost amounts to saying that unemployment and reduced standards are necessary, inevitable and even desirable —of course this is unfair, but it is the impression.

I have another objection to coming down so early in the debate so violently on the negative side, apart from not sharing this view. It seems to me that it is premature and unjustifiable to reach such conclusions until we have made some attempt at quantifying the prospects and relating our general ideas to the statistical facts, so far as we know them. When we can make some progress towards quantifying, this will have the further advantages that it enables us to give the more favourable and more pessimistic prognosis on different assumptions. For the quantifying, if we can accomplish it, will not be in the nature of a prophecy, but an analysis of the consequences of various alternative assumptions. After showing such consequences, we can then emphasise the importance of adopting that policy which has some chance of making those assumptions come true which lead to the more favourable conclusions.

[copy initialled] J.M.K.

To SIR RICHARD HOPKINS, *15 April 1942*

MEMORANDUM ON THE POST-WAR RELATION BETWEEN PURCHASING POWER AND CONSUMERS' GOODS

Your emendations help me here so far as they go. But I am still not at all happy about the concluding sections:

(1) I must warn you that when we come to the attempt to quantify the problem the results are at least as likely as not to lead to a contrary conclusion to those set forth here, except as regards the very early period. As at present drafted, there are several passages indicating that the inflationary tendency 'is likely to be considerably longer than two or three years'.

(2) It is noticeable that where statistical investigations have already been made the statements in the document are definitely not borne out. For example—

(*a*) I agree with the Bank's criticism on 16 (iv). The reference to hoarding of currency overstates the real situation. At one time we thought this might be the explanation of the increase of currency. Subsequent enquiry shows that there is little or no reason for supposing that the wage-earning classes are carrying about a holding of currency increased appreciably more than the increase in their incomes.

(*b*) The statement that a large and sudden increase in the cost of living is to be expected after the war unless we continue with large subsidies is quite contrary to the last statistical indications. It is certainly the case that the agricultural subsidies will have to be borne by the general taxpayer. But practically the whole of the rest of the subsidies is required to off-set war risks on sea and on land, which will come to an end immediately the war is over. I should say there is no reason to expect a rise in the cost of living unless prices rise overseas (which, of course, they may do) or domestic wages increase for reasons not justified by the cost of living or by increased efficiency.

(*c*) Surely, in the light of the last Budget figures, it is overstating it to talk of the difficulty of restoring the Budget to a balanced condition at an early date. It may well be the case that we shall have to go slow in abating war taxation. But to suppose that the regular Budget after the war will for a long time to come exceed £m2,400 is scarcely reasonable. No account is taken of the separation between the normal Budget for expenditure out of income and the so-to-speak capital budget, which surely we shall have to set up after the war.

(3) I still feel that it is much better to put the matter positively, namely, that the difficulties envisaged will surely come to pass unless we take constructive steps to solve two or three outstanding problems. In my judgement, far and away the most important and most difficult of these is the sufficient expansion of exports. But here also I do not like the way this is put in paragraph 6. This suggests that the supply of goods for the home market will be rendered insufficient by the requirements of the export trade. I agree that this will assuredly be the case in the short period. But I do not think that we lack the physical capacity to produce adequate exports. We can take this in our stride without interfering with the home supply. So far as exports are concerned, the essential difficulty will not be in producing them but in finding a satisfactory market for them. The second outstanding condition is that we should have a planned capital programme so that the capital demands are

released at the right pace. The third overriding condition is that we control consumption expenditure for what I should hope would be a very limited period.

This is my impression of the results which the attempt at quantification will lead to. But it is very possible that I may have to change my mind when I see them. My warning remains that it is unwise to be so dogmatic when we have it in view to produce a second document about the contents of which we are still very much in the dark.

[copy initialled] J.M.K.

P.S. Since writing the above I have had a word with Stone, who has already given a day or two's thought to analysing the relevant statistics. I find he is prepared to go further than I in doubting whether the statistics, when fully analysed, will justify the more pessimistic forecast. It is, of course, much too soon to prejudge the statistical outcome, when we have it, one way or the other. But it is easy to see how much room there is for optimism if one merely considers the proportion of current resources now being devoted to government purposes and the margin which will exist when these purposes are no longer required. This margin has to be divided between (*a*) doing less work (*b*) consuming more and (*c*) increasing gross investment. At first sight, on any reasonable hypothesis, it looks as if each of the three would get a good share.

[copy initialled] J.M.K.

The Treasury memorandum on purchasing power and consumer goods went to the inter-departmental Committee on 26 May. Before it was complete, however, Treasury discussion turned to other issues. On 14 May 1942 Sir Richard Hopkins circulated a memorandum to Keynes, Sir Hubert Henderson, Lord Catto and others suggesting that the remaining business of the inter-departmental Committee might involve a consideration of budgetary policy and national debt questions. At this stage, he suggested that there was wisdom in saying little more than previously on the transitional period, beyond raising the question of the budgetary accounting treatment of war remanets. On the longer-term issues, he believed that the Treasury would have to take decisions on the meaning of a balanced budget, the role of sinking funds, public works expenditure and budgetary accounting. On this last matter, he argued that, in normal circumstances, so much occurred on the accounts of local authorities and government-guaranteed bodies that the need for a special capital budget in the central government's accounts was minimal. Hopkins saw the role of the central budget as consisting of variations, about a norm of £100 million, in the size of the sinking fund for the retirement of the national debt, these variations being reflected in changes in taxation (primarily death duties). He saw counter-cyclical public works as hindered by administrative and other practical problems, while changes in most direct and indirect taxes would prove slow in operation and politically difficult and might not help the situation when they did occur. Hopkins concluded his memorandum with rejection of equalisation funds operated over the trade cycle in which the surpluses of booms covered the deficits of slumps.

Hopkins' memorandum drew written replies from S. D. Waley, Sir Hubert Henderson and Keynes. Waley's reply emphasised the absence of any sense in balancing budgets as such, given that their role in economic stabilisation was more important. He also raised such matters as semi-annual budgets for improved economic management and the integration of budgetary and monetary policy. Sir Hubert Henderson, for his part, raised the question of post-war interest rates in relation to sinking fund policy, supported a capital budget to aid the process of inter-departmental co-ordination, and agreed with Hopkins' line on equalisation funds within the budget proper, but not with respect to extra-budgetary funds.

Keynes's reply, which was rather brief, ran as follows:

To SIR RICHARD HOPKINS *and others, 15 May 1942*

BUDGETARY POLICY

I. *A sinking fund*

It depends on what you mean by it. I should aim at having a surplus on the ordinary Budget, which would be transferred to the capital Budget, thus gradually replacing dead-weight debt by productive or semi-productive debt on the lines which the Government of India have successfully pursued for many years.

But this would not involve repayment of debt, since I should expect for a long time to come that the government debt or government-guaranteed debt would be continually increasing in grand total.

It is probable that the amount of such surplus would fluctuate from year to year for the usual causes. But I should not aim at attempting to compensate cyclical fluctuations by means of the ordinary Budget. I should leave this duty to the capital budget.

In this connection Mr Meade will be putting forward a proposal, which I think deserves consideration, namely, that the amount of the contribution from employers and employed to the Social Security Fund should vary according to the state of employment, rising when unemployment falls below a critical figure and falling when it rises above it. He points out that the advantage of this is that it is not subject to the time-lag which applies to direct taxation, but can be brougbht into operation at the shortest possible notice and should have a very rapid effect. If, under a Beveridge consolidated scheme, the income of the Social Security Fund is of the order of £200 million a year, which could vary according to circumstances from zero to £400 million a year, there is a fairly large sum to play with, quite free from the objections to interfering with the normal tax system for such a purpose.

I do not agree that death duties are a special argument for sinking funds. Death duties are in effect a tax on savings, and therefore indirectly on income, though in individual cases they may be paid, just as income tax may be paid, out of capital. This is brought out rather clearly by the way in which we have handled it in the White Paper; the net savings in any year available for new investments are gross savings in the sense in which the ordinary man would understand it *minus* death duties.

II. *The capital budget and war remanets*

No special objection to keeping war remanets in a separate account. But I should prefer to merge them in the capital Budget.

The following are characteristic examples of what might properly be regarded as war remanets:

On the credit side—(*a*) proceeds of war disposals; (*b*) war damage contributions. On the debit side—(*c*) post-war credits; (*d*) post-war E.P.T. repayments; (*e*) war damage payments; (*f*) war risk payments. There is also something to be said for regarding post-war E.P.T. as a war remanet, taking it out of the ordinary Budget, crediting the net proceeds, so long as there are any, to the capital Budget and, when these are succeeded by net repayments, debiting such repayments.

If this were merged with the capital Budget, then as additional credit items I should show—(*g*) the surplus on the Social Security Fund in the surplus years; (*h*) the surplus on other extra-budgetary funds; (*i*) the surplus on the ordinary Budget in surplus years; (*k*) net new borrowings from the public; and on the debit side—(*l*) net redemption of debt (should there ever be such); (*m*) the deficit on the Social Security Fund in deficit years; (*n*) expenditure or advances on capital account.

The last item, namely, expenditure or advances on capital account, raises the question whether public boards and local authorities should borrow after the war either on their own credit, for what it is worth, or with a government guarantee; or whether we should substitute something more on the lines of the Local Loans Fund, by which all borrowings would be by the Treasury, direct advances then being made out of the pool for various capital purposes. I much prefer the latter alternative. (i) It will allow cheaper borrowing; (ii) it will avoid the present undefined and anomalous position, by which there is a sort of implied government guarantee, e.g. to municipal loans or to the Central Electricity Board, without the full advantage of this implied guarantee being realised in the price of the loans; and (iii) it will facilitate the management of conversions and the management of the market generally, if all borrowings are under the same title. We have seen during the war what great advantages there are in having a single borrowing programme.

III. *Interest rates in the early post-war period*

Sir H. Henderson has raised this very important question. But it is rather a different issue from the above on which, at greater leisure, I should like to write separately.

[copy initialled] J.M.K.

During the discussion of budgetary policy, in collaboration with Dick Stone, Keynes was attempting to estimate the post-war national income to provide guidance for post-war planning. On 28 May, when Stone's detailed estimates were ready, Keynes circulated them with a covering note.

NATIONAL INCOME AND EXPENDITURE AFTER THE WAR

1. This paper is an attempt to project the figures of the Budget White Paper into the post-war period, with the object of ascertaining in round figures the resources likely to be available for various alternative and competitive purposes. The figures given are based on what seem *prima facie* to be plausible assumptions, but they should be regarded as illustrative rather than prophetic. They have been set forth in an Appendix somewhat elaborately and in such a form that different assumptions can be easily substituted and the result calculated.

2. The upshot is that 'standard' post-war national income at factor cost with White Paper definitions can be taken (see Appendix §12) at £m6,500 (±200), increasing thereafter by £m100 annually, on the assumptions stated, of which the most important are the following:

(1) One million men in H.M. Forces. Each 250,000 above or below this figure would make a difference of about £20 million, this figure being the result of the conventional method adopted to measure the contribution to the national income of men in the Forces.

(2) 800,000 men unemployed (or a somewhat larger aggregate of men and woman together, 10 women reckoning as the equivalent of 7 men for the purpose of this calculation). Each 250,000 above or below this figure would make a difference of about £100 million.

(3) Wage cost at a level 30 per cent above 1938 in round figures. (Current wage cost is 28·4 per cent above 1938.) Each 2·5 per cent movement in wage-cost above or below this figure would make a difference of about £145 million.

(4) The margin of ±£m200 around £m6,500 is provided to allow for different assumptions as to the loss of skill of labour on account of the war and the gain in technical efficiency, compared with 1938, when the war is over. No separate allowance has been made to cover the loss of ultimate product resulting from a deterioration in the terms of foreign trade, this being regarded as one element in the factors on which depends the technical efficiency of the national productive resources.

3. The method adopted for the computation of the national income assumes that all factor costs, other than house rents, have increased to the same extent as the assumed increase in wage cost (i.e. 30 per cent). Gains in productive efficiency are assumed for the purpose of statistical comparison, to show themselves in an increased return to the factors of production, over and above the increase of 30 per cent in their cost, though, if they occur, they may in fact show themselves partly in lower prices and only partly in higher returns.

If market prices in fact exceed this index because they also reflect an excess profit due to scarcity, the national income measured in terms of money is increased by the amount of such excess profit. There is, however, a further reason of quite a different kind why the index number of market prices, including foreign as well as domestic produce, may differ from the index of wage cost. For if the price of imports has risen relatively to the price of exports, this is reflected in market prices, but obviously not in calculations relating to the amount of domestic output.

4. Does our figure of £m6,500 ($\pm$200) look reasonable on general grounds?

At a level of factor costs 30 per cent higher than in 1938, the national income of 1938 would have been about £m6,000; and the national income of 1941 about £m6,700. But the latter figure was somewhat reduced by the method adopted for computing the output of men in the Forces, namely as being measured by their pay and allowances in cash and kind, which works out at less than the net output per wage earner in industry. If they had been employed in industry, in addition to those already so employed, the value of the national income in 1941 would have been nearly £m7,000. Thus our post-war estimate assumes a substantial falling off from war-time productivity.

5. The most difficult and problematic of our assumptions relates to the measure of industrial efficiency after the war compared with 1938. As pointed out in the Appendix, a fairly large proportion of the labour force is employed during the war on the same or similar work to that on which they will be employed after the war. The progress of electrification, the improvements in the internal combustion engine, the greater familiarity with mass-production methods acquired by many manufacturers, the introduction of a wider range of American-designed machine tools, the standardisation of product and the cutting out of redundant and unnecessary variations of type, the concentration of industry, the elimination of middlemen and many unnecessary costs of distribution, the pruning of 'extras' which do not add to the value of product proportionately to their expense, the dilution of fully skilled men, the acceleration of training, the revolution in agriculture,—surely much or most of

all this will remain as a permanent gain. Moreover the loss of skill on the part of men absent in the Forces must have been partly offset by the great numbers trained in industry for the first time and the benefit to individuals by 'up-grading' and the advantage of experience on high-grade jobs which they might have waited for years to get or might never have had in peace-time conditions.

It can, therefore, be argued that, so far from industrial efficiency having stood still during the war years, we shall find ourselves with at least the usual secular improvement in hand as soon as the special war-time difficulties of black-out and of transport and of the shortage of certain materials and of excessive strain and overtime are removed. If so, the calculation in § 12 of the Appendix would justify the higher limit of £m6,700 for £m6,500 as our standard estimate of post-war national income; and we might adhere to this figure even after allowing for deterioration in the terms of foreign trade. The lower limit of £m6,300 assumes a very modest gain from the above war-time changes after allowing for a possible deterioration of labour skill.

We shall find in the sequel that if, after a short interval of transition, the state of industrial efficiency allows us to take £m6,700 in place of £m6,500 as our standard estimate (reckoned at a price level 30 per cent above 1938), this will make all the difference between comfort and discomfort in the early post-war years.

6. In the first two years after the war it would be prudent to assume a larger army, heavier interim unemployment, and temporarily reduced efficiency as compared with our 'standard' estimate of £m6,500. On the other hand, it is inevitable—particularly if the above factors are operating—that we should have a heavy adverse balance of trade during these two years, i.e. a continuance for the time being of overseas disinvestment.

It seems not unlikely that these two factors may be of the same order of magnitude, thus roughly offsetting one another and leaving disposable resources at a fairly constant figure around

£m6,500. For example, in the first year national income might be as low as £m6,150 and the adverse balance £m350; in the second year national income £m6,300 and the adverse balance £m200; in the third year national income £m6,450 and the adverse balance £m50; in the fourth year national income £m6,550 and the favourable balance £m50,—thus leaving the domestically disposable resources at around £m6,500 throughout this period; i.e. about 8 per cent in volume above the domestically disposable resources in 1938, although we should not be earning this increment from our own resources until the fourth year after the war.

7. It is to be doubted if we can get much closer to the prospects than this. As we have seen in §5 above more optimistic, but far from extravagant, assumptions as to efficiency, would allow us another 3 per cent improvement. It would need very pessimistic—and, surely, highly unplausible—assumptions to bring us out significantly worse off in disposable resources than in 1938. Such a result could only come about in practice through an absolute inability to import either in exchange for exports or on credit and its equivalent. An absolute inability to import necessary food and raw material would constitute a breakdown in our national economy of which this survey does not attempt to take account.

8. Can we forecast how this aggregate might be divided between (*a*) personal consumption, (*b*) government expenditure on goods and services and (*c*) domestic investment?

Let us begin with government expenditure (central and local) on goods and services. Pre-war expenditure corrected for higher costs and a larger army (we need not assume that additional munitions will be required—at least for a time!) might be put at £m1,300. Let us raise this to £m1,400 to allow a margin for unavoidable new services (other than new transfer payment services). After deducting expenditure by local authorities and adding (say) £m650 for transfer payments, this would correspond to an ordinary budget of about £m1,750. But, obviously, government expenditure would not fall to this figure until demobilisation had proceeded far enough to reduce the size of the Forces to our 'standard' assumption. The discharge by the Government of all arrears of payments in respect of war contracts, which do not involve any current expenditure on goods and services, are, on the other hand, in the nature of transfer payments. Altogether, perhaps we might take ordinary government expenditure on goods and services (including local authorities) at £m1,800 in the first complete post-war year, £m1,600 in the second and £m1,400 thereafter. (These figures are exclusive of the budgetary cost of transfer payments.)

9. For what level of personal consumption must we provide as indispensable?

In 1941 consumption, adjusted for indirect taxes on consumption, was £m3,863 at the prices then ruling; which for reasons explained above, were somewhat above the level of wage costs in this year. Adjusting to a uniform price level 30 per cent above 1938, consumption may have been about £m3,900 in 1941, and about £m4,650 in 1938.

Let us begin by assuming a consumption of £m4,000 in the first post-war year (which would probably mean a significant improvement on 1942 consumption which is likely to be appreciably below 1941). How much is left over for net investment?

To begin with, a small adjustment has to be made. National income as calculated excludes *all* indirect taxes. Expenditure, whether personal, government or investment, is not easily adjusted for indirect taxes on *production*, as distinct from consumption, amounting to about £m200. The above estimates of expenditure include indirect taxes on production. Thus in order to reckon how much is left for investment, the cost of which will also be inclusive of indirect taxes on production, we have to start by adding on £m200 to our estimated £m6,500 of disposable resources, in order to reach a total which includes indirect taxes on production.

Thus, on the basis of £m4,000 personal consumption and a government expenditure of £m1,800 on goods and services, we are left with £m900 for investment. If in the second and third years we allow the reduction of government expenditure first of all to £m1,600 and then to £m1,400 to be balanced by an increase of personal consumption first of all to £m4,200 and then to £m4,400, we have a steady figure of £m900 available for investment in each of the first three post-war years.

10. This represents a high, but not impossible, standard of austerity; for even in the third year after the war period consumption would be 5 per cent below 1938. How high a level of saving does it imply? To ascertain *total* saving, we have to deduct from £m900 the amount of overseas disinvestment, leaving £m550 in the first year, £m700 in the second year and £m850 in the third year. To ascertain personal gross saving we have to deduct government and business saving and add on death duties.

In view of the pressure of deferred personal expenditure and the natural reaction from war-time restrictions, it seems unlikely that total saving would reach these figures in the early post-war period except with the assistance of a level of taxation sufficiently high to allow substantial government saving and a somewhat strict direct control of consumption through rationing, etc.

If, however, we were content with a balance of £m600, instead of £m900, available for net investment in each year, thus reducing the demand on total saving by £m300, this result might be attainable with less strain; for we should have reached the pre-war level of consumption by the third year, and have got nearly half-way back to pre-war consumption in the first year.

Also if post-war industrial efficiency proves high enough to allow the substitution of £m6,700 for £m6,500 as our standard, that would permit £m800 as the rate of annual investment and also a satisfactory relaxation of restrictions on personal consumption. There might also be a further economy in the amount expended by government on goods and services below the assumed estimate. And unemployment might turn out to be less than 800,000, which is a pessimistic assumption.

11. The chief demands on the pool of resources available for net investment are, in the early period, the following: (*a*) re-stocking; (*b*) working capital; (*c*) costs of change-over to peace-time production including the liquidation of war contracts; (*d*) deferred repairs and maintenance; (*e*) war damage to buildings; (*f*) rebuilding the mercantile marine; (*g*) strictly new investment. Towards (*a*) and (*b*) we have the liquidation of government-owned stocks and other proceeds of the War Disposals Board. The other items can be met either at a slower or a faster pace. At a first glance it would appear that £m600 a year (equivalent to £m460 at pre-war prices) available for net investment would do no more than provide at a minimum pace for the items other than strictly new investment. But £m800 to 900 should be a fairly comfortable allowance. It should be remembered that these figures are calculated on the basis of a price increase of 30 per cent over 1938, and would be correspondingly higher if a higher level of prices in fact prevails. (It is apparent what an important difference £m200–300 of national output, more or less, will make in mitigating or aggravating the difficulties of the post-war situation, when we come to the final analysis.)

It would be useful if the appropriate Departments would make estimates of their capital requirements under each of the above headings in each of the first three post-war years.

12. It would seem likely that, in the first two or three post-war years, demand for goods and services on the part of the government, private consumers and investment, might be sufficient to absorb disposable resources of as much as £m7,250 if they were available and in the absence of any controls. This compares with £m6,500, increased by £m200 if we take the more optimistic assumptions, as the measure of the disposable resources likely to be available.

If this is correct, the necessity of controls both on consumption and on investment is evident. On the other hand, the restricted standards of consumption and investment which should be physically possible are not intolerable; and the higher limit of £m6,700, if attainable as the national output, should prove very tolerable indeed.

13. If it is permitted to draw morals from the above, the two following emerge clearly—

(*a*) The continuance of controls is indispensable since the existence of potential excess demand is indisputable and outside the limits of possible error.

(*b*) But the curtailment (or slackened pace) of investment should be left to be decided by actual physical impediments and not by an attempt to lay down beforehand a programme reduced to the procrustean bed of a predetermined figure such as £m600 or any other amount; for the range of uncertainty is too great to allow prior determination. No harm in having ready a programme considerably larger than we can carry out.

The amount available for investment is, within wide limits, necessarily and properly a *residue* and is subject to the wide range of error inevitable in estimating residues. The above suggests a range of £m600 to £m900 as reasonably probable; this is very wide, yet it would not be safe to assume that the true figure will certainly lie within it. Since inflation and not deflation is clearly the danger in the early post-war years, there is perhaps, some risk of our becoming too precautious about it. There should be only those limitations on *production* (as distinct from consumption) which are made physically inevitable by the shortage of materials or suitable labour.

The continuance of controls should clearly include the raw material controls in particular. These are the lynch-pin of the whole system, since rationing and price stabilisation and priority allocation all depend on them. But raw material control must not become a means, or a pretext, for hoarding raw materials. Consumers of raw materials must be prevented from hoarding them. But available raw materials should not be withheld from actual use unless for exceptional reasons. The maintenance of security stocks must not become a habit or stand in the way of *use*, particularly in the early years. When we again reach the era of surpluses, the time for re-building them will return.

J.M.K.

28 May 1942

Statistical appendix

1. The method adopted is to express the income from current production as a function of employment, labour productivity, factor prices etc., and then to make certain additions to this amount for items, such as the net income of dwelling houses, which do not depend on these variables. To avoid confusion in the main analysis it will be convenient to dispose of these special items first.

2. There are three items which it is convenient to exclude in this way and they will be denoted as follows—A = net income from dwelling houses etc., B = net income from foreign investments, C = income in cash and kind of H.M. Forces and Auxiliary Services.

It is evident that none of these items form part of the current net output of labour. C, which might at first sight seem an exception, cannot conveniently be so treated since the net output of the forces is treated as being equal to their income. They are therefore in a very different position from workers in industry for whom income represents about one-half of net output.

These three items have been estimated as follows—

	1938	1940	1941	1944
		(£ million)		
A	265	265	265	265
B	200	175	150	100
C	85	450	710	210
Total	550	890	1,125	575

The value of A is the same as the figure implicit in the White Paper. B for 1938 has been taken from the Board of Trade's estimate and for later years has been roughly estimated. C is the cash pay, allowances and income in kind of H.M. Forces and Auxiliary Services. The average income in this sense of all officers and other ranks of H.M. Forces in 1941 was £208. The estimate of C for 1944 assumes therefore that H.M. Forces are approximately one million in number.

We shall now estimate the remaining and more important part of the national income. The first factor to be considered is employment.

3. An estimate of employment involves the following steps

(*a*) An estimate of the number of gainfully occupied male and female wage earners. It will be convenient here to treat shop assistants as wage earners although in the White Paper they were treated as salary earners. From this figure an allowance must be made for unemployment.

(*b*) An allowance for the difference in the average productivity of men and women.

(*c*) An allowance for changes in hours of work.

(*d*) An allowance for the fall in the average productivity of wage earners due to bringing into industry of progressively less efficient workers.

In short, writing

N_m = number of male wage earners (including shop assistants) in work,

N_w = number of female wage earners (including shop assistants) in work,

s = the ratio of the productivity of the average female wage earner to the average male wage earner,

h = the proportionate addition to the labour force over 1938 resulting from the increase in hours worked,

z = the proportionate reduction in the labour force due to the fall in average productivity resulting from bringing less efficient labour into industry,

then employment is equal to

$$(N_m+sN_w)(1+h)(1-z).$$

Each of these variables must now be considered separately.

4. A rough estimate of the order of magnitude of the ratio of men's to women's productivity (s) may be made as follows. It may first be assumed that the ratio is not greater than unity nor less than 0·5 which is the ratio of earnings. Indeed, it is likely that the ratio is greater than 0·5 which is the ratio of earnings. Indeed, it is likely that the ratio is greater than 0·5 owing to the preference of employers for the employment of men and to the monopoly position of men's trade unions. On the other hand, in the case of similar work the average ratio is likely to be less than unity on account of the greater sickness rate among women; let us put it at 0·9. But again, over the whole of industry the average woman has a less skilled job than the average man, so that the ratio must be further reduced. In the absence of a lengthy investigation into the occupational grouping of the two sexes, we

shall assume that the true ratio is approximately the mean of 0·9 and 0·5, i.e. that $s = 0{\cdot}7$.

5. The information in paragraph 4 together with data on unemployment, an assumption about the post-war level of unemployment, and an assumed rate of growth of the wage earning population, may be used to make an estimate of wage earners in employment in 1944. Writing j for the annual proportionate growth of the wage earning population and k for the post-war unemployment proportion, it will be assumed that

$j = 0{\cdot}002$

$k = 0{\cdot}05$, i.e. the equivalent of 800,000 male wage earners unemployed (see below).

The position in 1944 can be worked out either from 1938 or from 1941. Provided we adopt the same assumptions in both cases and provided that any constants used are accurate, we should reach the same conclusion from each starting point. The two calculations for 1944 are as follows:

(1) Beginning with 1938	millions	
Male wage earners		
in work	10·53	
unemployed	1·41	
	11·94	11·94
Female wage earners		
in work	4·39	
unemployed	0·46	
	4·85	
$4{\cdot}85 \times s$		3·40
		15·34
$15{\cdot}34(1 + jt) j = 0{\cdot}002,\ t = 6$		15·52
Assumed permanent increase in female labour force resulting from the war	0·25	
$0{\cdot}25 \times s$		0·18

Less		
Wage earners retained in H.M. Forces on the assumption that these consist of 1·00 million men		0·40
Occupied wage earners in 1944		15·30
$15{\cdot}30(1-k)$: $k = 0{\cdot}05$		14·53

On these assumptions the employed wage-earning labour force in 1944 will be equivalent to 14·53 million men.

(2) Beginning with 1941

Male wage earners		
in work	9·69	
unemployed	0·21	
in H.M. Forces	2·11	
	12·01	12·01
Female wage earners		
in work	5·31	
unemployed	0·21	
	5·52	
$5{\cdot}52 \times s$		3·86
		15·87
$15{\cdot}87(1+jt)$: $j = 0{\cdot}002$, $t = 3$		15·97
Increase in female wage earners in work between 1938 and 1941 *less* decrease in unemployment of female wage earners over the same period	0·67	
Less		
$s(0{\cdot}67-0{\cdot}25)$		0·29
Wage earners retained in H.M. Forces on the assumption that these consist of 1·00 million men		0·40
Occupied wage earners in 1944		15·28
$15{\cdot}28(1-k)$: $k = 0{\cdot}05$		14·52

On these assumptions the employed wage-earning labour force in 1944 will be equivalent to 14·52 million men.

6. It will be convenient at this point to set out the method for arriving at the number of wage earners in the Forces given the size of the Forces. This is important since in the light of plans for demobilisation it is probably possible to make an estimate of the size of the Forces at various intervals after the war in place of the round figure used above.

It appears from a comparison of unemployment books surrendered and entrants into H.M. Forces that about 75 per cent of all entrants since the beginning of the war have been wage earners. At the beginning of the war there were about 468,000 men in H.M. Forces. Hence writing

T = all members of H.M. Forces in millions

W = peace time wage earners in millions

we have

$$W = 0{\cdot}75(T - 0{\cdot}468).$$

It is of course possible that the figure 0·468 is unduly swollen by abnormal additions to the forces in the period just before the war. If this be so, a figure smaller than 0·468 should be taken, in which case W would, of course, be larger for any given value of T.

7. It is possible to construct an index of hours worked in the following manner:

Let E_0 = average actual hourly earnings in year 0, i.e. 1938

W_0 = average hourly wage rates in year 0

H_0 = average normal hours in year 0

g = average ratio of overtime to normal rates of pay, and e_0, w_0, h_0 and n_0 be the values of E, W, H and N in a single industry in year 0. Then

$$E_0 = \frac{S(e_0 n_0)}{S(n_0)}$$

$$W_0 = \frac{S(w_0 n_0)}{S(n_0)}$$

$$H_0 = \frac{S(h_0 n_0)}{S(b_0)}$$

where S is a summation sign.

The proportionate change in hours between year 0 and year 1 is equal to

$$\frac{1}{g}\left(\frac{E_1}{W_1} - \frac{E_0}{W_0}\right) + \left(\frac{H_1}{H_0} - 1\right)(g - 1).$$

In order to evaluate this expression we shall assume that average normal hours have remained unchanged, i.e. that $H_1 = H_0$; that $g = 1{\cdot}5$; that, in view of the first assumption above, an index of weekly wage rates can be taken to represent the series W; and, finally, that on the average hours were normal in 1938. This being so, current hours as a proportion of the hours worked in 1938 are given by

$$0{\cdot}3+\frac{0{\cdot}505\,E_c}{W_c},$$

where

E_c = average current earnings

W_c = average current wage rates as measured by Bowley's wage index on the base August 1939 = 100.

We thus obtain as an index of hours of work on the base of 1938 = 1·000 the figure of 1·059 for 1940 and 1·089 for 1941.

It appears from studies on hours of work and fatigue that the weighted average of production in an hour of overtime is approximately 88 per cent of production in a normal hour. Accordingly, it would appear that additional working hours added some 5·2 per cent to the labour force in 1940 and about 7·8 per cent in 1941. The assumption that in the post-war period there is a return to the average hours worked in 1938, that is that $h = 0$, can therefore be seen to imply a considerable reduction in effective employment.

8. No data are available on z, the fall in the average productivity of wage earners due to bringing into industry progressively less efficient workers, but it does not seem likely that a reduction of more than 5 per cent of the labour force should be made to take account of the fact that new recruits to industry are less efficient than the average peace time worker. This is very roughly equivalent to assuming that the productivity of the average recruit is about 75 per cent of that of the normal peace time worker. Any fall in efficiency through time due to the necessity of tapping sources of labour with lower and lower productivity is assumed to be offset by the increasing efficiency of past recruits resulting from greater experience at their work.

We need to consider the probable level of z after the war. No doubt z will tend to return to zero, but against this must be set the loss of skill of many of those who have served in H.M. Forces, which will be felt at any rate in the short run, and also the fall in productivity due to a partial return in the short run, at any rate, to the restrictive Trade Union practices which have been abandoned during the war. Two calculations will therefore be made; one on the assumption that $z = 0$ and the other on the assumption that $z = 0{\cdot}025$, which should make adequate allowance for loss of skill during the war.

9. The second factor is productivity. In 1938 this may be estimated as follows:

$$p_m = \frac{Y-(A+B+C)}{(N_m+sN_w)},$$

where p_m is the net output per head of male wage earners. The value of this constant is £298. This productivity may be assumed to increase at a rate r per annum, so that at the end of t years productivity will be—

$$p_m(1+r)^t$$

Under peacetime conditions it is usual to assume that productivity increases at the rate of about 1·5 per cent per annum so that r would normally be 0·015. On the other hand it is argued that wartime gains in efficiency will not be fully retained in the change from wartime to peacetime output. It is not altogether easy to see why this should be so to any great extent since throughout the war, production of consumption goods still remains a fairly large part of total production and it is not unreasonable to suppose that it will be possible to apply most of the wartime technical advances to peacetime production. This process of re-organisation may however take time, so two calculations will be made with $r = 0{\cdot}010$ and 0·015 respectively. For the sake of interest a third calculation will be made on the assumption that $r = 0$.

10. Finally allowance must be made for changes in factor costs. To measure this an index of wage rates has been used. Although this is clearly inadequate in theory its use may perhaps be justified by the fact that while the earnings of the various factors of production have moved differently, the general movement may not have been very different from that of wages.

Bowley's wage rate index, denoted by c, has been used to measure changes in wage rates. The proportionate increase in 1941 over 1938 was 0·224. It is now nearly 0·3 and it will be assumed that $c = 0{\cdot}3$ in what follows.

11. The estimate of the net national income at factor cost may now be summarised thus—

$$Y = A+B+C+(1+c)(1+h)(1-z)(N_m+sN_w)p_m(1+r)^t$$

12. The foregoing data and assumptions lead to the following results:

Estimated net national income in 1944 at present factor cost

	$r=0$	$r=0{\cdot}010$	$r=0{\cdot}015$
$z=0{\cdot}025$	6,051	6,388	6,563
$z=0$	6,192	6,537	6,717

13. The chief assumptions on which these estimates are based may be summarised as follows:

(1) The estimate that the employed wage-earning labour force will be equivalent to 14·5 million men requires the following main assumptions:

(*a*) that there will be 1.00 million men of all ranks in H.M.Forces in 1944 and that 400,000 of these will be wage earners (see paragraph 5). It may well be that this is too low a figure for the first full post-war year but, if this is so, other factors (particularly (1)(*b*) and (2) below) are likely to diverge from what is here assumed in a way which will produce a contrary effect on the estimate of the national income.

(*b*) that unemployment among wage earners will be equivalent to 800,000 men (see paragraph 5). This is very considerably higher than the level of 1941 and as much as half a million higher than the present level.

(*c*) that of all the women who have entered industry or the Auxiliary Services from wartime motives or direction, 250,000 will represent a permanent addition to the wage-earning labour force (see paragraph 5). This does not seem extravagant and in any case is of minor importance.

(*d*) that the ratio of the productivity of the average female wage earner to the average male wage earner (s) is 0·7 (see paragraph 4). This is not of great importance, particularly in conditions where the sex composition of industry is not greatly changed, since an alteration in s would to some extent be offset by the value obtained for p_m.

(2) The average hours worked by wage earners are assumed to fall back to the level of 1938, that is, it is assumed that $h = 0$ (see paragraph 7). It is easily possible that this may not come about at once.

(3) The two assumptions about z (see paragraph 8) are set out in the main table (see paragraph 12).

(4) The three assumptions about r (see paragraph 9) are set out in the main table (see paragraph 12).

(5) The net income from foreign investments is assumed to be £100 million in 1944 (see paragraph 2).

(6) The calculations are based on a level of factor costs 30 per cent higher than those ruling in 1938 (see paragraph 10). At this higher level, the national income of 1938 would have been some £5,980 million and that of 1941 some £6,734 million.

14. The estimates in section 2 of the foregoing paper require a knowledge of the effect on the net national income of variations in (i) the number of men in H.M. Forces, (ii) the number of wage earners in work reduced to an equivalent number of men, and (iii) the level of factor costs. The calculations made in section 2 were derived from the following equations from which the effect of assumptions other than those adopted can easily be seen.

(i) Write Y' for the change in the net national income due to the transference of one man from civil life to H.M. Forces. Then

$$Y' = 210 - 0{\cdot}75(1+c)(1+h)(1-z)(1-k)\,298(1+r)^t$$

Assuming that $c = 0{\cdot}3$, $h = 0$, $z = 0{\cdot}025$, $k = 0{\cdot}05$, $r = 0$, $t = 6$, we have

$$\begin{aligned} Y' &= 210 - 0{\cdot}75 \times 1{\cdot}3 \times 1{\cdot}0 \times 0{\cdot}975 \times 0{\cdot}95 \times 298 \times 1{\cdot}0 \\ &= -59, \end{aligned}$$

whence each 250,000 men transferred to H.M. Forces would reduce the net national income by

$$£59 \times 250{,}000 = £15 \text{ million approximately.}$$

If these assumptions regarding z and r are replaced by the other extreme, namely that $z = 0$ and $r = 0{\cdot}015$, then

$$\begin{aligned} Y' &= 210 - 0{\cdot}75 \times 1{\cdot}3 \times 1{\cdot}0 \times 1{\cdot}0 \times 0{\cdot}95 \times 298 \times 1{\cdot}03 \\ &= -92, \end{aligned}$$

whence each 250,000 men added to H.M. Forces would reduce the net national income by £23 million.

It may therefore be said that according to the assumptions made each 250,000 men transferred from H.M. Forces will increase and each 250,000 men allowed to remain in H.M. Forces will decrease the net national income by some £15 million to £23 million.

(ii) Write Y'' for the change in the net national income due to the re-employment of one unemployed male wage earner. Then

$$Y'' = (1+c)(1+h)(1-z)\,298\,(1+r)^t.$$

On the same assumption as before we find that this expression lies between 378 and 423, whence the reduction of unemployment by the equivalent of 250,000 male wage earners would increase the net national income by some £95 million to £106 million.

(iii) Write Y''' for the change in the net national income due to a 1 per cent increase in factor costs. Then

$$Y''' = \frac{Y-(A+B+C)}{100},$$

from which it can be seen that, according to the assumptions made, a 2·5 per cent increase in factor cost would increase and a 2·5 per cent reduction would decrease the net national income by between

$$£5{,}476 \text{ million} \times 0{\cdot}025 = £137 \text{ million approximately}$$

and $$£6{,}142 \text{ million} \times 0{\cdot}025 = £154 \text{ million approximately.}$$

15. The problem in the last paragraph of section 4 in the foregoing paper can be treated by the same method as was used in 14(a) above. For, in the conditions assumed

$$\begin{aligned} Y' &= 203 - 0{\cdot}75 \times 1{\cdot}3 \times 1{\cdot}078 \times 0{\cdot}95 \times 298 \times 1{\cdot}044 \\ &= -83 \\ W &= 2{\cdot}11, \end{aligned}$$

so that if all the men who had joined H.M. Forces since the war began were to have returned to their civil occupations, the net national income would have been increased by

$$£103 \times 2,110,000 = £217 \text{ million approximately,}$$

that is, the 1941 net national income at factor costs 30 per cent above 1938 would have been £6,951 million.

16. The table in paragraph 12 suggests the following broad conclusions. It seems likely that immediately after the war the net national income may not be greatly in excess of the level in 1938. But in a short space of time, perhaps not more than a year or two, it should rise to as much as £6,500 million or more in terms of present factor costs and thereafter rise at a more moderate rate, perhaps about £100 million per annum, depending largely on improvements in industrial technique, organisation, etc. J.R.N.S.

The Keynes–Stone exercise drew comments from Dennis Robertson, Sir Hubert Henderson and Sir Richard Hopkins. Most of the comments dealt with the assumptions concerning unemployment, which most found very optimistic, efficiency or productivity, and post-war frictions. Keynes's replies to the comments set out more completely his view of the post-war world.

To SIR HUBERT HENDERSON, *3 June 1942*

NATIONAL INCOME AND EXPENDITURE AFTER THE WAR: SIR H. HENDERSON'S CRITICISMS

1. *Unemployment*

The calculations are in terms of equivalent men and probably represent about 900,000 men and women, if they are unemployed in the usual relative proportions. The main points here are, however, the following:

(i) It is assumed that, compared with 1938, 650,000 additional men are in the Forces. This can be regarded as a completely new demand for labour and might be, therefore, a partial answer to the question, what reason is there for expecting better employment than before the war. It is assumed that 1,800,000 equivalent men will be either in the army or unemployed. This is quite high, even on pre-war standards.

(ii) But it is a misunderstanding to suppose that the 5 per cent is a prophecy of what will happen if nothing is done and pre-war methods, generally speaking, are continued. Mr Stone and I chose as our basic assumption 800,000 equivalent men out of work, chiefly on the ground that it seemed to us that this was about the highest that the public would stand in post-war conditions without demanding something very drastic to be done about it, coupled with the fact that it did not seem to us impracticable to take drastic steps which would bring down the figure to this total. If one was to put in, as Sir H. Henderson suggests, a figure approaching 2 million men normally out of work after the war, I should have expected the rejoinder that we were wasting our time in assuming a situation which could not possibly be allowed to happen.

(iii) Sir H. Henderson has misunderstood the reference to the 'heavier interim unemployment in the first two post-war years'. This means heavier than the 800,000 men assumed in the basic year. In fact I took the income in the first year after the war at £m6,150, which allows for additional unemployment of 875,000 equivalent men, making 1,675,000 altogether.

(iv) Sir H. Henderson says that in this connection wartime experience is entirely irrelevant. But none of these figures is based on wartime experience.

2. *Growth in working population*

The casualties up to 1941 have been implicitly taken care of. If there are heavy casualties hereafter, a necessary adjustment to allow for this would have to be made. The assumed value of j, namely, the annual rate of growth of the wage-earning population, is exceedingly low, namely $\frac{1}{5}$ of 1 per cent. There is probably a margin here to offset, except in the very early years, some increase in casualties. j is so small as to make very little difference one way or the other unless a big alteration is to be made in its evaluation.

3. *Efficiency*

Admittedly, two views can be taken about this. This was emphasised in the paper. I remain of the opinion, especially after reading what Sir H. Henderson has to say about economies in distribution, that the assumption is not too optimistic, especially if one regards it as relating to the third year after the war rather than earlier. Here again, however, one can certainly emphasise that the forecast is not meant to be a prophecy of what will happen if we do nothing about it or pursue a passive and reactionary policy. In this sense we are dealing in what Sir H. Henderson calls 'a potentiality of increased production'. The figure is meant to be an estimate of a potentiality, which there should be no particular difficulty in realising, if we bestir ourselves to make sure that we lose no valuable part of the wartime economies and take the best advantage of wartime innovations.

4. *Post-war friction*

We have assumed an effective 7 per cent reduction, not merely of industrial hours, but over the whole of activity, compared with 1941. It is true that no further reduction of hours of work as compared with 1938 is assumed. One might well expect a further reduction of hours in conditions of abounding prosperity. But is it not paradoxical to expect a reduction of hours in circumstances which, on Sir H. Henderson's assumptions, will be extremely severe in most respects?

5. *Expenditure on the Armed Forces*

Perhaps my wording here was misleading. I am not assuming no expenditure on the output of munitions, but have allowed for the continuance of the pre-war output of munitions, aeroplanes and men-of-war at post-war prices, which would be, I think, of the order of £m150.

6. *Recalculation on Sir H. Henderson's assumptions*

The material for a recalculation on his less optimistic hypotheses is provided in the paper. The result is £m5,766 or £m5,636 according as $z = 0$ or 0·025. Let us take the mean figure of £m5,700.

7. The meaning of the question as to the 'extent of the increase in productivity per employed person required to put matters reasonably right' is not quite clear to us. A 16 per cent rise in productivity per employed person would be necessary to restore income to £m6,500, which is our basic figure.

Working on Sir H. Henderson's figure of £m5,700 plus £m200 for indirect taxes on production and taking off our standard assumption of £m1,300 for government expenditure on goods and services, which Sir H. Henderson has not questioned, we have £m4,600 left for consumption and investment. This is slightly below the consumption figure of £m4,650 of 1938. Thus a return to 1938 standards would mean that there could be no investment whatever, not even re-stocking, repair of houses, overtaking of arrears, etc. If we regard £m600 as the minimum figure for post-war investment at post war prices, we are left with £m4,000 for consumption in the standard year. This is very nearly equal to the actual consumption of 1941, which was £m3,900. In my paper I started off in the first year after the war with consumption at £m400 below the basic assumption, and in the second post-war year at £m200 below the basic assumption. With Sir H. Henderson's hypotheses, these figures become £m3,600 in the first year and £m3,600 in the second year, rising to £m4,000 in the basic year.

Thus he is supposing that we have a standard of consumption very greatly below anything we have suffered hitherto in the first two post-war years, returning in the third year to a little better than 1941 standards. This is with a bare minimum of investment. I do not find it plausible to suppose that we shall put up with this in circumstances in which 2 million men are normally unemployed. It would cross someone's mind that it was not very sensible to suffer these severe privations with all that labour available to make something useful.

[copy initialled] J.M.K.

From a minute to SIR ALAN BARLOW, *4 June 1942*

(2) *800,000 men unemployed.* I shall be dealing with this at greater length in answer to Sir H. Henderson's comments. The main point to bear in mind seems to me to be that we shall be operating in an atmosphere of potential boom, with overwhelming demands which we are not in a position to meet. Our only previous experience of such a situation has been during the war, when the number of unemployed males has been reduced to 79,000, and the number of equivalent males and females to about 120,000. I still think an estimate more than six times as large as this in circumstances of unsatisfied demand is not an optimistic assumption, but a very pessimistic one. Sir Alan Barlow's reference to labour-saving technological improvements would be all on the right side, since they would bring us a little nearer satisfying the demand for labour. They do not seem to me to be relevant to the numbers of the unemployed, if, in the special conditions of the post-war period, there are still unsatisfied demands for labour.

(3) The current wage cost includes, I think, all the wartime accretions to wage rates, as distinct from overtime. It does not, however, make much difference in this context whether we assume 30 per cent or some higher figure, such as 40 or 50 per cent. It means that all the measures of the national resources in terms of money are that much higher. The substantial consequences of a higher wage cost will be:

(*a*) a smaller effective burden of the national debt and of certain other transfer payments, if they are not raised proportionately;

(*b*) greater difficulty in obtaining the necessary volume of exports, unless there is a similar further increase in other countries.

(4) This seems to me to be true, but it only serves to confirm the probability of unsatisfied demand for labour for some time to come, since the only thing which will hold back reconstruction will be shortage of labour (unless there is also a shortage of imports).

From a minute to SIR RICHARD HOPKINS, *4 June 1942*

NATIONAL INCOME AND EXPENDITURE AFTER THE WAR (YOUR NOTES)

(1) Our unexpressed fundamental assumption does not go so far as to suppose that 'everything that could humanly be done has been done by the state'. That, I should say, would produce a reduction of the unemployed to the sort of level we are experiencing in wartime, when we are trying to do everything humanly possible, that is to say, an unemployed level of 120,000. As you will see in my comment on Sir Alan Barlow's note, I consider 800,000 rather on the pessimistic side. It certainly does not assume a continuance of the pre-war situation. But, since we shall be in an environment of potential boom with enormous unsatisfied demands, the main change will be forced on us by circumstances and will not require any surprising energy or intelligence on our part, except not to put unnecessary obstacles in the way of this potential demand being satisfied. That is to say, we are assuming a reasonable government policy in the face of the actual circumstances and the change which has taken place in public opinion in the light of war experience as to the practical possibilities of keeping unemployment at a reasonable figure.

I am afraid I am quite impenitent after having read the comments up to date about our assumptions being too optimistic. Indeed, further reflection is leading me, if anything, rather in the other direction.

J.M.K.

P.S. I see that I have not dealt in the above with your query how 1 million in the army could be an offset to 1 million unemployed: 1 million in the army is in effect an additional demand for labour on that scale and, therefore, in so far as unemployment is due to an inadequate demand for labour, it ought to cure the problem nearly as well as any other additional form of activity.

In the light of criticisms, Keynes then circulated a list of corrections and amplifications.

NATIONAL INCOME AND EXPENDITURE AFTER THE WAR

I propose the following amendments to this paper in the light of the criticisms which have reached me:

I. For paragraph 2 (1) substitute the following:

(1) *One million men in H.M. Forces.* Each 250,000 above or below this figure would make a difference of about £m50, apart from munitions, to the expenditure by the Government on goods and services; but a difference of no more than £m20 to the national income calculated by the conventional method adopted to measure the contribution to the national income of men in the Forces. A margin has been provided below in the first two post-war years to allow for higher figures during this period. A higher figure than 1 million after the transitional period is perhaps best regarded as one of the competing demands on our resources of which we have to take account in estimating the 'standard' expenditure on goods and services by the Government.

II. For (2) substitute the following:

(2) Unemployment is due to—

(*a*) the hard core of the virtually unemployable (100,000);

(*b*) seasonal factors (200,000);

(*c*) men moving between jobs (300,000);

(*d*) misfits of trade or locality due to lack of mobility (200,000); and

(*e*) a deficiency in the aggregate effective demand for labour.

Pre-war statistics are not a useful guide, because at all recent dates before the war (*e*) played a significant part, whereas the probable heavy demands for labour in excess of the supply indicated below suggest that the most convenient 'standard' assumption for the post-war period is the virtual absence of this factor. An attempt which was made by an official committee in 1935 to estimate the probable minimum level of unemployment, excluding factor (*e*), arrived at a figure of 760,000 or 6 per cent. Subsequent experience suggests that this survey may have overestimated the number of the virtual unemployables, an actual count of insured persons who have been classified as unsuitable for ordinary industrial employment made on 16 March 1942 having brought out a figure below 25,000 compared with 150,000 *plus* 50,000 casuals' unemployment assumed by the Committee. In view of this a 'standard' assumption of 800,000 men unemployed (or a somewhat larger aggregate of men and women together, 10 women reckoning as the equivalent of 7 men for the purpose of this calculation), which is about 5 per cent of the insured population, seems quite sufficient made up as indicated above between brackets. It compares with about 120,000 equivalent men, or less than 1 per cent, unemployed at the present time, when factors (*b*) and (*c*) above are virtually inoperative. Experience after the last war shows that, apart from a brief transitional period in the spring of 1919, the above estimate would have been more than enough to cover the facts up to the end of 1920, although Professor Pigou reckons that the slump must be regarded as having commenced in the summer of 1920. This should, however, be regarded as a standard assumption rather than as a prophecy; and it can be adjusted to any other assumptions by reckoning that each 250,000 above or below would make a difference of about £m100.

III. Add at the end of paragraph 2 (3): a higher estimate of wage cost would make little substantial difference to the estimates below, since most of the figures given would go up proportionately, the most substantial consequences of such higher cost being—

(*a*) a smaller effective burden of the national debt and of certain other transfer payments, if they are not raised proportionately; and (*b*) greater difficulty in marketing the necessary volume of exports, unless there is a corresponding increase in cost in other countries.

IV. At the end of paragraph 2 add—

(5) In the first post-war year national income is taken at the reduced figure of £m6,150. It is also assumed that Government expenditure on goods and services exceeds the standard assumption by £m400. It is not easy to judge the adequacy of these allowances. But the reasonableness of their order of magnitude can be checked as follows:

In 1941 there were 3,500,000 men in H.M. Forces and auxiliary services and about 500,000 men in the munition industries proper in excess of June 1939. This leaves us with an aggregate of 4 million men to be dealt with, a figure which is not likely to be much greater at the end of the war, after allowing for wastage. In addition to these 4 million there will be a further number to be reckoned during the period of the transition of the works in which they will be employed to peacetime activities. As against this, there will be some demands for labour, now unsatisfied, which can become effective immediately at the termination of hostilities. The above assumptions would allow for about 2,500,000 men either remaining in the Forces or in unwanted munitions and 1,250,000 men out of work. This is on the average of the first year and is, therefore, compatible with much worse conditions in the first half of it, and does not seem to involve too optimistic an assumption as to the rate of absorption.

(6) In the second post-war year income is taken at £m6,300 and government expenditure on goods and services in excess of the 'standard' at £m200. It will be seen that this still allows for a considerable delay in demobilisation and in the absorption of the unemployed.

V. Before the concluding sentence of paragraph 5 add:

It should be noticed that the 'standard' income of £m6,500 is not reached until the third year after the war, so that two years of peace is added to the period of war experience in which to acquire the assumed increase of efficiency, thus providing a further margin for pessimism.

VI. In paragraph 8, bottom of page, for '(we need not...)' substitute: '(we can assume that current output of additional munitions on the pre-war standard should suffice—at least for a time!)'.

VII. For 13 (*b*) substitute:

(*b*) But the curtailment (or slackened pace) of investment should be planned in the light of the actual availability of different kinds of resources when the time comes and not by an attempt...than we can carry out.

The above estimate of the amount available for investment on certain assumptions is arrived at as a statistical residue and is subject...

VIII. In the Appendix substitute 'standard year' for '1944' throughout.

IX. An attempt will be made to simplify the form and language of the draft before it receives more general circulation.

J.M.K.

9 June 1942

In the course of the summer of 1942, although on the Treasury's recommendation the Beveridge social insurance proposals had ceased to contain a detailed discussion of them, Keynes and James Meade continued to discuss the latter's idea for the counter-cyclical variation of national insurance contributions.[1]

To J. E. MEADE, *20 August 1942*

Dear James,

Thank you for sending me your paper no. 20 on the effect on employment of a change on the employers' social security contribution and Fleming's rejoinder in paper 21.

My feeling is that both of you, though in differing degrees, are too willing to assimilate the effects of a change in the employers' contribution to the effects of a change in the employees' contribution. For you are both of you, so it seems to me, allowing yourselves to use an essentially long-term argument for what is essentially and by hypothesis a short-term contingency.

If the effect of the reduction of the employers' contribution is to affect prices, then to the extent of this effect Fleming's original argument is correct. But I should have supposed that no effect, or a negligible effect, on prices is the correct assumption to make. The reduction comes about by hypothesis when output is well below capacity. The reasons why in such circumstances prices do not fall to prime costs are well known. The reduction of costs is by hypothesis a highly temporary one. I should have thought, therefore, that the reduction would operate almost entirely to the relief of the employer and would serve to bring his income that much nearer normal. No great harm in that, perhaps, and in some cases it might help to steer him clear of bankruptcy. But I should not expect that the immediate effects on employment would be noticeable.

I suggest, therefore, that you might give some consideration to the question whether the proposed fluctuations in the rate of

[1] For the earlier discussions and their upshot see above pp. 207–19.

contribution should not be limited to the employees' contribution. I believe that you could by that means get the greater part of your results at half the cost. From the point of view of the stability and solvency of the Fund, it would be much easier to work out a scheme, if the employers' contributions were not subject to the proposed fluctuation. I should have thought that one might find other ways in which the Treasury could use the same sum to the better advantage of employment than by allowing this concession to employers which is likely to be passed on to such a very limited extent in increased immediate expenditure.

Yours,
KEYNES

From J. E. MEADE, *21 August 1942*

My dear Maynard,

Many thanks for your letter of August 20th on the subject of changes in employers' social security contributions. We had just finished a redraft of our paper before I got your letter, and I enclose a copy of this redraft. We are agreed that changes in employers' contributions will be less useful than those in employees' contributions, (though there may be some difference of opinion as to the extent of this difference). You will see from paragraph 22 of the enclosed redraft that the only reason why we have continued to suggest that employers' and employees' contributions should be subject to equal variations is because we considered that any other proposal would be politically impracticable. It seems to me that the practicability of a scheme in which only the employees' contribution varied is a point which should most certainly be raised in any departmental discussion of the scheme which may follow.

On the question of economic analysis, may I put the point this way? In so far as the reduction in employers' contribution causes a reduction in selling price, it will be comparable to a reduction in employees' contribution. Such a reduction in price is, however, in many cases likely to be delayed. In the meantime, I agree, the increased profit income is very unlikely to lead to any significant increase in expenditure on consumption by profit makers. But may not the increased margin between prices and prime costs, at least in certain trades, lead directly to some increase in output and employment?

Yours sincerely,
J. E. MEADE

To J. E. MEADE, *25 August 1942*

My dear James,

I have your letter of August 21st about changes in employers' social security contributions.

Why do you say that you consider a different treatment for employers' and employees' contributions politically impracticable? I agree that the opposite proposal, namely to fluctuate the employers' contributions and not the employees', might give rise to such difficulties. But is the actual proposal likely to?

On the question of economic analysis I agree with you that 'in so far as the reduction in employers' contributions causes a reduction in selling price, it will be comparable to a reduction in employees' contribution'. But I do not think you put it strongly enough in saying that such reduction is likely to be 'delayed'. My point is that it is likely not to happen at all precisely because the reduction in question is by hypothesis temporary. If there were a permanent reduction in employers' contributions, then, after a time lag, one might expect it to be passed on in prices. But in this actual case the change will have been reversed before the time lag has been overcome.

I should agree that the increased margin between prices and prime costs might conceivably lead to some increase in output in certain directions, but I should have supposed that this would certainly not be large and, taking everything into account, I should be surprised if a given reduction in employers' contributions would have more than one-fifth at most of the effect of an equal reduction in employees' contributions.

Apart from these questions of substance, couldn't you make your draft shorter and clearer for the outside reader? I should have thought that the whole thing could be expressed in half the number of words actually used. If I were drafting it, I should turn it inside out, starting off with an explanation of the proposal, then point out its advantages and, if necessary, but at no great length, explain why you reject alternatives. It is generally rather a waste of time to rebut arguments which have in fact not yet been advanced by anyone, because the critics are sure to find different objections to make. Although this is an important and interesting contribution to a vital problem, in the course of drafting it you seem to me to have got it into a shape which will confuse and perhaps deter the non-expert reader.

Yours,
KEYNES

It was with these discussions with Meade and his colleagues behind him that Keynes entered the Treasury's consideration of the proposals as a part of its examination of post-war budgetary policy.

To SIR WILFRID EADY, *3 September 1942*

I feel that you and Gilbert have not done full justice to the great potentialities of the Meade proposals, for the following reasons:

(1) That part of your argument which relates to special unemployment applies to any remedy against unemployment which relies on an increase in general purchasing power. It is quite true that a general increase of purchasing power is not equally efficacious in all circumstances. But it is easy to underestimate the contribution it can make, even where special unemployment is the trouble, since by providing a good demand for labour elsewhere it greatly facilitates labour transfer out of the industries suffering from special unemployment. At any rate, Meade was not concerned to argue this. He was assuming that measures of increased general purchasing power as a cure for unemployment were now widely approved, both by experts and the general public, and he was considering the best technique for injecting purchasing power, assuming one wishes to do so.

(2) I think that you greatly under-estimate the quantitative efficacy of what he proposes. You point out that he would be

releasing about £m60 a year on each 2 per cent decline of employment. This is not far short of 1 per cent of the national income. The multiplier is generally taken as being, in this country, a trifle above 3. But, of course, it is not a constant figure at all levels of employment or in all circumstances. If, however, we assume the very conservative figure of 2 or a shade better, it follows that the release of £m60 would increase the national income, and therefore employment, by 2 per cent. This is exactly in the same order of magnitude as the evil it is endeavouring to remedy. If the circumstances were predominantly those of special unemployment, some people might want to put the multiplier a little lower. But then neither Meade nor anyone else has suggested that his proposal is in fact adequate *by itself* to maintain a constancy of employment. But he can argue, I think, that its quantitative effect is highly significant relatively to the evil it attacks. Moreover, if the contribution is 7*s* rather than 5*s*, the amount of the fluctuation might be greater than what Meade is assuming.

(3) Since Meade wrote the paper below, there has been a domestic discussion inside the Economic Section, in which I have taken part, as to whether the short-period efficacy of a reduction in the employers' contribution is anything like as great as a reduction in the employees' contribution. We all agree that it is less, and I go so far as to say that it is so much less as perhaps not to be worth while. I may be overstating my point and have not quite convinced the others. Nevertheless, I think it is well worth considering whether the proposals should not be restricted to the employees' contribution. This would mean upsetting the Fund very much less, since the sum involved would be only half as great. I should put the multiplier resulting from money injected through a reduction in the employees' contribution at least as high as 3. So at a conservative estimation you would get three-quarters of the effect at half the cost by restricting the fluctuation in this way.

(4) Unless I have misunderstood Beveridge, he is proposing

only a notional fund. That is to say, he would not be actually accumulating its actuarial liabilities. I agree, therefore, with Gilbert that the Treasury contribution should remain constant. As I understand, the contributions and benefits are to be such that there would be the desired degree of balance over a period of time if there were a fund. Indeed, if the Treasury contribution were to vary to make good the fall in the others, it might work the wrong way. For it would increase the size of the budgetary deficit without in fact increasing purchasing power at all. Unless the Treasury becomes more cynical about budgetary deficits than is likely, this will make more difficult a budgetary deficit for other reasons which would be more helpful and might lead to an increase of taxation, which would be actually harmful.

If I understand rightly, the relationship of Meade's proposal to the Beveridge scheme is as follows. When Beveridge first heard about it from Meade, he was extremely bitten by it and was anxious to make rather a feature of it. Hopkins felt that it did not really belong to the Beveridge scheme, but might possibly form one of the proposals to be considered in a memorandum on the general issue of remedying unemployment by the release of purchasing power. He, therefore, urged Robbins and myself to withdraw it so far as possible from Beveridge's attention, and that we have done. Beveridge is quite conscious of this and agrees that probably he had better content himself with not much more than a passing reference. At least that was the position last time I heard about it. If Meade and I can persuade you that it is as good as we think, it might well form a feature of the Treasury memorandum on the relationship of public finance to unemployment, which we ought to contemplate sooner or later.

[copy not initialled]

Keynes received the 'final' draft of Meade's proposals on 28 September 1942. At this stage, his suggestions were of a minor drafting order and are not reprinted here.

Early in 1943, James Meade attempted to get Keynes more actively involved in the employment policy discussions with the following letter.

From J. E. MEADE, *8 January 1943*

My dear Maynard,

The great public support which the Beveridge Report has received has suggested to me that there ought really to be a similar publication on the subject of post-war unemployment. The enthusiastic public reception of the social security proposals shows that there is an exceedingly strong feeling in the country about post-war internal reconstruction and that people are in such a mood as they have never been before for the reception of imaginative ideas for social reform. At the same time everything goes to show that there is a real feeling of uneasiness that nothing much can, or perhaps rather that nothing much will in fact, be done to prevent the re-growth of large-scale unemployment. People do not realise that the Government is giving any serious attention to this problem and it would be my guess that a really imaginative approach to this problem would now have such a reception as permanently to influence the course of post-war policy.

An exploration of the possibilities in this connection would no doubt cover the topics which are now generally familiar to economists, such as the use which can be made of our new national income statistics for the purpose of stabilisation and the various ways in which Government expenditure, private investment and private consumption can be controlled or influenced in order to prevent general depression. A public investigation and report on this topic should not be politically very controversial, but would put new heart into the public and would probably ensure once and for all that a sensible policy in this field would in fact have to be adopted by any post-war Government.

It would, moreover, provide an admirable opportunity for clearing up certain misunderstandings on this subject. For example, there is little understanding outside Government circles that the immediate post-war problem may be rather to prevent inflation than deflation; or that the immediate post-war unemployment that may result from demobilisation is one that cannot suitably be cured by general expansive policies. It requires, of course, rather policies of retraining, labour transference and general adjustment of production to peacetime uses. Moreover, this would present an admirable opportunity for making reference to the importance of international conditions and of economic relations with other countries that are suitable to an internal policy of stabilisation and expansion in this country.

It may be that there are better methods of getting these ideas across, but it occurs to me, to be quite frank, that what we really require is a Keynes Report to follow up the Beveridge Report. People cannot be enthusiastic about too many things at the same time. Personally I think the Keynes Report should have come before the Beveridge Report, but I do not want to see it postponed until a dozen other reports on matters of relative unimportance have anaesthetised the public.

Yours sincerely,

J. E. MEADE

Keynes's reply, which was part of a longer letter also dealing with agriculture, was brief.

From a letter to JAMES MEADE, *11 January 1943*

I am afraid, however, that there are essential differences between the Beveridge proposals and the post-war unemployment programme, particularly the following:

(1) Post-war unemployment is far less a question of a really concrete plan and would involve little, if any, definite legislation;

(2) it is very much more mixed up with external policy; but

(3) above all, all sorts of aspects of it are already being worked out by different Departments and by various Hurst Committees. It seems to me impossible to have a new commission working alongside all the present activities. Moreover, it is much too soon to decide that those activities are not being quite well and fruitfully conducted.

Despite Keynes's lack of enthusiasm, the Economic Section continued to attempt to force the pace on what had become by then an inter-departmental Committee on Reconstruction Priorities with a study by James Meade on the various measures which might be taken to preserve full employment.

Professor Robbins sent Keynes a first draft of the Meade paper in March 1943, and drew the following comment.

To PROFESSOR L. C. ROBBINS, *29 March 1943*

My dear Robbins,

James Meade tells me that he is now wanting to get on with re-writing the paper on the maintenance of full employment. Apologies for not letting you have sooner my comments on the draft of March 11th. But it was only this week-end that I was able to get down to it.

I have very few criticism of substance. The main one is perhaps that the multiplier effect needs more emphasis. There is very little reference to this before paragraph 57. One of the things I feel it important to impress on Ministers is that much less effort is required to prevent the ball rolling than would be required to stop it rolling once it has started. This is of the first importance. After the slump has fully developed, the relevant figures get dreadfully large. I feel there is some reason to hope that remedies on a much smaller scale would be sufficient to maintain the balance, if they are all ready prepared and are applied in good time. Indeed, I am confident that this is so, apart from international repercussions.

On the question of form I have much more criticism. But I appreciate that this is a very early draft. In its present shape I find it terribly indigestible. To begin with there is the language. A great deal could be cut out. There is far too much of 'In this connection there is one suggestion which merits close examination', etc. etc. Moreover, I should have thought there was a good deal which could be taken for granted. For example, do Ministers want the existence of unemployment in the past to be elaborately demonstrated to them? (If it is to be demonstrated, some interesting figures, which I have seen in a recent draft on a similar sort of subject by Loveday about fluctuations in incomes in 24 different countries, seem to me newer and more impressive than the figures for U.K. and U.S. given in paragraph 11.)

At the other end of the paper I should have thought that the section on industrial and labour market conditions might be omitted. You emphasise that this paper is primarily for Ministers. I should like to offer a prize for any Minister who reads it through without his attention wandering. Possibly John Anderson would win it, but there would be no *proxime accessit*. Since, in the main, this does not purport to be an original contribution, the form is above all what matters.

I should, therefore, make it much less expository. It is aiming too much at abbreviated completeness and is like the bare bones or reasoned index of a book. This would make it possible to concentrate on those things which ought to be done. I should plunge straight into that with the least possible preamble. On further reflection, I still very much like Appendix E.[2] I am not so much struck by Appendix F. I doubt if one could have the proposals both of E and F, and of the two E seems to me much the better and more likely to touch the spot.

Yours sincerely,
[copy initialled] K

As Meade re-drafted his paper for the Reconstruction Committee, he raised a further issue with Keynes.

From J. E. MEADE, *19 April 1943*

My dear Maynard,

I am at the moment redrafting our paper on the maintenance of full employment. As a result of the suggestion which you made to me in conversation, I have tried my hand at introducing a reference to the possibility of dividing the budget into a capital budget and a current budget. On consideration, however, I am now against the introduction of such a reference. We argue in our paper that one should try to control investment in such a way as to prevent violent fluctuations in national income, but we suggest that this may not alone be successful:

(i) because it is not always easy to control sufficient home investment promptly enough to prevent all variations in total investment, and

[2] This appendix contained Meade's scheme for counter-cyclical variations in social insurance charges. Appendix F contained an income tax credit scheme in which taxes collected to damp down booms would be refunded in the ensuing slump.

(ii) because there may be fluctuations in other items of national expenditure (e.g. in foreign investment) which need offsetting and which it would not be possible to compensate fully and promptly by immediate fluctuations in home investment.

The conclusion which we draw from this is that, in certain circumstances, it will be wise to operate on other forms of expenditure by a tax policy which stimulates (or restricts), say, personal expenditure.

This, however, involves unbalancing (or overbalancing) the current budget. It is my fear that if the budget is divided into a capital and a current budget, this will reinforce the orthodoxy of an annual balance for the current budget. We may, therefore, lose more than we gain from dividing the budget in this way.

It may be suggested that in so far as there is a case for operating through taxation on personal consumption, this is provided by our proposal for variations in social security contributions. But we should not urge the division of the budget on the assumptions that we shall get the social security scheme, because we may not get that scheme and may, therefore, need to fall back upon variations in ordinary taxation. There is, however, a logically more potent point. The great merit of a scheme like that for variations in social security contributions is that it acts as what I will call an 'instantaneous automatic stabiliser'. In other words, if plans go wrong and *if unemployment develops*, there is an automatic instantaneous adjustment stimulating demand to prevent the multiplier from doing its evil work of exaggeration. We may, however, foresee a slump in demand and to offset this we may wish to stimulate demand by a reduction in taxation *before unemployment develops in order to prevent such unemployment from appearing*. For this purpose, we must be free to plan taxation (and so the deficit of the current budget) ahead. I conclude, therefore, that we want both a potent 'instantaneous automatic stabiliser' such as the social security scheme and freedom to plan ahead year by year for a deficit or a surplus in the current budget; and I fear that the latter freedom would be prejudiced by a division of the budget.

Yours sincerely,

J. E. MEADE

To J. E. MEADE, *25 April 1943*

My dear James,

The Maintenance of Full Employment

I am not quite happy about the line of argument you set forth in your letter of April 19th. I doubt if it is wise to put too much stress on devices for causing the volume of consumption to fluctuate in preference to devices for varying the volume of investment.

In the first place, one has not enough experience to say that short-term variations in consumption are in fact practicable. People have established standards of life. Nothing will upset them more than to be subject to pressure constantly to vary them up and down. A remission of taxation on which people could only rely for an indefinitely short period might have very limited effects in stimulating their consumption. And, if it was successful, it would be extraordinarily difficult from the political angle to reimpose the taxation again when employment improved. On this particular tack your proposal about varying the insurance contribution seems to me much the most practicable, partly because it could be associated with a formula, and partly because it would be pumping purchasing power into the hands of the class which can most easily vary its expenditure on consumption without radically altering its general standards. This seems to me quite enough as a beginning. I should much deprecate trying to superimpose on this proposals to reduce taxation on drink and tobacco with a view to making people drink and smoke more when they were tending to be out of work, or to dealing with income-tax, where there is a huge time lag and short-run changes [are] most inconvenient.

In the second place, it is not nearly so easy politically and to the common man to put across the encouragement of consumption in bad times as it is to induce the encouragement of capital expenditure. The former is a much more violent version of deficit budgeting. Capital expenditure would, at least partially, if not wholly, pay for itself. Assuredly it is much the easier of the two to put across. These ideas are too young and tender to be put to the strain which your present line of thought would require.

Moreover, the very reason that capital expenditure is capable of paying for itself makes it much better budgetwise and does not involve the progressive increase of budgetary difficulties, which deficit budgeting for the sake of consumption may bring about or, at any rate, would be accused of bringing about. Besides which, it is better for all of us that periods of deficiency expenditure should be made the occasion of capital development until our economy is much more saturated with capital goods than it is at present.

I recently read an interesting article by Lerner[3] on deficit budgeting, in which he shows that, in fact, this does not mean an infinite increase in the national debt, since in course of time the interest on the previous debt takes the place of the new debt which would otherwise be required. (He, of course, is thinking of a chronic deficiency of purchasing power rather than an intermittent one.) His argument is impeccable. But, heaven help anyone who tries to put it across the plain man at this stage of the evolution of our ideas.

Yours sincerely,
[copy initialled] K

The circulation of the final version of the Meade memorandum on 18 May led to renewed discussions of the issues in the Treasury. On 20 May, Sir Hubert Henderson circulated a pessimistic 'Note on the Problem of Maintaining Employment'.[4] This naturally drew a comment from Keynes.

THE LONG-TERM PROBLEM OF FULL EMPLOYMENT

1. It seems to be agreed to-day that the maintenance of a satisfactory level of employment depends on keeping total expenditure (consumption *plus* investment) at the optimum

[3] A. P. Lerner, 'Functional Finance and the Federal Debt', *Social Research*, February 1943.
[4] Reprinted in *The Inter-war Years and Other Essays* (ed. H. Clay) (Oxford, 1955).

figure, namely that which generates a volume of incomes corresponding to what is earned by all sections of the community when employment is at the desired level.

2. At any given level and distribution of incomes the social habits and opportunities of the community, influenced ([as] it may be) by the form and weight of taxation and other deliberate policies and propaganda, lead them to spend a certain proportion of these incomes and to save the balance.

3. The problem of maintaining full employment is, therefore, the problem of ensuring that the scale of investment should be equal to the savings which may be expected to emerge under the above various influences when employment, and therefore incomes, are at the desired level. Let us call this the *indicated* level of savings.

4. After the war there are likely to ensure three phases—

(i) when the inducement to invest is likely to lead, if unchecked, to a volume of investment greater than the indicated level of savings in the absence of rationing and other controls;

(ii) when the urgently necessary investment is no longer greater than the indicated level of savings in conditions of freedom, but it still capable of being adjusted to the indicated level by deliberately encouraging or expediting less urgent, but nevertheless useful, investment;

(iii) when investment demand is so far saturated that it cannot be brought up to the indicated level of savings without embarking upon wasteful and unnecessary enterprises.

5. It is impossible to predict with any pretence to accuracy what the indicated level of savings after the war is likely to be in the absence of rationing. We have no experience of a community such as ours in the conditions assumed, with incomes and employment steadily at or near the optimum level over a period and with the distribution of incomes such as it is likely to be after the war. It is, however, safe to say that in the earliest years investment urgently necessary will be in excess of the indicated level of savings. To be a little more precise the

former (at the present level of prices) is likely to exceed £m1000 in these years and the indicated level of savings to fall short of this.

6. In the first phase, therefore, equilibrium will have to be brought about by limiting on the one hand the volume of investment by suitable controls, and on the other hand the volume of consumption by rationing and the like. Otherwise a tendency to inflation will set in. It will probably be desirable to allow consumption priority over investment except to the extent that the latter is exceptionally urgent, and, therefore, to ease off rationing and other restrictions on consumption before easing off controls and licences for investment. It will be a ticklish business to maintain the two sets of controls at precisely the right tension and will require a sensitive touch and the method of trial and error operating through small changes.

7. Perhaps this first phase might last five years,—but it is anybody's guess. Sooner or later it should be possible to abandon both types of control entirely (apart from controls on foreign lending). We then enter the second phase which is the main point of emphasis in the paper of the Economic Section. If two-thirds or three-quarters of total investment is carried out or can be influenced by public or semi-public bodies, a long-term programme of a stable character should be capable of reducing the potential range of fluctuation to much narrower limits than formerly, when a smaller volume of investment was under public control and when even this part tended to follow, rather than correct, fluctuations of investment in the strictly private sector of the economy. Moreover the proportion of investment represented by the balance of trade, which is not easily brought under short-term control, may be smaller than before. The main task should be to *prevent* large fluctuations by a stable long-term programme. If this is successful it should not be too difficult to offset small fluctuations by expediting or retarding some items in this long-term programme.

8. I do not believe that it is useful to try to predict the scale

of this long-term programme. It will depend on the social habits and propensities of a community with a distribution of taxed income significantly different from any of which we have experience, on the nature of the tax system and on the practices and conventions of business. But perhaps one can say that it is unlikely to be less than $7\frac{1}{2}$ per cent or more than 20 per cent of the net national income, except under new influences, deliberate or accidental, which are not yet in sight.

9. It is still more difficult to predict the length of the second, than of the first, phase. But one might expect it to last another five or ten years, and to pass insensibly into the third phase.

10. As the third phase comes into sight, the problem stressed by Sir H. Henderson begins to be pressing. It becomes necessary to encourage wise consumption and discourage saving,—and to absorb some part of the unwanted surplus by increased leisure, more holidays (which are a wonderfully good way of getting rid of money) and shorter hours.

11. Various means will be open to us with the onset of this golden age. The object will be slowly to change social practices and habits so as to reduce the indicated level of saving. Eventually depreciation funds should be almost sufficient to provide all the gross investment that is required.

12. Emphasis should be placed primarily on measures to maintain a steady level of employment and thus to prevent fluctuations. If a large fluctuation is allowed to occur, it will be difficult to find adequate offsetting measures of sufficiently quick action. This can only be done through flexible methods by means of trial and error on the basis of experience which has still to be gained. If the authorities know quite clearly what they are trying to do and are given sufficient powers, reasonable success in the performance of the task should not be too difficult.

13. I doubt if much is to be hoped from proposals to offset unforeseen short-period fluctuations in investment by stimulating short-period changes in consumption. But I see very great attractions and practical advantage in Mr Meade's proposal

for varying social security contributions according to the state of employment.

14. The second and third phases are still academic. Is it necessary at the present time for Ministers to go beyond the first phase in preparing administrative measures? The main problems of the first phase appear to be covered by various memoranda already in course of preparation. Insofar as it is useful to look ahead, I agree with Sir H. Henderson that we should be aiming at a steady long-period trend towards a reduction in the scale of net investment and an increase in the scale of consumption (or, alternatively, of leisure). But the saturation of investment is far from being in sight to-day. The immediate task is the establishment and the adjustment of a double system of control and of sensitive, flexible means for gradually relaxing these controls in the light of day-by-day experience.

15. I would conclude by two quotations from Sir H. Henderson's paper which seem to me to embody much wisdom.

Opponents of Socialism are on strong ground when they argue that the State would be unlikely in practice to run complicated industries more efficiently than they are run at present. Socialists are on strong ground when they argue that reliance on supply and demand, and the forces of market competition, as the mainspring of our economic system, produces most unsatisfactory results. Might we not conceivably find a *modus vivendi* for the next decade or so in an arrangement under which the State would fill the vacant post of entrepreneur-in-chief, while not interfering with the ownership or management of particular businesses, or rather only doing so on the merits of the case and not at the behests of dogma?

We are more likely to succeed in maintaining employment if we do not make this our sole, or even our first, aim. Perhaps employment, like happiness, will come most readily when it is not sought for its own sake. The real problem is to use our productive powers to secure the greatest human welfare. Let us start then with the human welfare, and consider what is most needed to increase it. The needs will change from time to time; they may shift, for example, from capital goods to consumers' goods and to services. Let us think in terms of organising and directing our productive resources, so as to meet these changing needs; and we shall be less likely to waste them.

KEYNES

25 May 1943

On reading Keynes's note, Sir Wilfrid Eady commented.

From SIR WILFRID EADY, *26 May 1943*

I see no objection to the circulation of your note on the Maintenance of Employment. It is a voyage in the stratosphere for most of us.

We are proposing in the first stage to ask Ministers to endorse the stabilisation and control policy for the early transitional period in detail: so far they have approved it in principle.

When we all know what is to happen in the transition period we can begin to look at the next phase. You will find your official colleagues obtuse, bat-eyed and obstinate on much of this!

W.E.

Keynes replied

To SIR WILFRID EADY, *27 May 1943*

THE LONG-TERM PROBLEM OF FULL EMPLOYMENT

Very sorry, but it does seem to me quite essential that all of you should become accustomed to the stratosphere—if that is really what it is! For, if the argument which I have tried to bring into the open in my paper is not understood by those responsible, they are understanding nothing whatever. It seemed to me advisable to make explicit the argument which underlies both Meade and Henderson. If you do not understand that, you are, as I say, understanding nothing, certainly neither Henderson nor Meade.

And, after all, it is very easily understood! There is scarcely an undergraduate of the modern generation from whom these truths are hidden. And, once they have been digested and have entered into the apparatus of the mind, it is possible for most people to move fairly safely over a terrain otherwise most dangerous.

KEYNES

Keynes's memorandum also led to further correspondence with James Meade.

To J. E. MEADE, *27 May 1943*

My dear James,

I enclose a brief note which I have written on the Long-Term Problem of Full Employment. You will notice that I do not directly traverse your paper. Indeed, I have no wish to do so. My criticisms are not of substance but of emphasis. And they really boil down to two points—(1) I think you lay too much stress on cure and too little on prevention. It is quite true that a fluctuating volume of public works at short notice is a clumsy form of cure and not likely to be completely successful. On the other hand, if the bulk of investment is under public or semi-public control and we go in for a stable long-term programme, serious fluctuations are enormously less likely to occur. I feel, therefore, that you do a little less than justice to investment under public auspices by emphasising the deficiencies of this method in the short period, whilst under-estimating their efficacy for preventitive purposes and as a means of avoiding the sharp fluctuations which, once they have occurred, it is so difficult to offset.

(2) I have much less confidence than you have in off-setting proposals which aim at short-period changes in consumption. I agree with Henderson that one has to pay great attention to securing the right long-period trend in the propensity to consume. But the amount one can do in the short period is likely to be meagre. I think it may be a tactical error to stress so much an unorthodox method, very difficult to put over, if, in addition to its unpopularity, it is not very likely to be efficacious.

It did not seem to me that Henderson's document was really very inconsistent with yours. It was largely concerned with a more distant period. Both of you, I think, are in danger of getting a little too academic for the purpose of Ministers. The only matters about which it is necessary that they should take immediate decisions relate to the first phase, whereas you, as it seems to me, are largely concerned with the second phase, and Henderson with the third phase.

However, I must not accuse you of being academic, since Eady tells me that my own paper moves in the stratosphere and will be entirely unintelligible to any civil servant,—to which, however, I am replying that he really must try to understand it, since the theory which I have brought out into the open underlies both your paper and Henderson's. If he does not understand this, he understands nothing. And, if, not understanding this, he thinks he understands either you or Henderson, he is deceiving himself.

Yours,
[copy initialled] K.

From J. E. MEADE, *31 May 1943*

My dear Maynard,

Thank you for your letter of 27th May and for your note on 'The Long-term Problem of Full Employment'.

I am glad that in the main you sympathise with the substance of our paper. On the question of substance I have only one comment to make on your letter. In the present draft of our paper we do not, I think, lay any very great emphasis on controlling the propensity to consume except through such schemes as that for variations in social security contributions, with which I understand you agree. Paragraphs 45 and 46 of our paper tend to rule out the use of ordinary fiscal policy for this purpose and lead up merely to the proposal of the social security scheme (or possibly as an alternative a deferred credit scheme) as 'stop-gap' to prevent the multiplier from getting under way. I should have thought, therefore, that the present draft (although not, I agree, earlier drafts) of our paper was not open to criticism on the grounds of stressing this unorthodox method.

I confess, however, that I cannot so readily assent to your suggestion that Ministers need not at the moment take decisions relating to anything later than the first post-war period in which supplies will be scarce and effective demand will be high. There are a number of reasons for taking the opposite view:

(i) I will not deny that the period of excess demand *may* last as long as five years as you suggest in your note, but I should have thought that it was at least possible (in my opinion more probable) that it would not last longer than two to three years. After all the amount of physical damage in relation to total capital stock is really not so huge, and there have been great increases in productive equipment and in productive efficiency etc. here and in the United States. The actual replacement of deficiencies so that we get back to where we were in, say, 1938 may not take much longer than a couple of years, particularly in view of the spurt that may occur in output per head as a result of wartime progress in technique. But if it is *possible* (even if it were not probable) that we shall, after two years of peace, be back where we were in the 1930s, Ministers should by the end, say, of the first year of peace have taken more or less final decisions on the broad lines on which they intend to deal with the situation. In view of all the complex problems they will have to deal with in the post-war period and of the hectic political situation in which they will have to operate, it is certainly not too soon for them to start work on this subject now in the calm of war.

(ii) Much work *has* already been done and many decisions by Ministers *have* already been taken on the immediate post-war problems. It is not as if Ministers were being asked to neglect these immediate post-war problems in order to build a distant Utopia. Having taken general decisions on the first stage, and having started detailed work on that stage, they are being asked now to prepare to take general preliminary decisions on a stage only a little further on.

(iii) What we plan to do in the immediate post-war transitional period should be related to our rather longer aims. There is a grave danger that Whitehall will plan to deal with these immediate transitional problems as if the problems were completely separate from the subsequent problems. For example, Civil Servants always treat the problems of 'physical reconstruction' and of 'public works policy' as if they existed in separate universes. In your note you properly show that, fundamentally, the same analysis applies to each of the three periods which you analyse; and the same should be true to a certain degree in our administrative mechanisms for dealing with them. In fact, some of the immediate post-war mechanisms which will be useful for restricting an excess demand would be useless as a means of stabilising or stimulating demand in a future period; these mechanisms should naturally be temporary. But other mechanisms can be used to stabilise and stimulate as well as to restrain, and it might be wise to turn these into more or less permanent features of our economy from the start. Is it, for example, really political wisdom to suppose that we shall have any chance of success if we put off discussing the scheme for variations in social security contributions until the close of the first transitional period, when the social security plan as a whole will be not only determined but actually in operation, when political wrangling will have started again, and when the willingness on the part of politicians and the public to consider radical changes will have passed? This is the surest way to assure that we shall get no such scheme.

(iv) The above arguments, in my opinion, provide solid economic reasons for the view that we ought to be concerned with these problems as soon as possible. There are, in addition, equally convincing political reasons. The public are, I am told, more concerned about employment prospects after the war than about any other major post-war issue. As the prospects of victory become clearer, this public interest will become more and more marked. Already Beveridge has set up his bureau to deal with the problem. He will probably get the answer wrong; but if his is the only answer in the field, and if the Government has not its own answer ready (and an answer which does not refer merely to good prospects of employment for a year or so after the war) there will be another first-class political row.

(v) Finally, I feel that it would be truly tragic if this opportunity were lost. The policy which is advocated is one which is to the interest of all classes and all political parties; it is one for the success of which intellectual enlightenment rather than a change of heart is required; and we have at the moment the unique opportunity of all political parties in a government which is seriously willing to consider social innovations. The opportunity is unlikely to recur. Perhaps you will allow me to add the personal note that, in these matters of a full employment policy, I have always regarded you as the guiding intellect and the moving force; and I believe that in this I am typical of the younger generation of economists.

Yours sincerely,

J. E. MEADE

To J. E. MEADE, *2 June 1943*

My dear James,

The Problem of Full Employment

I should find it easier to say whether I agree with you that there are further decisions which Ministers ought to take in the near future if you would tell me what the decisions are which you think they ought to take.

You will have noticed that in my paper I deliberately excepted your social security contributions proposal from deferment. I agree with you that this deserves early consideration. But I am not clear what else there is, which does not too much depend on the actual progress of events for it to be ripe for ministerial decisions at this stage.

Yours,

[copy initialled] J.M.K.

From J. E. MEADE, *3 June 1943*

My dear Maynard,

The Maintenance of Employment

Thank you for your letter of 2nd June. The following are the main points on which, in my opinion, Ministers might fruitfully take decisions in the near future—

(i) We are agreed that the social security contributions proposal falls into this category. In this connection I would only add that, if for one reason or another it should be rejected, Ministers should then proceed to consider the possibility of continuing into normal times of peace a scheme of deferred income tax credits on the principles outlined in Appendix F of our memorandum. Personally I vastly prefer the social security scheme. But the income tax scheme would be better than nothing; and in this case also the golden opportunity might be missed, if a decision was postponed until after the transitional period when the principle of deferred credits will have been forgotten.

(ii) There are decisions which should be taken now on the control of investment. It should be realised that the forward planning, control and timing of public investment is important both in the immediate transitional period, in order to restrain and spread out the demands for physical reconstruction, and also in the longer period for the stimulation of such investment. For example, it might be decided, in principle, that public authorities should prepare and revise annually a five-year plan for their future capital works, and this should be reviewed periodically by a central body for the purpose of the proper timing of expenditure. Certain inducements might be considered to persuade local authorities to keep in step with such a plan, e.g. by varying the rate of state grants for different types of works, according to the period in which they were undertaken. Here surely is a field of action and of administration, which is equally relevant to the immediate post-war period of restraint and to the subsequent period of stimulation. The danger is that if Civil Servants and Ministers concentrate exclusively on *ad hoc* mechanisms for restraint immediately after the war, they will fail to have built their controls in a way which will also be useful for stimulation later on. In that case we may well be caught napping again.

(iii) I am pretty sure that the same principle might be applied in perhaps a lesser degree to the control of private investment. Various measures will be used immediately after the war for its restraint. Which of these measures of control will, and which will not, be useful later on to stimulate private investment? This question should be considered now, since it should influence the way in which the controls are instituted or developed in the immediate post-war transitional period.

(iv) A minor matter. We have suggested in our paper (paragraph 44) that it may be worth while controlling the terms of hire-purchase finance in such a way as to impede such purchases when restraint is needed and to ease them when stimulation is required. Here again is a mechanism which might be usefully employed to restrain buying in the immediate post-war period, but could subsequently be readily used to stimulate buying. This would be much preferable to the employment, during the former period, of an *ad hoc* and temporary measure of restraint which will have no subsequent use.

(v) There are broad issues on which Ministerial decision should be sought for the purpose of dealing with 'structural' unemployment. For example, the problem of labour transfer (occupational and geographical) should not be regarded as merely a question of shifting labour during the immediate post-war period from war-like to peaceful occupations. Labour movement must be regarded as a continuing need, and decisions should be taken now to perpetuate, and, in certain cases, to develop so much of the Ministry of Labour machinery for this purpose as is considered desirable. Here, in my view, is an outstanding case of the need for considering the long-term problem when decisions are being taken on the maintenance of controls in the transitional period. I am one of those who think that it would be useful to offer two rates of unemployment benefit, a specially favourable rate being offered to those who are willing to be moved about. But whether or not this particular device is desirable, the subject wants discussion and decision as a long-run as well as a short-run problem.

(vi) The same is true of the location of industry. The problem of bringing work to the men (as a supplement to bringing men to the work) should be regarded as a continuing one; and decisions should be taken now with this in mind, and not merely with a view to improvising a temporary means of getting industry going in black spots after the war.

The above are examples of important economic issues on the long-run aspects of which discussions and decisions should be started now. I have tried above to outline the substantive economic reasons why decisions on these matters should be taken at once. You will see that one of my main reasons is that the decisions which are taken about the short run will be relevant to long-run policy and should, therefore, be taken after a consideration of the needs of the longer run. But I have also a subsidiary 'political' reason which I mentioned in my earlier letter, namely that many of these things will require considerable legislative or administrative changes and that these changes may be politically possible now or immediately after the war, and impossible later on.

The overriding argument, in fact, for taking decisions now, in my opinion, is yet another political consideration. The public are demanding plans for post-war employment policy; and if the Government have not fairly soon reached preliminary decisions on the matter (extending well beyond the immediate post-war transition) there will be another political explosion.

May I end by an *argumentum ad hominem*? In the international sphere you have advocated an International Clearing Union. In the immediate post-war years the principles of such a Union could not be fully applied. We shall need to continue all sorts of exchange controls on current payments for a period of years; we must hope that the principles of Mutual Aid in international commerce will be continued at least for some time at least for some purposes such as relief; and a whole series of *ad hoc* measures will be required to keep international monetary and commercial relations in balance. The Clearing Union scheme is, in essence, a longer-term measure for more normal times. Why, in this case, did Ministers need to take these decisions of long-term principle *before* they considered all the detailed hugger mugger of the process of adjustment? The answer, in my view, is clear: it was in order that they might see where they were going before they started to go there. Is not this true of internal policy also?

Yours sincerely,

J. E. MEADE

To J. E. MEADE, *7 June 1943*

My dear James,

The Maintenance of Employment

Substantially there is nothing with which I disagree in the list given in your letter of June 3rd of the main points on which Ministers might take early decisions. Indeed, the first page and a half of your letter seems to me to give much more suitable material for a brief memorandum for Ministers than the documents actually in their hands.

When I said that there was nothing on which Ministers could take early decisions, I did not mean to rule out these various important matters. My point—not clearly expressed—was that it did not seem to me that any matters arose either out of yours or out of Henderson's memorandum which led up to decisions which ought to be taken now.

None of the points in your letter of June 3rd seem to me to depend in the least either on the academic argument set forth in the Economic Section's memorandum or in Henderson's. None of the disputed points of fact, or prognosis, or prescription, or theory, implicit in these documents affects to any significant extent the six points in your letter of June 3rd. Nor do I think—though that is dangerous matter on which to prophesy—that any of them would meet with much difficulty or controversy from Henderson. These points have the great advantage of bringing the issues back to practical matters and away from a debate, which seemed to me was getting academic and might be endless.

Yours,

[copy initialled] K

Meade's paper came before the meeting of the Ministerial Committee on Reconstruction Priorities on 31 May. At the meeting, the Chancellor argued that it went too far and that he would like to make his own contribution in the future in a Treasury note. The meeting agreed to ask the Lord President to formulate proposals for future work on post-war problems, especially the transitional period, industrial location, labour mobility and public works. The upshot was the appointment in July of a Steering Committee on Post-War Employment, under the chairmanship of Sir Richard Hopkins, to carry out and co-ordinate the investigations.

Before the Steering Committee began its deliberations, Keynes was involved with other members of the Treasury, Economic Section, and Central Statistical Office in preparing another estimate of the post-war national income. In the early drafts, Keynes provided a chapter on the probable range of fluctuation of the estimates around a central estimate of just over £7,000 million for the national income at factor cost in 1948.

From 'Influences Affecting the Level of the National Income', June 1943

CHAPTER III: THE PROBABLE RANGE OF THE POST-WAR NATIONAL INCOME

30. Some of the factors analysed above are known with some precision; others are likely to change during the period in view, but have been assumed to remained stable because there is no sufficient evidence for predicting any particular degree or direction of change; others again cannot affect the final result significantly even if they vary somewhat widely. The gap between the more optimistic and the more pessimistic expectations which can reasonably be held, depends almost entirely on the view taken about three main factors: (*a*) the number of employed wage-earners; (*b*) the increase of productivity; (*c*) the terms of international trade.

31. The number of employed wage-earners may come to differ from that assumed in the table of reference for the following reasons:

(i) The number of women, who would not have been 'occupied' before the war but remain in employment as a result of the war, has been taken at 500,000. The Ministry of Labour believe that this is the lowest likely figure. The actual figure may conceivably prove to be as much as 250,000 higher.

(ii) The table of reference makes no allowance whatever for casualties, either military or civilian, not even for those which have occurred up-to-date. So far deaths from all causes in the forces amount to about 300,000 and deaths to civilians by enemy action to about 75,000. Not the whole of the resulting aggregate of 375,000 falls to be deducted from the estimate of the 'occupied' wage-earners, since not all the casualties are at the expense of the wage-earning class and since an allowance has already been made for normal mortality. Casualties up-to-date are, perhaps, sufficient to require a reduction of 250,000 from the estimate of 'occupied' wage-earners assumed in the table of reference. To this there has to be added a conjectural allowance for the casualties yet to come.

(iii) Taking (i) and (ii) together it is evident that the basic assumption for the numbers of the occupied population is likely to be somewhat too high. But a more important cause of divergence (either way) from the basic figure is the unemployment percentage which it is appropriate to apply to the occupied wage-earners to obtain a figure for the employed wage-earners. The assumption in the table of reference is an average unemployment of 1,200,000 or approximately $7\frac{1}{2}$ per cent of the total wage-earning population. (This is a mean figure and does not assume that unemployment will never rise above this or fall below it.) If we expect a return to more or less the same conditions which obtained in the ten or twelve years before the war, this is an optimistic figure. It might be argued that, even if we are more successful in handling cyclical unemployment, structural unemployment may prove a problem still more intractable than before in a free enterprise society which cannot direct (in peacetime as distinguished from wartime) either enterprise or labour to the desired activities or locations. On this more pessimistic view it might be prudent to look forward to an average unemployment of not less than (say) 1,500,000.

Against this it may be argued that even 1,200,000 is a pessimistic assumption in the light of the greater knowledge and experience of these problems and, above all, of the greater will to grapple with them and to regard their solution as one of our primary responsibilities, which exists today in all quarters. We cannot, on this view, regard the unemployment problem as substantially solved so long as the *average* figure is greater than 800,000, namely 5 per cent of the wage-earning population, or rest content without resort to drastic changes of policy so long as it exceeds 1 million. Those who feel confidence in the accuracy of current diagnoses of the problem and of our will-power to apply the appropriate remedies, would think it justifiable to assume an outcome more favourable than an average figure of 1,200,000, though they would readily admit that a higher figure is easily realisable on the basis of pre-war experience, if we adopt no new policies and are no more energetic and enterprising than in the decade of the thirties; and equally so if we are quite on the wrong lines in our new policies and ideas.

32. Taking one thing with another and allowing for all the considerations under (i), (ii) and (iii) above, it is likely that the optimists would not wish to improve on the basic assumption and would agree that it would be rash to rely on anything much better than this; while the pessimists might claim that this assumption may over-estimate the numbers of the employed population (including a substantial allowance for future casualties) by as much as (say) 750,000. Since, according to the ready-reckoner (§27 above), each reduction of 250,000 reduces the national income by £100 million, the net effect of this would be a reduction of the estimated national income by £300 million.

33. The other main assumption, capable of leading to a wide divergency of estimates, relates to the increase of productivity and of efficiency in production and distribution. The basic assumption in the table of reference supposes that the experience of the war has made no difference whatever, neither one way nor the other, to our efficiency and to our knowledge of new methods. It allows for the normal peace-time rate of progress of $1\frac{1}{2}$ per cent per annum, but nothing extra for the shake-up of the war experiences of industry, for the intensive training of labour, for the widespread introduction of the fruits of the best American experience, for necessity being the mother of invention, or for the long-overdue discarding of much dross and waste which clogged the pre-war system of production and distribution in this country. It assumes that industry will immediately relapse into doing exactly what it would have been

doing, or rather into that state of efficiency (or inefficiency) which it would have attained (or maintained), if the war had not occurred.

34. It is possible that the pessimistic school may rest content with this and not argue that the effect of the war on industry and distribution has been to deprive it of the normal progress which it would have made in the absence of the war. In this case it will be satisfied with the assumption in the table of reference, just as the optimistic school might accept the table's assumption concerning the numbers of the employed population.

35. On the other hand, there are substantial reasons for reaching a widely different conclusion. These reasons are partly statistical and are partly based on common observation of a number of separate facts. They can be conveniently reviewed under the following heads,—somewhat at length, since the crucial question in forecasting the national income is that of the right conclusion on this head.

36. (i) Apart from the adoption of new methods and inventions which the pressure and experience of the war have brought into existence, there was in 1938 great scope for the introduction into this country of methods and machinery which had been already adopted elsewhere, particularly in the United States. Details have lately become available (*Economic Journal*, April 1943, pp. 39–54, 'Industrial Production, Productivity and Distribution in Britain, Germany and the United States' by L. Rostas) for comparing physical output per head in certain manufacturing industries and mining based on the 1935 Census of Production in the U.K. and the 1937 Census of Manufactures in the U.S. These show that output per head in the U.S. ranged from four times greater (or even more) in iron and steel products, motor cars, and radio sets, and nearly three times greater in machinery, down to no more than 20 or 30 per cent greater in cotton textiles. Over the whole range of manufacturing industry American output per head averaged about double the British output. (On the other hand, there was little to choose

between British and German output per head.) Output per hour showed an even greater superiority than this, since American hours of work were appreciably less than the British. Some part of this superiority may have been due to natural advantages of size of market and in other respects. But a major explanation of it must also have been the use of more modern machinery, methods and factory layout, which were quite capable of being introduced into this country. Can we not expect, and indeed decide, to overcome some part at least of this avoidable inferiority? If so, we are entitled to anticipate a once-for-all addition to the normal rate of progress as a result of our having taken advantage, not of new technical inventions, but of those which have been already employed for some time in the U.S.

37 (ii) Is there not some evidence that considerable progress has in fact been made during the war in the direction of gaining ground on the U.S. over a wide front? An important piece of such evidence is to be found in the enquiries made by the Ministry of Production into the relative prices of production of the leading types of munitions of war which are being currently produced both here and in America. These indicate that on the average of such products our money prices of production in terms of money are less than two-thirds of the costs of similar products in the United States.* Having regard to the much higher level of money wages, the wider margin of profit and the larger allowance in the price for writing down capital expenditure in the U.S., this still indicates an appreciably higher output per head there than here. But, if allowance is made for these factors it would appear that American superiority in current output per head is not more than 25 to 50 per cent greater than here, which is a very great improvement on the pre-war position as indicated above. Moreover the comparison is in precisely those fields where American superiority used to be most marked. It would seem that our relative efficiency, over and above the current

* Ministry of Supply products—British prices 66 per cent of American; M.A.P. products, 57 per cent ship-building, 40 per cent.

improvements common to both countries, can scarcely have improved by less than 50 per cent on the average of the output covered by the Ministry of Production, and must have gained a great deal more than that in certain directions. Admittedly these figures cover only a part of the whole field. They provide in themselves no evidence of a relative gain in such important industries as, for example, textiles, building and coal. Moreover these industries have experienced in wartime the signal advantage of working to full capacity on the optimum technical scale of output. Nevertheless material gains should surely survive the war. The industries in question are amongst those which traditionally have been regarded as most suitable for this country, but which happened to have reached a dangerous age in the period before the war when they were tending to become fossilised in old practices and had fallen seriously behind America through a failure to adopt the best modern methods and machines. The whole of our engineering industry, both heavy and light, has been violently shaken out of its old habits and has been forced in a brief period to learn the use of the best modern precision tools, of factory layout, and, when suitable, of mass-production methods. There is evidence, as we have seen, that they have learnt their lesson well and have gone a long way towards overtaking American practice. Once the general ideas which lie behind the best modern practice have been learnt, they are easily applied to types of product different from those in the production of which the lesson was first learnt. Also the native capacity and originality of this country's designers and inventors has been fully confirmed by this war's experience. With modern methods of application behind them they should again be able to lead the world. No doubt such cheerful words will cause the heads of the very wise to wag with alarmed precaution. Nevertheless to suppose that all the above has gone for nothing would be an extreme assumption.

38. (iii) Some statistical evidence covering a much wider field than that of the Ministry of Production can be derived from the

conclusions of the latest statistical White Paper. The table of reference is based on 1938 and takes no account of what may have already happened to the growth of efficiency between 1938 and 1942. The adoption of this method has been inevitable in view of the abnormal conditions of 1942 and the difficulty of measuring with precision the comparative efficiency of that year and of the last pre-war year. But this does not mean that no relevant evidence about what has been happening can be obtained from the White Paper figures for 1942. The main difficulty is in calculating the price of the large proportion of total output which was produced for the Government. The White Paper estimated the increase in net factor cost of civilian consumption at 36 per cent, but did not attempt a figure for Government output. The price increase for such output was certainly much less than 36 per cent. Perhaps it would be safe to say that the increase in net factor cost for output as a whole was not greater than 30 per cent. If the growth of efficiency is worked out on this assumption, it is found to be about 12 per cent for the four years 1938 to 1942, instead of 6 per cent ($1\frac{1}{2}$ per cent for four years) as assumed in the table of reference. If we were to assume that this gain of efficiency will be retained and keep all the other assumptions (i.e. as to the hours of work in 1948 and the gain in efficiency between 1942 and 1948) the same, the estimate of net national income in 1948 would be about £m7,500, compared with £m7,087 in the table of reference. Now in some important respects we must expect that the gains of efficiency in wartime will be lost in peace-time conditions, if only because a large part of production will be changed over from directions where we have learnt maximum efficiency into directions where we still have much to learn. On the other hand, there are also important respects in which wartime production is at a grave disadvantage. The handicaps of the black-out, of transport difficulties, of inability to obtain delivery of necessary supplies, of rapid changes in type of product, of the loss to the armed forces of a large proportion of the most efficient labour in the prime of life, of using unskilled labour for skilled jobs, of excessive hours of work, of wear and tear not made good, of lack of opportunity to overhaul and repair plant and machinery–all these things mount up in the aggregate to a very great loss of efficiency which will certainly be recovered and made good when peace returns. It is paradoxical to maintain that productive efficiency per hour of work (not *aggregate* output which is the result of intensive hours of labour for the loss of which we have already made full allowance) will be very greatly less than it is now, when all the handicaps mentioned above have been removed.

39. (iv) We turn, finally, to a short catalogue of some facts of common observation which may be held to confirm, rather than question, the broad indications of the statistical evidence marshalled above:

(*a*) Many new factories with modern layout have been constructed, and there has been much capital expenditure of permanent value in manufacturing industry.

(*b*) A vast quantity of the most modern machine tools, are in the hands of every engineering firm, large or small, throughout the country. Some of these tools are general purpose, others can be adapted, but chiefly the users have learnt what can be done with this type of tool.

(*c*) There has been a very large increase in electrification.

(*d*) Wartime concentration has led to a great reduction of unnecessary types and much greater standardisation.

(*e*) Similarly it has led to the elimination of unnecessary processes and packing and useless extras.

(*f*) Also to the elimination of unnecessary labour and services both in production and distribution. Firms have been forced to give attention to what can be eliminated without disadvantage such as they might never have given except under pressure.

(*g*) The enormous economies of straight-run production to the maximum optimum capacity have been made abundantly clear to all producers.

(*h*) Necessity really has been the mother of invention in tens of thousands of cases.

(*i*) Successful experiments have been made in mass-production methods of what are called 'utility goods', which are of particular value because they are perfectly suitable to be carried over and indeed extended in peacetime production.

(*j*) British agriculture has enjoyed some revolutionary changes of method which may well increase its permanent efficiency by (say) 30 per cent.

(*k*) The experience of the Ministry of Food in the production, purchase and distribution of what constitutes more than a quarter of national consumption should have immensely valuable permanent results.

Again, it seems pessimistic to suppose that all this will have gone for nothing, which is what the table of reference assumes, and that we shall immediately relapse in all these respects to pre-war practices.

40. There remains the question of the post-war terms of international trade; that is to say, the question whether the prices of what we import are likely to rise more or less than the prices of what we export. In this respect the table of reference assumes no change in 1948 compared with 1938. In fact there has been no significant change during the war—partly as the result of the success of the Food Ministry and the Supply Departments, greatly aided by their control over shipping and by the shortage of shipping, in retarding the rise in the prices of what we buy, and partly because we can sell our restricted volume of exports for anything, within reason, that we choose to ask. But it would be unjustifiably optimistic to assume a continuance of this state of affairs after the war. The relationship of the prices of primary to manufactured products in 1938 was exceptionally in our favour. There is a widespread movement throughout the world in favour of improving the position of primary producers. If the relationship were to return to what it was in 1924, it would cost us £220 million a year, whilst a

return to the conditions of 1911 would cost us something of the order of £500 million. In fact, it was the progressive change of the terms of trade in our favour since 1911 that enabled us to surmount the difficulties arising from the loss of our foreign investments in the last war and of much of our staple textile exports between the wars. A large part of this improvement was due to changes in productivity on the continuance of which we can rely. But we must certainly be prepared for some reversal of the trend, and a reduction on this account of the estimate in the table of reference by less than £100 million (which would allow our imports to rise in price by $8\frac{1}{2}$ per cent compared with our exports) would not be reasonably prudent.

41. Taking all these matters into consideration and making allowances for the many difficulties of the post-war years—adopting, in fact, what the optimists would regard as a sufficiently cautious view—an estimate of £m7,250 for the net national income in 1948 rising to £m7,700 in 1952 might be suggested as suitably conservative. This is considerably short of what might be reached in all-round favourable conditions.

42. If, on the other hand, it is thought more prudent not to assume that we shall solve the new problems of post-war unemployment before we have done so, and not to assume that we shall retain wartime improvements in efficiency until this is proved to be the case,—if, in short, it is better to base ourselves on our pre-war experience rather than on hopes engendered by the energies and will-power of wartime before these hopes have been actually fulfilled in the slacker times of peace, then an estimate of (say) £m6,800 for 1948 rising to £m7,200 in 1952 is to be preferred. Even the lowest of these figures represents a substantial increase, namely about 12 per cent, in the real national income compared with 1938, whereas the estimate of £m7,250 for 1948 assumes an improvement of no less than 22 per cent over 1938 in real terms (though chapter II above shows that in the light of past experience there is nothing very unlikely in this).

42. In conclusion, an assumption (or method of presentation), which underlies all the estimates of these three chapters, needs to be emphasised. Prices in 1948 are assumed to have jumped 35 per cent over the 1938 level, which supposes that average hourly wages and other costs, including the increased cost of imports through a worsening of the terms of trade, have risen over this period by that much in excess of any improvement in efficiency. This allows room for an improvement in hourly earnings in 1948 by more than 35 per cent compared with 1938, the exact amount of the permitted excess depending on the growth of efficiency, the degree of deterioration in the terms of international trade and the growth of certain other costs such as the share of social security contributions falling on employers. After 1948 prices are assumed to remain unchanged. This means that hourly money-wages and other costs (including any further deterioration in the terms of international trade) will be free to rise cumulatively by the amount of the improvement in efficiency without disturbing the price-level. If efficiency rises by 1½ per cent per annum, then (provided there is no reduction in hours of work) it is assumed that this will be absorbed by higher wages, etc, not by lower prices leaving the average price-level unchanged.

43. There is a certain trap in this method of presentation which needs to be exposed. The term 'efficiency' is not clear and unambiguous and needs to be defined. Human services directly applied, as for example in domestic service or in education, are assumed to have a constant efficiency, since there is no measurable change in the quantity of the product, though there may be in its value. Thus in order to attain an increase of efficiency of (say) 1½ per cent per annum averaged over the whole of output, it is necessary to have an appreciably larger increase than this in the manufacturing industries where progress makes itself measurably felt in the quantity of a given product per unit of human labour. Nevertheless increases in the remuneration of services directly applied must obviously keep step, more or less, with increases in other wages. It follows that the

fruits of a quantitative increase in output in manufacture have to be shared by the producers of this output with those otherwise employed whose services are equally indispensable to society. Thus if manufacturing efficiency increases by 3 per cent, this may mean an over-all increase of 'efficiency' interpreted as above by no more than 2 per cent; and if an increase in hourly wages in manufacture is to be accompanied, as it should be, by an equal increase elsewhere in fields of necessary activity not equally susceptible to the gains of technical progress, the increase in wages must not exceed 2 per cent. It follows that the prices of manufactured products will tend to fall and the cost of direct services, etc to rise, thus keeping stable the price level as a whole. This assumption (which is an assumption for convenience of exposition and is not intended as a prophecy of what will happen) underlies the particular monetary measurement of the prospective national income which has been adopted in this memorandum.

Between Keynes's draft and the draft, dated 25 June 1943 which went to the Reconstruction Priorities Committee, the central estimate fell to £6,800 million and the discussions of the possible range of fluctuations became more pessimistic.[5] As a result, the final draft contained a note of dissent by Keynes.

NOTE OF DISSENT BY LORD KEYNES

In my opinion the conclusion that the effect of war experience on efficiency has gone for nothing cannot be sustained. If this is superimposed on other assumptions which are not very optimistic, the result reached is unnecessarily depressing. To expect a range of £m7,000 to £m7,400 would not be indulging exaggerated hopes—the position might well be better than the higher of these figures. This leads to a minimum figure of £m7,000, and this is the lowest estimate, in my judgement, on which we should base our plans. This will represent (after price adjustment) a very great reduction in the national income as it

[5] The Chancellor was prepared to take £7,000 million as a working basis.

will be at the end of the war, in spite of the return of some 3 million men from the forces into industry and the escape from the many handicaps which industry suffers in war conditions.

Whilst we may be overtaken after the war by many misfortunes, it is important to base policy on a consistent approach, even though this assumes hopes which are not certain of fulfilment. The figure of £m7,000 already assumes a state of affairs which many people will think disappointing. For example, it supposes that, if we have gained 5 per cent in efficiency as a result of the war, this will have been offset by average unemployment running up to 2 million. Moreover, if the national income falls significantly below £m7,000 this will probably mean a reduction of something like 20 per cent in the real earnings (including overtime) of wage-earners compared with what they are now, either because of unemployment or because of a reduction of real wages (though not more than 5 per cent need come off real wage rates), and that savings will not be sufficient to look after the building and other capital developments now in contemplation.

This memorandum approaches the problem from the *supply* side. If we approach it from the *demand* side, it soon becomes apparent that an estimate of less than £m7,000 makes no sense at all. I am preparing a brief supplementary memorandum giving what seems (to me at least) to be compelling reasons for this view—provided we accept the scale of capital investment which Departments are believed to have in view.

KEYNES

24 June 1943

At the time of these discussions, Josiah Wedgwood, a fellow director of the Bank of England,[6] gave Keynes another opportunity to spell out his view of post-war prospects.

[6] Hon. Josiah Wedgwood (1899–1968); Chairman (1947–67) and Managing Director (1930–61), Josiah Wedgwood & Sons, potters; Director of Bank of England, 1942–6.

From JOSIAH WEDGWOOD, *6 July 1943*

Dear Keynes,

I apologise in advance for this, but I am full of perplexity, and it is important to educate business men and bank directors. As you say, most people do not assimilate new economic or philosophic ideas after 25. I am trying to do a little better than that by reading (7 years late) your *General Theory of Employment [, Interest] & Money*. I am partly handicapped in understanding the definitions, detailed argument, and mathematical expression by having been brought up in the school of Cannan, who disliked the mathematical developments of the Marshallian School, and, like some other Johnsonian de-bunkers over-simplified and probably ridiculed too much.

(1) As far as I understand the argument of the *General Theory* and of your *Treatise on Money*, it is that if general unemployment is to be avoided, savings must find expression in 'real investment', and that the best way of ensuring this is to keep the rate of interest low enough for both state and business men to embark on a sufficient volume of additions to real capital. This involves state control of investment (similar to that exercised in wartime?).

(2) Alternatively or additionally the 'propensity to consume' must be increased, if employment falls off, but, despite remarks on pages 324–5, the main theoretic and practical emphasis seems to be laid on control of investment and the rate of interest as a necessary means of sustaining 'full employment'. Now I do not quite understand why keeping up the volume of investment and keeping down the rate of interest should necessarily have such a paramount importance in the anti-slump offensive—though perhaps some of your disciples give these measures a higher degree of all-importance than you do.

(3) Your example (page 129) *of avoiding unemployment and increasing real income and capital of the community by burying bottled bank notes in mines and digging them up again*: Since what we want is a 'full belly' rather than 'full employment', would not an equally good or better effect have been obtained (during the slump) by presenting the notes to the needy without the necessity for digging? I came to think in the '30s that if Government, instead of cutting the dole, had increased it, there would have been less unemployment, provided there were adequate safeguards against large scale 'lead swinging' and excessive trade union rigidity regarding swapping jobs and dilution etc. Is that true?

(4) More generally—does it not follow from your general argument that a guaranteed weekly minimum in sickness and health, in work or out of work (based on the known facts about existing national productivity and contingent only on the recipient's readiness to undertake any sort of work within his

mental and physical capacity) would help considerably towards 'full employment' in the desired sense? and that in so far as the Beveridge plan provides this, it helps to guarantee the employment assumption? (Always provided that (*a*) we are not tied to a system of fixed exchange rates and (*b*) Government and public are prepared to retain any controls and other war expedients necessary to stabilise the cost of living?).

(5) Returning to my lack of understanding of the paramount importance of the rate of interest—

(*a*) As you say in various passages, there are many ways (other than a low rate for borrowing) in which the community can get sufficient fresh capital (real investment) to maintain or increase its income.

(*b*) Again (as before) is it not often as easy and proper to increase consumption as to increase investment?

(*c*) I agree that in housing and public works 1 per cent in the rate of interest may make a good deal of difference. But it seems to me that in most manufacturing business one does not make decisions on extensions or improvements depending on 1 per cent or 2 per cent in the rate of interest. Certainly if one thinks one will be able in two or three years to borrow at 4 per cent, one may defer capital expenditure when the available rate is 6 per cent—but if one thought the rate would remain 6 per cent for a generation, I doubt if that would be a deterrent. Estimates of output, saving in costs, and future returns are open to too large a margin of error. So are estimates of upkeep, depreciation and obsolescence risk. The margin of error in all these items is far higher than the rate of interest itself. In my business, unless as careful an estimate as possible shows a minimum *net* return of 15 per cent to 20 per cent after deducting normal depreciation, I don't usually feel that capital expenditure on new equipment is likely to be economically justified—and I believe other business men think along the same lines.* If pressed as to why, I should say because one should usually allow at least 10 per cent to 15 per cent for optimistic error, risk of the unexpected, and obsolescence. That is when one is making a fair profit with existing equipment. Of course, if one is making little or no profit or a loss and capital expenditure on fresh equipment or building seems to offer the chance of working at a profit, then I agree that one might embark on it (if one could) for an estimated net return of as low as 10 per cent, or say 5 per cent over the rate of interest payable on borrowed money—because the alternative would be ultimate extinction. But I cannot think that the margin of error on the net return estimated from new buildings or plant could usually be

* My Railway uncle says the Railways used to stipulate 10 per cent net return on fresh capital normally and 20 per cent in bad times! Things are more cut and dried in railways than in manufacturing. J.W.

safely put at less than 5 per cent either way on the capital involved. There is so much inevitable guess work; the imponderables are usually pretty important; and e.g. I know that in the case of our new Works the cost saving hitherto has been greater on the un-budgeted than on the budgeted items. It seems to be like estimating walking times in mountainous country from an un-contoured or imperfectly contoured map!

(6) But, apart from any pre-war theoretical argument, it does seem to me that the rate of interest should be kept low after the war—in fact, kept as it is now—for many years by capital rationing (*a*) in order to enable Government and public authorities and others to borrow cheap and build cheap for essential works and priority goods, and (*b*) to enable short-term debt to be funded cheaply and (*c*) to safeguard the legitimate interests of Government bondholders. Is that correct theory and policy?

(7) Presumably, if home investment is to be stimulated by an 'artificially' low rate of interest, foreign investment must be strictly controlled also (and perhaps differential taxation on it introduced?) This alone means continuance of national Government Exchange Control, doesn't it?

(8) If, after the war, we decide to maintain and develop the measures and controls necessary to safeguard a healthy minimum income for all, to stabilise the internal price of necessaries, and to develop internal reconstruction with a low rate of interest, does it really matter greatly what happens to international Exchange rates? Those countries which follow our example will achieve stable exchange with the £, others not. Is this not better than being tied by the leg to the dollar, or to gold—or even to Bancor? That seems to the layman to be the fair deduction from the Keynes doctrine of the '30s and from Keynes practice in wartime. Is not 'Bancor' just an ingenious compromise to induce America to 'play ball' in the settlement of war debts and the reconstruction of Europe?

Again apologies for so long a letter and so many questions, which betray, I fear, not only colossal ignorance and 'rustiness' but also colossal optimism in hoping that a busy man is going to answer them! At any rate I hope it will not be long before we laymen have another pamphlet from you. I begin to realise why you want to get back to Cambridge after the War, for, as someone said, the world progresses by a series of calculated indiscretions, but institutional loyalty makes that difficult.

Yours sincerely,

JOSIAH WEDGWOOD

To JOSIAH WEDGWOOD, *7 July 1943*

Dear Wedgwood,

I am afraid that your questions are too long and searching for me to deal with them by correspondence. We must have a talk about it all sometime. In replying, I will limit myself to a point, which I think runs all through your letter. It is not quite correct that I attach primary importance to the rate of interest. What I attach primary importance to is the scale of investment and am interested in the low interest rate as one of the elements furthering this. But I should regard state intervention to encourage investment as probably a more important factor than low rates of interest taken in isolation.

The question then arises why I should prefer rather a heavy scale of investment to increasing consumption. My main reason for this is that I do not think we have yet reached anything like the point of capital saturation. It would be in the interests of the standards of life in the long run if we increased our capital quite materially. After twenty years of large-scale investment I should expect to have to change my mind. Even in the meanwhile it is a question of degree. But certainly for the first ten years after the war—and I should expect for another ten years after that—it would not be in the interests of the community to encourage more expenditure on food and drink at the expense of expenditure on housing. For that broadly is what it would come to.

There is also a subsidiary point that, at the present stage of things, it is very much easier socially and politically to influence the rate of investment than to influence the rate of consumption. No doubt you can encourage consumption by giving things away right and left. But that will mean that you will have to collect by taxation what people would otherwise save and devote to investment,—all of which would be a stiff job in the existing political and social set-up. Perhaps you may say that that is a reason for getting rid of the existing political and social set-up.

But is it clear that expenditure on housing and public utilities is so obviously injurious that one ought to attempt a social revolution in order to get rid of it?

Yours sincerely,
[copy initialled] K.

From JOSIAH WEDGWOOD, *10 July 1943*

Dear Keynes,

It was nice of you to bother with my letter, which clears up to a large extent my uncertainty as to your views on the rate of interest and your reasons for emphasising the desirability of more investment. I think I follow and agree with your first and second paragraphs, and the application of the second paragraph to post-war industrial problems has indeed been stressed by me in a memorandum on the pottery industry.

But I am not so certain that I follow your third and last paragraph, which leaves me guessing at the answer to my questions 3 and 4. For example, in the circumstances of 1930–3, if we assume that neither the plans nor the organisation for large scale public investment were ready, might not a short run policy of bread and circuses without additional taxation have been both possible and desirable? Or what are the implications of your treasury notes in bottles?

No—so pale an orange as myself does not deserve to be crushed by the steam hammer of your last two sentences! I am all for 'reform that you may preserve' (the proper motto for an old-established family business), and I also agree with the social philosophy of pages 374 and 380 of the *General Theory*.

I shall take seriously your kind suggestion of a further talk, and I hope you will really let me give you a return lunch on some convenient day, when cares of State are not too pressing. I look forward to seeing you at the Bank on Thursday.

Yours sincerely,
JOSIAH WEDGWOOD

During the summer of 1943, the Treasury also began to prepare a reply to the Economic Section memorandum by James Meade on the maintenance of employment for the Steering Committee. Keynes provided various comments on the Treasury draft written by Sir Wilfrid Eady.

To SIR WILFRID EADY, *10 June 1943*

MAINTENANCE OF EMPLOYMENT: THE DRAFT NOTE FOR THE CHANCELLOR OF THE EXCHEQUER

My comments on a first reading of your draft are the following:

1. Paragraph 6: Two distinct conceptions seem to be confused in this paragraph. There is the proposal for a capital budget. In a sense this is no more than a matter of presentation. But, from the point of view of the Budget Speech, it would be much more than that. Recent Budgets have attempted to adjust the amount to be borrowed on all heads to the amount of savings which we can reasonably hope to collect during the year. The Chancellor has aimed at covering any gap that would otherwise exist by increased taxation. There will have to be an analogy to this in peace-time budgets through the Chancellor making a forecast of capital expenditure under all heads, and comparing this with prospective savings, so as to show that the general prospective set-up is reasonably in accordance with the requirements of equilibrium. The capital budget will be a necessary ingredient in this exposition of the prospects of investment under all heads. If, as may be the case, something like two-thirds or three-quarters of total investment will be under public or semi-public auspices, the amount of capital expenditure contemplated by the authorities will be the essential balancing factor. This is a very major change in the presentation of our affairs and one which I greatly hope we shall adopt. It has nothing whatever to do with deficit financing.

Quite apart from this is the proposal that if, for one reason or another, the volume of planned investment fails to produce equilibrium, the lack of balance would be met by unbalancing one way or the other the current Budget. Admittedly this would be a last resort, only to come into play if the machinery of capital budgetting had broken down.

Thus the capital budgeting is a method of maintaining equilibrium; the deficit budgeting is a means of attempting to cure disequilibrium if and when it arises.

The proposals for deficit budgeting were, in my opinion, rather overstressed in the first version of the Economic Section's document, but they are not overstressed in the final version. Personally I like Meade's social security proposal. It is not open to many of the objections to other forms of deficit finance. Indeed, it can be defended on the ground that it will actually promote stability in the size of the social security fund itself. It is arguable, that is to say, that in periods of increasing unemployment the fund will actually make up a significant part of what it loses through reduced contributions through having to pay out less unemployment relief than would otherwise be the case.

About other forms of deficit financing I am inclined to lie low because I am sure that, if serious unemployment does develop, deficit financing is absolutely certain to happen, and I should like to keep free to object hereafter to the more objectionable forms of it. Assuredly the Chancellor of the Exchequer is entitled to take up at least as cagey a line to it as that. But I doubt if he need trail his coat by going into it in so much detail.

2. Paragraph 6 might also be criticised in the form of presentation on the ground that, particularly towards the end, it mixes up politics and merits. It is one thing to dispute Meade's proposal or alternative proposals on merits, and another thing to point out that they will present considerable political and psychological difficulties. It is not sufficiently clear when the objection is on one ground and when on the other. There is also superficial inconsistency whether in the immediate post-war period employment is expected to be good or is expected to be bad. There is an appearance that each of the two alternatives is adopted according as it suits the argument of the moment.

So very decidedly I should cut down all this and not lead the critics to think that the Chancellor is confusing the fundamental idea of the capital budget with the particular, rather desperate expedient of deficit financing.

3. I do not agree with the history of the first paragraph of 7 on structural unemployment. It is one thing to say that substantial structural unemployment continued all those years, quite another thing to suggest that, except in 1931/3, there was no deficiency in aggregate effective demand. I should have said that in almost every year of the pre-war decade there was a deficiency of effective demand, the actual level of unemployment being the result of a combination of this and of structural unemployment. You would certainly bring a hornet's nest about your ears in suggesting that structural unemployment was the whole trouble.

I agree that the problem of structural unemployment needs emphasising and that the memorandum of the Economic Section is open to criticism on the ground that it did not stress this sufficiently. But I wonder if the Chancellor of the Exchequer appreciates into what deep water the adoption of the more pessimistic expectation on this heading leads him. The optimistic view on this, and also on some other matters, which I am charged with maintaining is by no means intended as a prophecy of what is certain to happen. I regard it much more as the only hypothesis on which the kind of economic future which the Chancellor and probably most other people in the Treasury envisage as desirable really has a chance. It might turn out to be true that anything at all closely resembling free enterprise is incapable of dealing with the problem of structural unemployment. If so, I feel sure that free enterprise will go by the board to the necessary extent. I have not abandoned the view that something like free enterprise can be made to work. I think we ought to have a good try at it. And that try ought to be based on the assumption that the underlying conditions are not such as to make it impossible.

Now I suggest that the Chancellor gets into somewhat deep water if he hints at a chronic return to the sort of troubles we experienced before the war and leads his readers to feel that he is extremely sceptical as to the capacity of a free enterprise system to deal satisfactorily with the problem. I fancy he will find himself open to some rather unexpected rejoinders if he takes a defeatist line about the possibility of free enterprise dealing satisfactorily with the outstanding problem of the age. Much safer, I should have thought, to adopt a more optimistic line until the case is proved to be otherwise. But, of course, it is no good adopting the optimistic line unless one is prepared at the same time to give it a chance of coming true.

That leads me to my other criticism on the section about structural unemployment. Is not it rather futile to suggest an enquiry from the Departments into the 5/7 years prospects of certain critical industries? How can we possibly expect the Departments to give a confident answer? All they can say, surely, is that on the optimistic hypothesis it is so-and-so, and on the pessimistic so-and-so. Are we any further on?

Would it not be much better to end up with a recommendation for the preparation of detailed proposals how to handle structural unemployment in a free enterprise environment?

More generally, I feel considerable doubt whether you will have succeeded in your aim of avoiding provocation, if you consider into whose hands this paper will go. It will be read by a number of advisory economists, more particularly by some of those who advise Labour Ministers. I feel quite sure that the document will be interpreted by them, and they will so inform their masters, that the Treasury is intending to stone-wall on everything to the last, and would much rather be found drowned than learn to swim. This view would be reached, not so much as a result of anything positive that is said, but by the generally negative implications of the paper as a whole.

I suggest, therefore, that something which at least looks much more constructive in intention would be safer. Do I interpret rightly that the Treasury official policy at this stage is to be rather non-committal and lacking in positiveness until proposals from elsewhere have crystallised a bit more? If so, I do not lack sympathy with this approach. But if this is the policy, my recommendation would be that much the safest line to take is to invite Ministers to come down to brass tacks and rub their noses in the practical difficulties of the case, rather than envelop them in an all-embracing wet blanket.

I fancy you could get moderately near to what I am suggesting without very enormous changes in the draft. Something like this:

The first five paragraphs might stand practically as they are, though I suggest the omission of the last sentence of paragraph 5, which seems in that particular context to confuse the question whether Clyde Canals etc. are desirable as a long-term proposition when capital investment seems to be approaching saturation point and the quite different issue whether the sort of thing is suitable as a short-term make-weight to offset cyclical depression in other directions.

I should, however, supplement paragraph 3 by bringing in a reference to the capital budget in the first of the senses I have distinguished above. It would come in quite conveniently there. It could be explained that long-term stability of employment may largely depend on having a stable long-term investment programme; that we shall, therefore, have to have a periodic survey of the investment prospects of which the capital budget may be an important ingredient; and, if we can find ways of retarding or accelerating the long-term programme to offset unforeseen short-term fluctuations, all the better. No reason, surely, why the Treasury should not be fairly constructive and optimistic on this heading.

I should then cut down Section 6 and make it much more concerned with its title, which is 'Maintenance of Consumers' Demand' and much less with the objections to deficit financing as such. Why not ride this all rather lightly? 'Deficit budgeting' the Chancellor might say 'may well turn out to be a last resort, from which some of my successors will not in practice escape.

But a Chancellor of the Exchequer can scarcely be expected to bless it in advance as a general principle'—and let it go at that.

Paragraph 7 would then emphasise the importance and significance of structural unemployment and perhaps chip the Economic Section a bit for not paying more attention to it. The Chancellor could agree with the President of the Board of Trade that it requires special attention. I hope the passage about new industries will be kept and even emphasised. But structural unemployment could be treated as something to be handled forcibly and not something to be defeatist about.

The Chancellor could then conclude by saying that the problem really seems to divide itself into two main headings. The first is the means of ensuring stability in the long-term investment programme coupled with proposals for adjusting its tempo to unforeseen changes. He could say that the Departments concerned with building had provided first-class material so far as they are concerned in this problem. But there are many other types of long-term investment, examination of which has made nothing like as much progress. Is not the next thing to get down to dealing with these other types in the same comprehensive way as building has been treated?

The second aspect is the problem of structural unemployment. This comprises the question of the location of industry and inducements of private enterprise to come here rather than go there. It also involves the issue of the mobility of labour with particular reference to social security. Finally it is particularly concerned with the question of our new industries, where we start with a fairly free hand as to location. *Pari passu*, therefore, with the study of the investment programme should be a study of structural unemployment under the above headings.

This sort of approach would give a cheerful and constructive air to the whole thing without committing the Chancellor or the Treasury to any of the more dubious experiments and without getting involved in academic or ideological controversies.

KEYNES

To SIR WILFRID EADY, *30 June 1943*

THE MAINTENANCE OF EMPLOYMENT

I think I had better refrain from commenting in detail on your latest draft. There are substantial parts of it with which I do not disagree, and there are passages in the memorandum of the Economic Section which are not entirely to my liking. Nevertheless, I think that their approach is fundamentally much more sound, and on the general issues involved I am whole-heartedly on their side. I disagree fundamentally with the underlying theory of your paper. It seems to me to be in the last analysis not much more than Neville Chamberlain disguised in a little modern fancy dress.

I wonder whether the Chancellor will wish to expose so much surface in an academic controversy. Rightly or wrongly, this paper would provoke the deepest suspicions in nearly all the circles of the younger economists, and the Treasury would be regarded as past praying for. It would be said that the forces of deflation and contractionism after the war are going to shelter themselves behind the respectable barrier of 'maintaining controls', and the inevitability of structural unemployment. Indeed it is not unlikely, I begin to think, that there will be too much rather than too little control at the outset. Controls over demand, as distinct from prices, will have to be exercised with great elasticity and sensitiveness, if we are to avoid making the controls unpopular by giving colour to the conclusion that they themselves are actually creating unemployment. If the controllers overdo it and the level of unemployment is attributed to them by the public, with indeed some measure of reason, it will end in the controls being prematurely abolished. We shall then have too little control, and for the ensuing inflation it is the cautious souls who will really be guilty.

At the same time it is such a gentle and urbane statement of the point of view that for the purpose of fighting a controversy intended to win it has not a chance.

With the positive recommendations of your paper, as distinct from the analysis and the prognosis, I am in complete agreement in, I think, almost every case—complete and hearty agreement. Would it not be much better for the Chancellor to concentrate on these positive suggestions expressing, if he is so minded, some gentle cynicism about the brave hopes of the new world but putting the emphasis on the real point that, if these hopes are to be realised, there are some highly concrete matters, which need urgent attention and where action is necessary?

[copy initialled] K.

He also commented on a Treasury reply to an Economic Section paper on the maintenance of investment.

To SIR WILFRID EADY *and others, 9 July 1943*

In my opinion the first three pages of this memorandum totally misunderstand what the Economic Section is driving at. It is apparently supposed that, when they speak of the stabilisation of investment, they mean keeping investment at a constant figure, year in, year out, for a considerable number of years.

I am sure that this is not what the Economic Section mean. I should expect them to recognise that we may have to facilitate an exceptionally high level of investment in the early post-war years by encouraging saving and discouraging consumption. They would presumably desire these controls to be removed as soon as seemed advisable, with the result that investment would taper off. And, if one is looking forward to a much longer period—10 or 15 or 20 years—then, if it seemed that investment was becoming saturated, they would surely favour the stimulation of consumption and the discouragement of saving, so as to make a steady volume of investment at a gradually lower level compatible with stability of incomes.

What they are concerned with are two main theses:

(1) The maintenance of the national income at a stable level,

either by influencing consumption or influencing investment, as a long-term problem.

(2) The avoidance of the trade cycle and short-term fluctuations, for which they recommend primarily, though not exclusively, what they describe as the stabilisation of investment. But this would be entirely compatible with having investment at a higher level in the initial period than it would taper down to eventually.

I share the view, and I think they would, that, sooner or later, we shall be faced, if not with saturation of investment, at any rate with increasing difficulties in finding satisfactory outlets for new investment. It is very difficult to predict when this will come about. When it does come about, we shall then have to start on very important social changes, aimed at the discouragement of saving and a redistribution of the national wealth and a tax system which encourages consumption and discourages saving.

It may be that the Chancellor's official advisers are right in thinking that this period of impending saturation of investment is rather nearer than I personally think it is. But surely the Chancellor will appear in rather an odd light in taking up the line that those who press for a steady investment policy are in the wrong, whereas what we ought to be doing is getting ready in good time for discouraging saving to the utmost extent that we know how and can devise changes in social institutions to facilitate.

For that is what it comes to. If you accept the view of the Economic Section that we want to stabilise the national income, you have to do it either by encouraging investment or by encouraging consumption. We most of us, not only expect that we shall reach a point where the encouragement of consumption is the thing to put first, but we hope for it. All this, however, is in the future. The immediate task is to make good the losses of the country and equip the country with all the new investment it requires to be properly housed and thoroughly productive. When that task is complete, then we can turn our minds to encouraging in every way a higher standard of current expenditure. But, as I have said, the Chancellor surely looks a little odd in wanting to emphasise the aim of getting ready in good time to discourage saving.

When we come down to strictly short-term fluctuations, such as those which arise out of the trade cycle, the alternative remedies are to try to off-set fluctuations of general demand by increasing investment, or to try to off-set it by stimulating consumption. Personally I favour the first alternative. The Economic Section is fairly well balanced between the two, but gives more favour to the second alternative than I do. In other words, I am nearer to what I gather to be the Treasury view about this than the Economic Section is. Nevertheless, the discussion of this matter appears to me to be extremely confused and not to fit in too well with what has appeared in the first part. In the first part the Chancellor declares himself against the stabilisation of investment, misunderstanding, as I think, what is meant by this term. In the second part he appears to reject the alternative, namely trying to get the off-setting factor by encouraging consumption.

So you will see that, taken in its entirety, the document appears to me to darken counsel rather than otherwise and is likely, like all things based on misunderstanding, to lead to a good deal of fruitless controversy. Does not the very short draft flagged 'A' below meet the case sufficiently pending further more far-flung discussions, which are now to follow?[7]

KEYNES

By the time the Steering Committee got down to business at the end of September 1943, Keynes was in America (*JMK*, vols. XXIII and XV). Partially as a result, the main Treasury memorandum to the Committee, 'The Maintenance of Employment: Prefatory Note by the Treasury',

[7] Not printed (Ed.).

circulated on 16 October, was a pessimistic document emphasising the problems of structural employment and adjustment as being as fundamental as the aggregate problem raised by the Economic Section, challenging the financial bias in the Economic Section's proposals, especially as regards investment, emphasising that 'it would be wrong and dangerous in the Treasury's view to look to financial policy as the chief instrument for averting fluctuations' and raising difficulties over tax changes and unbalanced budgets.

While Keynes was in America, another proposal concerning employment policy came his way, as he reported to Sir Wilfrid Eady.

To SIR WILFRID EADY, *14 October 1943*

I was invited to lunch by Mr Lubin, Economic Adviser in the White House. When I arrived the other guest was Mr Carter Goodrich[8] of the I.L.O.

They alleged that when the Prime Minister was at the White House he and the President had a conversation (I gather, which is extremely likely, on the latter's initiative) on the question of preparing proposals to deal with the problem of possible post-war unemployment. The President mentioned with favour the use of the forthcoming I.L.O. conference as the preliminary platform from which to prepare public opinion for various measures. The Prime Minister is alleged to have encouraged him.

They then told me that it was proposed to appoint a small committee for the purpose of preparing an agenda for the I.L.O. conference, and they tried to make me believe that the names suggested for this committee had emerged under the above high auspices. I was not at all clear, however, exactly where high auspices ended and less high auspices began. It was felt, they said, that the I.L.O. itself was not capable of preparing the agenda. Moreover, the agenda should be more than the word

[8] Carter Goodrich (1897–1971); Professor of Economics, Columbia University, from 1931; U.S. Labour Commissioner, League of Nations, Geneva, 1936–40; Special Assistant to U.S. Ambassador, London, 1941; U.S. Government member of I.L.O. Governing Body, 1936–40, Chairman, 1939–45.

indicates, and should be a general guide as to the sort of resolutions which the conference should be asked to carry.

The names suggested for this committee, I was told, were those of T. V. Soong, Mr Van Zeeland, Mr Nash[9] of New Zealand, Mr Lubin himself for U.S., and myself for U.K. I fancy there was another name, which I have forgotten—I think it must have been Dr Schacht,[10] but am not quite sure!

I inferred that T. V. Soong had received the invitation with reserve and without commitment. I am afraid that I poured cold water, which was more definitely water and more definitely cold, on the suggestion that I should play a part. I said that I could well see that the President may think some such conference a good sounding-board from which to launch proposals or outlines of proposals which had been worked out in detail in the proper quarters. But I doubted whether that would be possible so early as January, and I was not much inclined to turn aside from taking an interest in what is going on behind the scenes in official circles, nor waste my own breath and my poor fountain pen's ink, and Mrs Stephens' carbons, on the quixotic enterprise they offered me.

They did not press the matter unduly and we passed on to other topics.

I seem to recognise in the above an echo from what we had already learned through other channels. Mr Van Zeeland's name, in particular, rings familiar in this context. Also the idea that there was to be an I.L.O. conference on unemployment in January or thereabouts. How far the President (much less the Prime Minister) has really blessed and encouraged all this I remain very much in the dark. I should not have believed a word of it had it not been for the presence of Mr Lubin, who after all is the President's principal personal adviser on such matters.

9 Walter Nash (1882–1968), G.C.M.G. 1965; member New Zealand Parliament, 1929–68; Minister of Finance, Customs etc., 1935–49; Minister in the United States, 1942–4; Member, War Cabinet, 1934–45; Deputy Prime Minister, 1940–9; Prime Minister, 1957–60.

10 Hjalmar Horace Greely Schacht (1877–1970); President of Reichsbank under Dawes Plan, 1924; resigned, 1930, reappointed President, 1935–9; Reichsminister of Economics, 1934–7.

However this may be, the infant did not strike me as a sturdy one. Neither Mr Lubin nor Mr Goodrich opposed my lukewarm and deprecatory observations, and I thought it was pretty obvious that in their minds they agreed with them. But there were certain motions which they had to go through, and gone through them they had.

KEYNES

When he returned from America, he remained relatively uninvolved in the work of the Steering Committee's discussions, either directly or indirectly, beyond keeping a protective eye on the Meade scheme. However, after the Steering Committee reported in January 1944, he turned to its consideration.

POST-WAR EMPLOYMENT: NOTE BY LORD KEYNES ON THE REPORT OF THE STEERING COMMITTEE

1. I am in general sympathy with the line taken in this Report and with its recommendations. It is, indeed, an outstanding State Paper which, if one casts one's mind back ten years or so, represents a revolution in official opinion. At this late date, I limit myself to some short notes on chapter II, Professor Robbins' note of dissent, and the appendices.

2. §46 provides an easy answer to the wrong question. No one really supposes that the Government can go on spending £14 million a day in conditions of peace. The right question is why we cannot continue to produce a net national product worth £8,000 million a year at present prices. It is true that hours of work have been excessive, but in all other respects this total has been reached in spite of extraordinary handicaps. The answer, if there is one, is not nearly so easy but would be more to the point.

3. §§81–83 dismiss rather lightly the possibility of directly influencing the pace of private investment. I notice that several

members of the Reconstruction Committee (Minutes of the 8th Meeting (*d*)) take the same view. A private Conservative Committee has made some proposals which at least deserve consideration. It might be wise in what is to be published to pay a little more attention to this. Something might be done if the major, private firms were brought to regard it as their duty to pay attention to the indications of the official barometer.

4. §87 calls attention to the delays to investment caused by the present complicated parliamentary procedure. This is very important. Should there not be a specific recommendation for the improvement of the existing expensive and out-of-date machinery of the private bill?

5. After seeing the evidence on which it is based, I believe that §101 under-estimates the maximum limits within which public investment can be made to fluctuate. More should be made of the point that early action on the comparatively modest scale which is possible at short notice may be enough to stop deterioration, but in the event of the deterioration continuing over a long period measures on a larger scale should be practicable.

6. §§105–117 bless the most original and (perhaps it may prove) one of the most powerful of the offsetting expedients brought before them, namely variations in social insurance contributions. It is all the more disappointing that in §117 the majority of the Committee recommend that the method should not find an early place in the Statute Book. This has too much the air of fighting a rearguard action. The Steering Committee remind me of Lord Balfour who, when he was asked if he believed in progress, replied that of course he believed in progress but it should be as slow as possible. I hope that the alternative suggested in §115 will be adopted by Ministers.

7. §§118–122 on Hire Purchase do not mention what has always seemed to be the most promising method of regulation, namely that there should be a prescribed minimum down payment and maximum period over which instalments may be

spread appropriate to each class of goods, and that these conditions should be stiffened up in good times and relaxed in bad times. (In this connection see item (*j*) of the Minutes of the 8th Meeting of the Reconstruction Committee.)

8. There seems to be some confusion of thought in the section on Budgetary Considerations (§§123–139) No objection can be taken to the warning in the earlier paragraphs against an undue growth of dead-weight debt, coupled, as it is, with an explanation that the proportion of such debt arising from the present proposals is likely to be neither large in itself nor out of proportion to the growth of the national income. In so far as the dead-weight debt is increased, the normal level of taxation must clearly provide for this. But the latter part of the argument, which seems to suggest that the tendency of the proposals is to unstabilise the national budget, is surely topsy-turvy. It would be a *failure* to adopt a remedy for severe cyclical unemployment which might have that effect. There appears to be no glimmer of a recognition that measures to stabilise the national income are *ipso facto* measures to stabilise the national budget. The additional charges falling on the budget in years of bad employment as a result of the Committee's proposals are, in fact, almost negligible; whilst the effect on the revenue of maintaining the national income should be obvious. The Committee give the impression that, whilst the measures they propose to avoid unemployment are admittedly necessary and advisable, a price has to be paid for them in the shape of budgetary deficits and perhaps a consequent weakening in international confidence in our position. Exactly the opposite is the truth. It would be a failure to take such measures which would inevitably unstabilise the budget and weaken confidence. Is it supposed that slumps increase the national wealth?

Moreover, the full strength of the case has been in this section entirely overlooked. In this part of the Report (though it is to be found elsewhere) there is no hint of the operation of what economists call 'the multiplier', that is to say the effect of injecting additional demand into the system in increasing the national income by at least double its own amount. Suppose for example that additional investment of £100 increases the total national income and output by £200 (which is probably an under-statement), and that the additional investment will not have a genuine permanent value in excess of £80 (which, one may hope, will also be an under-statement) it follows that the net result to the nation's production, strictly valued, will not be a loss of £20 (as some once argued) but a gain of £180. It follows that, if the increment of revenue exceeds one ninth of the increment of national income (which it certainly does), the transaction taken as a whole positively benefits the Exchequer there and then. The additional taxes, collected as a result of the induced investment in that very year in which it takes place, should be more than enough to write off the excess of the investment's cost over its true value. How slow dies the inbred fallacy that it is an act of financial imprudence to put men to work! If the Minister of Labour were found praising periods of cyclical unemployment on the ground that they gave the workers a much-needed rest and improved the nation's proficiency in the matter of darts, it should be for the Chancellor of the Exchequer to protest against such idling and to demand the present proposals for providing employment on the ground that they were essential to the solvency and stability of his Budget. This section has the air of having been written some years before the rest of the report. There are some acute outside critics who are well on the look-out for what they will regard as budget humbug, and it would be unfortunate to offer them so rich a feast. By all means emphasise the importance of maintaining budget equilibrium. But let this be represented as an important argument in favour of the rest of the proposals, as it most truly is, and not as an argument against them.

9. I find this particular section of the Report open to criticism for what it omits as well as for what it includes. Proposals have been before the public for some years under the description of

a *capital budget*. Something of the kind is included in most recent programmes and booklets for the cure of unemployment. They are not discussed in the Report or even mentioned. Yet they embody, not perhaps very clearly, a notion which is most desirable and useful. The failure to mention this matter will be interpreted to mean that the Treasury has turned it down, and the demand for it may well become the slogan of those who choose to regard this excellent Report as too timid and not going far enough. This would be particularly unfortunate, because the capital budget proposal is not merely consistent with the recommendations of the Report but is, in fact, not much more than a formal or regular embodiment of policies and calculations which permeate it throughout.

The term *capital budget*, though very convenient rightly understood, is liable to create misunderstanding because it suggests a closer connection with the Chancellor of the Exchequer's Budget than really exists and an interference with the latter which might result in a clouding and impairment of its soundness. In fact the adoption of a capital budget in the sense intended would leave the regular Budget practically the same as at present. The utmost that might be involved would be a slight tidying up of a few items as between (in technical language) 'above' or 'below the line' of the Exchequer Accounts, and even this would not be really necessary. A capital budget, in the sense in which I understand it, means a regular survey and analysis of the relationship between sources of savings and different types of investment and a balance sheet showing how they have been brought into equality for the past year, and a forecast of the same for the year to come. If aggregate demand gave signs of being deficient, the analysis would indicate a deflationary gap exactly corresponding to the inflationary gap which we have so often discussed during the war. This survey and balance sheet might well be presented on the occasion of the regular Budget Statement and form a part of the Budget White Paper. It would give an annual opportunity for examining whether the state of demand during the ensuing year looked like being adequate to maintain employment and national income at the desirable level and for the Government to explain to Parliament what steps it had in view to remedy a prospective disequilibrium in either direction. Such a procedure as this might give greatly increased confidence to the public that the maintenance of employment and national income was now an avowed and deliberate aim of financial and economic policy. I forbear to enter into details as to its precise form. But its silent suppression is much to be regretted and will be severely criticised.

10. I am in strong agreement with Professor Robbins' Note of Dissent on Restrictive Developments in Industry, and with his recommendations in §6. I am confident that he speaks here—and most effectively, if I may say so—for the great majority of responsible economists in the whole of the Anglo-Saxon world. For those who believe that it will be the role of this country to develop a middle way of economic life which will preserve the liberty, the initiative and (what we are so rich in) the idiosyncrasy of the individual in a framework serving the public good and seeking equality of contentment amongst all, Professor Robbins' admonitions go to the heart of things. The majority of the Committee attempt no serious rebuttal of his arguments. The Report would be much enriched and its balanced effect on public opinion enhanced, if Ministers were to approve the substitution of his Note for the parched and desiccated passages of the Report which correspond to it.

11. *Appendix A.* This appendix recommends *two* new financial institutions, one for small businesses and one for reorganisation. As regards the former, I suggest that it would be better to establish the principle that each of the clearing banks should regard a certain proportion of its resources as available for this type of business, rather than that there should be a combined institution for handling it. When the amount required is relatively small, the business might be better handled by an

individual bank than by a consortium, with the added advantage that this would allow for a desirable element of competition between the banks to show success and enterprise in the task. Consortiums of the kind suggested have not always in the past proved very lively affairs. Under the alternative here suggested an applicant turned down in one quarter can still try his luck in another. Moreover the accommodation in question would naturally merge in the provision of banking facilities generally. Under the consortium he would be at the mercy, with no appeal, of the lowest discoverable common factor of response without the bait of winning what might prove a loyal, life-long and valuable customer. This type of business should be made as *personal* as the size and character of our financial institutions permit.

12. *Appendix B.* §14 rightly emphasises the importance of stressing statistics of the volume of *total employment* rather than of unemployment (conventionally estimated). This will be particularly significant and instructive during the demobilisation period. The point is not overlooked in the body of the Report. But in presentation to the public I should like to see more lime-light directed on to it.

§22 rightly stresses the need to obtain better statistics of the level of profits. In this field the present state of our information is particularly defective, and deliberate obscurantism has prevailed. Important figures bearing on this, collected by the Board of Inland Revenue some years before the war, are still being withheld from students and from the public on the ground (so one is told) that, although the Board would welcome publication, this is a matter on which the F.B.I. is entitled to the last word. It would at least make a beginning of progress in a difficult field if Ministers would give an instruction for this material to be released.

I should like to call particular attention to the key position which the Board of Inland Revenue could occupy if, after the war, its methods were to be mechanised and its statistical staff greatly strengthened. The Board is already giving invaluable assistance within the limits of its wartime resources, and without this aid the preparation of the Budget White Paper would have been impossible. But its present methods were not devised to produce statistical by-products. If the Board's statistical staff were on the scale of the statistical staff of the Bank of England, extraordinary improvements in fiscal policy and in general administration, as well as in knowledge, diagnosis and forecast, would become possible.

With the Ministry of Labour handling labour statistics on the lines proposed, the Board of Trade conducting a continuous census of production (here the Report is weak-kneed and unambitious and hence, in my judgement, inadequate), the Inland Revenue digesting and analysing the vast body of information which passes through its files, and the Bank of England continuing and improving its running analysis of our external position, the new era of 'Joy through Statistics' (I do not write ironically) can begin.

Theoretical economic analysis has now reached a point where it is fit to be applied. Its application only awaits the collection of the detailed facts which the economist, unlike the scientist, cannot collect in a laboratory by private enterprise. The authors of the Report would, I think, have written with more confidence about their plans for the future and in a spirit of more buoyant hope, if they had fully appreciated what knowledge is capable of doing in making the future different from the past as soon as we decide to furnish the social sciences with *data* comparable to the *data* of the other sciences, appendix B is the clue to the whole business. I should almost have made it (somewhat strengthened up) the body of the Report, relegating the rest to appendices in small print which no-one would have been expected to read, for the excellent reason that, until appendix B has done its work, no-one can quantify his recommendations or say except in the most general terms what ought to be done, and that, when appendix B has done its work, it will all be obvious and as clear as daylight with no room left for argument.

KEYNES

14 February 1944

Keynes's paper brought a strong rejoinder from Sir Hubert Henderson entitled 'Lord Keynes and Employment Policy'[11] and a further note early in March 'Lord Keynes on Budgetary Considerations'. This last was the first of a long series of critical comments on the process of transition of the Steering Committee's report towards White Paper form.

As the White Paper, the product of many hands, moved towards completion, Keynes made comments on particular aspects of particular drafts.[12] However, his illness during March and April, the main period of drafting, and his concurrent concern with post-war international economic arrangements prior to Britain's agreeing to an international financial conference at Bretton Woods meant that Keynes's involvement was relatively limited, and that his drafting comments had little effect on the tone of the White Paper. The sections into which he appears to have put the most effort, those on the financial aspects of the proposals, cost of living stabilisation and the conclusion, survived only in small pieces.

Throughout the discussions, Keynes continued an intermittent exchange of memoranda with Sir Hubert Henderson, in many ways the White Paper's strongest critic. For example, on 27 March, in a memorandum called 'The Employment Policy', Henderson argued that the White Paper would result in external difficulties owing to the facts that unemployment in Britain normally came from a decline in demand for British exports and resulted in a deterioration in the balance of payments and that, in these circumstances, especially with the large sterling balances left behind by the war, budgetary policy of an unorthodox type would prove difficult to pursue. Thus, he suggested, the White Paper's ignoring of the external sector led those involved to overestimate the possibilities of a successful internal employment policy. To this memorandum, Keynes replied.

[11] Reprinted in *The Inter-War Years and Other Essays.*

[12] There was some pressure to get on with the White Paper at the time owing to the progress of Sir William Beveridge's private enquiry, eventually published as *Full Employment in a Free Society* (London, 1944).

To SIR WILFRID EADY *and* SIR RICHARD HOPKINS, *28 March 1944*

Sir H. Henderson has sent me a copy of his paper of March 27th on 'The Employment Policy', and I should like to comment on it briefly.

I share his pessimistic view about our prospective external financial position. I agree, therefore, that what he says under this heading, though not comfortable, is wholesome. I think it very probable that those Ministers who are mainly concerned currently with the post-war domestic front are living in a fool's paradise. Indeed, all this would form part of the theme of a paper which I hope to produce myself in the course of the next two or three weeks.[13] Nevertheless, I am sure that the advice which he bases on these prognostications should be most unhesitatingly rejected. Some of the reasons against it are briefly summarised below.

The fact that the maintenance of our exports is going to be a matter of life and death to us is surely a reason for expecting that the primary impulse to unemployment will not, and simply cannot be allowed to, come from that source. By whatever expedients may be necessary we shall have to maintain our exports. I consider that the seriousness of this position is a positive safeguard as compared with what was formerly the case. At one time we could pursue *laissez-faire* in this matter and just acquiesce in a declining trend of exports. Henceforward that will be simply out of the question. On this heading, therefore, I draw the opposite conclusion from Sir H. Henderson.

Much the same applies to the question of import restriction. I agree with him that we may very likely find ourselves in a position where this is unavoidable. It will mean that the working class will not be able to spend their earnings on imports just as they please. In other words, the position may have important resemblances to what is going on now. But the very fact that

[13] See *JMK*, vol. XXIV, pp. 33–65.

we shall have, not too reluctantly, to restrict imports when we see ourselves getting into difficulties will, of course, be very good for domestic employment, since the expenditure of earnings will necessarily be canalised to a greater extent into what we can produce at home. So here again I derive the opposite conclusion from the same premises.

Thirdly, the view, to which he obviously attaches a good deal of importance, that it will be good for our external credit if we allow large-scale unemployment to develop without attempting to use the remedies recommended in the White Paper seems to me a plain delusion. There may have been a time when that sort of policy attracted the approval of foreign financiers. Indeed, such financiers are still be found here and there. But the world changes. It will improve our external credit if we are seen tackling the problem of internal unemployment vigorously, and just to stand aside will have the opposite effect.

Finally, Sir H. Henderson does not appear to expect, or does not at any rate attach any importance to, the social and political consequences of deliberately using domestic unemployment as a remedy for external disequilibrium. Even if this policy had its advantages, it is surely obviously out of the question and might easily mean the downfall of our present system of democratic government. If, therefore, the evils which Sir H. Henderson fears develop (and I do not deny that they may), we must discover some other way out.

KEYNES

To put it briefly, Keynes's reply did not satisfy Sir Hubert Henderson. When the White Paper appeared on 26 May, three days after Keynes had defended the draft proposals for Bretton Woods in the House of Lords (*JMK*, vol. XXVI), Keynes provided a series of possible notes for the Chancellor's speech in the subsequent House of Commons discussion.

To SIR ALAN BARLOW, *15 June 1944*

WHITE PAPER ON EMPLOYMENT POLICY

You asked me if I had any notes I would care to put down for possible use in connection with the Chancellor's opening speech. Perhaps the most useful thing I can do is to note down a few points where it seems to me criticism is most likely to arise, and then endeavour to provide an answer to the criticism where I think there is one.

1. *Criticism.* It could be said that the policy is of the right kind, but that it does not go far enough; and that the concrete measures proposed are inadequate to solve the probable dimensions of the actual problem.

Answer. It is true that the figures mentioned are on the cautious side. They are not really to be taken as more than illustrative, since it is quite impracticable at the present date to quantify measures which have not yet been worked out in detail, and probably relate to a date 3 to 5 years hence at the least. It is proper, therefore, that at this stage members should concentrate on the quality of the policy and consider whether that is right. Quantities will have to be filled in at a much later date. Moreover, the figures prepared by Departments naturally take account in the main only of policies already within their knowledge. They cannot take account of future developments, which, even when they are in quite definite prospect, are still too indefinite in detail to be reduced to figures. I should add that in my own opinion—an opinion which I have frequently put forward during the course of the discussions—the White Paper considerably under-estimates the quantitative effect of the measures it actually proposes. That is only to say once again that the figures used are deliberately on the cautious side, and we have preferred to risk under-statement than over-statement.

2. *Criticism.* It could be argued that the proposals are too much of a thermostatic character; that is to say they are more

concerned with stabilising the level of employment than making certain that the level of employment will not only be stable, but will be high. It will be pointed out that many of the measures are of a nature accelerating this or that on one date, and balancing this by an opposite movement at some other date. Thus, the critic may say that this is a policy of having a steady level of unemployment rather than a high level of employment.

Answer. I think it has to be admitted that the actual text of the White Paper is somewhat open to this misrepresentation, but it is largely a matter of presentation. It is an implied premise that the general level of investment, etc., must be maintained at a suitable average aggregate. In considering practical measures one is of course inevitably concerned with fluctuations around the average; but it would be an entire misunderstanding to suppose that it is not a high level of employment that the Government policy is aiming at.

3. *Criticism.* It could be said that the emphasis on budgetary equilibrium is excessive, and that more stress ought to be laid on the advantages to be obtained from deliberately unbalancing the Budget in bad times.

Answer. It may be that some phrases intended to sound piously in some ears, tend to produce the wrong reaction in others; but in fact this is not a sensible criticism. As I have argued before now, the whole effect of stabilising employment will be on the receipt side to maintain the buoyancy of the revenue. Measures to increase investment and to maintain incomes will of course help the Budget on the receipt side. On the other hand it is the nature of our national accounting that practically nothing of the expenditure contemplated will fall on the normal Exchequer Budget. Neither modifications of the Social Security contributions, nor increased capital expenditure by Local Authorities and public bodies, nor inducements to Local Authorities, which will be spread over a period of years, will cost the Exchequer, narrowly interpreted in the budgetary sense, anything whatever. A forward employment policy is therefore entirely compatible with budgetary equilibrium; and not only so, but it is in fact the best way of ensuring budgetary equilibrium. Thus the criticism boils down to a complaint that proposals for taking off taxes in bad times have been rejected. These have been rejected for pretty good and obvious reasons, of which the Chancellor is fully cognisant. The criticism only becomes plausible, I think, by mixing up these specific proposals with the general impression abroad that a budgetary deficit, as such, is the inevitable accompaniment of public works.

4. *Criticism.* Reference to interest rates in Paragraph 59 has been subjected to criticism in some quarters of the Press. It is said that whilst we are promised a continuance of the cheap money policy for the time being, we are threatened with a reversal of it at some later date.

Answer. I have never myself been able to make much sense of that paragraph. If it relates to the short-term rate of interest I am very doubtful how much it will help. If it relates to the long-term rate of interest, then the practical and fiscal difficulties in the way of significant fluctuations over a short period, have not been sufficiently examined and are, in fact, overwhelming. Perhaps the only way of making good sense of this paragraph is to hint that the second sentence about the variation of interest rates need not be taken to mean fluctuations of the long-term rate of interest over short periods, but rather a policy of aiming at a long-term equilibrium rate, which helps to maintain average capital expenditure at the right figure, even if this requires a progressive change in the standard rate from time to time, a change which is more likely to be in the downward than the upward direction. I think it is the supposed suggestion of short-term changes in the long-term rate of interest, which in my opinion is quite unworkable, which has occasioned the criticism.

5. *Criticism.* I fancy that in Sir William Beveridge's proposals, when we have them, the capital budget will take a much more prominent part. The Government will be asked whether or not

it accepts the general principle of the capital budget, and if not, why not?

Answer. It is quite true that the White Paper does not adopt the term 'capital budget' as one of its slogans; but this does not mean that the actual policy lying behind this phrase has been rejected. In fact it has been most definitely adopted. There is a particular reference in paragraph 84; but the whole of chapter 5 is really concerned with the substance of what is popularly called the 'capital budget', namely a policy of surveying the whole field of capital expenditure and then acting one way or the other in order to keep it at the optimum level.

6. *Criticism*. It may be said that the part which can be played by private enterprise is insufficiently emphasised.

Answer. There may be something in this. The difficulty of laying more stress on it at this stage is that concrete measures are not easily proposed until the time comes. The principle of influencing private enterprise to accelerate and decelerate in accordance with national policy is accepted. Here I should have thought the Chancellor might ask for concrete suggestions. He could point out that the Government had entirely accepted the advisability and desirability of this, but it is a matter on which those concerned with private enterprise are in a much stronger position than Whitehall to make useful and practicable suggestions. He could invite aid rather than claim that the White Paper has said, or attempted to say, the last word on the subject.

Generally speaking, the attitude to the White Paper which I have found to prevail in Beveridge circles, is that in fact the Government have gone a very long way forward. They appreciate that the acceptance of this type of policy is the essential thing just now, and that it must be the future which will take care of the detailed working out. Some of the sentences in the foreword are declared by some, who otherwise might be critical, to be worth more than all that follows. It seems to me that this is the line which the Chancellor can quite well accept for himself. All that the Government is attempting to lay down at this stage is the general line and purpose of policy, the basic assumptions on which it proposes to act, and the general analysis of the problem which it proposes to accept as correct. The quantitative and detailed working out can only be done satisfactorily over a period of time. It would be quite premature to attempt something of that sort now and any attempt that might be made would almost certainly be proved inaccurate by events. As soon, however, as the general policy has been laid down, then it will be the duty of the various Departments and all other authorities concerned, to work out the details, with far greater particularity than has been done, or could be done, up to this point. The object of the White Paper is to choose the pattern of our future policy. This must not be confused with the technical working out of the very extensive blue prints, which will be needed to implement this policy, when it has been approved by Parliament. To the preparation of these blue prints, those concerned will of course proceed, as soon as the general line has been definitely laid down by the Government and approved by Parliament.

Finally, perhaps the Chancellor might consider whether he could safely, without entering into premature explanations about the sterling area, give some explanation of how the repayment of our war debt, in the shape of sterling balances, can prove a useful adjunct to the full employment policy. He could say, for example, that we shall clearly have to meet our accumulated liabilities to overseas creditors out of British exports. As regards some part at least of this, the rate of repayment will have to be adjusted to our capacity, and plans might well be worked out by which, in times of declining employment, particularly unemployment arising in the export trades, the position could be helped by a more rapid repayment of our obligations. This would meet the point made by some critics that if, as is very likely, the source of unemployment will sometimes be found in a declining level of exports, the existing remedies proposed do not touch the right spot.

KEYNES

After the events of the spring of 1944 which culminated in the White Paper, Keynes continued to take an interest in employment policy. At one level, his views were reflected in his correspondence. The first letter concerned Beveridge's *Full Employment in a Free Society* whose preparation had encouraged rapid publication of the official White Paper in May 1944.

From a letter to SIR WILLIAM BEVERIDGE, *16 December 1944*

I was able to borrow a copy of your book just before sailing so had a chance of looking at it on the voyage. Very warm congratulations on it. I thought it extremely good and found myself in general agreement with by far the greater part of it—as perhaps you would expect.

I was particularly fascinated by Table 18 on page 139 and the summary you give of Kaldor's appendix. If one could get people in the Treasury (and elsewhere) thoroughly to understand that table, knowing as well as you and I do just what it means and what lies behind it, and then decide which of the alternative rates they prefer or what compromise between them, and could stand an examination on this matter and themselves explain it, if necessary, to a chap like a Minister,—then, indeed, we should have made some progress.

The only weak spot in the volume was, I thought, the chapter on international implications. I do not pretend to have thought through this thoroughly, but have to confess that I did not find [it] much help to doing so. Clearly, if there is a big slump in U.S.A., the problem of maintaining employment here is made more difficult. But I looked in vain for even a shadow of an explanation of how the mysterious system known to me only by its name, namely bilateralism, is supposed to help or to prevent this situation.

My own private opinion is that you will find on further examination that bilateralism is merely a blessed word,—something that does not even begin to make practical sense. Ask some of your friends who seem bitten that way to tell you just how our relations with, to take two examples, India and Canada, will work out under this system, if there be any such system, and what would happen in the event of a slump in U.S.A.

On a very small point, page 267, either Oliver Lyttelton was talking through his hat, which is, of course, quite possible, or you have misunderstood his meaning. The 40 per cent he speaks of must, I think, have been in tons and not in value and relates almost entirely to our having to do without our usual imports of timber, paper, iron ore and scrap. As regards timber, having cut down everything ripe in the country, that obviously cannot continue. I fancy that the iron and steel industry do not believe they can be competitive without imports of iron ore and scrap, but whether they are right about this I do not know myself...

Yours ever,

K.

P.S. Two points of criticism. No harm in aiming at 3 per cent unemployment, but I shall be surprised if we succeed. I entirely fail to understand how you can avoid making public investment a counterweight to fluctuations of private investment. But perhaps this is not really what you intend.

To M. KALECKI, *30 December 1944*

Dear Kalecki,

Thank you for *The Economics of Full Employment*[14], which reached me as it were as a Christmas present. I found it a most excellent and instructive volume. When one gets a book like this, one feels that economics is really making progress. With one qualification, mentioned below, I found it all very good indeed, and there is scarcely a thing with which I do not agree.

Your own contribution seems to me most striking and original, particularly pages 44–46; also most beautifully compressed. It is a great comfort to read something so short and so much to the point. I am very much taken with your modified

[14] (Oxford, 1944).

income-tax. It will be alleged, I am afraid, that the difficulties of transition would be excessive, since it would mean that a new business might have next to no tax to pay for years, which would appear to give it a great competitive advantage. Nevertheless, there is, I think, a good answer to this, and such criticisms, which would be certain to arise, would be based on a fallacy.

Why don't you apply it, however, to working capital also? That would have the great advantage of mitigating the effect of taxation in impairing real capital when there is an inflation and presenting windfalls when there is a deflation. Indeed, I think you can claim it as an additional merit for your plan that it goes a long way to getting over the inequities which will arise when the level of prices at the time when depreciation is allowed is different from the level of prices when the outlay was originally incurred.

Apart from your own contribution, there is hardly an article which has not something interesting and even new. The one exception I make to this, as perhaps you will have guessed, is the section on International Aspects. This seems to me a frightful muddle, which leaves the reader more in a fog and stupider than when he began. It does not even make a beginning at the basic analysis needed to tackle this rather difficult and intractable problem. I wish I had time to think it properly through myself. It is not so difficult that it is impossible to write sense about it.

On a point of detail; I have not a copy of my House of Lords speech by me, but I find it difficult to believe that I said any such thing as is attributed to me in the footnote on page 145. I think I might have been given the credit of not being quite so foolish as that! The point I intended to make, and the point which I think I probably did make, was that we should be no worse off with the Plan than without it. If, as is alleged, I said that the International Monetary Plan 'would ensure the conditions necessary to maintain full employment at home, irrespective of conditions abroad and without further direct control of foreign trade', I must have been out of my mind. What is happening to Balogh? He has done some excellent stuff in the past, but much of what I have seen of his lately strikes me as extremely confused.

Yours sincerely,
[copy initialled] K

The third letter came in an exchange with T. S. Eliot.[15]

From T. S. ELIOT, *23 March 1945*

My dear Maynard,

I have no doubt that you are in San Francisco, but I cannot refrain from sending to you two copies of the *Christian News Letter*, the first containing an article on Full Employment by *Civis*—an economist who must remain anonymous, but whom I dare say you know; and the other a reply by *Metoikos* who is myself. It seems as odd to me as it will to you that I should be writing on this subject; and certainly it would have surprised me to be told that I should some day do so, at any time between the age at which I was keeping a scrap-book of the Boer War, and a month ago. But I hope that I have stuck to my own weapons on my own ground; and what I want to know is, if you ever get this and have the time to read the stuff, whether I have taken your name in vain.

But if you and Lydia are in town—I wonder if you have deserted Antoine's. I lunched there yesterday, and it seemed to me to have deteriorated appallingly.

Yours ever,
T. S. ELIOT

To T. S. ELIOT, *5 April 1945*

My dear Tom,

No, I am not in San Francisco, thank God, nor going to be. It should prove the biggest monkey house yet.

I am on your side against Civis.

Not long ago I was at a Conference where the Australians urged that all the Powers in the world should sign an international compact in which each undertook to maintain full employment

[15] The references are to *The Christian News-Letter*, 7 and 21 March 1945.

in their own country. I objected on the ground that this was promising to be 'not only good but clever'. Civis, like the Australians, takes exactly the opposite line. He thinks that we can reach the goal by promising to be 'not so much clever as good'.

It may turn out, I suppose, that vested interests and personal selfishness may stand in the way. But the main task is producing first the intellectual conviction and then intellectually to devise the means. Insufficiency of cleverness, not of goodness, is the main trouble. And even resistance to change as such may have many motives besides selfishness.

That is the first, ought-to-be-obvious, not-very-fundamental point. Next the full employment policy by means of investment is only one particular application of an intellectual theorem. You can produce the result just as well by consuming more or working less. Personally I regard the investment policy as first aid. In U.S. it almost certainly will not do the trick. Less work is the ultimate solution (a 35 hour week in U.S. would do the trick now). How you mix up the three ingredients of a cure is a matter of taste and experience, i.e. of morals and knowledge.

But, of course, the really fundamental point is what you say on your last page—and that does not go only for Christians.

Finally, there is a most definite smell of humbug about Civis, infecting his style as well as his mind.

Will you lunch with Lydia and me at Antoine's on Wednesday, April 18, at 1 o'clock?

Yours ever,
[copy initialled] M.K.

The fourth came in a comment on the Australian government's full employment proposals.

From a letter to S. G. MACFARLANE, *5 June 1945*

I expect that both of our countries incline to under-estimate the difficulty of stabilising incomes where exports play so large a part. One is also, simply because one knows no solution, inclined to turn a blind eye to the wages problem in a full employment economy.

A final letter covered more general ground, but best appears here. On his way to America for the Bretton Woods negotiations, Keynes read Hayek's *The Road to Serfdom* (London, 1944). When he reached Atlantic City, Keynes wrote to the author.

To PROFESSOR F. A. HAYEK, *28 June 1944*

My dear Hayek,

The voyage has given me the chance to read your book properly. In my opinion it is a grand book. We all have the greatest reason to be grateful to you for saying so well what needs so much to be said. You will not expect me to accept quite all the economic dicta in it. But morally and philosophically I find myself in agreement with virtually the whole of it; and not only in agreement with it, but in a deeply moved agreement.

Turning to a few special points, I think you strike the wrong note on page 69 where you deprecate all the talk about plenty just round the corner. No doubt this is partly due to my having a different view to yours about the facts. But apart from this, would it not be more in line with your general argument to urge that the very fact of the economic problem being more on its way to solution than it was a generation ago is in itself a reason why we are better able to afford economic sacrifices, if indeed economic sacrifices are required, in order to secure non-economic advantages? It seems to me that it is in this particular matter above all that the Communist doctrine is so desperately out-of-date, at least in its application to U.S.A. and Western Europe.

They ask us to concentrate on economic conditions more exclusively than in any earlier period in the world's history precisely at the moment when by their own showing technical achievement is making this sacrifice increasingly unnecessary. This preoccupation with the economic problem is brought to its most intense at a phase in our evolution when it is becoming ever less necessary.

The line of argument you yourself take depends on the very doubtful assumption that planning is not more efficient. Quite likely from the purely economic point of view it is efficient. That is why I say that it would be more in line with your general argument to point out that even if the extreme planners can claim their technique to be the more efficient, nevertheless technical advancement even in a less planned community is so considerable that we do not today require the superfluous sacrifice of liberties which they themselves would admit to have some value.

One point which perhaps you might have pressed further is the tendency today to disparage the profit motive while still depending on it and putting nothing in its place. The passage about this on page 97 is very good indeed; could not be better; but I should like to have seen this theme a little more expanded.

On the moral issue, I also find the last paragraph on page 156 extraordinarily good and fundamental.

I come finally to what is really my only serious criticism of the book. You admit here and there that it is a question of knowing where to draw the line. You agree that the line has to be drawn somewhere, and that the logical extreme is not possible. But you give us no guidance whatever as to where to draw it. In a sense this is shirking the practical issue. It is true that you and I would probably draw it in different places. I should guess that according to my ideas you greatly under-estimate the practicability of the middle course. But as soon as you admit that the extreme is not possible, and that a line has to be drawn, you are, on your own argument, done for, since you are trying to persuade us that so soon as one moves an inch in the planned direction you are necessarily launched on the slippery path which will lead you in due course over the precipice.

I should therefore conclude your theme rather differently. I should say that what we want is not no planning, or even less planning, indeed I should say that we almost certainly want more. But the planning should take place in a community in which as many people as possible, both leaders and followers, wholly share your own moral position. Moderate planning will be safe if those carrying it out are rightly orientated in their own minds and hearts to the moral issue. This is in fact already true of some of them. But the curse is that there is also an important section who could almost be said to want planning not in order to enjoy its fruits but because morally they hold ideas exactly the opposite of yours, and wish to serve not God but the devil. Reading the *New Statesman & Nation* one sometimes feels that those who write there, while they cannot safely oppose moderate planning, are really hoping in their hearts that it will not succeed; and so prejudice more violent action. They fear that if moderate measures are sufficiently successful, this will allow a reaction in what you think the right and they think the wrong moral direction. Perhaps I do them an injustice; but perhaps I do not.

What we need therefore, in my opinion, is not a change in our economic programmes, which would only lead in practice to disillusion with the results of your philosophy; but perhaps even the contrary, namely, an enlargement of them. Your greatest danger ahead is the probable practical failure of the application of your philosophy in the U.S. in a fairly extreme form. No, what we need is the restoration of right moral thinking—a return to proper moral values in our social philosophy. If only you could turn your crusade in that direction you would not look or feel quite so much like Don Quixote. I accuse you of perhaps confusing a little bit the moral and the material issues. Dangerous acts can be done safely in a community which thinks and feels rightly, which would be the way to hell if they were executed by those who think and feel wrongly.

Yours ever,
KEYNES

Keynes became more involved in one particular aspect of post-war employment policy early in 1945. As a result of a request from Mr Attlee asking for a paper on a post-war capital levy and a suggestion from James Meade of a wider enquiry into the measures available for reducing the post-war burden of national debt interest, the Government in January 1945 set up a National Debt Enquiry. Its members were Sir Edward Bridges (Chairman), Sir Richard Hopkins, Sir Herbert Brittain, Sir Cornelius Gregg, Paul Chambers,[16] James Meade, Professor Robbins and Keynes.

At the second to the fourth meetings of the Enquiry, on 8, 22 and 27 March 1945, Keynes gave an exposition of his theory of the relation between savings and investment, the nature of and effects of changes in the structure of interest rates and his proposals for post-war interest rate and debt management policy. For these meetings, whose summary minutes also survive, Keynes used a set of hand-written notes as the basis for his exposition.

NATIONAL DEBT ENQUIRY: LORD KEYNES' NOTES

I

Rate of interest determines equilibrium between savings and investment. If people become more willing to save and therefore willing to accept a lower rate of interest, a corresponding increase of investment takes place. Thus a greater willingness to save causes and is indispensable to more investment. Here virtue of saving. Doubt about this due to

(*a*) It did not fit the facts. For in this case there could never be general, as distinct from frictional and seasonal unemployment, i.e. there would always be a sufficiency of jobs offering

[16] Stanley Paul Chambers (b. 1904); member, Indian Income Tax Enquiry Committee, 1935–6; Income Tax Adviser to Government of India, 1937–40; Assistant Secretary and Director of Statistics and Intelligence, Board of Inland Revenue, 1942–5; Commissioner of Inland Revenue, 1942–7; Chief of Finance Division, Control Commission for Germany, British Element, 1945–7; Director, Imperial Chemical Industries, 1947.

for it would mean that whatever was earned was spent so that business as a whole would always cover its costs (subtleties here, I will not stop to explain)

(*b*) It was logically pure nonsense for $S = I$ at all rates of investment. Y either definable as $C+S$ or as $C+I$. S and I were opposite facets of the same phenomenon they did not need a rate of interest to bring them into equilibrium for they were at all times and in all conditions in equilibrium.

This was a paradox because decisions made by different people. What was the mechanism by which they were led to the same result.

The amount of savings is a function of income; the amount of income is determined by the volume of production; i.e. by the volume of consumption plus investment. Thus if investment falls, i.e. that part of output which is not consumed, off, income falls off, and therefore savings fall off and they always fall off by exactly the right amount to an exact farthing.

Now see what a reversal this meant. Instead of saving determining investment, it is much truer to say that investment determines saving—though this is in fact too simple.

War conditions make this obvious.

If this is the case, what brake is on investment and consumption exceeding what is possible.

The Price Level

Suppose decisions to consume and decisions to invest add up to more than what can be produced at the existing price level, competition causes prices to rise.

When investment $\left.\begin{matrix}\text{falls off}\\ \text{rises}\end{matrix}\right\}$ profits $\left\{\begin{matrix}\text{fall}\\ \text{rise}\end{matrix}\right.$

Thus volume of investment *plus* consumption determine both the price level and the profit level and hence the volume of employment. Thus changes in prices and employment depend on the propensity to consume and the inducement to invest. Now we begin to get back to the rate of interest and to seeing how much that there was in the old theory. The rate of interest does not determine the absolute amount of savings but it is one of the influences affecting the propensity to consume. Nor does it determine the volume of investment, but it is one of the influences affecting the inducement to invest.

Experience shows, however, that whilst a high rate of interest is capable of having a dominating effect on inducement to invest, it becomes relatively unimportant at low levels compared with the expectations affecting the inducement. The optimum rate of interest depends on (*a*) how much investment one wants, (*b*) how much reward to saving is socially desirable. The monetary authorities can have any rate of interest they like. Up to the point when inflation begins (and there are, as we have seen, other efficient ways besides the rate of interest to control that), a lower rate of interest tends to increase employment. Below a certain point other considerations may begin to prevail. But see how we are standing on our heads, a fall in the rate of interest increases investment and therefore increases saving. Thus a fall in r. of i. decreases propensity to save but nevertheless increases saving.

If, after the war, we need more saving to provide more investment, we have to reduce the rate of interest up to the point of full employment. Thereafter the old rules apply we have to raise the rate of interest to prevent inflation. We come back to our first point—the previous theory is what works in conditions of domestic full employment.

After the war we may have inflationary conditions for what is probably only a short time. So here is a 3rd reason affecting our immediate policy. The object of a high rate of interest after the war will be to prevent Kindersley [National Savings] from getting so much. The higher the rate of interest the less K will get. It is quite true that the propensity to save will be increased but the absolute amount of saving will be reduced.

But there remains another function of the r. of i. or rather of the short term of rates of interest. I have been speaking so far as if there was a single rate of interest. Obviously there is not. If you keep your money fully liquid in cash in current account, you [do not] get, and never have got, any rate at all. Obviously therefore it is not the reward of saving. You only begin to get a rate of interest in so far as you depart from liquidity. What determines the reward the individual requires to surrender his liquidity for a long or short period. In practice, of course, what some stockbroker who knows nothing about it advises him, or convention based on old dead ideas or past irrelevant experience. But assuming enlightened self-interest (which probably influences convention) it is your expectation of or a lack of expectation and temporary uncertainty about the future *changes* in the r. of i.

If it was certain that there would be no change in present short-term, longer-dated would always be best. If it was certain that they would fall rather than rise *a posteriori*.

But suppose, you just don't know and are chiefly interested in protecting yourself from possible loss in the event of your desiring liquidity, then the shorter are preferable and you need to earn a risk premium to lock yourself up longer.

Present position is a mixture of ignorance (when the C of E says cheap money is Govt's long-term policy, then this plays a lesser part) and of expectation of higher rate (both before the war and now again after the war). This is based on the false belief that it will be necessary to stimulate and encourage saving and that cheap money during the war has been the result of controls.

Now the authorities are only fettered in their policy if they themselves have a counter-liquidity preference. If they are indifferent about funding they can make both the short and long-term whatever they like, or rather whatever they feel to be right having regard to possibilities of under or over-employment and other social reasons.

If, however, they are not indifferent their motivation comes into play.

Historically the authorities have always determined the rate at their own sweet will and have been influenced almost entirely by balance of trade reasons and their own counter-liquidity preference.

All four reasons are relevant. The new school rationality itself.

2. *Relation to Unemployment: The Multiplier*

Continuous injection would cause instability if people spent the whole at home

Savings Transfer Exp.—buying sites

Expenditure abroad

Effect on prices—you do not get equivalent real expenditure

Temporarily run down stocks; also new investment, not always equal new *net* investment

Multiplier between 2 and 3

Meade's Social Services contribution—if people spent all the relief, you would always cure unemployment by taking 1*d* off income tax.

Authorities make rate what they like by allowing the public to be as liquid as they wish.

Suppose Tr[y] say half the debt must be more than 25 years off *or* floating debt must not exceed £*x*m then it is the public which set the rate of interest. If they require a great inducement to become so illiquid, then rates have to be higher. However it is a vicious circle, dear money provokes expectation of dearer money.

It is the technique of the *tap* issue that has done the trick.

Thus it is only if the Tr^{y} get rid of the Funding Complex that cheaper money is possible.

The Funding Complex originated in a situation

(*a*) when there was a fixed fiduciary issue

(*b*) Bank rate was the means of preserving the balance of payments

(*c*) the rate of interest was used as an instrument of deflation.

With the abandonment of both [*sic*][17] it becomes completely meaningless. I am not aware of *any* argument in its favour.

On the contrary it is expensive

it is inconsistent with the avowed policy of cheap money

(as Hoppy pointed out) it means losing control of the rate of interest.

Thus the reason for offering 3 per cent Savings Bonds are

(*a*) an inducement to saving as an offset to inflation (the Kindersley reason)

but chiefly

(*b*) a wider complex of the social reasons why the euthanasia of the rentier should not take place just yet.

But one offers these bonds, not in the hope that the people will subscribe, but in the hope they will not.

For the above reasons it is desirable to offer them the opportunity, but the less they accept the better and the cheaper for the Tr^{y}

Now let me begin to apply this policy

I have a major proposal to make which entails the 3 per cent offer to be available but not indefinitely. It is, in fact, a proposal to return to what was ideally the perfect security. At present our offers are dominated by the Funding Complex. We offer 3 per cent Savings 1955/65 and then pretend we are worsening the

[17] (*c*) was added at a later stage in the drafting.

offer by putting out ditto 1960/70 and then 1965/75. In fact each issue is worse and more expensive than its predecessor for the Tr^{y}. For we end by promising the continuance of 3 per cent for ten years longer. As soon as people believe that the long rate will not rise above 3 per cent and may fall below, Redemption 3 per cent become the market for they and they alone promise 3 per cent until 1986. Yesterday you could buy them at par.

The ideal security is old $2\frac{1}{2}$ per cent Consols or 3 per cent local loans redeemed at the option of the Treasury at any time. We pay the stipulated interest for so long as we choose and no longer.

Probably it is going too far to start a new security on these lines. But should offer a 3 per cent Bond repayable say in 1955 or after at the Treasury's option, though I should not much mind a compulsory date of redemption if that helps the market. 1955/75 might be the best variant. One could start a new series annually, which would be available for all borrowing purposes including local loans i.e. after Jan. next the new series would be 1956 or after; or if you prefer 1956/76—thus never promising more than 30 years ahead. A permanent tap issue, with power at any time, of course, to revise the terms of the next series.

Turn next to the other end

Brittain's table How much is overseas? I think it is directly and indirectly

approx	£2,000 millions
another	2,250
public [sector] incl. B of E	
J S Banks	2,000
	6,250

Broadly speaking no one else holds any

This now costs £62.5m

of which £20 goes overseas

£22.5 is out of one pocket into another
£20 goes to J. S. Banks
of latter £10 comes back in income tax

J. S. Banks are now clearly overpaid, but there is only about £m5 in it. Main point is we are worsening balance of trade by £10 as compared with reducing to $\frac{1}{2}$ per cent. Also when we come funding overseas debt, a part[icular] advantage if we can offer them a little more interest than they get now.

Thus Bill Rate $\frac{1}{2}$ per cent
T.D.R. $\frac{5}{8}$ as being six months

Can a use be found for Bank Rate?
How does one fill in the gap?

Short-dated securities should have a single redemption date. As they approach it they become shorts, and rise to par. Thus effective rate is higher than the nominal rate

Five year Exchequer bond $1\frac{1}{2}$
Ten year Exchequer bond 2

3

What we shall want in the future materially different from what we want now. Thus important to keep our hands free. At present we want to encourage prudence in the sense of distributing income through a man's life. When that time comes all sorts of fancy devices possibly with a counter-life insurance element in it e.g. annuities on joint lives which assume a nil rate of interest.

A deposit fund or Savings Bank for statutory charities at a suitable rate say $2\frac{1}{2}$ per cent per annum.

Also devices rewarding *de facto* illiquidity. Savings certificates and 3 per cent Defence Bonds existing types which may have a future. There is a great variety of fancy devices one could suggest. But the time for them is not yet. The essence of our interest policy should be to give a sufficient immediate reward to saving, so not to run prematurely against public psychology, and meanwhile to keep a free hand.

Bridges said game was up when everyone understood it. In fact the game is only up when the public believe that the Treasury understands it.

The system does not depend on controls and importance of extreme short-term stability in new issue market can be exaggerated. The controls are required to prevent inflation, and are probably the wrong way to prevent it. I should like to return to controls later.

Meanwhile, as run at present, the controls are the ideal way of persuading the outside expert that the authorities do not know a thing about it. From this point of view Lord Kennet of the Dene and Mr Brittain probably impress more confidence than almost any possible alternatives.

U.S. 2 per cent for 10 years
$2\frac{1}{4}$ for 15 years

After a further discussion of his views on 5 April, Keynes submitted a summary of his proposals to the Committee.

NATIONAL DEBT ENQUIRY: SUMMARY BY LORD KEYNES OF HIS PROPOSALS

I

1. The technique of tap issues, by which the preferences of the public rather than of the Treasury determine the distribution of the debt between different terms and maturities, should be continued into peace-time.

2. That is to say, the funding of the debt on long term should not be considered a primary Treasury interest.

3. No dogmatic conclusions should be laid down for the future about the rates of interest appropriate to different maturities, which should be fixed from time to time in the light

of experience and should pay attention primarily (*a*) to social considerations in a wide sense, (*b*) to the effects of Government policy on the market for borrowing by the private sector and on the problem of controlling and maintaining the desired rate of investment at home and abroad, and (*c*) to the burden of interest charges on the Exchequer and other funds.

4. The terms of the issues should, therefore, be such as to preserve the maximum degree of flexibility and freedom for future policy. But continuity of policy and gradualness of changes should be ensured unless in exceptional circumstances and for grave cause.

5. If, at any time, the terms offered result in an increasing preference on the part of the public for the shorter-dated securities, this need not, in general, be regarded as a cause for alarm; on the contrary, the resultant saving in the interest cost should be welcomed, and, unless the ruling conditions at the time indicate a different conclusion, opportunity should be taken for a further economy in interest cost by a lowering of short-term rates, with the result of a widening of the gap between short-term and long-term rates.

6. If, on the other hand, the terms offered result in an increasing preference for the longer-term securities, consideration should be given whether the social and administrative advantages of the existing terms outweigh the cost to the Exchequer; and, if not, the rate of interest on them should be reduced if it appears that these market conditions are likely to continue.

7. Changes in the complex of interest rates, with a view to controlling the trade cycle and to offset inflationary or deflationary trends, should not be precluded, but should affect the shorter-term, rather than the longer-term, issues, and should, as a rule, be regarded as secondary to the technique of rationing the volume, rather than altering the terms of credit by the machinery of e.g. the Capital Issues Committee by influencing the volume of bank advances.

8. The short-term rates on the Floating Debt in the hands of domestic holders should be no higher (except on the occasions when a stiffening of short-term rates is deemed to be a useful adjunct to a policy of rationing the volume of credit) than is required to give a return adequate to meet the costs of market and banking machinery.

9. A special short-term rate might be allowed on overseas funds in London, which could be the new meaning of Bank rate without any break in the continuity of tradition.

10. If the previously prevailing long-term tap rate, say 3 per cent, becomes chronically too high, in the sense that it attracts to the Exchequer an excessive volume of funds in that form and the supply of new investments expected to yield a corresponding return is running short, the rate should, in general, be reduced and other means could be sought, if necessary, to provide the social incentives and advantages which a lower rate might be inadequate to afford.

11. Such means (which would be suitable whenever the long-term rate appropriate to investment policy was too low for social purposes) might include—

(*a*) the further development of the existing facilities already available up to a limited amount for an individual holder, such as Post Office and Trustee Savings Bank deposits, Savings Certificates and Defence Bonds;

(*b*) the acceptance by the Treasury of deposits from charities and the like (perhaps including Life Offices) at a preferential rate;

(*c*) the offer of annuities on joint lives, calculated on the basis of a low rate of interest, but favourable to the holder in other respects, especially the principle on which the annuity is taxed.

12. If the prevailing long-term tap rate becomes chronically too low, in the sense that it encourages new capital formation on a scale tending to inflation, the rate should, in general, be raised.

13. Tap issues of short- and intermediate-term debt should

be, in general, on terms of repayment at a fixed date; and, where optional dates of redemption exist, advantage should be taken of the option to repay if, otherwise, the bonds would be standing at a premium (thus indicating that the rate of interest they carry has become too high to be appropriate to the term of maturity they have now reached), unless there appear to be special reasons at the time to the contrary. (As an immediate matter this might be put off until a 5 year Bond at $1\frac{1}{2}$ per cent is available and Treasury bills are reduced to $\frac{1}{2}$ per cent. If the $2\frac{1}{2}$ per cent stocks optionably repayable were paid off at that moment, a considerable part might be expected to go into the new five year bonds or Treasury bills, thus saving at least 1 per cent in interest.)

II

14. The progressive application of the above general principles to the situation after the end of the German war would aim at the following results:

(*a*) Bank rate to be reduced to 1 per cent and to govern the rate payable on overseas money in the hands of the Bank of England, so that this rate would remain unchanged;

(*b*) Treasury bills rate to be reduced to $\frac{1}{2}$ per cent and Treasury Deposit Receipts to carry $\frac{5}{8}$ per cent;

(*c*) Subject to action on (*b*), 5 year Exchequer Bonds at $1\frac{1}{2}$ per cent and 10 year Bonds at 2 per cent on tap, a new series to be started annually;

(*d*) 3 per cent Savings Bonds on tap, a new series to be started annually, with an option to the Treasury to repay after 10 years and with, preferably, no final maturity (or, if necessary, a fixed latest date of repayment 35 years hence);

(*e*) No change in the present terms affecting Tax Reserve Certificates, Savings Bank Deposits and Savings Certificates, (but a reduction of the rate on Defence Bonds to $2\frac{1}{2}$ per cent).

15. The justifications for maintaining the offer of a 3 per cent bond, certain for 10 years, are—

(i) that it would be premature to move to a lower rate at a time when the opportunities for investment are exceptionally abundant and before the conditions normal to the post-war epoch have been established;

(ii) that the return to the investor and the cost to the Exchequer of a 3 per cent bond is modest so long as direct taxation remains at or near its present level;

(iii) at the same time, the option of early redemption safeguards a future liberty of action;

(iv) and, if the effect is to cause a famine of bonds carrying a longer fixed term, this may help industry and Public Boards to float off bonds successfully which compete with the Exchequer issues on terms of maturity, whilst involving no immediate additional burden of interest and being sometimes appropriate to a long-lived physical investment, as well as in the rate of interest—for a counter-liquidity preference has more meaning for the private borrower than for the Exchequer.

16. There are arguments for introducing the changes piecemeal and also arguments for introducing the new debt structure as a connected whole. If it is thought better to defer major changes until (say) the occasion of an Autumn Budget and after the General Election, this position could probably be held for the next six months by withdrawing the $1\frac{3}{4}$ per cent bonds of 1950 and replacing them by 2 per cent bonds of 1955. (Or, if this is felt to be too sharp a move, 2 per cent bonds of 1953). The new 3 per cent Savings Bonds should probably be introduced, and the existing issue withdrawn, without notice, if a flood of money into the existing issue is to be avoided.

17. The new structure, if announced in an Autumn Budget, might be accompanied by the introduction of revised criteria for the New Issues Control suitable to the commencement of re-conversion and by the opening of the doors for business of the two new Finance Institutions.

KEYNES

18 April 1945

APPENDIX A: THE FLOATING AND SHORT-TERM DEBT AS AT 31 DECEMBER 1944

	£ million
Treasury bills	
Home banks, including Bank of England	620
Overseas banks*	1,175
Discount market	344
Other non-public holders	95
Total non-public	2,234
Public Departments	1,572
Total	3,806
Treasury Deposit Receipts	1,794
Ways and Means Advances	
Banking Department	59
Public Departments	588
Total	647
Total floating debt	6,247
Tax Reserve Certificates	760
Total floating and short-term debt	7,007

In round figures the total floating debt is probably held approximately as follows:

	£ million
Overseas holders (direct and indirect)	2,000
Home banks and discount market	2,000
Public Departments	2,250

* Direct holdings; other overseas debt is covered indirectly by Treasury bills and Treasury Deposit Receipts.

APPENDIX B: MATURITIES 1945–1955 (INCLUSIVE)

(Amounts shown as at 31 December 1944)

	Assuming all options exercised		Final maturities only	
	Security	£m	Security	£m
1945	2% Conversion 43/45	245	2% Conversion 43/45	245
	2½% National War Bonds 45/47	444		
	2½% Conversion 44/49	207		
	2½% National Defence Bonds 44/48	80		
1946	2½% National War Bonds 46/48	493	—	—
1947	—	—	2½% National War Bonds 45/47	444
1948	3% Conversion 38/53	302	2½% National War Bonds 46/48	493
1949	2½% National War Bonds 49/51	714	2½% Conversion 44/49	207
1950	1¾% Exchequer Bonds [£202 m at 31.3.45]	37	1¾% Exchequer Bonds 1950 (£202 m at 31.3.45)	37
1951	2½% National War Bonds 51/53	522	2½ National War Bonds 49/51	714
1952	3½% War Loan (option)	1911	—	—
	2½% National War Bonds 52/54	809	(N.B. War Loan option opposite)	
	2¾% Funding 52/57	101		
1953	—	—	3% Conversion 48/53	302
			2½% National War Bonds 51/53	522
1954	3% National Defence Loan 54/58	321	2½% National War Bonds 52/54	809
1955	3% War Loan 55/59	303	—	—
	3% Savings Bonds 55/65	713		

Total £m7,202

APPENDIX C: LONG-TERM AND UNDATED MATURITIES

	£ million
Funding 2½% 1956/61	200
3% 1959/69	364
4% 1960/90	320
Victory 4% (average term 1962)	179 (net)
Savings 3% 1960/70	1,009
1965/75	99
Consols 2½% etc. after 1923	299
Conversion 3½% after 1961	739
Consols 4% after 1957	401
Total	3,610

APPENDIX D: SUMMARY

	£ million
Floating and short-term debt	7,007
Intermediate debt	7,202
Long-term debt	3,610
Miscellaneous non-marketable debt (N.S.C., Defence Bonds etc.)	2,954
Total	20,773

APPENDIX E: YIELDS ON TYPICAL SECURITIES AS AT 13 APRIL 1945

The yield to a holder on the same security varies according to the way in which he is taxed—i.e. whether

(*a*) both interest and capital gains (or losses) on redemption are exempt from tax, e.g. a charity;

(*b*) both interest and capital gains (or losses) on redemption are brought into taxable profit, e.g. a bank or finance house or insurance other than life;

(*c*) interest but not capital gains (or losses) on redemption is brought into taxable profit, e.g. ordinary business or a private holder.

The gross yield before tax is the same to holders (*a*) and (*b*) if it is assumed that income tax is unchanged throughout the term of the bond. The gross equivalent yield, as compared with the yield on a security selling at its redemption price, to holders (*b*) and (*c*) depends on assumptions about the future rate of tax.

In the following table the gross equivalent yield is calculated on the assumption of a standard rate of tax at 10*s* throughout the term of the bond. If income-tax falls through time, the average yield over the whole period to holders (*b*) will prove lower than in the table on bonds standing above par, and the yield on bonds standing below par will be higher; whilst the opposite will be true in the case of holders (*c*).

The earliest date of redemption is assumed when the price is at or above par and the latest date when below par.

(Approximate figures)

	(*a*) and (*b*)	(*c*)
Optional date of redemption 1945 or earlier	negative	negative
Optional date of redemption 1946 or earlier	$1\frac{1}{8}$	negative
Years to run:		
three	2	$1\frac{1}{4}$
four	2	$1\frac{1}{2}$
five (current tap issue)	$1\frac{3}{4}$	$1\frac{3}{4}$
six	$2\frac{1}{4}$	2
seven	$2\frac{3}{8}$	$2\frac{1}{8}$
nine	$2\frac{5}{8}$	$2\frac{3}{8}$
ten*	$2\frac{5}{8}$	$2\frac{3}{8}$
fourteen	3	3
twenty (current tap issue)	3	3
forty-one (Redemption Stock)	3	3
Undated (old $2\frac{1}{2}$% Consols)	3	3

Sir Richard Hopkins was then asked to prepare a report for the Chancellor on cheap money using Keynes's proposals as a basis. This report, after further discussion, went to the Chancellor on 15 May 1945.

At its other meetings, the Enquiry discussed capital issues control, issues control, the problem of an externally caused deflation,[18] financial policy and employment policy—where it appears from the summary note that Keynes

* These are 3% stocks with a final date of maturity 14 years hence. There is no stock with a final date 10 years hence. N.W.B. with a final date 9 years hence yield £2 6*s* 6*d* and £2 3*s* 4*d* to the two classes of holders.

[18] Keynes remarked, according to the minutes, that the risk of this eventuality made Beveridge's target of 3 per cent unemployment too ambitious, as the authorities would be unable to offset completely the loss of external markets through internal expansion and devaluation was unlikely to prove completely effective. Therefore, he emphasised in serious situations the role of import controls, official encouragement of the consumption of domestically produced goods, and, as a last resort, state trading and bilateralism.

was still attracted by Lerner's notion of functional finance—post-war anti-inflation policy,[19] capital taxation or 'capital levity' as Keynes called it, and capital budgeting. This last subject brought another memorandum from Keynes, along with a memorandum from Sir Herbert Brittain entitled 'Proposals for a Capital Budget'

NATIONAL DEBT ENQUIRY: THE CONCEPT OF A CAPITAL BUDGET (MEMORANDUM BY LORD KEYNES)

1. This question is essentially a question of *presentation*. It does not enable anything to be done which could not be done without it by means of the existing technique and in conformity with the existing form of the Exchequer Accounts. Nevertheless presentation may be of great importance by bringing out clearly the relevant criteria for policy and by high-lighting what it is desirable that Parliament and the public, and also officials, should understand.

2. The name has been used for at least four distinct concepts, all of which deserve examination, namely—

(i) a clearer segregation of capital items paid for out of, and received into, the Exchequer and a budgetary forecast of them for the coming year;

(ii) a compilation and budgetary forecast of *all* capital expenditure under *public* control, including local authorities and public boards;

(iii) a compilation and budgetary forecast of capital expenditure for the economy of the country as a whole, including the private sector;

(iv) as a temporary convenience during the post-war transitional period what might be termed a separate *remanet* budget to deal with items of Exchequer receipts and outgoings which do not properly belong to the income and expenditure of the current year.

[19] Here Keynes placed great emphasis on controls and reductions in taxation. Keynes advocated tax cuts because he believed that the addition to demand would not be that large as compared to their psychological effect on individuals' saving behaviour.

3. I will call these respectively (i) Exchequer Capital Budget, (ii) Public Capital Budget, (iii) Investment Budget, (iv) Remanet Budget.

4. It is important to emphasise that it is no part of the purpose of the Exchequer or the Public Capital Budget to facilitate deficit financing, as I understand this term. On the contrary, the purpose is to present a sharp distinction between the policy of collecting in taxes less than the current non-capital expenditure of the state as a means of stimulating *consumption*, and the policy of the Treasury's influencing public capital expenditure as a means of stimulating *investment*. There are times and occasions for each of these policies; but they are essentially different and each, to the extent that it is applied, operates as an *alternative* to the other.

5. An Exchequer Capital Budget should cover both the capital expenditures which are now entered 'above the line' and included in the estimates to be paid for out of the normal Budget, and also the capital expenditures which are now entered 'below the line' and are financed by loans specially authorised for the purpose. Sir H. Brittain's analysis indicates that the former comprise at present a number of miscellaneous items which are individually small, adding up to £12m in 1936 and £21m in 1945 on Civil Votes; whilst the latter consist almost exclusively of Post Office capital expenditures. (In 1936 there were quasi-capital items of £60m on Defence Votes, a corresponding item in 1945 being, of course, outside the scope of reasonable calculation.) Sir H. Brittain explains that this is in conformity with the existing criterion for charging 'below' or 'above' the line according as the expenditure does or does not bring in a cash return in subsequent years. This seems to me wrong. The criterion should be whether the real return in meal or malt is spread over a period. If so, it is reasonable that the charge on revenue should be similarly spread. Moreover the present criterion leads to meaningless anomalies. A new G.P.O. is charged 'below', a new Somerset House 'above'. A capital

contribution to school buildings is 'above' in the Exchequer Accounts and is paid for out of Revenue, and is 'below' in the Local Authority Accounts and is paid for out of loans. The cost of a road is 'above', of a railway is 'below'. And so on. (I am not burdening this paper with a discussion of the treatment of defence expenditure, especially on ships, which presents a special problem, to the solution of which we were finding our way before the war.) Hitherto the matter has been, it appears, of small importance. But it may not be so in future. Forestry, national parks, contributions from the Exchequer to the capital costs of town and country planning etc. will present larger-scale issues than formerly. The existing practice is an unnecessary deterrent to capital expenditure. With a full employment policy, we should not be biassed as between two useful capital projects because one will bring in a direct cash return and the other a social or indirect cash return. In both cases, of course, the subsequent service of the loan should be charged on the Revenue Budget and the income from the investment (if any) brought in as Sundry Revenue; the Sinking Fund element, whether in respect of the dead-weight or productive debt should be carried down as a contribution from the Revenue Budget to the Capital Budget, to provide finance for new investment or to reduce debt in the event of the Exchequer Capital Budget showing a net reduction of central borrowing.

6. The Exchequer Capital Budget should comprise *inter alia* such items as the following:

(i) the surplus or deficit of the Unemployment, Health and other similar extra-budgetary funds;

(ii) the growth or loss of funds in the hands of the N.D.C. and other public accounts;

(iii) changes in the fiduciary issue;

(iv) the net receipts of the Post Office and Trustee Savings Banks;

(v) net receipts (or repayments) of public debt held by the private sector;

(vi) net receipts (or repayments) of overseas Government loans;

(vii) the profits of the E.E.A.;

(viii) sinking Funds charged to the Exchequer Revenue Budget;

(ix) new capital expenditure on Exchequer Account;

(x) advances to the Local Loans Fund. (But see below §§14 *et seq.* the transitional arrangements perhaps convenient in Stage III.)

7. It has been the practice of this country hitherto to entrust most capital expenditure of a public character to Local Authorities or Public Boards. I am not aware of any intention to change this. If so, the significance of the Exchequer Capital Budget will be incomplete if taken in isolation, and it should be regarded rather as an item required in building up the Public Capital Budget, which should also comprise the capital expenditure of all bodies, boards, authorities and institutions which are scheduled as belonging to the public, as distinct from the private, sector of the national economy.

8. It is an integral part of the Government's full employment policy, as I understand it, that some authority will exist (the Treasury I hope) charged with the duty of examining and reporting on the state of the Public Capital Budget as a whole, not merely after the event but also prospectively. At one time I had conceived that this should be the task of a semi-independent statutory authority to be called the National Investment Board. But with modern developments of policy, decisions on such matters have become so much a part of the Government's economic programme as a whole that they should not be dissociated from the Chancellor of the Exchequer as the responsible Minister and his official Department.

9. Nevertheless, in this event the Treasury will have to be as self-conscious and publicly explicit as a National Investment Board would have been. The best means of public presentation and parliamentary discussion will no doubt be discovered

ambulando. The summary figures of the previous calendar year will, of course, be incorporated in the annual statistical Budget White Paper. But it will, I think, overload the Budget proper if the attempt is made to present this issue to Parliament at the same time as the Revenue Budget. I suggest that the Public Capital Budget should be presented to Parliament more on the lines of the Departmental Estimates. An estimate of the net public investment of the coming financial year might be presented as early as possible in the calendar year, accompanied with a statistical White Paper setting out the realised results of the previous calendar year. (It would be advisable on all grounds—for we must watch the trend closely—to keep the statistics in the Treasury month by month on the basis of monthly returns by all the investing public bodies to be delivered within a week of the end of the month, so that a sufficiently accurate summary of the past year should be available very soon after its close.)

10. The Public Capital Budget should comprise such items as the following: (i) the receipts and expenditure of the Exchequer Capital Budget; (ii) sinking funds and amortisation of Local Authorities; (iii) ditto of other Boards etc. included in the public sector; (iv) the gross new investment of the public sector not already included in the Exchequer Capital Budget.

11. As one of the principal purposes of the Public Capital Budget will be to balance and stabilise the Investment Budget for the national economy as a whole, the need for current up-to-date information about net investment in the private sector, with a separate division for changes in stocks, is a necessary corollary of or (if you prefer) prolegomenon to the above. I suggest that the continuous current collection both of the statistics of current performance and of prospective plans by the private sector should be entrusted to the Ministry of Trade and Production (if that is to be its name), which would be charged with the duty of passing on absolutely up-to-date information to the Capital Budget division of the Treasury. The

best and latest information on this aspect would, of course, be reported to Parliament along with the estimates of the Public Capital Budget.

12. In the years in which the Capital Budget division in the Treasury found itself in a position to report to the Chancellor that the prospective private investment coupled with the prospective public investment which it was not convenient to retard or postpone looked like being fully adequate or excessive, the Chancellor would recommend in his Revenue Budget an increase in the Sinking Fund towards the extinction of the dead-weight debt. And contrariwise.

13. It is contemplated here that the annual amortisation of the productive debt would always be charged to the Revenue Account of the authority responsible, including the Exchequer in the case of projects financed out of the Exchequer Capital Budget. It would also be a good plan, I suggest, to include in the Revenue Budget a modest normal contribution, say £25,000,000 a year, towards the extinction of the dead-weight debt, or rather, as I would prefer to put it, towards the conversion of the dead-weight debt into productive debt. This would mean, of course, that the normal programme of the Public Capital Budget would have to aim at providing sufficient total investment to cover the dead-weight Sinking Fund of the Revenue Budget, in addition to current amortisation, public and private, and to the current net savings of the private sector. This would have the advantage of making it possible to offset a modest unforeseen disturbance of investment-savings equilibrium by reducing the normal sinking fund to zero, avoiding to this extent the necessity of budgeting for an actual Revenue deficit. This seems to me to be the correct doctrine of the Sinking Fund when taken in conjunction with a full employment policy. In fact, on the assumption that the outlets for public investment are not yet nearly saturated and that we are, for the time being at least, more concerned with increasing the capital equipment of the nation than with raising the immediate standards of private

consumption, the larger the 'normal' Sinking Fund of the Revenue Budget the greater will be the latitude possessed by the Treasury for quickly offsetting unforeseen disturbances without budgeting for an actual deficit. One's qualms about pushing this very far, pending further experience, are due to doubts about the prospective outlets for public investment for more than a short period ahead and to the possibility that more durable results (in stabilising full employment) may be attained by allowing a fairly high priority to creating habits of more liberal standards in private consumption.

14. There remains the Remanet Budget, which is a question of purely temporary interest and importance. The point is that various large items, involving both receipts and expenditure, arising out of the liquidation of the finance of the war, will be in danger for the first three years or longer after the war of so swamping the normal Revenue Budget as to obscure the relevant criteria of a permanent character. There may result, through the difficulty of sufficient clarity of exposition, a serious lack of rational discussion and understanding of the critical problems of the post-war Revenue Budgets. This might be avoided by setting up an extra-budgetary *War Liquidation Fund* to which such items would be credited or debited.

15. There will be room for legitimate differences of opinion where to draw the line. But the following are some examples of items which might be suitable candidates for such a Fund:

Receipts

(i) Disposals of Government-owned stocks of commodities (including, e.g., the new wool disposals body).

(ii) Ditto of military surplus.

(iii) Ditto of lend-lease material whether received freely or covered by a loan.

(iv) Receipts from the expiring or diminishing E.P.T.

(v) Profits emerging from various war-time sub-funds of Departments, particularly Ministry of Food and Ministry of Supply.

(vi) Profits of the E.E.A.

(vii) Receipts from assistance towards the reduction or cancellation of overseas war debt.

(viii) The proceeds of overseas loans required to balance the international payments account in Stage III.

Expenses

(i) Refund of E.P.T. post-war credits

(ii) Refund of income tax post-war credits

(iii) Refund of E.P.T. to cover deficiencies and end-of-war adjustments

(iv) War gratuitites

(v) Demobilisation expenses overseas

(vi) War Damage compensations

(vii) The subscription of capital to the Bretton Woods Plans.

16. The above items will amount altogether to some thousands of millions sterling and are, no doubt, incomplete. Some of the above might be carried direct to the Exchequer Capital Budget (e.g. (viii)) and others might be carried direct to the extinction of domestic debt. Indeed, the difficulty of drawing the line might make it convenient to amalgamate the Remanet Budget with the Exchequer Capital Budget. The point is to exclude as many as possible of these large abnormal items from the normal Revenue Budget, with a view to getting into good habits about balancing the latter on permanent lines at as early a date as possible.

17. I take this opportunity to remind the Committee what is in danger of being overlooked that, if we have to raise abroad as Exchequer receipts the large sums which we are anticipating as necessary to cover the adverse balance of trade in Stage III, it is quite certain (even after allowing for the proposed centralisation of the borrowings of Local Authorities) that there will be no net borrowing by the Treasury on the domestic market during Stage III, and even a large reduction of market Government debt is quite probable. This probability is increased by the prospect that the bulk of small savings will, no doubt,

continue to reach the Treasury. We may all of us have been rather short-sighted about this. Large overseas loans on the anticipated scale, unaccompanied by corresponding investment, are liable to produce a colossal deflationary pressure. The Investment Budget in Stage III will have to be large enough to absorb the whole of the excess of the receipts over the expenses set forth in §15 above as well as current savings and amortisation. Otherwise severe unemployment is bound to result. Just as overseas investment helps to maintain employment, so equally overseas borrowing for consumption purposes serves to impair it. This is one reason why it is dangerous to delay in relaxing control of the capital issue market. At present it beats me to see how the market is to be nursed back quick enough into sufficient absorptive power. The remedy may have to come through applying to the borrowing of all public and semi-public bodies the centralised technique which is to be used henceforward for Local Authorities.

19. I would urge on the Committee that enough has been said above to prove the tremendous importance, which I began by emphasising, of a method of presentation, both to officials and to Ministers and to Parliament, which facilitates clear thinking on matters at the same time so complicated and so novel and yet so essential to the effective implementation of accepted policies.

20. I believe that the announcement by the Chancellor of a presentation on the above lines would have an enormous public success, since it would greatly increase confidence that the Full Employment policy is intended seriously. Moreover under cover of the novel presentation it might be possible to get through some wholesome matter which otherwise would have to face stiffer opposition.

KEYNES

21 June 1945

The Enquiry discussed Keynes's and Brittain's papers at its last meeting on 28 June 1945. It agreed on the desirability of retrospective publication each March of surveys of total national investment on a calendar year basis, on the desirability of preparing forecasts of capital expenditure (but not their publication), on the desirability of annual and quarterly surveys of government capital expenditure, with forecasts appearing in the Budget Statement, and on the need for changes in the Budget accounts with the inclusion of items under capital ('below the line') expenditure depending on their size and benefits over a period of years and with a separate unpublished wartime remanet account. Finally the Enquiry agreed that the sinking fund should not exceed £25 million per annum for the time being.

Keynes's final contribution to discussions of post-war economic management came somewhat later. Richard Kahn found the following notes on his table at Tilton after his death in April 1946. They were circulated within the Treasury.

POST-BUDGET REFLECTIONS (LORD KEYNES)

The level of prices and wages and the cost of the Stabilisation Policy the key to the situation.

External prices already round 200.

Wholesale prices (largely governed by external prices) 175 (Feb).

Wages 160

Cost of living 131 (when stabilisation policy began in 1941 cost of living 128
wages 122).

A recent calculation in *The Economist* puts normal Budget expenditure in (say) 1948 at £2,750 million or rather more than £1,000 million reduction on this year. Would anyone put it at less?

Colin Clark's 25% argument—pseudo-scientific; but with some sound empirical basis.

This indicates a net national product of £12,000 million (since expenditure would also rise somewhat).

W. P. puts last year at £8,500 million at a price level of about 150 for consumption and probably higher for investment.

If this was revised to 200 income would be by 1948 or 9 say £11,500 which is within striking distance of the target.

I venture to predict that the Budget will never be balanced except at a prices and wages level in the neighbourhood of 200.

I urge that, very secretly and behind the scenes, we should be preparing for a movement in that direction.

It will not interfere with foreign trade, since almost all other countries are in the same boat. It may even help by preventing the terms of trade moving against us. Indeed by that time external prices are likely to be well above 200 (which will facilitate payment of external debt) and the subsidy might easily approach £500 million. Prices are going to break loose everywhere in the world.

If allowing the cost of living to rise causes some inevitable repercussion on wages, this will not matter, since there is room for it. Moreover wages, as experience clearly shows, will rise anyhow.

During 1947 cost of living should be allowed to rise gradually to 150, first of all by withdrawing as many individual subsidies as possible and concentrating on a few articles and then by reducing it on the remaining articles. Wages should, of course, not be *encouraged* to go up. But, naturally, we must expect that this will be used as a pretext for some rises. Our wage policy should be to get the wage rises *in the right places*. One of the advantages of the proposed policy is that it allows a margin for this.

Publicly we should talk in terms of a price level of 150. Any prices or wages in excess of this should require special justification, e.g.

in the case of prices external movements or justifiable wage increases

in the case of wages increased productivity (as indicated by continuous census of production)

a low pre-war base

or relatively low net advantages as indicated by unpopularity of an industry.

It is better to reduce subsidies and reduce taxation than to increase subsidies and increase taxation. And that is the choice before us. A gradual and controlled rise—or a collapse of policy and a crisis.

I suggest that these reflections should be remitted to the Budget Committee for study, both from the statistical and from the policy angle.

STATISTICAL FORECASTS

Direct estimation of investment ex post and comparison with forecast

At present you can tell only by direct estimate what investment will be next year, but not what it was last year.

Also of depreciation* which has become very arbitrary.

Also work in progress.

Inland Revenue with Hollerith cases.

Continuous censuses of production and distribution.

Collaboration with firms on investment forecasts and output forecasts generally.

Concentration on chronicles and let Habakkuk wait. Fortunately we have—probably three years for improving the statistical apparatus.

For investment forecasting is primarily needed against a deflation.

No harm in some fighting for supplies, which will be dealt with at the physical, not the overall end, in an inflation phase.†

Physical controls in the over-investment phase.

Overall programming in the underinvestment phase.

Thus Habakkuk is not urgent.

* It is net investment (including work in progress) which comes out as a residue. But it is gross investment which will be directly estimated. Depreciation is what is deducted in reckoning profit.

† Investment in excess of physical supply cannot happen. Investment in deficit of physical supply can happen.

Post-Budget Reflections

I

We have been using 'inflation' to mean pressure of demand to raise prices above current cost of production, e.g. in Budget Speech. Quite a useful practice. But inflation of this sort a temporary factor, I think, and one which we have learned to keep under good control.

The real question is the price level which is going to be determined by costs of production, internal and external. If the costs can't be controlled, it is futile and dangerous to attempt to exercise any general control over the price level. Subsidies in special cases have to be kept in strict control and in reasonable relation to the general price level. This does not mean that it is necessarily a mistake to use taxes *plus* subsidies—e.g. to make bread and milk cheap, tobacco and beer dear. But a prudent policy needs to be based on a clear view as to what the general price level, as determined by costs and apart from temporary scarcities, is likely to be.

II

Current and prospective price levels. Very likely imports 250, wages 175.

III

Key position of this in Budget estimates: 2,750 is 32 per cent of 8,500.

An increase of 25 per cent would make income 11,000.

But expenditure would also rise, though not so much, and revenue would rise more.

Direct Taxes

Capital Tax ½ per cent.
Corporation Tax on all Schedule D profits 3*s*.
Earnings: personal tax on income earned 5*s* deducted at source in excess of £2 a week.
Allowances applied, first to social security contributions.

Personal Tax				
At present	1,000		500	
earned	166		83	
	834		417	
Personal	110		110	
	724		307	
			115	27
3*s* on	50	7. 10*s*		
6*s* on	65	19. 10*s*	182	81
9*s*	609	270		108
		297		

An initial notional book value of all real estate and assets.

This book value to be written down appropriately for depreciation and scrapping and added to by new investment in the business quinquennial valuation.

The initial value to be declared by the taxpayer. He cannot claim more on compulsory acquisition. His depreciation allowance cannot be calculated on more.

New investment to be exempt from Corporation Tax.
In lieu of N.D.C. Capital tax ½ per cent, Interest Tax 8*s* 6*d* deducted at source.
Profits tax 6*s* in the £ deducted at source.

All money reinvested in business exempt from profits tax but no depreciation allowances hereafter.

Standard earnings tax 5*s*.

Surtax on excess of net incomes over £1,000 ranging from 1*s* to 15*s*.

Allowances on deficiency of net incomes below £1,000.

A capital tax on real estate and business assets.

An initial book value for different classes of asset.

A depreciation writing off allowance for each class.

A realised profit and loss allowance on disposal.

No depreciation on allowance on outside assets.

Investment in business exempt from profits tax (on previous investment depreciation as at first).

The initial book value on depreciable assets to be the book value as now accepted by I.R.

Value of real estate not subject to depreciation to be declared at 25 times Schedule A.