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## SECTION TWO: *New Works*

### 1. Studies in the Theory of Money and Capital

*(For list of volumes in The Library see page 392)*

**STUDIES IN THE THEORY OF  
MONEY AND CAPITAL**

*by*

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WOKING

## P R E F A C E

THIS BOOK is the outcome of a desire expressed by some of my friends in England to have an English translation of some of my earlier works. While this idea was being carried out, the plan was slightly modified, since I wished to add a contribution from my later studies in the central field of economic theory. For this reason I have limited the selections from my earlier writings to two papers concerned with the same theme. The present volume therefore consists of three relatively independent parts, written at different times. Each part may be read by itself, but, since the three parts deal with related problems of economic theory seen from different angles, they may be considered as forming a connected whole.

An inverse chronological order has been followed in the book.\* Part One has not previously appeared in print. Part Two contains the more important sections of the work *Penningpolitikens Medel* (Methods of Monetary Policy), printed for private circulation in 1929 and published in Swedish in 1930. Part Three is a translation of a study entitled "Prisbildningsproblemets uppläggning från kapitalteoretisk synpunkt" (The Pricing Problem from the Point of View of Capital Theory) which appeared in the *Ekonomisk Tidskrift* in 1929. A compressed version of another paper printed in the *Ekonomisk Tidskrift* in 1935, dealing with a much-discussed problem of public finance, has been added as an Appendix.

In the translations accuracy has been the principal aim. The main differences from the Swedish versions are the insertion of additional subheadings, and certain regroupings, compressions, and deletions, the purpose of which is

\* Except in the case of the Appendix.

to make the argument easier to read. A few additions have also been made at some points in order to bring out the intended meaning more exactly. In the "Algebraic Discussions" of Part Three, the more elegant notation used by Professor Bowley and others has been substituted for the Walrasian notation used in the Swedish original. Passages which do not agree with the author's present views have been retained, with the addition either of new explanatory paragraphs, or of new notes. These are indicated by square brackets.

Differences of method between the two later parts and the first are the inevitable consequence of the development of the author's thought over the last ten years. It should nevertheless be possible for the reader to tackle the parts in their present sequence, starting with the more general problems and proceeding to more special ones.

Taking the sections, for the moment, chronologically, Part Three may be described as an attempt to approach gradually a realistic economic theory, beginning with a simplified static analysis and introducing successively more complicated assumptions. In the two first chapters an endeavour is made to fuse together the pricing theories of Walras and Cassel on the one hand and the capital theories of Böhm-Bawerk and Wicksell on the other. Subsequent chapters introduce dynamic problems within the static framework, this being possible under certain simplifying assumptions. If perfect foresight is assumed, the dynamic problem can evidently be handled in a manner quite parallel to the Walrasian scheme. I believe that this approach is not entirely unrealistic, since people actually do anticipate correctly much of what takes place. The analysis then continues by introducing unforeseen events, which may also be pressed into the static scheme if they are assumed to cause discontinuous shifts from one temporary equilibrium position to another.

The treatment of monetary problems in Part Two is mainly based on the same simplified method of analysing a dynamic process as a series of temporary equilibria, between which there occur unforeseen events with consequent gains and losses. For the rest these problems are dealt with on Wicksellian lines. The price level of consumers' goods is principally determined by the relation between consumption and saving on the one hand and the relation between the volume of consumers' goods and that of capital goods produced, on the other. These relations are in their turn determined by the level of interest rates and by expectations concerning the future. This line of thought is illustrated by an analysis of cumulative processes on various assumptions, taking into account among other things the important distinction between short and long term rates of interest. Finally, the Wicksellian concept of a "normal loan rate of interest" is shown to be wanting in precision when more dynamic assumptions are made.

The first of the studies of Part One summarizes my present views. The traditional approach to realistic dynamic theory (used in Part Three) is not regarded as necessary or even suitable in all cases. Instead, economic theory should if possible be so framed as to be applicable to real conditions from the beginning. This means that we should proceed from general terms to more differentiated and complex terms. The main outlines of the reorganization of the systematic structure of economic theory that follows from the adoption of this view are briefly indicated. The "Algebraic Discussion" which concludes this part is an endeavour to give a general formulation of some basic economic concepts, in such a way as to make them directly applicable to real situations; and to give a systematic account of the relations between these concepts. Although the task may seem elementary, it is

of fundamental importance, and my exposition shows that it presents certain difficulties. It is my hope that I have been able, by utilizing the distinction, now well established in the Swedish school, between *ex ante* and *ex post* estimates, to find a simple solution of the much-debated question of the relation between saving and investment. It has not however been possible to include in the present volume that full analysis of the working of the economic process which is needed in order to complete the discussion.

Mrs. U. K. Hicks has with never-failing interest and patience followed the work from beginning to end, and if the result is a book worth publishing, this is due to her tireless efforts, extending down to the smallest details, and to her valuable advice concerning the planning and execution of the work. Professor J. R. Hicks has also followed the development of the book with interest from the start, and has in addition read the page proofs and given me much helpful advice. I wish to express my deep-felt thanks to them both. I am also indebted to Dr. P. N. Rosenstein-Rodan, who has aided me by word and deed throughout. Among my Swedish colleagues I desire to record my gratitude to Dr. Dag Hammarskjöld of the Finance Department for various improvements made as a result of my discussions with him concerning the contents of Part One, and for his kindness in reading the page proofs, and to Fil. lic. Tor Fernholm, who has not only translated the greater part of the book but has also, by his sound judgment, valuable suggestions, and keen criticisms, materially improved its contents.

ERIK LINDAHL

LUND, SWEDEN

*June 1939*

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## APPENDIX

### THE PROBLEM OF BALANCING THE BUDGET

In 1927 a Commission was appointed to investigate the unemployment situation in Sweden. Its findings are important not only as a contribution to the solution of some of the problems of current economic policy, but also for pure science. Economic experts played such a large part in the investigation that the report may not unreasonably be considered the principal achievement of Swedish research into the problems of the trade cycle in recent years. In saying this we have in mind not only the monographs published as supplements, for which, besides the chairman of the committee, six professors and assistant professors of economics were responsible. The two reports of the commission itself also contain new theoretical and statistical material of high scientific value. This is no doubt largely due to Dr. Dag Hammarskjöld who held the post of secretary to the commission for some time. Nor does the scientific character of these reports detract from their interest for the layman. The first part forms a comprehensive handbook to the economic development of Sweden since the war, the second contains a survey of current problems in economic policy, taking account of their theoretical implications.\*

It is very natural that the Commission should have devoted its attention principally to cyclical unemployment, since its work was necessarily influenced by the depression which came on during the time of its investigation. The progress of recovery since that time, however, does not in any sense diminish the importance of its achievement. What was proposed was

\* *Arbetslöshetsutredningens betänkande (Unemployment Commission Report)* vols. i-ii (Statens offentliga utredningar, 1931, No. 20, and 1935, No. 6); *Bilagor (Supplements)*: (1) Bagge (S.o.u., 1931, No. 21), (2) Huss (S.o.u., 1931, No. 21), (3) G. Åkerman (S.o.u., 1931, No. 42), (4) Hammarskjöld (S.o.u., 1933, No. 29), (5) Myrdal (S.o.u., 1934, No. 1), (6) A. Johansson (S.o.u., 1934, No. 2), (7) Ohlin (S.o.u., 1934, No. 12).

nothing less than an extensive programme aiming at smoothing out trade fluctuations by political action in various fields. The principal tool for this purpose is the rational direction of monetary policy. For this a method was outlined; but it was proposed to supplement it by measures concerned with financial, commercial and wage policy, in order to make monetary policy fully effective.

In the following pages, I shall confine myself to the following points concerned with the economic effects of financial policy: (1) The problem of balancing the budget in the long period. (2) Modification of the long period programme to counteract industrial fluctuations (when external relations allow of the pursuit of an active policy). (3) The effect of international complications. (4) Budgetary technique. The most convenient method appears to be to proceed by way of comment on the extensive investigation of these problems carried out by Professor Gunnar Myrdal at the instance of the Commission.\*

## I. THE LONG TERM SOLUTION

Every budget is of course formally balanced, since the sum of the items on the expenditure side must always be covered exactly by revenue. A demand for a balanced budget must therefore mean that the sum of *certain* kinds of revenue must be equal to the sum of *certain* kinds of expenditure. The most natural procedure is to start either from total *current revenue*, i.e. revenue other than that arising from the sale of capital assets or from borrowing; or from total *current expenditure*, i.e. expenditure that does not lead to an increase in the aggregate net assets of the community. If these two are exactly equal,

\* Myrdal, *Finanspolitikens ekonomiska verkningar (The Economic Effects of Public Finance)*, Statens offentliga utredningar, 1934, No. 1.

[Reference to Swedish conditions in sections 1-4 (written in 1934) thus refer to the state of affairs prior to 1935. An account of the important budgetary reforms of 1935-38 is given in section 5.]

[For a good treatment of these and connected problems from the English point of view, reference can now be made to Ursula K. Hicks, *The Finance of British Government 1920-1936*.]

the budget is obviously balanced in the sense that the net value of total public assets remains unchanged,—supposing that this is assessed on the same principles as those on which the budget is drawn up. If current revenue exceeds current expenditure, a corresponding rise in the net value of public assets occurs. Myrdal introduces the term “financial soundness” in order to characterize “the long term trend of development of the net assets of the body public.” His intention is to make it clear that the problem of balancing the budget is concerned primarily with whether, and to what degree, the State (and local authorities) should increase or reduce their total net assets.

Myrdal points out that there are a number of advantages in a relatively high degree of “financial soundness” as far as long term policy is concerned. He also shows that it is particularly desirable to increase “soundness” when the net property of the state is small or negative, and current taxes are therefore so high that their incidence is necessarily unsatisfactory. “The dilemma, however, is that under our assumption with regard to the volume of direct expenditure, such a transition to a higher degree of financial “soundness,” which would apparently be justified by the high level of taxation, demands an immediate and protracted increase of current tax rates, in order ultimately to obtain tax rates that are correspondingly lower, as a result of the reduction of loans, the paying off of debt or the creation of special funds.”\* It is a pity that he does not include a more complete treatment of the particular taxes through which the increase in the public assets might be financed. For it is not easy to base the argument for an increase in certain taxes on the ground that these very taxes are already too high and must therefore be reduced. The solution would seem to lie in higher taxes on *capital*

\* *Op. cit.*, p. 112.

(especially inheritance taxes, but also other true property taxes) in order by this means to secure lower taxes on current *income*.

When the problem is stated in this way, greater light is also shed on the real conflict of interest that exists in the political treatment of the problem. In general, a rising net value of public assets must be advantageous to the working classes, so long as the relief from taxation thus made possible is not offset by a flight or other loss of capital. On the other hand, the programme must tend to encounter opposition from the rich, who are forced to finance tax relief in the future by a reduction of their property now, but will have to share the benefits of the tax reduction with the whole community. A real divergence of political interest thus arises from the fact that an increase in the net assets of the state implies some mitigation of the inequality of the present distribution of wealth.

This is indeed the crux of the matter. The long term solution of the problem of public investment is of primary importance for the distribution of wealth. Its direct relevance for the problems of the labour market, especially the unemployment problem, is, comparatively speaking, less. Of course it may be argued that the scheme suggested would affect the internal supply of capital and that thus a change in the demand for labour might occur. It is also conceivable that a reduction of taxes on income made possible by a rise in net public assets, might make workers less unwilling to accept a certain reduction of their nominal income, and that the average level of employment might be somewhat increased. But these consequences of a particular solution of the problem of public property which might well be neutralized by each other or by other circumstances, can hardly be of decisive importance. From the point of view of the



labour market there do not seem to be any arguments for departing from a comparatively high standard of "financial soundness," if this appears to be called for on other considerations.

The accepted standard of "financial soundness" in terms of Swedish financial traditions may be summed up by saying that the net assets (in the wider sense) of the State should in the long run be increased by the amount by which the value of new capital assets, not yielding a money income, exceeds the depreciation of old assets (of the same type), plus a certain amortization of public debt. Capital investment must therefore be financed to this extent by current revenue and not by loan. The standard set for the increase of the net assets of the Local Authorities is not the same, since on the one hand they have a limited right of borrowing for the acquisition of durable capital equipment (whether or not income yielding), which calls for exceptionally heavy outlay in relation to the normal yearly level; but on the other they are required to finance even self-liquidating capital expenditure of a more ordinary character out of current revenue. These principles have, it is true, no special significance,\* but they appear to be as acceptable as any others. It would, perhaps, have been desirable to have a more exact statement of the rate at which public debt should be paid off. Amortization should if possible stand in some relation to total receipts from inheritance taxes and other genuine property taxes. But the chief limitation to the principle is its reference to long periods of time; it is essential to modify it for the solution of the annual budget problem.

\* The principle adopted by the Swedish state is explained by the accounting system in force prior to 1935: no money values were in general set on capital assets not yielding money income, and a decrease of the net assets accounted for would therefore occur if such investment were financed by loans.

## 2. THE SHORT TERM SOLUTION

The mitigation of economic fluctuations means, so far as the labour market is concerned, that unemployment is reduced in depression but in the boom may perhaps be somewhat greater than it would otherwise have been. The advantage of such a policy is that the reduction of unemployment is presumed to be much larger than its increase, so that there is a reduction in the average degree of unemployment in the long run.

This problem must necessarily be stated in terms of certain political assumptions which require specific justification on one point at least. Myrdal appears to assume that the direction of financial policy to ironing out trade fluctuations will leave the scope and extent of private activities unchanged in the long run. The Unemployment Commission is still more positive on this point. Its report is profoundly influenced by the view that government activities should not be expanded at the expense of private enterprise. Such an expansion may, however, be permissible when it does not cause a contraction of private activities, but takes place through the employment of productive resources that would otherwise have been (wholly or partly) idle. Whether or not one is wholly in sympathy with this view,\* it may usefully serve as a starting-point for an analysis of the question of the degree to which the mitigation of trade fluctuations through financial policy is desirable.

In view of the intimate dependence of the internal

\* The measures of financial policy that seem justified from this point of view may be characterized as the *minimum* concerning which the various political parties in Sweden agree. If the programme is shifted in a direction more favourable to state enterprise, it might include other measures more powerful in mitigating trade fluctuations, but which may gradually diminish private economic enterprise. The soundness of such measures, always a political question, is not discussed in this paper.

economic situation on the regulation of interest and loan rates by the Central Bank, and on the relation of the national currency to that of other countries, there can in my opinion be no doubt that any smoothing out of trade fluctuations regarded as desirable should be attained primarily through monetary measures. The primary responsibility for trade cycle policy must accordingly lie with the Central Bank, since it is intimately concerned with the responsibility for the care of the monetary system. Public Finance can therefore only be a supplementary instrument, and should if possible be co-ordinated with the policy pursued by the Central Bank. Myrdal and the Unemployment Commission seem to be of the same opinion on this point.

If such a financial policy is to be successful, it is important that it should not come up against difficulties arising from the relation of the country to other countries. There must accordingly be what Myrdal terms an "international margin" for an independent policy. Also, the technical budgetary apparatus and the character of public administration must be such as to make the policy feasible. Finally, there must be grounds for believing that fairly reliable short-term economic forecasts can be made.

It is necessary to make these assumptions more exact when the import of the financial policy is discussed in detail. It will be helpful to start first with relatively *favourable conditions*, and to investigate later how far the conclusions must be modified under more complicated circumstances.

The background against which a cyclical budgetary programme must be seen, is that public action has on the whole a "natural" tendency to intensify such fluctuations rather than the contrary. This means that after a slump has set in, a reduction of current revenue is anticipated

at the time when the budget is tabled, and also an increase in current expenditure due to emergencies arising out of the depression itself. For this reason the greatest possible economy is aimed at, both in current expenditure and in capital investment. The latter will thus be curtailed in the same way as in private enterprise. During the boom the situation is reversed: not only is current expenditure more generous, but there is also a more pronounced tendency to carry out constructional work, requiring loan funds, and thus the prevailing scarcity of capital is intensified.\*

The least that can be demanded of public policy (assuming that there is scope for an active internal cyclical policy), is that it should not aggravate fluctuations, but should remain *neutral*. The majority of the Unemployment Commission have taken this cautious position, which agrees with the view expressed earlier by one of its members, Professor Bagge. This implies that the total volume of public works and purchases should be adjusted to a normal trend of development. They should accordingly not be made to depend on annual fluctuations in the business situation. The unavoidable surpluses and deficits on the revenue side in different years would then be evened out through

\* The above shows, however, that the reaction of public policy to trade fluctuations is not *solely* additive. For during the depression there are usually "budget deficits" and during the boom "budget surpluses." This means that in the former case current expenditure tends to exceed current income, and in the latter case to fall short of it. This compensating tendency is strengthened by the efforts commonly made to utilize hidden reserves, in order to avoid sharp increases in taxation during depression, and by action in the contrary direction during a boom. These circumstances, also mentioned in Myrdal's work, are nevertheless not sufficient in themselves to counterbalance the intensifying influence already mentioned, which is above all due to the practice of synchronizing the volume of public investment with the general economic trend.

transfers from and to a fund created specially for this purpose, or by short term borrowing.

The realization of this programme would undoubtedly mean a real advance in comparison with traditional budgetary policy. And from the standpoint of economic policy the result should in many instances be fairly satisfactory, provided that the management of monetary policy, on which the responsibility for mitigating economic fluctuations primarily rests, is sufficiently active and efficient. But in my opinion it would be both inconsistent and unfortunate to commit oneself to this "neutral" financial policy so completely as to preclude the possibility of a more active policy when it is clear that it would give favourable results. Nor has this been the intention of the Unemployment Commission, since it speaks of "feeling one's way." The arguments supporting a "neutral" budgetary policy amount merely to saying that although certain deviations are reasonable in themselves they are not worth the risk, since they are difficult to carry out, and may often be ill-timed. In so far as it is believed that these difficulties can be overcome, the arguments for such a neutral policy lose their force.

I believe it is possible to find another solution of the problem, practically as safe as that proposed by the Unemployment Commission, and with more favourable effects on unemployment and industrial fluctuations. This solution presupposes, first that relatively elastic methods of balancing the budget (to be explained later), are sanctioned and generally practised, and secondly, that the commencement of all public works and orders capable of postponement, should rest on decisions of *two* types. First there would be a decision to *grant* the appropriation out of means available in the current annual budget, and, later, other decisions concerning the payment of the appropriated sum and the *carrying out* of the

actual work itself. The effect of our solution would be that, after the reforms have taken effect, the authorities granting appropriations would be at liberty to react to industrial fluctuations in the way that seems to them most rational. Under our assumption it may be hoped that this reaction will have a tendency opposite to that which is common now. There is at present very little scope for postponement of work when appropriations have once been granted. The greater number of such grants are naturally made during a boom, when income flows more abundantly and the authorities take a comparatively optimistic view of the taxpayers' ability to pay. But it is quite natural and advantageous to postpone the utilization of appropriations, when circumstances permit, until a reversal of the economic trend has taken place, and costs have fallen to a more advantageous level.

The timing of public works brought about by applying these principles is manifestly not affected by criticisms of the attempts made to accelerate public constructional work of various kinds during the recent depression. Such difficulties were due partly to insufficient preparation, whereby the work was begun too late, and partly to the fact that when they were decided upon it was necessary to estimate, consciously or unconsciously, not only their direct remunerativeness but also their advantages from the point of view of unemployment. Our programme presents no such difficulties. Moreover, it tallies well with the long term planning programme for public activity. The only difference is that planning is accompanied by a vote of appropriation, falling under the budget of the current year, but freedom in choosing the time for using the appropriation is allowed.\*

\* [A similar scheme is the approval of an alternative "emergency budget," to be applied if the economic situation deteriorates.—Cf. Section 5 below.]

I do not mean to deny that this type of solution has difficulties of its own, partly of a technical administrative nature, and partly depending on the correct interpretation of the economic situation. The former cannot be dealt with here. Only one point need be noticed—the solution would be facilitated if the financial policy of local authorities were placed partly under State supervision.\*

Mistakes are naturally almost inevitable in interpretation of the economic trend. But such mistakes should by no means prevent the fulfilment of the crucial part of the programme, namely the postponement of constructional work, etc., during every boom until the following slump. The principal source of error lies in failure to realize when the slump is over, as a result of which the works may not be as evenly timed during the depression as would have been desirable. But even then the situation will always be better than if constructional work had been distributed indiscriminately over good and bad years.

If this programme were to be carried out at all fully, important advantages would be realized. (1) Financial gains would accrue to the State and to the local authorities through the reduction in the average level of costs for constructional work, etc. (2) There would be less unemployment and better utilization of productive capacity during depression years, and (3) more stable prices and less violent economic fluctuations, owing to the monetary

\* In this connection it should be made clear that the solution of the problem for local authorities is especially urgent, since in their case the alternative principle of an unvarying volume of expenditure cannot as a rule be upheld. For a local unit the building of a new schoolhouse or poorhouse, is a relatively large undertaking of a non-recurrent nature. This constructional work cannot be evenly distributed over a period of years. The choice lies between timing it in a good year, when labour is scarce and the prices of materials are high, or waiting for a depression year, when the unemployed can be utilized and advantage taken of lower costs in other respects. The latter alternative is of course preferable from every point of view.

effect of the recurrent "under-" and "over-balancing" of the budget, through the adjustment of public expenditure between boom and depression years.

The programme is based on the principle that public authorities moved by the desire of securing financial gains, will act in such a way as also to secure the other two advantages which are of importance from the general point of view. In this respect the programme appears to be more effective than the "passive" financial policy advocated by the Unemployment Commission. Since it is politically quite neutral, its adoption seems justified, whenever conditions permit of an independent internal policy of economic stabilization.

To what extent this programme might subsequently be expanded by more drastic measures in order still further to stabilize industrial fluctuations is a question that must be dealt with in relation to a particular set of circumstances. We shall confine ourselves here to two points.

The most difficult problem in this field is the organization in the depression of *additional public works*, which are not directly remunerative but which lead to increased employment of labour and other factors of production, and thus appear advantageous from the angle of an unemployment or expansionist policy. Conflicts of economic interest often arise in judging the value of such works. Some of their effects have certainly no drawbacks from the point of view of private interests, for instance the reduced expenditure on unemployment relief and the improvement in the prospects of private industry due to the stimulus given to demand for goods of all kinds arising from the works. Other effects, however, bring advantages to certain groups only and are harmful to others. In so far as the public works mean higher prices for the services of labour, for raw materials, etc., there is a stimulating effect on the persons and enterprises selling



these services and goods. But those who demand them in competition with the State, and whose own products have not been affected by a corresponding rise in prices, find themselves worse off than before. This is one of the most important causes of the frequent opposition to such public works, when they are not organized as unemployment relief of the usual type. Even if the Unemployment Commission is right in saying, that these works appear in a more favourable light when a considerable part of the productive capacity of a country is idle, the theoretical solution of the problem must build to a certain extent on premisses and valuations of a political character and the practical solution must build on the actual distribution of political power. Because of the intricate and delicate nature of this problem energy should in the first place be concentrated on the politically neutral programme characterized above.

In still another respect it appears that the measures justified from the strictly financial viewpoint should be supplemented by direct action aiming at economic stabilization. When the budget is "over-" or "under-balanced," the supply of net saving available for private investment is affected. The supply is reduced by "under-balancing" or current "deficits," when the public demands weigh heavily on the capital market, and increased in the opposite case. Since private demand for investment varies similarly, a better correspondence between these two factors is attained by the proposed policy. In this way, budgetary policy becomes a valuable aid to monetary policy in its task of *preserving equilibrium on the capital market*. Nevertheless, it is improbable that the stabilizing influence of budgetary policy will be of exactly the extent which is desired in every given case. For public activity is the result of the decisions of numerous different central and local authorities actuated by their

individual considerations. The total result may therefore require adjustment in order to secure better correspondence with monetary policy. Such an adjustment would perhaps be brought about by providing that the directors of the Central Bank should each year advise the Government of the degree of "underbalancing" or "overbalancing" of the budget during the near future which would be desirable from the monetary standpoint. The budget should then be adjusted accordingly whenever possible. In this case budgetary measures would deliberately be resorted to in order to attain an end called for by monetary policy, namely, the maintenance of equilibrium on the capital market.

The views laid down here as to budgetary policy under certain simplifying assumptions are explained in more detail in Myrdal's work, in the Commission's report (chap. VII) and in Ohlin's supplement to the report (chap. V) where the implications of a public works policy are investigated. Although the authors of these works would probably not agree to all that has been said above, we seem on the whole to be of the same opinion with regard to the following main points:

(1) The trade cycle should not be allowed to affect *normal public activities*. This means that the tendency to reduce expenditure in bad years and increase it in good should be resisted in respect of normal activities. Any modification of financial policy in this direction which may be required for a special reason should be effected through adjustments in the earnings of the factors of production rather than through variations in the volume of their employment.

(2) Public *constructional work*, whether self-liquidating or not, should be distributed between depression and boom years in such a way that the best budgetary result is attained, i.e. the lowest costs with given advantages.

Such works should consequently be concentrated in depression years with their comparatively low level of costs, in so far as such a policy does not hinder the public bodies from carrying out their duties. Public action will then automatically give rise to a "counter-trend" with a stabilizing influence on the general trend.

(3) The *tax burden* should on the whole be lighter during the depression and heavier during the boom. This presupposes that the budget is "underbalanced" in the former case and "overbalanced" in the latter. The degree of government "over- or underbalancing" should be determined in consultation with the Central Bank, to ensure that budgetary policy is in conformity with the programme of monetary policy. Budgetary policy will then influence the supply of savings available for private investment, and ensure a better correspondence with the variations in demand during the different phases of the trade cycle.

### 3. MODIFICATIONS CAUSED BY INTERNATIONAL RELATIONS

So far the problem has been discussed without taking into account *international relations*. The complications arising when they are taken into consideration may conveniently be demonstrated by typical examples. For my part, I should be inclined to stress the importance of different currency systems in this connection. A few reflections on this point may therefore be added.

It appears to be a general rule that the gold standard increases the need for a cyclical budgetary policy, but diminishes the feasibility of carrying it out. The opposite is true in respect of independent currencies.

If it is on the *gold standard*, a small country like Sweden must for the most part adjust itself to international trade fluctuations. The opportunities for an independent policy

are very limited, unless commercial policy is vigorously directed to this end. In any case, the risks attending a highly developed budgetary policy of the kind suggested above are considerable, particularly because of the unreliability of economic forecasting. For example, in a depression it may be asserted with a high degree of probability that a reversal of the trend is to be expected after a time. But it is difficult to foretell in what way this will affect the future level of prices. This difficulty is of fundamental importance, for an attempt to create an expansion by raising prices may have unfortunate consequences, if the right policy would have been the opposite one of accelerating the price fall, so as to reach equilibrium at a low price level as soon as possible. Our conclusion is that the mitigation of economic fluctuations by budgetary measures, though especially desirable in view of the limited possibilities of monetary policy in these circumstances, is only practicable to a comparatively limited extent. The rules of budgetary policy laid down above must therefore be applied with caution.

In a country with a *free currency*, on the other hand, I believe that the rules can be of greater importance. It is true that international trends are equally difficult to foresee in this case. External influences on national trends and the possibility of parallel internal and international developments must also be taken into account. But the crucial difference is that it remains possible to exercise a decisive influence on the future internal price level. The possibility of carrying out a financial programme of rational trade cycle policy is thereby substantially increased. During depression public works financed by loans which will tend to reverse the trend, may for instance be justified. The effect of these measures may perhaps be insignificant, owing to external depressing influences, but the danger that arises under a gold standard, that the

government may be forced to repay its loans in a currency with a far higher value, is absent. Even if the general policy is that of maintaining more or less stable exchange rates, internal prices may be brought to any desired level by adjusting exchange rates at a single stroke. But when monetary policy is skilfully managed and the great possibilities of a free currency in the stabilization of general economic trends are judiciously utilized, the importance of certain portions of the budgetary programme outlined above is at the same time reduced.

#### 4. THE ARRANGEMENT OF THE BUDGET

This brings us to the problem of budgetary technique. A financial policy of mitigating periodic fluctuations implies, as we have seen, that the budget is "underbalanced" during the depression and "overbalanced" during the boom. The problem is, then, how flexibility can be attained in the annual technical budgetary procedure without endangering the long term planned increase of public net assets in the wider sense. The main problem is to ensure that a budget "deficit" in one year will really be counterbalanced by a corresponding "surplus" in another, so that the long term net rise in assets will not fall below the desired figure.

Myrdal has linked his proposed solution of the budget problem with a demand for a recasting of the Swedish system of budgetary accounting so as to make it more comprehensive. Such a reform would in the first place imply that besides the direct monetary expenditures of the various departments the annual value of the services obtained through the utilization of real capital assets owned by the Government should be included in the accounts. The principle would be the same as that in force in the Swedish government-owned business enter-

prises, where interest and depreciation on invested capital are included in the books as outlays or costs.\* This more comprehensive accounting system has the advantage that the principle now adopted in Sweden for balancing the budget (see p. 355) can be formulated more flexibly. Even non-remunerative capital investment can to some extent be financed out of loan, since future budgets will bear the charge for depreciation. Renewal funds will thus be expanded *pari passu* with the fall in the value of equipment, and net public assets will accordingly not be diminished.

However, as we shall see, even without departing from the traditional system of budget accounting, fairly good guarantees can be secured for the realization in the long run of such an increase in public assets as is regarded as desirable, if flexible methods of annual balancing are practised. For such a purpose it is of fundamental importance that the budget should be drawn up in such a manner that the degree of "over-" or "under-balancing" can be clearly realized in every case. This result can be attained quite as well under traditional methods of budget accounting as with a more complete system.† That an intentional abuse of the technique of balancing can go to greater lengths under the former system than under the new system is in comparison of subordinate

\* [In 1935, since this paragraph was written, Sweden introduced this accounting system for all public real estate, cf. p. 378.]

† The following quotation from Myrdal (*op. cit.*, p. 138) may accordingly be regarded as equally valid under the present system of budget accounting, if the budget were drawn up more clearly in the manner recommended here: "At least in this way every possibility of weakening the public finances in ways hidden from the public view and from public control is excluded. They may of course be weakened all the same, but then the weakening is conscious. The attainment of such increased clarity is in the last resort all that can be gained through methods of pure budget technique aiming at better guarantees for financial soundness."

importance. It is therefore by no means necessary to make the adoption of new principles of balancing the budget dependent on a recasting of the system of public accounts.

In order to elucidate my idea of the rational employment of the new budget technique, I have worked out below two alternative schemes for arranging the budget, of which the first includes only monetary receipts and expenditure but the second shows in addition also the calculated reserves and costs of the capital equipment owned by the State.

The *first* alternative keeps fairly closely to the system in use in Sweden before 1935. It is based on the principle that expenditure normally covered by taxes or by other true revenue is always included in the ordinary budget, whereas all other monetary expenditure is invariably accounted for in the extraordinary budget. All so-called current expenditure, i.e. that for current administration and other consumption purposes, interest on the public debt, etc., is accordingly referred to the ordinary budget. Capital expenditure, i.e. investment in capital assets, debt repayment and money appropriated to capital funds (this last item is not included in the table), are on the other hand divided between the ordinary budget and the extraordinary budget in accordance with the principle adopted for the long term increase of net assets. If it is desired that the Swedish tradition in this respect should be retained, the ordinary budget should thus be debited both with non-remunerative public investment and with certain regular repayments of the State debt. Other capital expenditure should be included in the extraordinary budget. This division of expenditure between the two budgets is conceived as institutionally established, through legislation or otherwise.

Such a method of drawing up the budget has the advantage that the extent of balancing can be directly

PROPOSED METHOD OF DRAWING UP THE BUDGET:

ALTERNATIVE I

ORDINARY BUDGET

<p style="text-align: center;"><i>Current revenue:</i></p> <p>Taxes, customs, excise, fees, net income from State enterprises, interest on capital lent out, and other monetary revenue .. .. . <math>e</math></p> <p>Received from extraordinary budget .. .. <math>a + b + c - e</math></p> <p style="text-align: right;">Total .. .. . <u><math>a + b + c</math></u></p>		<p style="text-align: center;"><i>Current Expenditure:</i></p> <p>Expenditure for consumption purposes, interest on public debt, etc. .. .. . <math>a</math></p> <p style="text-align: center;"><i>Expenditure for maintenance and increase of capital:</i></p> <p>Expenditure for non-remunerative capital investments .. .. . <math>b</math></p> <p>Regular amortization of public debt .. .. <math>c</math></p> <p style="text-align: right;">Total .. .. . <u><math>a + b + c</math></u></p>
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EXTRAORDINARY BUDGET

<p style="text-align: center;"><i>Loans, and realization of capital assets:</i></p> <p>From cash reserves .. .. . <math>f</math></p> <p>Loans .. .. . <math>a + b + c + d - e - f</math></p> <p style="text-align: right;">Total .. .. . <u><math>a + b + c + d - e</math></u></p>		<p style="text-align: center;"><i>Expenditure for increase of capital:</i></p> <p>Expenditure for self-liquidating capital investments .. .. . <math>d</math></p> <p>Transferred to ordinary budget .. .. <math>a + b + c - e</math></p> <p style="text-align: right;">Total .. .. . <u><math>a + b + c + d - e</math></u></p>
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ascertained from the current budget. If current income is exactly equal to the expenditure included in this budget, it will be balanced according to the established norm for the long term increase of public net assets. If current income ( $e$ ) is larger or smaller than the expenditure in question ( $a + b + c$ ), the budget is correspondingly "over- or under-balanced." In the table given above a case of "underbalancing" is assumed. The deficit in current income can then be made up by an amount specially assigned from the extraordinary budget. The size of this amount ( $a + b + c - e$ ) shows the degree of "underbalancing." If it had been a case of "overbalancing," its size would have been evident from the surplus arising in the ordinary budget and appearing as a special item on the expenditure side ("transferred to extraordinary budget"). These transfers from or to the extraordinary budget will thus recur as additions to the expenditure or to the income side of the latter. The total of both budgets will accordingly be affected by them.

The application of new and more flexible principles of balancing implies that the budget need not be balanced in every single year, but that negative and positive deviations are allowable provided that they counterbalance each other in the long run. Therefore, if the budget has been "underbalanced" in certain years, a corresponding "overbalancing" must take place in the succeeding years. A definite tradition in this respect may perhaps develop, which would entirely eliminate the danger of a long series of "underbalanced" budgets. However, it would hardly be desirable at first to lay down general rules for the solution of the central problem in this connection, that is, the period within which a defined degree of "underbalancing" should be compensated by a corresponding "overbalancing." In general it may be taken to be a desirable objective, that the

surpluses and deficits of the ordinary budget should counterbalance each other fairly well over the course of the trade cycle. But since cycles may in the future be more irregular than hitherto, this principle cannot be laid down in terms of exact periods. Besides, it should be noted that economic fluctuations are not confined to trade cycles in the narrower sense. We have also to take into account other periods of advance and retrogression, shorter or longer, and it may be wise to modify the balancing of the budget accordingly. Further it should be remembered that the capital investment that is to be covered in the long run by tax revenue may show considerable variation. It may be desirable to even these out by corresponding formal "under- or overbalancing" of the budget. If these variations are spread over periods as long as decades, it would no doubt be best to attain the requisite adjustment in some other way, for instance by modifying the norm for the regular amortization of the public debt.\*

The *second* alternative for arranging the budget differs

\* This last case may well become acute in the near future, if it is decided to employ the permanently unemployed during the next decade on extra public works which result in a considerable increase of non-remunerative capital assets (e.g. roads). If the expenditure for this purpose is included in the ordinary budget, in accordance with the principles laid down above, and if the latter is nevertheless balanced and if the rate of repayment of the national debt is maintained, the result will be that the net assets of the State (in the wider sense, including these new capital resources) will receive unusually large increments during this decade. If it is desired to distribute this increase over a longer period than a decade, then either the balancing of the budget may be allowed to end in a deficit for this decade (to be covered by a corresponding "overbalancing" during the succeeding period), or else the regular repayments on the national debt for the decade in question may be reduced. Both of these methods have the same real import, but the latter would seem to be preferable, since for psychological reasons it is perhaps undesirable to operate with "underbalanced" budgets over such long periods of time.

from the first mainly by the inclusion of certain calculated items: on the income side the interest on buildings and other real capital owned and used by the State, on the expenditure side the value of the services rendered by these assets (which can be dissolved into interest and depreciation). As the interest item (*g*) appears on both sides of the budget, its only effect will be an increase of the total. The inclusion of the depreciation item (*h*) on the cost side has a more important consequence, since it enables us to calculate the total amount ( $a + h$ ) which it is necessary to cover by the revenue (*e*) of the ordinary budget, in order to maintain public wealth in the wider sense. If, however, in accordance with the Swedish tradition, a "balancing" of the budget implies not only that the public wealth is maintained but that it is annually increased by an amount corresponding to the regular amortization of the national debt (*c*) plus the normal increase of non-remunerative capital assets ( $b - h$ ), then these two items must also be included with ordinary expenditure, as normal appropriations to capital funds. In consequence all investment, both non-remunerative and self-liquidating, can be transferred to the extraordinary budget, to be covered either by the realization of capital assets or by new loans. It will thus mainly register the transfer of public wealth from one fund to another. The amount of this will be varied by a change in the sum transferred to or from the ordinary budget.

This budget arrangement [which is adapted to the new Swedish accounting system] has, of course, certain definite advantages in comparison with the first alternative. It exhibits more clearly the annual variation in public wealth which the budgets imply. It also enables us to compare them with an established standard of "normal" annual increase of public wealth. Further it is not necessary to maintain the present distinction in the method of

PROPOSED METHOD OF DRAWING UP THE BUDGET:  
ALTERNATIVE II

ORDINARY BUDGET

<i>Current revenue:</i>	
Taxes, customs, excise, fees, net income from State enterprises, interest on capital lent out, and other monetary revenues .. .. .	<i>e</i>
Calculated interest on real capital owned and used by the State .. .. .	<i>g</i>
Received from extraordinary budget .. .. .	<i>a + b + c - e</i>
Total .. .. .	<u><i>a + b + c + g</i></u>

<i>Current expenditure:</i>	
Expenditure for consumption purposes, interest on public debt, etc. .. .. .	<i>a</i>
Calculated rent on real capital owned and used by the State—	
1. Interest .. .. .	<i>g</i>
2. Depreciation (Appropriation to sinking fund) .. .. .	<i>h</i>
<i>Expenditure for increase of capital:</i>	
Increase of capital funds .. .. .	<i>b - h</i>
Amortization of public debt .. .. .	<i>c</i>
Total .. .. .	<u><i>a + b + c + g</i></u>

EXTRAORDINARY BUDGET

<i>Loans, and realization of capital assets:</i>	
From sinking funds .. .. .	<i>b + f</i>
From capital funds .. .. .	<i>a + b + c + d - e - f</i>
Loans .. .. .	<i>a + b + c + d - e - f</i>
Total .. .. .	<u><i>a + 2b + c + d - e</i></u>

<i>Expenditure for maintenance and increase of capital:</i>	
Expenditure on non-remunerative capital investment .. .. .	<i>b</i>
Expenditure on self-liquidating capital investment .. .. .	<i>d</i>
Transferred to ordinary budget .. .. .	<i>a + b + c - e</i>
Total .. .. .	<u><i>a + 2b + c + d - e</i></u>

financing non-remunerative and self-liquidating investments. All investments can be financed by loans or capital assets without danger to the net public wealth, as long as sufficient amounts are transferred to the capital funds in the ordinary budget. It will thus be possible to evade annual fluctuations of the tax burden arising from the fluctuating needs of non-remunerative investment, e.g. for social purposes or for armaments. We have already mentioned the difficulties in this respect inherent in the first method. It must be admitted however that these difficulties are not insuperable.

In the above I have only attempted to explain the main principles of the new budget technique. These principles may of course be realized even if the details of the budget are arranged in a different way from that proposed here. It is accordingly of no real importance if the deficits or surpluses occurring in the ordinary budget are transferred to the extraordinary budget, as has been suggested above, or are debited or credited instead to a special fund, "the budget equalization fund" (cf. below).

The most important divergence between the method for drawing up the budget recommended here and that recently practised in Sweden lies in the fact that this method shows more plainly the degree of "over- or underbalancing." In 1931-4 when the budget was "underbalanced" two different methods were employed. First, certain items of expenditure were transferred from the ordinary budget to the loan budget, and at the same time certain future revenues were reserved for the rapid repayment of the new loans. Secondly, certain capital assets and funded reserves were drawn upon for the ordinary budget (among them non-recurring revenue obtained by changes in the manner of accounting, etc.). This "underbalancing" was expected to be neutralized during

the next few years by a corresponding "overbalancing," arrived at by burdening the ordinary budget with the extra amortization of the public debt just mentioned, and with appropriations to special funds (in addition to the expenditures re-transferred from the loan budget).

What does not seem quite rational in this arrangement is that two different methods have been combined in order to effect the "under- and overbalancing." It is true that this combination may easily be explained on historical grounds; since it was formerly regarded as permissible to cover small deficits in the ordinary budget by making use of cash reserves. The departure from tradition would be minimized by retaining this method unchanged, and accounting for the financing of such loans as are needed to make up the balance, in the form felt to be least risky in the eyes of the general public. But as soon as new principles of balancing have been intentionally adopted, logic demands that one should go the whole way and do away with the old distinction between "underbalancing" as permissible when cash reserves are utilized, and as contrary to financial tradition when financed by loans (though in the case in question perhaps justified as an extraordinary measure for combating the depression). There is no difference in fact between these two kinds of "underbalancing" and it is foolish to nourish the misconception just criticized by retaining the distinction.

It would be better to solve the problem on new and rational lines, so that the result will be fully satisfactory for the long period problem as well. In the first place, all cash reserves called upon should be entered in the extraordinary instead of in the ordinary budget. The deficit exhibited in the ordinary budget would then at the same time be fully accounted for. Whether it should be evened out by a transfer from the extraordinary to the ordinary

budget (the method advocated above) or by transferring certain specified items of expenditure from the ordinary to the extraordinary budget, is a question of relatively subordinate importance. As the latter method lacks the necessary flexibility, and it becomes more difficult to judge the degree of the balancing if items of expenditure are continually transferred from one budget to the other, the former alternative seems preferable.

The argument so far has been confined to the finances of the National Government. For Local Authorities the question requires different treatment, since the financing of non-remunerative capital investment by loan is allowed under certain circumstances. As a safeguard against continuous financial deterioration, Swedish law requires both large (75 per cent) majorities for decisions to raise new loans, and a certain amount of supervision by the Central Government. In spite of this, however, the finances of Local Authorities are markedly inflexible. All expenditure for administrative purposes and also for the normal increase of capital equipment has to be covered each year by current income, and assessments for local taxation are accordingly as a rule higher in depression years than otherwise. The introduction of more flexible principles of budget balancing appears to be a highly desirable reform in this sphere also. The creation of local equalization funds (with a certain amount of Government supervision) seems to be the simplest method of mitigating the unfavourable influence of industrial fluctuations on the finances of local units.

##### 5. A NOTE ON SWEDISH BUDGETARY REFORM (1939)

The principle of counteracting the business cycle by underbalancing the budget in depression and overbalancing during the boom, has been put into practice in recent years in Sweden by Mr. Ernst Wigforss, the Finance Minister. As mentioned above (p. 375), an intentional underbalancing of the budget

was allowed in the last depression, mainly by issuing new loans for financing unemployment expenditure. These loans were of short currency only, since according to the plan they were to be repaid during the coming upward phase of the trade cycle, when the budget was to be overbalanced. This plan was, in fact, successfully realized: already by the middle of 1938 all the loans were fully covered.\*

Since the new era of financial policy had its beginning in the midst of the depression, it was more difficult to realize the other part of the programme—the concentration of public investment in the downward phase of the business cycle. Such a timing of public works presupposes intensive preparation which had not been undertaken. Since then, however, considerable progress has been made in the direction of long-period planning of public investment, which will assist in mitigating business cycles in the future. This planning includes not only the investments of the Central Government and of State-owned enterprises, but also the investments of Local Authorities.

In order to secure a better approximation between the basic principle and existing budgetary technique, Mr. Wigforss has also successively introduced new methods of drawing up the budget of the Central Government.

The first step was taken in 1935, when real estate of a non-remunerative character was included both in the capital and in the income accounts of the State. A special capital fund, corresponding to the value of these assets, was established; at the same time the calculated value of the services rendered by them was included in the budget as expenditure, and the same amount *minus* sums transferred to special sinking funds appeared as the net income from the real estate fund (see the table on p. 380 and cf. p. 373). It was thus possible to finance capital expenses of this nature by borrowing without diminishing the accounted net assets of the State, and since the yearly depreciation of the assets was covered by current revenues in the budget of each year (as just explained), the maintenance of the value of Government-owned assets was also provided for.

\* See E. Wigforss, "The Financial Policy during Depression and Boom, *The Annals of the American Academy*, May 1938, pp. 25 ff. Cf. also *ibidem*, p. 63, and Brinley Thomas, *Monetary Policy and Crises*, pp. 205 ff.



Meanwhile a more thoroughgoing budgetary reform was prepared by a committee of experts whom the Finance Minister had called upon to draw up a complete scheme for the rearrangement of the budget according to the new principles. This scheme was incorporated in the budget for the financial year 1938-39 and has been also applied, with small modification, to the budget for the following year. The main lines of the scheme are shown in the table below.\* A few comments may be in order here.

The essential point is that the ordinary or current budget should include only such expenditure as should normally be covered by current revenue (and not by loan or capital assets). A positive or negative difference between current revenue and the corresponding expenditure should be expressly recorded as a surplus or deficit (as suggested above). But these surpluses and deficits are in this plan kept apart from the capital budget and transferred to a special fund, the so-called Budget Equalization Fund. In order that this fund, which should also register the difference between the budget estimate and the actual receipts and expenditure, should be kept at a certain level in the long run, it is intended that the budget for each year should contain a programme for the solution of the balancing problem for the succeeding ten years

As in the second table given above (p. 374), all capital expenditure which leads to an increase in the capital funds included in the public accounts, is carried to the capital budget. This budget will thus register total public investment, both self-liquidating and non-remunerative. But the methods by which the investment has been financed cannot be directly ascertained from the budget, since only one undifferentiated item appears on the income side. The necessary funds must, however, either be taken from sinking or other capital funds, or be created by new loans. (Cf. the table on p. 374.)

So far the scheme is in substantial accord with the second table above. But we now come to a point of difference: the item "Expenditure for increase of capital" entered on the expenditure side of the current budget in the table above does

\* The real budgetary situation is assumed to be the same as in the tables given above, and the algebraic signs have the same meaning in both plans, so that a direct comparison between the proposals can be made.

## METHOD OF DRAWING UP THE BUDGET APPLIED FOR THE BUDGET-YEAR 1938-39, IN SWEDEN

### CURRENT BUDGET

	<p>A. <i>Proper State Revenues:</i> Taxes, Customs, Excise Fees, etc.</p> <p>B. <i>Income from Capital Funds:</i>  I. State Enterprises .. ..  II. Central Bank .. ..  III. Real Estates .. ..  IV. Loan Funds .. ..  V. Shares, etc. .. ..</p> <p>Deficit to be transferred to the Budget  Equalization Fund .. ..</p> <p style="text-align: right;">Total .. ..</p>	$\left. \begin{array}{l} \\ \\ \\ \\ \\ \\ \\ \\ \\ \end{array} \right\} \begin{array}{l} \\ \\ e + g \\ \\ \\ \\ \\ \\ \\ \end{array}$		<p>A. <i>Proper State Expenditure:</i> Services of the Various Departments ..</p> <p>B. <i>Expenditure for Capital Funds:</i>  I. Public Debt (Interest) .. ..  II. Sums written off New Capital In-  vestment .. ..</p> <p style="text-align: right;">Total .. ..</p>	$\left. \begin{array}{l} \\ \\ \\ \\ \\ \end{array} \right\} \begin{array}{l} \\ \\ a + g + h \\ \\ \\ \end{array}$	
380	<u><math>a + h + i</math></u>			<u><math>a + g + h + i</math></u>		
	<u><math>a + g + h + i</math></u>			<u><math>a + g + h + i</math></u>		

### CAPITAL BUDGET

	<p style="text-align: center;"><i>Funds Available</i></p> <p>Loans and Realisation of Capital Assets .. ..</p> <p style="text-align: right;">Total .. ..</p>	$\left. \begin{array}{l} \\ \\ \\ \end{array} \right\} \begin{array}{l} \\ \\ b + d \\ \end{array}$		<p style="text-align: center;"><i>Capital Investment:</i></p> <p>I. State Enterprises .. ..  II. Real Estate .. ..  III. Loan Funds .. ..  IV. Shares .. ..  V. Other Funds .. ..</p> <p style="text-align: right;">Total .. ..</p>	$\left. \begin{array}{l} \\ \\ \\ \\ \\ \end{array} \right\} \begin{array}{l} \\ \\ \\ \\ b + d \\ \end{array}$	
	<u><math>b + d</math></u>			<u><math>b + d</math></u>		
	<u><math>b + d</math></u>			<u><math>b + d</math></u>		

not appear here. The underlying argument is that the budget is "balanced," if public net assets, as they appear in the accounting system, are kept unaltered. The expenditure side of the current budget, therefore, besides expenditure for consumption purposes and interest on the public debt, should only contain amortization items, corresponding to decreases in these assets.\* An increase in the accounted net value of public property corresponding for example to the regular amortization of the national debt, is thus not necessary for "balancing" the budget.

This seems to be in full accordance with the original meaning

\* In accordance with this view, another item "amortization of *capital losses*" was also entered in the current budget, in the original budgetary scheme proposed by the experts. It was argued that the maintenance of public assets presupposed that a decrease in them, occasioned by capital losses, should be compensated by corresponding appropriations in the current budget. Against this reasoning objections might be raised both from the point of view of principle and of practice. In point of principle it is hardly consistent to cover capital losses out of current revenues. A strict adherence to such a programme would lead to quite disastrous results in a depression period, when public, as all other values, are falling. Only such losses as refer to the activities of the current year should be covered by current revenue. In practice, the Financial Authority will probably not ascertain more capital losses than it finds convenient having regard to the budgetary situation. This more flexible application of the principle appears, thus to involve the danger, that the balancing problem may be so manipulated that the public cannot discover how far it has really been solved. The amounts written off in the current budget may for example be diminished during the depression and increased during the boom. Thus the aim of the whole reform—that the public should be made aware of the real budgetary situation,—could very simply be sidestepped. It was therefore on good grounds that capital losses were omitted in the final scheme put into practice by the Finance Minister.

In the budget for the financial year 1939-40 an item called "Losses on Capital Funds" is included on the expenditure side of the current budget. This item, however, refers not to capital losses in the true sense, but to such more normal losses, connected with the capital funds of the State, as are expected to be realized during the current year. The reasoning above does not apply to losses of this type which of course, like other regular yearly expenses, should be covered by current revenue.

of a "balanced" budget. But it corresponds less well to the standard of "financial soundness" accepted in Sweden (see above p. 355), which not only implies that the net property of the State should be maintained, but that it should be *increased* in a certain degree. From this point of view, the budget is "balanced," if it provides *both* for a certain accounted increase in the net public assets, caused by the regular amortization of the national debt, *and* for a certain other increase, appearing in the accounting system or not, corresponding to the excess of new non-remunerative investments over the depreciation of the old ones.

The first kind of increase in public wealth has, as just mentioned, clearly been omitted in the present budgetary scheme. The practical importance of this deviation from the traditional standard of "soundness" is, however, not very great, since only a fairly moderate amount is in question. But an odd consequence of the arrangement may be pointed out.

If a reduction of the national debt or some other form of increase in public net assets (other than non-remunerative investments) is desired, it can, on this arrangement of the budget, only be realized by an increase in the Budget Equalization Fund and a corresponding "overbalancing" of the budget. Should the programme for increasing public wealth be extended over a period of several years, the Equalization Fund will thus lose its original meaning, and its part in achieving the solution of the short-term balancing problem will be somewhat obscured. If such a plan were to be realized, this complication should therefore be met by the appropriation of the required amount from the Equalization Fund to the Capital Budget.

Of greater importance is the second kind of increase in public wealth, namely that of non-remunerative investment, yielding no money income. A strict application of the new scheme outlined above would certainly have implied that this increase would also have disappeared. If such investment is entirely financed by borrowing, and if the yearly appropriation in the current budget only corresponds to their actual depreciation, there will neither be any accounted nor any hidden increase in net public assets.

In the scheme outlined above on p. 374 this difficulty was met by the introduction of a special appropriation in the

current budget for "increase in capital funds," corresponding to the excess of new non-remunerative investments over the depreciation of the old ones ( $b-h$ ). In the Swedish budget for the financial year 1938-39, another arrangement was made by which the same result was at least partially obtained. With regard to new non-remunerative investment it was decided that a substantial amount (25-50 per cent) of their costs should immediately be written off and the corresponding appropriation made in the current budget (indicated in the table by the letter  $i$ ). This important modification of the reform of 1935 (see above) represents in fact an approximation to the old treatment of such investment, the real import of which was that they were written off 100 per cent immediately. Since  $i$  is probably less than ( $b-h$ ), the real increase in public wealth will be smaller than with the old method of balancing the budget, assuming that the amount of investment does not change. It should be observed that this increase in wealth, just as under the old system, does not appear in the book values, since it only corresponds to the excess of the sums written off over the actual depreciation of non-remunerative investment.

We may therefore conclude that the traditional standard of "financial soundness" in Sweden has been somewhat modified by the recent budgetary reform: the accounted increase in wealth has been omitted and the hidden increase *ceteris paribus* diminished. But it seems probable that sufficient compensation will be given by an increase in the total amount of non-remunerative investment.

Finally we may briefly refer to the methods adopted in Sweden for the adjustment of the budget, if changed economic conditions should make a subsequent correction desirable. The traditional method was the presentation of a supplementary budget, when an increase in the appropriations proved unavoidable. This method was, however, not sufficient for a flexible adaptation of expenditure to business fluctuations, for after the adjournment of the Riksdag in the end of May, the Government has no constitutional power to take the financial measures which might be necessary in case of a recession in trade. Therefore, in the first half of 1938, when it was difficult to foresee whether a downward phase of the business cycle would begin during the financial year 1938-39, a special "emergency budget," adapted to a state of depression, was

passed as a complement to the regular budget which was based on the assumption that no material change in the conditions of trade would take place. The emergency budget includes conditional appropriations which may be used only in case of a substantial deterioration of business conditions. Whereas the regular budget thus has the character of a minimum budget adapted to the needs of the boom, the emergency budget represents together with the regular budget a maximum budget adapted to the needs of depression. Since the question of how to finance the conditional appropriations is not solved in the emergency budget, it follows that it may lead to a deficit. The new system with a supplementary emergency budget has not yet been tried out, since so far it has not been necessary to put it into force. But the method seems to go a long way towards overcoming one of the greatest difficulties connected with a financial policy directed to mitigate business cycles, that of correctly judging the coming development of trade.

The budgetary scheme now applied in Sweden is thus on the whole clear and simple and in conformity with the new principles for balancing the budget.

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