

ECONOMIC PLANNING OR LAISSEZ-FAIRE

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CHAPTER ONE : INTRODUCTION

ECONOMIC PLANNING OR LAISSEZ-FAIRE

CHAPTER ONE

INTRODUCTION

Six years of war have led many of us to think about, and to question, the principles and customs which govern our way of life. Today we are not only considering political issues over which we ordinarily show little concern; we are examining the very basis upon which our society is founded. We ask ourselves just what is the democratic way of life? Is totalitarianism such an evil system of government? Is our economic system in need of renovation? And so on.

I have chosen to discuss here, in my thesis, a matter which I consider of extreme importance, now that we are starting again to rebuild our economy. My aim is to arrive at definite conclusions about the advisability, the possibility and the necessity of comprehensive economic planning as a successor to our present economic system. In order to accomplish this, I propose to point out the existing evils and weaknesses of the capitalist democracies, to examine the socialist answer, and to study both the advantages and dangers of planning.

Economic planning has been defined by Barbara Wootton as "The conscious and deliberate choice of economic priorities by some public authority".¹ Professor Hayek thinks that it is "the imposition of a complete budget of production on the community in which the output of every commodity ... is laid down for years ahead, in which the occupation and distribution share of every citizen are determined by a central authority over which he has no ultimate control and on which he can exert no influence either as a producer or a consumer."²

1 - Barbara Wootton, Freedom Under Planning, London: George Allen & Unwin Ltd., 1946 p. 12

2 - Friedrich von Hayek, The Road to Serfdom quoted in Durbin, "The Importance of Planning", Journal of Pol. Economy, Jan. 1946, p. 360

I think the area of economic planning may be more clearly understood if we assume as Durbin does that planning is "a principle of administration and not an inflexible budget of production"¹, as Hayek contends. For my purposes I shall consider economic planning as the supervision of economic within the state by a centralized controlling body in an attempt to obtain a more efficient economic system.

Because much of my discussion will turn on various features of the free enterprise or capitalist economy, it is necessary at this point to give a brief outline of the main characteristics of this system.

First of all we must distinguish between the present type of economy found in the democracies, and the theoretical capitalism in which two assumptions are made. There it is assumed that each man knows best how to further his own interests, and that when these interests are furthered, the interests of the state as a whole shall be furthered. Therefore state interference must be kept at a minimum - to the establishing and maintaining" the rules of the game". It is also assumed that pure competitions prevails.

Pigou defines a capitalist industry as -

"One in which the material instruments of production are owned or hired by private persons and are operated at their orders with a view to selling at a profit the goods or services that they help produce." 2

The producer is free to make the economic decisions involved in the production of a commodity or service. He does this in competition with other producers. Value is contributed to the product by its utility and relative scarcity, and measured by its price, which is

1 - Durbin, op. cit. p. 300

2 - A. C. Pigou, Socialism Versus Capitalism, (London: The Macmillan Co., 1937), p. 1

determined on the market essentially by supply and demand. The producer will expand output until the cost of producing the marginal unit equals the revenue obtained from selling it, because in doing so he will maximize his profits. He will also contract production if he finds the cost of producing the marginal unit is greater than the revenue derived from selling it. In this way still assuming perfect competition, the optimum productive use of resources is obtained.

The agents of production, land, labour and capital are bought by entrepreneurs because of their capacity to contribute value to marketable goods and services. The payment for land is in the form of rent, labour in the form of wages, and capital in the form of interest and rent. The agents of production receive their rewards based on their assignable contributions to the joint product. That is to say, the value of the product is allocated among the agents which cooperate to produce it.¹

1 - The amount of rent is determined by the marginal productivity of the land. For example a farmer rents a small proportion of his land, so that the remainder of his farm is being combined with capital and labour to the amount that existed before. He finds that his total product decreases. It is this diminution which measures the productivity of the small portion of land that he had rented. If the loss accompanying the subtraction of the land is fifty dollars, then the rent the farmer will charge will be no less than fifty dollars. Similarly wages are determined by the marginal productivity of labour. The entrepreneur will increase his number of labourers employed until the last one taken on exactly earns his wage by the amount he adds to the commodity which is being produced. The supply of labour as well as the supplies of the other factors of production serves to determine the marginal productivity of the worker. When the supply is great the workers will compete for jobs, forcing the wage rate down, until all workers can be employed. In other words when all the marginal workers throughout industry as a whole add just enough to the various products, they are helping produce, to warrant their employment. When labour is scarce, and the last available worker employed is being paid less than the value he adds to the product, employers will compete for labour by raising wages in order to obtain the maximum profit combination of the factors of production. (Continued on the next page)

The entrepreneur is at all times seeking to find the optimum combination of his productive resources to keep his costs per unit of output at a minimum or in other words to secure a maximum profit. If he finds that by using more capital and less labour, his costs are reduced in producing the same amount of goods. Then he will use more capital and less labour.

The function of allocating resources among different uses is accomplished by the pricing system. Price machinery enables the producer to reduce all his agents of production to a common denominator, so that each decision he makes will be directly comparable to some alternative decision.

The pricing system may be defined as advice for limiting the use of resources and consumption goods which have alternative applications which are considered to deserve precedence, to the extent required by their inadequacy to fill completely the selected applications.¹ The pricing system is based on the advantages arising from division of labour, since it facilitates and expedites exchanges. Where productive functions are specialized, with productive processes lengthened and consumption rationalized, differences and conflicts emerge among individual aims and choice which necessitates the institution of some method of "articulation".²

Capital, like land and labour earns returns based on its marginal productivity, but unlike land and labour, its supply will be effected by direct money cost. This cost must be defrayed from its marginal product. Therefore the entrepreneur before buying a new machine will estimate its marginal productivity. From this he will deduce the annual earnings, subtracting the amount which should go every year into the reserve for depreciation to replace the machine when it is worn out. The amount he estimates will be residual, and is his anticipated interest on the investment.

1 - H. W. Watkins, "The Price System", The Encyclopedia of Social Sciences ed. E. Seligman, Vol. XII, 1935 p. 366

2 - Ibid, p. 366

Our pricing system has developed to its present form chiefly due to two factors. Firstly because of the use of money as the unit of reckoning values, and secondly because of the market price system, which afforded the means by which checks upon the uses of resources could be enforced, in addition to which, the burden of these checks, necessary under any system, is borne with greater equanimity, if it appears to be the result of fate, rather than of human agency.¹

The static theory which has evolved with this type of economy has assumed money to be neutral in the composition of the price structure. Prices are considered to be the product of real costs and real utility, worked out automatically by marginal analysis, to obtain the maximum product at the minimum cost.²

There are great differences in the economy pictured above and the economy we find in such capitalist countries as Great Britain, the United States and Canada. Here, partial planning, restrictionism, cartels and combinations, have a marked effect on the economic system of the country. Pure competition is the necessary expository tool of the theorist. In reality it does not exist. Producers become monopolists because they have control over a certain resource, or because they have a new technical process which enables them to produce more cheaply than their competitors. Demand is influenced by advertising, which in a sense can create a partial monopoly. Many of these monopolies can control prices to a very great degree, in as much as they control supplies of certain products. They may either produce a smaller amount to sell at a higher price, or a larger amount to sell at a lower price. Often they will practice discrimination by selling the

1.- *ibid*, p. 367

2 - *ibid*, p. 369

same product to different groups at different prices. In maximising profits the only factors which limit monopolists are prospective competition, (since the profits may attract other producers into the field), the appearance of substitutes of the price is set too high, and the risk of state control.

It is true to a certain degree as Lord Keynes suggests that there is a tendency for the big enterprise to socialize itself, in that the shareholders are almost entirely dissociated from the management, so that the personal interests of the latter in making profits, becomes quite secondary, and the stability and reputation of the institution are considered first.¹ This dissociation is the result of several developments. In the first place big joint stock companies are in the public eye, and are therefore vulnerable to public criticism, so that the name of the company must be a constant consideration. In the second place, the majority of the stockholders, have bought shares, not with an eye towards management, but merely as an investment yielding good dividend. The extreme example of this type would be the Bank of England before the war. However, the fact remains that some of the huge financial empires which exist today, are strong enough in some cases to determine a country's trade policy, and to obtain a very strong representation in the government. Very often this is not beneficial to the general public. In some cases it may do considerable harm. These big enterprises

1 - J. M. Keynes, The End of Laissez-faire, (London: Hogarth Press, 1926), p. 42

are responsible only to themselves for the economic decisions they make, although their decisions may effect millions. Anti-trust laws and combination acts have failed to limit them. In the main their actions are governed by motives of power and money, and it does not necessarily follow that, because the love of money is the force to which is harnessed the task of distributing economic resources, the real wealth of the country will be increased to a maximum under these conditions of imperfect competition. There are other complicating elements also. Many adjustments in production take a long period of time to be carried out. Labour is not very mobile in moving from one line to another if the necessity arises for it to do so. Ignorance of all the facts may lead to overproduction in some fields and underproduction in others. The individual does not necessarily know best how to further his own interests, and in any case it does not follow, that if he does so, everyone will gain.

On the international plane, aside from transportation cost, trade barriers of many kinds, such as tariffs, exchange controls, quotas, and so on, will have a tendency to make for extremely inefficient use of the world's total resources. The effects of this are felt very greatly in many individual countries. Certain states are faced today with the problems of finding new markets, competing with more efficient producer countries and dealing with other states which are not yet back on their feet financially. Canada is a notable example.

The increased power of industrial unions and trade unions is another disturbing factor, because of the irresponsible use to which it is put by unscrupulous labour leaders, with refusal to assume

corresponding responsibilities. The fact that a recent stevedore strike was able to embarrass the United States' foreign policy merits grave consideration. Other strikes on this continent have been able to tie up production to a very great extent, at a time when we are trying to get back to a peacetime economy. They have seriously impaired reconversion plans, in addition to increasing the risks of serious inflation, by slowing down production when demand is at a peak.

Perhaps the most serious development of the present day is the intensification of the business cycle, with its fluctuations which cause great hardships, aggravating serious social maladjustments such as unemployment. We all agree that something must be done to control and to minimize the swing from boom to depression and depression to boom, but what?

These are some of the problems we face under capitalism. Planning aims to work out better solutions for them. However at the same time any planning adopted, whatever its nature, must be compatible with what we consider to be the fundamental principles of democratic society. For example, we must be sure how much freedom we are willing to sacrifice if necessary, to have more efficient use of our productive resources. This is but one of the many questions which has to be considered in any discussion of planning. Lord Keynes reached the heart of the matter in his statement -

"Our problem is to work out a social organization which shall be as efficient as possible without¹ offending our notions of a satisfactory way of life."

It is my desire to discuss planning in this light.

1 - *ibid*, p. 53.

CHAPTER TWO : THE PROBLEMS OF CAPITALISM

THE PROBLEMS OF THE FREE ENTERPRISE SYSTEM

1. Related to production

Chief among the problems of the free enterprise system is that created by monopolistic competition. Underlying the structure of the free enterprise economy is the principle of pure competition, and it is the lack of such competition which creates our problem.

1

Pure competition -

".... represents a condition in which no individual group or bargaining unit has any discretionary control over supply or price these being completely governed by the separate actions of the competitors, who follow their own interests in entire independence". 2

This definition implies that the number of buyers and sellers must be large enough, so that no one individual has more than an negligible influence in the market. It also implies that the class of goods being offered is perfectly standardized, so that each seller is faced with competition of substitutes which in every way correspond to his own product.³

On the other hand pure monopoly, which in practice never exists, since potential competition from near substitutes is always present, and the monopolist is therefore never completely free in determining his price and production policy, may be defined as -

1 - Pure competition may be distinguished from perfect competition in that the latter may be interpreted to involve perfection in many other respects than in the absence of monopoly, for instance the time element in adjustments to changing conditions may be regarded as being accomplished instantaneously.

2 - J. M. Clark, "Monopoly", The Encyclopedia of Social Sciences, Vol. X, p. 624

3 - Chamberlin, E., The Theory of Monopolistic Competition, (Cambridge: Harvard University Press, 1935), p. 7

"Unified or concerted discretionary control of the price at which purchasers in general can obtain a commodity or service and the supply which they can secure, or the general control of price through supply, as distinct from the lack of such control which marks the ideal situation of perfect competition". 1

In as much as there is control over supply, competition from substitutes is excluded.

Pure competition and pure monopoly are merely abstract conceptions of the economic theorist. Elements of competition and monopoly are inextricably woven to form the pattern of present day so called free enterprise economies. 2 The conditions which arise between these two opposite conceptions are various shadings of what is known as monopolistic competition. Whether this condition will be closer to either pure competition or monopoly will depend on two factors:

- 1) As the number of sellers increases, conditions will approach those of pure competition. 3
- 2) Differentiation of the product by certain characteristics of the product itself, or by conditions surrounding its sale, will introduce elements of monopoly into the situation. 4

It is this field of monopolistic competition with which we are concerned. The problem is chiefly a problem of production, in as much as it involves the control of production of certain goods, through the monopoly of certain productive resources, productive techniques, or superior localities. In order to appreciate the problem fully, let us for a moment digress, and sketch briefly the growth of monopolies and quasi- or partial monopolies.

1 - Clark, *op. cit.* p. 634

2 - Chamberlin, *op. cit.* p. 3

3 - *ibid.*, p. 34

4 - *ibid.*, p. 56

In England monopolies date back to before the time of queen Elizabeth, yet the really serious development of monopoly in the form of vast trade combinations took place in the United States at the end of the Civil War. Protective tariffs were high and the vast continent of North America was being opened up, with huge numbers of immigrants pouring into the country. Fortunes were to be made by those who were able to centralize control over industrial processes and resources, in order to meet the rapidly growing demand for goods at their own prices.¹ In Canada, the same state of affairs existed on a proportionately smaller scale, while at the same time, Germany, another country with high protective tariffs and a large home market, "... adopted the policy of accepting and even encouraging monopolies, but endeavoured to bring them under state control".² So it was, that later monopolistic competition came to be the basis of industrial organization of the totalitarian state. To return to England, after 1875, the gradual shift from free trade to protection merely served to accelerate the growing movement towards monopolies, which until this time had not been serious.³

Today monopolies are strongly entrenched in the free enterprise countries of the world, despite such federal legislation as the Sherman Anti-trust Act, and the Clayton Act in the United States, and the Combines Investigation Act in Canada, as well as sections 498 and 498A of the Criminal Code.

It has been suggested -

"... that monopoly or agreements among sellers is the typical market situation and that competition is self-destructive rather than self-perpetuating, representing

1 - D. A. MacGibbon, "The Problem of Monopoly", Commerce Journal April, 1944, p. 83

2 - *ibid*, p. 84

3 - *ibid*, p. 84

an unstable transition period between two periods of price control." 1

The overall picture tends to invalidate this idea, however. Generally speaking monopoly is the result of some special form of privilege, whether it be a tariff, patent law, control over natural resources or transportation facilities. Otherwise monopolies evolve through unfair competition or illegal combinations in restraint of trade. The evils which make monopoly undesirable in the view of the majority may be divided into three main categories.²

Firstly, monopoly hampers the working of the free enterprise system by limiting the entrance of new competitors into the field already monopolized. The potential monopolist may use his power to destroy, very often in an unfair manner, competition which already exists, although this competition may be technically as efficient as the monopoly itself.³

Secondly, where monopoly exists, the monopolist is able to set the price within certain limitations to suit himself, and the public must usually pay a higher price for the goods they require, than would be the case under pure competition.⁴

Lastly, limitations on the output of goods, in order to raise their prices, involves a faulty allocation of productive resources, since the monopolist invariably operates at less than optimum capacity. "In almost every possible case the monopoly's output will

1 - Reynolds, The Control of Competition in Canada, (Cambridge; Harvard University Press, 1940), p. 269

2 - MacGibbon, op. cit. p. 88

3 - *ibid*, p. 88

4 - *ibid*, p. 88

be less than the socially desirable output".¹ In order to utilize our resources most efficiently, an allocation must be made such that the marginal units of every kind of productive service contribute equally among their alternative uses to the social product. As the objective of monopoly is to maintain "an area of abnormally high yield", the monopolist will try to prevent the influx of resources which would reduce the monopolized industry to the competitive level. This means the exclusion of available resources from uses which, by their market value, are of greater importance, with their consequent diversion to less productive uses.

So far only the more concentrated monopolies have been considered. From the viewpoint of society, the situation with regard to partial monopolies is possibly more harmful. While these organizations may be able to enforce output limitations on the various member firms, they are seldom able to restrict the number and size of these firms or to withhold output quotas from newcomers. In addition to the exploitation of the consumer through price, this results in gross wastage of investment. With each newcomer, quotas among the rest will be reduced, so that a smaller utilization will be made of the available capital throughout the industry. In the long run, producers within the industry may receive a return on their investment, which is no greater than what they would receive under conditions of competition, even though prices have been maintained.²

1 - Joan Robinson, The Economics of Imperfect Competition,

(London: The Macmillan Co., 1933), p. 174

2 - H. C. Simons, A Positive Program for Laissez-faire,

(Chicago: University of Chicago Press, 1934), p. 8

Two other aspects of monopolist competition must be considered also. The first is a tendency for a wider spread of individual incomes, which is socially undesirable. The few at the head of monopolistic organizations are able to amass fortunes, as they are to varying degrees protected against the "rigors of competition", while those exposed to its full force must struggle, in many cases, to make the barest living.¹ The second concerns advertising. It is argued that advertising is "justified because it widens markets,² promotes large scale production, and thus lowers costs and prices". This is true to a certain extent, but today advertising is no longer within the limits where it is justifiable. The advertising of identical commodities by various sellers represents complete social waste. To the extent that the commodities are not identical, but nearly so, the degree of waste is only slightly less. Through the widespread use of radio, press, magazines and movies, big corporations spend money in fantastic amounts to create exceptional demands for their goods. Too high a proportion of what the consumers pay for goods and services is a payment for the grandiose flights of advertisement which the producers sponsor. Most of us will be very much relieved when the day of the "soap opera" is over.

Thus monopolistic competition leads to an uneconomic use of the productive resources. Not only is the consumer being exploited by usually having to pay a higher price for goods and services he desires than he would under competition, but the resources are being channeled off from more productive uses to less productive uses. At the same time output is restricted, so that the scale of product-

1 - Clark, "Monopoly", Encyclopedia of Social sciences, Vol. X, p. 629

2 - Chamberlin, Opp. Cit. p. 165

ion is smaller than in the case where monopoly elements are negligible.¹

Two courses of action lie open to us. One school holds that we should follow a vigorous program to maintain a system of free competition by -

"the elimination of monopoly in all its forms :

- 1) Through drastic measures for establishing and maintaining effectively competitive conditions in all industries where competition can function as a regulative agency (as a means for ensuring effective utilization of resources and for preventing exploitation) and
- 2) Through gradual transition to government ownership and operation in the case of all industries where competition cannot be made to function effectively as an agency of control." 2

This school also feels that under such a system of free competition, the paralysis of the business cycle would be less severe, as the laws of demand and supply would be free to operate to maintain the flow of goods and services and the full employment of labour and other productive resources, without the hampering effects of monopolistic and quasi-monopolistic resistences.

The other school of thought believes that the "anarchic" system of free enterprise is responsible for the business cycle, and its accompanying difficulties, and that a more organized control of supply is needed, which would envelop both monopolistic and competitive enterprises. This school of thought is represented by the advocates of economic planning.

1 - MacGibbon, op. cit. p. 88

2 - Simons, op. cit. pp. 17-18

The elimination of monopoly and monopolistic competition from the free enterprise system, in addition to providing a solution for these problems, would also to a large degree answer the remaining problems of production. The nature of these problems and just why they exist, will evolve from the discussion which follows.

The inefficiency of production is another way of saying that productive resources are wasted or misused. This waste or misuse may be due to several features of the free enterprise system; the business cycle, restrictions on inventions and new industrial techniques, and inefficient methods in the use of natural resources.

The business cycle represents irregularity of production. In the prosperity phase of the cycle, producers expand their output of goods and services. Business conditions then precipitate a crisis, and with this crisis, producers reduce their outputs. During the ensuing depression, when the demand for goods is low, production continues to be at a minimum, until the recovery phase is under way, and expansion begins again. In order to appreciate this phenomenon, the nature and the course of the cycle must be examined.¹

Let us assume that the economic system is in temporary equilibrium, in that the entrepreneurs who make the decisions with respect to the use of resources have no motive, taken in aggregate, to either contract or expand their activities. (In actual practice this condition would never exist, but it is a useful starting point). Originating forces from outside the economy, such as war, inventions,

1 - The general description which follows is based on J. A. Eatoy, Business Cycles, (New York: Prentice - Hall Inc., 1946), pp. 104-127

substantial changes in consumers' wants, cause a series of business responses whose nature depends on the general complex of industrial and financial conditions. These responses are expressed in changes in the volume of productive activity, the volume of bank credit and its rate of circulation, prices and so on. It is these cumulative responses, rather than the originating forces which give the wavelike effect of cycles. The originating forces produce the effect they do, because they operate on a business system that tends to react in certain ways. As these business responses cause the shape of cyclical changes, they may be regarded properly as essential causes of cycles from within the system.

Now let us examine the operation of these responses through the various phases of the cycle.

(1) Expansion

This begins under the stimulus of an originating cause. In the expectation of rising profits, entrepreneurs increase the scope of their business activities. They employ more labourers and they order more raw materials. This increased demand for raw materials puts people to work in other plants as does the increased demand for consumption goods, which results when the workers spend additional wages paid by the entrepreneurs. If the position from which expansion started was one of incomplete employment of resources, increased demand for goods is satisfied by the rapid increase in supply. The expansion is marked by increased production, but not rises in prices.

However, as a considerable increase in wage disbursements is made to men producing raw materials or equipment, and these wages

are spent on consumption goods, the time lag which occurs in the production of such goods will lead to a rise in prices. The delay in the increase of the price level is due to the fact that plants are not at the time being used at capacity. Hence, they can increase output without a proportionate increase in total costs. Soon bottlenecks, rising costs and expanding plants lead to a general rise in the price level.

This rise is dependent upon an increase in the volume of monetary means of payment, which is effected largely through the expansion in bank deposits. The velocity of circulation increases, (but the evidence indicates only enough to account for the increase in output. Hence the increase of prices must be accounted for by the increase of money).

The rise in prices is by no means uniform. Wholesale prices rise more than retail prices. The prices of raw materials rise more than those of manufactured goods. Farm product prices tend to follow the swing of raw material prices. This disturbs to some degree the symmetry of the price system. Price relationships are disturbed. Changes occur in the price spreads from one level to another, and these generally result in changes in the distribution of national income.

There are also changes in the cost structure. Wages tend to lag behind prices due to convention and a reserve force of labour, which is brought into employment before wages and salaries start to rise. Interest, especially long run interest is slow to rise, and in the case of existing debts, is fixed. Thus the margin of profit is increased, as various cost elements lag behind the general rise in the level of prices.

(2) Boom

The increase of profits and its expected continuance causes a rapid rise in stock market values. The outstanding change is in stocks which reflect the capitalized values of prospective earnings and so register the rising profits of companies. Entrepreneurs stimulated by profit prospects, make further investment, again depending chiefly upon an expansion of bank credit. This capital expansion leads to further demands for consumers' goods through increased wage disbursements and a strengthening of the price level. There is a prevailing spirit of optimism shown in real estate and stock market booms.

(3) The End of Expansion

The cumulative forces of expansion are being overcome by a series of limiting forces brought into play by the expansion itself. The gradual rise of costs relative to prices cuts down the bulge of profits. The increased demands in the market for materials, labour and money capital, have resulted in rising prices, wages and interest rates, which were formerly held back by available reserves. Costs of production rise as entrepreneurs resort to poorer grades of equipment, workers and management, as the best grades are all used. In many cases new plants have been built, resulting in sudden rises in overhead costs. All these factors combine to raise unit costs.

The problem of rising unit costs result from the scarcity of efficient means of production, might be met by increasing prices but for two factors - the limit imposed by diminishing bank credit and increasing consumer resistance to rises in prices.

Price rises must be accompanied by an increased volume of bank credit in circulation (or increased velocity). The point is reached however, when the pressure on bank reserves limits loans and the volume of deposit liabilities. The banks raise interest rates and examine with greater care projects brought to them. This tends to check prices and the rise in stock market values. The restriction of collateral may limit credit further.

Increased consumer resistance is due to the fact that although incomes may increase, the standard of living doesn't rise easily, so that more is saved from these increased incomes than is spent. The increase in demand for durable goods falls off, since they do not have to be replaced for a considerable period of time.

(4) Recession

This marks the period during which the forces making for contraction finally overcome the forces of expansion. The outward signs are - liquidation in the stock market, strain on the banking system, the beginning of falls in prices, reductions in order and so on.

The fall in the stock market is chiefly due to the realization that profits cannot be maintained. It is due in part to insiders trying to get out early, and in part to the pressure of the banks on brokers' loans. This helps to bring about the fall in prices and profits. Borrowers on stock market securities find their collateral shrinking and may have to pay off some of their loans. Many may find it convenient to liquidate some of their holdings of commodities, thus weakening price. The banks become unwilling to expand or even

maintain the volume of loans, as a result of this weakening of the basis of credit.

The cumulative wave of liquidation which sets in on the stock market, the money market and the commodity market leads to a prolonged phase of declining activity.

When a crisis occurs it is the result chiefly of a collapse of confidence, which causes sudden demands for liquidity which feed on their own impossibility of satisfaction. A spectacular and unexpected failure may easily lead at this time to panic which results in a general run on financial institutions.

(5) Contraction

There is along period of stagnation and industrial contraction, marked by falling prices, a curtailment of productive activity and a decrease in the volume of employment of resources.

The fall in price in earlier stages may be due to liquidation of accumulated inventories. It is later due to a great reduction in the volume of bank credit. Banks and businesses are unwilling to continue on a normal scale of borrowing. Many hold cash balances because they fear the future. This fall in purchasing power is the fundamental background for the price falls, which despite general reductions in output mark the depression. Prices fall unevenly. Those for manufactured goods fall less than those for raw materials and semi-finished goods. Wholesale prices fall more than retail prices. Monopolistic competition tends to keep certain prices unnaturally high. All this leads to a distortion of the price structure and changes in the income distribution which may prolong the depression.

Wages and salaries lag behind the falling price levels due to public opinion, custom, trade union regulation, and so on. Interest rate insurance and taxes are also slow. The margin of profit in many cases turns into a loss. All this creates pessimism, which exaggerates the actual losses. The weakening of expectation from which recession started, brings about price falls, reductions in output, unemployment reductions in purchasing power, and falls in the volume of bank credit. Finally contraction limiting forces arise to bring contraction to an end.

(6) Revival

Prices at last cease falling, due to scarcity of supplies, the wearing out of durable goods, and the need of replacements in industry. Demand accumulates. The cost-price relationship becomes more favorable. Lagging costs begin to fall. The less efficient workers and managements have been eliminated. Hence, the margin of loss is reduced and any quickening of business may now start a wave of recovery. Stock exchange activity becomes greater. The lower level of interest is more favourable to an increase of brokers' loans. The expansion of construction and other capital projects may start. Invention and improvement have been encouraged. Thus,

if the expansion proceeds on any substantial scale, the tendency will be for greater industrial activity to get under way, and the phase of recovery moves into the phase of expansion. Production in modern free enterprise economies is very highly specialized, with great economic interdependence among producers, which means that when business is good for any one industry, conditions for others will tend to improve.

The evils of the business cycle lie in the uneconomic use of productive resources which arise from it, and the accompanying social upheavals which are generated. During the period of expansion, many entrepreneurs allow technical inefficiencies to exist in their industries, and some may overexpand because they are overly optimistic of future conditions. Others try to create demands for new goods, which later prove to be unwanted, thus representing an inefficient use of productive resources. During depression, thousands of labourers are idle, and plants produce a minimum of goods, so that the country suffers from a waste of both capital and labour resources. These then are the conditions which should be rectified.

"The effective functioning of our economic organization, requires full utilization of existing resources, including labour, use the best of technical methods, and less obviously, economical allocation of resources among available, alternate uses." 1

This should be the aim of the free enterprise economy.

Two main schools of present day economic thought have put forward solutions to this problem, based on their analysis of the cause and nature of the business cycle.

The first school consists of the followers of Keynes and Hansen. They believe that -

"...fluctuations in economic activity, supposedly peculiar to a capitalistic economy, stem from the unpredictable behavior of individuals in using their income. They may spend, invest or hoard it and to quote further "... unless people behave in such a way as to bring about a fairly constant flow of money into consumption and saving, and

1 - Simons, op. cit. p. 7

relatively constant distribution of money among individuals, the system will be unstable. It will be subject to economic fluctuations, the length and amplitude of which are related not inconsiderably to the decisions made." 1

Keynes interpreted the behavior of individuals as being based on a "liquidity preference", (the desire to hold cash balances), as the chief factor disturbing economic equilibrium. This he claims is due to uncertainty as to the future of the interest rate. Individuals will hoard in expectation of a long run rise. Keynes also assumes that as incomes increase, proportionately more is saved by the individual. This action, independent of the rate of investment, tends to reduce the expected net return on investment. Yet for the same reasons individuals are inclined to anticipate higher future rates of interest. Therefore there is a tendency for investment to lag behind savings, with the consequence that substantial segments of labour and capital remain idle over indefinite periods of time, due to a long period "declining propensity to consume". Once the process of decline has been initiated by an excess of savings over investment, equilibrium will only be restored when there is a reduction in saving equal to the deficient aggregate demand for capital goods.²

The stagnationist assert that in the long run, net investment is related to the growth of population, territory and technology, and that now that the period of economic conquest of new territories, and of increasing birth rates as well as technological developments of a nation building scale, such as railways, is over, we

1 - E. W. Swanson and E. P. Schmidt, Economic Stagnation or Progress (New York, London: McGraw - Hill Book Co. 1946). p. 3

2 - *ibid*, pp. 4-5

are faced with a choice between a high level of employment induced by continuous government spending, or unemployment with political and economic instability.¹

The liberalist school of thought does not accept these conclusions. They have presented several criticisms to it.

(1) Territorial and population changes are as a rule extremely gradual and almost imperceptible, especially for a country such as the United States.²

(2) There is no evidence that a declining birth rate has affected the demand for capital.

(3) The greatest economic progress in the United States came after territorial expansion and railway building had long since been completed.

(4) Entrepreneurs condition their plans largely by these factors determining their expectations as to price and cost.

I prefer to accept the liberalist explanations of economic fluctuations. They take the view that -

"... any interruption of the process of capital formation tends to bring a reduction of business activity, a reduced flow of goods and hence unemployment,"³

and argue that economic growth and progress have been prohibited by certain anti-economic elements, which have rendered competition ineffective, and which must be reduced or eliminated through positive government action, designed to reestablish "the rules of the game."

In the view of the liberalists, the evils of the cycle phenomenon arise from two factors:

1 - *ibid*, p. 16

2 - *ibid*, p. 16

3 - *ibid*, p. 8

(1) the unequal flexibility of different sets of prices, and more important,

(2) the reliance of the state upon competitive controls in the field of currency where they cannot possibly work.¹

(1) The inflexibility of certain prices arises from contractual commitments over long periods, and from other monopolistic elements in free enterprise economies, which sacrifice volume to price, in order to increase their own gains. While other prices may fall, these will never the less remain consistently high, thus tending to dislocate the whole price system. Labour monopolies prevent wage cutting by employers at the expense of wholesale discharge of workers. Firms are forced out of business, because they simply cannot afford to pay the high prices for certain productive resources they require.²

(2) Commercial banking with its rapid cumulative expansion and contraction of credit is perhaps the most important single cause of the business cycle. Purchasing power is at one time high by virtue of expanded credit, and at another low with contraction. This has a profound effect on the economy, through the impact upon investment and the demand for goods. Here state action is necessary to prevent these extreme fluctuations of the volume of money and credit within the system.³

Price fluctuations are bound to occur in a free enterprise economy, but the harm done would be considerably lessened by the removal of monopolistic elements and their resulting frictions, and the acceptance of the state of one of its basic functions - the provision and regulation of the circulating medium.

1 - Simons, op. cit., p. 14.

2 - ibid, p. 15

3 - ibid, p. 15

Two other points must be mentioned with regard to the efficiency of production. The first pertains to patents, which prevent the public from benefiting from technological discoveries, through the creation of monopolistic conditions, or the prevention of these discoveries being put into effect. When this occurs, in the long run, there is a waste which is needless.

The second concerns the conservation of natural resources, by which I do not mean the attempt to save resources for the future through present abstinence, (it is very possible that these resources may not be as greatly needed in times to come), but rather a prevention of their wasteful utilization.

This waste results -

- (1) from the marketing of socially undesirable products; products not designed to stimulate new wants, but to induce the consumer to buy the advertised good in place of a substitute good, and
- (2) From the exploitation of resources for short term profits with utter disregard for their highest yield.

These then are the problems of production in the free enterprise economy. Two general solutions have been offered.

- (1) A rejuvenation of this type of economy, to make it function properly on the principles of free competition, or
- (2) A shift from control of the system by competitive forces to government planning.

3. Related to distribution.

The problem of distribution in the free enterprise economy is twofold. Individuals are required to make two sets of economic decisions.

(1) They must decide how to allocate their productive resources to obtain money income.

(2) They must decide how to allocate their money income in order to secure want satisfaction.¹

The first relates to production, the second to consumption. Three fundamental differences arise between these two sets of decisions. In the first place, the organization of resources in production is a technical problem different from any in the subjective field of choosing final products in consumption. Secondly, the social organization of different kinds of productive capacity is also available for uses other than procuring money income,² while money income may be used only in the purchase of products.

In theory, each individual apportions his money income among products in such a way as to receive equal increments of utility from the marginal increment of expenditure on every product. It is assumed that there is only one price for the same product in the same market. But every individual does not buy and consume every product, nor is he on an indifference margin with respect to doing so. The utilities of various products to different individuals cannot be compared. Incremental utility really only measures price for any two products, for all individuals who consume both, or are on the margin. The equilization principle is then only valid in

1 - Knight, F. H., Notes on Utility and Cost, p. 3

2 - *ibid*, p. 4

a market where everyone buys and consumes every product, with differences only in proportions.¹ This raises complicated questions as to the conditions under which an individual establishes an indifference equilibrium between one product he does not consume and one which he does. If he is free to do so, two reasons may be given - it may merely be a matter of taste, or it may be that at the existing price scale and with his given income, the incremental utilities of final units of other products are higher than the initial utility of the one in question. In addition the individual may not be free to do so.²

With regard to the allocation of productive resources among different uses in earning a money income, limitations of the equalization principle through restrictions of the freedom of the individual to transfer resources from one use to another are similar to those on the money expenditure side. With division of labour freedom exists only before specialization begins. Afterwards, it is only possible to speak of equalization at equilibrium of money return to different units of labour, as to classes of labourers, within which all individuals are quantitatively alike, and all of whom can transfer from one occupation to another, within their given class, without changing the quantity of labour furnished as measured by the value of the added product and the income received. Similarly other productive resources are limited as to mobility by differences in the suitability of different resource types to different uses.³

1 - *ibid*, p. 6

2 - *ibid*, p. 7

3 - *ibid*, p. 9

Other difficulties arose with respect to the marginal approach. While marginal imputation holds in the static state, and shows the ideal working of the free enterprise system, from a dynamic standpoint, factors arise which obstruct the working of this principle. Imperfect markets, bargaining handicaps, cases where the minimal dose is large - all cause departures from marginal equilibrium.¹

The marginal principle will operate at full efficiency only if in production, at equilibrium, similar units of productive capacity earn equal incomes. For this to be the case, both the productive capacity itself and the income earned must be defined in purely objective terms. The effects of differences in the subjective attitude of the different owners must be inoperative, and productive organization must be reduced to amateur of making physical resources produce a maximum money return, uninfluenced by other considerations.² At any equilibrium point, the relative supply of two products must be determined at the margin of indifference by resources which move from one field to the other in response to the least difference in the pecuniary value of the product. This requires that either the entire capacities of the agencies to earn money is devoted completely to money earning or that a fixed fraction of their capacity be so devoted.³

Three other points should be mentioned in conclusion.

(1) In present day free enterprise economies, monopoly and monopolistic competition tend to prevent productive resources from moving from

1 - J. M. Clark, "Distribution", The Encyclopedia of Social Sciences
Vol. IV, p. 172

2 - Knight, op. cit. p. 26

3 - ibid, p. 26

a less productive use to a more productive alternative, as I have pointed out before.

(2) One of the underlying assumptions of the free enterprise economy is that the economic behavior of the individual is rational. Where this is not the case, there will be inefficiencies in the working of the system.

(3) The problem of distribution is related to the problem of value and price. When the latter is solved, a solution to the former may be obtained from it. When the price system fails to operate smoothly, in allocating goods and services, distribution is pushed farther from optimum, since price is the common denominator which makes this allocation function.

3.- The Institutional Factors

In the financial structure of modern business, the corporation plays a very important role. Many benefits have accrued to society through the development of the joint stock company. Limited liability has tapped sources of capital which before were impossible to utilize, and with this increase in capital, industry has been able to make great strides, particularly in modern times. However, at the same time, certain undesirable features have developed also, chief among these being the practice of pyramiding control by means of the holding company. This has enabled men like Rockefeller to build huge financial empires, which, while they have added to social gain to a certain degree, have been undesirable in forming monopolies and exerting undue political control. The consumer remains relatively speaking, politically inarticulate, but the monopolistic producer is able to exert considerable influence through lobbying and pressure groups.

The commercial bank by means of expanding and contracting credit emphasizes cyclical swings, with serious results as has already been pointed out. This often has the effect of neutralizing sound government fiscal policy, which may be attempting to control the volume of money in circulation, and thereby lessen the effects of the business cycle.

Government monetary-fiscal policy is not however very often what it should be. Money is the basis of our enterprise economy, since price not only serves to allocate productive energy among different industries, but also apportions output between consumers goods and capital goods. It is the medium of exchange in the

¹
economy. Money also effects the economy through its use as a measure of value. The increase and decrease of the amount of money in circulation has a marked effect on the general price level, as well as on relative prices. Hence the need for good government monetary policy. In the past, government have obtained money for finance by inflating the currency to create new purchasing power, (really only a method of indirect taxation). To a limited extent this may be beneficial, but on the whole tends to be harmful since certain groups in the economy are hurt by it. For example, all persons with rigid or relatively fixed incomes are hurt. A continually unbalanced budget by creating new money (or extending government credit) will eventually lead to inflation. There will be a loss of confidence by business, with decreased private expenditure, increased hoarding, and a falling off of investment and long term commitments. Finally the public loses all confidence in the government to control the situation, with result - panic buying. The end is then in sight.

Judicious government spending would certainly tend to alleviate the business cycle. Increased taxing and decreased spending in good times, and increased spending with decreased taxation in bad, would decrease the full force of cyclical swing. Political considerations create grave difficulties in following a program of this nature. In the first place, people tend to evaluate governments by the amount they reduce taxes. Therefore there is a tendency for most governments to try and lower them regardless of the economic consequences. Secondly, there is the problem of predicting the

1 - H. G. Moulton, Financial Organization and the Economic System.

(New York, London: McGraw - Hill Book Co., 1938) p. 24

cycle, and planning ahead. Who is to predict how accurately we can plan? A final consideration is that by spending on building materials, the government will tend to keep the prices for these things high with the possibility of penalizing private industry.

Through progressive taxation, governments can help to create a more equal distribution of wealth. Here again political expediency enters the question. The direct tax, although it places the burden of taxation on those who are best able to bear it, is unpopular, while the indirect tax, which does not do this and is therefore regressive, is very popular since it is a more painless method of paying. The burden is shifted, and as in the case of the sales tax, may be to varying degrees passed on to the consumer. Many governments follow the easy course and tax indirectly.

One of the main features of government economic policy following the depression of the thirties, true not only of capitalist countries, but of nearly all states, was the practice of protection of home industries through trade barriers such as the tariff. In Nazi Germany, this was carried to an extreme in an attempt to make the country as nearly self-sufficient as possible for the coming world war. International trade bogged down almost completely during this period, with the result that the world's economic resources were inefficiently used, and many not used at all. Consumers in one country were barred from benefiting from superior production methods of another country in a certain industry. They were forced to pay more for the same commodity produced at home. In addition to these conditions, the tariff often operated to create monopolistic conditions with their accompanying economic evils.

The democratic form of government which accompanies the free enterprise form of economy leads as a rule to inconsistent economic policy. In crucial times, a depression for example, this may have a severe impact on the economy as a whole. As yet we have found no solution for this, and we will find no solution, until each individual citizen has been educated so that he is fully conversant with economic principles and policies.

In conclusion, let me sum up the main problems which face the capitalist economy today. These are unemployment, monopoly, and the business cycle, with relatively low national income and a very unequal distribution of wealth. Their existence has led many to favour the alternative choice provided by economic planning.

CHAPTER THREE : THE PROBLEMS OF SOCIALISM

INTRODUCTION

"Socialism refers to that movement which aims to vast in society as a whole, rather than in individuals, the ownership and management of all nature-made and man-made producers' goods used in large scale production, to the end that an increased national income may be more equally distributed without materially destroying the individuals economic motivation or his freedom of occupational and consumption choices." 2

This definition of socialism implies a number of things. To appreciate it fully, the individual parts must be examined carefully. In the first place, the term "movement" means that there exist organizations with specific programs using deliberately chosen tactics designed to transform the idea of socialism into concrete working socialized economies. "Society as a whole" refers to the continued existence of some form of organized society and the existence of some form of what we call in the broadest sense a "democratic" organization of society. The vesting of "ownership and management" in society rather than in individuals means that the decisions concerning the use of producers' goods would be directly made by society instead of individuals. "Ownership" of property is synonymous with the power to make decisions with regard to its use. It is this power which socialism plans to transfer from the individual to society. "Nature and man-made producers' goods" are used in large scale production whenever the individual controls such a quantity of producers' goods that he finds it desirable to employ hired labour to assist him in using them. When we say that the aim is to increase national income, we imply that the potential output of existing productive agents is greater than their present

1 - This introduction is a summary of the Loucks and Hoot treatment in Comparative Economic Systems, pp. 276-294

2 - *ibid*, p. 276

actual output. If income is to be more equally distributed, the extremes of high and low income must disappear. This is all to be done "without destroying the individual's economic motivation". In other words, while partially trying to shift from individual economic incentives to social non-economic incentives, the desire for the individual to acquire income with which he can buy goods for his personal use will be the incentive which provides human energy for the productive process. "Freedom of occupational choice" means that the individual will have substantial freedom to choose the particular channel of occupational endeavour which he wishes to follow. By "freedom of consumption choice" is meant the absence of rationing of consumers' goods. The individual is free to choose without the restrictions imposed by the current allegedly misleading advertising and sales talk. A more equal distribution of personal incomes will mean greater freedom of consumers' choice for many who were formerly excluded from a wide range of choices by smallness of income.¹

The central issue between socialism and capitalism is one of property rights in producers' goods, of the economic decisions relative to these goods, and of the distribution of the output of these goods in combination with labour. Socialism proposed to organize production, distribution and consumption differently from capitalism, and to this end advocates changes in the legal institutions which the socialists feel are the basis of the evils² of capitalism.

L - *ibid*, pp. 277-278

1 - *ibid*, p. 279

The socialists make several basic criticisms of the capitalist system. They point out that profits can be made by charging a low price and selling a large quantity of goods. The business man may be induced to create a scarcity of goods in order to profit from their sales at high prices. In addition to this, very large fixed investments may make it unprofitable for the business man to utilize technological improvements. Hence society fails to benefit in both these examples of the working of the profit motive.¹

The socialist claims that competition leads to waste through destructive methods of production, withholding goods from the market, and destroying them to keep the price up. Price wars may ruin efficient plants through unethical competitive practices. At the same time, the combination and cooperation which tends to reduce this foster monopolistic price-fixing.²

Under capitalism, certain types of goods which are produced to meet unhealthy demand (for example, the demand for pornographic literature), are to the detriment of society, because of the fact people will buy them. Production is not at its full potential. Monopolies with their quota systems, and the tendency of producers to restrict production when times are hard means that there is waste, as we are not employing our productive resources to their full advantage.

The socialists criticize the unearned incomes which are a feature of our economy, whether they may be a result of inheritance or individual control of scarce productive resources. They believe that unearned incomes contribute to the spread of incomes from the

1 - *ibid*, p. 200

2 - *ibid*, p. 202

few that are very high to those that are very low. They believe that the source is private ownership of productive resources, with its resulting title tribute, such as land rent, the interest on inherited funds, monopoly profits. They consider that such maldistribution will have a very unhealthy effect on the productive processes.¹

The socialist attack on capitalism may be summarized under two main headings:

- (1) Criticism of the manner in which production is carried on.
- (2) Dissatisfaction with the way in which the products turned out are awarded individuals and families.

Thus we may say that the basic aim of socialism is to improve the position of the propertyless classes of society by a redistribution of the income derived from property.

1 - *ibid*, p. 294

THE ECONOMIC PROBLEMS OF SOCIALISM

1. Related to production

The central problem of socialist economic theory is the problem of the allocation of resources in the absence of a freely operating price system. As I have pointed out before, the entrepreneur uses the pricing system to reduce to a common denominator all the goods and services which enter into the manufacture of his particular commodity. This enables him to assess the cost of production under different combinations of the productive services. It is the pricing system which in establishing a means of comparing the efficiency of various methods of production and of various combinations of productive services, provided the basis for the allocation of productive resources to different uses.

Professor Mises was the first to point out this problem of allocation of resources without a freely operating price system in his article on Economic Calculation in a Socialist Community.¹ His main contention was that an economic use of available resources (the use which will maximize returns) was only possible if pricing was applied not only to the final product, but also to all the intermediate products and means of production. Since there is no market for the exchange of the agents of production with the exception of labour service under socialism, as these are owned and used by the state, he maintained that they are incapable of being priced. His conclusion is that no other process takes into consideration all the relevant facts in the same way as does the pricing process

1 - Mises, "Economic Calculation in a Socialist Community",
Collectivist Economic Planning, ed. by Havel.

of the capitalist market.

Professor Halm followed the lead given by Mises, maintaining that while freedom of consumption will guarantee that consumers' goods are priced, these prices are meaning less as they can only be compared with the arbitrary prices of the agents of production (with the exception of labour) which are set by the central authority. Halm looks upon the pricing process as "an endless network of exchange relationships from which individual pieces cannot be arbitrarily torn without injuring the rest". If it is impossible for all the agents of production to enter the pricing process, then the remaining parts will lack the interdependence necessary for the effective working of an exchange economy.¹

The first major step towards a solution was taken by Professor Dickinson, rounding out the earlier work of Enrico Barone. He shows in his article Price Formation in a Socialist Community,² that it is theoretically possible to evaluate the factors of production without a competitive market.

Dickinson starts with four assumptions:

- (1) All goods for personal consumption are privately owned
- (2) The factors of production are publically owned.
- (3) Production is organized into autonomous corporations which are grouped in trusts on the basis of their technical nature.
- (4) These trusts are grouped into industries which are supervised by an economic council with the final word in all matters involving production and distribution.

1 - Halm, "Further Considerations on the Possibility of Adequate Calculation in The Socialist Community", *Collectivist Econ.* p. 1 ed. by von Hayek. (London: Routledge, 1935)

2 - *Economic Journal*, Vol. xiv, June, 1933. p. 237

In setting up this hypothetical economy he distinguishes between the goods and services which the individual must choose for himself (such as food) and those not provided through the action of demand and supply on the market, but which must be provided for the group as a whole through group action, (for example roads). Money will be used in this economy, and all relevant and statistical data such as costs will be published.

Dickinson claims the possibility of mathematical determination of all the prices which are necessary for the complete and accurate allocation of productive resources. The problem is to be solved in the following manner. Selling on the market will be done by sales agencies which will keep stocks of goods on hand at a level sufficient for current needs. These stocks will be replenished by orders sent back to the producing corporations. Agencies will sell their goods on the basis of what the market will bear, adjusting price to avoid surplus of stock. In this way the demand schedules for consumption goods can be statistically constructed. The orders sent into the production corporations will enable them to construct the demand schedules for goods of a higher order and thus enable them to set the prices they will charge the selling agencies. Thus Dickinson claims it is possible to calculate prices all the way down the line, by equating supply and demand and through successive approximations obtaining an adequate costing system. He admits the difficulty which arises with goods which are in joint and composite demand, but claims it is still possible to reach a solution.

This theory has been chiefly criticized on the grounds of

practicability. The number of equations and their innumerable solutions make it impossible to adjust production to meet the preferences of consumers. Under dynamic conditions by the time one set of equations would be solved, the situation would have changed again completely. Professor Lerner also points out that in computing a consumers' demand schedule under competition, the assumption is made that all other prices are constant.¹ But Dickinson in calculating the proportions of different factors of production to devote to different uses, is adding together the individual demand schedules for different products at various prices thus contradicting the assumption.

Dr. Oscar Lange has offered the most satisfactory contribution to the solution of the problem of pricing in socialism which has yet appeared, in his tract On the Economic Theory of Socialism,² in which he examines the economic possibility of socialism. In setting out to attack the problem he asks two questions:

- (1) Will the consumer have freedom of choice?
- (2) What will be the allocation of resources to satisfy their preferences?

Assuming the answer to the first one is affirmative, then the consumer's preferences (shown by demand schedules)

1 - A. P. Lerner, "Economic Theory and the Socialist Economy", Review of Economic Studies, vol. 11, October, 1934

2 - Oscar Lange, On the Economic Theory of Socialism, ed. by Lippincott, (Minneapolis: University of Minnesota Press, 1938).

must govern production and hence allocation of resources. To utilize resources fully economic calculation is required, and for this, a method of evaluation. (Lange preceeds this with a discussion in which he concludes that the consumer should be free to choose the goods he desires to consume, on the basis that to have another choosing for him might set up a dangerous precedent towards totalitarianism).

Mises postulated three theses which he considered to be valid:

- (1) Public ownership means no factor market.
- (2) No factor market means no prices.
- (3) No prices means no rational calculation.

Lange agrees with the first and third of these, but not the second, as he considers that Mises has assumed too narrow a concept of price. In its narrow meaning price may be defined as the exchange ratio of any two commodities on the market at the moment of time, but a wider view may be taken and price considered "as the terms¹ on which alternatives are offered".

Lange believes that for optimum allocation, three classes of information are necessary. In the first place, there must be a preference scale for finished goods based on individual demand schedules. Secondly, "the terms on which the alternatives are offered" must be known, and lastly, one must know the amounts of resources available for production.

This is to say that really to allocate resources, demand, prices and supply must be known. Mises believed the second unattainable without a market. Lange claims that ultimately in

1 - ibid, p. 60

both capitalism and socialism, price is determined by the possibilities of transforming one commodity into another. He believes that socialist entrepreneurs will be able to set up accounting prices equally as significant as the market prices of capitalism.

Two assumptions underlie the competitive market:

- (1) The number of competing producers and consumers is sufficient so that the influence of any one upon price is negligible.
- (2) There is freedom of movement throughout the industry, i.e. mobility of productive resources.

To obtain equilibrium an objective and a subjective condition must be fulfilled. The consumer must maximize the potential utility of his income, and the producer must maximize his profits. This he does by minimizing his costs through the equilization principle. He will expand output to the point where marginal revenue equals marginal cost.¹ In this way the supply element of short-run equilibrium is determined and at the same time the producer's demand for ultimate productive resources is expressed. The prices of these resources will be such as to equate supply with demand. With freedom of movement between industries, the total output of the industry will be such that average cost per unit will equal the price of the product. (At the point of equilibrium under competition marginal revenue equals marginal cost equals average cost). The objective condition is satisfied when equilibrium prices equate supply and demand, Lange believes that the

1 - This may be only a short run equilibrium, since average costs are not necessarily minimized.

problem is solved by trial and error. Every competitor regards prices as fixed and unaffected by any action that he may take. He will act in the manner indicated above, and so prices will move under the impulse of a large group of competitors. Equilibrium prices are approached by a series of trials, each arising from the error of that proceeding it, until equilibrium is restored. When prices do not equate demand and supply forces come into play which bring about this return to equilibrium.

Similarly in socialism the same two conditions would have to be fulfilled. Prices, now of both the marketing and accounting variety would have to equate demand and supply. On the basis of these prices individuals will operate according to certain principles. Accounting prices will be objective in that any deviation from equilibrium through errors in the price structure will be revealed by shortages or surpluses of the commodity in question, thus pointing the direction in which the production managers must move to remedy the situation. Consumers' preferences will determine demand. Managers, however, will not as before attempt to maximize profits, but will be guided by certain accounting rules laid down by the central authority. Productive services must still be combined in the most efficient manner to minimize costs of production by equalizing marginal returns. To replace the profit motive of the competitive system, the central authority must ensure that managers of a whole industry expand and contract the industry to the point where marginal cost equals price.

Three rules are laid down :

- (1) Combine the factors of production to minimize average cost.
- (2) Produce to the point where marginal cost equals price.
- (3) The owners of the ultimate factors will sell these to the highest bidder as before. The central authority will fix prices on capital and natural resources, and these will go only to the industries where the return from them will be greatest.

Lange has shown us how a specialist economy might operate to obtain an optimum allocation of resources in the absence of a competitive market for the factors of production.

The next problem in production we must consider is that of the regulation of the rate of interest in a socialist state, in order to encourage capital formation. Georg Halm claims that rational interest calculation is impossible under socialism.¹ With capital owned and allocated by the community, a rate of interest which will determine the relative needs for capital can no longer be obtained. Any arbitrary fixation of the interest rate by the central authority would in all probability be in error, as the scarcity of capital in relation to the demand for it would be unknown.

Dickinson states that interest calculation is possible through the capital demand schedules at various rates of interest.² From these the central authority would be able to compute aggregate

1 - Halm, "Further Considerations on the Possibility of Adequate calculation in the Socialist State", *Collectivist Economic Planning* Ed. by F. A. Von Hayek

2 - Dickinson, "Price Formation in the Socialist Community" *Economics Journal*, xliii, December, 1933

demand. Then with the interest rate and the amount of accumulation connected by an equation, it may be seen that when one is fixed, the other is automatically determined. Calculation for the surcharge of risk, says Dickinson, will at first be largely a matter of guesswork, since free consumers' choice will mean a demand which is unpredictable to a certain extent. However, he points out that statistical information might possibly be able to remove some of this unpredictability.

The interest rate must be so determined that the formation of capital is encouraged. Lange, with subsequent corrections by Lerner, believed that this should be done arbitrarily by the central planning authority.¹ In other words they believed that the interest rate could be set by this central authority so that capital could be accumulated at the rate they deemed necessary. Their position is briefly that investment should be made in an industry when the resulting output from these investments will cover the costs of producing it. This would include an interest charge on the capital involved in the work. Hence investment decisions would be decentralized in form and direction while it would be up to the planning board to determine the amount of capital to be invested in all industry during a certain period and then set the interest rate so that aggregate demand would be adjusted to this amount.

This treatment of the problems has been criticized on several grounds, the first being the conception of the demand for capital in terms of the diminishing productivity of a given stock of capital.

1 - Lange, op. cit.

If this were true, the higher the interest rate, the less capital will be used, and conversely, the lower the interest rate, the more capital will be used. This would mean that the interest rate controls the rate of investment. In actual practice, as investments increase, there is a cumulative movement of invest, which arbitrary interest adjustment would probably fail to check.

Secondly, Lange has been criticized for not taking into consideration the question of full employment in projecting his ideas on the interest rate. The interest rate must be so regulated that the danger of technological unemployment is nullified. When the question arises as to whether producers should produce only to the point where marginal cost equals price, if men will be unemployed at this level, the former rule laid down must be overlooked in order to insure full employment. It is pointed out that the interest rate does not reflect the future need for capital for additional jobs. This is due to the fact that workers who have been displaced are no longer cost items for the producer, who has replaced them by technological improvements. However, the central planning authority would certainly consciously try to avoid this in so far as possible by starting long run investments during any given period which would be equally distributed between projects which diminish jobs and projects which create jobs, with proper allowance for length of time involved for different investments to react.

Lastly, under Lange's scheme, investment would be organized through a decentralized system which would be operated by the response of accounting prices from the production managers would

be without relevant data almost to the same degree as their equivalent members of the capitalist society.

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Dr. Dobbs¹ points the way to a possible solution to this problem, by suggesting that all investment decisions be centralized as much as possible. The central planning authority should decide on how much of the community's resources should be invested, and compare the various productivities of the different resources as reported by the different industries. Where the marginal productivity in terms of final product is estimated to be a maximum, resources should be used. Each production manager would submit a proposed plan to the central authority which has been worked out on the basis of an accounting price which is an estimate, which is an estimate rather than an automatic regulator for the actual decisions to be made. All projects could then be expressed by the ratio between their net productivity and their cost, to form a priority list down which all resources could be allocated. The only problem which would then face the production manager would be that of running his plant in the most efficient manner possible.

Dr. Dobbs' proposed scheme of action may be sound economically, but it is open to question on social and political grounds. His scheme in operation might in effect very easily lead to totalitarianism.

It remains for me to clear up two other considerations,

1 - Dr. Maurice Dobbs, "Economic Theory and the Problems of a Socialist Economy, Economic Journal, December, 1936

related to production in the socialist state, these are freedom of the consumer and freedom of the worker. Discussion around both points will be centred on material from Barbara Wootton's book, Freedom Under Planning.

To begin, Miss Wootton examines the freedom of the consumer. She makes the distinction to buy what you like out of the existing stock of goods, and the deeper meaning which is known as consumer sovereignty. She also points out that there is the freedom to save to be considered, and comes to some interesting conclusions with regard to this latter freedom.

Let us examine the freedom to spend. Since "planned decisions and unplanned market reactions are in fact alternate ways of determining economic priorities",¹ we must attempt to surmise to what extent the situation would be altered in moving from the free enterprise system to planning. Under planning, the problem involved is to allow the maximum choice within the available total to each individual or group of individuals, at the same time ensuring that all these choices add up to the right total. As Dr. Lange has shown us, this may be worked out by the trial and error method, in order to estimate the demand for certain goods and to price them adequately. Distribution of commodities may still be operated through the use of money supplemented by free distribution without limitation in certain cases, as for instance the public highways, in order to give the maximum freedom as we now have it under the free enterprise system. Planning is no threat to freedom of consumption in this sense. However, Miss Wootton believes that planning is incompatible with the next type of freedom, that

1 - B. Wootton, op. cit., p. 43

of consumers' sovereignty.

Consumers' sovereignty --

"implies ...that the pattern of production should be determined by the actual choices that the consumer makes amongst the goods that are offered for sale to him - by the ballot box of the market place in fact." 1

Under the rule of consumers' sovereignty, sales will be influenced as much by the policy of whoever has the power to fix prices as by the preference of the consumers. Even if all goods were put on sale at the most economical, unsubsidized price possible, and everything judged by the sovereign consumer, as being worth taking, bought and everything is unsold, voted down by him, in a continuous pattern of trial and error, there are still serious limitations to this idea of consumers' sovereignty. Unjustifiable plural voting takes place, in the sense that differences in money mean that the man who is wealthy is able to buy where the poor man can't, although the poor man's need may be greater. Competition in actual fact is never perfect, so that we never find the situation where goods are priced exactly at their minimum necessary cost of production. Miss Wootton draws the conclusion that --

"The weakness of the thorough going critics of the conscious determination of economic priorities is that they constantly compare an ideal, theoretical consumer sovereignty (in which demand corresponds precisely to desire and all production is competitive) with the actualities of planning in a world of flesh and blood and imperfect human institutions." 2

1 - *ibid*, p. 52

2 - *ibid*, p. 61

She also points out that for the vast majority of people, freedom in this sense is of no importance, as they are on the whole completely unaware of it. Only a few prize it at all highly. Thus she considers it a freedom well worth foregoing in order to gain the advantages of planning.

Freedom to save means the freedom to distribute your income through a period of time, that is to say the freedom to choose between saving and not saving -- to spend your income when you feel like it. This is a freedom which all of us rank highly. Yet there is a conflict here, between this freedom and the ideal of full employment for which we are striving. When a person refrains from spending money, he is actually decreasing the amount of total purchasing power which has been created by production, and hence, *ceteris paribus* will tend to cause goods to sell at prices below their real value. This will lead to unemployment as the entrepreneur attempts to cut his costs in order to stay in production. Thus as people save or spend or invest, we have a fluctuating demand for goods since our decisions are affected by anticipations of future business conditions and we often act on the impulse of the other fellow. If he thinks business is good, he will invest his money and because we see him do it, we tend to think that business is good too and invest our money along with him. Only when no saving occurs can there be full employment, if the government remains passive. Hence when we exercise our freedom to save we are endangering the liberty of the worker to do more than simply walk the streets looking for a job. A solution lies through what is known as deficit financing on the part of the government. This is carried out when the state undertakes to

make good the deficiencies and compensate for the vagaries of consumer spending. Only under such a system should we be allowed to enjoy our freedom to save. Miss Wootton concludes that government planning in this manner is necessary in order to reach full employment.

"The task of adjusting, one way or another, the total amount of spending by public authorities and private persons to the total capacity and demands of the labour market must become a public responsibility". 1

Let us now turn to freedom of the worker, which Miss Wootton has divided into three categories:

- (1) Choice of employment
- (2) Freedom of collective bargaining
- (3) Freedom of enterprise

Choice of employment means that the individual has the freedom to choose the kind of work that he would like to do and also has the privilege to accept or refuse any particular job which is offered to him. The problem here under planning is to ensure that important jobs are filled by men with the ability to handle them properly. This will be the case if the conditions for employment are made sufficiently attractive. By trial and error the rate of payment may be set so that these people with sufficient competence will be attracted to the given job. To insure the workability of such a system, people must be willing to move from job to job, as the demands of industry require, in response to this method of inducement. This would undoubtedly be the case if the fear of unemployment were removed. At the same time, there must not be excessive mobility, for this is to be even more feared than

1 - *ibid.* p. 69

undue sluggishness. The rates of pay should be actually adaptable to the demand for labour necessary to fulfill any plans. If variations in wages are to be the stimulus which will attract workers into jobs here, and repel them from other jobs there, then the adjustments upwards and downwards must be made through careful planning. In this way legal restrictions may be avoided, and the freedom of choice of employment needs to be restricted by any economic sanctions. The strongest restriction - fear of losing one's job, and the gap before one has a chance to get another, disappears if vacancies are to exceed applicants, but the fear has already been partially allayed by the introduction of unemployment insurance or relief. Miss Wootton believes that -

"... the only way to combine universal freedom from

want with the use of strictly economic sanctions against excessive or deficient mobility is to widen the margin between the minimum subsistence paid in all cases even of voluntary unemployment, and the normal insurance benefit payable as the right to the genuinely unemployed, by pushing the latter generously upwards". 1

Therefore if completely free choice of employment tended to produce an inappropriate distribution of labour, or excess mobility between different jobs, these mistakes would be corrected by means of effective economic inducements.

Tied in with the free choice of occupation is the freedom of collective bargaining. Here the problem with regard to planning is that if we rely on wage adjustments to adjust supply and demand in the labour market, how can a system of collective bargaining

1 - *ibid*, p. 87

be allowed, and at the same time be sure that those adjustments will in fact be made. If a certain group in the economy claim the right to determine their wages by independent collective bargaining there can be no assurance that the answer they arrive at will be the one which will fit into the plans of the government. In other words, conscious determination of productive priorities means also conscious regulation of relative wage rates.

"With a free choice of employment, every pattern of production implies a pattern of wages. We are thus faced with the double task, that of designing the wage pattern correctly, and that of transferring it from paper to practice." 1

Miss Wootton goes on to discuss the possibilities of some kind of industrial arbitration, with the trade unions in advisory capacity, and special tribunals which would include "impartial" persons. To the individual this would mean that instead of having his wages fixed for him by a bargain between his union and his employers, they would be fixed by a neutral body who has heard both sides of the argument. As standard rates of wages are not the result of his own decisions, he hasn't really lost too much, all things considered.

The final freedom is the freedom of enterprise. This does not concern us here, but is rather a problem of drawing the limits between complete socialism and partial socialization of the economy which will be discussed later.

1 - *ibid*, p. 95

2 - Related to distribution

The socialists make several basic criticisms of distribution in the capitalist economy. These are chiefly concerned with personal distribution. However let us first turn to a consideration of functional distribution in the socialist state. Here the socialists are undecided among themselves as to the basis for the payment to the owners of labour and the other productive services. They disagree as to whether payment should be on the basis of merit, or on the basis of need.

If payment to productive resources were on the basis of productivity, a pricing system could be worked out on the basis of Lange's suggestions, so that through the trial and error method of establishing equilibrium prices, with production managers combining in the most efficient manner the marginal products of the services of the same value, so that they would also be equal in value. For any efficient working of the conception of alternative cost, resources must be paid in this manner to insure that any given resource will be most economically used. In other words, where there is a choice between two uses of a resource, the one in which the resource will be most productive is the one where it will receive the greatest return. The problem is twofold. In order to secure an allocation of goods, there must be a pricing system, if this allocation is to be rational. At the same time the allocation will only be rational if the resources are paid on the basis of their marginal productivity. The economic principle that -

"the maximum return from any resource is obtained by equalizing the increments of return from equal small increments of the resource in all the alternative modes of use,"

must be fulfilled.

However it is with regard to the payment of one productive resource in particular that differences of opinion arise - namely the payment to labour. In the definition which is laid down for socialism, it was stated that the distribution of the national income would be carried out without destroying the individual's economic motivation, meaning that the individual would be motivated by the desire for increased personal income to expend human energy. These incomes could be based on the productivity of the individual. But many socialists feel that the payment to the individual should be on the grounds of need, not of productivity, and consequently they postulate the substitution of non-economic incentives for the pecuniary motive, so that these non-economic motives would serve to induce the individual to strive to the best of his ability to produce, in whatever occupation he is engaged. Thus while payment would still in a sense be payment on the basis of productivity, it would be payment in a large degree in things other than money. If we remove the profit motive, we must substitute some other motive in order to make the economic system function. This raises questions as to the desirability of non-economic as against economic motives which are in the field of sociology rather than that of economics. There are grave doubts as to the advisability of using extreme nationalism as the central motive and at the same time it is too much to expect of human nature that a motive of love

for our fellow men could be utilized, however worthwhile it may seem. It would then appear that payment to resources should be on the grounds on productivity.

Distribution of income is perhaps the main concern of the socialist, and some of his most severe criticisms of the capitalist economy relate to this field. One of the most important aims of socialism is to eliminate unearned incomes and to narrow considerably the spread of incomes which prevails under the free enterprise system. There are three main causes of these two phenomena, says the socialist, all arising from one source - private property. These are land rent, interest on inherited funds and monopoly profits. All are in a sense what may be called title tribute, and as such should not be allowed to exist. These forms of income are to a greater or less degree unearned in the sense that the return is by no means proportional to the amount of effort put forth by the individuals who receive them. They tend to spread the range of income much further than is morally justifiable. The advocate of socialism maintains that by placing the ownership and management of "all nature-made and man-made producers' goods used in large scale production" in the hands of society rather than any particular group of individuals, these unearned incomes will be eliminated. Dickinson postulates that all goods for personal consumption should be privately owned, and all the factors of production by publically owned.

3. Institutional Factors

Finally let us consider the institutional factors in socialism. Here, what concerns us chiefly is the formation and power of the central planning authority.

For Durbin,¹ this institutional problem means the creation of an economic system in which the responsibility for making economic decisions is transferred from the private corporation or group to representatives of the community, (to form the Board of a Public Corporation). These representatives are in turn answerable to a Supreme Economic Authority, which is dependent upon an elected parliament. Such a centrally directed economy can be instructed to adapt its program to the changing wishes of the consuming public or the changing conditions of technical efficiency, using a pricing and costing system to guide the decisions of the planning authorities.²

Miss Wootton points out that the political freedoms which we value and must retain along with planning, possibly as has been suggested above, are the freedom to criticize the present government and its work, the freedom to form opposition parties, and the freedom to replace one government and one legislature by another without resort to force. If the latter freedom is to be maintained, then the tenure of every government and legislature is relatively insecure, and in present day democracies a government cannot expect to last more than five years on the average. Our problem is that economic planning requires contin-

1 - Durbin, op. cit.

2 - ibid., p. 358

uity, hence in some way we must make these two things compatible.

"Nothing can alter the fact that we cannot both make effective long term plans, and continually exercise the right to change our minds about anything at any time." 1

At present we have continuity through the establishment of boards such as the B.B.C. in Great Britain, and the Board of Grain Commissioners in Canada, through which continuity has been reached. These have a definite job to do, which is laid down in their charter along with their constitution and a definition of the limits of their authority. Different governments tend to leave these boards to work out their own problems and thus establish continuity to the solution, if not coordination. If Durbin's Boards of Public Corporations and his Supreme Economic Authority were to be left to operate in the same way, perhaps continuity could be established, and our political freedoms left relatively untouched.

This has been a brief survey of what socialism might mean in economic terms, and it has been the socialism of books. Following this I propose to examine a concrete example of a socialist program in actual practice, by looking at the present day economy of Great Britain as it has been set up by the labour party.

1 - Wootton, op. cit., p. 117

CHAPTER FOUR : PLANNING IN PRACTICE

PLAINING IN PRACTICE

As a current illustration of the practical difficulties of economic planning, the British government has issued a White paper entitles Economic Survey of 1947¹, in which they have outlined the problems that face Britain in the coming year, and the broad outlines of how they intend to "plan" the economy.

The general statement is made that -

"the object of economic planning is to use the national resources in the best interests of the nation as a whole. How this is done must depend on the economic circumstances of the country, its stage of political development, and its methods of government." 2

With this in mind, there are five main national needs, which must be considered above everything else in the allocation of national resources.

- (1) Defence. Britain has certain military commitments which she must meet and at the same time she must keep her forces equipped.
- (2) Payment for imports. Britain must import half the food she consumes and most of the basic raw materials for her industries. She must produce and sell enough exports abroad to pay for these imports.
- (3) Capital Equipment. This must be modernized and expanded, as well as maintained, if Britain is to produce enough to meet her needs.
- (4) Personal Consumption. The "regular consumption needs" of the nation must be met through production, importation, transportation and distribution of goods and services.

1 - Economic Survey for 1947 - Cmd. 7046, February, 1947

2 - ibid, p. 5

(5) Public services. Such services as education must be maintained and improved.

If these demands on the economy are to be met, production must be increased considerably beyond its present point in Great Britain.

The nature of the plan the labour government intends to follow is not yet clear as to detail. Broad outlines have merely been traced. In the first place, economic planning must be conducted in such a manner that the maximum possible freedom of choice is preserved for the individual citizen. Certain economic conditions in Great Britain call for special consideration. For many years, under the capitalist system in Britain, the decisions which relate to production have been in the hands of many thousands of organizations and individuals. The public has been accustomed to a wide range of choice and quality in what it buys. National existence depends upon imports, so that Britain must export goods in return which are able to compete in world markets, as to price, quality and design. Industry must be able to adapt itself to world markets very rapidly, as a result. Planning must therefore be flexible.

The three basic elements of the governments plan are:

- (1) To create an organization with sufficient knowledge and information to assess the national resources and determine the national needs.
- (2) Through a system of "economic budgets" by which resources and needs will be related, the government will know what is the best use of resources in the national interests.

(3) To develop methods through which the government will be able to influence the use of resources in the desired direction without interference to democratic freedoms.

So far, short time planning has been chiefly emphasized, in order to have a guide for the decisions which had to be made in the short run allocation of resources. However, soon planning for long term decisions will be underway.

In the making of the plan "economic budgets" are prepared by a central staff which works with various representatives of the Government Departments. These budgets deal with man-years of work and quantities of goods, which may be totalled in terms of money, and constitute national production and consumption. These budgets must ultimately balance since it is impossible to consume more than is produced. No more people may be employed than are ready to work. At first, requirements will considerably outnumber available resources, but this gap will be closed by some of the requirements being left unsupplied. This process of choosing the requirements to be met, must not be left to chance, otherwise, some of the vital requirements may be squeezed out by non-essential ones.

There shall be two main budgets, the first setting out resources and requirements in terms of manpower and the second in terms of national income and expenditure. These will be supplemented by special statements such as one from the Ministry of Transport stating the requirements of the railways for equipment and maintenance, and so on.

After the Official Committee has made a full examination of the possible means of striking a balance, a report will be made to the Ministers describing the whole position. The Ministers will then decide what steps should be taken and their decisions will form the backbone of all subsequent action.

Government controls are used to direct the economy in the direction indicated by the plan. The level of government expenditures made by other public authorities will determine the production of a wide range of goods and services, (direct services such as education and socialized industries such as the mines.) Fiscal policy can be used to exert indirect influence on the economy, while direct controls such as rationing, import licensing, and so on, may be used to allocate scarce resources of all kinds. Others such as price control influence the course of production by limiting profit margins.

The objective of the Labour government's economic policy is to improve the standard of living of the people. If this is to be done, during the immediate period ahead, costs of production must be steadied, the manpower situation in undermanned industries must be improved, and above all production must be stepped up until a balance has been reached between total demand and total supply.

The remainder of the White paper gives a detailed report on what the situation was in 1946, and specific objectives which lie ahead in 1947.

For our purposes these may be summed up very briefly as follows:

- (1) The central problem is coal and power, and upon this everything else depends.
- (2) In order to increase production, the labour force must be expanded, and the output per man-year increased.
- (3) In order to meet payments for imports, exports must be recovered to 140 percent of the 1938 volume by the end of the year.

Unless Britain concentrates on these, the foundations of her national life may never be restored.¹

This gives the picture in broad outline of the position in which Britain finds herself today, as well as the main features of the Labour government's economic policy. In order to reach some concrete conclusions about planning it is necessary to distinguish between features peculiar to the situation for Britain and the situation as it would be in some other democracy which was attempting to "plan" their economy to a given degree.

During the war Britain lost approximately one quarter of her assets - factories, machinery, houses, half her shipping, half her foreign stocks and bonds, to the tune of \$30,000,000,000. Her Military commitments in Palestine and India cost her \$1,750,000,000, but she cannot yet give up either responsibility. She is called upon to feed her section of occupied Germany. Her manpower situation is desperate. Her war casualties were somewhere around 600,000 people. The six year diversion of many craftsmen to wartime purposes has slowed down their output. Many people

1 - The outline of the policy above is based on the White paper - Economic Survey for 1947

are employed in maintaining the government controls such as rationing. The armed forces claim 1,250,000 men. This leaves only 6,250,000 for the manufacturing industries. At the same time forty percent of all those within the age group twenty to thirty want to emigrate. In order to help out the situation, Britain must turn to mass production. Here she is handicapped by the fact that it has been a tradition for her to turn out hand-finished goods of incomparable quality. Now she must manufacture her goods for export by mass production in order to be able to undersell competitors and build up her world markets again. This will be hard since many of her old customers have tended to become more self-sufficient as a result of the war. At the same time she must absorb today's rising cost of materials, fetch them home, and also absorb the costs of higher wages and shorter working hours.¹

What concerns us now is how the British government has actually carried out its schemes and what success it has had with planning. The coal crisis of this winter may give us an illustration of just what is being done. The government has initiated a sound long-run policy for the mines. The coal shortage in itself was unavoidable, but the government is to blame for allowing it to turn into a crisis. The shortage had been prophesied many times by experts, and earlier it would have been possible to avoid some of the resultant economic paralysis by stricter allocation of existing supplies of fuel among the users. Such a policy was urged by some of the Ministers in the Cabinet, but the government decided that rationing would be unpopular, and the restriction of supplies

1 - F. and M. Drake, "Can Britain Work it Out?", Atlantic Monthly, March, 1947

from less essential users would cause a certain amount of unemployment, therefore they decided to pin their hopes on a mild winter and left things alone. The handling of the crisis was even worse than the approach to it. The public were not warned and kept in touch with the situation. The first inkling of it broke in a Debate in the House of Commons, which the government had tried to avoid, at the end of a vituperative political speech, late Friday afternoon. Then nothing more was let out to the public, until Mr. Attlee's uninspiring political speech of Monday. Such handling is bound to destroy a large amount of the confidence of the people in the government. In addition the government has refused to accept the responsibility for their poor management of the affair and prefer to blame the cold weather. They could not have prevented the coal shortage, but they could have prevented generalized economic paralysis, and turned the crisis, when it came, into a challenge to the British people, instead of allowing it to breed despondency throughout the country. This shows us one of the main difficulties of planning in a country which for so long has been based on the free enterprise system. The planners were in complete agreement that something had to be done about the fuel shortage, yet the only short-run policy they seemed to be able to agree to was a policy of do nothing and hope for good weather.¹ This lack of concrete policy seems to me to point to one of the essential features of planning, and that is, in order to accomplish anything, without becoming bogged down in endless harangues and arguments, authority must become so

1 - "Mr. Macomber's Crisis", The Economist, February 15th, 1947

centralized that freedom is endangered. Planners must also realize, that they must carry the public along with them, so to speak. If people are to accept the controls that are inevitably to be established, they must know the reasons for them. To accomplish the desired ends, the controlling authority must sell itself and its plan to the people.

In relation to the broader problem of the British economy, the fuel problem is but an illustration of the general situation. Nationalization, housing, education, social welfare, industrial reconstruction, defence, all have been allowed to proceed indiscriminately. The American loan will soon be running out. An overwhelming proportion of it is being spent on consumer goods. Unless the government acts quickly all dollar imports will be suspended, leaving her with a raw material shortage, which cannot be as easily overcome as the power shortage. If Britain is to pull through, she must adopt a realistic positive policy now. The main features should be :

- (1) Recruitment of additional workers
- (2) Revision of taxation to increase the incentives to effort and enterprise.
- (3) A wage scale designed to accomplish the same end.
- (4) Complete overhaul of the apparatus of control.¹

If the labour government is to make a policy of this nature effective, it must override the interest of the trade unions in the interest of the country, and return to longer working hours, with increased productivity from the labourers. Social justice must be sacrificed for the time being, in the face of social productivity. If

1 - "Mr. Macawber's Crisis" opp. cit.

unfair privileges will lead to increased production, then they must be granted for the time being. Finally, it must admit that at the moment, nationalization and control have been carried too far for the present situation. Unnecessary controls should be abolished, as they use up administrative skill and handicap enterprise.

Government claims that public ownership would greatly stimulate production have proved false. The boards and commissions that have been set up to make the decisions for specific industries may have the best will in the world, but it is still impossible for them to avoid becoming tied up in red tape. There is often competition between commissions for certain resources, which tends to waste valuable time. Private management is protesting that it is impossible to raise production under such conditions. If the professional managements decide to withdraw, rather than endure such conditions, they would be almost impossible to replace. Without them Britain would have little chance to reach her objectives, since the solution of her problems will depend to a large degree on the quality of the management in key industrial positions. Many feel that the government is being used by the Trade Unions for their own ends, such as the closed shop. Management hesitates to risk capital, uncertain of the future and afraid to expand under programs which they may or may not be able to see through to the end.¹

This disunity between government and industry must be reduced to a minimum if Britain is to reach her production goal. If she fails to reach it before the loan expires she will be faced with collapse.

1 - "Mr. Macawber's Crisis" opp. cit.

What may we conclude from all this? In the first place, Britain is in such poor condition economically, that drastic measures are necessary. Planning for her is necessary. As in wartime there must be some definite authority to say that first things come first, and to see that they do. The conservatives with their policy of encouraging free enterprise would accomplish little more than has already been done by the labour government. What is called for is definite planning which will determine priorities and insure that resources go where they will be best used in restoring Britain to a sound economic basis. As yet the labour government has failed to do this. They have stated the problems which face the nation as a whole, but do not seem to be able to agree among themselves, the specific measures which should be taken to reach a solution to them. At the same time they have actually hampered the recovery of industry by revolutionizing management, and attempting to accomplish too much in too little time. By doing so they are destroying the initiative of many in key positions in industry. There is apprehension that by attempting to do too much the government is risking the chance of accomplishing something effective.

The most disturbing fact of all is that the long promised and much postponed "Economic Budget" consisted almost "wholly of diagnosis and hardly at all of prescription". It appears that the government is even yet undecided on the important details of the plan which they have so broadly outlined. Nothing to improve the situation seems to have been done beyond exhorting

"every man and woman in the country to devote themselves unflinchingly to the tasks which face us,...(the British)...confident that they can achieve victory in the economic field as in the six years of war they triumphed over the enemy."¹

The people of Britain will need more than courage and endurance to win their race against time. They need wise leadership and decisive action on the part of their government if they hope to have their economy back on its feet before the American dollars run out.

Underlying the economic there is a less obvious, but more important issue at stake, which although perhaps beyond the scope of economics, yet is relevant to the things we are considering. This is the question of individual freedom in Britain today. People are becoming uneasy as planning has invaded upon certain rights which before have been so scrupulously respected. The men who are now planning the economy of Britain are men of integrity and ideals, yet when minority voices are silenced, the way to serfdom is opening up. Already, it is becoming a condition of employment in Britain to belong only to unions affiliated with the Trade Union Congress. Attempts have been made to limit the jurisdiction of the courts, to deny the individual his full rights over house and land.²

"During a recent attempt to strong arm nurses of a big London hospital into a closed shop union, the nurses protested and were roughly dismissed. Instantly headlines blazed. Editorials crackled. A long menacing growl across the nation. The government backed down, the growl subsided. But for a moment there had been prescience that the vast irrevocable

1 - C. R. Attlee, Economic Survey for 1947

2 - K. and F. Drake, opp. cit.

powers of Nationalization, if misdirected, could lead, over the dead body of John Bull, to One Party, One Leader - to Despotism." 1

This is the real danger of planning. When times are hard and stomachs empty, freedom is a hollow word, but in the long-run, is it worth sacrificing to fill the stomachs and to have a measure of material satisfaction? Britain fought for six years because she did not think so. Let her be on her guard that she does not lose the precious heritage of freedom in the battle for economic survival.

1 - K. and P. Drake, op. cit.

CHAPTER FIVE : CONCLUSIONS

CONCLUSION

The time has come to draw conclusions. We have looked into the problems of the capitalist economy, examined socialist theory and observed the effects of planning in Great Britain. Now the results of the study must be analyzed and set forth.

Planning is not the answer to the problem of the ideal type of economy. The replacement of the free market organization by a centralized political control will eventually lead to the destruction of freedom and then democracy, to be replaced by a totalitarian social order. The socialist aims are incompatible with the methods they would use to obtain them. They want greater social justice, equality and security, and believe that the way to reach these goals is through the abolition of private enterprise and through government ownership of the means of production - in other words a "planned economy" with control established through a central planning body, instead of the entrepreneur working for a profit.

Planning and the democracy we know in Canada today, are two methods to our ends which in the long run can never be harmonized. Even if every member of the legislature would prefer the planning of economic activity to no plan at all, yet no one plan appears preferable to no plan at all. Witness Great Britain, where the Labour government has been unable as yet to agree on a specific and detailed plan, but merely the general outlines of such a plan. This is a problem which cannot be solved by breaking up a plan and

voting on particular issues. For any plan is a complex whole with each part carefully adjusted to the others, and in order that it may work, none of it can be compromised for the sake of conflicting views.

The argument is put forward that as long as parliament has the final say in what the planners put forward, we would be in no danger of losing our freedom. This would mean that parliament would be asked to produce an agreement on everything, where before she was asked to act only where she could agree. The majority system will break down since majorities as a rule can only be obtained where the choice is one between limited alternatives. This would eventually lead to a system of delegated legislature, with more and more matters being passed on before they were cleared through the house. Parliament is only able to control the execution of tasks where it can give definite directions: where the end has first been agreed upon, and the delegates are merely working out the detail. However the situation would be entirely different if the reason for delegation was that no real agreement between ends could be reached, or when the planning body would be choosing between ends, of which parliament was not even aware. Parliament would soon degenerate into the medium of the government to spread¹ propaganda and the official answers to complaints.

"It is the price of democracy that the possibilities of conscious control are restricted to the fields where the agreement exists and that in some fields things must be left to chance. But in a society which for its functioning depends on central planning, this control cannot be made dependent upon a majority's being able to agree; it will often be necessary that the will of a small minority be imposed upon the people,

1 - Friedrich von Hayek, The Road to Serfdom, (London: 1944) p. 64

because this minority will be the largest group able to agree among themselves on the question at issue." 1

The conclusion is that planning will lead to the totalitarian state because dictatorship is the most effective instrument of coercion and the enforcement of ideals and is therefore essential if planning is to be on a large scale. The conflict between democracy and planning arises from the fact that democracy is an obstacle to the suppression of freedom which the central direction of economic activity requires.

Under planning our Rule of Law would of necessity become the rule of arbitrary government. Our laws are now so designed that rules have been established which apply to general types of situations and allow the individual freedom in everything which depends on time, place and circumstance. Thus the individual knows beforehand these "rules of the game" and is therefore able to adapt himself to them. If he is to be able to plan into the future, the actions of the state must be predictable - determined by rules which have been arrived at independently of the concrete case.²

The central planning authority would not be able to limit itself to merely providing opportunities for unknown people to adjust themselves as they pleased, as they simply could not tie themselves down to the formal rules which would prevent arbitrary action. If the planning body is to direct individual action to achieve particular ends, its actions must be a result of a complete knowledge of the circumstances of the particular case, and therefore these actions would be unpredictable. Since they are unpredictable they are no longer impartial, and at the same

1 = *ibid.*, p. 69
2 = *ibid.*, p. 75

time it becomes more and more difficult for the individual to plan.

If our economic activities are to be consciously directed they will of necessity have to be directed through a staff of experts, with ultimate authority resting in the hands of one man, whose actions cannot be limited by democratic custom and procedure.

So far, the reasons I have given in order to refute planning have been political rather than economic. Yet, I believe that planning can be refuted also on purely economic grounds. The planners tell us that we are to have freedom of choice of occupation and freedom of choice of consumer goods. At the same time, they tell us that to accomplish the ends they seek, it is necessary that the state manage all productive resources. I fail to see how they will be able to direct labour and yet leave the workman free to choose his trade. They claim that by a regulated wage scale, they will be able to direct labour into the channels they desire without using coercion. I do not think that this would be possible in practice. Some jobs would require an inducement far out of line with the type of work being done and the marginal productivity of the worker in order to secure the number of labourers necessary. An example of this can be seen in the coal mining industry of Great Britain today. The situation has become such that many British socialists, and supporters of planning are beginning to advocate conscription of labour.

Economic planning would affect not only our marginal needs, but would determine the things which we would be allowed to consider as marginal. The central body which would control our productive resources would therefore control the means to all our ends, and hence would decide which are to be satisfied and which are not to be satisfied. The basis of the freedom of choice in a competitive society lies in the fact that, if one producer refuses to satisfy our wishes, we may turn to another. With central direction of the whole economic system by a small body of planners we would be entirely dependent upon their decisions and be forced to accept what was offered at the terms given.¹

I do not see that this is in line with the fundamental economic concept that the aim of an economic system is to give the greatest number of individuals, the greatest amount of satisfaction possible, through an allocation of productive resources which will be the most efficient for this purpose. In some cases it might be possible that certain articles could be turned out at a lower cost under planning than competition, by standardization of the article, but over the whole field, this would not be the case. With the decreased incentive resulting from the fact that entrepreneurs would not feel that they were working for themselves, and from the greater security presumably provided for all, the industrial pace would inevitably slow down. The stimulus of competition which causes producers to strive for newer and better methods of turning out their goods would be lacking. Under planning our economy would become poorer, consumers would have a narrower range of goods

1 - *ibid*, p. 93

and services to choose from, and what is most vital, we would stand to lose the freedoms we now have, and which the socialists hope to maintain under planning. Max Eastman, a communist put it this way:

"It seems obvious to me now - though I have been slow, I must say in coming to the conclusion - that the institution of private property is one of the main things that have given man that limited amount of free and equalness that Marx hoped to render infinite by abolishing this institution. Strangely enough Marx was the first to see this. He is the one who informed us, looking backwards, that the evolution of private capitalism with its free market had been a precondition for all our democratic freedoms. It never occurred to him looking forward, that if this was so, these other freedoms might disappear with the abolition of the free market." 1

Since planning is concluded to be unsatisfactory, we must turn to some other solution to eliminate the problems which I have already shown exist in our economy today.

No combination of economic planning and competition can be worked out unless it is planning for competition, which the advocates of the "planned economy" do not consider planning at all. A compromise between the two is impossible because the pricing system would cease to operate as an effective guide to production, unless the whole economy is on a competitive basis.

Let me now turn to reaffirm free enterprise as the most complete answer and the most efficient economic system which man has yet devised to accomplish his desired ends. This system is based on the doctrine of laissez-faire. The fundamental concept is that where competition can be created, then it is the best way of guiding individual efforts. In order to work beneficially, a carefully thought out legal system is required. (This does not deny that where competition fails we must resort to other

1 - Max Eastman, Readers Digest, July, 1941, p. 39

methods of guiding economic activity). Competition is regarded as superior because it is the most efficient way to regulate the economic actions of individuals, and more important because our activities can be adjusted without coercion or arbitrary intervention of authority. The pricing system of such an economy enables entrepreneurs to make their decisions which regulate their businesses in relation to others by watching the movements of comparatively few prices. This will function properly only if the individual producer has to adapt himself to these movements of price and cannot control them himself. The more complicated the whole economic system becomes, the more dependent all become upon the division of knowledge between individuals whose separate efforts are coordinated through the mechanism of the pricing system.

Having briefly restated the case for the free enterprise economy, it is now necessary to draw up a program ¹ to correct the evils which we have previously observed as existing in our economy, today - in a word, the business cycle, the problem of monopoly, and the extremes of wealth and poverty which are bound to be the case.

The state must reassume its responsibility for controlling the circulating medium of the economy. One of the chief causes of the business cycle is the adverse fluctuation of bank credit due to the system of fractional reserves. This could be eliminated by 100% reserve banking. It would be foolhardy to try and accomplish this overnight but rather it must be done over a

1 - Many of my suggestions are based upon those proposed by Professor H. C. Simons in his pamphlet A Positive Program for Laissez-faire, op. cit.

period of time by gradually building up the bank reserves. (This might be accompanied by a small reduction of deposits, however this course followed to any large extent would have catastrophic deflationary results). In Canada this could be done through the Bank of Canada buying up large numbers of securities which the commercial banks now hold, until the reserves were at the 100% level. This would mean that there would be no multiple expansion of credit, since deposit money would equal cash money. The banks could still operate on a fractional reserve system with regard to savings deposits, since these tend to be much more stable, but it would mean the end of current accounts.

There are a large number of advantages to such a policy. Commercial banks would no longer run the risk of long runs, since 100% of the depositors' money would always be available. The interest bearing debt of the government could be substantially reduced, since the Bank of Canada would acquire a great part of the debt which the commercial banks now hold. Our monetary system would now be simplified, since no essential difference would exist between money and bank deposit money. Our currency could be made completely homogeneous. Banking operations would be greatly simplified, since the banks would not be allowed to lend out money deposited by customers while they at the same time were using that money by drawing cheques against it. Most important the alternating periods of inflation and deflation of bank credit would be eliminated. The amount would remain fixed in total and this total would be regulated by the Bank of Canada. Business cycle fluctuations, in so far as they were caused by this inflation and

deflation would be minimized. The Bank of Canada could control the quantity and through the quantity the value of money in the economy to stabilize the price level.

Along with such a monetary program, it would be necessary to restore and maintain effective competitive conditions in all industries where competition can function properly as a means of insuring effective utilization of resources. At the same time the government should take over and operate all industries which are natural monopolies in that competition cannot be made to function properly. This would call for a complete revision of the position of the private corporation. Provisions should be made that no corporation engaged in one line of production should own any securities of any other such corporation. Limitations should be placed on the total amount of property that any one corporation may own, so that no single company can become large enough to dominate the particular industry to which it belongs, the amount for each particular industry being set by the federal government. The number and kinds of securities that corporations may issue should be prescribed by law. Investment companies holding stock in operating companies should have no voting rights, and be prohibited from exercising influence over such companies with regard to their management. This is to prevent the pyramiding of control. Interlocking directorates should be prohibited by legislation which would prevent anyone from serving as an officer in any two companies in the same line of business, or any officer of an investment corporation from serving as an officer in an operating

corporation. The patent laws should be revised, so that they will have no tendency to help create monopolies. These measures would prevent the exploitation of the consumer by the monopolist; the maldistribution of resources which results from monopolistic competition and monopoly, and the price rigidities which emphasize the harm done by the business cycle.

In order to secure a more equitable distribution of the country's wealth among individuals, a revision of the taxation system is necessary. This must be accomplished through a system of progressive taxation. Reduction of inequalities might be obtained without too much loss of efficiency or destruction of initiative through taxation. Gains at the lower level of the income scale could be secured without much significant loss to those with large incomes, so long as they maintain their rank in the income scale. In addition all unearned income such as inheritance should be heavily taxed, in order to prevent the perpetuation of huge fortunes. The income tax should be established as a purely personal levy, with no exemptions of any kind. All items of income should be included in calculating what the individual should pay. The possibilities of evasion of this personal income tax by stockholders with respect to the undistributed earnings of corporations should be effectively blocked. All inheritances, gifts and bequests would be included as personal income of the recipient in the year received.

The government should reduce tariffs in so far as possible, since they discriminate against the home consumer, and since they

may tend to make possible the formation of monopolies, where the field within national boundaries is too narrow allow effective competition. This must be done gradually, so that those industries which are now protected by a tariff will not be completely dislocated.

There must be limitation upon the squandering of our resources in advertising and selling activities. To keep up with other companies firms are forced to spend enormous amounts on advertising. In order to gain the cooperation of the merchants, each producer must provide fantastic "mark ups", in order to keep up to his competitors. Consumers must be prohibited access to wholesale markets, in order to protect the retailers. This has had the result of consumers paying tremendous tribute to these middlemen. Advertising moreover, intrenches monopoly by setting up a financial barrier to newer and smaller firms. Therefore the merchandising system should be remodeled, not only to free wasted resources for useful employment, but also to remove one of the conditions which hinder the working of competition.

This program may be summarized as follows:

(1) Reorganization of the monetary system

- a) By the abolition of private deposit banking on the basis of fractional reserves
- b) The assignment of the responsibility of administering the monetary system to some federal authority (in our case the Bank of Canada) to maintain a stabilized price level.

(2) The establishment of effective competition in industries

where this is possible by the elimination of private monopoly

a) Through legislation dealing with the powers and the rights of the corporation

b) Through renovation of the patent laws.

(3) Where competition will not be effective, then the industry should come under government ownership or supervision.

(4) A revision of the taxation system to create a more equal distribution of income

a) Through progressive taxation

b) Taxation of unearned incomes

(5) A reduction of tariffs

(6) Prevention of excessive advertisement and unhealthy selling practices.

If the government were to pursue such a program, then many of the economic evils which surround us today could be eliminated. However, in a democracy, before a government can take action, it must have the people's support. Progressive taxation is never popular. The monopolists will fight to maintain their position. Countries abroad will put up tariff barriers which force us to do the same in many cases. The possibilities of such a program being carried through today are slim indeed. We are heading the other way towards planning it seems, not so much on this continent as yet, but almost everywhere else in the world since the war. What the believers in free enterprise and the democratic way have to fear most today, as Professor Knight puts it:

"The greatest danger to freedom undoubtedly is that a dictatorship may effectively sell itself to the people - even to the great majority - make them like it, and give them more of feeling of freedom than they can expect under the necessarily somewhat disordered processes of democracy and free enterprise. It is not yet demonstrated that most of the people prefer freedom, with the responsibility and struggle of planning their own lives in relation to the plans of others, rather than having the job taken out of their hands and done for them by a paternalistic bureaucracy, in the 'faith' that the latter will do it in a tolerably competent and disinterested way". 1

1 - Frank H. Knight, "Freedom Under Planning", The Journal of Political Economy, (October, 1946), p. 463

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