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THE ECONOMICS OF WELFARE



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THE ECONOMICS OF WELFARE

BY

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PREFACE

IN preparing this revised third edition, I have removed a number of minor errors and have made, I hope, some improvements in analysis and exposition. I have also tried, so far as possible, to bring my references to facts and laws up to date. The main changes in the structure of the book are as follows. A portion of what used to be Chapter VIII. of Part IV. and the Appendix entitled "Taxes on Windfalls" are omitted, as the matters there discussed are now dealt with in *A Study of Public Finance*. The following Chapters are new: Part I., Chapter IV.; Part II., Chapter VIII.; Part III., Chapter XVI.; Part IV., Chapter VII. Chapter XI. of Part II. replaces, under a new title, what used to be Chapter X. and has been entirely rewritten. The first five divisions of Appendix III., which are concerned with the subject-matter of that Chapter, are also new. In these divisions I have made free use of an article entitled "An Analysis of Supply," which appeared in the *Economic Journal* in June 1928; and in the new Chapter VII. of Part IV. I have used part of an article on "Wage Policy and Unemployment," which appeared in the same journal in September 1927.

The scheme of the book, which is displayed in more detail in the Analytical Table of Contents, is as follows. In Part I. it is argued, subject, of course, to a large number of qualifications, that the economic welfare of a community of given size is likely to be greater (1) the larger is the volume of the national dividend, and (2) the larger is the absolute share of

that dividend that accrues to the poor. Part II. is devoted to a study of certain principal influences of a general kind by which the volume of the dividend is affected, and Part III. to a study of influences specifically connected with labour. In Part IV. the question is raised in what circumstances it is possible for the absolute share of the dividend accruing to the poor to be increased by causes which at the same time diminish the volume of the dividend as a whole; and the relation of disharmonies of this character, when they occur, to economic welfare is discussed. The two Parts contained in the first edition, which discussed respectively the Variability of the National Dividend and Public Finance, are omitted from this, as they were from the second edition. Their subject-matter is now treated more fully in my *Industrial Fluctuations* and *A Study in Public Finance*.

I have done my best, by restricting as far as possible the use of technical terms, by relegating specially abstract discussions to Appendices, and by summarising the main drift of the argument in an Analytical Table of Contents, to render what I have to say as little difficult as may be. But it would be idle to pretend that the book is other than a severe one. In part, no doubt, the severity is due to defects of exposition. But in part also it is due to the nature of the problems studied. It is sometimes imagined that economic questions can be adjudicated upon without special preparation. The "plain man," who in physics and chemistry knows that he does not know, has still to attain in economics to that first antechamber of knowledge. In reality the subject is an exceedingly difficult one, and cannot, without being falsified, be made to appear easy.

In publishing so comprehensive a book, I have had to face one somewhat special difficulty. Legislative and other changes both here and abroad are so numerous and rapid that some of the legal enactments and general conditions to which I have referred in the present tense are certain, by the time the book

is in the reader's hands, to have been superseded. I do not think, however, that the impossibility of being completely up to date in a world of continuous change matters very greatly. For the illustrations I have used are not brought forward for their own sake. The service I ask of them is to throw light on principles, and that purpose can be performed as well by an arrangement or a fact that lapsed a year or two ago as by one that is still intact.

I would add one word for any student beginning economic study who may be discouraged by the severity of the effort which the study, as he will find it exemplified here, seems to require of him. The complicated analyses which economists endeavour to carry through are not mere gymnastic. They are instruments for the bettering of human life. The misery and squalor that surround us, the injurious luxury of some wealthy families, the terrible uncertainty overshadowing many families of the poor—these are evils too plain to be ignored. By the knowledge that our science seeks it is possible that they may be restrained. Out of the darkness light! To search for it is the task, to find it perhaps the prize, which the "dismal science of Political Economy" offers to those who face its discipline.

A. C. P.

KING'S COLLEGE,
CAMBRIDGE, *November 1928.*

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§ 1. Broadly speaking, the worker's output will be larger, and the national dividend more advantaged, the more nearly his remuneration is adjusted to services rendered. § 2. Adjustment is complicated by the fact that a man's services to his firm include more than his immediate physical output. § 3. By the fact that output is liable to vary in quality as well as in quantity. § 4. And by the fact that even quantity of output cannot, in some occupations, be measured. § 5. Under time-wages some degree of adjustment is feasible. §§ 6-7. Under piece-wages adjustment could be made closer if it were not for the difficulty created by the "cutting" or "nibbling" of rates. §§ 8-9. Premium bonus plans and piece-rate plans are compared. § 10. The difficulty of "cutting" and "nibbling" may be dealt with by means of collective bargaining. §§ 11-12. The task-wage system is discussed. § 13. The conclusion reached is that the interests of the national dividend will be best promoted under a system of piece-wage scales controlled by collective bargaining.

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THE DISTRIBUTION OF LABOUR AMONG OCCUPATIONS AND PLACES

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CHAPTER XI

UNEMPLOYMENT VERSUS SHORT TIME

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§ 1. The analysis of the two preceding chapters is relevant to a comparison of the three principal ways open to employers of meeting periods of depression : namely, (1) working full time and dismissing some of the staff ; (2) working full time and rotating employment among the whole staff ; (3) working short time with the whole staff. § 2. The causes determining the choice between the short-time plan and both the other two plans are considered. §§ 3-4. Those determining the choice between the dismissal plan and both the others. § 5. And those determining the choice between the rotation plan and both the others. § 6. The short-time plan and the dismissal plan are the most usual. § 7. *Prima facie* the dismissal plan seems certain to be the more injurious to the national dividend, because, through the unemployment it creates, it reacts adversely on the quality of the workpeople. § 8. But against the other method is to be set its tendency to prevent workpeople from moving to other jobs or places when the interests of the dividend require that they should do so. § 9. The suggestion that manual workers should be placed in the same position as the permanent salaried staff is discussed.

CHAPTER XII

✓ THE PRACTICABILITY OF INTERFERENCE TO RAISE WAGES

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§ 1. The "natural course of wages" is understood to mean the system of wage rates that would prevail in the absence of interference on the part of some person or body of persons external to the workmen and employers involved in the discussion of them. § 2. Interference may be attempted by consumers' associations or by governmental authorities. § 3. In some conditions interference can be baffled by undetected evasion ; but this cannot generally be done when workpeople are organised. § 4. There are special opportunities for evasion when the regulating authority is only able to determine minimum day-rates for "ordinary" workers. § 5. Where undetected evasion is not practicable, there are various sanctions by which interference can be made effective.

CHAPTER XIII

METHODS OF ENGAGING LABOUR

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§ 1. Three methods, the casual method, the preference method, and the privileged class method, are distinguished. § 2. Examples are given. § 3. The influences which favour the adoption of one or other of these methods are indicated. § 4. The relation between the casual method and short engagements is brought out. § 5. The suggestion that the State should intervene to encourage continuity of engagements is discussed.

CHAPTER XIV

INTERFERENCE TO RAISE WAGES IN PLACES AND OCCUPATIONS WHERE
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§ 1. Real wages must be distinguished from money wages. § 2. A wide-reaching definition of fair wages is given which includes the ordinary common-sense definition as a special case. § 3. In the concrete several kinds of unfairness may be combined in a single unfair wage, but this complication may be ignored in our analysis. § 4. Unfair wages may be distinguished into two broad classes, those which, though unfair, are equal to the value of the marginal net product of labour in the place or occupation to which they refer, and those which involve an element of exploitation and are less than the value of this marginal net product. § 5. As regards the former type, the effect which interference will produce on the magnitude of the national dividend is independent of the *reason why* the general conditions of demand for labour at any point where wages are unfairly low are what they are, and depends exclusively on the nature of the cause by which the distribution of labour has been prevented from adjusting itself to those conditions. § 6. When wage rates are unfairly low because *costs of movement* prevent a redistribution of labour in ways that would make them fair, interference will injure the national dividend. § 7. When wage rates are unfairly low, because ignorance prevents the desired redistribution of labour, the effect of interference will be different in different circumstances, being dependent in part upon the methods of engaging labour that prevail. § 8. The way in which the latter type of unfair wages distinguished in § 4 (that, namely, in which the wage is less than the value of the workman's marginal net product) is liable to arise is explained. § 9. It is shown that interference directed against unfair wages of this kind is likely, in general, to benefit the national dividend. § 10. When the wage rates of women workers, in any occupation, while fair relatively to those of women workers elsewhere, are unfairly low relatively to those of men workers in the same occupation, interference designed to make them fair relatively to men's wages will, in general, injure the national dividend. § 11. In practice the detailed discriminating forms of interference to which the preceding discussion points may need to give place to rougher methods.

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§ 1. Inside any industry fair wages as between different men engaged on the same class of job mean wages proportionate to efficiency. § 2. Under time-wages more can be accomplished in this sense than is sometimes supposed. § 3. Under piece-wages the difficulties are less, and several allowances must be made. § 4. First, an allowance for differences in the assistance which different men receive in their work from machinery and nature. This allowance can be calculated closely. §§ 5-6. Secondly, an allowance for differences in the exact character of the operation which different men perform. This also, with the help of "elementary rate-fixing," can be calculated closely. § 7. Thirdly, an allowance for differences in the assistance they receive from the co-operation of managing power. The calculation of this is much more difficult; but something can be done by the establishment, alongside of the piece-rate scale, of a minimum day wage.

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CHAPTER XVIII

WAGE RATES AND CAPACITY

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§ 1. Where workpeople are highly incapable, and, therefore, in receipt of very low wages, it appears *prima facie* probable that the national dividend might be indirectly advantaged by forcing up wages above what previous considerations suggest; because higher wages might improve capacity. § 2. Not much light can be thrown on this matter by statistical comparisons. § 3. When low wages are due to exploitation, the forcing up of wages will not cause the workpeople affected to lose their jobs, and so there is full scope for reactions on capacity. § 4. Apart from exploitation, the prospect of these reactions is most favourable in occupations where the demand for labour is inelastic. § 5. Where interference with wages other than exploited wages is warranted by its reactions on capacity, it is essentially a temporary interference.

CHAPTER XIX

A NATIONAL MINIMUM TIME-WAGE

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§ 1. In this chapter we have to consider the effects of establishing by law a national minimum time-wage. § 2. This, being of general application throughout the country, could not be evaded by any redistribution of workpeople of different qualities among occupations. § 3. It would, incidentally, prevent a certain amount of exploitation, and would so far do good. § 4. But its main consequence would be to drive a number of low-grade workpeople out of private industry altogether. § 5. If the State took no further action in regard to these people, the dividend would be certain to suffer; and, even if it undertook to organise training for them, the driving out of old and incapacitated people who are past training would still be an evil.

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§ 1. It remains to examine the comparative effects on the national dividend of wage rates fixed by a rigid settlement and wage rates fluctuating on both sides of a standard set up by the settlement in accordance with temporary changes of circumstance. § 2. Wage rates fluctuating (or plastic) in response to temporary changes of demand can be shown to be *directly* more advantageous to the national dividend than fixed wage rates. § 3. And the result of a comparison of the direct effects is rarely upset when the indirect effects also are taken into account. § 4. But for practical reasons wage changes cannot be operated at intervals of less than two or three months. §§ 5-9. When the elasticities of the demand and supply of labour in any occupation are given, the wage fluctuation appropriate to any given fluctuation of the demand schedule is larger, the larger is the fluctuation of that schedule. The practical implications of this proposition are drawn out; and the consequences of the practice of making for stock are indicated. §§ 10-11. When the demand schedule for labour in any occupation fluctuates in a given manner, the wage fluctuation appropriate to that fluctuation

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is smaller the more elastic is the supply of labour in the occupation. The practical implications of this proposition are drawn out. § 12. Automatic machinery for making adjustments to fluctuations in the demand for labour is provided by sliding scales. §§ 13-18. A detailed study is made of the various forms which these may assume and of the problems connected with them. § 19. When relations between the parties are sufficiently good, better results may be obtained by arrangements under which joint-committees adjust wages at two- or three-monthly intervals, not merely in accordance with a mechanical index, but also with a view to other factors of which this may fail to take account.

PART IV

THE DISTRIBUTION OF THE NATIONAL DIVIDEND

CHAPTER I

THE GENERAL PROBLEM OF DISHARMONY 643

The purpose of this Part is to inquire whether any important causes can be distinguished which affect in different senses the size of the national dividend as a whole and the size of that part of it which accrues to the poor; and to study the practical problems which the existence of such causes suggests.

CHAPTER II

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§ 1. Certain statistical investigations conducted by Pareto seem, at first sight, to show that the magnitude and distribution of the dividend are rigidly bound together, in such wise that it is impossible for the dividend as a whole and the real income of the poor to move otherwise than in the same direction. § 2. But the statistics set out are not adequate to support this conclusion. §§ 3-5. Nor are its logical foundations sound. § 6. The possible openings for disharmony must, therefore, be studied in detail.

CHAPTER III

THE SUPPLY OF CAPITAL AND LABOUR 654

§ 1. The distribution of income among people is analytically quite distinct from the distribution among factors of production discussed in economic text-books. Nevertheless no great error is introduced if we identify the income of the poorer classes with the receipts from wages of the factor labour. §§ 2-6. In an elaborate discussion it is shown that a cause operating to increase the national dividend by increasing the supply of capital cannot, in present conditions, at the

same time diminish the real income of labour. § 7. A cause facilitating the investment of capital abroad *may* act discordantly from the standpoint of a short period, though hardly from that of a long period. § 8. On the basis of a proof that the demand for labour in general in any one country is likely to be highly elastic, it is shown that a cause operating to increase the national dividend by increasing the supply of labour cannot at the same time diminish the real income of labour. § 9. A complicating side-issue is examined. § 10. And some practical implications of the results attained are noticed.

CHAPTER IV

✓ INVENTIONS AND IMPROVEMENTS 669

§ 1. The problem of this chapter is to determine in what, if any, conditions, an invention or improvement, which increases the aggregate dividend, will diminish the absolute share of labour. § 2. This problem is not settled by determining whether an invention increases or decreases employment in the industry in which it is made. § 3. Its solution turns on the *comparative proportions* in which the quantities of labour and capital respectively available in occupations outside the one to which the invention applies are affected. §§ 4-6. An analysis on this basis is carried out in detail. § 7. The conclusion is reached that an invention that benefits the national dividend may at the same time lessen the real income of the poor; but that this is a very improbable contingency.

CHAPTER V

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§ 1. It is next required to determine in what, if any, conditions the forcing-up of the wage rate of a group of workpeople will at the same time injure the national dividend and increase the real income of labour as a whole. § 2. The particular workpeople directly concerned, if they are not themselves purchasers of the commodity they produce, will be benefited if the demand for their labour has an elasticity less than unity. § 3. The influences which determine this elasticity in different circumstances are examined. § 4. The whole body of workpeople, if they are not purchasers of the commodity, will be benefited if the demand for the labour of the particular workpeople has an elasticity less than unity. § 5. Since, in fact, workpeople are themselves purchasers of most of the things that workpeople make, the prospect of a net gain is not, *prima facie*, very bright. § 6. Moreover, when account is taken of the cumulative reactions set up on the side of capital, this prospect, and with it the likelihood of disharmony between the effect on the dividend and the effect on the absolute share of the poor, is lessened. § 7. This conclusion must, however, be qualified, in so far as the State undertakes to help with public funds persons thrown into distress through unemployment.

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§ 1. *Prima facie* the policy of rationing discussed in Chapter XIII. of Part II. may produce disharmony. It has to be asked whether in fact it can do so. § 2. In the Great War rationing benefited distribution without damaging production. §§ 3-5. In normal times rationing, so arranged as to check the consumption of rich people, would, if applied to commodities of decreasing supply price, lessen both the aggregate national dividend and the share accruing to the poor. § 6. If applied within suitable limits to commodities of increasing supply price from the standpoint of the community, it would increase both these things; whereas, if pressed beyond these limits, it would injure the dividend while benefiting the poor, thus involving disharmony. § 7. The possibility of net social advantage from rationing, brought out in the course of this chapter, must not be taken, in view of the friction and administrative difficulties involved, to prove that it is on the whole desirable.

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§ 1. The expectation of voluntary transferences from the rich tends to increase the contributions they make to the upbuilding of the national dividend. §§ 2-3. Special opportunities for these transferences are open to wealthy employers as regards their workpeople,

and to wealthy citizens as regards their fellow-townsmen. § 4. They may be further stimulated by a judicious use of honours and decorations. § 5. Voluntary transferences are not, however, sufficient, and transferences by taxation are also required. §§ 6-9. The effect on the national dividend of the expectation of transferences from the rich through an income tax not differentiating against saving is studied. § 10. An income tax that does differentiate against saving is considered. § 11. Transferences through death duties are discussed. § 12. On the whole, the expectation of substantial coercive transferences from the rich is likely to damage the national dividend to some unknown extent.

CHAPTER X

✓ THE EFFECT ON THE NATIONAL DIVIDEND OF THE EXPECTATION OF TRANSFERENCES TO THE POOR 718

§ 1. Transferences may be distinguished according as they (1) differentiate against idleness and thriftlessness, (2) are neutral, (3) differentiate in favour of idleness and thriftlessness. § 2. Transferences that differentiate against idleness and thriftlessness are illustrated; the expectation of them tends to augment the dividend. § 3. Neutral transferences are illustrated. §§ 4-6. If they are made in money or things readily convertible into money, the expectation of them tends slightly to lessen the dividend; but if they are made in things that poor people would not otherwise have bought at all, they need not do this, but may have the opposite effect. § 7. The expectation of transferences which differentiate in favour of idleness and thriftlessness damages the dividend. § 8. Such transferences may be in part, but only in part, avoided by devices like universal old-age pensions. § 9. Their injurious consequences are small when they differentiate in favour of a failure to make provision by insurance. § 10. But they are large when they differentiate in favour of idleness, so far as this is voluntary. § 11. In some circumstances, therefore, deterrent conditions, the form of which is discussed, have to be coupled with relief.

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✓ THE EFFECT ON THE NATIONAL DIVIDEND OF THE FACT OF TRANSFERENCES FROM THE RELATIVELY RICH TO THE POOR 740

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§§ 4-6. But transferences in the form of training or of care in sickness to normal adult workers may yield a large return. § 7. And well-managed transferences in the form of education and nurture to children a very large return. § 8. Transferences in the form of general purchasing power are less likely to be employed effectively. § 9. Some friendly supervision over the use made of them seems to be desirable.

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