

GIUSEPPE UGO PAPI

INTRODUCTION TO POST-WAR RECONSTRUCTION PROGRAMMES

INCOME - NUTRITION - UNEMPLOYMENT
- MONETARY REHABILITATION -
RECONSTRUCTION FINANCE - ECONOMIC PLANNING



INTERNATIONAL INSTITUTE OF AGRICULTURE
ROME
VILLA UMBERTO I

P R E F A C E

This brief collection of studies dealing with problems which logically come under consideration before proceeding to the examination of particular subjects, such as, say, agriculture, takes as its starting point the notion of the total real income of a country, and with reference to the transition from war to peace, examines the importance for the equilibrium of the economic structure and for social security, of the problem of replacing money incomes, which will cease when hostilities come to an end, by real incomes, of which the flow may perhaps be small during a first period but which are ready to increase and to be redistributed in the form of securely growing personal incomes. It then studies how a rational solution of problems incumbent on all countries, such as those of assuring sufficient food for all the classes of a community, the employment of available labour energies, etc., cannot disregard this notion of real income.

The growth of real income, which in modern economy is expressed in terms of money, requires at least approximate stability in the purchasing power of the currency, thus depending upon a satisfactory solution of the problem of monetary rehabilitation. It also depends upon the activity of the State which, while providing more especially public services typically instrumental for the larger production by individuals of consumption goods, is contained within the limits of economic expediency, and accordingly takes care not to destroy present goods in the absence of the certainty of future compensations which could at least replace those subtracted from the supply of consumer goods, available for individuals or of producers goods used for the production of such commodities.

As after the war recourse can only be had to the sources of income for obtaining the means required for providing the several public services and attaining the purposes the Government has in view, it would seem necessary that any action taken by public bodies, whether for raising funds — a strictly financial activity — or for spending them — an economic policy activity — should avoid reducing the production of real income, as it would thus undermine the very foundations of recovery, both individual and collective.

On the one hand private producers and consumers may make plans for the future use of their income and for its subsequent distribution between purposes serving consumption or production. On the other hand the Government and other public bodies, anxious to act on prudent lines, may make plans for helping, or at least for not hindering, or in the worst case for hindering as little as possible, private productive activities.

Conceived in this manner, the plans laid down by public bodies will also help to produce real income and to encourage its increase during the period in which such policy is in a position to develop through the convergence and amalgamation of other rational activities. Thus the notion of increasing real income which we took as our starting point is finally seen to be not only the chief object of private activity, whether organized according to plans or not, but the object which Governments and other public bodies can never renounce without causing serious loss.

Between books which investigate and books which expose a situation, a study which is the result of slow meditation necessarily gravitates towards the former. This may not secure for it public favour. It will however leave it the fervent desire to see the organisation of a better life-after the greatest, perhaps the most terrific series of events experienced for years by millions of human beings.

Rome, May, 1944.

GIUSEPPE UGO PAPI

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I.

THE SUBSTITUTION OF NEW INCOMES
FOR THOSE WHICH HAVE CEASED

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SUMMARY

PART I: THE CONCEPT OF INCOME. — A definition is given of the concept of the aggregate *real income* and of the *money income* of a country during a given period, as well as of the concept of *personal income*, real or expressed in money, as resulting from the distribution of the aggregate income. A distinction is made between the productive activity of individuals aimed at the production of consumption goods through the various stages determined by technical factors, which is self-supporting so long as it is maintained out of the proceeds of the sale of its products and which, therefore, may be defined as *independent*, on the one hand; and the productive activity of the State aimed at the production of public services in the largest sense of this term, which represents a productive activity financed out of the aggregate *income* through taxes, out of *savings* through loans, out of *capital* through the consumption of its substance and out of the proceeds of the *creation of monetary means*: a productive activity and which, therefore, may be defined as a *derived* activity, on the other hand.

This distinction brings into relief the fact that the simultaneous recourse to all the above mentioned sources puts at the disposal of the State an amount of purchasing power which cannot be considered as aggregate money income, so long as the country is in a position to check the effects of the continuous increase of these means upon the price level of the various groups of goods and services tending to rise; but whose coincidence with the concept of money income is restored, if and when the country is no more able to ensure the complete return of the money issued to its source and thus to prevent the rise in prices.

Within the limits of the amount thus obtained, the State is enabled to develop an activity which, whatever may be its actual economic worth, would not have been possible if it had been financed out of the original money income.

PART II: THE MEANS OF INCREASING REAL INCOME AND SAVINGS. — Immediately on the termination of the war, the volume of the "derived" production of public services by the State undergoes a modification; and that because, for various reasons, the relative importance of the several sources from which it was financed, is changed. There arises, therefore, the problem of the substitution for the money incomes derived from the activities of the State, which had ceased, of real incomes which can now be obtained on a larger scale from independent production.

To permit such independent production to increase, it is essential, however, that the demand for consumption goods be increased. There follows an examination of the possible bases of increased demand: incomes which have survived; incomes in course of increase; savings. International exchanges extend these bases. Recourse to foreign incomes by means of exports and to foreign savings by means of borrowing abroad add the proceeds to the domestic demand for consumers' goods, thus contributing to the increase in the supply of such commodities. In other words, there is an expansion of real income, which constitutes the typical manifestation of a country's prosperity.

PART I
THE CONCEPT OF INCOME

I. — Independent individual production. The concepts of total and individual income, of real and money income.

The different forms of productive activity exercised by the members of a civilized community may be divided, according to their object, into two distinct groups: (a) Production of *consumers' goods for individual consumption*, such as food, clothing, houses, etc., all intended for the immediate satisfaction of human needs (1). These consumers' goods are produced by means of various capital goods, such as energy, machines, materials, means of transport, etc., the process of production being divided into a number of separate *stages* determined by the state of technical knowledge. (b) Production of goods which may be called *consumers' goods for the consumption of the community*, which consist in the administration of justice, in the defence of the territory, including all the industries engaged in the production of goods necessary for actual or potential warfare, construction of roads, railways and other public works. All these may be considered by the individual members of the community as producers' goods intended to insure a larger and securer production of goods for individual consumption, and thus assimilated to producers' goods proper (machines, energy, etc.).

Most individual members of the community, singly or in groups, are engaged in the *first* of these two forms of production. This production is kept going by the *returns* obtained from the sale of the consumers' goods produced, such for instance as bread, irrespective of the number of intermediate stages which the product may have to go through. And the

(1) "Consumers goods" include also, evidently, those goods which some would call "non material" because the material nature of these goods is not immediately obvious: a lawyer's or a doctor's advice, a professor's lecture, etc., as well as so-called "personal services" (not to be confused with the services of the factors of production): human activities which modify the extent of a human need directly, without recourse to any matter extraneous to the human person itself. Such, for instance, is the activity of a masseur.

study of these productive activities gives a fairly clear insight into the nature of the total income and of the individual income.

In fact, in all modern communities, the use of money — as well as of credit facilities — permits the realization of *two* important functions, namely, first, that of *anticipating* the equivalent in money of the consumers' goods forming the object of productive activity, before its process of production had been completed; and, secondly, to *distribute* the money equivalent of the consumers' goods produced among all the enterprises engaged in the various phases of their production and, in their respective spheres, among the different factors of production.

Now, that which is anticipated or distributed consists in consumers' goods, such as quantities of baked bread, or, instead, of their equivalent in money calculated at current prices. Thus, in the end, it is the aggregate of the consumers' goods produced and consumed during a given period of time — generally a month or a year — characterized by approximative *periodicity* and the *possibility of consumption without damage* to the source from which they come, that constitutes the *total real income* or, in other words, the *total real dividend* of the community. Since, given a certain mass of money, the consumers' goods are exchanged at certain unit prices, the sum of all the products of the multiplication of the quantities of such goods by their respective prices constitutes the *total money income* of the community (1).

The *individual* income, on the other hand, constitutes that part of the aggregate consumers' goods which the use of money and of credit permits to *anticipate* from the quantity actually produced for distribution among those who take part in their production. Evidently this part also presents the characteristics of *periodicity* in the flow of production and of the *possibility of being consumed without damage* to its source, to which we have already referred above.

(1) There exists a school of thought which considers that the total income comprises also the increase in producers' goods taking place during the period of time concerned — the month, the year, the five-years' period, etc. — compared with the aggregate of producers' goods which existed during the preceding period. In any case, however, in order to avoid duplications, as the producers' goods, by their nature, must eventually be transformed into articles for consumption, it would appear advisable to take the increase in them into consideration only when such transformation has already taken place, and to the extent to which it will be possible to ascertain it, during the period of time immediately following upon that actually considered. Thus the increase in producers' goods can only be considered as a *potential* increase in income. The extent to which an increase in the quantity of consumers' goods will take place, if the producers' goods really fulfil their productive function, can then be ascertained only in the course of a period successive to that during which the increase in producers' goods had been realized.

The *individual income* thus represents the remuneration of every participant in the process of production for his contribution to the common work. Every person in receipt of a certain sum as income deducts from this sum all the elements of costs, thus reducing it to *net income*. The more exactly this operation is carried out, the nearer the sum of net incomes comes to represent a *reproduction* of the total income.

The typical case of an individual seeking to obtain a net income is that of an entrepreneur who pays the prices required to secure the supply of the various factors of production, including his own work, and profits by the eventual margin over and above his costs. But this situation is common to all those who, in order to obtain an income, must sustain costs, which may be involved in training, in transport, in publicity, in taxes, etc. This situation appears with particular clearness under the competitive system, in which the sum of the prices paid for securing the supply of the factors of production tends to equal the sum obtained from the sale of the products, or, in other words, the total money income of the community.

Thus, the total income and the individual income become in a sense *complementary* notions, both in the case when they are expressed in terms of consumable commodities and constitute *real* income, and in the case in which, expressed in terms of money, they represent the *money* income of the community as a whole, or of its individual members.

A direct consequence of the consideration of the income as "the essential result of the economic activity of man" (1) — that is as the aggregate of goods produced and consumed during a certain period of time and capable of directly satisfying certain needs — is that the producers' goods intended, through various phases, to produce articles of direct consumption, *cannot* be considered as part of the income, either total or individual. Their inclusion would unavoidably result in a duplication. It is true that certain commodities may be considered as being at the same time consumers' and producers' goods, according to the use to which they are put. There may, therefore, arise some doubt as to whether they should be included in the aggregate of goods which consti-

(1) Among the modern treatises on economics the one that devotes most attention to the concept of income is that of MAsCI G.: "Corso di economia politica corporativa", Foro Italiano, Roma, 1940, Vol. I, pp. 217-222. Also DE VITI DE MARCO, A.: "Principi di economia finanziaria", Einaudi, Torino, pp. 191 *sq.*

tate the real income of a country, or not. As, however, the commodities which may be considered at the same time as goods for direct and for indirect consumption, are not very numerous in civilized society, the calculation of the real or money income of a country would not appear to be seriously affected by the possibility of duplication arising out of such ambiguity in the classification.

2. — Productive activity of the State and the sources of its financing.

(A) THE REVENUE OF A COUNTRY : ORDINARY FINANCE.

In our preceding study of the productive activities of individuals we have pointed out the existence of a certain *parallelism* between the real income, total or individual, and the money income which represents the sum of the products of the multiplication of the quantities of consumers' goods by their respective prices. Beside the production of consumers' goods in its various phases, which is carried out by individuals and is kept going by the proceeds of the marketing of the products, there exists, however, a production of goods and services of a public character, which, as we have had occasion to say, may be considered as consumers' goods for the community's use and, at the same time, as producers' goods, in so far as they ensure a securer and larger creation of real or money income for the country.

This production carried out by the State is financed from different sources : *national income, savings, consumption of capital or inflation*. In its turn, it distributes incomes to those engaged in it. It follows that, in so far as such production is financed by drawing upon the incomes of the citizens, the incomes which the State distributes by the production of public services, in the form of wages, salaries, interests on public debt, subsidies or bonuses, *cannot be added* to the aggregate incomes derived from independent individual productive activity (calculated *before* the levying of taxes), as such an addition would involve a duplication. This is the first observation to be made in connection with the productive activities of the State based *exclusively* upon the incomes of the individual citizens. The second observation is that, so long as the productive activity of the State is financed by the taxation of the citizens' incomes, the *relation* between the real income (aggregate of consumers' goods produced), on the one hand, and money income (product of the multiplication of the quantities of consumers' goods by their respective prices), on the other hand, is in no way changed.

It is true, however, that the money incomes distributed by the State or by public bodies, for the organization and management of public services, special or general, are themselves subject to *taxation*, just as are the incomes derived from the independent individual production of consumers' goods. A furnisher or an employee of the State is as much a taxpayer as a private business man or employee. It should however be noted in this connection that the taxation of incomes distributed by the State in order to keep the public services going has, at any rate, the effect of *diminishing* the amount of taxes which, otherwise, would have to be levied on the aggregate incomes derived from the independent individual production of commodities and services. As a result, *so long as the State obtains the means necessary for the financing of its productive activity exclusively by drawing upon the incomes of its citizens*, the proceeds of taxation which it spends on public services *cannot be added* to the total of incomes derived from independent individual production: and never will there arise a discrepancy between the real income and the money income, as defined above.

(B) SAVINGS.

A discrepancy between real and money income makes its appearance as soon as the State begins to draw upon sources *other* than the citizens' incomes. In other words, this takes place when the State, instead of having recourse to expedients of *ordinary* finance, thus drawing upon a source which reproduces itself indefinitely — as this seems, at first sight, to be the case when the necessary funds are obtained by the taxation of private incomes — passes to the application of measures of *extraordinary* finance involving the levying of taxes which cannot be paid out of income and have to be met by *drawing upon* the capital and which, therefore, represent a direct claim of the State on the people's savings. In this case, in order to keep its activities going, the State is compelled to draw not only on the incomes of the individual citizens, but on *what, in the past, they have been able to save*.

The State draws upon all forms of savings, whenever these are available in sufficiently large amounts and whenever there exists, on the part of their owners, a readiness to invest them in Government bonds. The available funds may include *private savings*, which the Government proposes to borrow on terms attractive to their owners; they may represent *undistributed profits* of business enterprises; *surplus receipts* over and above the sums budgeted by public bodies; during exceptional periods, they may include sums *saved* by persons entitled to reparations

(such as those paid for war damages), etc. Theoretically, recourse to this source is *limited*, however, by the extent to which it is possible to *increase* the burden of taxation by the addition of sums due in *interests* and *repayment* on the newly contracted debts. But in any case the *addition* to the incomes derived from independent individual productive activity of the sums distributed by the State to those engaged in the various public services — if these are financed out of the proceeds of previous saving, and if the money thus spent does not leave the country — does not lead to any duplication in the calculation of total income.

(C) CONSUMPTION OF CAPITAL: SOURCES OF "EXTRAORDINARY" FINANCE.

If, however, the savings are scarce, if the public is not willing to subscribe to public loans, if fiscal charges cannot be increased, the State, faced with the impossibility to finance its activities out of taxation, may find *other* resources by proceeding to the "consumption" or in the "disinvestment" of capitals, which may take different forms (1).

(1) *Within* the country, the exhaustion of stocks of raw materials, of semimanufactured and of finished commodities, which cannot be replaced; the reduction or the complete elimination of the amortization and the insurance of fixed capital; the conversion of consumers' into capital goods (melting down of statues or of metal ornaments, for instance, for obtaining the metals they contain); the destruction of durable goods, movable and immovable, for the raw materials they are made of, the disposal of artistic objects, etc. In the relations *with foreign countries*, the export of gold reserves; the transfer of foreign credits, by means, for instance, of the sale of foreign securities, or of claims upon foreign debtors; the disposal of profit-bearing investments abroad; the sale abroad of parts of the country's capital to pay for imports of articles of consumption; the seizure by foreigners of part of the national wealth of the country through requisitions, annexions of territories or confiscations. For some of these examples see BORGATIA, L.: "Consumo bellico e ricostituzione del capitale nel dopoguerra", *Giornale degli Economisti*, July-August 1941, and following issues.

In the White Paper accompanying the British budget draft for 1941-42, "Capital Disinvestment" is divided into:

(a) "Overseas disinvestment": This is the adverse balance of payments of the United Kingdom on current account. It excludes any liabilities incurred as a result of Lease-Lend (which is also excluded from the expenditure figures); but it includes, for the Budget forecast 1942-43, the Canadian Government contribution of 225 Mn.

(b) "Home disinvestment": "Residue being the net disinvestment of capital at home."

For 1938, this item was estimated independently. For the war years, the residue has been provided from the following sources:

(a) Sales to public authorities of capital assets (such as sites, buildings and stocks of goods previously owned privately);

(b) Sinking funds and depreciation funds of firms and institutions;

(c) Net depletion of stocks and working capital (apart from sales under (a) above) carried by private finance, measured by the reduction in their value as reckoned in the calculation of the year's profit;

less (d) New investment financed out of privately owned funds;

(e) Replacements and renewals charged on depreciation funds;

(f) Replacements of war losses actually carried out (including new ships in private ownership and stocks of commodities lost and replaced within the year).

It would appear right, therefore, to *add* to the incomes derived from independent individual productive activities also those distributed by the State to persons engaged in the performance of public services and derived from the consumption of capital. In the consumption of capital one may frequently find the explanation of the fact that, in some countries, in spite of the public charges absorbing a very large part of the national income, the standard of life of the people is higher than that which one could expect considering the residue available after the repeated subtractions effected by the State from both current income and savings.

The State may equally well draw on the same *three* sources of funds, if it is in a position to discover and to use them, on *foreign markets*. Thus, it may draw upon the income of other countries by *exporting* goods and services; on the *savings* of other countries by raising foreign loans; finally, on the *capital* of other countries by *acquisitions, requisitions, annexations* and *confiscations*. The charges involved in the first of these three forms of using foreign resources consists in the *costs* of the commodities and services exported; the charge in the second case consists in *interests and repayment* of loans, spread over a certain period of time; the charge in the third case consists in the *purchase prices* or in any expenses and efforts in connection with the carrying-out of the requisitions, annexations or confiscations mentioned above.

3. — **Consequences of the use of these three sources: "generic" inflation and disparity between the money income, as monetary expression of real income, and the money income actually available to the State for the financing of the various public services.**

When the State draws not only upon the citizens' incomes, but upon savings and capital as well, it would appear that, in the end, all these three sources may be reduced to a single *one*, namely, the real income. Savings, indeed, are in a large part due to the amount of income which permits saving. The consumption of capital, on the other hand, represents merely the withdrawal of some of the factors which contribute to the creation of income, and thus means a diminution of real income. This latter always constitutes the final object of all the activities of the State, unless it is ready to assume itself the production of consumers' goods, in substitution of the private producers, with a view either to greater material advantage or to the protection of some political interests.

Admitting the possibility of reducing these three sources of income out of which the activity of the State is financed to a *single* one, however, in so far as the State continues to draw upon savings and consumes the capital, one *cannot* avoid adding, to the money income calculated as described above, which constitutes the expression of real income in terms of money, the income derived from these other sources. In such a case, the amount of money which can be distributed among those engaged in the various public services *exceeds* the money income, as defined above, by the total amount of the income derived from these *two* new sources. More exactly and in accordance with what we have pointed out above, it is always possible to establish, by considering the proceeds of the drawing upon savings and of the consumption of capital, *which part* of these proceeds does *not* contribute to the national income of the country concerned, because, for instance, it is transferred abroad. As to the part which is transformed into a constituent of the national income of the country concerned, it may be *added* to the money income as defined above. The result always constitutes a certain volume of purchasing power at the disposal of the State, *without* counterpart in a corresponding increase in the available mass of commodities for consumption. In other words, we are faced with the phenomenon of inflation which may be described as *general inflation*.

On those markets on which the economic forces at play enjoy a certain liberty, an expansion of purchasing capacity, irrespective of the sources from which it comes, causes a *temporary rise in the prices* of both producers' and consumers' goods. Thus, the *prices being higher*, the coincidence of the money income and the real income is restored; in other words, there is a return to the notion of money income as the sum of the products of the multiplication of the quantities of consumers' goods by their respective prices. On those markets, however, on which economic forces are denied any possibility even relative, of free play, the effect of an increase in purchasing capacity upon prices can be *postponed*, thus producing a *disparity* between the amount of money income, as defined above, and the amount of money of which the State is in a position to dispose.

This *disparity* is important in that it permits, on the one hand, to decide *up to which point*, and by what means, one is justified in *adding* to the incomes derived from independent individual production the incomes of those engaged in the various public services which are derived from the two other sources: savings and the consumption of capital;

and, on the other hand, to understand certain developments — or, if we may say so, certain “elasticities” — of monetary and financial policy, especially if the State seeks to maintain a certain proportion in the use of the three alternative sources indicated above (1).

We are not going to dwell here at length upon the question of the extent to which one may *add* to the incomes derived from independent individual production those coming from the productive activity of the State financed by drawing upon savings and upon capital. We can only say this. As the money income remains always the sum of the products of the multiplication of the quantities of consumers' goods by their respective prices, it is relatively easy, at any moment, to calculate that income on the basis of current prices, *adding* to it the amounts which the State takes from the savings and from capital with a view to redistributing the proceeds of drawing upon these two sources, if these proceeds remain in the country. This way of defining and of calculating the income stresses the fact that the notion of income is essentially dynamic. Indeed, when the income has been determined once, it has to be *continually* re-calculated, as it is subject to continuous variations.

4. — Limits of the duration of “ordinary” finance.

We think it worth while to enter somewhat deeper into the question of *limits* imposed to the activity of the State based upon these three sources of financial means; in other words, of the “elasticity” which such activity may possess.

The problem of the *limits* of “ordinary finance” must be clearly distinguished from that of the *efficiency* of the State's normal activities, that is of the possibility of increasing the real income. Both are based upon the same concept of revenue, but the problem of the *efficiency* of the State's activities presents itself in the following terms (2). If all that the State takes from the income, the savings and the capital in order to spend it on various public services does *not return to the cycle of production of real income* of the country, that is to say, is not restituted to the process of production of consumers' goods, produced and consumed within the period of time concerned, the activities of the State *hinder* greatly the re-production of real income in the same measure

(1) For comparison with the definition of the concept of income by other writers see Appendix to the present Report, p. 36.

(2) In this connection the reader might refer to the two first essays in the present writer's volume: “Equilibrio tra attività economica e finanziaria”. Giuffrè, Milano, 1943.

as before. This has two effects. The first is that the dividing line between "ordinary" finance, which can be continued indefinitely, without damage to the sources of financing, and "extraordinary" finance, which cannot be so continued, becomes blurred. The second that, under the same conditions, if there is no increase either in production or in savings capable of *making good* the losses due to State action, a financial policy which, in appearance, seems to draw only upon the citizens' income, and which, therefore, would appear as capable of *continued* application, in actual fact also draws upon the capital of the country. Accordingly, it is necessary to act with great circumspection in giving the State the means of extending its activity, even should these means be obtained from current income, thus bearing all the appearance of entering within the framework of ordinary finance.

The problem of the *limits* of the financial activity of the State is quite different. In all legislation there exists a fixed *minimum* income which is considered as altogether exempt from taxation. It is asked: if the exemption of minima incomes, which represent real incomes, is observed, and supposing that the real income and the amount of income of which the State can dispose coincide, how long may *ordinary* finance — that is finance drawing exclusively upon the citizens' income — be continued? The reply would appear to be that this possibility exists up to the moment when, as a result of *investing* the proceeds of taxation in various items of expenditure, of destroying part of what is collected in taxes, of taxing *all* incomes *over* the fixed minimum, all the incomes of the country, whether derived from independent individual productive activity or from that of the State, are reduced to the minimum fixed for exemption. This is the theoretical limit of "ordinary" finance, whose actual attainment may be more or less *retarded*, according to the conditions of the different countries and to an infinite number of various circumstances, such as, for instance, the initial amount of incomes or the extent of the liabilities to be met, as in the case of goods which, as a result of uneconomic investments of funds levied by taxation, are destroyed. This limit, however, helps in clearing up the ideas about the possibilities of extension of the activities of the State financed *exclusively out of the incomes* derived from independent individual production (1).

(1) This represents a further refinement of the theory developed by the present writer in his essay on the: "Costo finanziario di una grande guerra. Nota sul limite della finanza straordinaria", *Giornale degli Economisti*, July-August 1942, republished in the volume mentioned above.

5. — “Generic inflation” tends to increase during the period of preparation for war, while shifting the limits of the application of ordinary finance.

But, whenever the State has recourse to the existing savings and to the consumption of capital *as well*, its finances acquire definitely the character of “extraordinary” finance, which means that it cannot be applied repeatedly, and the limits to which we have referred above are shifted still further, all the more if the State adopts measures aimed at strengthening one of these sources of revenue out of which to finance its activities relatively to the other. Such is the situation which is particularly apt to develop during periods of profound dislocation of the economic system.

Suppose that a State decides to prepare for a war, or has to face one, within a relatively short time. In order to produce all the commodities necessary for this purpose, sometimes on an enormous scale, it requires various means which it seeks to acquire either by diverting them from employment in other activities, or, perhaps, by importing them from abroad. The prices of labour, of fixed and circulating capital, of savings, the activity of enterprises, all tend to increase. Numerous branches of production of *consumers' goods* are reduced to a standstill. The transition from a state of peace to a state of war and the prosecution of this latter, which have been frequently discussed in detail in the course of the last few years, involve the adoption by all countries, to a smaller or greater extent, of certain measures (1): *restriction of consumption*, with a view to make available for war requirements as large a part of the productive forces as possible; *prohibition of production* of certain commodities; *prohibition of certain investments*; *price control*; *control of foreign trade*.

These measures have the effect of swelling the amount of savings, of which large masses flow to the banks. These include the *contributions* of persons with relatively small incomes which represent the fruit of real acts of *abstinence*; the contributions of the savers who *prefer* this investment and transfer their available funds from current or deposit accounts to saving deposits; the funds made available by the *disinvestment* on the

(1) CABIATI, A.: “Il finanziamento di una grande guerra”, Einaudi, Torino, 1941. — SINGER, H. W.: “The German War Economy”, *Economic Journal*, April 1941, p. 19; June-Sept. 1941, p. 192; April 1942, p. 8; June-Sept. 1942, p. 186.

part of businesses condemned by war to *inactivity*: shipping or overland transport companies, hotels and tourist bureaux, importers, businesses with *slow* turnover such as land reclamation, housing and construction of public buildings; production of goods for *civilian* needs, such as textiles, paper, leather, stage, etc. They include the *working capital* of enterprises which profit by the war and keep liquid funds out of which, when needs be, they settle their accounts with other concerns with which they come into contact in the course of their own productive activity (1).

This condition, common to numerous business enterprises, as well as the incitements to voluntary saving which all the Governments encourage by all means (2), contribute to the accumulation of *deposits* which, in their turn, lead to the increase in the circulation of notes among those who have no current accounts with the banks, and of cheques among the possessors of such accounts, *without* a corresponding production of commodities for consumption, thus conferring to the market the characteristics of a "condition of great liquidity". The banks, which constitute an essential part of the mechanism of the market, accentuate their activity as intermediaries either by opening credits directly to business enterprises engaged in war work, or by acquiring Government bonds and helping the placing of public loans. The "liquidity" of the market may also be increased by the *consumption of capital*, which, in some countries, assumes large proportions (3). Thus, even when the State draws only on the *three* sources indicated above — incomes, savings and capital — the revenue of which it disposes *diverges* very greatly from the amount of real income expressed in money.

As a result, the possibilities of the development of State activities are extended. The illusion that a war can be brought to an end by the

(1) See the study by the Governor of the BANK OF ITALY: "I riflessi della guerra sui fenomeni della moneta e del credito", *Rivista Bancaria*, February 1942, pp. 57 and 62.

(2) See in this connection the very well documented *Der Deutsche Volkswirt* for the years 1940 and 1941, as well as the articles in the *Economic Journal* quoted above, April 1941, p. 34 and June-Sept. 1942, p. 203. For the effects of a "situation of liquidity", see the same *Journal*, in the section on "Monetary Policy" of *The German War Economy*, in the issues for June-Sept. 1941; April 1942, pp. 35-36, and June-Sept. 1942, pp. 203-204.

(3) In Great Britain in 1940 three quarters of the additional expenditure was covered by drawing upon investments. In 1941, the percentage thus met diminished to one half of the increase. In the Budget of the German Reich for 1941-42 the consumption of capital represents an amount of 2,500 million RM. (*Economic Journal*, June-Sept. 1942, p. 202).

lack of financial means is dispelled, especially if, since the very beginning of its preparation or from the outset of hostilities, the minimum income is not forced too much down (1).

6. — Specific inflation and its tendency to increase the possibilities of ordinary finance.

The possibility of financing the activities of the State may also be increased by having recourse to a *fourth* source, namely to *specific inflation* by which is meant the *creation* of new currency without a corresponding increase in the supply of commodities for consumption.

Such a creation of new money permits those who put it in circulation to acquire ever increasing quantities of the commodities they require. Whenever this additional money is distributed in the form of incomes within the country, the consequent *increase* in incomes swells the total money income of the country which, at the start, was equal by definition to its total real income.

At any rate, it should be noted that whenever the amount available to the State from the proceeds of the second, third, and fourth sources of finance, comes to be spent under different heads, *bringing about a rise in the prices of consumers' goods*, of which the production does not in the meantime increase, but either diminishes, or, at the best, remains unchanged, the rise in prices leads to a contraction of the purchasing power of the money received from all the four sources from which the activities of the State are financed, viz., current incomes, savings, consumption of capital and fresh currency issues. As a result, to continue the activity of the State, even on the same scale as before, *fresh and continuously increasing* monetary means are required.

Specific inflation may take place in different ways. One of these is through the banks. By granting credits or by acquiring securities on a liberal scale, the ordinary bank may run the risk of freezing its assets, in spite of the large flow of deposits and of the capacity of the credit machinery as a whole to make further advances. If and when the danger is aggravated, the bank is forced to seek re-discount or advan-

(1) These considerations might possibly have induced some authors to arrive to contrary conclusions and to think that the financial means are *unlimited*. Suffice it to say, however, that if one recognizes the fact of economic goods being available in limited quantities, one must necessarily, in the end, come to the conclusion that it is this limitation that counts.

(2)

ces against securities pledged with it as collateral to loans, with the Central Bank, thus enabling and encouraging this latter to *issue fresh* notes, without these latter having a counterpart in commodities. In this way the possibilities of financing war production, already ample as a result of drawing upon the three other sources, are further increased.

There exist, however, other ways by which specific inflation is produced. Such are, for instance budget *anticipations* (1); the *raising of wages*, a measure which sooner or later recoils upon the State as the principal purchaser during the war; the granting of *subsidies to families*; the *supplementary prices*. All these lead to the *creation* of new money in quantities increasing progressively from month to month and from year to year (2).

(1) A concrete case of specific inflation intended to make good a chronic Treasury "deficit" has been cited in the *Bollettino di Informazioni dell'Associazione fra le Società per Azioni* of September-December 1943:

"On May 31, 1940, the Treasury deficit was over 38,000 million lire, and it went on increasing till, on June 30, 1943, it reached 65,818 million lire.

"Faced with such a situation, the Treasury was compelled to have recourse to the fiduciary issue of the Bank of Italy, notwithstanding the fact that, at some periods, it was able to mitigate the situation temporarily by means of loans.

"From the 1st to the 31st of July, 1943, in spite of the issue of 5 per cent. Five-Years' Treasury Bonds effected during the fortnight from the 7th to the 21st of June, which brought in 11,972 million lire, the Treasury was again forced to draw upon the note circulation of the Bank of Italy, because during that period, apart from the growing war expenditure, one had to reckon with a diminution by 894 millions of the proceeds of the ordinary Treasury Bonds, whose aggregate amount had fallen from 56,247 to 55,353 million lire, as well as with a reduction of 2,162 million lire in the proceeds of current accounts, which had diminished from 54,860 to 52,698 million lire.

"The largest recourse to the note issue of the Bank of Italy was in July, when the sum so obtained reached 10,385 million lire, thus increasing the debt of the Treasury to the Bank by the end of the month from 47,595 to 57,980 million lire.

"This last figure represents only the advances made by the Bank of Italy to the State for the needs of the Treasury. If, in addition, one takes into account the notes put by the Bank at different times at the disposal of the Treasury against various other securities, as well as the rediscount made by the bank for the *Consorzio Sovvenzioni su Valori Industriali*, amounting to a total of 34,241 million lire, in connection with the certificates issued by the Treasury to this body, for the payment of daily allowances to the families of the mobilized and for various public works, of the expenditure in connection with the certificates issued by the military authorities for the payment of different military orders, one sees that the total amount of bank-notes entirely absorbed by the State reached on July 20, 1943 the figure of 96,541 million lire."

This statement does not mention explicitly one of the motives of the recourse to specific inflation which consisted in the "price guarantees" in connection with various products. Yet, when the State commits itself to such guarantees, the subsidies thus paid tend to grow into tens of milliards of lire. Such subsidies "under the illusion of being able to fix the prices of certain products, have caused the greatest damage to the Treasury, without in any way having secured an appreciable material benefit for the consumer", as the Bulletin adds a little further. The duty of revising them and of doing away with a considerable part is an imperative necessity.

(2) Pigou, A. C. in "Types of War Inflation", *Economic Journal*, December 1941, pp. 440 sq., distinguishes between "wage inflation" and "deficit inflation" (making good a rise in prices), showing that the latter is relatively less injurious. Concerning the effects of specific inflation the reader might consult our essay "L'inflazione nella finanza di guerra", in the volume "Equilibrio fra attività economica e finanziaria", Milan, 1943.

There exists a whole literature denouncing the evils consequent upon such inflation, when the State does not succeed in neutralizing it completely by some expedients capable of absorbing the surplus of currency in circulation; expedients whose efficiency experience shows to be decreasing continually. Recourse to the *fourth* source for financing the activities of the State tends thus enormously to increase the disparity, already created by general inflation, between the amount of money income — which we defined as originally equal to real income consisting in consumers' goods produced and consumed within a certain period of time — and the amount of income of which the State can dispose. The State is thus placed in a position to expand its activities without considering their economic effects: activities which are essentially destructive of wealth because of being based upon an illusion, no less illusory for being convenient, concerning the notion of money income.

To clear up this illusion and to see clearly what it implies in reality, should be a necessary preliminary of all investigation into economic, social or financial phenomena.

Here it was sought to show how much, and in what way what is called, not always properly, *money income* comes to diverge from the real income of a country; how it can be measured according to all the canons of logic, and to what kind of public activities this notion of income may serve as basis. By the wealth of their material and by the efficiency of their methodological expedients, the statisticians are in a position greatly to contribute to the clearing-up of the much-discussed concept of income. This may prove exceedingly useful for practical application in time of war, and still more in times of peace, prayed for by all the peoples the more ardently, the more the ordeal of war is prolonged.

PART II

THE MEANS OF INCREASING REAL INCOME AND SAVINGS

7. — Difference of attitude of the governments towards the two forms of inflation: generic and specific.

The attitude of the Governments towards the two forms of inflation — generic and specific — may be different.

While encouraging the formation of savings whose use is deferred till after the war (1), a Government can have recourse to specific inflation only to a *very limited* extent, leaving at the same time a relative freedom of action to economic forces. In this case, the increase in purchasing capacity, irrespectively of the source from which it comes, brings about a rise in the prices of consumers' and of producers' goods, so that, as we have had occasion to point out, the concept of money income as the sum of the products of the multiplication of the quantities of the various consumers' goods by their respective prices, which is equivalent to the real income, tends to reconstitute itself at higher prices.

On the other hand, the State may need, in a more or less pronounced form, to have recourse to specific inflation *on a large scale*, this being the easiest way in which it can obtain relatively large quantities of the commodities it requires for the prosecution of the war. While doing so, the State seeks rigorously to avoid all effects of the mass of money in circulation upon prices by ensuring that the currency, even if it has no counterpart in commodities, should be forced to return to the Government (2).

(1) Some writers are at pains to show that "forced saving" should be preferred to increased taxation since the "forced" savers do not lose their title to their savings. This, however, is true only if the war over, they become once again available to them without loss in their purchasing power.

(2) In connection with the practical measures intended to insure the so-called "circuit of capital" (the return to the issuing authority of the additional issues of currency) — such as the limitation of consumption, the fixation of prices, the suspension of investments — as well as with the reasons of the failure of the circuit to close, observable in all countries — such as the incomplete utilization of equipment; psychological factors which persist in certain directions, in spite of apparent advantages (thus, for instance, shares, even bearing lower dividends, are sometimes preferred to Government bonds); ignorance of certain data; *progressive* expansion of Government expenditure — much instructive information is to be found in the annual report of the Governor of the BANK OF ITALY of March 30, 1942, pp. 22, 23, 26, 76-79 and 105-106.

The Government may also be compelled to have recourse *on a large scale* to *all* the sources of State finance, including specific inflation. In this case, however, if it proceeds from the start to large issues, it cannot take all the measures necessary to ensure an efficient circulation of the funds culminating in their return to the Treasury. Thus, the influence of the mass of currency upon prices becomes evident, even if it is not officially recognized. The State Budget is continually threatened in all its attempts at keeping a balance between the incomings and the outgoings. The revenue diminishes in its real purchasing capacity so long as the money continues to depreciate, as may be seen by referring to prices. As the war is prolonged, the importance of specific inflation as a means of financing the State tends to increase.

8. — Changes in the amount of incomes distributed by the State after the cessation of hostilities.

When, starting from what has just been exposed, we turn to consider the conditions which may be expected to prevail during the period following upon the cessation of hostilities, we must ask ourselves what would then be the sources out of which the State would be in a position to draw the means necessary for assisting economic recovery.

In the *first* instance, the problem may be considered as it should present itself in the countries less favourably situated in respect of resources for financing the war; in other words, in countries forced to have recourse *on a large scale* to specific inflation and unable to ensure the return of the money issued to the Treasury. After which, the easier problem of the countries less embarrassed financially may come for consideration.

Secondly, the problem resolves itself not by the discovery of sources other than those already enumerated above, as the human mind, at least for the moment, cannot discover such other sources of any importance, but rather by ascertaining the modifications in the *comparative importance* of the sources already indicated and by finding out which of them can be reckoned upon with greater assurance during the period which will follow the cessation of hostilities.

As a matter of fact, *immediately before the armistice*, in every country involved in the war there exist :

(a) Incomes of independent individual producers who continued their activity as furnishers of goods for consumption, even if in many cases on a reduced scale. These represent real incomes which, in terms

of the prices current on the officially recognized market or, more probably, on the unofficial market, form correspondent money incomes.

(b) Incomes distributed by the State to those engaged in the production of public services, including the defence of the territory in its largest sense, the amounts spent in this way being obtained by means of taxation levied upon the incomes of the independent individual production, in so far as this has survived. These proceeds of taxation, distributed in incomes, cannot, however, be treated as an addition to the incomes of independent individual productive activity.

(c) Incomes distributed by the State either out of funds obtained from the existing savings of individuals or of banks, or by drawing upon *capital*, or, finally, by the creation of new monetary tokens. These incomes, irrespectively of whether they are expressed in terms of commodities or of money, must be considered, in so far as they remain in the country, as an *addition* to the incomes of the first category.

At the end of the war, the incomes of the *first* category which are derived from the production of goods absolutely essential to the consumer even in war-time, remain; remain also those of the *second* category to the extent to which they are covered by taxation.

As to the incomes of the *third* category, it should be noted that the productive activities directly dependent on the war, naturally, cease; and with them cease the incomes of those engaged in them, with the result that certain productive agents are unemployed. Moreover, in seeking to restore budget equilibrium, there is usually a rigorous revision of expenses: the contracts for supplies to be continued, price guarantees and various measures of social and wages policy, are all revised (1).

(1) In particular, concerning the desirability of *reduction in the rate of interest upon Government bonds*, the following observations might be made. Even apart from the moral repercussions of such a measure, especially in the countries which, after having had large recourse to specific inflation and being unable to escape its effects, have had to stabilize the purchasing power of their money at a lower level, thus wiping out, to the extent of the margin between the old and the new purchasing power, all the existing savings; a reduction in the interest rate of the Public Debt involves a *further* blow to the savers, as well as a *new* obstacle on the way to economic revival. In fact, the interests are, indeed, paid out of the proceeds of taxation which, in its turn, reduces the incomes upon which economic recovery ultimately depends. Yet, while the taxes are transferred and their burden is spread over the community, so that their weight is distributed among a large number of different subjects; the interests are received by the holders of Government bonds and constitute in their hands a certain aggregate of purchasing power which, even if small, serves to support the demand for consumers' goods. More details concerning recourse to Public Debt and its management will be given in the essay on financial reconstruction.

This also tends to reduce the amount of incomes compared with that distributed during the war.

On the other hand, and that especially during the period, more or less long, which follows immediately upon the cessation of hostilities, the State is compelled to meet *fresh* expenses in pensions to invalids, in subsidies to the families of other military, in the liquidation of various war-time administrations, which often constitutes a complicated and delicate task, in different measures intended at the mitigation of unemployment, etc. Although they are not so heavy as those involved in the financing of war, these new expenses, which are distributed in the form of new incomes, serve to a certain extent to make good the disappearance of other incomes which had ceased at the cessation of hostilities.

In any case, however, the amount of incomes derived on the morrow of the war from independent individual productive activity and from the expenditure of the State, is bound to be *smaller* than that of the incomes distributed during the war.

9. — Changes, after the cessation of hostilities, in the relative importance of the different sources out of which the activities of the State are financed.

This difference may also be increased because the State is *no more* in a position to draw, at least to the same extent, upon all the sources from which it obtained the financial means for maintaining its activity during the war. Indeed, at the end of the war, especially if the hostilities have been prolonged, drawing upon capital is not likely to constitute anything like an appreciable source of revenue. In those countries in which it had not been possible to ensure the return to the Treasury of the surplus currency issued, and thus to prevent its effects upon prices and wages, the resulting specific inflation demands that, as an essential preliminary to other action, the purchasing power of money be *stabilized*, at least *de facto*. This can only be achieved if all further recourse to the creation of monetary tokens is definitely eliminated. Otherwise the incomes and the savings will continue to lose purchasing power; and all attempts to encourage recovery, to re-absorb the factors of production thrown out of work by the cessation of the war, and all possibility of establishing the budget of the State and of ensuring its being executed, will be frustrated by the instability of the purchasing power of money.

True, the stabilization, even if only *de facto*, of the purchasing power of money, accompanied by a severe restriction of credit, may also bring

about the failure of enterprises engaged in the production of consumers' goods, especially if these enterprises had been used to live exclusively on bank credits. Failing these credits, these firms, faced with high costs of production, cannot make both ends meet and are compelled to reduce the employment of the factors of production, or even completely to stop their activity. Thus, as a rule, especially because during the preceding period enterprises of this kind usually become very numerous, stabilization tends generally to provoke the unemployment of factors of production. Such unemployment, however, is a necessary evil which has to be accepted in order to prevent evils even far greater (1).

As a result, on the one hand, having revised the contracts with its furnishers, reduced to a minimum all its expenses and eliminated all recourse to specific inflation and, on the other hand, not being in a position to draw any more on capital, the State sees itself reduced to *two* only of the four sources indicated above, namely to the *incomes* and the *savings*, upon which it can reasonably reckon. The *incomes* which are still available to the State are those derived from independent individual productive activities, on the one hand, and from those public services which remain

(1) To the reasons in favour of the stabilization of the purchasing power of money, considered for the case of a closed market, should be added those which would appear to recommend such a course in the case of *communicating* markets. The depreciation of the currency in terms of goods and of foreign currencies forces the country to pay *more* for many of the commodities it imports, whose prices cannot fail to affect those of the goods destined for internal consumption; it is only during the initial period that it encourages exports. In the long run, as the rise in the prices of the various means of production employed in the manufacture of commodities destined for export, whose prices are also raised in consequence, exports have to cease, even before the countries of origin or those of destination impose any restrictions. Thus, the incomes earned during the period of transition and adjustment disappear, while the possessors of incomes still surviving, as well as the owners of savings in money are constrained to the melancholy sight of the situation getting ever worse along with the diminution of the purchasing power of the currency in which their incomes and their savings are expressed.

When, in recognition of the *de facto* situation, the old currency is replaced by a new one at the rate of 10 old units for one new, all the prices, in terms of the *new currency* tend to be reduced to the extent of the depreciation of the original currency. In the process, all the savings accumulated before the inflation are destroyed to the extent of the depreciation, that is, in this case, in the proportion of 10 to 1. A banknote of 10 old units is worth new one; and the same applies to securities. A house which costs 10,000 original units to build is only worth 1,000 new units.

A very important problem is that of determining the right *level* of stabilization. Though, owing to experience and to the growing recognition of the "economic solidarity" existing between the different countries, no one is in a position really to chose in this case, without regard to what is done by others, it would appear that this should correspond to the *lowest* level of the purchasing power the currency to be stabilized possesses abroad, even if in this way the destruction wrought in the amount of cash savings is greatest. A stabilization carried out on such terms encourages the development of exports during the period of adjustment, thus permitting to make good, at least partly, the losses in savings caused by this mode of deflation which, from the point of view of the savers, would appear more drastic.

in operation, on the other hand (1). And against all the miraculous cures and all the illusions concerning taxes which would expropriate the rich and benefit the poor, there remains the fact that the most efficient instrument in this case is a fiscal system improved, simplified and well adapted to the annual flow of the incomes derived from an intensification of productive activity whose possibility will be discussed below.

The second source consists of the *savings* accumulated during the war — either in a currency still in course of depreciation, or in a currency stabilized by measures more or less drastic — by those who drew their incomes from individual productive activities or from the performance of public services. To these savings should be *added* those accumulated after the cessation of hostilities (2) by people in receipt of incomes and able to put by some part of these. Here also, against all the miraculous cures and illusions, if the instrument used is borrowing, the essential condition is the capacity of the country to absorb the loans issued in the persuasion that by doing so it acts in its proper interests.

Obviously, since the burden imposed by borrowing the public's savings consists in the interests payable on the loans, which are defrayed by means of increasing taxation, *it is always to the income of the citizens* that the State is compelled to have recourse. By income of the citizens we naturally mean here that derived from independent individual productive activity, which constitutes the real basis of all activity of the State. It is this productive activity that is alone in a position to furnish incomes capable of *making good*, during the period immediately following on the war, the difference between the number and amount of incomes distributed during the war and the reduced number and amount of incomes, which individual productive activity and the performance of public services on behalf of the State are still in a position to distribute.

If, thus, it is only from *larger real incomes*, that is to say from a larger production of commodities for consumption and of those which serve, in some way or other, to their production, that it is possible to make

(1) See EINAUDI, L.: "La condotta economica e gli effetti sociali della guerra italiana", Laterza, Bari, 1933, pp. 130, 338, 384, 386.

(2) The period after the war may be likened to that "phase" of the business cycle which closely resembles depression. Accordingly, it would appear that one should have recourse to borrowing, at least so long as the State finds the savers ready to subscribe to its loans. In this sense, the spread of economic culture might greatly facilitate the task of the governments. Otherwise, it would be necessary to have recourse to extraordinary taxation of the forced loan, whose consequences would prove even graver than those of voluntary loans.

good the difference between the incomes distributed during the war and those still existing after its termination ; we may ask ourselves what are the factors which can contribute to the larger production of consumers' and producers' goods, capable of reabsorbing the productive forces put out of work by the cessation of hostilities.

10. — Factors of a potential increase in the demand for consumers' goods.

In the long run, the increase in the production of both consumers' and producers' goods depends upon *an increase* in the demand for such goods which, in its turn, depends upon a corresponding increase in the incomes, or, at least, upon the prospect of such increase.

(A) Some would be inclined to find a possible basis for an *increase* in the demand for consumers' goods in the fact that, as a result of the cessation of certain expenses from the budget of the State, a possibility would arise of diminishing the fiscal charges and of reducing the recourse to private savings, which would make a larger part of the incomes and savings for the purchase of commodities for consumption. We have seen, however, that, on the one hand, the State would have to meet fresh expenses instead of those which had ceased, and that, on the other hand, the possibilities to have recourse to the sources of State revenue largely used during the war would be greatly restricted. It would hardly be wise, therefore, to exaggerate the amount of incomes and of savings which, after the war, might become available as a result of the reduction of fiscal charges and of diminished borrowing.

(B) Another basis, perhaps even more extensive than the former, for an *increase* in the demand for consumers' and producers' goods, might be found in the fact that, after the termination of hostilities, along with the gradual mitigation or elimination of the various rationing schemes and of prohibitions, there would be a diminution in the purchases of pictures, various objects of art and luxury goods, and that this would permit to divert the amounts used for such purchases to the acquisition of larger quantities of goods of general consumption, thus encouraging the expansion of productive activities, the creation of new real incomes and the re-absorption of the factors of production. Here, however, we are faced rather with a change in the demand — from luxury goods to necessities — permitting a larger employment of the factors of production in the manufacture of the latter, than with an effective *increase* in the

demand for *all* goods. Besides, the amounts involved can hardly be considered as sufficiently large to provoke an economic revival and to make up for the incomes lost as a result of the cessation of hostilities.

(C) From the economic point of view, the end of the war is generally characterized by a more or less far-reaching exhaustion of the stocks of consumers' goods, sometimes completely destroyed, and by the general dearth of commodities. The incomes derived from those productive activities which have survived the war are scarcely sufficient to keep going the production of the first necessities of life, such as bread, footwear, houses, etc., and of the goods complementary to these, serving in their production, or used as substitutes. Yet, in order to stimulate an *increase less urgently needed*, it is essential that independent individual production be in a position to distribute incomes *in excess* of those strictly needed for the satisfaction of the most urgent vital requirements, or that these incomes be *on the increase*, first as incomes of the producers and then as incomes of the owners of the various factors of production. Such a distribution of high or rising incomes, may only happen as a result of certain "favourable events" taking place in connection with the important branches of production, which would lead to an expansion in the volume of production, to a rise in the *profits* of the producers and to an increase in the *real incomes* of all those engaged in productive activities.

Thus, more even than during the war, after it the human mind will have to exercise itself in seeking to "create", as far as possible, the "events" which can favour the intensification of productive activities, as a necessary preliminary to a lasting economic recovery capable of re-absorbing the factors of production thrown out of work. As we shall explain in more detail elsewhere, in dealing with unemployment, by the cessation of hostilities only such "favourable events" — be they scientific discoveries applicable to agriculture and industry, technical improvements in the means of production and of transport, or the elimination of artificial barriers to international trade — capable of increasing the profits of the producers and of raising the real incomes of all those taking part in production in general, can pull the world out of the post-war depression.

(D) Finally, an important contribution to the increase of the demand for consumers' goods should come from the mass of *savings* accumulated already during the war and, though to a smaller extent, even after the

cessation of hostilities, by the possessors of incomes derived from independent individual productive activity and from that of the State. Here, however, in so far as the importance and the durability of action of this factor is concerned, a distinction should be made between the savings *which can be immediately used in the purchase* of consumers' or producers' goods, until they are finally exhausted, and which, therefore, contribute to this extent to the intensification of productive activities, on the one hand, and on the other hand, the savings which, on the repeal on the various prohibitions of production and consumption, may profitably be *invested* in productive activities and produce incomes amounting to, say, 50,000 for a million invested; within which limits the demand for consumers' and producers' goods may be increased in a more durable way and, in the long run, to a larger extent.

Indeed, in the former case the increase in demand, which depends only on the existing amount of savings tending to dwindle down gradually with the expenses, may be larger and may seem to give a greater stimulus to recovery, but when the savings are exhausted, there is a crisis in production, which has had only a temporary stimulation.

In the latter case, the immediate increase in the demand for commodities is certainly smaller, but as it is more durable and continuous, it can be reckoned upon with greater assurance to create durable incomes in substitution of those which had ceased on the termination of hostilities. Thus, the stable economic recovery is favoured more by the savings which can be invested and produce incomes, than by those employed in the direct purchase of commodities, even if they are very large.

11. — Recourse to the income of other countries by means of the exportation of " finished manufactures " and of factors of production.

Moreover, it should be pointed out that — in a situation characterized by the fact that the money and real incomes which had disappeared *cannot be made good* by new incomes, in which, besides, heavy government expenses have to be met, thus making heavy claims upon the relatively scarce incomes still available, on the termination of hostilities — the countries of the type just dealt with above, are forced to turn to foreign *incomes* and foreign *savings*.

As to foreign *incomes*, they may be drawn upon by any country if this prepares sufficient outlets for its exports. This permits to the industries working for export to increase their activity to a maximum, thus

absorbing a considerable part of the unemployment due to the cessation of production for war. In the meantime, the exports may extend not only to finished goods, but also to factors of production of which the country has an excess, compared with its own requirements: this excess may consist of amorphous masses of savings, of producers' goods, or of labour.

This is why the problem of *emigration of factors of production* — especially of labour — from the countries with dense population to those in which the population is relatively sparse, is fundamental in any attempt at world economic reconstruction. To permit that the factors of production in general, and labour in particular, flow there where they can be used to the best advantage, within the limits which every particular country may fix, considering its own special conditions, is merely a canon of good sense. It rests with the governments to put this canon in effect, may be gradually, step by step, as soon as they agree to collaborate in this sense. By means of international agreements the governments can regulate the quotas of workers to be admitted, the conditions of work and the rates of remuneration. One may even admit the possibility of a moderate levy being made on the workers which the country of origin might be ready to defray in its effort to find honest employment for its labour abroad. The proceeds of such levies might, in part, be used for the constitution of a fund of insurance against certain risks run by the emigrants in the country of immigration, in case the government of the latter should not arrive at some convention on this point with the country of origin of the worker. In part, these proceeds might be used to build up a fund which would enable the country of origin to acquire goods in the country of immigration or elsewhere. It is obvious that the details of such schemes may vary and may give ground to numerous combinations. Even if such a transfer of factors of production undoubtedly involves certain losses for the country of origin, it certainly represents, in the course of the period immediately following the war, a safety valve which the countries of the type dealt with above can hardly dispense with.

Evidently, what is needed for the intensification of the exchange of merchandise, services, capital and men, is the will, at least on the part of some countries, to do it. Accordingly, there must be agreements in respect of the *goods* to be exchanged and of the *means of payment*, in virtue of which every country will have to effect a revision of the various measures applied to the home market during the war.

The intensification of exchanges involves also the necessity of developing the *merchant marine* and the means of transport generally. Every country has to choose between assuming the burden of freights to pay to foreign ship-owners on the one hand, and that of subsidies which it may be considered worth while to grant to national shipping companies in case if the current freight rates on the international shipping market are not in themselves sufficiently high to encourage the construction of ships not only for the country's own use, but also for freighting to those who may be in need of means of rapid transportation at relatively modest rates, on the other hand. Government assistance is here desirable in all those cases, when it is necessary not only to reconstruct a merchant fleet which is needed for the development of commerce, but also to create, even if at a certain distance in time, a source of *revenue* in addition to those which have survived.

12. — The recourse to foreign savings by means of loans of which the proceeds are to be invested in activities of assuredly productive nature.

A country may obtain access to *foreign savings* by borrowing at low interest rates, with a view to strictly limiting the employment of the proceeds of such operations in the borrowing country in productive activities *to such advantage* as not only to meet the interests on the loans, as well as the amortization and insurance quotas, but to secure a *net profit* which would constitute an income in addition to those which serve to make good the incomes which had disappeared on the termination of hostilities.

There exists a whole literature on the *conditions* permitting the transfers of large masses of savings to be carried out between the lender and the borrower, on the *forms* which such transfers may take; on their *consequences*, beneficial or otherwise, for the parties concerned, and on the *guarantees* to be demanded and given (1). We cannot refer to these studies even briefly without digressing from our immediate task of merely indicating the general directions to be followed by all countries after a war in this domain, and the sources to which the State can reasonably have recourse in the financing of its activities. These stu-

(1) CABIATI, A. *Op. cit.*, pp. 32, 41, 64, 151-5, 172-9. See also the fifth study in the present volume.

dies show that it is possible to count upon the savings of foreigners for the creation of new incomes in the country *only* on condition that there exist among the peoples concerned much good faith and a readiness to co-operate. It is best if these feelings exist among all the peoples ; at the worst they must exist between some. And it is not so much human reasoning, as the incalculable extent of the destruction and losses caused by the war, that demand the restoration of economic solidarity among the peoples who want to learn something from its experience.

13. — Problems common to all the three categories of countries.

In this first report our object was to elucidate the concepts of *real* and of *money income*, aggregate and personal ; the principal *sources* from which the activities of the State are financed and the influence these sources exercise upon each other ; the modifications taking place in the *relative importance* of these different sources due to the transition from the state of peace to the state of war ; the most probable *bases* of demand for consumers' goods on the morrow of the war ; the principal possibilities which would present themselves for *expanding* these bases, on the assumption that all countries will be ready to exchange with others finished goods and factors of production. In this report we have deliberately dwelt on the more difficult case of those countries which have been forced to have recourse to specific inflation and have not been able to ensure that the money thus issued should close the circle by returning to the Treasury.

Notably *different*, in respect of the post-war problems, is the situation of those countries which, having escaped the effects of general and specific inflation, and having preserved the "circuit of capital" almost undisturbed, envisage a "smooth transition" from the state of war to the state of peace, on the only condition that the production of consumers' goods — especially those for which the process of production is brief, such as foodstuffs, or textiles, to be followed by that of goods with a longer cycle of production — be encouraged and rendered intensive and capable of availing itself of all the technical improvements and innovations discovered during the war. This would enable the surplus money income accumulated during the war to be absorbed (1).

(1) The difficulty of such a transition is not ignored by its advocates themselves. In our opinion, at least until the goods available for consumption become sufficiently abundant to be exchangeable for money superabundant at the beginning, at prices which will decrease gradually, attempts will have to be made to *ensure the circuit*, and many of the restrictions upon consumption, investments and home and foreign trade have to

Equally *different* is the situation of the countries which, having permitted specific inflation to exercise a certain influence upon prices, envisage an official devaluation of their currencies, or consider the possibility of concluding a series of agreements with other countries upon which long-term international economic relations might be based.

We are not going to discuss the particular plans proposed to this effect (1). But we may point out that all the countries have one problem *in common*: that of *making good* the disappearance of certain

be maintained after the cessation of hostilities. It is one thing to demobilize gradually, and quite another thing to preserve, with a view to rendering the operations easier, certain restrictions upon individual activities, for a period determined by the rapidity with which the production of commodities for consumption is restored. This helps also to deal with the uncertainties inherent in a process of deflation, which after the preceding great war all the countries wanted to avoid in view of the uncertainty as to the level of prices which should be attained as a result of the process of producing goods intended to absorb the surplus money in circulation, as well as of the date at which the equilibrium which it was sought to achieve between the commodities available for consumption on the one hand, and the masses of money, on the other hand, might be established. As a matter of fact, the real beneficiaries of deflation should be the possessors of fixed incomes. Yet, unless the whole operation is carried out by the State at its own expense, one can hardly imagine how the individual enterprises would be able to get on, with the prices of their products declining continually, without financial assistance from the government. In the latter case, however, the disproportion between the commodities available for consumption, on the one hand, and the masses of money in circulation, on the other hand, would tend to reproduce itself.

The restoration of equilibrium between the mass of money in circulation and the quantity of goods for consumption is also delayed when the State has recourse to public works or to internal colonization for the absorption of the unemployed, or when the banks are too liberal in their advances to the industries working for the recovery. In this case, the quantity of commodities available for consumption is only increased slightly and indirectly. The "smooth transition" may work in a single country, but as soon as this comes into contact with the world outside, its money becomes liable to depreciation in terms of foreign currency, and this cannot fail to affect the prices of consumers' goods within the country, thus neutralizing the effects of deflationary measures. For some time there may, indeed, be a certain expansion of exports; but if this happens, it does, on the one hand, postpone the adjustment between the mass of money and the quantity of commodities on the market which is necessary to achieve the intended lowering of the price level; on the other hand, it has the effect of compelling other countries to take measures of self-defence against exchange dumping, re-imposing import duties, closing the frontiers, etc., thus reviving the motives for other international conflicts.

(1) Even in the case of the plans of KEYNES, SCHUMACHER and MORGENTHAU-WHITE the little information available at the present does not permit any serious investigations to be made. In all these cases one has to do with problems of more restricted scope, which have to be adjusted to the general principles exposed above.

Apart from criticisms of detail — some of which may be found expounded with skill in *The Economist* of May 1st 1943, article on "Currency Plans", the reader is referred to PREDNÖL, A.: "Die angelsächsischen Währungspläne und die europäische Währungsordnung", *Weltw. Archiv*, July 1943; COPPOLA D'ANNA, F.: "Progetti e discussioni sull'ordinamento monetario post-bellico", *Rivista di Politica Economica*, April 1943; FEDERICI, L.: "Due piani di organizzazione monetaria per il dopoguerra", *Rivista Bancaria*, June 1943 — the plan of Keynes envisages the financing of international trade and the stabilization of the rates of exchange even on the hypothesis that the present trade barriers erected by the different countries should remain.

incomes and savings with others sufficient to take their place. *Common* also is the *diminution* in the possibilities of finding the wherewithal to finance the activities of the State, which may reasonably be resorted to. *Common*, as well, is the necessity to *increase* the incomes and the savings by means of a larger and more rapid production of goods for consumption. This object will be the more easily achieved, the sooner a serious attempt will be made to do away with the plethora of privileged corporations, monopolies, combinations, etc., whose number has lately reached surprising figures in all countries (1).

Only after having cleared up all these basic notions concerning the state of the different countries on the cessation of hostilities, as well as the general problem of outstanding urgency and importance, we are in a position to pass to the examination of the problems bearing upon the particular sectors of the life of the nations: agriculture, industry and commerce. Only if the solution of these particular problems is fitted closely into the framework of that of the general problems arising out of the termination of the war, it will be possible to avoid contradictory orientations, a wrong employment of the productive forces, the failure to produce those commodities of which the world stands so badly in need: and that not for the immediate future only, but for an indefinitely long future period. This necessitates, on the part of the peoples and of those who rule them, a solid knowledge of the results of their actions.

From the purely technical point of view, which in all the plans attains a high level of ingenuity, this might even appear generous. It is doubtful, however, that a large expansion of trade may take place unless the countries concerned do away with all the barriers, regulations and prohibitions and insure, in agreement with other countries, all the conditions necessary for the disposal of its products, and, consequently, for the development of its productive activity, thus achieving the conditions of its own equilibrium (which is also a necessary preliminary condition of equilibrium in international relations), of which monetary technique may then insure the suitable crowning. It can never serve as a starting point for its successful and durable establishment.

In other words, irrespectively of the ingenuity with which the monetary plans may be devised and operated, the probability of their successful realization can be increased only on condition that every country, in co-operation with the others, re-establishes its own balance, thus ensuring the stability of the purchasing power of its currency both at home and abroad.

Among these conditions the one absolutely indispensable is the freedom of international movements of finished goods, and of means of production, of men and of capitals.

(1) The painstaking and valuable study of SCAGNETTI G.,: "Gli enti di privilegio nell'economia corporativa italiana", Padova, 1942, which makes a distinction between the various forms of State intervention in economic life, strikes the reader by the extreme abundance of *consorzi*, of organs of control and of encouragement, of mixed concerns, of enterprises under direct management and of organizations enjoying in a greater or lesser extent the position of semi-State corporations.

14. — The passage to the problems bearing on particular sectors of the national economy, such as agriculture.

In the complex of economic activities which all countries will have to face on the morrow of the war, agriculture certainly occupies a prominent place; and the study of the existing plans of reconstruction, even admitting that these have so far been formulated but vaguely, suggests different ways of approaching the solution of the problems arising in this field. Naturally, every country is free to solve the problems of the proportions and of the limits of each of the various *sectors* of its economy, as well as those particular problems which present themselves in each of these sectors. There is, however, one observation to make, without any bias in favour of some particular solution. A vigorous development of the productive forces of the land, which will be called upon to contribute to its utmost to the cure of the numerous wounds caused by the war, is only possible on condition that land is more advantageously combined with the other factors of production, making full use of recent technical progress.

This means supplying *capital* to those who, in possession of labour and of land, stand in need of capital to employ then to the best advantage and to carry out important works of land reclamation and improvement which would be sure to pay and to increase the value of the country's territory; supplying *labour* to those who possess land and capital in order to ensure an increase in production to the general advantage of all the world; coming to realize that when, with a view to some immediate advantage or for the sake of some sectional interests, there is an artificial encouragement of certain branches of production for the benefit of a particular group of the agricultural population, this always turns in the end against those very groups which it was sought to protect. These, in a general outline, are the indications pointing to the path to be followed in seeking to ensure security and progress to agriculture on the morrow of the war.

Obviously, in all countries there may be the possibility of intermediate solutions pursuing objects *different* from those of maximum output. But even in such cases the economic situation of the country should never be lost sight of, and should be considered as marking the highway which leads to certain recovery. If this highway cannot always be followed strictly without deviations, the security which it presents shall always serve to determine the extent of permissible *deviations* when these are

imposed by unavoidable circumstances, to be tolerated only so long as these circumstances persist.

It is in the light of these elementary observations that all the problems bearing upon agriculture should be considered on the morrow of the war, including that of nutrition, so much discussed under the urgent pressure of need in these times which focus the attention of most countries upon the complexity and the fundamental importance of this problem.

Appendix

THE DIFFERENT INTERPRETATIONS OF THE CONCEPT OF INCOME

Our concept of income and the methods serving to measure *directly* its amount *coincides* in the end with the conceptions applied in the study of concrete problems.

I. In the course of the last few years it has become customary in England, in presenting the draft Budget estimates, to annex to the bill a great mass of information concerning the economic situation of the country, contained in a separate "White Paper" which comprises two sections, closely related to each other: the one dealing with the "sources for the financing of the war", and the other with "national income and expenditure." In this document the concept of income and the method used to ascertain it, are *indirect*. In other words, they start from the "expenditure", either individual or national. "In wartime — says the *Economist* of April 17, 1943, — all expenditure — that is, all forms of consuming labour and materials — can be divided into the two heads of personal expenditure on consumption and Government expenditure". The latter for very proper reasons, cannot be further sub-divided, but this year it is possible, for the first time, to sub-divide the total of expenditure on consumption. In summary form, the figures for the last three complete calendar years are as follows:

	1940	1941	1942
	(in million pounds)		
Personal expenditure on consumption: food, drink and tobacco	1,852	2,010	2,232
Rent, rates, water, fuel, light and household goods . . .	985	995	1,003
Clothing	496	450	462
Travel	185	202	215
Other services	461	469	465
Other goods	303	383	423
TOTAL	4,282	4,509	4,800
Government expenditure on goods and services	3,059	4,194	4,608
Total expenditure on goods and services	7,341	8,703	9,408

Where did these goods and services come from? The first and most obvious source is the production of the community. This can be *measured* by the sums of money paid out to the people in the course of producing the years' output.

It might be instructive to follow the computation of the income thus conceived, as it is made in the document. In the concept of income as the sum of the remunerations of the factors of production no distinction is made between income and savings, even if the expenditure is met out of these latter. If, then, it becomes necessary to consider the national income thus conceived not at *cost* prices, but in terms of the *prices current on the market*, there must be *added* to the sum of the remunerations of the factors of production the amount of indirect taxes which, being easily transferable, enter into the prices of all products, raising them accordingly. As it is said, the price of a bottle of whisky always includes the amount of the duty. (Really *all* taxes, whatever

the régime under which they are levied — competitive or monopolistic as it might be — are always transferred, in the end, by raising the prices of the goods or services in whose production human activity is employed. It would therefore be more logical to add to the sum of the remunerations of the factors of production the aggregate amount of direct taxation as well. The discussion of this point, however, would lead us too far away from our subject). In spite of the addition of the said amount of indirect taxes, if part of the expenses in consumption cannot be met out of the money income distributed in the community — interests, rents, wages, profits — the *balance* has to be met by *drawing upon capital*, either at home or abroad.

The amounts available from the sources indicated above for meeting the expenditure, individual and national, appear to be as follows :

	1940	1941	1942
	(in million pounds)		
Rent, etc.	389	385	384
Profits and interest	1,624	1,926	2,183
Salaries, etc.	1,288	1,338	1,408
Wages, etc.	2,425	2,970	3,409
Net national income at factor cost.	5,726	6,619	7,384
Indirect taxes, etc. less subsidies	837	1,087	1,219
Net national income at market price	6,563	7,706	8,603
Drafts on capital { domestic	22	200	173
{ external	756	797	632
Total available resources at market price.	7,341	8,703	9,408

The White Paper speaks of the "net" national income, the latter being computed after deduction of the costs of maintenance and of the amortization charges. Unfortunately, the gaps in official information do not permit the amount of such expenses to be exactly calculated. An approximate estimate gives the sum of 475 million pounds. This further addition permits to express the income, given as "net" to be expressed in terms of gross income, thus covering *all* the aggregate expenditure of the years 1938 and 1942.

INCOME			EXPENDITURE		
	1938	1942		1938	1942
	(in million pounds)			(in million pounds)	
Net national income at factor cost	4,490	7,384	Expenditure on :		
Indirect taxes less subsidies	622	1,219	Consumption	4,035	4,800
Net national income at market price	5,112	8,603	Government	845	4,608
Depreciation, etc. funds (475) (475)			Maintenance and increase of domestic capital	(762)	(302)
Gross national income at market price	5,587	9,078	TOTAL	5,642	9,710

In this table also, like in the preceding one, the *difference* between the totals on the credit and on the debt side, amounting to 55 million pounds in 1938 and to 632 million pounds in 1942, represents the extent of the consumption of capital exported abroad

II. As we have noticed, the concept of income, as envisaged in the White Paper, does not take into account the "source" represented by savings. On the other hand, the document considers the consumption of capital; it does not envisage the eventuality of inflation. The comparison between the figures for 1938 and those for 1942 can only be conclusive on condition that no changes in prices have happened in between. If, instead, any rise in prices is admitted, the figures which express *real* quantities, must be reduced to terms of uniform purchasing power. The author of the article in *The Economist* (p. 519) postulates a rise of 30 per cent. in the prices in 1942, 25 per cent. in 1941 and of 15 per cent. in 1940: percentages which are no more than an approximation. No real comparison is, indeed, possible, unless the figures for the following years are reduced to those of 1938, a correction thus being introduced for the changes in purchasing power.

In practice, the *real* income of a country can be calculated by dividing the *money* income by the *index number* of the general level of prices. On the other hand, real income can also be measured by means of the *index of production*. In such a calculation, the prices are used as weights, and it remains to decide as to the year for which the prices should be used in weighting. The variations in real income depend upon the prices people attribute to different goods at different epochs (BOWLEY, A. L.: "National Income in America and the United Kingdom", *Economica*, August 1942).

Now, our conception of the aggregate money income as the sum of the products of the multiplication of the quantities of the different goods by their respective prices also implies that all the productive activity is measured by the sum of the remunerations of the various factors, including the *entrepreneur*. But, making a clear distinction between income and savings; considering directly the consumption of capital; considering separately the phenomenon of inflation, this conception would appear better suited for the investigations with which we are concerned and which distinguish between the *income* of a country, on the one hand, and the *amounts available* to the State from different sources, on the other hand.

III. Whichever of the conceptions of income be adopted, if — as in the case of the White Paper — one disposes also of data concerning the aggregate amount of private *consumption*, the *expenditure* of the State and the *consumption* of capital, both at home and abroad, and if it is assumed that there is no inflation, or that it is insignificant, as this would appear from the fact that the rise in prices is exclusively attributed to increased production under conditions of restricted supply of factors of production, it becomes possible to see the changes that took place in this respect in the course of time and to learn what are the *real* "sources" — not only financial — from which the community draws the means for the prosecution of the war.

	1938	1940	1941	1942 (1)
	(millions of pounds of 1938 purchasing power)			
1. Consumption	4,035	3,551	3,408	3,408
2. Government expenditure	845	2,660	3,355	3,545
3. Maintenance and increase of domestic capital.	762	395	220	232
4. Overseas disinvestment	— 55	— 658	— 638	485
5. Gross national income	5,587	5,948	6,345	6,700

In terms of 1938 purchasing power, Government expenditure had increased from 845 million pounds in that year to 3,545 million pounds in 1942. The increase

(1) 1942 was the first complete year in which Lend-Lease was in operation: this has the effect of making both Government expenditure and overseas disinvestment *less* than they would otherwise be.

can reasonably be considered as representing the cost of the war of the year 1942, which is covered out of the following real sources :

	(millions of 1938 pounds)
Cost of the war in 1942 (increase in item 2)	2,700
Derived from :	
Increased production (increase in 5)	1,113
Reduced consumption (fall in 1)	627
Reduced provision for domestic capital (fall in 3)	530
Overseas disinvestment (change in 4)	430
TOTAL	2,700

On the proportions in which the community has recourse to each of the different sources from which the *real* means for financing the war are obtained, depends the extent of reduction suffered by the savings accumulated by past generations, by the capital equipment which existed at the beginning of war preparations, of the cultural and artistic treasures of the country. The more this diminution is grave, the more complicated are bound to prove the problems of the return from the state of war to that of peace.

IV. The above explanations permit us more easily to understand some of the recent definitions of total, real and money income.

SIMON KUZNETS ("National Income and its Composition 1919-1933", National Bureau of Economic Research, New-York, 1941, 2 vol., quoted by BOWLEY ("National Income in America and the United Kingdom", *Economica*, August 1942), gives the following definition: "National income... is the net value of the services which individuals and their property contribute to the production of economic goods; or the value of the commodities and services produced by the country's economic system minus the costs of the commodities (raw materials and capital equipment) and of services of enterprises consumed in the production process". It may also be described as "the sum of all payments by enterprises to individuals... and of the savings of enterprises after all costs and disbursements sustained in the production process have been deducted."

COLIN CLARK ("National Income and Outlay") says: "Income from an industry's surplus of proceeds over purchases, plus increment of stock, valued at the average current prices over the period."

According to BOWLEY (*Ibidem*, p. 236): "The change in the value of stock is separated into change due to quantities and change due to price... It can be argued that part of the stock can be sold at the current price and the receipts raised as income, so that

$$\begin{aligned} X &= p_1 q_1 - p_0 q_0 = (q_1 - q_0) p + q_1 (p_1 - p) + q_0 (p - p_0) \\ &= \frac{1}{2} (q_1 - q_0) (p_0 + p_1) + \frac{1}{2} (q_1 + q_0) (p_1 - p_0) \end{aligned}$$

— the first term is measurement of the change due to increase of quantity; the second of that due to an increase in price — gives the right formula. In fact there is no change in value of fixed or working capital and income; it is a matter of convenience and definition. In a balance sheet that sets on the receipt side income and on the expenditure side consumption and savings, any variant of the distinction can be raised and the total still equal each other". This is the system adopted in the White Paper in balancing income and consumption, with the only difference that, here, to consumption are added the savings.

II.

THE NUTRITION PROBLEM

II.

THE NUTRITION PROBLEM

SUMMARY

PART I: REFERENCE TO STUDIES MADE BY THE INTERNATIONAL INSTITUTE OF AGRICULTURE. — Review of the contributions made by the International Institute of Agriculture to the study of the complex problem in the field of statistical, technical and economic enquiries.

PART II: ECONOMIC ASPECTS OF THE NUTRITION PROBLEM. — After noting the permanent nature of the problem in the post-war period, the lines along which further enquiries may be made are defined. With special reference to economic enquiries attention is called to the fact that the possibility of assuring sufficient nutrition to all classes of a community presupposes as an indispensable condition an adequate supply of agricultural products — in substance, an adequate production of real income. A search for the most suitable means for providing it in such amounts as will assure the lowest price for the several products is the first step towards the solution of the problem of securing food in quantities « sufficient for all ». These means — with the costs referring thereto — are supplied by foreign imports and improvements in the methods of production.

Other means may, undoubtedly, be tried: incomes may be raised by various means, political prices may be fixed, assistance may be given to certain groups of producers. But if these measures are not accompanied by a more copious supply of agricultural products they will never be able to assure sufficient food for all classes of a community. If they are beneficial to some they will be injurious to others. And even the advantages secured to the privileged classes will sooner or later be neutralised by price rises reflecting not only the inelasticity of the supply of foodstuffs but also the heavier burden of taxation which provides the means for favouring now one now another group of citizens.

In our last study, which deals with the cost and useful results of the various interventions of the public authorities, we shall outline still vaster problems of a scope so wide as to involve all branches of government activity.

PART I

REFERENCE TO STUDIES MADE BY THE INTERNATIONAL INSTITUTE OF AGRICULTURE

1. — Introduction.

In a very detailed report submitted to the XIVth General Assembly of the Institute Mr. J.J.L. van Rijn, Delegate of the Netherlands and of the Dutch East Indies and Vice-President of the Institute, has already given an account of all the circumstances which, since the XVIth General Assembly of the League of Nations in September, 1933, gave rise to a "Joint Committee on Nutrition Problems". Members of the technical commission of the Health Committee of the League of Nations, delegates of the International Labour Office, Delegates of the International Institute of Agriculture, and experts on agriculture, hygiene, and economics were invited to sit on that Committee.

During the following year, and precisely in September, 1936, the Joint Committee, availing itself of many studies of which several were prepared by the International Institute of Agriculture, submitted to the VIIth General Assembly of the League a report dealing chiefly with the interdependence of nutrition and public health. This report also contained brief but valuable studies on the economic aspects of the problem and concluded with the express reservation that this matter would be studied more thoroughly. In fulfilment of this undertaking, and while the Joint Committee was pursuing its studies on the economic aspects of the nutrition problem, a report to the XIIIth General Assembly of the International Institute of Agriculture recalled the need of securing a more scientific dietary for all classes of the population and called attention to some of the consequences for agricultural production of certain discoveries made by the science of hygiene.

In April, 1937, at Geneva, during the third and last session of the Joint Committee, whose agenda included the examination of economic questions in their relation to agriculture, the delegation of the International Institute of Agriculture, prompted by the debates which had

taken place at its XIIIth General Assembly, intervened in defence of the interests of the farmers, threatened by a mistaken interpretation of certain advances made by science in the fields of health and nutrition.

2. — Statistical studies.

The contribution made by the International Institute of Agriculture to the statistical side of these enquiries deserves special mention.

(A) Any policy which aims at assuring a rational diet for the nations must start by acquiring an accurate knowledge of the present situation of production and consumption of the various foodstuffs in the several countries. The basis for this knowledge can only be given by accurate and detailed agricultural statistics.

Thanks to the assiduous work performed since its foundation by the International Institute of Agriculture in assembling and collating such data, statistical returns relating to a great number of farm products have progressively improved and embrace an ever larger part of the world.

The information periodically assembled by the Institute has thus already made it possible to know for several products and with sufficient approximation to the truth, the total quantities produced and available for human consumption and the measure in which the several countries participate in their consumption.

(B) The basic data thus placed at the disposal of Governments and students were made great use of in the work of the Joint Committee on Nutrition Problems, as also for the studies made in this field by the International Labour Office. At the request of the latter, the Institute prepared the chapter on the statistics of agricultural production and food consumption published by that Office in the volume, "The dietary régime of the workers and social policy".

(C) One of the meetings of the Joint Committee on Nutrition in which the Institute took a specially active part, also directed the attention of the statistical service of the Institute to certain special studies and problems whose importance was emphasised at the meetings of the said Committee. On its initiative, acting in concert with the Institute, a subcommittee on Food Statistics met in Rome in March, 1936. It presented a series of requests to the Institute which can be summed up under the following heads :

(a) to supply information on the consumption of cereals, sugar, meat, milk and other dairy products, poultry and eggs, fresh vegetables and fruit ;

(b) to indicate, as far as possible, the trends of production, consumption, and prices of these products in those countries for which sufficiently complete data are available ;

(c) to obtain from the municipalities data on the deliveries of milk and fresh vegetables in some large cities and to use them for completing the information mentioned under (a) and (b) ;

(d) to pursue these efforts systematically with a view to improving agricultural statistics and supplementing the insufficient data now available on protective foods, and to draw the attention of the several Governments to those special points on which improvements are desirable

(e) to collect data on the financial aspects of the assistance enjoyed by agriculture in the several countries and on the effects of this assistance on the production, importation and exportation of foodstuffs ;

(f) to collect and study the wholesale and retail prices more especially of protective foods, and show the relations between these prices and the trends of production and consumption in the several countries.

(D) To give prompt satisfaction to enquiries (a) (b) (c) and (f): the International Institute of Agriculture prepared a special publication which appeared in Vol. IV of the collection of documents presented to the second session (June 1936) of the Joint Committee on Nutrition Problems. This work contained first of all a series of estimates on the production and consumption of products of special interest to the Joint Committee (milk and dairy products, butter and cheese, meat eggs and poultry, fruit and vegetables, cereals, sugar). The summary of the statistical information available on this matter was accompanied by a statement pointing out the defects in the available data and the direction which the future statistical enquiries of the Governments and the Institute might take. Several series of index numbers of wholesale and retail prices for some protective and other foods followed, and notes on the measures taken for giving financial assistance to agriculture in a number of countries.

(E) As regards point (d) of the recommendation of the sub-committee, the Institute realised that to bring the extensive work contemplated to a successful conclusion it was advisable to proceed by stages, making a

series of thorough studies for each of the groups of products taken into consideration, with the assistance in each case of specialised experts.

In the first place it devoted its attention to the study of the statistics for vegetables and fruit. A detailed documentary record was prepared on the statistical data then available in the several countries and on the methods used in their compilation. The material thus collected was published in October, 1938 in the volume "Vegetable and Fruit Statistics". The examination of the statistical services in each country is preceded by some general remarks on the nature of these statistics and on the special problems related thereto, and a final chapter contains the general conclusions and some recommendations of a general character for their improvement and unification.

(F) Following the publication of this volume the Institute called a meeting of the International Committee for Horticultural Statistics which met in Rome in December 1938. Special experts were sent as delegates by the following countries : Czechoslovakia, France, Germany, Italy, the Netherlands, the United Kingdom, the United States. After examining the several methodological and scientific problems relating to the statistics of vegetables and fruit, the Commission made a series of recommendations for their improvement and unification. The report summarising these recommendations was communicated by the Institute to the Governments of all countries.

It was the intention of the Institute to proceed on similar lines with the study of other statistics of special interest for nutrition problems, such as those for milk and dairy products and meat. But the difficulties of the international political situation have compelled it to postpone these studies.

3. — Scientific enquiries.

The problem of nutrition involves several questions of a scientific character for the solution of which international collaboration would be of the greatest value.

(A) For securing current information on the quantity and quality of the food products consumed the International Institute of Agriculture had prepared some suggestions for nutrition enquiries. But the rules followed in making the enquiries have not always been uniform and the classification adopted has often been based on the personal views of the

writers to whom the work was entrusted. The absence of uniform methods and in some cases the fact that the work was not done by experts, account for the fact that positive results were not always secured.

It would be advisable to have dietary tables prepared in each country showing for the several foodstuffs, their average content of calories, proteins, fats, carbohydrates, vitamins and mineral salts; the approximate number of the analyses made for establishing the figures; differences as compared to average composition; seasonal influences and those exercised by the various methods of cultivation. These tables should be drawn up by standardised methods adopted by all the countries.

Special importance should therefore be attached to the future standardisation of such efforts.

(B) War conditions have led the International Institute of Agriculture to pay special attention to the quality of the raw materials used for human nutrition, and in the first place to the quality of bread.

Bread, the staple food *par excellence*, is often of poor quality; it is often adulterated by the various methods of milling and baking. Consumers have to accept it as it is and to suffer the consequences.

The "Monthly Bulletin of Agricultural Science and Practice" has published general remarks on the factors determining the quality of bread, specifying the component ingredients which should be contained in its chemical composition, its digestibility, and the extent to which it is assimilable by the human organism.

The question of the bolting of wholemeal flour, which contains larger quantities of nitrogenous matter, mineral salts and vitamins, has also been examined. Serious criticisms have been made from the health standpoint of the processes used in the baking industry. At the present time, attention should be called to all mistakes in nutrition which react on the health of the people.

(C) An unbalanced dietary may, in the long run, by acting always in one direction, lead to organic troubles, rendering people specially susceptible to general diseases and debility, leading to serious diseases differing according to disequilibrium. Unbalanced diets are generally associated with malnutrition and shortage of calories. It was therefore a matter of prime importance to give information on the possibility of supplying well-balanced dietaries with the foods available. This balance can, in practice, be secured in various ways.

The scientific service of the Institute has published articles on the progress of the science of vitaminology. They show that the lack of vitamins (protective foods) may in a relatively short time cause very serious organic troubles, whereas a lack of calories, if not too pronounced, will not lead to such results.

Therefore, special attention should be paid to securing "protective" foods, as their insufficiency is not perceived as readily as is that of the energy-yielding foods. The absence or insufficiency of vitamins in a dietary leads to organic troubles known as avitaminosis, previtaminosis and hypovitaminosis.

(D) War is the great creator and revealer of these troubles. The restrictions it places on the choice of foods naturally rich in vitamins which are the surest guarantee of the physiological fitness of the individual; the very limited use of fats and consequently of the lipo-soluble vitamins; the relatively heavier consumption of various substitutes and of canned foods frequently prepared in a way which does not secure their vitamin content; the high prices ruling for some essential foods, which weigh heavily on the meagre resources of a large part of the population, all these consequences of war lead undoubtedly to a deficiency of vitamins and consequently to various pathological conditions.

The quantity of vitamins supplied today, under existing food restrictions, cannot suffice. The human organism requires larger quantities of certain foods and very often it no longer succeeds in assimilating those with which it has to be satisfied.

Therefore, under these conditions it becomes necessary to supply some groups of the population with vitamins in a pure or concentrated form. Efforts at the preparation of foodstuffs with a high vitaminic content may do much to protect health and to preserve the community from the many dangers threatening it.

The supervision of the vitamin content of foodstuffs and canned foods and the suppression of food adulteration is becoming more and more indispensable in many countries and, in our opinion, should be regulated by new international laws and conventions.

(E) The distribution of vitamins among plants and the choice and development of new crops raise questions of great practical importance. Among them is that of ascertaining the degree in which the vitamin content of plants varies with the different factors affecting their

growth such as the fertilisers used (natural or chemical), soil reaction, selection, etc.

Generally speaking, the vitamin content of animal foods may be affected very decisively by the forage fed to stock. It is thus possible, without modifying the food habits of a people, to supply the vitamins required for a well balanced dietary by modifying stockfeeds. Any deficiency in vitamins may thus be compensated.

The Institute has not failed to call attention to *Recent observations on remedies which can be applied in the case of the serious deficiencies in the lime, phosphate, iron, iodine, etc. content of the present food régime*, and has suggested the urgent need of supplementing deficient dietaries. It may in some cases be easier to take such measures than to secure supplies of milk or other valuable foods. The great insufficiency of the supplies of lime and phosphates in certain countries has not hitherto been realised. It is essential that these mineral salts should always form part of the daily dietary. If something is to be done to avert a danger, which in many countries grows more serious under present conditions, supplies of tri-calcic phosphates and various organic preparations of calcium should be prepared as soon as possible.

It is to be hoped that simple and rapid measures will be taken, as a much more serious decline in public health may arise at a rate which will progressively increase.

The Institute has also called attention to the chief sources of foods heretofore more or less neglected and to the possibility of using waste and residual products in conformity with physiological needs. It would undoubtedly be possible to secure a more rational and intensive use of such materials during this period of exceptional food scarcity.

(F) In planning its work, the International Institute of Agriculture has made a special study of the *problem of improving the dietary of the small farmers* who account for the great majority of workers engaged in agriculture.

The improved nutrition of the country people is an essential condition for agricultural progress and exercises a marked influence on production. Changes in the dietary of the peasantry of several countries may react very sensibly on the world market for staple foods leading to an increased demand for several foodstuffs.

Efforts directed towards improving the dietary of the peasantry are indeed beset with difficulties and the methods used may vary with the

special conditions prevailing in each country but the solution of this problem should be considered in its practical aspects and should lead to a general effort carried out by international action.

Two main difficulties are met with in studying the dietary of the agricultural population :

- (1) that of ascertaining existing conditions ;
- (2) that of applying modern physiological and biochemical knowledge to their improvement.

Generally speaking, it may be said that the peasantry are very badly nourished. Almost everywhere their standard of living is insufficient and below the average for the country. This has a pernicious influence on their health, intelligence, and working capacity and on the demographic situation of their respective countries.

In establishing rational dietaries the several types of dietary should be studied. The measures taken in the several countries for improving nutrition are many, but they are insufficient in the case of the peasantry. The solution of this age-long problem will call for a very great and general effort on the part of all agricultural institutions.

(G) Another subject studied by the Institute is that of the better use of labour on the farm. The question of using agricultural labour to the best advantage is of world-wide importance. When insufficiently nourished the body first consumes its reserves, and then its labour power declines. When once the right balance is lost, the consequences become of increasing gravity as time passes.

Is there a definite minimum of nutrition below which health and labour yield are endangered ? Is it possible to live and work for long on reduced rations ? These are the most urgent questions whose solution demands enlightened government action.

Nervous balance and muscular yield are closely connected with the state of nutrition. Present working conditions demand of the individual an intense effort which exceeds his psycho-physical reserves. Unfortunately, the rules governing rational and economic activity are no longer respected. Fatigue becomes chronic and its effects accumulate ; it ceases to be an individual and becomes a collective phenomenon. Nervous troubles are becoming more and more frequent. What are the causes of the great spread in recent years of nervous trouble in country districts, troubles which had hitherto been considered as exclusively urban ? Evidently they have no specific connection with the country-side.

(H) *The problems of unemployment and malnutrition may acquire after the war considerable importance.* The means which will help in the future to provide food-relief for the unemployed should be the subject of a thorough study with a view to finding practical conclusions which will be of the greatest importance to all countries.

The first task to be undertaken when the war comes to an end will be that of preventing a famine. All measures taken should aim at utilising without delay all the human and material resources available for re-starting production and for assuring the fullest use of all existing food-stuffs and their substitutes.

For the purposes of reconstruction it would be useful to set up:

- (1) International Victualling Committees for distributing foodstuffs among the several countries in conformity with their respective needs;
- (2) National Nutrition Committees of an advisory character, composed of experts on nutrition, public health and economics;
- (3) Scientific Committees on Nutrition which should endeavour to lay down definite rules for assuring adequate standards of nutrition.

It may seem superfluous to insist on the need of steady co-operation, both national and international, between the research and other organisations interested in nutrition problems. As part of its general effort the International Institute of Agriculture is devoting special attention to the problems raised by under-nutrition. It is to be hoped therefore that it will be possible to secure increasingly active international collaboration in co-ordinating, pursuing, and developing these essential enquiries.

4. — Economic enquiries.

In the field of nutrition the International Institute of Agriculture, acting on the recommendations of the Joint Committee on Nutrition Problems and in conformity with the resolutions passed by the Permanent Committee, is studying the following questions:

(A) *The consumption of meat in the several countries.* — A study on meat consumption appeared in 1937 in the December issue of the "International Review of Agriculture", being a first attempt at examining the problem from an international standpoint. This study is based on the statistics of consumption for 21 countries in different parts of the world and on the budgets of worker families in 23 countries. Starting with a brief review of the causes leading to the increased consumption of meat

during the XIXth century, the article enquires into the present status of consumption in the several parts of the world and the prospects for future development.

(B) *The dietary régime of the peoples of the Far East.* — The debates which took place in the Joint Committee on Nutrition and at other international meetings often emphasised the importance for the agricultural exporting countries of the New World of a further improvement in the dietary régime of the countries of the Far East. The dense population of those countries and the very low standard of living and food consumption which characterises them is such that even a modest improvement in their consumption would undoubtedly have very important results for the world market of wheat and other cereals for which the exporting countries cannot always find adequate outlets. The International Institute of Agriculture has therefore stressed the importance of studies on present developments and trends in the dietary régimes of those countries. In response to wishes expressed, the Institute has published some studies on the subject. The first, published in 1938 in the September issue of the "International Review of Agriculture", entitled "The Dietary of the Peoples of the Far East", notes the salient features characterising their dietary and distinguishing it from that of the white peoples, thus giving the reader the general notions required for a study of the question in the several countries. The second article, published in the same Review in August 1939, is entitled "The Dietary Régime of the Chinese People". This study based on family-budgets and nutrition enquiries, shows the present status of nutrition of the Chinese and the possibilities for its improvement. Materials have also been collected for Japan, British India, and some other Oriental countries. Unfortunately the alterations which the war has required in the plan of work have hindered the continuation of these studies.

(C) *The spread between the prices received by producers and those paid by consumers for foodstuffs.* — As the consumption of the great majority of the population is fundamentally determined by their purchasing power which varies on the one hand in function of available income and on the other of the prices charged for products bought on the market, it is evident that the relation between these prices and those paid to producers is a matter of prime economic and social importance. It would indeed be useless to wish for an improved dietary if retail prices

were to remain so high as to reduce demand below what is necessary to meet essential needs.

Both for the farmers, whose interest it is that producers should not suffer the consequences of excessive demands of the middleman, and for consumers this is a much debated question, discussed so far however without the help of statistical data which would allow of judging the fairness of some of the statements made. In response to recommendations made by the Joint Committee, the Institute has undertaken to collect data on this matter for a certain number of countries and to publish the results.

This has led to the preparation of the Report "*Investigations into the spread between producers' and consumers' prices for certain foodstuffs*", drawn up on the basis of material already contained in the publications of the several countries and of studies made, at the request of the Institute, by some countries which do not yet possess statistics on these matters.

The report contains studies on 12 countries : Austria, Canada, Denmark, Finland, France, Germany, the Netherlands, Norway, Poland, United Kingdom, United States, and Switzerland. Six of these countries (Austria, Denmark, Finland, Norway, the Netherlands, and Poland) supplied the Institute with special studies made in response to its enquiries ; for the others the data contained in publications already issued have been used. These studies form Part II of the Report under consideration.

Part I of the Report is entitled "Distribution Costs and Consumers' Prices" and contains an account of the chief conclusions to which the study of the material assembled and published in Part II has led. Apart from a brief introduction, Part I contains some chapters dealing with the "The normal structure of distribution costs", "Factors leading to excessive distribution costs and margins" and lastly "Methods for reducing distribution costs".

PART II
ECONOMIC ASPECTS OF THE NUTRITION PROBLEM

5. — The nature of the problem.

The problem of securing adequate — *i.e.*, not only sufficient but also cheaper — food supplies for all classes of the population is no new one and presents itself for consideration as an aggregate of problems the solution of each of which depends on that of several others.

Both in poor countries agriculturally and industrially backward, and in rich and industrially powerful countries, in periods of depression and in periods of prosperity, not all classes of the population are able to nourish themselves so as to satisfy the essential needs of the human body. Even in peace time this situation has many consequences — physiological, social and economic — adversely affecting the combination of the factors of production, and political consequences productive of a whole series of reactions. All these consequences increase in number and importance during the more or less lengthy parentheses of war and its aftermath, and therefore call for a thorough study in view of the effort which will be required of all Governments desirous of avoiding evils which in some cases might be of incalculable gravity.

In its sad reality, the conduct of a war — in view of the monetary aspects of the phenomenon generally referred to as its “financing” — is made possible by *reducing consumption, increasing production, and consuming capital*. The reduction of consumption does not however affect all classes of the community involved in the war, nor, in the case of those affected, is the reduction made on the same scale for all.

Equiries into the economic conditions prevailing during the first world war (1) lead to the conclusion that, in some countries at least, the introduction of rationing entailed less sacrifices on the rural population, whose consumption of food when they remained on the land was extended to those foods for which ration tickets were issued even if they were not included in their usual dietary. This was the case, for instance

(1) EINAUDI, L.: “La condotta economica e gli effetti sociali della guerra italiana”, Laterza, Bari, 1933, pp. 181-3.

with sugar and coffee. When the country people moved to the cities for military service or other war purposes, their régime included many other goods and services to which they were not accustomed. In the case of workmen, craftsmen, business men, and traders, *i.e.*, of all those who in the towns worked directly in connection with the war, consumption was not reduced but on the contrary increased. On the other hand, such groups of the population as government and business employees, pensioners, house and land owners, bearers of pre-war government securities, widows and orphans deriving their incomes from trust funds, were called on to make sacrifices which often required real heroism on their part.

Unfortunately, the reduction of consumption, entailing all too often insufficient nourishment for whole classes of the population, does not cease with the cessation of hostilities, especially when, as shown in our previous study, the sum total of incomes distributed among those engaged in productive activities — whether State or private — is lower than that received by producers on private or government account during the war years. This means that those whose dietary had improved during the war will probably return to their previous condition. Those who during the war were already compelled to make heavy sacrifices will see them prolonged and sometimes aggravated. On the whole, and apart from temporary donations of food and other products which may be made to certain countries, it is easy to foresee that the dietary of most of the peoples, whether or not they were involved in the war, will deteriorate in the post-war period. The problem of assuring proper nutrition — sufficient for all classes of the population and at the same time scientifically sound — will thus be incumbent on all countries after the war, even should generous measures of relief make it possible to avoid the spread of famine in some countries.

6. — Lines for the development of statistical enquiries.

Further studies which will enable the several countries to consider measures for securing at least sufficient nourishment for their people as well as a balanced dietary, require as their starting point complete returns relating to the fundamental facts affecting the demand and supply of foodstuffs. So far the result of exhaustive enquiries are neither available for all countries nor have the enquiries been made on uniform lines within each country.

A right understanding of *demand* requires first of all a knowledge of the *food habits* of all classes of consumers in each country. In this connection frequent and serious deficiencies in the data available on consumption and prices will have to be made good. This will require concerted action by the several countries for the solution of many problems of methodology, and unified systems for the collection and collation of the data so as to make the results obtained comparable. Any changes in ascertained habits should be systematically recorded, whether, as in many countries, they denote improvements due to the spread of knowledge on food requirements and on the best means for satisfying them, or whether, as occurs in the period of transition from peace to war conditions, or from war to post-war and peace conditions, they denote deterioration.

To secure a proper knowledge of the *supply* of food products it would seem essential to obtain (a) reports on growing crops and other foodstuffs obtained in relation to the ascertained habits of consumption; (b) reports on any changes in these crops which may be made to bring available supplies into keeping with prevailing habits so as to assure to all members of the community an adequate and progressively scientific dietary; (c) reports on the *productive potential* of a country with a view to the full attainment of the above aim.

If carried out on uniform lines so as to make the returns for the several countries comparable in time, these surveys of the demand and supply of consumption goods will be of use for ascertaining the several trends of consumption, production, and prices in each country and in the international comity of nations; in short, they will show the several stages which the various countries, singly and collectively, must traverse to attain their goal which is that of improving nutrition standards.

7. — Lines for the development of scientific enquiries.

Only by acquiring a knowledge of the nutritive value of foods can people avoid the danger of spending their available means to less advantage than the degree of culture attained by the community would allow. Therefore, from the *scientific* standpoint, the solution of the problem of securing a sufficient and balanced dietary requires (a) that an "optimum dietary" be determined for each country whose food habits have been ascertained, taking into due account its economic structure and climate, and the possibility of securing supplies and markets. (b) In

the second place suitable measures must be taken for giving wide publicity to the most advanced ideas on the subject. The most recent *scientific discoveries* must be promptly applied to relieve the conditions of the under-privileged classes or groups of the population. (c) In the third place, active encouragement should be given to studies for unifying as rapidly as possible the methods of analysing and inspecting foodstuffs and vitamin products. Only by applying these methods and making these efforts will it be possible to iron out any differences which may exist between the food habits of the several countries and the optimum dietary possible for them.

But the scientific viewpoint broadens out to cover problems relating to the *increase and improvement* of food supplies, *i.e.*, to the improvement of farming methods and the development of agricultural productive activities in such wise that the *supply may be proportionate to the demand* regulated in accordance with the dictates of medical science.

The study of the scientific side of the problem of securing a sufficient and an increasingly rational dietary for all, therefore includes questions relating to the use which should be made of productive factors, both in the period immediately following the war during which the national supply of foodstuffs will have to be supplemented by recourse to those of other countries, and in the ensuing period in which each country will endeavour to meet the deficiencies of others by developing its own resources to the utmost, and finally in the subsequent period in which agreements between the several countries will tend to re-establish the international division of labour based on the principle of producing to the best economic advantage (1).

The scientific technological side of the problem also covers questions relating to the transition from one of these periods to the other, a tran-

(1) In this connection it is useful to read the "Final Act of the United Nations Conference on Food and Agriculture" (Hot Springs, Virginia, U. S. A., 18 May-3 June 1943, Stationary Office, London, 1943, pp. 23-26).

The several proposals for forming pools for such products are linked up with the final purpose of giving all countries equal "purchasing possibility" — which is not the same thing as equal "purchasing capacity". The redistribution of goods in accordance with the real demand and supply capacity of each country, enlarged in time by credit devices, would thus be greatly facilitated, more especially as at the same time some seasonal price fluctuations would be reduced, and the supply of farm products could more easily be brought into keeping with actual demand. It is, however, very difficult to place all the countries on the same footing of equality as regards the possibility of offering and purchasing the several products, even supposing that they have the capacity of doing so. The largest, or the only source of supply always ends by occupying a preponderant position.

sition which may vary in length from one country to another, and also questions relating to the acquisition of the various kinds of capital goods (machines, fertilisers, etc.), to the variety of the crops raised, to soil conservation and protection, to discoveries and inventions, to the extension or reduction of the area fit for cultivation brought about by the introduction of new methods of farming. All the many-sided and ever changing activities engaged in the production of farm commodities may be considered from the scientific standpoint which directs the efforts of producers to increase the supply of essential commodities.

In this connection, a timely reminder has called attention to the fact that "although accurate data are not available on the insufficiency of calories which characterises some types of nutrition, there can be no doubt that an appreciable increase in the consumption of foods of high energizing value — such as cereals, vegetable fats, and in some countries sugar — will be required in a great number of countries if the dietary of some groups of the population is to contain sufficient energy-yielding values.

"Taking the world as a whole, it is probable that if nutrition policies attain their goal, the increase in the demand for energy-yielding foods by the groups under consideration will more than compensate for a long time to come the reduction in the demand for these foods which will accompany the improved qualitative dietary of those groups who now absorb a sufficient quantity of calories.

"Nutrition policies will not therefore call for radical alterations which would replace the production of the energy-yielding foods by that of protective foods. Nor do they require that agriculture should produce protective foods in advance of market demand, *i.e.*, before a demand at remunerative prices has made itself felt. What is needed is rather that, as the movement in favour of a better system of nutrition grows and spreads, and as the demand for protective foods increases in countries already enjoying a high standard of living, the agriculture of those countries should gradually adjust itself to changed demand and that an evergrowing quota of their resources be devoted to the production of protective foods. The best proof that agriculture can adjust itself to the expansion of the demand for protective foods is afforded by the fact that it has already done so. The new trends of agricultural production in many countries afford clear proof of this..." (extract from the Report of the Joint Committee of the League of Nations, Geneva, 1937, pp. 172-173).

The study of the scientific technological side of the nutrition problem is therefore a complex one, and it is the necessary premise to any improvement in the supply of those foods which a country may desire to make available to the under-privileged classes of its population.

8. — Lines for the development of economic enquiries.

Subject to further and deeper studies, the direction along which experts may be expected to conduct their enquiries and politicians develop their plans for international co-operation in the field of statistical enquiries, can be easily foreseen. Again, as regards public health and agricultural methods, a whole series of problems arising from the growth of knowledge in a variety of directions can also be clearly outlined. But if we turn to the economic aspects of the question, we find indeed some notable and often original studies, as for instance those of the relations between nutrition and incomes (1), between nutrition and prices (2), on the measures Governments should take in behalf of this or that group of consumers, this or that group of producers (3), on the spread between wholesale and retail prices (4). But if we are to get to the bottom of the facts in the case, it would seem indispensable to define carefully what is meant by the economic side of the problem so as to discern its essential features, unbiased by preconceived notions.

A careful examination shows that the economic aspect of the problem of securing sufficient nourishment for all classes of a given population has so far claimed but little attention, perhaps because it has been held implicit both in the demand of the consumer when he applies to the market for foodstuffs, and in the offer of the producer when he brings his supplies to the market. Undoubtedly, the request for and the offer of commodities, and more especially of foodstuffs, is made on the basis of economic expediency. But even if we limit our scope to that of securing for all classes of the community sufficient nutrition, the means devised to this end cannot be determined exclusively by the consideration of private interests, whether of consumers or of the several groups of producers, but must rise to the consideration of the general interest.

(1) INTERNATIONAL LABOUR OFFICE: "Workers Nutrition and Social Policies", Geneva, 1936, pp. 68, 122, 125-127; LEAGUE OF NATIONS: "Final Report of the Joint Committee", pp. 205, 268, 282, 288.

(2) L. o. N. *ibid.*, pp. 213-223, 226.

(3) I. L. O. *ibid.*, p. 126; L. o. N. *ibid.*, pp. 50-126, 230, 232-238.

(4) Contribution made by the Economic Bureau of the Institute above mentioned at p. 54.

If an adequate dietary is to be placed within the reach of all classes of the community, it must necessarily be an inexpensive one, and therefore the notion of the general interest implies that of a more *copious* supply of agricultural products.

Starting from this essential premise, the solution of the problem requires the simultaneous consideration (*a*) of the demand for foodstuffs based on the consumer's income and on the distribution he makes of it in purchasing food and other more or less numerous commodities at ruling prices; (*b*) the supply of foodstuffs, likewise based on the returns the producer can obtain from them at the said ruling prices, a supply which it is presumed is susceptible of increasing should production be encouraged by higher prices; (*c*) the conflicts which may arise between these divergent interests; (*d*) the possibility of harmonising them in the general interest. Should the parties directly concerned be unable to agree on this point the State may facilitate an agreement by measures which react on the prices of the commodities concerned, and by lowering or raising them check or encourage a more plentiful and cheaper supply.

Consequently, the study of the economic side of the complex nutrition problem widens out, and embraces not only the motives which induce the individual demand or supply of a commodity, but also the results of the measures by which the State — more or less aware of its own activities in this field — now comes to the assistance of consumers to increase their demand, now to that of producers to facilitate the growth of supply, now to that of both these groups, provided the measures taken are not such as mutually to neutralise one another.

In substance, the enquiry into the economic aspects of the problem of securing sufficient nourishment for all members of a community consists, first of all, in ascertaining by what means it would be possible to secure a larger supply of farm products at lower prices, or else how to secure a rise in incomes which, in the case of consumers, may be either general or partial but which in the case of the producers more or less favoured by State intervention, will always be partial. In the second place, the enquiry will consist in studying the consequences of the policies adopted. The fact is that unless a larger and cheaper supply of foodstuffs is encouraged, even a general rise in incomes will be found insufficient for the purpose as soon as they have to meet the higher prices due to the scarcity of the supply. On the other hand a rise in incomes limited to certain groups will be found still more ineffective if the supply of products should not

increase, as not only will these incomes have to meet the higher cost of commodities, but as a result of the phenomenon of cost transfers they will also have to meet the burden of heavier taxation, for government assistance to one or other group is only made possible by increasing the revenue through recourse to new taxes or loans.

Thus an enquiry into the economic aspects of the problem under consideration, which at first sight may seem a simple matter, really requires great care and some courage if we are not to beat a retreat from the facts disclosed. But these requirements are precisely the features which best justify the enquiry.

Often in the study of economic problems what is needed is not so much the discovery of new truths — which in this as in all other fields of human knowledge is not always possible — but rather to consider fearlessly those truths which are known, although obscured by the complexity of the phenomena observed or by the pressure of the interests involved.

9. — How to secure a larger supply and reduce the cost of foodstuffs.
(A) Foreign trade.

From the consumer's standpoint, the economic aspect of the nutrition problem consists in the possibility of acquiring a sufficiency of food to meet the requirements of health standards. This possibility seems attainable either by the reduction of production costs and therefore, under a competitive system, of prices, or by a rise in incomes, either general or limited to the incomes of certain groups of consumers, or by political prices for certain products. It is worth our while to consider these various means.

The reduction of food costs and therefore of prices may be secured in one of two ways. The first is offered by foreign trade. Any country which, on comparing the cost of producing two or more products, notes a difference in "comparative costs" and specialises in the productive activities which can yield it the highest returns, will succeed in securing a reduction of costs. This reduction is much more reliable than that obtained by a given country or person specialising in certain commodities not because comparative costs — the cost to the same country or person of producing two different commodities — differ, but because there is a difference in absolute costs, those met by two countries or two persons in producing the same commodity.

Nevertheless, a country which in building up its economic structure has not strictly adhered to the principle of specialising in the most profitable products, and which therefore carries on other activities more costly than those which an exclusive consideration of economic expediency would suggest, cannot, in the course of time, suddenly give up the home production of certain commodities and rely on imports from abroad at much lower prices with a view to securing cheaper food supplies for its people, without running the risk of incurring losses which in some cases are enormous.

In the case of individuals, the costs of such a policy are accounted for by the losses which lower competitive prices cause to home producers and by the expense incurred for replacing, when possible, crops which are too costly to cultivate by others which are less so and which could be raised in the country. In the case of the community, these costs include the loss of security afforded by the free disposal of essential commodities whose arrival from abroad may be endangered by various circumstances. Thus, although foreign trade may offer the most rapid means for increasing the supply of foodstuffs — presumably elastic — and for reducing their cost, the advantages offered to consumers are obtained at a cost to producers and to the community at large which cannot be disregarded.

10. — (B) Improvements in production.

The reduction of food costs, secured with a view to making certain foods accessible to the largest possible number of persons, may also be obtained by improving the methods of cultivation and marketing, the means of communication, transport, publicity, and credit. It would be superfluous to show in detail the influence of all these improvements on costs. They have moreover formed the subject of a voluminous international literature.

For instance, the use of chemical fertilisers and agricultural machinery, systems for freezing, drying, and preserving fruits and vegetables — by which the risk of deterioration of the several commodities is reduced — price fluctuations due to seasonal conditions attenuated, and conditions secured which render supply more uniform, the development of means of communication and transport both national and international, the limitation of the number of middlemen, which while it depends on the density of the population and on the importance of the services, sometimes incon-

spicuous, which they render to the consumer, can always be reduced by organising central markets, combining over wide areas marketing, economic, administrative and credit services, as is done by the great co-operative associations for production and sale which tend to organise themselves on the model of great business undertakings — in short all the improvements introduced into the various fields of human activity, all help to lower production costs. Such improvements add to the area available for cultivation, inclusive of sub-marginal lands; they reduce unemployment; they increase the yields obtainable; and under a system of competition, even if only partial, they lower the price of the product to the advantage of the consumer.

**11. — A rise in real income affords the premise for cheaper food.
Effects of lower costs and prices on a foodstuff.**

The reduced cost of agricultural products thus obtained, and under an approximately competitive system, the reduced prices — whether due to imports or to a better combination of the factors of production in the home country — will be accompanied by a larger supply and may therefore permanently favour the result of securing sufficient nutrition for all groups of the community. Substantially, an increase in the supply of products is seen to afford the premise for a cheaper dietary.

Valuable studies to which reference has already been made based on international inductive enquiries, tend to throw light on the elasticity of demand, *i.e.* on the relation between proportionate variations in price and proportionate variations in demand for certain foods. The demand for the energy-yielding foods in the form of calories — fats, cereals, sugar — has little elasticity, therefore a fall in price will not always lead to an increase in the demand for the cheapened commodity. Similarly, there is little elasticity in the demand for foods for which no substitutes are available to consumers. There is also little elasticity in the demand for foods, whether energy-yielding or protective, when the needs of each person tend to be fully satisfied. These notions may be useful in guiding the policies of both individuals and public bodies interested in regulating prices or in setting up consumption prohibitions.

On the other hand, unless, as above stated, the full satisfaction of needs has been nearly attained, there is a wide margin of elasticity — sometimes exceeding the unit — in the demand for protective foods, milk, liver, eggs, fat fish, green vegetables, fresh fruit, butter, due

partly to the facility with which they can be replaced by substitutes very similar in many respects to the original products. Not infrequently differential prices accentuate the elasticity of the demand for protective foods. Thus the consumption of milk is encouraged not so much by slight reductions in the standard price, as by the introduction of preferential prices for various groups whose consumption of milk is insufficient: school children, pregnant women, nursing mothers, unemployed workers (1). The premise for this system is a sales' monopoly exercised mainly in the interest of the community as a whole.

But just as absolute elasticity or absolute rigidity of demand are not found in practice, so the study of the margin of elasticity of the demand for one or other product and of the various conditions affecting the consumer, tends to show the *degré* in which the advantage of a fall or the disadvantage of a rise in the price of a product react on consumption. But even in the case of an inelastic demand a fall in price, obtained in one of the ways above described, will assist in improving the nutrition of the under-privileged classes of the community. If the fall is considerable and allows the consumer to satisfy his more urgent needs at less expense, he will be able to devote the savings thus effected to the purchase of larger than usual quantities of other foods or on commodities which he used not to purchase at all. For reciprocal reasons, even in the case of an inelastic demand, a price rise will affect nutrition unfavourably. Progress and retrogression in this respect are therefore very frequently independent of the demand for one product rather than for another.

12. — Sufficient nutrition resulting from a general rise in income, even if in varying degree.

The increased possibility for most people to acquire suitable foods in sufficient quantities for satisfying their respective needs may also be

(1) HICKS, J. R.: "Value and Capital", Oxford, 1939, p. 58, 132; TINBERGEN, J.: "L'élasticité de la demande des produits des industries agricoles", International Congress of Agricultural Sciences, Scheveninguen, 1937; SCHULTZ, H.: "The Shifting Demand for Selected Agricultural Commodities, 1875-1929", *Journal of Farm Economics*, April 1932 (the two last mentioned authors are quoted in the "Final Report of the Joint Committee of the L. o. N." p. 212); we may also be allowed to refer to our article "Di qualche uniformità nel piano di un consumatore", *Giornale degli Economisti*, November-December 1942, par. 9, 13, 14, which examines more especially the influence exercised on the action of consumers by the expectation of price changes, as they present themselves either of a transitory or permanent character.

the consequence of a rise in incomes, even if in varying degree or only partial. The former occurs during periods of recovery and prosperity brought about in the economic cycle by events which at one and the same time favour several branches of production. But here again elasticity in the supply of farm products is required. Should it be impossible to increase said supply, *i.e.*, to increase substantially the real income obtained from the products of the soil, the rise in money income, even if widespread, would be neutralised by a rapid and marked rise in the price of the inelastic supply of commodities offered for sale. Therefore the premise for favourable solutions of nutrition problems consists always in a decisive rise in *real* income.

On the implicit assumption that this rise may occur, it can be noted that as income rises, expenditure on food tends to increase but not proportionately. Indeed, the percentage of income spent on food tends to decrease, and within the limits of the increased expenditure the consumption of the energy-yielding foods — more especially of cereals and fats for which the demand varies but little, tends to decline while that of the protective foods — meat, fish, milk and dairy products, fresh vegetables and fruit — for which the demand is very elastic, increases (1). Thus, though varying in effect with the degree of elasticity of the demand for the several foodstuffs, a rise in income tends to raise the level of nutrition by increasing to some extent the quantity and to a larger extent by improving the quality of the food consumed.

The recipients of larger incomes will, in such cases, be inclined to obtain the calories required from more expensive foods. When once they have procured themselves the food they consider necessary, they will be inclined to expend their remaining income on other needs than those of nutrition as for instance, on clothes, better housing, travel; in other words, the situation will be similar in many respects to that arising from a fall in the price of foods for which the demand is inelastic. The saving in the expenditure of income effected in the case of such a price-fall, and the margin of receipts made available by a rise in income will serve purposes *other* than the purchase of food, even in those cases in which the dietary *selected* by each person, with its various combinations of energy-yielding and protective foods, differs considerably from the optimum dietary of the hygienist. Such differences can only be ironed out by the spread of knowledge on health requirements.

(1) L. o. N.: "Final Report. . . ." Op. cit., p. 233.

Although less certain than the relation noted between prices and nutrition levels, the relations between income and nutrition are more obvious in the case of the lower-income categories of the population who must content themselves with a lower dietary during periods of economic depression, making up for it by increasing their food consumption during periods of recovery and prosperity to an extent which varies with individual tastes. It is therefore easy to foresee that in the case of the lower-income categories, the period immediately following on the war will witness a deterioration in dietary all the more marked (*a*) when the margin between the total income obtained during the war and the total income obtainable after the war is a wide one (see the first study, par. 13); (*b*) when there is a considerable change in the distribution of incomes, leading to a decline in average income and the multiplication of small incomes.

In the post-war period the level of nutrition will tend to remain unaltered should the difference in the sum total and the change in the distribution of incomes not occur, and it will tend to improve should circumstances favourable to productive activities allow at an early date of a rise in incomes and should this rise be followed by a marked though not proportionate increase in the expenditure on food.

13. — Sufficient nutrition consequent on a partial rise in incomes, such as a rise in the incomes of some groups of consumers or through the adoption of political prices.

A rise in incomes limited to certain groups only may lead to government intervention to secure the redistribution of the unvaried sum total of real income. But here again, whatever means be chosen, it will be vain to expect cheaper food for all classes of the community unless the supply of foodstuffs increases. It may be secured for some groups at the expense of others, but it is impossible to escape from the circle formed by the effective consistency of real income.

A rise in the incomes of consumers can be secured by fixing minimum wage rates, granting family allowances, doles to the unemployed, public works, social insurances, the direct supply of food to young children, women, old people, unemployed persons. All these measures help the favoured groups to overcome the difficulties they encounter in securing

adequate nutrition (1). It would however seem desirable to ascertain who, in the last resort, has to meet the cost of such measures.

The actual disbursement of a minimum wage or a family allowance may be made by private persons or concerns. Should such disbursements however prove too burdensome for certain concerns whose production costs are thus raised to a point at which they exceed any attainable returns, and should the Government be called on to assist business enterprises by bonuses, subsidies and price supplements, it is interesting to ascertain by what means the measures taken on behalf of consumers may be financed.

The Government can procure the funds required for supplementing the incomes of some groups by drawing on the incomes of its nationals through direct *taxation* up to a certain limit and through indirect taxation. As however, with a few exceptions easily identified, all taxation is finally transferred and embodied, by the phenomenon of transference, in the prices of the commodities whose producers are taxed *de jure* or *de facto*, the burden of taxation is converted into an increase in the cost of production which must necessarily react on the price of commodities. This holds good whether the price raising reaction be apparent or whether it be concealed by the fact that the production of public services, which stand in the relation of capital goods to consumption goods, increases production to such an extent as to neutralise, by the increase of productive potential — *i.e.*, by the increase of real income — the rise in price due to the more or less easy transfer of the burden of taxation.

But should the total real income not rise — and the public services provided by the State do not always lead to an increase in the production of consumption goods — the rise in the price of foodstuffs determined by taxation will, in its turn, neutralise in whole or in part the aim in view which was that of raising the income of some groups of consumers. This neutralisation is evident when the State raises the funds required for financing its policies by indirect taxation of essential commodities which weighs heavily on the poor; but it exists in the case of all forms of taxation, direct or indirect, which by transfer lead to a rise in the price of consumption goods, however difficult the inductive enquiries needed for confirming this assertion may be. The fact is that the devices for

(1) I. L. O.: "Workers' Nutrition and Social Policies", pp. 68, 122, 125; L. O. N.: "Final Report...". *Op. cit.*, pp. 205, 282, 288.

the redistribution of incomes — and taxation may in many cases be considered as such — are productive of much smaller results than were foreseen when the action was first started.

Under these conditions, and if taxation inevitably reacts on the price of consumption goods, — unless in the mean time production increase to such an extent as to offset the rise in prices — it would be vain to expect that the under-privileged classes will benefit by taxes levied at steeply progressive rates. In the long run, even progressive taxes raise the prices of consumption goods and run counter to the purpose of promoting a sufficient dietary for all classes of a community by increasing the available incomes of certain consumer groups.

Should the State in its endeavour to raise certain categories of income have recourse to *savings* for securing the means to this end, the higher rate of interest which will accompany the increased demand for savings and the heavier taxation required to meet the service of the national loans thus raised, will cause the rise of production costs and, in the last resort, the rise of the prices of foodstuffs. Thus the consequences of State action taken in favour of certain groups of income will always more or less neutralise the results secured by such action.

We are led to almost identical conclusions if we consider the consequences of securing the means for paying doles to the unemployed, carrying out public works (of late years many enquiries have been made on this subject), shifting on to the shoulders of the community at least a part of the cost of social insurances or the whole cost of the direct supply of food. All these measures, unless accompanied by an increase of total real income, *i.e.*, by the increased production of consumption goods, may indeed redistribute income, but they are neutralised by the higher prices which reflect the burden of taxation, and are therefore far from solving the problem of securing cheaper food for those classes whom the State wished to favour.

A partial increase of income may be assured by the adoption of political prices for certain products. Their effect is similar to that of a rise in the income of the consumers of such commodities. An example common to many countries is that of the price of bread. The cost met by the State to keep it low is covered by taxes and loans. But the advantage of cheap bread, conferred on all but which benefits more especially the underprivileged classes, entails higher prices for many other commodities among which are included not infrequently those

consumed by those very groups whom the measure was designed to benefit.

14. — Increase of farm incomes and consequences which oppose cheaper food supplies.

The consequences to which we have just called attention are not modified in those cases in which a country, for reasons other than exclusively economic ones, is induced to introduce or to persist in the production of foodstuffs at a cost higher than that entailed by the production of other commodities and when for this purpose it has recourse to measures of protection. The inevitable reaction of such a policy is to raise the price of the goods thus produced and of many others, as the protective measures do not increase but on the contrary reduce total real income (1).

Nor are the consequences modified when a country, breaking with longstanding traditions, decides to import at lower prices commodities until then produced at home and when it raises the necessary funds for compensating home producers for the loss they thus suffer by recourse to taxes and loans with the results above described. Neither are they modified when the community sees fit to pay a bounty to an exporter to enable him to meet foreign competition on world markets in spite of high costs. Duties on imports, compensation to home producers, export bounties, and all the other various expedients to which present day protection has recourse, all alike entail a less efficient use of the factors of production, a smaller real income, higher prices, and less consumption. All these phenomena definitely hinder an advance towards a more adequate dietary for all classes of the community. They hinder it because they do not at the same time encourage — and they never can encourage — a larger supply of agricultural products, a higher real income, lower prices. The loss caused by the reduction, or at best the stationary status, of real income is the more noticeable in the case of the modest family budgets of the poor; in their case the higher prices of the energy-yielding foods for which demand is inelastic and consumption cannot be reduced, entails desisting from the consumption of protective

(1) See the 3rd. study, par. 4 and 20. See also ROBBINS, L. "Economic Planning and International Order", Macmillan, London, 1938.

foods for which the demand is elastic and from the satisfaction of other needs related to housing, clothing, etc. The effects are similar to those noted in periods of crisis and depression, only they affect all budgets.

Similar consequences, *i.e.*, obstacles placed in the way of a larger supply of consumption goods and of a more economical nutrition régime, attend those measures of which we have had so many examples in the last decades whose purpose is to raise the prices of farm products whose level has fallen below that of manufactured goods. Hence in countries producing foodstuffs on a large scale, measures have been taken to limit production so as to reduce the ratio of supply to demand, considered as constant, thus raising the price of farm products in a measure which hinders the spread of a sound dietetic régime.

Should the limitation of farm production be considered insufficient for securing the ends in view; should the authorities decide to compensate and pay bounties to those farmers who loyally respect the said limitations; should the Government decide to take over any surplus products in excess of current demand, thus compensating farmers for the limitations placed on production and maintaining farm prices at a higher level than that prevailing for industrial goods; and should the funds required for carrying out these government policies be supplied by taxation and loans, in addition to the higher prices consequent on the limitation of output, a new motive for a rise in the price of consumption goods will be set going. Besides the price rise due to the limitation of production and consequently of supply, there will be the rise caused by the transfer of the heavier burden represented by the growth of direct and indirect taxation and the service of the debts. It is evident that these policies are yet more actively adverse to the spread of an adequate dietetic régime for all classes of the community.

In conclusion, if we consider that to the consequences of government action for raising consumer incomes — action which however hinders the spread of a sufficient dietary for all — must be added those resulting from government measures taken for increasing farm incomes, which no less than the former hinder the spread of adequate nourishment for all, we shall see that the obstacles placed in the way of an advance toward a more economical system of nutrition will increase, and the urgent need of revising any policy which does not admit of an enduring increase of real income immediately available for the needs of all classes of the community will become apparent.

15. — Consideration of the more general aspects of the problem under examination.

The fact is that the problem of nutrition, viewed in its economic aspects, does not allow of the consideration of the interests of individual groups. It demands a knowledge of yet broader problems on the part of those who desire solutions which will take all interests of farmers and consumers into due account. We must ascertain not only, as above stated, all the conditions governing the supply and demand for farm products but also the limits within which State action in favour of individuals or groups must be contained if it is not to injure the interests of other individuals or groups.

The notion of a limit to the activities which the modern State has been constantly extending, springs from the acquisition of definite notions about national income both real and monetary, State intervention, the cost and value of each act of intervention, public planning understood as the timely coordination of interventions guided more or less by economic considerations. The first of these notions is dealt with in our first study; we shall try to define the others in a further study whose purpose is to enquire into the several factors and the leading policies of both private and public plans. We may however be allowed to state here that although these notions may seem to be remote from the concrete problems under consideration, yet their study alone can suggest to those desirous of taking into account all possibly conflicting interests and all the possibilities for harmonising them, uncontradictory solutions for extending to all classes of the population the opportunity of securing economical and rational nutrition.

16. — Possibility of harmonising the two aims : " economical and rational nutrition ,, for all countries.

In those countries in which all classes of the population are not sufficiently nourished, the two objective aims — more abundant and cheaper food, a more rational and ample dietary — do not coincide. They are separate though not conflicting aims.

It would seem that in reconstructing their national agriculture the guiding motive of those countries in which all classes of the population are not sufficiently nourished should be above all that of securing cheaper

food so that farm products may be made accessible to all, with those few exceptions which cannot be eliminated in any society.

Those countries in which certain classes of the community are ill-nourished will be able to identify the means for securing larger supplies of farm products at lower than present prices by using as a basis for their enquiries accurate statistics relating to (a) the regional consumption of farm products, possibly also of the "need" in relation to environment and to standards of living; (b) production and the many and various improvements which may in any way affect it; (c) imports and exports of agricultural products and capital goods (fertilisers, machinery, etc.) classified respectively by countries of origin and sale; (d) possibility of developing more fully the national territory by carrying out long-dated and large-scale land improvements. Each country can easily perceive the means for cheapening the supply of farm products and for securing them finally in sufficient quantities for all its nationals.

An eye must be kept on the cost of all productive improvements and on the cost of the several imports not only as represented by the cost of the commodities exported in payment of those imported, but also as represented by the losses entailed by the changes in its agriculture, which the country may be able and may have to make, as also by the need which may arise in some cases of abandoning the cultivation of certain crops with the consequent unemployment of the factors which contributed to their production. Taking these costs into account, each country can ascertain if and when the reduction of food prices can be actually brought about. It will be found possible to ascertain these facts only when the possibility of securing supplies of farm products, at first unsystematically and as urgent needs may require, and later on by carrying out plans of production on the basis of agreements with other countries (see par. 7, p. 58) has been assured. In the meantime, each country will be able to judge when it will be able to secure, in addition to cheaper food supplies, a more rational dietary for its people, one which will combine sufficiency with higher nutritive value.

Not all countries will be able rapidly to couple this latter desideratum with that of sufficient quantity, especially if the attainment of the ends in view should require recourse to be had to products of higher quality or to imports from abroad which will hinder the cheapening of food products. But *if* in pursuance of the higher and ultimate aim of securing a scientifically balanced diet, it should be possible, thanks to a set of favourable circumstances, to secure cheaper food supplies, then the

phrase "more abundant and more rational nutrition", far from being a mere commonplace and in some cases self-contradictory statement, will serve to mark for all countries, fully aware of what they are doing when they undertake reconstruction, one of the most significant victories in the laborious march towards the goal of a higher form of civilisation, neither too delusive nor too remote.

III.
UNEMPLOYMENT

III.

UNEMPLOYMENT

SUMMARY

PART I: DIAGNOSIS. — The factors determining wages are defined and implicitly, those governing the employment of labour forces. Voluntary and involuntary unemployment are defined. The essential conditions for securing, over a long period of time, the employment of labour, are established; they are free competition in the production of goods of many kinds for the market to meet the tastes of consumers; an increase of total real income and of the average quota pertaining to each member of the community at a rate more rapid than that of the growth of population, facilities for exchanging with other markets both consumption goods and the factors of production including labour, thus giving rise to the phenomenon of the migration of workers.

The conditions are also established which, over shorter periods of time and with the help of the other conditions mentioned, facilitate the growth of real income and the employment of labour. Some explanations of the alternation of economic fluctuations (the business cycle), and of the increase of unemployment are reviewed and estimated.

PART II: SOME REMEDIES. — The notion of a "favourable event" affecting at the same time several branches of production of a nature to increase the income of the entrepreneur and of all participating in his activities is illustrated. A logical sequence of measures suited for securing the permanent or temporary absorption of unemployed labour is outlined. Public works are considered from the point of view of their instrumental character for the production of consumption goods. The consequences of other very wide-spread policies such as social insurances, doles to the unemployed, the protection of sundry productive activities are illustrated. The need of inductive studies and of organizations for research which will direct all the energies of each country towards a lasting economic recovery, is urged.

PART I
DIAGNOSIS

1. — The factors which determine the employment of labour forces.

Unemployment occurs when the supply of labour exceeds the demand at a real wage which can only be lowered at the cost of needs which, either objectively considered or in the opinion of the workers themselves, are essential to life (1).

As is known, the *demand* for labour by the entrepreneur class takes into consideration two main circumstances: the productivity of the last worker engaged on a job at a given wage — net marginal productivity — to which therefore the wages paid to all the workers employed by the undertaking tend to be related as to a maximum limit; and the discount of this productivity which the entrepreneur must make when, as is usually the case, he pays the wage before obtaining any return from the sale of the product. As is also known, the *offer* of services by the workers is always determined by the minimum wage required to enable them to live and bring up successors who will eventually replace them. This minimum, often referred to as the “standard of living” of the working classes, varies from country to country and from one period to another in the same country; it either exceeds a minimum of physical requirements below which no civilised society can descend, or it coincides therewith.

Between these maximum and minimum limits supply and demand tend to determine the price paid for labour; *i.e.*, the worker's wage;

(1) The bibliography on unemployment is copious. For the purposes of the present report we have consulted the following works: BEVERIDGE, W. H.: “Unemployment, a Problem of Industry”, London, 1930; CLAY, H. “The Post-War. Unemployment Problem”, London, 1929; INTERNATIONAL LABOUR OFFICE: “Hours of Work and Unemployment”, Geneva, 1933; NATIONAL BUREAU OF ECONOMIC RESEARCH: “Business Cycles and Unemployment”, New York, 1923; HOBSON, J. A.: “The Economics of Unemployment”, London, 1931; PIGOU, A. C.: “Industrial Fluctuations”, London, 1929 and “The Theory of Unemployment”, London, 1933; KEYNES, J. M.: “The General Theory of Employment, Interest and Money”, London, 1936; HAWTREY, R. G.: “Capital and Employment”, London, 1938. The study by the author of this Report: “Recenti teorie inglesi sulla disoccupazione” (Recent English theories on Unemployment) *Giornale degli Economisti*, January, 1939, has also been taken into consideration.

and considered from a static (situation at a given time) or from a stationary (repetition at any time) point of view, they also determine the employment of labour at the disposal of the market.

In times of full employment the labour market attains a state of equilibrium. In times of partial employment, the fact that a quota of the available labour forces are out of work indicates that the entrepreneur class considers that the productivity of those seeking employment is so low, *coeteris paribus*, as only to entitle them to a wage inferior to the minimum considered as indispensable by the working classes, even though it be higher than the minimum required to satisfy physically indispensable needs in a given country and at a given period.

In the course of time — and viewed therefore from a definitely dynamic standpoint — the volume of employment, and therefore of possible unemployment, is affected only by the *variation* in the supply and demand of labour. Should the real wage exceed the minimum physically indispensable to enable the workers to live and rear the successors who will replace them, any increase in the supply of labour or any decrease in the demand — even if it reduce the margin between the real wage paid to occupied workers and the minimum indispensable for their physical maintenance — will not necessarily reduce the volume of employment which has been attained, nor will it lead to that excess of supply as compared to demand which we have defined as unemployment. But if the real wage paid to the employed workers is barely equal to the indispensable minimum at the time and place considered — even though exceeding the strictly physical minimum above mentioned — any increase in the supply or decline in the demand will tend to throw at least some of the employed out of work. It would thus seem that elasticity and permanency are conferred on present employment only when the real wage *exceeds* the minimum required to meet the indispensable physical needs of the workers.

2. — Voluntary and involuntary unemployment. Long term facilities for absorbing the former. Possible obstacles in the way of absorption.

A market on which there is unemployment, defined as an excess of supply at a minimum real wage as compared to demand, exhibits :

(a) workers employed at a wage which, under a competitive business system, tends to rise to the aforesaid maximum, and which under

a system of competition on the labour market tends to fall to the aforesaid minimum ; should the two forms of competition coincide, the wage will tend more in one direction or the other as one or the other form of competition prevails ;

(b) workers who might find employment at the prevailing wage-rate, but who consider it inadequate, and therefore prefer to withhold the offer of their services : *i.e.*, the voluntarily unemployed ;

(c) workers for whom there is no demand because, given the price of the product and the conditions under which the entrepreneur works, the net marginal productivity of any workers in addition to those already employed, is held to be low, null, or negative. Some writers class the workers belonging to this group with the "involuntarily unemployed", especially when, in spite of the rising cost of essential goods and the reduced purchasing power of the wages they receive, the workers who have jobs do not give them up. This means that those who are out of work will remain unemployed even if, in the course of time, they should be willing to accept a lower wage. This distinction, although useful in studying these complex phenomena, is not however an essential one.

In the course of time, especially if their number be small compared to that of the employed, the voluntarily unemployed are gradually absorbed by undertakings desirous of enlarging their business and who therefore increase their demand for labour, as already shown by the fact that at an earlier date they had enquired for workers but had not succeeded in securing them. Obstacles in the way of the absorption of the unemployed may arise from the fact that in all undertakings the employment of more hands lowers the net marginal productivity of each worker : It is indeed a fact that all employees, new and old hands alike, may endeavour to increase their yield. If this is not the case, the wages of all alike must fall.

Hence a struggle arises between the workers already employed and ready to resist wage cuts, and those who at first hesitated but are now willing to take a wage lower than that which they were formerly unwilling to accept ; and between employed and employable workers, should they find a means to join forces in an effort to maintain the existing wage-rate, and on the other hand the entrepreneurs who resist the pressure of the coalition of interests which has thus been formed. But as the entrepreneurs are willing to renounce in favour of the wage-earners at least a part of the profits they expect from the enlargement of their business, these disputes are settled, and voluntary unemployment is

seen to be a transitory phenomenon on a market on which the workers show an understanding of the situation, or on which *per capita* yield increases, or on which the entrepreneurs enjoy facilities for expanding their business activities or on which all these conditions are found. Therefore a remedy for voluntary unemployment will not be long delayed.

3. — Free competition on a market producing a variety of goods is the first condition for the increase of employment and the absorption of voluntary unemployment.

The above reasoning does not hold good in the case of "involuntary" unemployment, even if considered over a long period of time. All that can be done in its case is to point out some conditions favourable to an increase — of course gradual — of employment and to the absorption of the masses who may have been thrown out of work.

The *first* of these conditions is that of securing a free competitive market. In practice, this is seldom found. We find indeed in all countries individual undertakings competing with each other, but we also find a more or less large number of others which have combined together, or enjoy monopolies, or are public utilities working under conditions which secure them a quasi monopoly. It would therefore be more correct to postulate as the first condition for securing the fuller employment of labour, not the existence but the tendency towards a free competitive market. By tendency we mean the inclination of its members and of the qualified authorities to reduce privileges, monopolies, forms of protection, subventions, favours granted to individual concerns or to groups, placing them in a position which makes them unassailable even by more able competitors (1).

It has often been shown that in the course of time such a tendency facilitates the employment of workers. The differential profits secured

(1) A whole artificial system extending in the most varied directions (see note to p. 33 of Study 1) will have to be eliminated. In some countries there are hundreds of privileged corporations which only continue to exist to prolong favours granted as the result of political pressure, in most cases to the injury of consumers. We need only mention the organisations set up for the production and sale of commodities under a system of monopoly: fuels, ores, iron and steel products, engineering and chemical products; transport services; banks. Will the courage required for demobilising in the post-war period all the super-structures of the war years — and not only of the war years — be forthcoming? Will there be energy enough to denationalise them?

by some entrepreneurs incite others to undertake new enterprises, thus creating a *further* demand for labour. Should these enterprises prove successful, the differential profits which were first secured by one or a few entrepreneurs are enjoyed by others and distributed over a larger number of persons participating in the productive activity considered, and among these are the workers. At the same time the old established businesses which may have to meet the competition of other and more capable concerns, are very often induced to *increase* their output so as not to lose the market. Thus they try, if possible, to reduce costs by expanding production, or else by securing larger sales if the demand for the goods they produce is an elastic one, for even should competition reduce prices, larger sales may offset or more than offset the loss thus incurred. An increased demand for labour is thus assured.

Leaving out of account the fact that as prices are lowered, either as a result of increased demand or reduced costs, consumers effect savings which are either used immediately in making larger purchases of the same or other goods, or else become available on better conditions — as for instance at a lower rate of interest — for facilitating the expansion of productive activities and creating an *increased* demand for services. So, by diverse paths which all increase the demand for labour, a competitive system, or a trend in that direction, increases employment and promotes the absorption of the unemployed.

It is indeed conceivable that should undertakings working under a system of monopolies or combines, find, for instance, new markets for their products, they may consider plans for enlarging output and increasing the demand for services. Such a possibility is, however, subject to various conditions, whereas under a competitive system, the assiduous endeavour of a whole body of undertakings to lower costs so as to raise profits stimulates business expansion considered as a means for distributing producer incomes and consumer incomes over a larger number of participants, and this affords the means for absorbing any unemployment which may exist. It is, of course, understood that even under a competitive system the absorption of the unemployed will continue, as already noted, only until such time as the gradually falling wage-rate will reach the level of the minimum indispensable for meeting the physical requirements of the working classes at a given time and place.

This aptitude to promote employment and absorb the unemployed which characterises a market tending in the direction of free competi-

tion, is yet more marked when a *variety* of goods are produced. When this is the case, even if the undertakings engaged in one branch of production should reach the point when they have utilised to the utmost all available factors of production including labour and when any additional labour forces, by lowering *per capita* yield, would also lower the wage rate, the said factors, including labour, may turn to other forms of employment and secure their utilisation to the best economic advantage. Thus, on a market which favours free competition the several factors of production will at last be distributed over the several branches of activity in such a way that their net marginal productivity will be equalised, and with it the rate of remuneration which tends to that degree of productivity as to a maximum. By securing in each branch of activity the most efficient combination of the factors of production, inclusive of labour, it will also secure their most economically advantageous use. The production of a variety of goods under competitive conditions therefore affords a safety valve against unemployment.

4. — A frequent example of an obstacle placed in the way of free competition and of the consequent shrinkage, actual or deferred, of the demand for labour.

To insist on noting that conditions of free competition are rarely found and that therefore the first condition for assuring fuller employment of labour is unattainable, in no wise detracts from the truths above stated. It is indeed true that existing conditions are those of "imperfect competition". But even so, the fuller employment of the factors of production — and therefore of labour, — may be secured only by the policies of groups or of States directed towards securing less imperfect conditions of competition, which means the suppression of the monopolistic tendencies which have developed to an excessive extent in the last decades, and especially during the war. On the other hand, should policies dictated by special interests aim at hindering competition, or at consolidating the obstacles placed in its way, the opportunities for the employment of the working masses will decline, and the possibilities of absorbing the unemployed will become ever more remote.

Examples of obstacles in the way of free competition and of the consequent actual or deferred shrinkage of the demand for labour will be given and discussed in the last paragraphs of this study. Here we will only give

an example of a case which frequently occurs. A group of workers engaged in one of the branches of production above mentioned, organised as privileged corporations, or the State at their request, interferes to prevent the reduction of a wage-rate exceeding the minimum, a reduction made unavoidable by the fact that the business concerns considered absorb voluntary and involuntary unemployment.

Two alternatives offer: either the entrepreneur *does not* or *cannot raise* the price of the product and in that case the higher wage assured to the group of workers considered will be paid out of the differential profits which the entrepreneur had succeeded in securing. In that case the result will be that while under a system of free competition which encourages the reduction of costs and prices the differential profits secured by the originally most competent entrepreneur would have been distributed over the whole community — owners of the factors of production and consumers — the interference of the group of workers or of the State will lead to the assignment of the said profits to one favoured group.

The other case is that in which the entrepreneur is able to *raise* the sale price. Then the higher wage secured by the said group will be paid by the consumers. This already confers a different significance on the case as compared to the former one. But in both cases the favoured situation of the group — be it secured at the cost of producers or consumers — prevents the returns secured by either from being used for increasing employment in general and for absorbing the unemployed in particular, as would have been the case under a competitive system. The wage of a given group of workers can be raised only at the cost of reducing future employment for other workers, unless, as already stated, the yield of all workers employed be raised or, when this is possible, the wages of workers engaged in other activities be reduced in a measure at least equivalent to the increase secured by the favoured group. Otherwise it will not be possible to use "producer incomes" and "consumer incomes" for securing wider opportunities for employment of labour as would automatically occur under a competitive system (1).

(1) For other examples of obstacles to this régime and of the consequences to which they lead see par. 19. See also the article by CASSEL, G.: "The economic basis of social security". *Skandinaviska Bank Quarterly Review*, April 1943 and the articles by RÖPKK, W. on "Full Employment" in the *Neue Zürcher Zeitung* of 10th, 11th and 12th August, 1943.

All this, and for the reasons set forth in our second study, does not imply an *a priori* condemnation of all forms of intervention in favour of certain groups, certain factors, certain activities. Nor does it imply that the Government should never protect special interests. Our purpose is to make clear that the results of such intervention are not always those hoped for. They should therefore be foreseen and as far as possible their importance should be ascertained.

5. — Second condition for the increase of employment and the absorption of the unemployed ; Real total income must increase more rapidly than population.

The second condition for increasing the demand for labour and securing the absorption, if need be, of the unemployed, is the growth in time of the average quota of real income pertaining to each member of the community. This quota ultimately determines the "standard of living" of the several recipients and more especially of those of the working classes. Indeed, the growth of the real income of a community depends on the expansion which can safely be secured for its productive activities. But the variations in the average quota of that income pertaining to each member of the community depend also on the growth of the population.

Facts teach us that the growth of a population, considered as a whole — *i.e.*, as increased by births and decreased by deaths — tends to increase the available volume of consumption goods but at a slower rate than that at which the population itself increases. In other words, an increase of population tends to lower *per capita* wealth, and this reduction tends, in its turn, to lower the birth-rate and increase the death-rate, thus substantially containing the increase of population within the limits in which productive activities develop.

In function of these two developments, that of production and that of population, the average quota of real income pertaining to each member of the community *increases* when the premises exist which are indispensable for imparting a vigorous impulse to productive activities. Such are the presence of *available capital* seeking investment in any reasonable undertaking, the abundant *supply* of all the factors required to meet the exigencies of the most economically valuable combinations of these factors, their *high marginal yield* due to the skill of the workers, the natural or artificially procured fertility of the soil, the proficiency of the machinery,

the profitable nature of the methods of production used, able business management. Thus, to use a hackneyed example, in the XIXth century the community, on the strength of these premises, developed the various forms of productive activity at a rate exceeding that at which the population increased, which in its turn was able to grow without lowering the *per capita* quota of real income. The result of such conditions is that during a period of varying length the demand for labour and the opportunities for employment increase, and any unemployment there may be tends to be gradually absorbed.

The average quota of real income pertaining to each member of a community — and therefore the standard of living, or at least that of certain classes — may be described as *constant* rather than increasing when production and population vary at the same rate. It may be said to *decrease*, and with it the real income of a community, when it does indeed grow with the growth of the population but in a lesser degree, or when it declines with the decrease of the population but in a greater degree. Obviously, a community in which, *coeteris paribus*, the average quota of real income pertaining to each member is constant or decreasing, will not be able to enlarge the opportunities for employment nor to reabsorb unemployed labour forces.

6. — The expansion of both production and population depend in their turn on the attitude of individuals and governments.

As Jannaccone has properly pointed out in a study going to the root of the matter (1) of which some essential points are here referred to, the expansion of productive activities and of population depend not only on objective natural and technological conditions, of some of which mention has just been made, but also on subjective conditions, especially on the attitude of the men and women who more or less consciously regulate both forms of expansion.

This regulation may be left to the parties concerned or to the State, or, as is more generally the case, to both. In this way the expansion, the stationary character, or the decline of the real income of a community

(1) JANNACCONI, P.: "Produzione e popolazione lavoratrice in regime di mercato libero e di mercato controllato" (Production and Working Population under a free market system and a controlled market system) in *Rivista italiana di scienze economiche*, January, 1939.

— and more obviously of the quota of that income pertaining to each of its members — will depend ultimately on the conscious will of man, expressed partly as individuals and partly as the State.

In regimes which admit of free private enterprise or which hinder it little by the intervention of the State or of the dominant political groups, the extent to which the production of consumption goods expands is determined by the individual distribution of income as between consumption and savings available for productive investment.

Individuals may assign a conspicuous part of their incomes to consumption and a small part to savings because the incomes themselves are so small that they barely suffice for satisfying their more urgent needs. When this is the case, the community can re-establish the requisite ratio between the expansion of production and the growth of population in one of two main ways, (a) by devoting all efforts to increasing the total real income — and consequently the several individual incomes — while at the same time seeking to improve the distribution of income, thus conferring on large bodies of workers the possibility of making larger savings, or (b) by limiting the growth of the population.

On the other hand, a conspicuous quota of individual incomes may be assigned to consumption and little to savings because the recipients prefer to cultivate refined tastes and luxurious habits rather than practice self-denial. But in this case, the existence of high incomes and excessive consumption, if practiced by many classes of consumers, will, in the course of time, be found incompatible. The classic economists, studying conditions in what was implicitly a closed market, had clearly shown that “the demand for products is not a demand for labour”, and consequently the demand for luxuries does not always imply more opportunities for employment for the working classes (1). The demand for products tends rather to bring about the displacement of labour forces from some activities to others for which the demand is greater, unless indeed increased demand be accompanied by a simultaneous increase in the supply of all the means required for securing the most suitable combinations of

(1) To secure employment for other workers in addition to those already occupied, investors must renounce a further quota of consumption and accumulate savings to be assigned for remunerating new labour forces. Should a mere demand for products perhaps previously unavailable — such as velvets — make itself felt, the higher selling prices may displace workers engaged on the production of other commodities, for instance, to the velvet factories; but unless there be additional savings available for capital uses employment will not increase.

productive processes. Therefore, a distribution of income more favourable to consumption than to investments will lead to a situation in which the rate of production of consumption goods will be less rapid than the rate of increase of the population. In the course of time, this will lead to a reduction of real income, even though the absolute figure for income should still for some time be rising. Unemployment will then threaten. The standard of living of many classes of the population will tend to fall, though in a degree varying with the varying fertility of those most keenly affected by economic conditions. In substance, on a community whose members enjoy a large degree of freedom in determining the distribution of income, rests a heavier responsibility for limiting consumption in excess of the essential minimum so as to assure the accumulation of the capital required to enable the expansion of productive activities to keep ahead of the growth of the population.

On the other hand, the regulation of the expansion of production and of population may be entirely entrusted to the State, as is the case under those régimes which centralise the ownership of the means of production, production policies, and the assignment of income to producers. But centralised action makes no less arduous the task of dividing the total income between that received by individual citizens — who, should they so see fit, may, in their turn, save part of it — and that paid into a fund available for investment in productive activities. Sometimes under these régimes the names given to economic groups which remain substantially identical are changed. But the problem of regulating the two forms of expansion, production and population, is still the same. Should the State not succeed in promoting the expansion of production on a scale which exceeds and precedes the expansion of the population, the average quota of real income pertaining to each member of the community will not suffice for increasing the opportunities for employment and absorbing any unemployment which may exist.

This condition can be observed in countries which, though they do not centralise the ownership of the means of production and production policies, yet encourage by assiduous government action and unremitting allurements, the reproduction of human lives with a view to asserting ideals of national power. Undoubtedly national power cannot exist and never has existed in the absence of a large population. But it is no less certain that if it be desirable to avoid the phenomenon of densely populated but poverty-stricken countries the growth of the population requires a proportionately larger expansion of production. To hold out

to such countries the prospect of territorial conquests, colonial expansion, or lucrative emigration as a means of offsetting such poverty, is to offer them too uncertain a means of redress. Should such projects, which may run counter to the national ambitions of other States, fail to succeed, they will only be a source of disillusion and losses which may weigh heavily on whole future generations (1).

7. — The sense in which the failure to secure the expansion of *per capita* income may be ascribed to under investment .

When neither the individual citizens nor the State do or can assign to productive activities all that is needed to assure their expansion at a more rapid rate than that of the population, the employment of labour and the absorption of possible unemployment will become difficult, even on a market on which conditions favour free competition. It is customary to say that this occurs, and that total real income declines, owing to "under investments". This expression, this ellipsis, can never alone explain the complex phenomenon of unemployment. It can only account for it when accompanied by all the preceding arguments which show the need that the growth of population in general and that of the working classes in particular be accompanied by an adequate demand arising from the expansion of production, which in its turn is made possible by the presence of a whole series of favourable conditions in a given country.

In substance, the reasoning must therefore take into consideration all those conditions, affecting the supply and demand of labour which, as above stated, concur in determining its employment. To assert that unemployment is due to "under investment", *i.e.*, to the fact that the rate of the formation of capital available for productive enterprise is too slow, is only a partial explanation. The availability of capital ready to flow towards various productive activities is only one of the requisite conditions for securing the expansion of production, the growth of income, wider opportunities for employment, and the absorption of the unemployed. No objection can be raised to the use of the expression "under investment" in reference to this one condition, *i.e.*, excess of consumption and defi-

(1) JANNACCONE, P.: *Op. cit.*, p. 38. See also "The Colonial Problem, an Economic Analysis" by the author of this report. King & Son, London, 1938.

ciency of savings, provided all the other conditions which encourage the growth of income and the more extensive use of the factors of production be borne in mind.

8. — The third condition for the development of employment and the absorption of the unemployed: Facilities for exchanges with other markets. The phenomenon of the migration of labour.

A third essential condition for securing wider opportunities for the employment of labour is that the market which has labour at its disposal be able to communicate with other markets and to exchange consumption goods, semi-manufactures, and the factors of production with them without encountering an undue number of obstacles. In our first study we made reference to the fact that recourse to foreign income through exports raises in the exporting country the volume of incomes available for replacing those which cease with the cessation of hostilities. The growth of incomes facilitates the employment of the labour which remains in the country. The same may be said of recourse to foreign capital available for investment in any country calling for it for encouraging the expansion of productive activities and increasing the opportunities for employment. The larger the imports of capital in countries with abundant supplies of labour, the smaller will be the need for emigration. It would seem superfluous to insist on this point.

The phenomenon of the exportation of the factors of production from the poorer countries is however a special one and worthy of thorough study. Such exports are generally confined to labour and the movement is known as emigration.

Its origin is readily discerned. When in all the available jobs open to the worker in his own country the value placed on his net marginal productivity by the entrepreneur class is inferior to the minimum wage essential for meeting his physical needs, and when at the same time the social aid extended to him is insufficient, or only temporary, labour tends to transfer itself to other markets on which opportunities for the same or for other employment allow of its productivity being valued at a higher rate than the aforesaid minimum. Emigration is thus grafted on to the problem of unemployment in a more or less efficient effort for combining labour with the other factors of production available for assuring a higher yield and a higher wage in whatever country be most favourably situated for securing the most suitable combination of those factors, always on

the condition that it has not been possible to attract foreign capital to the country nor to secure on the spot favourable combinations of the factors of production.

The emigration of labour may be examined from many points of view (1). The following will serve as examples: (a) as trends of emigration from certain countries and of immigration to others; (b) from the point of view of the policies of the countries of origin, — desirous, for instance, of preserving the nationality of the emigrants and of protecting them against all risks, including that of assimilation by the immigration countries; and of the policies of the immigration countries, inclined to limit the number of immigrants and to discriminate in their regard in accordance with varying standards; (c) from the point of view of the social — and on each adjective a whole volume might be written — economic, demographic, ethnical, political consequences of emigration in the countries of origin, and of immigration in the countries of arrival; (d) from the point of view of the practical organisation of information services in the countries of origin on the number of persons desirous of emigrating, on their professional qualifications, working environment, favourable characteristics, the facilities afforded to emigrants, the cost of carrying them, the facilities afforded them for liquidating any property they may have in the home country, the most suitable forms of credit; and, the

(1) The bibliography on the phenomena of the migrations of labour is also a copious one, in consideration of the many aspects which may be enquired into and the complexity of the interests involved. For the purposes of this Report the following have been consulted: DUVAL, J.: "Histoire de l'émigration européenne, asiatique, et africaine au XIXème siècle", Paris, 1862; CHANDÈZE, G.: "De l'intervention des pouvoirs publics dans l'émigration et l'immigration au XIXème siècle", Paris, 1898; COLETTI, F.: *Della emigrazione italiana (On Italian emigration)* in *Cinquant'anni di vita italiana*, published by the Accademia dei Lincei, Milan, 1911; FERENCZ, J.: "Die Arbeitslosigkeit und die internationalen Arbeiterwondlungen", (Unemployment and international labour migrations). Jena, 1913; PERTILE, G.: "La rivoluzione nelle leggi dell'emigrazione". (The revolution in emigration law). Turin, 1923; JEROME, H.: "Migrations and Business Cycles", New York, 1926; INTERNATIONAL LABOUR OFFICE: "Une étude historique des statistiques des migrations" in *Revue Internationale du Travail*, September 1929; "Statistica nazionale e internazionale delle migrazioni". (National and international statistics of migrations) in *Le Assicurazioni Sociali*, May-June 1930; "Le migrazioni e le previsioni demografiche e sociali" (Demographic and social migrations and forecasts) in *Le Assicurazioni Sociali*, March-April, 1931; "Il progresso della politica internazionale delle migrazioni" (The progress of international migration policies) in *Economia*, March, 1932; WILLCOX, W. F.: (National Bureau of Economic Researches): "International Migrations. I. Statistics, II. Interpretations". New York, 1929-30; VALET, H.: "Les restrictions à l'immigration", Sirey, Paris, 1930; INTERNATIONAL LABOUR OFFICE: "La Cooperation internationale technique et financière en matière de migrations colonisatrices" Technical Conference of Experts. Geneva, 1933; BOWMAN JOSIAH: "Limits of Land Settlement", Council of Foreign Relations, New York, 1937.

practical organisation of information services in the countries of arrival on the conditions of admission, the advantages immigrants may secure, the conditions of the soil or of the factories in which the several classes of immigrants for whom there is a demand will have to work, the fiscal régime, the land settlement plans, the financing of the activities of the immigrants until such time as they may have realised substantial profits, the organisations for assisting them to find work and during the first period of employment, and the possibilities for granting them credit, the best means for the transfer of their remittances, their insurance against several kinds of risk (1).

Studies on workers' migrations might also enquire into the most suitable means for encouraging practical collaboration between all the countries in some degree concerned in migratory currents. An accurate survey might be made of all the possible outlets which scantily peopled countries or continents could offer to surplus population. An endeavour might be made to throw light on the many aspects of this complex activity, which is generally a sad and always a delicate phenomenon. Many of these aspects have already been dealt with at length by individual students, national and international research institutes, congresses, conferences, not to speak of the Governments of the several countries concerned which have taken more or less numerous and more or less efficient measures for the solution of the many concrete problems to which labour migrations give rise. Nevertheless, the origin in so far as it is related to the persistent unemployment of labour forces remains that above stated.

9. — Considered over shorter periods of time unemployment is more acute during the depression phases of the economic cycle.

We have defined the factors which determine the employment of labour — demand and supply of workers at a given real wage — and ascertained the conditions which are most likely to promote it in the course of time — free competition, the increase of the average real income received by the individual members of a community, and trade relations with other markets — and we have shown how the absence of any of these

(1) See the recent study by COSTANZO, G.: "The policy of immigration and settlement in the South American countries", published in the *Monthly Bulletin of Agricultural Economics and Sociology* of the International Institute of Agriculture, Rome, May-June, 1944.

conditions hinders the employment of labour. If we now try to get closer to the realities of economic life, characterised during periods of varying length by alternating periods of prosperity and depression, we shall have no difficulty in perceiving that all the factors above mentioned are inherent in the situation.

The degree in which unemployment increases during periods of depression is found to vary. In a progressive community, accumulated savings, reserves of capital goods and raw materials, the tendency of real income to increase over longer periods, may provide compensating factors to offset the phase of economic regression. In a stationary or declining community, unemployment may increase progressively, showing the same tendency as income to decrease over longer periods. The important thing is to ascertain the causes of this increase of unemployment, as only a correct diagnosis enables recourse to the most suitable remedies.

10. — A widely accepted explanation of economic fluctuations.

A whole host of theories have been elaborated to explain economic fluctuations and, implicitly, to explain unemployment which makes itself particularly felt in the descending phases of the business cycle. At present the most widely accepted theory is perhaps that which ascribes these crises and depressions to "under investment". "When that [depressions] happens, it is because, in the jargon that is now familiar, savings are in excess of investment. The community is trying to save in money without saving in real terms; it is trying to enrich itself by amassing claims on itself rather than by accumulating physical property of lasting value" (1).

It is, however, necessary to specify that the expression "under investment" has for the purposes of this theory a very different meaning from that assigned it by the classical school of economists, owing to the implicit consideration of events over longer periods of time. For the classical school, "under investment" and unemployment were due as we have seen to an excess of consumption as compared to savings, which were sup-

(1) "Full Employment, The Aim": *The Economist*, October 3, 1942. See also October 10, October 17, 1942, January 2, 1943. In substance, these articles set forth the theory of KEYNES, J. M. as developed in many brilliant writings and more especially in his "The General Theory of Employment, Interest and Money", Macmillan, London, 1936.

posed to be always willing to flow at once towards productive activities. In the opinion of the more recent theorists of the economic cycle, "under investment" and the unemployment to which it gives rise are due not to an excess of consumption as compared to savings, but to hoarding — an excessive preference for liquidity on the part of the quota of income saved, which quota, instead of being less than proportionate to normal consumption may be proportionate or more than proportionate to it, especially when personal income is growing and consumption by the owners of income fails to keep pace with it. It is a question of savings which are unwilling to flow towards productive investments. Hence a disparity between the volume of savings and the volume of investments.

The classical school believed that in the long run *all* savings were invested in productive activities. The opinion of the recent theorists of the economic cycle is that as the inclination to consume does not increase proportionately to the increase of income but in a lesser degree, and as the inclination to invest accumulated capital in goods or productive activities does not develop, the community ends by spending less than the amount required for purchasing all the consumption goods which have been produced. In this case, reduced consumption does not imply larger investments and more employment, as might have been presumed on the assumption that savings are always seeking investment in productive activities. In this way a gap is opened between incomes derived from productive activities and the future demand for consumption goods. As a result of this gap, not all the savings of the several incomes are converted into productive activities. This gap gives rise at more or less regularly recurring periods, to depressions characterised by unemployment.

11. — An attempt at a more thorough explanation of the economic cycle.

These ideas have given rise to many comments in international literature. Some have endeavoured to show that hoarding, which is the backbone of the whole theory, is a phenomenon of no very great importance except in periods of great unrest. In this connection, the war years have multiplied in all countries the instances and forms of hoarding. But, as a rule, people hoard for varying periods which differ with the character of the persons concerned and of their environment, but which are presumably of no greater length than that of the productive cycle for a large

number of goods. Therefore, the balance between savings and investments tends to be reestablished even over shorter periods of time, though perhaps subject to a deduction which, if it remain fairly constant, in time will permit us to note the steadiness of productive investment, and will enable us to ascertain also the constancy of productive investment.

But whatever may be the importance of hoarding for individuals, to point out a disequilibrium between *excessive* savings — due to insufficient consumption if incomes are rising and any how to a preference for liquid savings — and the scantiness of investments, is to ascertain a fact rather than to give a real and proper explanation of the causes which produce it. To establish the fact that a part of the total income received by the several recipients and saved by them in various ways, does not re-enter circulation because it does not flow towards productive investment, does not explain why savings are thus retained. To point out the disequilibrium between savings and investments is only to call attention to a fact. What is important is to ascertain why people who were accustomed to invest their savings now prefer to keep them in a liquid form.

A careful examination would seem to show that the reason for this preference should be attributed to the prospect of smaller profits consequent on a high estimate of the risk incurred in producing the quantities which had been customary until a certain date. This estimate of the risk leads to the high cost of each investment, a cost insufficiently offset by the prospective profit — *i.e.*, either the rate of interest, if the investor be the owner of the savings, or the business profit if the owner of the savings be the entrepreneur. As soon as the entrepreneur perceives, when the price rise has attained a certain level, that costs are rising more rapidly than prices owing to the inevitable “burdens” connected with an often stormy period of business expansion, and that therefore profits are likely to fall (1), and as soon, as this perception spreads among most of the undertakings existing on the market the output of capital goods slows down, the distribution of incomes to all partaking in production declines, consuming capacity shrinks, there is less demand for labour and more unemployment.]

¶ The perception by the majority of entrepreneurs of a divergency between the rate of the upward trend of costs and that of prices, leading

(1) I may be excused for referring to an article of mine “Escape from stagnation: an essay on business fluctuations”. King & Son, London, 1933.

to lower profits and fewer orders for capital goods determines "the culmination of the ascending phase" the "point, or the beginning of the crisis" which logically precedes the "ascertainment" or report on the disequilibrium between savings and investments. Indeed it would seem to afford the most likely explanation of that disequilibrium.

12. — To secure fuller and steady employment of labour "favourable events" are required which will promote the increase of the real income of the entrepreneur.

Time spent in obtaining a more thorough knowledge, even if it be only a *summary one*, of the causes of unemployment over longer and shorter periods, may be considered as well spent, for as already stated, it is useless to think of finding suitable remedies for the evil in the absence of as correct a diagnosis as possible of the complex social phenomena involved.

Those who believe that depressions are due to "under investment" suggest low interest rates, (cheap money), tax facilities, easy credit as means for stimulating productive activities. These encouragements would indeed seem preferable to mere grants in aid and to the bestowal of purchasing power on consumers in the form of doles or a call to the colours. But to make sure that notwithstanding the preference given to liquid savings, the cost of either of these policies will be met out of savings which it is presumed are being hoarded, it would be necessary to have recourse to forced loans obtained from well identified groups of holders. On the other hand those who ascribe depressions to the fact that the majority of the entrepreneurs on a given market have become aware that costs are rising more rapidly than prices, that consequently they foresee smaller profits and therefore reduce their orders for capital goods, thus retarding all stages in the process of production, recognise indeed the value of the remedies proposed; but to emerge from the more or less stagnant situation which accompanies a moderate recovery in the output of the more essential goods based on the use of existing income and savings, and to advance towards a rise in the quota of growing income which alone would allow of a more extensive and more continuous use of labour forces, they believe it is essential first to increase the income of the entrepreneur.

In many countries the incomes which have survived the depression and the savings available at the end of the hostilities will only be able to absorb a limited number of the unemployed. If unemployment is gradually

to disappear without returning in a yet severer form, the quota of real income received by the entrepreneur, representing the difference between the cost and the price of the goods or services he has produced, must have the possibility of increasing to a considerable extent in many lines of production simultaneously. The real income of a community, as pointed out in our first study, is the sum of the real incomes which arise and are distributed among the several persons participating in the production of consumption goods. But of all real incomes the most important is that of the entrepreneur, *i.e.*, the quota of consumption goods, expressed may be in terms of money, which comes to him after he has paid the price for the use of all the other factors of production. Nowadays, almost all productive activities are carried on by the undertaking, whether owned by a private person, group, or State. It may therefore be said that as long as the real income of the entrepreneur increases, the real income of all collaborating with him increases also. Should it be impossible for his real income to increase, those of the other factors of production will not increase.

Now, a lasting increase in the real income of the entrepreneur cannot be obtained as the result of the automatic mechanism **functioning** at the end of a period of depression. Such lasting increases can only occur as the result of "favourable events" affecting several important branches of production at one and the same time, and bringing with them a larger volume of consumption goods, higher real income for the entrepreneurs, higher real incomes for all participating in the favoured activities.

Such events may be related to an effective development of human activity which encourages larger outputs and there is nothing mysterious about them for they have always occurred from time to time in the history of human civilisation.

In our opinion these "favourable events" are essential for assuring, after a period of depression, the start of a serious recovery and a marked increase in the opportunities for absorbing any unemployed labour.

13. — Summary of the preceding paragraphs.

To sum up, unemployment is the result of causes reacting on the supply and demand of labour; excess over a long period of consumption as compared to savings, due either to low incomes or to expensive habits of free competition; the tendency of the average share of income

pertaining to each member of the community to remain constant or to decline with the growth of the population; insufficient exchanges with other countries; and, over shorter periods, the preference, shown, for instance, for liquid savings and the consequent tendency to hoard. Deeper enquiry will show that the absence of incentives to invest savings and to encourage a demand for labour may be attributed to the fact that most entrepreneurs have, at a given stage in the upward trend of prices, become aware that costs are increasing more rapidly than prices, and that consequently the prospects for profits are rapidly deteriorating.

The *convergence* of the causes affecting unemployment, working over longer or shorter periods of time, suggests diverse remedies. Obvious remedies are those which favour a free competitive market by eliminating harmful forms of privilege and which encourage easy and plentiful trade exchanges as a means for securing employment. Should consumption be found excessive as compared to savings — and should the excess be due to luxurious habits — an obvious remedy can be found in the regulation of consumption which, in the case of the wealthy classes may even lead to certain prohibitions. Should the excess of consumption as compared to savings be due to the low level of the incomes received, obvious remedies are to be found in measures for checking the growth of the population and in the grant of certain facilities to productive activities with a view to securing an increase of real income on a larger and more rapid scale than the increase of population.

As regards the preference for liquid savings, lower rates of interest, tax-facilities to investors, the foundation of institutions willing to grant credits on advantageous terms, political policies which inspire confidence in the future, are all means which may contribute to remove it. Nevertheless, only an event which favours at one and the same time several branches of production — due either to chance or consciously brought about — will be able to lift business out of the depression and secure a considerable increase of the opportunities available for the employment of labour.

PART II
SOME REMEDIES

14. — After the war fuller and more permanent employment will only be secured by increasing incomes and savings.

The several remedies for unemployment above mentioned should form part of the policies devised for overcoming the difficulties of the immediate post-war period ; although some of them, such as free competition and rising incomes, must be considered as likely to be secured only after some time has elapsed.

In our first study we compared some of the characteristics of the post-war period — though in this case the phenomena present themselves on a much larger scale — to those of a period of economic depression which we described as characterised by the presence of : (a) incomes resulting from independent private activities which have continued active even during the war — though in many cases on a reduced scale — to supply the indispensable needs of the people ; (b) incomes which the State distributes through the production of public services, or by drawing on the above mentioned incomes, or by drawing on savings, or by spending capital, or by the creation of monetary instruments. We added that the means required for securing economic recovery and for carrying on essential government activities in the post-war period, could be obtained mainly from such permanent sources as incomes and savings, and from the former rather than from the latter.

Should these views be correct the maximum limits within which permanent employment can be found for all those factors of production — and first of all for labour — which may be unemployed in the post-war period — will be determined in the first place, at existing wage and interest rates by the size and permanency of the entrepreneur's income, and after that by the size and permanency of the incomes of all persons participating in his productive activity, which enable them to acquire consumption goods and to assure their future production. In the second place — by existing savings, used either for the direct purchase of consumption goods, whose production thus tends to increase, so long at least

as the said savings are available for spending ; or for the production of goods and services and for producing new incomes with which the recipients will afterwards purchase consumption goods thus assuring the continuity of the several forms of production and the employment of labour. Thus to secure in the post-war period the fullest and most permanent employment of labour possible, every conscious effort should be directed towards raising the amount of real incomes and of savings desirous of investment in productive activities.

15. — The form in which the event favourable to production may present itself.

We have already made mention under this head of *improvements* in the processes of manufacture arising from the pressure of war needs but which can be used in peace time for the more advantageous production of consumption goods or even of public services ; improvements in the means of transport which by assuring greater rapidity bring markets into closer contact and reduce production costs for a variety of goods ; greater *facilities for trade* between the countries willing to repeal or lower the innumerable barriers set up in recent years, while taking into due account the losses which such action will inflict on the hitherto protected industries in the countries thus throwing open their doors to closer trade contacts ; the grant of *long-term credit on favourable conditions*. All these are conditions which, when coordinated by the conscious action of skillful entrepreneurs and backed by enlightened government action, might well open up in many branches of business the prospect of those wider margins between costs and prices which would induce entrepreneurs to enlarge their business and increase the employment of labour.

The provision in a given country of the preliminary conditions, referred to in par. 5, which are essential to the progressive growth of production will depend substantially on the foresight of business men and on the prudent policies of Governments. These essential premises are available savings at low interest rates, high yields of all the factors of production, their abundant supply which will facilitate the adoption of the combinations most economically desirable, and also the conditions most favourable to fuller employment such as a definite tendency in favour of a free competitive market, the firm intention to remove the obstacles in its way, trade relations with the largest possible number of countries so as to se-

cure more opportunities for selection in the purchase and sale of goods and services, the growth of income at a more rapid rate than the growth of population, and lastly, over shorter periods of time, recourse to the most efficient means for stimulating the flow of savings towards productive investments, such as low interest rates, tax exemptions, fiscal facilities, organisations for credit.

It would therefore seem possible in the post-war period to arrive at a wise *coordination* for this purpose of the several factors which we have shown to be essential to fuller employment of labour rather than to wait the uncertain advent of "favourable events" to give rise to a recovery promoted by the need of satisfying unsatisfied requirements, a recovery which should be followed by a definite increase of the real income earned by the majority of the entrepreneurs on a given market.

This coordination, which might simultaneously widen the spread between cost and prices in many branches of production would produce real incomes for the entrepreneurs, allow of a larger demand for labour on their part and of fuller employment for the working masses and would therefore itself constitute the "event" favourable to independent private activities.

Now a foremost part of this coordination of factors and conditions favourable to the growth of production is the incentive to exports with a view to adding new purchasing power to national incomes promoting either an increased demand for the goods and services already produced on the market or the demand for new goods whose production can be undertaken with the further employment of labour. These policies doubtless call for careful handling, but they should be fostered by all available means. Their development calls for careful and detailed enquiries into all the possible forms of *competition* which will have to be met on the international markets which it would be desirable to secure for national products. The task is a long one calling for much patience, but it alone can increase, within a relatively short period, the available supply of real incomes on a given market.

At the same time, as we have repeatedly said, national savings — which do not always amount to a considerable quota of the total income — may be advantageously supplemented by those of other countries which find it to their interest to invest in productive activities on the market in question. The influx in various forms of savings from abroad enlarges the production of consumption goods on the debtor market, allowing a

future reduction of costs by which consumers will benefit to a degree which will progressively increase with the approach to a system of free competition. The production of goods for export, consisting frequently of a wide variety of agricultural and industrial products, will expand; and if the contribution from abroad be made in the shape of capital goods — fertilisers, raw materials, implements, machinery, which can easily be converted from war uses to productive uses — the danger of specific inflation will be avoided. At the same time an increased demand for labour at given wage rates will be created on the debtor market and the absorption of the unemployed will be promoted.

**16. — Logical sequence of the measures for absorbing the unemployed.
Production of capital goods and execution of Public Works.**

The coordination to which reference has been made, suitably carried out by the policies followed by private enterprise and favoured by clearly defined notions held by the responsible authorities, while providing, at least in the intention of those who prepared it, the “event” simultaneously favourable to many branches of productive activity, will also suggest the logical sequence of the several tasks to be performed in the first post-war years with a view to securing the fuller employment of labour.

The following would seem to be the right sequence. The *selection* of the branches of *production* which it is thought desirable to revive will be made by private entrepreneurs acting either on their own initiative or at the request of the State, with due regard to the needs of the home and international markets and to general requirements. The activities which will be most easily revived will be those in a position to support themselves on the proceeds of their sales, while taking into account the various forms of assistance required in the early stages of adjustment.

When the selection of the most economical consumption goods to be forthwith produced has been made, it will be found necessary to produce on the spot, repair, or even import *capital goods* for the production of commodities intended for home consumption or for export. What capital goods should be produced at home so as to give immediate employment to the unemployed masses and what should be imported from abroad will be the next problem the entrepreneur will have to solve, and here again he will be guided by the consideration of lower costs which alone can as-

sure stability, or at least long duration, to his activities and to the distribution of the incomes to which they will give rise.

But if after the war the production of consumption and perhaps of capital goods is to be made possible or much more efficient, the need will be felt for carrying out certain *public works* which, in their relation to the aforesaid productive activities may be described as instrumental. Such, for instance, in the first place would be those for reconstructing and improving the efficiency of the means of communication and transport more or less severely injured by the war. This would include the repair and building of roads, railroads, and tram-lines; such, for instance, are works for reconstructing houses, hospitals, essential public buildings, and those for increasing the efficiency of the southern territory, land-improvements and roads of access to them, and when freight rates or the need of obtaining supplies from abroad make this advisable, the improvement or building of ports and docks for the merchant marine. The instrumental character of such works in their relation to consumption goods will decline progressively when their purpose is protection against floods, irrigation and water derivation works, the construction of mountain reservoirs. But in all cases an exact knowledge must be had of the more or less immediately instrumental character of the public works contemplated in their relation to the production of consumption goods, and of their consequences for the absorption of any unemployed labour.

17. — I steady employment be the aim, it would seem desirable to draw a distinction between public works of a truly instrumental character required for the production of consumption goods and others not, or hardly, of that description.

If we wish to ascertain the volume and duration of the employment public works may afford the labouring masses, it is important to draw a distinction between them based on their instrumental character in relation to the independent production of consumption goods. Let it be granted that, whether typically or remotely instrumental in the production of consumption goods, economic considerations must guide the decision whether the capital goods required should be produced on the spot or imported from abroad and whether in accordance with the decision taken, the outlay estimated will be available in full for giving work to the unemployed or only for that part remaining in the country. On the basis

of the decision taken, the estimated cost of each public work will afford employment either to all or to some of the unemployed. But here we should remember that any outlay on public works *competes*, as regards the financial resources to which recourse must be had, with the outlay required for the production of the capital goods instrumental for the production of consumption goods.

This being the case, public works (1) can only create values offsetting the cost they entail when they are definitely of an instrumental character as regards the production of said consumption goods. Only then are they economically justifiable and only then can they, for the purposes we are discussing, assure steady employment for a part at least of the employable workers. If when carried out they undoubtedly increase the output of consumption goods, the growth of real income at the disposal of the community will, in its turn, afford employment to some at least of the labour engaged on them at an earlier stage which will be thrown out of work when they are completed. But if such works are *not* instrumental for the production of consumption goods, they may indeed assist in facing contingent needs of a social and political nature but, in spite of the brilliant theories of the "multiplier" (2) they will only afford temporary employment to the labour engaged on them.

The fact is that all public works carried out for the purpose of absorbing large masses of unemployed are characterised by two forms of utility. One is transitory, due to the redistribution of incomes in the interest of certain easily identifiable groups to the injury of many others not so easily identified. (In this consists the difference between the reactions of a system of taxation worked out in conformity with the economic structure of a country and the reactions of State interventions for non-economic purposes such as that now mentioned). The other is permanent and is shown by a comparison of the *present cost* of the public work with the *present appraisal* of its value which — as in the case of all future goods — is ascertained by capitalising the estimated returns at the current rate of interest. It may be admitted that, in practice, and more especially if the work is of social or political importance the comparison between

(1) What is here said of public works can be repeated for all State activities. See also the last study of this volume.

(2) For bibliographical indications the reader is referred to the essay by the present writer: "Aspetti economici di una politica di opere pubbliche" in the volume *Equilibrio fra attività economica e finanziaria*. Giuffrè, Milan, 1943, p. 157.

costs and resultant value need not always be favourable. Nevertheless, the execution of public works solely in view of their temporary utility inevitably *destroys* goods in the country carrying them out, decreases its total income, and affords only temporary employment to the labour engaged on them at the start.

It may well be that in meeting the very difficult post-war situation, no country will be able to avoid the need of carrying out public works of this latter description, beginning with the reconstruction of public buildings and monuments thus finding employment for large bodies of workers. We purpose studying in another report the problem of financing such works of reconstruction (1); here it would seem advisable to repeat that the employment of labour on such undertakings can only be temporary should the works themselves be only remotely instrumental for the production of consumption goods for which there is a demand on the home and foreign markets.

18. — Unemployment insurance neither promotes nor favours the employment of labour forces.

Notwithstanding all the efforts made with a view to supplementing national incomes and savings with the incomes and savings of other countries, so as to encourage the more extensive and independent production of consumption goods; notwithstanding all the efforts made with a view to preparing an environment favourable to such an expansion of production by carrying out public works of a typically instrumental character which will therefore yield a revenue in the course of time; the unemployment of labour may still persist especially when it is not possible to lower existing wage-rates (2). The pressing nature of the problem then suggests recourse to more or less hazardous measures, most of which disre-

(1) Administrative and financial rules may be suggested by the wide experience acquired, at least in Italy, with legislation on earthquakes, taking of course into due account the different proportions of the post-war problems.

(2) The observations contained in par. 4 make it unnecessary to enlarge on the consequences of a policy of artificial wage-rates, *i. e.*, wages which are not in keeping with the yield of the worker in the productive combination of which he is part. After all, high wages raise the costs of production, thus causing considerable loss to the export trade which is placed at a disadvantage in its competition with foreign products, and they adversely affect the execution of public works, even of those which are typically instrumental in their relation to the production of consumption goods. The scale on which such works are carried out is reduced by the higher costs entailed by higher wages. See also *The Economist*, article on "Financial Strategy", March 1943, p. 440.

guard economic principles and are guided exclusively by social and political considerations. This makes it all the more urgent to examine their inevitable consequences.

As some of these measures hinder free competition they may therefore also be considered as hindering an increase of employment. But some further details may serve to show more clearly this ultimate consequence, which is not always perceived by even the best intentioned persons.

Some writers give us to understand, though they do not say so explicitly, that they consider involuntary unemployment can be adequately controlled by a wide system of social insurances. In substance, such insurances tend to ear-mark funds obtained by contributions made either by the groups concerned — workers and employers, or by the State, *i.e.* by the whole body of citizens. As the funds thus obtained are themselves dependent on the cyclical movement of economic life, they tend to increase when the incomes of the contributors increase because the same percentage levied on a growing income secures larger yields and because in prosperous times when the factors of production are fully employed, there is less need of having recourse to the fund itself; and they tend to diminish when the incomes of the contributors are falling.

When special funds are provided for this purpose, insurances against involuntary unemployment amount to a real form of taxation. The sources from which they are drawn are always the same, *i.e.*, the incomes and savings of the several parties concerned. The advisability of keeping insurance contributions separate from taxes arises only from a spontaneous division of the relief work the Government undertakes. There can be no doubt that when the incomes of contributors are falling off, the burden of the contributions, like that of all other taxation, causes or accentuates the "passive" situation of the entrepreneur and of all participating in his productive activities. Then, in many cases, the State covers this deficit of the entrepreneur class by levying taxes on other groups of citizens and assigning the proceeds to specified undertakings. The deficits of the unemployed or of other persons adversely affected by the conditions to remedy which the insurance system was set up, are met out of the special insurance fund. This fund may be said to anticipate, in so far as the persons required to contribute to it are concerned, taxes levied by the State in behalf of the unemployed, the advantage of insurance being that savings are thus made promptly available which would otherwise have to be procured under less favourable conditions.

By establishing these notions, two points are made clear. First, that the grant of assistance to the unemployed can never provide a solution, even if only partial, of the problem of securing steady employment for labour. Insurance can only give temporary aid. Secondly, that both the contribution levied for such insurances on individual contributors and the burden placed on the State by social insurances in general — a burden which the State re-distributes by direct and indirect taxation over the whole body of citizens — curtail incomes and savings. And as the yield of social insurances is hardly ever used in its entirety for securing a larger output of consumption goods, the real income of the community, (as has been noted in par. 4) will sooner or later decline. The reduction of income will reduce the possibility of providing steady employment for those workers whom it was desired to insure against the risk of unemployment. Thus the remedy, based on social policies which call for widely inclusive social insurances to satisfy the masses, if it can be justified when used as a temporary measure, proves inadequate for solving the problem of unemployment and harmful if a sharp eye to its consequences does not keep it within proper bounds.

19. — The same argument holds good for doles to the unemployed.

Should doles amount to sums comparable to the minimum wage ruling at a given time on a given market — and in some cases they even exceed it — the voluntarily unemployed have an additional reason for refusing the jobs offered them and for transforming unemployment from a temporary into a permanent condition. Again, should the difference between the wage with which they would be satisfied and the dole they receive for doing nothing shrink, the involuntarily unemployed will cease to seek for jobs and will grow accustomed to relying on the charitable dispositions of the community.

On the other hand, the sums expended on doles, levied on the incomes, of the taxpayers, do not promote production of consumption goods, neither do they raise the total real income of the country. At best they reduce the consumption of those on whom they are levied while enabling the unemployed to become consumers. But the unemployed rarely consume as much as did the original owners of the taxed incomes prior to the taxation. Indeed, it seems likely that the two outlays on consumption can never balance, as the whole of the dole is not spent on consumption goods,

and even if it were, the several outlays are not entirely devoted to the purchase of those profitable commodities which give rise to independent revenues instead of needing to be themselves subsidised.

Under these conditions, the minus difference between the amount and value of consumption arising from the expenditure of the doles to the unemployed as compared to the consumption which took place, or might have taken place, before the taxes used for paying the doles were levied, shows that the real income of the country has been reduced. At best it has not been raised as would have been the case if the original incomes had been directed towards productive activities able to support themselves on the receipts from the sale of the commodities they produce. Thus charitable relief — fully justified from the humanitarian and social standpoint — hinders the increase of real wealth and therefore hinders, in the last resort, the employment of labour.

These consequences are not modified by the fact that the fund from which the doles are paid is drawn not from incomes but from savings which would otherwise have been invested in more profitable activities either at home or abroad and even in periods of depression and low prices ruling for goods and services. Should the fund be levied by the taxation of incomes or by loans drawn on savings which would have been hoarded and not invested, the advisability of assigning them for doles will still depend on the volume of consumption goods to which the expenditure of the doles will give rise and on the absorption of unemployment which their production will lead to.

But in any case the production of consumption goods brought about or increased by the savings — whether willing or unwilling to seek investment in productive activities — will cease as soon as the fund formed for this purpose is exhausted and the doles cease. Unless in the meantime and for other reasons (improvements, discoveries, etc.), the activities set going by the expenditure of the doles should be able to support themselves on returns from sales and thus be able to hold their own on the market. Therefore, the efficiency of the policy of drawing on savings to distribute them in doles is always transitory. It does not and cannot solve the problem of finding work for unemployed labour (1).

(1) The State assigns for doles a thousand million monetary units, which we presume are levied on incomes which is the supposition most favourable for the continuation of said assignment. Applied to the production of real income — consumption goods or instrumental goods used for the subsequent production of consumption goods — this

When the sad phenomenon of unemployment exists, the community may, or rather should, come to its relief. But if something better than a mere panacea is to be sought, the direction to be followed will be that of encouraging the output of commodities for which there is a real demand at home or abroad and which are therefore profitable. Doles, whether paid out of funds levied on the incomes of the taxpayers or drawn from savings can only provide a temporary remedy. To persist in them only hinders the growth of real income and the future employment of labour.

20. — The protection of productive activities cannot permanently favour the employment of labour.

Some writers consider that the protection of activities which otherwise could not take root in a given country affords a means for providing work for the unemployed.

It is easy to see that by granting protection or other forms of assistance as a means of introducing or reviving a productive activity which in the absence of favourable conditions for its development could never live in a given country on receipts from sales, State intervention does not create *ex novo* new productive factors in addition to those in existence which can be combined with any unemployed labour. Such intervention merely displaces productive factors from uses to which they had directed themselves as being more profitable under existing competitive conditions on the home or foreign market, to uses which only protection can make profitable. Thus the employment of labour in protected occupations may be secured, sometimes on a large scale, but at the cost of employment which might have been given in other occupations or in other countries with more copious results for all, therefore including the classes whom the advocates of protection wish to favour (1).

thousand million would have given permanent employment to a certain number of workers, for instance, ten thousand. Distributed in doles, the thousand million do indeed relieve for a certain time a still greater number of unemployed. When, however — say at the end of a year — the fund is exhausted the real income available in the country is found to have been lowered, or at best it will not have increased as much as would have been possible had the thousand million been used for profitable forms of production. Unless in the meantime income has been increased by other causes to that amount which would have been the case had the thousand million been at once applied to the aforesaid activities. Therefore the assignment of doles aggravates rather than settles the problem of finding work for the unemployed.

(1) "Protective duties, even if efficacious, favour some industries and attract available labour and capital to them. But the duties do not create capital, therefore they cannot create a new demand for labour on the market considered as a whole. They

To this argument the objection is raised that until the outbreak of the second world war, agricultural and industrial activities were only made possible by protection which, over long periods of time, enabled work to be provided for large bodies of labour. They do not deny that at bottom, protection hinders the growth of total income, and in the course of time, the fuller employment of labour. But, they say, were protection to be repealed where would the workers hitherto engaged in these sheltered occupations find work? To deprive agriculture and industry of protection would mean that in the first post-war period unemployment, already a serious menace, would increase to an often threatening extent. In reply to those who suggest as a remedy opportunities for emigration — safeguarded in every way so as to reduce on the one hand the risks incurred by the emigrants on the other the drawbacks to the country of origin — the aforesaid writers point out the net loss which that country would suffer by the departure of workers, especially of skilled men on whom large amounts of capital have been invested to bring them up to a certain level of productive yield.

That emigration inflicts a loss on the country of origin, thus deprived of forces trained often at considerable expense and effort, cannot be denied. But, in the course of time, this loss may be made good by remittances, the value of which will increase in a measure corresponding to the skill and energy of the emigrants. We cannot, moreover, neglect the losses caused by setting up or reintroducing protection, such, for instance, as the withdrawal of means of production in the country of origin and elsewhere from activities which could be self-supporting and in which the said means could secure larger yields and earn larger remuneration. The higher price of the commodities produced with the help of protection des-

therefore deflect the natural direction of investments. They force the labouring population to change more or less suddenly its previous distribution between the several industries. While on the one hand the duties stimulate a demand for labour in the industries to which capital is attracted, on the other hand they necessarily lead to a shrinkage of the demand in the occupations from which capital is deflected.

“There has not therefore been a numerical compensation between the thousands or tens of thousands of workers who have more easily found employment in these industries, and the hundreds of thousands of agricultural labourers or wage workers who have found in emigration an escape from unemployment at home. Nor can we even say that there has at least been a compensation between the larger amounts of wages paid to some and the smaller amounts paid to the others.

“For protection not only changes the distribution of the working population, forced to change its occupation, but also gives rise to a production crisis, as it reduces the general average wage rate”. DE VITI DE MARCO, A.: “Un trentennio di lotte politiche”, Rome, Collezione meridionale editrice, pp. 83-84.

troys moreover for an indefinite period all those returns which might have been available to consumers had they purchased the said products at a lower price, perhaps by importing them from abroad. We are therefore justified in enquiring whether the losses suffered by a given country once for all as a result of the emigration of a certain number of workers are heavier than those suffered for an indefinite period as the result of protection.

The balance-sheet may be drawn up in conformity with strictly economic principles, or, as is frequently the case, on the basis of social and political considerations. It is not easy to lay down *a priori* policies. Each country must face and reflect on the concrete problems arising from its present conditions. Nevertheless, it would seem that we are justified in stating that should unemployment continue when all reasonable efforts have been made for providing fuller and steadier employment for the workers, the reduction of the supply of labour by emigration offers the inevitable, though regrettable, solution.

21. — Organisations of preliminary studies. International collaboration of public bodies.

To observe the logical sequence in which in the post-war period profitable productive activities will be reestablished by private enterprise, and action will be taken by the State for encouraging them and for carrying out certain public works, it would seem essential that all countries should be able to avail themselves of a series of data on (a) real and monetary *income* and its distribution; (b) *savings* and the rate of their accumulation in a given unit of time; (c) currents of *imports* and *exports* of the several commodities, taking into due account the modifications which have taken place in recent decades and the present and probable possibility of enlarging and diversifying the several markets of origin and destination; (d) the *employment* and unemployment of the several groups of workers for whom reliable statistical data are available.

These investigations of real conditions would be preliminary to an accurate description of the several productive activities which could support themselves on the proceeds of their sales and which should therefore be developed and extended vigorously, and of the several kinds of public works, inclusive of those typically instrumental for the production of consumption goods and of those which are less definitely of that descrip-

tion. On this basis the preparation and subsequent execution of the several plans of production — by private enterprise in the case of consumption and capital goods, by the State in the case of the various kinds of public works — could be greatly assisted by the work of a national research body which by facilitating contacts between all engaged in preparing such plans and between them and the public administrations, and by acquiring as complete a view as possible of the several initiatives and activities could eliminate the danger of overlapping and contradictory action, taking care from the start — and therefore with the least possible waste of energy — that all the forces of the country be so directed as to secure larger real incomes and fuller employment of labour. As is evident and has been repeatedly stated in the course of this study, private enterprise for the production of consumption goods for sale on the home and foreign markets, no less than the initiatives undertaken for producing or importing capital goods to be used for their production, and the plans for public works typically instrumental for such production undertaken only to provide work for the unemployed, will require — apart from the financial arrangements of which we shall speak in another study — a systematic series of agreements with the selling countries and with those which offer markets for national exports; in some cases with countries whose exports compete with those of the home country. They therefore presuppose voluntary international collaboration without which no one will be able to attempt the solution of problems of some importance. They also presuppose prudent activity on the part of the public authorities.

At first, at least the Government of each country might assist in overcoming the difficulties which may beset private enterprise, as, for instance, in the case of supplies of capital goods required from distant parts of the country or from abroad, by agreeing to import them for subsequent distribution in conformity with the needs of the several branches of production; or by securing credit on favourable conditions which it would be difficult for the individual enterprises to obtain. It would not be a case of setting up and perpetuating purchasing or sales monopolies, credit monopolies, preferential customs' tariffs, nor of bargaining for political advantages, but a question of loyally supplementing the efforts of sound undertakings which if left to their own resources might not always be able, even with the best efforts on their part, to secure the ends in view.

It is desirable that the extent to which private initiative, capacity, and interest can co-exist with government action in the difficult work of reconstruction should be examined with a definite tendency to allow

State intervention to be guided by a respect for the principle of economic advantage, which we shall analyse in our last study.

Liberty, now so much talked of even though its real meaning does not always seem to be understood, is undoubtedly the irrepressible aspiration of the human spirit, the instinctive goal of all beings desirous of developing their personality in social relations with their fellows. Nevertheless, given the complex phenomena of social life, long denials of such liberty cannot alternate with the sudden assertion of opposite systems.

It is neither conceivable nor desirable in the interests of the individual members of a community that a sudden change be made from the intricate regulation of economic life to a complete and perhaps contradictory freedom of action, especially during a period in which, in view of the nature of the problems to be solved, the aim is that of securing in as short a space of time as possible the progressive increase of real incomes and the fullest possible employment of all the available factors of production.

Minds free from ideological preconceptions and from political pressure will perceive that the cause of individual and national liberty will be best served in the post war period if individuals and Governments alike give due weight to economic standards, which should be harmonized with others of no less importance. For this purpose an accurate knowledge should be acquired of those restrictions of freedom which should be gradually repealed as national income increases and of the lines which should be followed to encourage a business revival and fuller and steadier employment: in short, for potentializing human personality, which is the supreme purpose of all civilised societies.

IV.

NOTES ON THE PROBLEM OF MONETARY
REHABILITATION

IV.

NOTES ON THE PROBLEM OF MONETARY REHABILITATION

CONTENTS

The stages of monetary rehabilitation are clear. The cessation of the issue of paper money, immediate or deferred for a relatively brief period. An estimate of the average level which the prices for the main groups of commodities and services should reach. Firmness on the part of the monetary authorities in pursuing the goal of eliminating fluctuations in the purchasing power of money. The continued application of measures for limiting consumption until such time as the supply of both consumers' and producers' goods shall increase.

Some of the difficulties arising from deflation policies are foreseen. The requisite conditions for assuring the stability of the foreign exchange rates of the currency which is to be stabilised are determined. The probable post-war movements of real incomes in terms of the stabilised currency are taken into consideration.

MONETARY REHABILITATION

1. — The problem of monetary rehabilitation in countries severely affected by the war.

On the cessation of hostilities, what will be the situation of those countries whose territory has long suffered from the scourge of war? Apart from positive data, it may be assumed that the national wealth of the countries concerned will have been reduced by the consumption of capital always characteristic of war; by the destruction of property, sometimes on a large scale; by depredations ruthlessly carried out under the all too convenient pretext of war needs which has authorised year after year systems of spoliation and terror which run counter to all law and to all the acquisitions of the human spirit.

Industrial and agricultural plants and undertakings will be worn out or destroyed, at least partially; farm lands will be devastated; plantations cut down or laid waste; stocks of raw material and machinery which cannot be replaced, belonging to large or modest business concerns, will be exhausted; dwelling houses and public buildings will be wrecked or ruined in enormous numbers; land, water and air transports will be reduced to such an extent as to become insufficient for meeting even the most essential requirements of the populations.

In public finance there will be alarming deficits; huge public expenditure — including that for the armies of occupation met by the unlimited issue of paper money leading to the steady deterioration of the purchasing power of the currency; revenue will be reduced in volume and efficiency; sources of income, savings and capital consumption will to a great great extent have run dry; there will be a scarcity of gold and high class foreign exchange; in spite of good intentions the various clearing systems will be unable to collect many credits; the indebtedness of the governments to private persons will have grown to apparently crushing proportions.

Yet more serious will be the mental deformations produced in the population by the habit of seeing their mode of life in its most varied manifestations regulated by the public authorities; by striking instances of profits easily secured by the redistribution of wealth which

always accompanies war — even if the fortunate beneficiaries are not, as a matter of fact, very numerous and are not always able to keep the revenues thus secured; by the desire to find some means of escaping from the innumerable hardships which always follow a war, even by recourse to risky innovations whose inconsistency and delusive nature cannot, alas, be shown by preventive criticism — always difficult in periods when susceptibilities are aroused and interests deeply disturbed — but only by direct experience. In this connection, some remarks on the state of mind prevailing in the countries which, in the previous war, suffered losses, far less severe indeed than those already estimated for that now being waged, are exceptionally valuable and above all applicable to present conditions (1).

(1) EINAUDI, I., writes in: "La condotta economica e gli effetti sociali della guerra italiana", Laterza, Bari, 1933, pp. 388-389 "..... the State became the sole supplier and sole purchaser; . . . all new savings were acquired by the State at remunerative rates. Workers were compelled to accept the hours and wages fixed by the Committee for Civilian Mobilisation, they were subject to fines and sometimes to imprisonment if they did not fulfil the labour obligations required by the authorities; but at the same time they were guaranteed a living wage, insured against accidents, unemployment and invalidity; an impartial tribunal settled labour disputes and denied to industrial employers the right of sudden dismissal and lock-outs. Both farmers and manufacturers were compelled to sell the goods they produced at "fair" prices fixed by the authorities, but care was taken that these prices should be fair not only to consumers but also to producers, i. e. that they should be in keeping with production costs. When the high price of raw materials and intermediate products on the free market raised costs to a level which would have justified a rise in prices deemed excessive from the social and political standpoint, the State intervened, withdrawing the raw materials from a régime of free bargaining, and reserving them for distribution by the authorities to the concerns considered most in need (see par. 74, 80, 81, 84). Never had industrial risks been so small as in those war years, never had the economic policies of the heads of undertakings been so safe and easy. Just as the State, with paternal solicitude, took measures to see that the soldiers did not lack arms and provisions, so it took care that the fighter in the economic arena should not lack what he needed for a living if a consumer, nor a living wage if a worker, nor a "just" profit if an entrepreneur. And as each interpreted what was fair and necessary in accordance with his own wishes, so the State mercifully assured to all a reward for their efforts, measured not by their deserts but by their needs. There was widespread astonishment that it was possible to go so far without excessively increasing taxation, of which the real burden had been raised only moderately (see par. 19 and 22), and that the great mass of indebtedness incurred by the State had not led to the catastrophic consequences which economists and financiers had rivalled each other in prognosticating in the pre-war years. So that the so-called failure of economic science was a frequent subject of ironical remarks. It seemed as though a new means had been discovered whereby wealth was destroyed by the immensely increased war consumption and the undiminished peace expenditures, while at the same time general well-being was increased by assuring safer returns to capital and labour (see par. 126). Why return to the former conditions of perpetual struggle between one manufacturer and another to snatch the crumbs of an excessively low profit? Why give free reins to the struggle between the poor and the rich, between peasants and landlords, between workers and manufacturers? Why fluctuate between rising wages in periods of prosperity and unemployment in periods of depression, if State regulation of industry as taught by the war, and arbitration made it possible to assure to all social classes fair and steady compensation for work performed? If the expression "collectivist econ-

Under such conditions, the countries which have suffered most severely will find themselves faced by formidable problems. First in logical sequence will come that of the rehabilitation of the currency, as the intensification of production and the attempt to balance the accounts of both the governments and the major business concerns can only be taken into consideration if prudent policies are first directed towards preventing a decline in the purchasing power of the money of each country.

2. — Attempts at stabilising for a given period of time the purchasing power of money on the home market and, reciprocally, the average level of prices.

After what has been said in our first report, it would seem superfluous to dally over theoretical discussions. If credit is to be brought back to its typical function of anticipating real income and encouraging its growth, it will evidently be essential to stop further issues of paper money. Issues made in the form of advances to the Treasury must cease at once. To avoid an excessive number of sudden business failures, action may for a certain period of time be less drastic in the case of advances made on behalf of independent productive activities, but at the end of that period they also should cease.

omy", was displeasing, that of "associated" economy was acceptable, and represented moreover an old aspiration of the Italian entrepreneur class and of those among them (see par. 11, 116, 117) who looked to the State as guardian, saviour and guarantor".

Further on (pp. 390-391) EINAUDI notes "... The war, with its ration cards and rationing systems, planted the idea of economic equality firmly in the minds of all. All were equally entitled to bread, to food, to a roof, just as they were all equal before the duty of dying in defence of the country. This idea, necessary in war time and innocuous if limited to a short period of time, became a dissolving ferment when inculcated during long years. The idea took more especially the form of the "just" price, by which was meant that price which had been current during the lifetime of the generations who were working when the war began and of those who had brought them up. Those generations had lived during the century following the close of the Napoleonic wars which stands apart in the annals of human history as characterised by the unprecedented steadiness of the metallic content of the several currencies and by the no less unusual honesty of the governments. These conditions had given rise to the rooted idea that the price of bread ought never to exceed 30 or 40 centimes per kilogramme, that meat was worth two lire, that a room should be had by paying a rent not exceeding 100 lire per annum. These being the "just" prices, the governments were compelled to have recourse to fiat prices, requisitions and rationing and to block house rents in order to prevent prices from rising to a level which would have been logically in keeping with the issues of paper money made by the same governments. Thus all classes, with the sole exception of those whose incomes remained fixed, found themselves in possession of surplus revenues as a result of the divergence between rising incomes and a rate of expenditure which had either remained stationary or was limited by the lack of supplies".

In those countries which were unable during the hostilities to neutralise the consequences of specific inflation by securing a complete return of the money issued to the tills of the State by what is known as the "capital circuit" — and which will therefore find themselves at the close of the war in a less favourable position than others — the cessation of the issue of paper money may induce the large volume of notes hoarded during the periods of greatest uncertainty, to re-enter the market. Their reappearance will help to facilitate credit transactions, either by direct negotiations between private parties or indirectly through the banks, and will delay, and may even to some extent prevent the collapse of business enterprise and the unemployment of means of production. The business concerns thus salvaged will, of course, be those less accustomed to rely on the continuous grant of credit and on the steady rise of prices as a means of offsetting the high cost at which they were established during periods of general and specific inflation. In the case of other more uneconomic concerns, their disappearance will be advantageous. The inevitable losses thus incurred will afford the measure of the cost of monetary rehabilitation to the community, a cost which may, however, in time be offset by a durable increase in income.

The reappearance of the hoarded notes on the market will, however, contribute to raise the average level of prices of the various groups of commodities and services.

At the same time, in attempting to attain an equilibrium, many forces will be induced, after the war, to press for a rise in the price levels already reached, for instance, a rise in wages which will inevitably lead to a rise in the cost of the goods of which the said wages constitute a part, and a rise in rents so as to allow of their adjustment to the increased value of house property. Such increases will be desired as affording the means for enabling those many prices which have remained at a lower level than the general upward price movement would have justified, to adjust themselves to the volume of the paper currency issued and reappearing on the market.

Consequently, in the course of time, the average level of prices for the main groups of goods and services will tend to rise above that ruling when hostilities ceased, at least to the same extent as the rise in the demand for the notes issued, and the same may be said for those other monetary instruments for which the note issues provide a basis. Their volume should indeed be multiplied by the velocity of their circulation, whether they be notes or cheques. As is well known, the velocity with

which money in all its forms circulates tends to decline in periods of economic uncertainty which encourage hoarding in all its forms, and tends to increase in periods of greater productive activity. It also increases when confidence in the stability of the purchasing power of the currency declines, there being then a tendency to convert money into consumers' and producers' goods at any cost.

The more rapid circulation of money contributes, in its turn, to a rise in the price level. And this rise involves: (a) a loss to the owners of fixed incomes, of whom it may be said that they are forced to save; but an advantage to those in receipt of elastic incomes, at least until such time as the rise has spread to all those goods which may be acquired by the said incomes; (b) a loss to exporting industries, which in such periods represent a conspicuous and desirable source of income. It would be vain for the authorities providing for monetary rehabilitation to under-estimate the importance of either of these phenomena.

3. — Instances of the obstacles in the way of stabilization and of firmness on the part of the monetary authorities.

The policies above referred to may meet with difficulties should increases in wages and salaries be claimed by groups of workers and employees, to whom the average levels to which the prices for the leading groups of goods and services will rise in relation to the volume of notes issued by the banks and now reappearing on the market, is unknown. Such increases, if granted, will be financed either by means of increased taxation, or, as we had occasion to point out in our third study, at the cost of other classes of citizens whose incomes, considered as a whole, will be reduced to the precise extent to which those of the other groups will be increased. Or else the cost of such increases will be met by the creation of new monetary instruments. In the latter case, the average price levels will rise above the level which might have been expected to result from their relation to the volume of notes issued, and the attempt to stabilize the purchasing power of the currency will be frustrated (1).

Apart from the demands of the groups concerned, the average price levels may also be raised above the extent which the volume of the note issue might have led us to expect, should the banks use their note reserves as a basis for allowing overdrafts to the limit of the elasticity of their resources, thus adding credit inflation to currency inflation.

(1) See on this subject "Financial Strategy", *The Economist*, October 10, 1942.

Nevertheless, while desirous of favouring the growth of production, the authorities on whom devolves the duty of supervising the money market, will always be in a position to check the excessive expansion of this form of credit, and to hinder further rises in the prices of various groups of commodities and services; they can, in short, eliminate the obstacles in the way of stabilization.

When the firmness shown by the monetary authorities is such as to restore confidence in the stability of the currency, destroying the incentive which induces the holders thereof to get rid of it for fear of further depreciation, there is no reason why the level of prices should rise above the more or less approximate limit which the volume of the currency in circulation, multiplied by the velocity of each of its forms, would lead one to expect. And, even in the least favourable hypothesis of a further issue of notes or of cheques — should the function of credit, either national or foreign, be limited exclusively to that of anticipating real income, or if, as from a specified date, the volume of the new issues remains below that of the figure obtainable by multiplying by their respective prices the volume of goods produced over the period by the processes of manufacture, — the average price levels for the main groups of goods and services will have no cause to rise above the limit corresponding to the degree of inflation which has already occurred in the country under consideration. Indeed, in the course of time, as the supply of goods and services increases price levels will tend to decline below the "points" attained as a result of the operation of its chief causes, namely the inflation of currency and the scarcity of commodities.

An increase in the supply of consumption goods, whose production in its several stages would be encouraged by the joint efforts of private business and of governments, would indeed help to attenuate one of the chief causes — which makes itself felt in spite of all fiat prices, prohibitions issued against cornering, rationing, blocks, requisitions — and also to eliminate the effects of exceptional causes, such, for instance, as the incentive to corner certain goods (1) — as the increase in the

(1) An able defence of fiat prices as an emergency measure for avoiding the rarefaction of commodities as a result of cornering by persons who, in the absence of such fiat prices might fear a rise, has recently been made by GINI, C. "I calmieri", *Rivista di Politica Economica*, 1943. He does not fail to recognize — indeed he emphasizes — the importance of the fundamental causes of price rises: the scanty supply of goods or services and monetary inflation. He only justifies fiat prices in so far as they remove, or should remove, the incentive to cornering. In practice, however, if fiat prices are unskillfully enforced (and the difficulties in the way of their enforcement are not few) the incentive to corner will again make itself felt.

available supply would do away in the minds of prospective consumers with the expectation of a rise in price. There thus remains only the most patent cause of a price rise : the creation of monetary instruments; in other words, the issue of new notes, even if in reduced volume and for periods of no great length, with a view to avoiding the failure of too large a number of business concerns accustomed to live on credit, and the issue of cheques to which the ordinary deposit banks might have recourse. If, however, the aforesaid limits are observed, stabilization will not be injured thereby.

As a result of the respect of these limits, the phenomena which can be observed in periods of rising prices will be reversed and exports will be encouraged, thus allowing of the purchase at a lower cost of other commodities or instrumental goods, and helping to spread the fall of prices to other products on the home market. At the same time, the increasing supply of such goods, either home made or imported, does away with the need of measures for limiting consumption and restricting productive activities, measures which have survived from the war period.

Some restrictions on consumption or investments may remain in force, which are tolerated by the population as the war had made them customary. The reasons justifying them are however different from those which led to restrictions made to ensure the so-called "monetary circuit". One of such reasons for instance, to which reference has already been made in our third study (par. 6), is that of avoiding loss of incomes arising from an increase of production which is expected to be more rapid than that of the population, and of obtaining an increase in the quota of the average real income per head. This motive may indeed suggest the advisability of prolonging and even intensifying the veto placed on the consumption of certain commodities considered as luxuries especially when they can only be secured by purchasing them abroad while they might be produced on the home market. Nevertheless, it is desirable that all restrictions should be repealed as soon as possible (1).

(1) References to this matter are made in the report prepared for the League of Nations by a group of international experts headed by Sir FREDERICK PHILLIPS of the British Treasury, and of which only a summary has been published in the *Financial News* of July 28 and 29, 1943. It bears witness to the desire felt that the restrictive measures enforced by agreement between the several countries should be repealed. A country which should increase its own rations more rapidly than others might cause prices to rise and make it impossible to maintain rationing in other countries. Likewise, a country in receipt of relief should continue its rationing measures, and guarantee the adequate distribution of what it produces and what it receives. It would seem necessary that each country should coordinate its action on the following points : (a) the increase

With the cessation of the creation of *new* money, or, to be more exact, with the return of credit to its typical function of a means of anticipating real income so as to ensure its equal spread in time or, as some would say, to ensure its being stationary, the process of lending for the production of consumers' goods and of the successive repayment of such loans — when, in the meantime, the population increases at the normal rate and the turnover of business grows rapidly — not only stabilization is favoured, but conditions are created for an increased supply of consumers' and producers' goods and the consequent durable lowering of prices which frees the consumers from many restrictions. No doubt the invariability of the mass of money, accompanied by an increase in population and an expansion of business, tends to lower prices. More decisive, however, is the increase in the efficiency of the factors of production, especially of labour, which results in a growth of real income (1).

4. — Difficulties of deliberate deflation.

To depress the prices of goods and services on a given market may seem to be the result of withdrawing paper money from circulation to an extent exceeding the increase foreseen in the average level of prices caused by the reappearance of hoarded notes and by the operation of forces favouring a price rise. Thus, for instance, a withdrawal of 35 per cent. of the notes issued may be contemplated if an increase of barely 25 per cent. is expected in the average level of prices. But the difficulties in the way of this and other deflationary policies are at once apparent.

of rations ; (b) the increase of the purchasing power of those to whom said rations are assigned ; (c) the maxima prices for commodities.

Obviously, however, as was stated in our second study, the solution of the problem will be all the easier the greater the increase in the supply of consumption goods in a given unit of time. Should a larger supply, made available to the several classes of the population, allow the prices of consumption goods to fall below the maxima prices previously fixed, these will become superfluous. It may be that the Government, with a view to keeping the prices of certain commodities at a low level, will take measures to "supplement" them by paying subsidies to the producers. Now, should the subsidy be suddenly stopped as soon as there is a prospect of an increased offer which, however, is not yet adequate for meeting in full the demand, there would be danger of causing a rise in prices, especially in retail prices, leading to a rise in wages and in production costs. It would therefore seem more prudent to wait until the supply should further increase before repealing the subsidy.

(1) This has been clearly set out by TAUSSIG, F. W. : "International Trade", New York, 1927, p. 351 : "If, say, the same labor produces twice as much of woollen cloth, woollen cloth will be one-half the price it was before. The general index number of prices will show a fall in prices ; but the money income of the woollen producers would be the same (disregarding transitional effects) and the total money income of the population would be the same. Other prices would not be altered". It is said then that "the country is growing up to the currency", (p. 396).

Thus, for instance, the Government calls on owners to present their notes at once to be stamped, under penalty of cancelling all those not thus marked, reserving itself the right either to credit the owners by opening bank accounts in their names with the full value of the notes presented, subject to definite limitations of the use of such accounts, or to return to their original owners a much smaller part of the stamped notes than those presented, or to adopt both measures, thus returning part of the stamped notes and crediting the owner of the others with bank accounts subject to limitations, such for instance, as the prohibition of withdrawal before a specified date.

Whatever the arrangement may be, it will always amount to the confiscation of a part of the liquid funds of the owners. And as these funds vary in importance, subject as they are to a whole series of conditions and habits which have frequently attracted the attention of students, the incidence of the confiscation of even a part of these notes presented for stamping will necessarily be unequal. Thus some people who may hold large sums of liquid money because they are not very rich, or because their incomes reach them intermittently, or because there is a considerable interval between the time of receipt and expenditure, would be seriously affected by such measures; while others who, although very rich, have little ready money in hand, or whose incomes are received with greater regularity and whose expenditures coincides with receipts, might be almost unaffected by such confiscation.

In those countries in which a succession of governments have proceeded with the stamping of vast quantities of paper money — either simultaneously or in batches — the last government which assumes the responsibility for public affairs might be induced to stop inflation and to fix in terms of goods or services a different purchasing power for the different series of notes issued by the different governments at different times. The rates of exchange — *i.e.*, the purchasing power in terms of foreign currencies — of the notes issued by various governments at various times might also reflect this diversity. Now, the assignment or the recognition, on the basis of purely accidental characteristics, of a different purchasing power to the different issues of notes, will affect unfairly their respective owners, and when the recognition of different degrees of purchasing power is accompanied by confiscation, even if only partial, of the notes issued — a confiscation whose incidence, as we have seen, will be unequal — the unequal treatment the holders of the notes in question will be cumulative.

If later on, under the pressure of urgent requirements, in such a period as the post-war one, the government should restore to circulation all or part of the notes it has withdrawn from their individual holders, the injury caused them will be aggravated by the failure of a policy which aimed at limiting the expected rise in prices. And even should the government not restore to circulation, through its own expenditures, all the currency thus withdrawn from individuals by confiscation or by discriminating the purchasing power of the notes, and merely provide the public with the means whereby they may secure for themselves the money they may need — as, for instance, by giving them the right of obtaining advances on government securities already issued, perhaps in the form of cheques — the new resources which will thus be added to the mass already in existence will cancel the deflationary effects of the confiscation of part of the notes carried out at the cost of such unequal loss to their owners.

The same reasoning would hold good for any policy involving the stamping of all the notes issued which, when stamped, would, for a specified period, lose part, let us say one half, of their original face value. All the notes thus stamped would be returned to the persons presenting them, who would be credited with the percentage by which the notes were reduced — for instance, the other half — in the form of bank accounts of which they would be able to avail themselves at the end of a specified period or at a date which the authorities would reserve themselves the right to announce later on. Such measures would always affect the holders of notes unequally, as they would be based not upon their actual ability to defer consumption as being the owners of large incomes or vast fortunes and therefore in a position to be content with deferred credits opened in their names, but exclusively by the fact that they happened to hold the notes, a fact accounted for in periods of uncertainty by the desire of insuring against various risks and not by the receipt of incomes or the possession of a capital so conspicuous as to permit the postponement of consumption.

And here again, if the part of the ready money credited to the holders of notes and of which they will be able to avail themselves at the end of a specified period, should, in the meantime, be spent by the State to meet emergency needs and perhaps to encourage productive activities which will not however neutralize, by making available a larger supply of commodities, the return into circulation of the mass of notes withdrawn from private owners, we shall again be faced by the uselessness of such

policies whose purpose is to limit the rise in prices by confiscating the notes already issued, a policy which is prejudicial and unfair to the persons affected and ineffective for the community.

In the post-war period, drastic deflationary policies may indeed be taken for the purpose of countering the effects of specific inflation and of ensuring, to some extent, the gradual adjustment of prices to the volume of the notes issued. But the governments which adopt such measures cannot afford to ignore their reactions, nor should they fail to take account of the fact that, except in cases of urgent danger, a line of action free from such shocks, and decided upon with a full realization of the losses it will entail on individuals and of the advantages it will confer on the community, is always preferable to a sudden and violent change of direction.

5. — The stability of the purchasing power of a currency on the home market and abroad is always in function of the home and international market.

Thus deliberately reduced to its simplest terms, the study of the monetary problem, starting from the quantity of the monetary instruments issued, goes on to inquire into the ratio at which the monetary unit of one country is finally exchanged for that of another. This ratio depends partly on the amount of money in circulation in each country and partly on other elements such as the price levels, both actually ruling and expected to rule on the markets concerned; on their respective import and export currents and the changes likely to occur in them; on the readiness of the countries whose monetary situation is stronger not to reduce, by strictly enforcing the quantitative principle, the purchasing power of the weaker money to an extent fully corresponding to the quantity of notes in circulation, the purpose being to maintain the purchasing capacity of the weaker country as a market for the goods and services of the stronger. The determination of this rate is of the greatest importance in deciding at what level the prices of the main groups of goods and services should be fixed at the time when the country will resume the exchange of goods, men and capital with other countries.

Let us suppose, for instance, that the purchasing power of a national currency affected by heavy inflation be reckoned as equal to one fifth of that of one or two foreign currencies which have themselves been depreciated but to a lesser extent, say by barely once or twice their value. It is also desired that the purchasing power of the currency on the home

market — *i.e.*, in relation to commodities on the home market — should not be reduced by more than the aforesaid ratio. For this purpose a certain quantity of old notes are withdrawn from circulation in exchange for every new note issued or for bonds of the country to whose money the currency under consideration will be attached, an issue, so to say, of “money of occupation”. Let us suppose a quotation of 100 monetary units for a dollar instead of the 20 previously required; of 400 units for a pound sterling instead of the previous 80. The exchange would then be made at the rate of 5 old notes for one new one, or for a monetary unit of occupation money — 100 : 20, 400 : 80. In respect of this new rate one will still be able to say, as before, that 20 new notes will be required for the purchase of a dollar and 80 new notes for that of a pound sterling, on condition, of course, that the reference is to “monetary parities” (1).

As regards the future relations of each currency to gold, or to any standard of value, it will only be possible to fix them on the basis of elaborate inquiries, of agreements between governments, and on condition of the manifest willingness of many countries to collaborate for that purpose. It would seem premature, at least for the time being, to fix a date at which all these conditions may be secured.

Undoubtedly the adjustment of the innumerable prices for goods and services to “monetary parities” fixed by agreements, meets with difficulties, and may give rise to price levels even higher than those which, on the market of the weak money country, may correspond to the rate at which the old notes were exchanged for the new or for the

(1) The *Wall Street Journal* of December 10, 1943, defines the typical functions of “invasion money”. It may be considered as a deposit receipt, an I. O. U. The occupying authority, in need of labour or materials for war purposes, pays for them with the I. O. Us. delivered to the nationals of the occupied territory, who exchange them at the local banks for current Italian lire at the fixed rate of exchange. The I. O. Us. return through the normal banking channels to the General Head Quarters of the occupying authority which takes them and supplies the population of the occupied territory with certain commodities for which it pays in the national money. In this way the I. O. Us. are cancelled. The military government pays for the goods required by the occupied territory in its own currency when purchasing them on its own market, in the currency of the other countries when purchasing them on their respective markets. The I. O. Us. are redeemed in the currency of the occupying country. Occupation costs are met by the occupying country. Thus the system is not one of crude confiscation, but represents for the occupied territory the exchange of goods and services against imported goods. Other transactions offer the population of the occupied territory the means of securing commodities from countries other than those of the invading armies. In this way, “invasion money” may also be advantageously used for the foreign trade of the occupied country.

On the contrary, however, — at least for some countries — the reality has been quite different. Assimilated even in the small notes, if not in the shape, to the notes already in existence, exchangeable at par with it, invasion money has constituted a new source of specific inflation for the occupied country.

“money of invasion”. After some time, however, the price level, expressed either in the old or in the new notes, or in the money of occupation, tends to reflect the degree of inflation which the countries in a stronger monetary situation have been willing to recognise in respect of the money of the country under consideration. Thus the purchasing power of this currency abroad will coincide with its purchasing power on the home market.

This coincidence, however, will remain fictitious until such time as conditions are restored which will permit the free-movement of goods, capital and men from one country to another as soon as one of the purchasing powers — for instance that on the foreign market — breaks loose from its purchasing power on the home market, or viceversa. If, for instance, the purchasing power of a currency abroad is recognized as having decreased five fold in respect of its pre-war purchasing power, as soon as there is a rise of prices in the country occupying a stronger monetary position to whose currency that of the weaker country is linked, the results will be obvious. Either the weaker country will at once be able to export goods, men and services, to the stronger, or the foreign purchasing power of its currency will decline to the full extent of the increase which has occurred in the price level of the country with the stronger currency, and before long the purchasing power of the currency on the home market will also be depressed.

Inversely, should the general level of prices in the country with an inflated currency rise above what is required by its depreciation in terms of a foreign currency — for instance, if because of the effects on the volume of the currency exercised by the return into circulation of hoarded notes, prices rise to a higher level than had been expected, while other forces also contribute to the rise, — the maintenance of a stable relation between the purchasing power of the currency on the home market and abroad will depend upon the freedom of movement of goods and services permitting them to be acquired abroad at prices relatively lower than those ruling on the home market. Otherwise, the purchasing power on the home market will fall below that attributed to it on the foreign market, and all prospects of that stability which the national and foreign authorities aimed at securing will vanish.

In substance, home and foreign purchasing powers fixed by agreement in view of the advantages which the two parties to the understanding may secure thereby, do indeed represent prudential measures of marked value during periods of monetary disorder and almost com-

plete trade paralysis. In the absence, however, of the conditions essential for the maintenance of such purchasing power, or if, when changes in conditions require certain modifications in the purchasing powers thus fixed and in the resulting "monetary parities", such modifications are not made — the levels fixed for each currency will become merely apparent.

The stability of the purchasing power of a currency at home and abroad is a function of the equilibrium of the economic structure of the market concerned and of the other markets with which it trades, and accordingly it depends on effectively satisfying all the conditions required for restoring such equilibrium as soon as it may be disturbed. It is often forgotten that the absolutely free operation of the machinery which restores equilibrium — and these in the last resort are the movements of goods, capital, men and services — is the sole condition which can insure equilibrium between communicating markets. No manipulations, no monetary plans have ever succeeded in replacing them. Their absence, or even their imperfect attainment, represents the weak point of all the most up-to-date systems of international "clearing" whether unilateral or plurilateral.

6. — Monetary functions and the availability of money.

It is not the purpose of these notes to deal with the various advantages claimed for one or other of the monetary systems which have been put into practice or only proposed. They express no opinion on the systems introduced to meet emergencies. They only set forth the reflections of a student who foresees that at the close of the hostilities there will be a general re-examination of values in the monetary as in other fields of economic activity and who endeavours to ascertain what experience has confirmed before the time comes for translating into action the plans considered most in keeping with the needs of the coming times.

An essential quality of any unit used for measuring length, weight, capacity or price is that it possess the greatest possible degree of stability.

For measuring prices, — *i. e.*, the ratio in which one commodity is exchanged for another, — a slow evolution led to the selection of gold because of its *relatively* stable purchasing power. Wheat, silk, tobacco, furs, copper, all selected from time to time to discharge the functions of money because at certain periods they were more generally acceptable in exchange for other commodities, had been found less suited than gold

for such purposes because their collection, intrinsic qualities, and markets were more subject to vicissitudes, and because of the frequent fluctuations in their respective purchasing power.

When the commodity selected for use as money possesses the stability sought for in any standard of measures, it encourages and steadies the exchanges, even if it is not materially used in effecting the several transactions. Thus in drawing up contracts and for the transfer of commodities it is only necessary to refer to the monetary unit. In fact, some monetary units have never even been coined. They have been described as "ideal", for in fulfilling their task of facilitating exchanges and measuring prices it has not been found actually necessary to dispose of the commodity selected to serve as money.

A further function of money is that of acting as a means of payment. But here again, large supplies are not needed. At first it seemed essential to keep the home market supplied with the amount of money required for converting into cash all claims representing money. But the instruments created by the development of credit have in practice gone very far toward replacing metallic money. Thus, on the home market and for the purposes of a reserve, a distinction is no longer drawn in practice between convertible and unconvertible credit claims. In the case of international exchanges, the advisability of using the commodity selected as money for the settlement of debit balances only begins to be felt when the debtor finds it comparatively economical and when the creditor finds that money is the commodity he can most easily convert into the various commodities he requires.

As it has become evident that each country balances its international accounts by exporting those commodities which are comparatively the least costly, it is only in the initial stage of a rupture of the balance of these accounts that the commodity selected for use as money is found to be one of the most readily exportable. Gradually, as the quantity of that commodity held by the original owner diminishes, money becomes more valuable than other commodities and is replaced in its function as a means of payment by foreign bills (1). These, in their turn, represent

(1) Such substitution took place under a gold standard system proper. But under systems which may be described as substitutes for gold monometalism — for instance, under the gold exchange standard — the yellow metal was not even used for international settlements. Typical examples are those of India, analysed by KEYNES, J. M. "Indian Currency and Finance", London, 1913, and that of Egypt illustrated by BRESCIANI-TURRONI, C. "Egypt's Balance of Trade", *Journal of Political Economy*, 1934 and more recently "La funzione del regime aureo", *Giornale degli Economisti*, July-August 1941.

money obtained by exports which have become comparatively speaking less costly and which are directed towards the market where they are most in demand and where they fetch the best prices. On their side, imports, in conformity with the elementary principles of economic expediency, are also purchased from the countries where they can be bought at the lowest price, regardless of whether the markets of the selling country are willing to purchase the exports of the buying country. The real advantages of so-called triangular or multiangular trade consist precisely in the fact that each country meets the deficit of its balance of payments with another country by exporting to a third, a fourth, a fifth, in short to any market offering the possibility of selling to the best advantage.

The following is, therefore, the point at issue. As long as it is possible to purchase commodities and pay for them with other comparatively cheaper ones, whatever be the market on which the latter may be sold, the availability of money is of little importance. Money temporarily lubricates the wheels of trade by offering the most efficient means for translating into action the premise of international economic solidarity which may lead to intensely active collaboration. The reason for the existence of a monetary system is therefore to serve as an instrument or a premise of civilised life. As exchanges multiply and monetary systems are simplified and perfected, the mercantilist error which identifies wealth with money, is gradually disproved and the volume of the commodity selected for use as money required for discharging the aforesaid functions of instrument of exchange and standard for measuring prices, and as a means of payment is reduced.

7. — Monetary effects of trade barriers.

This delicate and accurate mechanism has been wrecked more especially by the prevalence of protectionist policies.

A country may be said to be economically strong when it possesses the resources essential to its existence and does not need to have recourse to imports, or when, if it imports, it is in a position to insist on favourable conditions of trade. This enables it to become a creditor country, collecting more than it has to pay. A country is economically weak when it is obliged to import the commodities essential to its existence and is forced to pay for them by exporting commodities or services which are not essential to the "strong" countries, and which they may therefore value at an even lower price than that at which they are offered by the most

successful competitor on the world market ; or which at best they may value at that price, including the cost of carriage. In this situation the debtor country may have to meet liabilities exceeding the receipts to which it has a claim. Of course, there are many gradations between the extreme cases of "strong" and "weak", "creditor" and "debtor" countries.

It can now be recognized that some of the countries richest in natural resources have insisted on being paid for the commodities they exported not with other relatively less costly goods or services, but with the commodity selected for use as money. The incentive thus given to a rise in the price of that commodity in the debtor countries, the blow struck at the stability of the foreign purchasing power of their respective currencies, whose rate of exchange on other markets declined, the inducement given to the weak money country to suspend the payment of imports already received, (thus leading to "frozen" credits), and to limit future imports, all these are phenomena which have led on the one hand to a steady decline in the exports of the creditor countries who ran the risk of seeing their credits frozen as a result of the impossibility in which the debtors found themselves of paying in gold ; and on the other hand, to a steady reduction of imports by the debtor countries, forced to correct by this means the excess of their liabilities over their claims. All these means however have failed to right the balance of payments of either the creditor or the debtor countries, for it is evident that with the decline of imports, exports, whose ultimate purpose is to pay for imports, cannot expand. Thus international trade has declined and a deadlock has slowly but inevitably followed, causing the heaviest losses to the weak countries who had neither stocks of commodities nor compensating factors to offset the consequences of their downward rush to an untenable and absurd situation.

From the monetary standpoint, this process by which the creditor countries raised complicated trade barriers against payments in the form of goods and services, led in the first stage to the distribution of the commodity selected to serve as money among the major creditor countries of the world. Subsequently, as their respective ranks as creditors became differentiated, the largest creditor of all came into possession of almost the whole supply of the commodity selected to serve as money. When this situation arose, the largest creditor country found itself compelled to renounce its claim to have all payments settled in that commodity, as almost the whole available supply was already in its possession. Even

had the debtor countries decided to use the gold until then assigned for industrial purposes for the settlement of their debts, this *extrema ratio* could only have been deferred for an unspecified time, but could never have altered the final result of the creditor's refusal to accept payment in commodities other than money. It could only have attenuated, perhaps for a considerable length of time, those protective measures which no less than progressive taxation end in the long run by neutralizing themselves.

But the protectionism of the creditor countries — and similarly that of the debtor countries — only accounts for the first phase of the process which has made it impossible for an international monetary system to operate. While it explains the accumulation of the commodity selected for use as money in the hands of the largest creditor on the international market, it does not explain why that commodity stagnates in the vaults of the creditor instead of being redistributed over the several countries. Now, it is precisely this phenomenon of stagnation which runs counter to all standards of economic expediency, making quite impossible the existence of any system based on a commodity considered at certain periods as more acceptable on the market than others.

The country in which the commodity selected for use as money has accumulated as the result of the settlement of its claims in cash, having reached the point when it can no longer insist on payments in that commodity of which it now has sole control, finds itself faced by the alternative of retaining the money or exporting it to other countries whose supplies are low and who are prepared to pay a higher price for it, of course in the form of other goods and services.

In the first case — unless it should decide to select another commodity to serve as money — so long as the available supply on the international market of the commodity used as money and the demand for the same have not reestablished the balance, the creditor country suffers a loss equal to the difference between the profit obtained by exporting other goods and that which it would have obtained by exporting commodities which have become comparatively less costly.

In the second case — that in which the largest creditor decides to re-export it — the commodity will reenter circulation for the very same reasons which led to its selection for use as money, *i. e.*, the possibility of selling it on a wider market than that open to any other commodity. The defects in the distribution brought about by protection will tend to correct themselves automatically. All this leads us always back to the same conclusion. Either confidence returns and the instruments of

exchanges are again needed and in that case the monetary commodity which has accumulated in one country will again flow into the others; or the mercantilist error prevails, and with it the impossibility of operating any international monetary system founded on that commodity becomes evident.

Should the country which has accumulated all the available supplies of the commodity selected for use as money decide to hoard it until the time comes when that commodity will be preferred to any other thanks to the value attached to it by the masses who for centuries have been accustomed to consider it as the one and only means of payment, we enter a field of speculations with a political background. But we prefer not to take into consideration the possibility of a desire to secure a monopoly. Anyhow the situation which would arise would not be due to any defect in the monetary system selected — whether based on gold or on some other commodity — but it would depend on the premises governing the life of the international community which, no less than community life in a given country cannot securely rest upon an acknowledged inequality between the strong and the weak without collapsing and degenerating into conflicts. If international community life is to last, it must be directed towards attenuating economic disparities not by forcible action but by promoting exchanges carried out in a spirit of lasting and willing cooperation.

8. — A clearing system cannot solve the problem of frozen balances.

The system of effecting payments by means of clearing agreements which link the countries in couples desirous of availing themselves of such an arrangement, would apparently reintroduce the system of direct payment for imports by exports. As a matter of fact, it becomes a weapon in the hands of the stronger nation against the weaker.

Under such agreements the latter cannot purchase their imports on the cheapest markets nor sell their exports on those willing to pay the highest price. They must accept their raw materials from the stronger of the two parties to the bargain, paying them at a higher price, and must be content to see their own exports valued at the price the other partner sees fit to offer. Should they also be required to accept in exchange for their undervalued exports, goods which they either would not have purchased at all or would have purchased elsewhere at a lower price, they will find it practically impossible to avoid a rise in costs and prices on the home market and their standard of living will be lowered. But however serious this economic loss may be, it is of little account when compared to the fact

that the economically weak country will find all its possibilities of expansion placed entirely at the mercy of the stronger country, for it will be unable to alter the production of the commodities it was accustomed to export and to provide for the development of its economic equipment without the consent of the partner to the "bilateral" agreement who can always refuse to supply it with the raw materials it may need.

We need only consider the hypothesis of an agreement between a certain number of the economically stronger countries to see that under a system of bilateral agreements the economically weak would find themselves in a still worse position for bargaining. Therefore, though they may be accepted as expedients for meeting the consequences of unceasing protectionism, bilateral clearing agreements are not suited for permanently replacing a real monetary system.

Multilateral clearings in spite of all ingenious devices, still allow of the existence of balances which could be unfrozen to the advantage of both countries concerned were it only possible to export goods, capital and men so as to balance the budget of international payments of both the countries concerned. As stated, it is only when the above condition is fully secured that each country will be in a position to bargain on a footing of equality with others, a condition eagerly to be desired by all who wish for a vigorous revival of economic activities.

9. — The movement of real and monetary incomes after the war.

The solution, even partial, of the problem of monetary stability implies the need for each country to make reliable forecasts of price levels for the main groups of goods and services. The principles adopted for effecting stabilization will decide whether these levels can continue to be those ascertained when hostilities came to an end, or whether, sooner or later, they should rise above or fall below the levels then attained. To know or forecast as accurately as possible the average price levels is, as we have said, important in calculating the nation's monetary income, the part of State expenditures which varies with prices, the pressure of taxation, the amount of receipts, etc. Any reduction in the purchasing power of money and, inversely, any rise in the average prices of the main groups of goods and services, adversely affects the yield of even the best system of taxation, increases the volume of expenditure, endangers all efforts made for balancing the national budget, and complicates the calculation of real income.

We have identified national income with the aggregate of consumers' goods existing in the country, and demonstrated, in our first study, that the sole resources on which the State can count after the war for defraying the cost of its activities will be incomes and savings. A realistic vision of the conditions which, at the end of the war, all countries will have to face as a result of the consumption of capital, devastations, depredations, concentration of productive activities on war needs, the lessons taught by the experience of the period following the last war, and the usual rhythm of recovery after a phase of depression, lead us to expect a real income greatly inferior to — according to some calculations 30 to 40 per cent. below — the pre-war real income (1938); and, what is no less important, they lead us to expect possibilities of increases in the said income, varying from country to country, but always limited, not exceeding 2 to 4 per cent. at the best (1), *i.e.*, should a combination of favourable conditions contribute to intensify production

(1) It is not easy to measure in all countries the growth of production and trade in relation to the progress of civilization and, among other things, of population. Studies by eminent writers, such as CASSEL, G.: "Theoretische Sozialökonomie", 1927, pp. 52-53; SNYDER, O.: "Business Cycles and Business Measurements", London, 1927; CLARK, COLIN: "The Conditions of Economic Progress", London, 1940, call attention to the fact that in the second half of the XIXth century and in the first decades of the XXth, the rate of growth of the aforesaid factors, included under the name of "economic progress", could be calculated at between 2 and 3 per cent. per annum. For Italy, a valuable study by COPPOLA D'ANNA, F.: "Prospettive della finanza e dell'ordinamento tributario italiano", Associazione fra le società italiane per azioni, 1941, pp. 22-26, referring to the experience of the other post-war period, also makes a low estimate of the percentage increase of national production. "Rapid and impressive variations of national income generally take place, whether they be in the nature of a fall or a rise, in connection with the alternating phases of the economic situation. There are indeed cases in which an increase, even important, of income takes place at a fairly swift rate, but this requires the concurrence of exceptional circumstances such as those prevailing in Japan during the last quarter of a century, and in Germany since the advent of the National Socialist régime".

In the case of Italy, GINI, C. calculates that in 1925 the Italian national income amounted to 100 milliards of current lire which, taking into account the differences in the level of wholesale prices and of the cost of living, were equivalent to about 17 and a half milliards of pre-war lire, as against the 20 milliards calculated by the same writer for the period preceding the outbreak of the first world war. Since then other writers, some of them following the same methods as GINI, have recalculated at different dates the Italian national income; we thus have an estimate of 94 milliards for 1928, one of 95 milliards for 1932, one of 90 milliards for 1936, and one of 115 milliards for 1939. If these figures be reduced to lire of a purchasing power equal to that of the lire in 1913-14, (*) we have:

for	1914	an	income	of	20,000	million	lire
»	1925	»	»	»	17,500	»	»
»	1928	»	»	»	19,500	»	»
»	1932	»	»	»	19,000	»	»
»	1936	»	»	»	23,000	»	»
»	1939	»	»	»	22,500	»	»

(*) The estimate has been made taking as basis the arithmetical average of the wholesale price indexes and of those for the cost of living.

and lead to the "creation" of "favourable events" in several directions at the same time. Keeping in mind these limited possibilities, we shall be able to face the post-war problems without forgetting realities and we shall not place our trust in miraculous solutions.

Real income can be expressed in monetary income, as we have already said, by multiplying the volume of consumption goods by the prices ruling at a given time or by the prices which are expected to rule in relation to the volume of notes issued; although, so long as note-issues continue to be made, they will be partially withheld by hoarding. Substantially, the conversion can be made by multiplying the volume of goods by pre-war prices, multiplied in their turn by a coefficient — 5, 6, 7 — which indicates the actual reduction of the purchasing power of the national currency in terms of goods and services on the home market. There is a tendency at times to mistake their monetary expression for the actual volume of goods and services available for satisfying human requirements. But a clear definition of concepts and common sense, helps however to dissipate harmful delusions and to preserve contact with realities.

The increase which occurred between 1925 and 1939 is undoubtedly remarkable: 5,000 million lire with a purchasing power equal to that of 1913-14, which represent 28.6 per cent. of the income estimated for 1925. The population of the Kingdom increased from 1925 to 1939 by approximately 5 million units; *i. e.*, 12.5 per cent. Consequently, the average income per head rose in the period considered from 437.50 to 500 lire of 1913-14, or, should we prefer to express it in figures nearer to present realities, by 2,240 to 2,560 lire having a purchasing power equal to that of 1939.

If however we compare the total income of 1939 with that of 1914, the increase is seen to be considerably smaller, and in view of the longer period of time elapsed and the much greater increase of the population of the country which occurred in that period (from 37 to 45 million) it will be found that the *per capita* income fell from 540 to 500 pre-war lire and expressed in 1939 lire, from 2,675 to 2,560 lire.

On the whole, the above figures, notwithstanding their broadly approximative character, call attention to several facts whose importance should not be underestimated. Six years after the end of the world war, and when the difficulties of the first post-war period had already been left some years behind, the national income was considerably below the pre-war level. In the following years the amount of the Italian income was affected, as elsewhere, by the ups and downs of the economic situation. But if we consider the period from 1914 to 1939 as a whole, we shall see that in 25 years the national income increased only by 12.5 per cent. If we compare the estimate of 1925 with that for 1939, the increase is, indeed, more noticeable and as it is concentrated in a small number of years, it may be considered as sufficiently satisfactory, but this does not alter the fact that it took 14 years for the Italian income to increase by 28-29 per cent. The rate of increase is thus seen to be but little in excess of $1\frac{3}{4}$ per cent. per annum.

Guided by these facts, it would therefore seem necessary to consider it unlikely that in the first years of the period which will follow the present war, the real national income will exceed the level attained in 1939. It will be difficult for us to count on an increase of our national income exceeding 2 to 3 per cent. per annum.

Recently CASSEL: "The Economic Basis of Social Security", "Skandinaviska Bank", March 1943, criticised the estimates given by BEVERIDGE who foresees a notable increase of the total British income as a result of the war; Cassel considers that the factor represented by labour will decline, and that the factor represented by capital will be reduced by high taxation as well as by consumption and destructions.

V.

THE PROBLEM OF FINANCING GOVERNMENT
ACTIVITIES

V.

THE PROBLEM OF FINANCING GOVERNMENT ACTIVITIES

SUMMARY

PART I: (A) ORDINARY TAXATION. — The problem of financial rehabilitation is defined and included in the wider one of encouraging the growth of total real income. In the post-war period as in others, receipts and not expenditure will finally determine the scope and intensity of government action. Particularly after a war, receipts from expenditure grow slowly and to a smaller extent than expenses. Consequently all countries feel the need of ascertaining both the facts relating to the environment in which government activities are carried on and the limits within which it is advisable to restrict them.

After classifying post-war expenditure, it should be divided into fixed and varying expenditure, and the various kinds of receipts by which it can be met should be examined. Efforts to secure higher yields by the control of tax evasions, double taxation, and tax exemptions. Attempts to secure higher yields by raising the rates, by recourse to proportionate and progressive taxation, or by levying new taxes. Scanty fiscal efficiency of progressive taxation which grows with the growth of indirect, as compared to direct, taxation. Scanty deflationary efficiency of direct and indirect taxation.

(B) EXTRAORDINARY TAXATION COMPARED TO INCOME OR CAPITAL. — Present scanty fiscal efficiency of extraordinary taxation on excess profits or on capital, which are both definitely opposed to the growth of real income. The dangers of these two forms of taxation; some precautions for mitigating them.

PART II: (A) RECOURSE TO NATIONAL SAVINGS. — Recourse to national savings in the form of loans presupposes an elastic fiscal system which will permit of assuring their service. Loans even in the post-war period will be preferable to an extraordinary tax on capital. The significance of the problem of the national debt for both private and national budgets.

(B) RECOURSE TO FOREIGN SAVINGS. — Definition of the phenomena arising from the ingathering of existing savings and of savings in amounts exceeding those already accumulated. Phenomena arising from the expenditure of savings obtained on the lending market, the borrowing market, and on other markets, viewed for each country on the hypothesis of a system of gold monometalism or of an irredeemable paper currency. The case of a country which can process raw materials and semi-manufactures at a lower cost than others. Phenomena arising from interest and sinking-fund payments on loans.

The migrations of savings and of workers tend to adjust themselves over a period of time and to complete each other. When suitably used, foreign loans assist the re-equilibrating mechanisms of the economic structure of a country. Recourse by the government or other public bodies to foreign loans requires stricter justification.

PART I.

(A) ORDINARY TAXATION

1. — The problem of financial rehabilitation for countries which have suffered severe war losses. How it forms part of the more general question of encouraging the growth of real income.

When we have once acquired a clear notion of real income, monetary income, the stability of the purchasing power of money, and of the limits which may be attained, in a given period and more or less gradually, by the average general price level, which may be decomposed into average price levels for the main groups of goods and services, the problem of financial rehabilitation is necessarily seen to be part of the broader problem referred to in our first study, that of creating new real incomes to replace those monetary incomes which cease with the cessation of hostilities. Substantially, it is a question of promoting the revival of the production of consumption goods. When, on the basis of logic and experience, the several problems have been ranged in order of importance, the solution of a special problem cannot compromise the solution of the general problem. It would be vain to seek for financial rehabilitation by recourse to means which would injure the already modest recuperative powers of real income. This essential need must be taken into consideration by all efforts made in the post-war period to rebalance the budget of the government and of other public bodies.

In practice, such efforts take the form of an energetic elimination of all expenses which are not considered strictly indispensable for the working of the State; in providing extraordinary receipts to meet extraordinary expenditure; in securing if possible a balance between ordinary expenditure and ordinary receipts (1), a balance which in spite of fluctuations

(1) DE VITI DE MARCO, A. "Principi di economia finanziaria", Turin, 1934, p. 24, remarks that the distinction drawn between ordinary and extraordinary receipts and expenditure is a vague one. "The distinction is a vague one: it depends above all on the point of view of the person who draws up the estimates; the following formula might therefore be adopted: Supposing that the initial conditions under which the estimates are made continue, receipts and expenditure, which it is expected will reappear during future financial years, are called ordinary, and those which are expected to cease are called extraordinary".

should be an enduring one. The apparently simple result implies in reality a knowledge of all the factors of which the financial administration of the country can make use ; the consciousness of the need of avoiding at all costs ill-judged deviations and demagogic policies ; a political conduct guided by a moral fibre strong enough to resist the sometimes formidable pressure of special interests, with the single object of securing the growth of real income as a means for reconstructing the economy of vast territories strewn with ruins representing a loss which cannot at first be even estimated.

2. — In the post-war period as in others receipts will determine the scope and intensity of Government action. Classification of expenditure.

On the cessation of hostilities all the governments will have to meet those expenses bequeathed them by the war which will survive the most severe retrenchments. It might therefore seem that during this period at least expenditure determines the receipts required for meeting it. If, however, we consider the inadvisability, on which we have again insisted, of squeezing out receipts which compromise the growth of real income, we shall readily see after all that available means — *i. e.* the receipts obtained from incomes and savings — determine if not the amount of the expenditure, which is a legacy inherited by the government, at least the extent to which it is possible to cover it over periods of longer or shorter duration. The recognition of the fact that even in the post-war period available means determine the scope and intensity of government activities, by throwing light on the main object of this period, will enable us to define more accurately the financial problem and to avoid disappointments and the adoption of risky policies.

At the beginning of the post-war period we find (*a*) expenses which are not indispensable for the activity of the State and which should therefore be eliminated in spite of more or less active resistance ; (*b*) expenses which cease with the cessation of hostilities ; (*c*) expenses which, on the contrary, arise as a result of the cessation of hostilities (these are either incurred once and for all, or they recur over a certain number of financial years at the end of which they expire) (*d*) expenses which, recurring over a certain number of financial years or for a number which cannot be foreseen, (e. g. pensions), are at last included among ordinary expenditure and call for receipts which can also be of an enduring nature.

An example of the first group — expenses to be eliminated — is afforded by those incurred for some employees of the State administration and for the members of certain committees. Should retrenchment however be limited to the expenses incurred by the State for staffing some offices (providing of course that they are not at once replaced by others) or to the suppression of some committees, or to the suspension of examinations held for the admission of new employees, or to the postponement of the liabilities entailed by promotions; or to the reduced consumption of printed matter and stationery, there would be little hope of reducing the innumerable expenses entered on the State estimates. Among the expenses which should be eliminated are those incurred for “integrating” and “supplementing” the prices received by producers for certain commodities which, while figuring on the budgets of some countries for many milliards, and incurred for the purpose of stabilising prices with government help, do not benefit consumers to an extent which can even distantly justify the enormous burden they entail. It is however far from easy to cut them off at once. The enormously long list of direct and indirect subsidies which the State grants to various groups of agricultural and industrial concerns should also be revised and shortened (1).

Of the *second* group — that of expenses which cease with the cessation of hostilities — examples are afforded by those relating to government orders which have not yet been executed. When military operations cease, the dates fixed for the delivery of munitions may be cancelled; the firms to whom the orders were given may be authorised to continue the work on their own account or on that of others, using the materials supplied by the government for which they will keep a separate account. At the end of the other war several concerns, whose working

(1) Indeed it is no easy matter to give a detailed list of the subsidies the government may grant. They take the form of direct loans to some concerns on the understanding that they will only be returned when conditions make this possible; of loans to agricultural and industrial concerns made through the agency of semi-official banks, the payment of the interest on the same being guaranteed by the government; the partial payment by the government of the interest on loans made for special purposes, as, for instance, loans for land improvements, for the development of the fishing industry, direct payments which the government pledges itself to make over a certain number of years to ensure so-called “economic development”. To this class belong the subsidies to shipping lines, to railways leased to private companies, to agriculture in general and more especially to favour the production of wheat; subsidies to air-transport services, and to the merchant marine.

In the second part of this report dealing with disguised loans, reference will be made to the annuities the Government pledges itself to pay to facilitate the immediate execution of public works.

entailed in its turn new expenditure though on a lower scale than that entailed by the production of munitions, were entrusted with the task of winding-up the work in course of execution and of modifyng the many rules regulating supervision, requisitions, limitations placed on free bargaining.

It is not so easy to define the *third* group of expenses — those arising from the fact that on the cessation of hostilities new extraordinary expenses replace those which cease, and are incurred either once for all or for a series of financial years whose number cannot be accurately foreseen. Such, for instance, are the settlement of bills for munitions which have not yet been paid for; subsidies connected with the dismissal of the workers engaged in the munition factories which represent a charge met, at least in part, by the State; expenses incurred for the vocational retraining of war cripples and invalids; for insurance policies issued in favour of the men called to the colours; for the protection of war orphans and for assisting the families of the men who fell; for indemnities paid to the demobilised men and to their families; for subventions to local government bodies for losses incurred in connection with war operations to enable them to carry out repairs which cannot be deferred or to cover their budget deficits; for assisting the homeless or those evacuated from other localities, or the unemployed. To this group belong expenses incurred for compensating war losses; for assisting agriculture in the difficult transition period from war conditions to those of the armistice and later on of peace; for assisting the revival of land and sea transports; for carrying out public works for the purpose of checking, at least at the start, the growth of unemployment should it not be possible or should it prove more costly to keep the mass of the fighting men under arms.

Many other expenses of an extraordinary description, and therefore not regularly recurrent, load down the post-war budgets. It is indeed true that we must be on our guard against mere book entries. But when all possible retrenchments have been made, an attentive study will make it possible to ascertain at once how much of the expenditure still to be met should be imputed to payments falling due in other financial years, how much should be met in the current year, and how much should be left for future years so as to make it possible to meet it out of ordinary or extraordinary receipts.

Lastly, examples of the expenses which, although arising from the war pass gradually into the group of ordinary expenses, as it is not pos-

sible to establish *a priori* the number of financial years during which they will have to be met, are afforded by State contributions and assistance of various kinds, pensions to war cripples and invalids, the service of the national loans.

3. — Fixed expenditure and expenditure which varies with variations in the average price level. Tendency of ordinary expenditure to increase after the war.

Among the expenses belonging to the third and fourth groups — substantially, those which are additional to the expenses met by the State prior to the war — some at least are *fixed*, that is to say they relate to liabilities which do not vary or vary only as a result of measures of a general description. Such fixed expenditure belonging to the third group covers several forms of assistance of a charitable nature and temporary assistance to various forms of productive activity. Among those belonging to the fourth group are the expenses incurred for salaries and pensions to government and local government employees.

Other expenses belonging either to the third group (extraordinary expenditure) or to the fourth (ordinary expenditure) *vary* with the fluctuations in the average level of prices for the main groups of goods and services. Such, for instance, in the third group is the expenditure on public works, and in the fourth the expenditure connected with those branches of production exercised by the State in the form of monopolies and the expenditure connected with rises in salaries and pensions.

Among ordinary expenses, (fourth group) the part which remains, or should remain fixed — interest payments, salaries, wages — tends to increase in the post-war period, partly because of recourse to some of the means required for meeting extraordinary expenditure, such as government loans, whose service leads to an increase of the relatively fixed quota of ordinary expenses, partly because of the general increase in salaries and other forms of remuneration. At the same time, the expenditure, which varies with the price level, such as appropriations made by the several government departments for productive activities or activities supplementary to those of private enterprise, tends to exceed that which, though generally of a fixed nature, increases. Thus ordinary expenditure — either variable or not — tends to increase in the postwar period just when the sources for financing government activities are reduced to two, *i. e.* incomes and savings. This makes it all the more difficult to succeed in restoring budget equilibrium.

4: — The increase of receipts from income lags behind the growth of expenditure.

The post-war increase in ordinary expenditure as a result of the heavier charges the State has to meet and of the rise in prices, if compared to government expenses prior to the conflict, is not only a nominal, one expressed in terms of money, but is substantial. Thus, the method of defining the depreciation of the purchasing power of money on the basis of the balance-sheet of the year preceding the conflict would appear to be rather too simple: it consists in multiplying by the coefficient of this depreciation — 5, 7, 10 — the average price levels for the main groups of goods and services, the monetary income of the country considered, the expenditure of the government or other public bodies, and then waiting to see the pre-war situation reproduced in figures. The fact is that each of the above-mentioned values — average price-levels, total real income of a country, expenditure, receipts, — may be modified by causes other than those related to the creation and circulation of monetary instruments. To fail to take all these possibilities into account and to look only at their monetary expression, means running the risk of not perceiving the real nature of the phenomena.

On the other hand it is very generally held that when the price levels of the main groups of goods and services rise at least to the limit allowed by the arrest in the issue of paper money or by the reappearance of hoarded notes, and when the variable quota of government expenses adjusts itself to those levels, a considerable part of all such expenditure is distributed in the form of monetary incomes on which taxation can be levied or which can give rise to savings on which the State can draw, and that therefore receipts tend to increase and to offset expenditure, increased for the reasons above mentioned.

But, in the first place, we observe a notable time-lag between the rise of prices, the increase of government expenditure, the growth of the incomes over which this expenditure is distributed, and the growth of receipts. In the most favourable hypothesis, that of the arrest of the issue of paper money, receipts can only increase when prices have been stabilised and when government expenditure, the incomes to which it gives rise, and the pressure of taxation have adjusted themselves to the new and higher price levels. Before these adjustments have been made there is a period during which there is no reason why receipts should increase to an extent which will balance previously increased expenditure. In the less

favourable hypothesis — that in which the issue of paper money does not cease or in which hoarded notes have not yet all returned to the market — the time-lag between the growth of expenditure and the growth of receipts will tend to be prolonged and will perhaps be accentuated.

5. — Apart from the lag, the receipts from income fall as compared to expenditure:

In the second place it has been shown in other publications (1) that one of the results which can be ascertained in a brief time is that not all the expenditure incurred by the State is redistributed in the form of incomes and enters into subsequent exchanges. (The many criticisms of the theory of the “multiplier” have called attention precisely to the fact that at least a part of the sums spent by the State, even if those assigned for public works are taken into account, does not enter the cycle of the production of real income). But let us admit, for the sake of argument, that the major part of government expenditure is redistributed in the form of incomes. Not all these incomes will exceed the minimum which the community decides to exempt from taxation. It may therefore be that in a short time not only will there be a time-lag between the growth of expenditure and the slower growth of receipts but the receipts themselves will be reduced owing either to the fact that the incomes themselves are scanty or exempted by law from taxation, or because the savings to which the incomes arising from government expenditure, both ordinary and extraordinary, may give rise, are small.

The reduction in the ratio between receipts and expenditure is more evident when considered over longer periods of time, for instance, over a year or a period of five years, during which the activities of the State draw on consumption goods or goods which might be used for producing them for private consumption. But as these goods are not assigned for *economic* activities, there can be no certainty that they will be reconstituted in a like amount or by goods of like productive capacity. In such cases, as already stated, the action of the State, though it may be justified from many points of view, causes a loss of real income to the country. And if real income be reduced the receipts levied on incomes cannot increase.

There are therefore no sound foundations for the opinion that when average price levels rise accompanied by a rise in total monetary income,

(1) “L'attività finanziaria nelle fasi di una fluttuazione economica” in the volume “Equilibrio fra attività economica e finanziaria”, Milan, 1942, p. 95.

expenditure may increase but receipts will increase in a corresponding measure. Even should assiduous control enable the fiscal authorities to maintain unaltered the pressure of taxation on the monetary income which has increased with the rise in prices, the increase in receipts will in the first place only be obtained after an interval of time, and in the second place the rate at which receipts will increase will be slower than that at which expenses will increase and the lag will correspond to the extent to which the State destroys consumption goods or the means of producing them without the certainty of replacing them in the future, by amounts corresponding to those ascertained at the time when they were drawn on.

It is true that both the receipts from incomes arising from independent private production and those from the incomes arising from the distribution of ordinary government expenditure, may be supplemented by further yields. As when, for instance, the State has recourse to national or foreign loans to meet extraordinary expenditure, which is distributed in the form of incomes exceeding the minimum amount on which the community has decided not to levy taxation; such incomes may be taxed and may yield returns which supplement the other receipts. But no country can decide *a priori* to what extent its receipts from incomes will fall below the growth of ordinary expenditure, nor the amount of the supplementary receipts to which reference has just been made. It is indeed likely that the difference will be covered by supplementary receipts, but the certainty that it will in time be so covered can only be given by the adequate growth of total real income.

6. — Inquiries preliminary to the study of receipts from incomes and from savings.

We have thus defined the problem of financial rehabilitation and included it within the vaster problem of the revival of the production of consumption goods; we have pointed out that, ultimately, in the post-war as in other periods, the scope and intensity of government action is determined by the means on which it can draw; we have noted the fact that unless favourable events occur the increase of receipts follows the growth of expenditure at a later date and in a lesser degree.

Income, expenditure, receipts are not static; they are moving currents which must be followed with great attention through the course of time.

When all recourse to the issue of paper money and the consumption of capital has stopped and when expenditure has been scrupulously

cut down the authorities, whose duty it is to provide for meeting expenses, will consider the situation of the ordinary and extraordinary receipts *i. e.*, the possibility of having recourse to both simultaneously. And if they wish to perform their difficult task wisely and with a due sense of proportion, they will feel the need of ascertaining certain facts and fixing the limits within which they can work, as otherwise their action could only be experimental, which is unfortunately only too often the case.

Only in so far as one can ascertain that in a given country at least some groups of incomes leave margins *in excess* of the minimum amounts considered indispensable for meeting essential needs and for developing the production of the less essential consumption goods required by the home or foreign market, will it be possible to study the means best suited for financing government activities in the post-war period ; to study the consequences arising from drawing on part or the whole of this margin ; to study the effect on expenses of these receipts. Without at least an approximate knowledge of the size of these two margins, the authorities would have nothing to go on but hypotheses which would offer them no safe means of reaching the solid ground of concrete solutions.

It would therefore seem indispensable that all countries desirous of directing their policies along sound lines should make enquiries (*a*) on the *amount* of total real or monetary *income* estimated at the beginning and presumed to exist at the end of the war ; (*b*) on the *distribution* of total income as ascertained at the beginning and presumed at the end of the war, taking care to note any differences between the two sets of data ; (*c*) on the *amount* of voluntary *savings* estimated at the beginning and presumed to exist at the end of the war ; (*d*) on the *minimum income* considered indispensable for satisfying the more irreducible needs ; (*e*) on the *minimum* amount of *savings* considered indispensable within a given period of time for developing the production of consumption goods of a less essential description but required nevertheless by the home and international markets ; (*f*) if possible, on the *difference* for each income group between the minimum "double" estimated as above, and the income actually received by each citizen so as to ascertain, at least theoretically, what the State could levy within a given period were all incomes reduced to the "double" minimum ; (*g*) if possible on the *difference* for each income group between the income received and the income spent by each recipient, so as to ascertain the material possibility of a further reduction of consumption in the post-war period or at least of maintaining the restrictions placed on consumption in the preceding period and of draw-

ing on savings to finance government activities productive of public services or engaged on the work of reconstruction.

Limiting our remarks to receipts from incomes, should there be no margin between minimum income and income received on which taxation can be levied, or should this margin be inadequate to meet government needs it would seem to be necessary on a *closed* market (*a*) to limit government activities; (*b*) to await the growth of total real income which when redistributed in the form of increased incomes would also allow of larger yields; (*c*) when possible, to reduce private consumption below the previous minimum. When the market is *in communication* with others it will be possible to have recourse not only to these sources but also to the incomes of other countries by means of exports (1).

7. — Limits within which it is possible to draw upon incomes during the transition period from peace to war and for the conduct of the war:

When the size and, if possible, the distribution of the total income of a country is known, and when the volume of existing savings is known, we must ascertain the extent to which it is advisable for a government and for local government bodies to draw on this income by means of taxes and loans. We have already said (2) that in the transition from peace to war — characterised by a marked, sometimes a progressive, decrease in the production of consumption goods for private use and by the growth, sometimes unmeasured, of the production of consumption goods to be used by the community, for instance arms and ships, or of consumption goods for the armed forces (3) — the State when it secures the necessary means for carrying on its activities by drawing exclusively on the incomes arising from those forms of private production which continue active during hostilities, finds its expansion limited by the aforesaid tendency of all incomes to fall to that minimum level which, in a given country at a given time, is considered indispensable for satisfying the most urgent individual needs: a minimum therefore which cannot be taxed, at least not openly.

(1) See the first Study, par. 11.

(2) See the first Study, par. 4.

(3) The modifications of the economic structure and distribution of incomes thus brought about are the subject of the eager if not always systematic enquiries of international literature. See CABIATI, A: "Il finanziamento di una grande guerra". Einaudi, Turin, 1941, and for a bibliography our "Lessons", Vol. III, Part II.

When the State also draws on available savings and has recourse to the consumption of capital it finds the limits to its expansion enlarged by the contributions made by these two sources. Otherwise stated, the aforesaid tendency of incomes to sink to a minimum level is delayed to the full extent of this contribution which increases by its full amount the sum available for financing government activities.

When the government also has recourse to specific inflation, the limit is further displaced to the whole extent of the contribution made by the new monetary resources.

8. -- Neutralization of the first three sources by the fourth and regression of the limit just referred to.

But as soon as the amounts which the yields of the second, third, and fourth sources of receipts placed at the service of the State are assigned to the several chapters of expenditure and raise the prices of consumption goods and services, whose production, in the meantime, instead of growing diminishes or at best remains constant, the limit, which at first was enlarged to the full extent of the contribution made by the last three sources, tends to mark a regression. Specific inflation injures the efficiency of the money yields obtained from incomes, savings, and the consumption of capital; it also injures the efficiency of its own yield. The more copious it is, the less efficient it becomes, and the less effective it is in opposing the tendency of incomes, consumption and production to fall to the minimum level. Therefore, during war the expansion of the limits within which government activities may be carried on through recourse to the last three sources of financing, and more especially to specific inflation, can only be temporary during periods in which the capital circuit obtained by limiting consumption, as well as by blocking prices and investments, can be made to work in full.

Should the circuit not work well, the government, if it desire to continue in like measure its activities, will need to make ever larger issues of paper money which will intensify the regression of the aforesaid limit.

The purchasing power of estimated receipts will decline with the circulation of the new paper money. As their purchasing power declines, all who are in receipt of incomes which are only slightly above the minimum are likely to see them reduced to that minimum or below it, and they will be unable to stand a further increase of taxation or to put aside savings. The recipients of average-sized incomes will find themselves redu-

ced to the fixed minimum and their respective capacity to pay taxes and make savings will be curtailed. Only incomes much in excess of the minimum will continue for some time to be taxable and capable of assigning a part to savings. This will be true more especially for the incomes pertaining to the first recipients of the new notes with which the State purchases the goods it needs. The reduced yield of all the sources of receipts which finance government activities will become evident.

9. — Limits within which it is possible to draw on incomes after the war.

In the transition from war to peace, private enterprise, desirous of intensifying production, and the government which has to meet post-war expenditure, compete in drawing on the sources for feeding their respective activities. This competition is all the keener because the sources to which the State can have recourse are now reduced to two, incomes and savings. Under these conditions, the extreme limit placed on financing government activities by recourse to incomes might be fixed, even in the post war period, by the tendency of incomes to fall to the minimum tax-exemption level: a minimum, moreover, which for many reasons, more especially on account of losses extending over a long period of time, should be higher than that fixed during the period of hostilities. It may also be found that the exemption limit should be displaced to the full extent of the contribution which can be made by savings which, to the extent in which they exceed the minimum held indispensable for independent productive activities, can be drawn on by the State in the form of loans.

We may also call attention to the difficulty of defining the minimum level of savings indispensable for sustaining productive activities, as this minimum tends to vary with economic fluctuations, and the prospect that the profits of private enterprise will be higher or lower than the interest rates which the State offers on loans for which it competes with private enterprise so as to finance its activities. Nevertheless, it would seem necessary to fix this limit so as to avoid the excessive absorption of savings in public activities.

In any case, the respect of a minimum income level and of a minimum volume of savings affords the permanent basis for (a) a minimum of productive activities supported by the expenditure of the minimum tax-free income on the more essential consumption goods, (b) a minimum of productive activities expended on other kinds of consumption goods,

perhaps less essential but likewise in demand on the home and international markets, activities in which the savings for which public bodies are competing, are invested, (c) government activities supported by both incomes and savings to the full extent of the difference between the minimum income and that received by the several recipients, between the minimum volume of savings and the volume of savings existing in a given country.

Should the volume of private savings exceed the minimum which it is agreed should be respected, because, for instance, the indispensable minimum for private needs has been calculated on a generous scale, and should the State succeed in drawing on the said savings, the limit to which government financing may go, and therefore the limit placed on the expansion of government activities, will be enlarged to the extent of this last mentioned contribution.

10. — The more logical and more immediate post-war limitations.

But the extreme limit — justifiable when the urgency of war needs induces the country to make demands regardless of their cost in goods, to intensify production by all means, and to take financial measures however drastic they may be — cannot be attained in times when the interests of the community demand intensified production, a definite increase of real income which distributed in the form of larger incomes to all those who participate in these increased activities will help to correct the disequilibria in the economic structure, to promote a fuller satisfaction of needs, and to favour the accumulation of large amounts of savings. It would seem vain to seek for other forms of equilibrium, — financial, social or political, — if the equilibrium of the whole economic structure be not first secured or be not likely to be secured.

Now, should a fiscal system try to secure the whole difference between the minimum tax free income, estimated as above, and the income obtained by each recipient, it will remove all incentive to increase the supply of consumption goods and of the factors of production. This will hinder the development of real income, unless indeed the minimum tax-free income be fixed on a very generous scale; in which case the maximum limit of financing operations, and therefore of the expansion of government activities will be narrowed. The fact is that heavy taxation, the confiscation of profits and of the remuneration required to determine the offer of the several factors of production are not the most effective means for securing the growth of income which is determined by contrasting motives of emula-

tion and profit. Heavy taxation, by smothering these motives, ends by endangering the foundations on which rest the possibility of securing the means for financing large scale government action.

If, on the one hand, the heavy burden of taxation weakens the incentive which induces private enterprise to secure high incomes and accumulate savings, and if on the other hand the State spends the receipts obtained from taxation and loans on activities which, as regards the formation of total real income, are too remotely instrumental, the result will be that productive activities will progress at a slower rate, if they do not indeed come to a standstill; the disparity between the supply and demand of consumption goods will reappear; the State budget and the balance-sheets of the more important business concerns will again show a deficit; and as a result the financial operations required by the expansion of government activities will have to be contained within the limits logically assigned them by the consideration of the economic value of each intervention whether it be for raising revenue or spending it.

The transfer of all the means of production to State ownership, and State management of all branches of production would not settle the problem, as it would not succeed in promoting that more decisive growth of real income which alone can afford a more solid basis for the growing activities of the State. On the contrary, the impossibility of securing a better combination of the factors of production, not only from the technical but also from the economic standpoint, by placing them under a central management has often been demonstrated. It is only by keeping the standpoint of economic expediency in view that it is possible to secure the growth of total real income not only during a given period but continuously, and of assuring the permanent development of new enterprises.

As is proven in the last of these studies, the economic expediency of each intervention by a public body is shown by the favourable comparison between the costs and the useful results of each collection of funds and of each expenditure. The State can never afford interventions which are economically of little advantage; or at least it should never do so without realising the consequences of its action. The results of such action are in the first place the loss of the advantages which would arise from a revival of production and a larger supply of consumption goods, and in the course of time they positively reduce production.

Carelessness and incompetence may fail to perceive the immediate and logical limitations which should be placed on government action in the first post-war period. The consideration of the other tendency —

that of incomes to fall to the minimum level fixed for tax-free incomes — a tendency which is only temporarily postponed, is in marked contrast with the main purpose which should be pursued during this period, *i. e.*, a definite increase of total real income.

11. — E to secure larger yields from existing taxes. The notion of the pressure of taxation.

When the real conditions in which it has to work are known, when the limits within which it can operate are realised, when the policy of reducing ordinary and extraordinary expenditure to a minimum has been carried out, the State, endeavouring to secure the financial rehabilitation of a country, has spontaneous recourse to an effort to secure larger yields from existing taxation.

The ratio between the yield of the several taxes — government, local, and in some countries also compulsory contributions to syndical, insurance and relief funds — and monetary income is described as the pressure of taxation. This ratio is in function of several factors, among which the level of average incomes in a given country, the distribution of total income between the several classes of recipients, the more or less marked tendency of the said income to grow, remain stationary, or decline, the tendency of the recipients to save or to invest, and so on (1).

(1) International comparisons may sometimes react on the advisability of increasing the pressure of taxation. But with few exceptions, the fiscal statistics of many countries are not only incomplete but are far from being homogeneous, a quality which alone would allow of reliable comparisons.

Thus, for instance, on the sole basis of percentages — let us say of 25 % or of 35 % — used for measuring the ratio between the yield of taxation and the total income of different countries, it would be difficult to assert on the basis, of the first of these two percentages that the pressure of taxation in Italy is lower than *e.g.*, in Germany on the basis of the latter. As a matter of fact the average for incomes in Italy is much lower than in Germany, 2,500 in 1936 as compared to 8,500 in Germany and 9,000 in England. It is true that the lower average Italian income is accompanied by a lower standard of living and by a higher capacity of the citizens to make sacrifices. But this assertion does not affect the fact of the low level of average income. Moreover, in Italy the distribution of total income prior to this war showed that barely one tenth of it was received by recipients of more than 2,000 lire per month. Under these circumstances, a percentage of 27 % indicates on the one hand that the pressure of taxation is already very considerable, and, when we consider the characteristic distribution of total income, it shows that this pressure weighs mainly on average and small incomes. On the other hand, the effort to meet great financial needs by levying taxation at high rates on the larger incomes will yield scanty results unless at the same time average and small incomes are severely squeezed.

Some enquirers may be led to compare the growth of the yield of taxation in various countries during a given period — for instance during the war — while neglecting to take into consideration the difference of the several situations on which they base their calculations. In a country where average incomes are high, such for instance as the

The fact is that the pressure of taxation varies not only from country to country but, within each country, from one period to another. For instance, during the first world war (1914-18) the pressure of taxation was reduced. In Italy, in 1916-17 the yield of taxation had only increased by 18 % at a time when the monetary income had doubled. At the close of hostilities the pressure of government taxation had not yet returned to the pre-war level.

12. — Dynamics of the pressure of taxation.

To follow the changes in the pressure of taxation during the present war it would be necessary for each country to make reliable estimates of the average level of the prices actually ruling for important groups of goods and services. On the basis of these averages it would be possible to calculate the monetary income and to compare it to the yield of taxation. As however the requisite data are lacking, it would seem legitimate to presume, on the basis of other data, that marked changes have occurred in the pressure of taxation. For instance, the calculations might be based on the ratio between the yield of taxation and State expenditure instead of on the ratio between yield of taxation and total income; or other indi-

United States, the yield of taxation which was negligible prior to the present war when compared to the total monetary income, has been very considerably increased during the war. In a country where average incomes are small the yield of taxation, which was already very considerable before the outbreak of hostilities when compared to total monetary income, will only show a slow rise during their progress. Could it be affirmed that the former country in responding to the demands of the State has made greater efforts than the latter? In the instance referred to the contrary is the case. The fact is that in judging the comparative pressure of taxation in several countries, great circumspection is required. On the difficulty of drawing comparisons between the pressure of taxation in different countries see COSCIANI, C., "Studio sulla pressione tributaria e sulla evasione in Italia" "Associazione fra le Società per Azioni", 1943.

Further obstacles in the way of reliable comparisons arise from differences in the organisation of the fiscal systems, which may lead to errors of judgement. Thus total taxation absorbs 24.5 % of the income of Great Britain and 39.1 % of that of Canada. "Evidently — remarks the *Bollettino d'informazioni* of the aforesaid *Associazione*, of June 1-15, 1943, p. 190, the pressure is not on a uniform basis because the fiscal systems are very different. In Canada, 44 % of total taxation consists of indirect taxes, 28 % of the tax on turnover, and only 20 % of the direct tax on incomes. In Great Britain indirect taxation accounts for only 36 % of the total, the tax on turnover for 15.5 %, and direct taxation of incomes for 39 %. There are moreover differences between the various groups of incomes. In Great Britain incomes of L. st. 80 are exempt from income tax in the case of unmarried persons, and those of 140 for married persons; in Canada the equivalent figures are L. st. 135 and 245. On very high incomes (i.e., those exceeding L. st. 12,500) taxation is heavier in Great Britain than in Canada; but in the case of average sized incomes the reverse is the case. Thus the unmarried tax-payer in receipt of an income of L. st. 1,250 pays L. st. 494 in the United Kingdom and L. st. 538 in Canada.

ces might be used the value of which would have to be examined by the student.

It is true that the ratio between the yield of taxation and State expenditure cannot fully replace the ratio between the yield of taxation and total income. Not all the amounts expended by the State are redistributed in the form of incomes. A part, for instance, may go abroad in payment, let us say, of imports. Nevertheless, it is very interesting to know what quota of government expenditure is actually met by sums levied on incomes. As whether it be large or small to begin with, this quota declines in almost all countries as the war proceeds.

This reduction will be a relative one if, in the country taken into consideration, the pressure of taxation was already so high as to induce the government to seek the receipts required for financing its activities from other sources. The source derived from incomes then loses importance as compared to other sources. The reduction is an absolute one when it is due to defects in fiscal machinery which allow of tax evasions. Long intervals between the revision of income assessments ; delays in procedure ; defective definitions of taxable income ; methods of assessment which facilitate the concealment of taxable property such as assessments based on circumstantial evidence which are less strict than would be desirable in times of financial stringency ; specific duties, for instance, instead of *ad valorem* duties ; methods of tax collection which are more costly and less reliable than others as, for instance, collection entrusted to middlemen rather than to tax collectors employed by the government itself — are all causes which lead to the decline of the pressure of taxation as a result of which the increase of total monetary income is not accompanied by an adequate increase in the yield of taxation.

Several other indications may be of use in deciding whether the decline in the pressure of taxation is due to formal or substantial causes. Thus, for instance, if during the war and inflation years the yield of direct taxation on land and buildings remains constant ; if the increase in the yield of taxation on incomes from movable property (personalty) shows only a moderate increase at a time when government expenditure on orders given for munitions of war and on subsidies for supplementing prices, *i. e.* on purposes which are to the advantage of the producers of goods required for the war or to the civilian population as a whole has risen to tens of milliards of lire ; if the increased yield of taxes on consumption is also a moderate one owing to the stability or slow rise of the prices of many essential commodities such as house rent, public

services, essential commodities, heating, light, as a result of the severe limitations placed on those forms of consumption which are most profitable to the Treasury, clothing for instance in the widest sense of the word (1) we should be justified in coming to the conclusion, even in the absence of reliable estimates of total monetary income, that tax evasion is taking place on a large scale. This is explained — not justified — by the serious difficulty experienced in keeping track of the complicated phenomena of the redistribution of incomes and goods caused by inflation. It is remedied by the effort to bring the pressure of taxation back to the pre-war or to higher levels.

13. — In some cases the return of the pressure of taxation to its previous level is equivalent to its increase.

The attempt to bring the pressure of taxation back to its previous level must however be made with caution when it is carried out during hostilities in countries having recourse on a large scale to specific inflation, and which are unable to neutralise its effect on prices by securing the « circuit of capital ». For in such cases, should the depreciation of the purchasing power of the currency be more rapid than the increase of income received by the several recipients, — *i. e.*, should incomes increase during the period but should the decrease in their purchasing power be still more rapid, — the policy which aims at raising the pressure of taxation on the nominally increased incomes which, however, have in reality decreased to a level equal to the pre-war level, will really mean increasing that pressure. It is indeed evident that levying the same percentage on an income whose purchasing power has declined, means placing on it a heavier burden.

(1) See the interesting article "Tributi e reddito nazionale" in *Economia europea*, July, 1943. In the case of Italy the A. points out that at the end of the first three years of the war the yield of direct and indirect taxation had risen a little less than 45 %, State expenditure had more than tripled, the general level of current prices could be considered to have doubled. When it will be possible to estimate total monetary income at the end of the hostilities, more accurate estimates will be possible. There seems however to be no doubt that during the war certain sections are being formed — such for instance as those of industrial and agricultural incomes — where the pressure of taxation has been reduced. Moreover, if we take into consideration the increase of personal incomes of the great majority of the consuming classes — industrial workers, small holders, métayer and tenant farmers, small land-owners, men called to the colours, the recipients of subsidies of various descriptions — the increase of their respective purchasing power and of their taxable capacity is confirmed by the inelasticity in the demand for certain non-essential commodities, however much their price may increase.

No less caution is required in the post-war period, so long as prices, notwithstanding the stoppage in the issue of paper money, continue to rise above the level reached when hostilities ceased as a result of the return of hoarded notes to the market and of the further decrease in the supply of goods. The price-rise will be a limited one if stabilisation is firmly pursued. As moreover all incomes do not share in the increase, many of them remaining stable or rising to levels only slightly higher, it will be necessary, when making the preliminary enquiries, to ascertain their real consistency so as to avoid the danger that taxation, on the pretext of returning to pre-war levels, be really raised, which is not always desirable under post-war conditions.

14. — The control of tax evasion and of double taxation.

The first form which the endeavour to secure larger returns from taxation may take is the control of tax evasion, both in the forms it had assumed before the war and in those assumed during the hostilities. Tax-evasion implies the withdrawal from the action of the fiscal authorities of taxable wealth. The attempt to prevent this requires the strict assessment of all incomes, if need be by recourse to various methods and at various rates (1). The scientific organisation of the fiscal administration with a view to securing this would entail the removal of all the drawbacks mentioned in par. 12 as giving rise to the phenomenon of tax-evasion.

The second form which the endeavour to secure larger returns from existing taxes may take is, though it may sound paradoxical, the control of double taxation. Such duplication occurs when direct taxation is levied twice or more times on the same income, or the same portion of an income, or several times by the same branch of indirect taxation (2).

(1) "It would seem that a single rate affords a better guarantee of equal treatment. This would be true if all incomes were assessed with the same degree of accuracy. But as this condition can never be secured in full, it is only when rates differ that the inevitable discrepancies in the assessments can be eliminated, provided that the legislator is really desirous of securing this end. If, for instance, the salaries of civil servants or even the incomes of land-owners were taxed at the same percentage at which the incomes of the professional classes are taxed this would not be equality of treatment". DE VITI DE MARCO, A. "Primi principi di economia finanziaria", Turin, 1934, p. 179.

(2) In Italian legislation examples of double taxation are afforded by (a) the tax on the incomes of land-owners who may not deduct interest payments made to creditors who are guaranteed by mortgages on the rural or urban immovables and the income tax levied on the interest payments themselves; (b) the tax on the consumption of raw materials — for instance, iron, — and the tax on the consumption of manufactured iron goods; for if, as a result of the phenomenon of transfer which the legislator favours so as to tax the income of the consumer of manufactured iron, the two taxes should be amalgamated in the price of the said manufactured goods the in-

The notion differs from that of a heavier burden resulting from a rise in the rate of taxation or the levy of new taxes on the income of the same tax-payer.

The need of preventing evasions leads to recourse to many taxes rather than to single taxes, and to the contemporary use of direct and indirect taxation which are supposed to complete each other in securing the taxation of the income on which they are levied. On the other hand, the need of avoiding double taxation leads to action for identifying the nature of the several incomes, as a result of which while the mass of consumption goods produced by a given country in a given time are identified with a view to their taxation, an effort is made not to strike them more than once.

The tax administration which expects to receive a certain yield from a given number of taxes on taxable wealth, finds itself deprived now by tax evasions and in the future by double taxation. The effort to prevent both these abuses in the postwar period is not only in keeping with the interests of the tax-payer but is a means of avoiding the future shrinkage of income and consequently of the yield of taxation. It is the most natural if also the most perplexing means for securing a well-organised financial rehabilitation. It is a policy which should be supplemented by the revision of tax-exemptions.

15. — A third form which the effort to secure larger returns from existing taxation may assume: the reduction of tax-exemptions.

As a matter of fact the burden of the various forms of taxation is rarely borne by the whole monetary income of a country. Not all recipients of income are called on to contribute to it, nor are all required to contribute in like measure. Apart from that portion of income which, as we have seen, succeeds in evading taxation, a conspicuous part of the total monetary income is exempted by law from taxation. The exemptions depend for the most part on special circum-

come obtained will be struck repeatedly by the same tax; (c) the taxes successively levied on the transfer of the same volume of savings, as when a first investment is made in securities or immovables and when these are sold at a higher than the buying price the proceeds being invested a second time in other securities or other immovables on which other taxes are paid; or when on the death of the owner of the securities or immovables the estate duty represents — in relation to the original investment of the *de cuius* — the final duplication of the several indirect taxes on transfers which have been levied in the course of time.

stances (1), or on the exemption of minimum or small incomes. The exemptions granted to small incomes give rise to systems which, by means of *progressive* rates, tend to displace the burden of taxation from minimum and small to average and large incomes.

When tax-evasions attain conspicuous figures and tax exemptions are granted on a large scale, the burden of direct and indirect taxation ends by weighing on only a part of the total monetary income, a part which, in countries with a low average and few high incomes, approaches half and sometimes falls to even a lower percentage. Thus the recipients, who are nearly always the same persons, of the incomes on which taxation, and more especially direct taxation, is levied are inclined to feel that they are called on to carry excessive burdens and subjected to unequal treatment, perhaps at the very time when the ratio between the yield of taxation and total monetary income is, on the contrary, tending to decline.

16. — Difference in the difficulty experienced in reducing tax exemptions during the war and in the post-war period.

It is easy to revise tax exemptions during hostilities, when the total monetary income and the several incomes among which it is distributed, are constantly rising. It is especially easy when the contributions of the several sources which finance government activities are increasing and when their redistribution for the most part among the smaller incomes, makes it less difficult to subject to taxation incomes previously exempted. But it is not so easy, even during a war, to revise tax exemptions in a country where the average income is low and where therefore the level of the incomes thus exempted is a low one, except in the case of exemptions granted for reasons other than the low level of the income thus favoured. At such times, special privileges confronted by the need of meeting financial demands are more easily suppressed.

But a revision which desires to be a well-considered one, is faced by much greater difficulties in the post-war period. Not only does it

(1) For instance, the interest on national debt securities — as the exemption enabled the State to offer a lower rate of interest ; the rents from new urban dwelling-houses, an exemption granted to encourage their construction ; the incomes of agricultural workers not always in excess of the minimum subsistence income ; the income arising from activities which it is considered desirable to encourage, as for instance to promote industrial development in certain parts of the country, land improvements in others, and so forth.

require as a premise the accurate assessment of surviving incomes and of the new incomes which have arisen, but it must take into account the fact that by suppressing recourse to note issues and to the consumption of capital, the sum available for government needs tends to decrease and the growth of average and small incomes, towards which the said expenditure flowed more abundantly during the period of hostilities, tends to shrink. Consequently, and until such time as a decisive revival of independent private productive enterprises carried on with the participation of large numbers of persons belonging to the lower income groups, sets in, any attempt at a revision of exemptions with a view to their reduction will meet with strenuous opposition, and is likely to give only scanty results.

In addition to this in the post-war period, besides making a strict assessment of the incomes which still subsist and of the new incomes which have arisen, it is necessary to consider, in the case of irregular incomes and of those which expire in this period, the possibility of granting relief from taxation, abatements, suspension from entry on the tax rolls, discriminations : in short a whole series of facilities to which recourse is also had when passing from peace to war conditions, and which are based on much the same motives during the inverse period of transition from war to peace.

Thus, for instance, when note issues cease, should the prices of the main groups of goods and services continue to rise until they reach the level agreed on for an at least *de facto* stabilisation, equity will require that while strictly enforcing existing and new taxation, discriminations be made in favour of those incomes which have not increased. And this makes it still more evident that the endeavour to reconduct the pressure of taxation to the pre-war level cannot be carried out by merely calculating a percentage of the total monetary income — 30, 35, 40 per cent. — and requiring taxation to rise to it without more ado. The endeavour demands the most vigilant assessment of the several incomes so as to decide in which cases the reduced fiscal severity can be revived with a probability of success, and to what extent it will be possible to carry out the taxation of incomes without compromising the growth of real income.

In short, the control of tax evasions is the only means of securing larger returns from existing taxation which seems likely to give results of some importance in the post-war period. The other means — the avoidance of double taxation, the reduction of tax exemptions, — are not likely to give results of importance when compared to the size of the finan-

cial needs which have to be met. On the other hand, even the decisive results which may be secured by the control of tax evasions are likely to be so at the cost of the savings made possible by the incomes received during the war rather than at the cost of the incomes themselves, whether they be those which have survived the war or new incomes whose volume is definitely smaller than in the pre-war period.

This is the reason why the extraordinary taxation of excess profits earned during the war of which we shall soon speak, inserting itself among the means used for preventing tax evasions, endeavours to draw on capital increments when it is applied or continues to be applied in the post-war period.

17. — Increase in the existing taxes by the application of proportionate and progressive rates.

If we set aside the idea of securing larger yields by such general measures as retouching existing taxes, modifying fiscal machinery, levying new taxes which not infrequently entail high administrative costs and a more numerous staff, the raising of the rates of taxes already in force presents the problem of the degree in which they should be graded, of the phenomena which such rises will produce, of the possibilities of securing conspicuous and more especially enduring yields. Such studies are fruitful when they can be made on existing systems of taxation. Nevertheless, the problem of the graduation of rates requires, in post-war periods to be courageously faced so as to protect the community against platitudinous commonplaces and appeals to justice which not infrequently conceal tendencies which are far from impartial and which are financial delusions.

In face of needs such as those of the post-war period it would seem equitable that the wealthier classes should be called on to contribute in a progressive degree to the needs of the State. The exemption from taxation of small incomes was the first step towards progressive taxation, for when minimum and small incomes — which in all countries represent as a whole a large and conspicuous body — are exempted it becomes necessary to offset this exemption by increasing more than proportionately the taxation of the larger incomes which in all countries are not very numerous and represent a small total. This is the truth. The curve showing the distribution of incomes presents nearly everywhere the same outline.

But in each country progressive taxation can only continue on condition that incomes likewise continue to be high and such as to induce private persons to accumulate savings. High incomes are precisely those

called on to support the burden which minimum and small incomes wish to avoid. On the other hand, savings are the vital sap of all consumptive and productive activities. If savings are not made because the income obtained from them, when applied to production, is the object of persecutions as soon as it exceeds a certain level; if high incomes tend to disappear because they are more severely curtailed, the burden of taxation, required to meet unpostponable needs will again have to be met by the smaller and minimum incomes.

But when progressive taxation is so graded as to respect the type of average income characteristic of each country, *i. e.*, when it does not weigh more heavily on that average income or on those exceeding the average and therefore does not reduce either the number or the size of the higher incomes, nor the incentive to make savings, the interest of the fiscal authorities to secure the highest tax yield and that of the less wealthy classes to secure the fullest exemptions possible will be satisfied (1); and it is possible to expect that taxation will be in a position, at least as regards its organisation, to meet the progressive needs of government.

It might almost be said that progressive rates are effective not in cutting off the high points of incomes but in shearing off completely high income levels. In short, steeply progressive rates levied on a small number of high incomes endanger by the elimination of these latter the increase of real income — which alone can support the burden removed from minimum and small incomes — and will therefore endanger the yield of taxation. Should the yield decline, it will become necessary to tax more highly average incomes and to reduce the exemptions granted to smaller and minimum incomes, as occurred not long ago in England (2).

(1) "The leaders of the masses often forget that the indefinite accumulation of savings has reduced the cost of living, increased the wages of labour, and assured the progressive yield of taxation, and has therefore made it possible to follow a policy of growing tax exemptions in favour of small incomes, and they give way to the common delusion that it will be possible to preserve the advantages conferred by larger production and to win, in their own interest, those of a better distribution. But to wish for a better distribution of wealth and hinder the increase of the things to be distributed, to desire that taxation be lightened and at the same time to hinder the increase of taxable property are fundamental and incorrigible contradictions". DE VITI DE MARCO, A.: "Primi principi di economia finanziaria". Turin, 1934, p. 175.

(2) The "Economist" of January 9, 1943 called attention to the fact that in 1942 the increase of total net monetary income — *i. e.*, leaving out of account indirect taxes which help to swell the prices of goods and services — was considerable, although less conspicuous than that which occurred in 1941; it amounted approximately to 10%. In the number of August 1, 1942 (p. 133), the same periodical showed that almost all the increase of total monetary income is distributed over incomes of the lower groups; a small quota was distributed to the groups between 1,000 and 2,000 pounds, nothing was distributed to the incomes of the higher groups. The result has been a

18. — Dangers of so-called extra-fiscal finance.

The need of respecting the increase of total real income — even when it entails high personal incomes — and of not hindering the accumulation of savings, places a limit on social aims which purpose carrying on their activities by levying funds from private incomes by means of progressive taxation. It is not unusual to hear loud talk of the need of “equalising

great increase in the number of incomes belonging to the lower groups on which income tax is levied.

“The biggest increase has taken place in the lowest income categories. The number of individual incomes between £ 125 and £ 250 a year rose from 7,250,000 to 9,200,000; those between £ 250 and £ 500 rose from 1,750,000 to 3,500,000; the size of the £ 500 — £ 1,000 group increased from 500,000 to 685,000, and that of the 1,000 — 2,000 group from 195,000 to 210,000. But here the increase suddenly stops. Indeed, as the table shows, the number of incomes in excess of £ 2,000 a year in 1941-42 was precisely the same as in 1938-39. Even the numbers of the individual income groups above £ 2,000, taken to the nearest 100, is shown unchanged”.

On the basis of facts set forth in the “Budget White Paper” (Cmd. p. 347) the “Economist”, in its issue of August 8, 1942, is able to take into consideration millions of other small incomes which had never been considered for purposes of taxation, adding them to the figures above given. A more complete picture of the distribution of individual incomes is thus afforded.

Now, that the percentage distribution of personal incomes — both gross, i.e. before the application (this time) of direct taxes, and net, after the application of the (this time) direct taxes, attention being also called to the fact that “indirect taxation” weighs more heavily on small incomes — is shown by the table and the accompanying comment which we quote in full, in view of their respective eloquence.

Percentage distribution of personal incomes

Range of Gross Incomes	Distribution of Gross Incomes		Distribution of Net Incomes	
	1938-39	1941-42	1938-39	1941-42
	%	%	%	%
Under £ 125	35 1/2	33 3/4	38	39
£ 125 - £ 500	39 3/4	45 1/2	42 1/4	47 1/2
£ 500 - £ 1,000	7 1/2	7 1/2	7 1/4	6 1/4
£ 1,000 - £ 2,000	5 3/4	4 3/4	5	3 1/2
Over £ 2,000	11 1/2	8 1/2	7 1/2	3 3/4
	100	100	100	100

“The first two columns show the effect of what may be called the economic changes of the war; the second two show the effect of the economic changes together with that of taxation. It would appear that 79 1/4 per cent of the gross personal incomes of the community, and 86 1/2 per cent of its purchasing power (the net personal incomes after direct taxation), is now in the hands of those whose gross incomes are less than £ 500 a year. During the war, the middle classes (£ 500 to £ 2,000) have had their share in the national purchasing power reduced by one-fifth, the rich by one half”.

In the number of October 10, 1942 of the same periodical, the effects of the progressive rates of the “Income Tax” and the “Surtax” upon the higher incomes are stressed. It should be noted that the rate of increase in this case cannot be considered as exceedingly high.

war losses" due to various and inevitable price rises; of "shortening social distances"; of modifying an "iniquitous distribution of wealth". Taking only these aims — which include moreover several others — into consideration, it is easy to observe that the distribution of incomes is brought about by all the conditions which characterise the economic structure of a country. To wish to modify this structure without previously modifying those conditions and with them the concrete possibility of

"How severely the higher income categories have been dealt with was shown by the Chancellor of the Exchequer on September 30. In 1941-42 only 80 individuals were in receipt of net incomes (after taxation) exceeding £ 6,000, against 7,000 in 1938-39; in the £ 4,000 to £ 6,000 group the number was 1,170, against 12,000, in the £ 2,000 to £ 4,000 group it was 30,750 against 56,000; and in the £ 1,000 to 2,000 group 105,000 against 155,000. For all practical purposes, there is now a ceiling of about £ 6,000 on individual net incomes; and only a mere handful of individuals are able to retain net incomes over £ 4,000. (Details of changes, in direct taxation on incomes of £ 2,000 and over since 1913 are given on page 466)".

As a consequence of the fact that the greater part of the increase in the total money income having taken place in the lower income groups, as well as of the diminution in the number of larger incomes and of their amounts, it became necessary to reduce the exemption limit of the lower incomes and to raise the rates of both the "Income Tax" and the "Surtax". In fact:

"The number of individual incomes reviewed for taxation showed an impressive increase between 1938-39 and 1941-42, from 9,800,000 to 15,000,000; this means that one in every three members of the population, including women and children was in receipt of an income above the exemption limit in the past financial year. The increase in the number of persons actually liable to pay tax was even more marked, rising from 3,800,000 to 10,500,000; two out of every nine persons had to pay income tax last year. The reasons for this increase are twofold. First, the net of the tax as been widely cast by the reduction in the exemption limit; secondly, the number of incomes in the lower categories has shown a remarkable increase as a result of the growth of the national income".

The result was a change in the proportions of the contributions to the Income Tax of the different categories of incomes:

"Equally interesting is the change in the proportion of the gross income in each of the four income categories which is sliced off by Income Tax and Surtax. (This is shown in Table III). The increase in the contribution of each group again varied in inverse ratio with the level of income. The proportion subtracted from the under £ 500 group by direct taxation has been increased eightfold; the percentages taken from the £ 500 to £ 1,000, and from the £ 1,000 — 2,000 groups, have been more than doubled; but the increase has been less marked in the over £ 2,000 group, which was already taxed before the war. The lower and middle income groups have been called upon to make a much heavier contribution".

These are instructive facts. They confirm the theoretical remarks contained in our study (a) on the effects of markedly progressive taxation, (b) on the consequent need of revising the exemptions granted and of taxing the smaller and minimum incomes, (c) on the tendency of incomes to be levelled down. All these results react negatively on the growth of total real income. War economy is an experiment — compulsory indeed but in its final results, salutary — of collectivist economy. Those who may desire to continue it after the cessation of hostilities, should be prepared to see the importance of the consequences above set forth increased, and first among them the reduction of real incomes. Even in this period, this reduction may occur in spite of the increase of total monetary income, or, to express ourselves more accurately, in spite of the sum placed at the disposal of the State by the sources which finance its activities. But what counts is real income and consumption goods, which alone can satisfy human needs.

directing private and government activities towards one or other aim, is a total delusion.

No machinery of taxation can be so effective in correcting a distribution of incomes which is considered defective as the use made of government expenditure, which is the first to be assigned for improving the economic structure of a country and the volume of real income arising therefrom. Only when positive results have been secured in this preliminary and decisive direction can a taxation system attempt to secure a more equitable distribution of the increased income. To reverse the process and to expect the fiscal system to secure greater equity will be seen to be hazardous.

When private incomes are drawn on, the attainment of social aims tends to be subordinated, as we have said, to the need of increasing the volume of real income — the fulcrum of all private and State activities — so as to bring it up to the level of the expenditure to be met. When a need has been accurately ascertained, the principal object of all financial activities is that of satisfying it in the best way possible. Should the means selected be advantageous to some groups of citizens — as is for instance the policy directed towards the stabilisation of the purchasing power of the currency which protects the poorer classes, or a wise fiscal policy which shortens social distances by granting tax abatements and exemptions to some incomes — it is legitimate to affirm that the financial policy has also in view extra-fiscal aims. But this assertion does not alter the essence of the matter. The very search for a social activity, subordinate to that of drawing on incomes to meet expenditure, shows still more clearly — at least in periods in which government needs are more urgently felt — the limits within which financial activities can afford effective help for the solution of problems of another description.

19. — Even if direct taxation does not reveal it, the progressive character of taxation is accentuated by the growth of indirect taxation.

Although it may not appear in rates perceptible to the general public as in the case of direct tax rates, the progressive character of taxation is gradually accentuated with the growth of indirect taxation in a degree disproportionate to anything noted in the case of direct taxation.

The phenomenon can be observed in many countries. For a long series of years the development of commercial policies based on high protection on the one hand, and on the other the expansion of government

activities and the consequently increased financial needs have compelled statesmen to raise the rates of the taxes on consumption, until the possibility of having recourse to substitute products checked this tendency; to tax luxuries heavily both as an offset to tax exemptions or the very light taxation of commodities of general use, and because in countries with a high standard of living commodities considered as luxuries are relatively few in number and therefore cannot easily yield large returns from taxation; and in this way the taxes on consumption from proportional have become progressive.

Much the same motives, in addition to exemptions and discriminations in favour of the under-privileged groups, have on the one hand, extended the sphere of applicability of indirect taxes on property transfers, thus taking advantage of the fact that the tax-payer offers less resistance to indirect taxation; on the other hand these motives have led to the adoption of progressive rates which in some cases, for instance in that of estate duties, have become real instruments for the confiscation of income. In both branches of indirect taxation — that on consumption and that on business transactions — the tendency to expansion and the tendency to progression have thus asserted themselves, tendencies which continue and indeed are likely to be accentuated in the post-war period with its enormous financial needs and the inevitable appearance of demagogic policies.

These tendencies give rise to all the consequences mentioned in our reference to progressive taxation on the growth of private enterprise, on the survival of high incomes, on the formation of savings, on the growth of total real income. Those who undertake the financial rehabilitation of a country cannot neglect them without adversely affecting the growth of the supply of consumption goods essential to meet individual needs.

20. — The different deflationary effects in time of direct and indirect taxation. The effect of State activities on inflation.

The different degree of importance of direct and indirect taxation as influencing not the possible trend to progressivity in the distribution of the whole burden of taxation and the hindrances in the way of the growth of total real income — the constant subject of our study — but the stability of the purchasing power of the currency, which is the essential premise to the formation and growth of income, has been reaffirmed

in recent international literature. (1) The question is one of interest in a period which tends to stabilise the purchasing power of the currency as a preliminary step towards the rehabilitation of the budget of the State and of the balance-sheets of the more important business concerns.

Both forms of taxation, direct and indirect, it is said, tend to absorb purchasing power. But direct taxation reduces at once the income of each recipient and has therefore a deflationary effect, or at least an anti-inflationary one; whereas indirect taxation does indeed lead to a rise in prices of the goods the consumption of which is taxed, but leaves the income in the hands of the recipient and it is only later on, when the higher prices of goods and services make themselves felt, that it succeeds in absorbing purchasing power. Thus the deflationary effect of taxation which is immediate in the case of direct taxes is deferred in the case of indirect taxes.

These observations hold good however for relatively brief periods. As soon as the yield of taxation, whether direct or indirect, is spent by the government — which in practice does not wait to make use of the yield, as to meet urgent needs it has recourse to such short term loans as Treasury Bills or note advances made by the Central Bank — the income situation which existed before the levy of the taxes, whether direct or indirect, is reproduced at least in its main lines. The problem is not therefore one of much importance for post-war monetary policies.

It is indeed true that not all the amounts the State levies on incomes return, as we have said, to the circuit of the production of real income, and the expenditure of the sums collected does not always lead to the full reproduction of the situation which existed prior to one or the other form of taxation. But however great may be the curtailment of total real income, the redistribution of government expenditure over personal incomes always enables the recipients to influence prices by the acquisition of goods and services, and always neutralises deflation, at an early date when direct taxes are levied, later on in the case of indirect taxation.

Attention should indeed be called to the fact that government activity by the expenditure of receipts from taxation not only neutralises the deflation which may have been brought about by the application of one or other group of taxes, but if, as we have said, it destroy present goods without the certainty of reconstituting them in like measure in the future

(1) Reprinted from the "Bollettino d'Informazioni" of the "Associazione fra le Società per Azioni", June 1-15, 1943 p. 191.

— thus hindering the reproduction in like measure of real income — it will be a cause not of deflation but of inflation. For if favourable changes in the system do not occur to compensate these disadvantages, it will curtail the supply of present goods, leaving unaltered the volume of the currency. And under these conditions, not only the deflationist efficiency of direct or indirect taxation is unable to make itself felt, but State activities give rise to inflation.

This result may also be defined as a “monetary” one, or more accurately, as neutralising the deflationary action expected from the taxes, whether direct or indirect. It is however obvious that it is not the direct result of either the one or the other form of taxation. It is the result of the aims selected, which are not all inspired by the notion of economic expediency — some of them indeed could not be — and which entail the destruction of present goods without rapidly offsetting them by others, and sometimes without even offsetting them in the course of time.

To sum up what has so far been said, in countries with a low average income and suffering from the consequences of severe inflation, the success of ordinary systems of taxation requires that they be reorganised and improved. But such taxation must not exceed certain limits which our study will try to discover, if it is not to become fruitless from the fiscal standpoint and harmful to the increase of production which is so desirable, more especially in the difficult post-war period.

(B) EXTRAORDINARY TAXATION IN RELATION TO INCOMES OR TO CAPITAL

21. — The difficulties in the application of extraordinary taxation. The tax on excess war profits.

Heavier taxation of incomes, although it depresses by so much the price of the goods from which the income is obtained — for instance, a tax on dividends depresses the prices of shares by an amount equal to the capitalisation of the tax at the current rate of interest — may well be supposed capable of enduring over a certain space of time. On the other hand, a tax on excess war profits cannot continue, as it refers to clearly defined phenomena which are not likely to repeat themselves in the course of time. Such a tax, as above stated, finds its place among

measures for the control of tax evasions, more especially those forms of evasion which are readily met with in war time. When however it continues to be applied in the postwar period, this tax itself must conform to the rule applicable to all the taxation of such a period and which requires that it should not hinder the recovery of real income.

There would seem to be no doubt that during a war it is difficult to avoid on the one hand excess profits and on the other profits on a scale lower than normal arising from the increased or reduced opportunities for using the factors of production, even when a certain price structure has been maintained. Nor does it seem doubtful that inflation works to the injury of fixed incomes and to the advantage of variable incomes. All these circumstances make it seem advisable to introduce on the one hand tax abatements and on the other tax increases. It is however one thing to express approval of such measures and quite another to take the necessary steps for taxing excess war profits.

A tax on excess profits is a typical example of a tax levied on real income. It affects indeed either new incomes which have arisen as a result of the war or incomes in excess of the normal. But it is very difficult to levy such a tax without causing losses.

A first difficulty is met with in defining the notion of *ordinary* income. Whether we consider "ordinary" the income assessed for the purposes of a tax on movable property, of which the tax on excess profits becomes complementary, or whether we consider "ordinary" the incomes obtained by all those who carry on the same productive activities, the difficulty of defining it accurately arises from the marked differences existing between the several business enterprises working on the same market. Even if we accept the distinction drawn between marginal and intermarginal undertakings, each of these latter have different outputs, costs, and sales prices. In each the differences between "savings on costs" and "heavier costs" take a different direction, and are noted in a different manner by those managing the business. On the other hand, it is not always justifiable to judge on the basis of the volume of output which can be disposed of at current prices whether an income should be considered as "ordinary" (1). In a progressive society, excess profits — *i. e.*,

(1) On the tendency of tax-payers to return a larger capital so as to make their ordinary income appear smaller; on the opposition which the fiscal authorities make to this attempt; on the consequent result that if the return is not accepted the ordinary income is held in large part to be "excess profits"; on the criteria accepted for calculating the sums to be deducted when assessing the tax on account of plant

in excess of income carried in a previous time unit — are phenomena common to all intermarginal businesses, even though they occur in degrees determined by the economic expediency of the various combinations of the factors of production. Thus, even in peace time and in a market tending towards free competition, it is difficult to assess the excess profits of intermarginal business undertakings.

In war-time the difficulty is still greater, as then the only incomes on which this tax can be levied are those arising not from the ability of the directors of the business but from factors originating from the war conjuncture. The only profits which would seem to be taxable, more especially in war time, would seem to be those arising either from high prices — due to an increased demand for goods and services and a smaller or more uncertain supply — or from lower costs in the case of the mass production with its diminishing costs, of clothes, foot-wear, arms, and munitions (1).

The rise in price or, in some cases, the reduction of costs, is however offset by the marked rise of many other elements in the cost of many kinds of goods and services. Such, in the case of undertakings recently established, are the high costs incurred to cover heavier risks which war industries must face, as compared to the smaller risks of old established industries; the need of more rapid amortisation — in the course of a year or two they must deduct for this purpose large sums from the profits received — the need, common indeed to all undertakings, to accumulate large reserves to meet the post-war depression. The costs of established business undertakings are also increased by the risk of currency depreciation, the heavy wear and tear of machinery which with the prolonged duration of the war affects woollen and cotton mills, tanneries, plants for the manufacture of medicines, etc., as a result of the uninterrupted work required to meet the huge orders they have to fill. Prices must be high to cover these costs, and the profits which serve as a cover, even if arising from war conditions, cannot always be taxed without committing an obvious injustice.

depreciation and amortisation, during and after the war; on the strictness of the assessments, on the instalments fixed for the payment of the tax, and lastly on the results of such taxation, see the striking pages written by EINAUDI: "La guerra e il sistema tributario italiano". *Op. cit.*, pp. 129-229, and "La condotta economica e gli effetti sociali della guerra italiana". *Op. cit.*, pp. 217-223. The valuable study by COSCIANI, G. "Considerazioni economiche in tema di tassabilità di sovraprofiti di guerra" in "Studi economici finanziari corporativi" July-October 1941, is exhaustive and contains a copious bibliography.

(1) CABIATI, A.: "Il finanziamento di una grande guerra". Einaudi, Turin, 1941. pp. 140, 113, 118.

22. — Precautions to be taken if the tax continues to be levied after the war.

After the war the difficulties are no less, although the tax then tends to become a tax on capital increments. But it is no less difficult to ascertain the situation of the capital of each individual at the beginning and at the end of a war. Capital is the result of goods which during the hostilities may have circulated and escaped the notice of the Treasury. No less, perhaps even more difficult, is it to afford proof that a given capital, or increment of capital, has arisen from acts of self-denial extending over a number of years and not from speculations. Another difficulty which besets private persons, most of whom do not keep books relating to the management of their fortune, is that of proving that they owned liquid funds or stocks prior to the war. In the absence of such evidence, the taxation of capital increments amounts in the post war period to a further burden placed on the *same* incomes which were taxed during the hostilities by the tax on excess profits and on profits obtained from immovables and shares; especially so if in the meantime the latter have been converted from bearer into registered shares of which the owner can no longer conceal possession. Thus, the disparities which occurred during the war are not reduced but intensified.

On the other hand, the ethical purposes and the intention of equalising burdens which should justify this tax, can no longer be adduced when it fails to strike *all* excess profits. As a matter of fact it is not levied on interest rates, in whose stability the State, as largest debtor, is interested; on the excess wages of workers employed in some industries, which are frequently very considerable; on the excess profits of agricultural undertakings and of shipping companies whose freight rates rise to a very striking extent. Where then is equality of treatment?

A tax on excess profits, even if it could be levied on all such amounts, can never confiscate them entirely without depressing all productive enterprise. Fiscal severity, often called for by persons who do not understand these matters, always yields results which are greatly inferior to the angry expectations which had been entertained.

In any case, should the taxation of excess profits be continued after the war, experience and a realistic point of view suggest the advisability of converting it into a tax on capital increments arising from war conditions, subject, when possible, to some precautions. Such, for instance, would be the strict definition of the purpose of the tax; the possibility of striking

a balance between war-time excess profits and any sub-normal profits secured in the post-war period; moderate rates; payment by instalments, so as to allow those undertakings which had tied up their excess-profits, to mobilise them without undue loss and so as to safeguard the purpose in view, which is that of levying taxation on income; exemptions in favour of the increments of small fortunes or of those which their respective owners are ready to invest in activities productive of real income — such as industrial plants — or at least in reconstruction work, the erection of workmen's dwellings, schools, etc. (1).

Whatever may be the margins of income and capital which can be assessed in a country and on which the State can levy taxation, the experience of the previous war warns us not to entertain delusions on the yield of a tax on excess war profits when compared to the financial needs of the post-war period.

23. — On a capital levy.

On the other hand, a capital levy, "the logical extension of a tax on income", does not justify great hopes. When the tax-payer's income does not suffice to meet such a charge, and when he is compelled to sell or mortgage at least part of his property to meet it, the extraordinary tax on capital is only applicable once for all within the limits of the "liquid funds" existing in the country or which can be obtained from further savings, with all the consequences of such recourse. The resultant losses are always considerable, whether the limits above mentioned are respected or not.

If the limit of the liquid funds existing in the country be exceeded, it should be remembered that the disinvestments which the tax-payers in question may be forced to make will entail losses which the fiscal authorities should take into account for they will react on tax revenues. A skilful entrepreneur will prefer heavier taxation on income — which ends by clearing away the less skillful heads of industrial enterprises — rather than a tax on capital which, as its purpose is to levy more than the income of the entrepreneur, will always compel even the most skillful

(1) Very sensible remarks have been made on this head by COPPOLA d'ANNA, F.: "Prospettive della finanza e dell'ordinamento tributario italiano". "Associazione fra le Società per Azioni", 1941.

to reduce the size of their business and should the business have attained a maximum of economic expediency, their returns from it will be considerably reduced with a loss to all concerned.

On the other hand, some writers consider that a tax on capital, levied once and for all -- even if it be referred to income (20 % on income is the equivalent of 1 % on capital) -- and levied even at a high rate, for instance, 200 % of the said income, and at progressive rates, does less harm to production than an ordinary tax levied on income at a constant rate, say 10 %. The reason adduced is that when incomes are rising, the ordinary tax absorbs goods to an increasing extent. An extraordinary tax, on the other hand, whether compared to income or to capital is levied once and for all (1). This assertion, however, implies the certainty that the community is making such definite progress as to secure to the tax-payers on whom the tax is levied and who are compelled to disinvest, future compensation for the loss now suffered. Should the compensation not be forthcoming, and should the tax, because it is heavy or still worse progressive, compel the taxpayers to make heavy disinvestments, a considerable hindrance would be placed in the way of the growth of real income.

Seen from this standpoint, the other assertion made by Pigou loses its importance, *i. e.*, that when the State has urgent need of funds taxation should be levied preferably on the wealthiest, because those who with the rise of incomes see their available margin grow more than proportionately have much less difficulty in mobilising their wealth. As a matter of fact it should be noted that when the receipt of a large income assures a wide margin, it is not left idle. It is put to profitable use, or deposited with banks who through loans assure its investment in profitable transactions.

A capital levy, by obliging the larger owners to disinvest at least a part of their capital, inflicts losses which extend to many economic situations, places deposit banks in difficulties, and in the last resort reacts harmfully on the yield of taxation: all consequences similar to those brought about by progressive taxation and all the more dangerous in times like those of the postwar period.

Such losses are the consequence of a capital levy, even when it does not exceed the afore-mentioned limits of the liquid funds existing in the

(1) PIGOU, A.C. : "Political Economy of War", London, 1921, pp. 202 *sq.*

country. Either the extraordinary tax on capital is steeply progressive — when for reasons just mentioned it hinders the growth of real income and the accumulation of savings — or it is only slightly progressive and then if the yield is to be of some importance, it must be levied with severity on average and small fortunes, must sequester their incomes for several years and plunge their owners into astonished dismay. Many consider that a capital levy *only* affects large fortunes, shameless enrichment, and that its purpose is to satisfy the claims of equity. This is not in keeping with facts. Countries with a low average level of income must tax with severity both average and small fortunes if they wish to secure appreciable results.

24. — Some precautions.

If rates be moderate and payment be made in instalments, the extraordinary tax may be converted into a tax on income levied over a certain number of years. But in countries where an ordinary tax on capital already exists the new tax will amount to a duplication. Under the several names of ordinary and extraordinary, both taxes, theoretically measured by capital, will be levied on income. The tax on excess war profits amounts likewise to a duplication of the tax on personalty. The two ordinary taxes on income and on capital, and the two extraordinary ones on excess war profits and on capital increments due to the war, will in the long run be levied practically on the same incomes, and will therefore intensify those disparities of which, in spite of the best intentions, no system of taxation ever succeeds in freeing itself.

Should it be impossible in the post-war period to forego a capital levy, some precautions might be taken to mitigate the losses entailed. Here again the purpose of the tax should be strictly defined ; the rates should be real and preferably proportionate ; the level of the rates should not be very high in relation to the instalments agreed on for making the payments ; and these last should, in their turn, be in function both of the volume of the amounts to be levied and of the degree of liquidity existing on the market ; exemptions and abatements should be made in accordance with principles of equity ; and so forth and so on.

Another precautionary measure is that of co-ordinating the application of an extraordinary tax on excess war profits — which being levied on nominal capital increments arising from the war conjuncture draws on certain percentages thereof — with the levy of an extraordinary tax on

capital, which within the limits suggested by the aforesaid consequences will be levied on capital and on real and ascertainable increments. In the difficult post-war period these two taxes, devised with different rates in view of the different nature of the taxable property, may yield considerable amounts on condition, however, that the assessments and the collection proceed rapidly. Otherwise, further disappointments await the anxious expectations of those who follow policies designed for the purpose of levelling wealth.

PART II.

RECOURSE TO NATIONAL SAVINGS

25. — Loans preferable to extraordinary taxation.

So far we have endeavoured to show that in countries with a low average income level, heavy inflation whose effects it has not been possible to neutralise, and which have suffered severely from the destruction of their sources of income, ordinary taxation cannot yield conspicuous returns even when all efforts, such as care in making the assessments, heavier taxation, progressive rates raised to their utmost limits, are used to secure them. On the other hand, the contribution made by extraordinary taxation, even if it be appreciable, cannot be used to meet ordinary expenditure. All this points to the need of recourse to the other available margin referred to, that between the amount of savings considered indispensable for the development of production and the total amount of savings-existing in the country. Recourse to this presupposes (a) a wide margin, (b) the possibility of meeting interest charges on loans out of ordinary receipts, in short, abundant savings and the elasticity of the whole fiscal system.

In times favourable to the accumulation of savings, a loan, as we said, is the cheapest and rapidest form of extraordinary taxation (1).

(1) The matter has been stated with most perspicacity by GRAZIANI, A.: "Istituzioni di scienza delle finanze", Turin, 1929, p. 628: "When we find in a political society those economic divergencies of comparative appraisements of present and future goods between tax-payers and capitalists, national or foreign, public loans offer the most economical means of providing for expenditure, as they make it possible to devolve to the satisfaction of the needs of the community that wealth belonging to capitalists which is, presumably less valued than any other portion of wealth. Should the authorities who interpret the valuations made by the members of a political community be mistaken in the kind of measure they take, the taxpayers can at once change the system of the contribution, as if a loan has been made when it would have been more advisable to levy a tax, all they need do to eliminate the effects of the said loan and make them similar to those of an extraordinary tax is to purchase securities of the public debt for a value equal to that of the interest charges they have to meet; and if on the other hand the mistake was made of levying a tax rather than issuing a loan they can contract a private debt, thus replacing a heavy temporary burden by a lighter but at the same time a more lasting one".

Recently CABIATI, A.: "Il finanziamento di una grande guerra". *Op. cit.*, pp. 37, 44, 59, 75-6, 127, 151-7, 165-66, has reaffirmed this notion, as a result of enquiries of an

But should the fiscal system be inelastic and should the service of the debt be more costly for the State budget, the advisability of having recourse to savings, even when available, may be doubted by the financial authorities. As a rule they are alarmed by the so-called problem of the national debt. This perhaps explains the many alterations introduced into the traditional means for reducing its weight : sinking funds, redemption by taxing the wealthy, partial or total repudiation.

26. — The problem of the national debt.

In what sense does a problem of the national debt exist ? It consists in this, that the debt can indeed be cancelled, wiping it out with a sponge in the belief that this will injure the wealthy, the powerful, those perhaps who wanted past expenditures or even perhaps war. As a matter of fact, the wealthy are indeed injured but so, and to a much more serious extent, are small and average-sized investors, banks, insurance companies, charitable and relief institutions, more especially in a country whose government during a long period of war preparations or during the war itself has forbidden all productive investments. In such countries repudiation would mean annulling the results of the only means millions of

unusual description, and comes to the conclusion (a) that both loans and taxes can be paid only out of existing liquid means or previous economies, which, however, cannot exceed certain limits ; (b) that a loan leads to a rise in interest rates which perhaps could be avoided by a uniform tax on all incomes which would lower the interest rates paid on all investments of savings ; (c) that nevertheless as a uniform tax has never been secured, extraordinary taxation, when equilibrium is secured on a given market, will give rise to much more serious disturbances than the system of loans, and these disturbances will be the more serious the higher the burden placed on the taxpayer by the tax, the more unequal the distribution of incomes, and the more readily the burden of the tax can be transferred. Thus, supposing that a country engaged in war can invest savings in undertakings which yield higher returns than the interest which has to be paid to private creditors, the State should not hesitate to have recourse to loans for the amounts required to cover the costs of the war and should leave available savings for investment in productive activities (p. 127).

This same superiority of the loan over the tax explains why the wealthy man who can invest his savings very profitably suffers loss not only when an extraordinary tax is levied on him which compels him to disinvest, but when he is obliged to subscribe a loan the interest on which is inferior to the profit he would have secured by investing his money otherwise. But those who have fewer opportunities for securing high returns, benefit by subscribing to a loan the interest on which is at least equal to the current rate of interest. It is true that a loan is more advantageous to the wealthy classes than a tax (pp. 154, 165) : the easier it is for each individual to reduce consumption in view of the high level of incomes, the greater will be the benefit secured by receiving interest payments. But, unlike a tax, the loan leaves the citizen free to subscribe in relation to his possibility of making future savings and undertaking future liabilities. Thus there can be no doubt that a loan is preferable when we consider that it causes less disturbance on the market.

people have had for investing their hard-earned savings, sometimes of many decades.

If, on the other hand, the Government decide to respect the engagements it undertook when issuing the loans, only the new savings arising from the growth of real income will be available for reducing the debt. Other expedients — such, for instance, as assigning for its redemption part of the tax revenues (sinking fund quota), or the whole revenue obtained from certain taxes (for instance, a capital levy), — will shift the weight of the debt from one to another group or groups of incomes on which the taxes are levied for such purposes, but will neither reduce nor eliminate it from the economic life of the country.

27. — Automatic amortisation.

The view of De Viti De Marco who believes that under certain conditions the amortisation of the national debt is automatic, is well known. He holds that the citizen no longer notices the weight of the debt when his activities succeed in producing an income sufficing for the satisfaction of essential needs and enabling him to offset the charge of the direct and indirect taxation levied on him to meet the service of the debt (1).

It is of course true that not all those who contribute to meet the cost of the service of the debt attain the balance referred to. The State can however favour it and thereby secure advantages much exceeding those that the operations of the Sinking Funds or the yield of taxation of a confiscatory character are likely to provide.

In the first place, the State can ascertain the quota of the yield of all taxation, both direct and indirect, absorbed by the service of the debt;

(1) "At that moment the national debt may be considered as extinguished *de facto*. This proposition, both as an abstract truth and as a concrete tendency, demolishes the opinion which holds that modern States will not long be able to support the burden of the national debt on account of the enormous expenditure entailed by its service. The full weight of a loan is felt by the economy of the tax-payers at the time of its subscription, when payment of the interest on same is provided for out of ordinary budget revenues. Later on, as the date of the issue gradually recedes, the fiscal pressure of the debt steadily diminishes. The alarming figures of the original national debts and of the interest on same, remain, but offsetting credits (*partite di giro*) gradually tend to empty the payment of debts of economic significance. This phenomenon may be considered as an automatic amortisation of the national debt" (DE VITI DE MARCO, A.: "Primi principi...". Op. cit., pp. 385-86).

The plans laid down for building up the several Sinking Funds run counter to this automatic action; they often provide for payments and redemptions at fixed dates and neither satisfy the needs of the State nor of private citizens. If, in spite of this, they are kept up the purpose is not to reduce the cost of the debt which the tax-payer has to meet but to show that the State pays its debts, even if only partially and irregularly.

and although not all those who contribute to the service of the debt pay all the taxes, (often indeed they only pay some) it can ascertain approximately the average quota, 10 % or 20 %, of each income group absorbed by the said service. On the basis of these data it may safely be stated that the burden of the debt is lightened and disappears in the case of the several tax-payers as they gradually obtain an increment of income equivalent to the taxes levied for the service of the debt. This balance is obvious when the results of his productive effort enable the tax-payer to purchase securities the interest on which amounts to not less than the taxes he pays for assuring their service. But it also exists whatever the investment may be in which the tax-payer invests the fruits of his successful productive work.

28. — How cautious policies may favour such amortisation.

Such compensation may be facilitated for each individual balance-sheet by a knowledge of the measure in which the securities of the National debt are distributed over the several groups of income-recipients. If, as is generally supposed, the recipients of small incomes possess a smaller absolute amount of such securities, the Government which has ascertained this fact will be in a position to promote fiscal abatements in favour of small incomes — an abatement entailing that of the taxes levied for the service of the debt — as also abatements of direct taxation in favour of those higher income groups whose recipients show that they hold government securities — thus facilitating their diffusion among the public and their automatic amortisation as well as the conversion of “compulsory” savings into national debt securities, as, for example, in the case of dividends above a certain level — a conversion which affords another way by which higher incomes may contribute to bring about the aforesaid balance between taxes and interest payments. By intensive proganda and by the offer of favourable conditions the State can also facilitate the diffusion of its securities among small investors and promote the inclusion in all balance-sheets of interest receipts on national debt securities which still more clearly show that the taxes levied for this purpose are offset by receipts.

One objection remains. The growth of real income does indeed facilitate in the case of each individual tax-payer the aforesaid balance between receipts and expenditure; but it does not facilitate it so obviously in the case of the State budget, called on to meet heavy inter-

est charges for the service of the debt. But even if the pressure of taxation is unchanged, a total growing income yields larger returns. Should the tendency of the income to increase make itself definitely felt, the State can increase the pressure of taxation and lay the foundations for that balance between receipts and expenditure, which far from being an all-pervading obsession will then be secured as the result of a slow economic recovery, foreign to all forms of wonder-working.

It may not however be possible for many countries in the post-war period to avoid the conversion of the national debt, carried out for the purpose of relieving, at least partially, the State budget (1).

Prepared by action taken to raise the quotations of the securities, and protected by abundant liquid reserves, conversions have a better chance of success if made at a time when there is little demand for reimbursement by security holders desirous of investing their capital in other ways.

It should however be remembered that payment in full of interest rates could only be suspended subject to the undertaking to resume them as soon as economic conditions allow. In this way the holder of government securities might be credited with that part of the interest the payment of which is suspended, in a bank deposit account, available at a specified date, on condition that, in the meantime, the State undertake to abstain from all policies having the purpose of depreciating, more or less intentionally, the purchasing power of the currency.

These are financial policies suited to States with a solid moral structure and carried out by men of undoubted capacity who can command respect and enjoy credit not only with the investors of their own country

(1) For references to some of the measures taken in Italy between 1935 and 1942 to form reserves, such for instance, as the reduction of the dividends of joint stock companies and the use of the funds provided by monetary revaluation, the investment in Treasury bonds of a part of new capital issues, higher war profits, and purchases of shares, and as showing the consistency of the national debt and the possibility of reimbursing the floating debt, see the detailed report of ARENA, C.: "Appunti sulla ricostruzione economico-finanziaria" Istituto di Finanza Corporativa, 1944. We find there the following particulars.

On 30th May 1943 the national debt amounted to 255,054 million lire of capital indebtedness, distributed as follows: consolidated debt, 52,945 million; deferred annuities, 38,907 million; Treasury notes 5,762 million; redeemable — consisting mostly of nine-year Treasury bonds for which the earliest date of maturity is 1948, with the exception of 21,443 million falling due on 1st September 1944 — 157,440 million. At the same date the floating debt amounted to 155,960 million distributed as follows: Treasury bills, 43,303 million; extraordinary advances 58,882 million; interest bearing current accounts 53,775 million. An increase of 20 milliards was foreseen for the end of June 1943. Part of the floating debt is held by semi-official corporations. ARENA suggests that the remainder be transferred to the capital debt by means of voluntary conversions, carried out in conformity with the policies adopted for financial rehabilitation.

but also with those of other countries. This is important, because foreign capital does not offer itself only for charitable purposes. It is attracted by inducements and clearly defined guarantees which command confidence in so much as they are offered by countries which, if compelled by necessity may indeed suspend partially or totally the service of their debt so as to recover strength, but do not repudiate or deny the fulfilment of liabilities duly authorised by law and undertaken in times of great danger for the whole community.

29. — Disguised borrowing: Loans obtained from semi-official institutions.

So far, reference has been made to loans issued by the State and offered for public subscription in various ways. But not all State loans are obvious to the majority of tax-payers. To say nothing of the issue of paper money, there are two forms of loans made in forms which are not manifest to those who pay taxes to cover the cost of interest payments and the amortisation thereof.

The first of these are the loans the State obtains from the *Cassa Depositi e Prestiti* (Deposit and Loan Bank) at a rate of interest equal to that which the Bank pays in its turn to its depositors; and therefore lower than that ruling on the market. At first sight, the transaction may appear to be advantageous to national finance and to the community. But it should be judged with caution. The second concerns the liability of the State to pay to the concessionaires of public works *annuities* inclusive of interest and amortisation payments.

It is true that in the case under consideration recourse to the first of these two sources cannot be repeated for huge amounts. Indeed, a State can obtain only once the capital which at a given moment is held by State institutions — Post-Office Savings Banks, State insurance institutes, social insurance funds, funds deposited with the Courts, and held for all these institutions by the *Cassa Depositi e Prestiti* — in exchange for bonds of the national debt for a nominal value corresponding to the loans asked for and bearing a low rate of interest. In the following years it will have to content itself with absorbing, as a maximum, the annual increments of the aforementioned amounts (1) It is however true that these increments become considerable with the

(1) EINAUDI, L.: "La finanza della guerra e delle opere pubbliche". Bono, Torino, 1914, pp. 103-06.

multiplication of the several forms of insurance (life-insurance, old-age and invalidity insurance, etc.), made compulsory for increasingly large groups, and that the habit of drawing on them leads to well-known drawbacks, such as the absence of a strict control on State expenditure which can be met with relative facility by loans made at a low cost; loss to the country of the difference between the average interest rate which might have been secured by investing savings in productive activities and the rate obtained on loans to the State.

It may be objected that not all the savings deposited with the State, first by their transfer to its custody, and then by the attribution to it of the annual increments, would have secured on the market the returns obtainable in a period of economic prosperity. Nevertheless, the community always incurs a loss when a mass of national savings are thus prevented from entering the free market where they would have lowered interest rates with all the favourable reactions thus produced on the capitalisation and growth of real income.

Moreover, the conversion of the deposits of some State banks — for instance of the Post Office Savings Banks — into government securities seriously endangers their liquidity, making it subject, like that of any other bank, to the possibility of the simultaneous withdrawal of deposits consequent on panics or other exceptional events. And if this danger of insolvency is not immediate in the case of the State insurance institutes, as the payment of the amounts insured and of the interest due to the policy-holders is deferred to a future time, they run the danger common to all holders of government securities of a fall in the price of the securities into which funds belonging to others have been converted, and hence the danger of the devaluation of the capital of the several corporations who were overloaded with such securities. This devaluation may be caused by subsequent bond issues the government may make, or by a rise in interest rates not extended to government securities.

The consequences above referred to occur when the absorption of the deposits held by the *Cassa Depositi*, social insurance institutes, and sometimes by private banks also, instead of being the result of the subscription of long or short term government securities is affected by opening current accounts which the Treasury obtains from the aforesaid institutes.

These current accounts may or may not bear interest in favour of the State banks which open them. In the former case, the rate of interest is always inferior to the current market rate and the case is pre-

cisely the same as those previously mentioned. The system of huge Treasury accounts has been accepted with favour in some countries when the issue of Treasury Bills was suspended. At first sight it may seem to be more elastic than the issue of short term securities. But a more careful examination shows that none of the consequences complained of are avoided, and that, in addition, the Treasury has to keep a huge amount of cash in hand, which if it does not remain entirely idle can only be used in small transactions on the Central Bank and which could be more profitably invested by private owners.

Lastly, the dangers of insolvency and of the devaluation of the capital of the creditor institutes exist whenever the State requires that private banks or insurance companies purchase government securities regardless of the distribution of liquid funds in the ratios suited to their active operations, inclusive of investments in securities. The State has recourse to such action either for the purpose of placing a new loan on the market in which investors have not confidence, or to increase the demand for securities already issued and neutralise the decline in their quotations caused by subsequent issues.

30. — Loans considered as made to the State by the concessionaires of public works and which the State repays by means of annuities.

A second form of disguised borrowing consists in the State undertaking to pay annuities, subventions, or contributions to public corporations, associations, or private companies for the execution of public utility works.

Instead of specifying an amount to be immediately provided for in the budget, the Government prefers to say that for carrying out a given work it is necessary to make a budget appropriation with which to pay over a given period of years an annuity covering the interest payments on loans raised by the municipality, railway-company, land-reclamation association, or other body to which a concession for the execution of a given work has been granted.

These appropriations are entered on the budgets of the departments most closely connected with the purposes for which the several works are carried out, and which very often contribute to their cost. But in practice the annual expenditure for such contributions is only entered for a few tens of millions, and those whose business it is to examine the budgets do not perceive that the Government is incurring a load of

indebtedness which sometimes amounts to milliards ; they raise no objection to the extension of these loans which the Government is obtaining from the concessionaires of public works and which it repays by means of annuities inclusive of interest and amortisation instalments (1).

The concessionaire who has not the money required for starting and completing the work planned, contracts a loan on the open market, offering as surety the annuities the State undertakes to pay him.

He may apply in the first place to a bank, perhaps an ordinary bank, for advances (provisional financing) guaranteed by his credit on the State.

When the work is finished he may definitely surrender the annuities the State owes him to a State bank — generally to insurance institutes — and make provision for returning the loan obtained for provisional financing from the ordinary bank.

On their side, the insurance institutes, if they have large available capital resources, find it advantageous to invest them without any risk by advancing annuities and to wait over a long period from 5 to 50 years which is the maximum length of the annuity payments under the laws of some countries, for the gradual recovery of the sum loaned.

The only difference between the system of open public loans and of these disguised loans is that while the securities of the national debt circulate easily and are taken by all classes of investors — and on their

(1) As an example we give the following table showing the situation in Italy in 1935 :

	Total indebtedness of the Italian state in 1935 millions of lire
Consolidated	9,892
Redeemable	82,099
Floating	11,285
	<u>103,276</u>
Treasury debts	798
Credit held by the Central Bank	1,773
Morgan loan	960
Sundry debts	8,370
Excess of budget deficits over surpluses	5,987
Debts of the local government administrations	1,184
Annuities (deferred payments)	30,000 to 32,000
GRAND TOTAL	152,348 to 154,348

At that date the expansion of the national debt was chiefly due to deferred payments. Undoubtedly many public works had been carried out ; but from the exclusively economic standpoint they could never be considered as investments bringing in an income which would adequately offset government expenditure on them. (see the III study in this volume, par. 16 and 17).

behalf by private banks also which collect undifferentiated savings — the system of annuities addresses itself exclusively to the capital held by semi-official corporations which, by discounting the annuities due from the State, finance the concessionaires of public works.

It may certainly become dangerous to arrange for a division of labour between private banks and State banks under the impression that it will thus be possible to secure for the State "economic independence". It may also become dangerous to spread among the public the conviction of the greater safety enjoyed by deposits made with State banks with a view to attracting towards them most of the new capital accumulated in a country. The danger lurks in the fact that the State may thus be too easily induced to incur expenditure.

But if State banks exist in a country, the danger that the State may have too ready recourse to savings exists whether government loans take the shape of national debt securities or that of reimbursements by means of annuities. So this system, if hedged round with some guarantees — such, for instance, as a maximum limit placed on the annual budget liabilities on their account, a maximum rate of interest the State is willing to pay on annuities, inclusive of interest and amortisation payments, the right reserved by the State when making the concession to redeem the loan as soon as the market rate of interest falls below that agreed on for the annuities — is not more costly (except for the small amortisation quota in addition to that for interest) nor does it present more serious drawbacks than others.

31. — Similar effects of open and disguised borrowing.

The effects on the financial market are not different from those met with in the case of open loans, for after all both transactions are State loans. In substance, all the State does is to reimburse the cost of starting and completing works, the responsibility for which is left entirely to the concessionaire (1).

It may be that the danger of insolvency is not immediate in the case of banks which anticipate annuities, and in a certain sense it may be said

(1) For fuller details, see my report "Des fonds spéciaux dans les finances publiques et plus particulièrement des programmes de travaux publics", "Congrès International des Sciences Economiques", Domat-Montchrestien, Paris, 1937.

See also "L'influence de l'émission et de l'amortissement des emprunts d'Etat sur le marché des capitaux industriels et commerciaux", "Conférence Internationale des Sciences Economiques Appliquées". Goemaere, Brussels, 1930.

to be immobilised when they are credit banks working with their own capital or with capital obtained by the sale of their own debentures, or when they are semi-official insurance institutes not exposed to the danger of the possible withdrawal of deposits. Nevertheless, the phenomena now so well known — and among the most apparent is the rise in interest and bank rates and the diversion of savings from productive investments through the instrumentality of the stock exchange accompanied by the fall in share quotations — are sure to occur should the State issue new loans in the form of annuities, even though the maximum limits placed by the Treasury on annual liabilities for such contributions be respected.

Evidently all these phenomena, here referred to only incidentally, will be all the more keenly felt the more extensive is the issue of such loans. Should the total volume of State annuities be small as compared to the whole resources of the financial and money markets such phenomena will not be very apparent.

Among the consequences of the issue of government loans, mention should be made of the variations in average price levels which are not so much affected by the velocity of the circulation of government securities as by the mass and velocity of the circulation of notes, cheques, bills and other means of payment in which the advances made by the various institutes on the security afforded by the government annuities are paid. Thus this second category of semi-disguised loans also reacts on the financial market in a manner similar to that produced by the issue of paper money, and this must be taken into account by the authorities when taking measures for stabilising the currency.

(B) RECOURSE TO FOREIGN CAPITAL

32. — When it becomes necessary.

Mill asserts: "Whenever capital is withdrawn from production or from the fund destined for production that whole is withheld from the labouring classes. . ." There exist cases, however, in which borrowing does not have such consequences: "namely, first, when what is borrowed is foreign capital, the overflowings of the general accumulation of the world; or, secondly, when it is capital which either would not have been saved at all unless this mode of investment had been open to it, or after being saved, would have been wasted in unproductive enterprises, or sent

to seek employment in foreign countries". He adds that those in need of having recourse to savings find in the tendency of the interest rate on the home market to rise, the principal reason for seeking credits on markets which offer it at lower rates (1).

In drawing a comparison between recourse to taxation and recourse to loans, Wagner does not seem to distinguish between home and foreign loans. He points out that heavy taxation withdraws capital from production which would otherwise flow towards it and entails disinvestments, and in these two ways reduces available capital, the flow of incomes, the formation of new savings. It is therefore advisable to secure capital wherever it can be had at least cost (2).

Graziani also calls attention to the fact that "loans may be used to meet extraordinary expenditure, and recourse should be had to them all the more readily when they are incurred to meet expenses relating to services which can yield a revenue to the State, and especially when the State obtains the capital from foreign sources or from the available resources of the nation" (3). As to the assertion that the debtor becomes tributary to other foreign governments — apart from the fact that heavy taxation, by reducing capital resources, would also have reduced the taxable capital — it should be remembered that while it is true that the interest on the loans has to be paid, this is done at the times which are considered most suitable for the national economy.

In substance, when taxation cannot be raised without reducing investments, real income, and the formation of capital; when the savings available in a country are small and the population does not or cannot make further savings (4); under the pressure of financial needs recourse

(1) MILL JOHN STUART: "Principles". Book I, chap. V., par. 8, and book V. chap VII, par. 1.

(2) WAGNER, A.: "Finanzwissenschaft" 3rd ed. Vol. I, Leipzig, 1883, pp. 144-169

(3) GRAZIANI, A.: "Istituzioni di Scienza delle Finanze" Book II, chap. I, p. 71.

(4) If recourse is not had to forms of taxation or of inflation -- which latter by causing prices to rise compel the recipients of incomes which have become inadequate not to spend them because the said prices have become inaccessible to them -- it is still difficult to carry out the intention of "forcing the public to save". GAMBINO, A. in some "Appunti sulla ricostruzione dell'economia italiana", "Istituto Nazionale di Finanza", 1944, remarks that ultimately it is always the individual who decides between consumption and saving, and that when he is induced to save rather than consume the goods which can still be freely purchased, he is always accomplishing a voluntary act. This is true; but it is no less true that his voluntary action is restricted within ever narrower limits by the various prohibitions. And should the income not be spent on goods which can still be freely purchase and which the incomeholder may consider of little value to him, the prohibitions will have been effective in compelling him to save.

to foreign capital becomes inevitable. This is so in the case of individuals, in conformity with the tendency to reconstruct the ratio required by technical development between the various factors contributing to the growth of production; and in the case of public bodies — in the first place of the State — with given precautions and under certain conditions, as, for instance, when it is a question of meeting emergency expenditure and it is possible to reckon on a certain elasticity of the fiscal system and of the economic equipment of the country.

As a rule, loans are sought in countries with a high average level of incomes and extensive international relations. Experience shows that in such countries the supply of capital is more elastic, and more readily follows those variations in interest rates on loans enjoying like security and of the same duration which are sometimes noted in the case of such securities as shares and debentures. In countries where the total income is very much subdivided and the average low, higher interest rates are required to overcome the diffidence of investors towards foreign loans.

Not much has been written on the subject of foreign loans, but the literature on the subject has attained a considerable degree of accuracy in defining some of the phenomena. We shall endeavour, as is our custom, to examine the chief consequences of a foreign loan to the lending and to the borrowing country during the period over which the instalments of the loan are paid and the interest and sinking fund payments made. We shall explore the grounds for considering that some theories on the subject are well founded and see within what limits and with what additions they may be able to afford a solution for the many phenomena of the post-war period, during which it is easy to foresee and to hope that large loans may be made by the richer countries to the poorer.

33. — Phenomena accompanying the collection of savings existing on the lending market.

A loan made by one country to another always ultimately takes the form of goods and services exported from the lending country on a larger scale than was usual prior to the payment of the first instalment, goods and services which are received by the borrowing country in larger amounts than before.

It is customary to assert that by granting a loan the lending country forces its citizens to reduce their consumption, or at least their future con-

sumption of commodities (1), as a part, sometimes a considerable part of available capital is directed by the loan towards uses advantageous to a foreign country and leads to a reduced supply of consumption goods on the home market, a reduction corresponding to the amount and duration provided for in the conditions of the loan. It is only when the loan is returned in full or in part that the lending country can again expand its own consumption, unless it might be added, this consumption in spite of the contraction which has occurred in the meantime, should prove to be so abundant as to arouse no desire for more.

This assertion is not always supported by an examination of the facts which accompany the collection of savings and their expenditure on the lending, the borrowing, and on sundry markets.

When the amount of the foreign loan to be made does not exceed that of the capital available in the country — mainly in the form of bank deposits, (to simplify our argument we do not take into account the several forms of hoarding) the collection of savings does not place restrictions, immediate or future, on the country collecting them. The banks of the lending country appeal to their depositors to subscribe the loan. More frequently however, as the borrower has to use the loan to meet long term liabilities, the banks themselves consider it preferable to have recourse to the ordinary machinery of personal credit, *i. e.* the issue of securities by the business concerns or governments of the borrowing country ; such securities are better suited for collecting savings than the mere withdrawal of deposits which, more especially in the case of business concerns, represent circulating capital held for short term investments.

Consequently, the banks of the lending country purchase the shares and debentures of the business concerns or public bodies of the borrowing country, and redistribute them among those desirous of holding foreign valuta which is found very convenient in certain kinds of business transactions ; or they themselves, — when indeed the government is not itself the lender—issue securities of their own on the basis of the foreign issue, which offer to national investors a fuller guarantee and enable them to solicit even small subscriptions, thus overcoming the preference of investors for liquidity. The rate of interest both on the securities issued by the foreign borrower — a matter of no concern to the lending market — and on the securities which the bank or the government of this latter

(1) CABIATI, A. : " Fisiologia e patologia economica negli scambi della ricchezza fra gli Stati ", Giappichelli, Turin, 1937, pp. 190-1, 171-3.

may see fit to issue, may even exceed the rate paid on bank deposits. Should however the capital invested by the lender in the new security be limited to that which lay idle or yielded a low return, there is no reason why the higher rate of interest should persist.

Nor is there any reason why the prices of goods intended for consumption on the home market and of those imported or exported should vary; or should they vary, there is no reason why such changes should last. Therefore the collection of savings on the lending market affects interest rates and price levels but little and only momentarily and does not place restrictions on present or future consumption.

34. — Phenomena consequent on the collection of savings in excess of the amounts available on the lending market.

As a matter of fact neither does the collection of a larger amount of savings than that available on the lending market entail restrictions.

In such cases the collection of savings may be made possible by lowering consumption on the home market should the banks of the lending country refuse or curtail loans to business working to produce goods for home consumption. The rationing of credit entails sooner or later a smaller supply of goods, higher prices, the reduction of consumption. It also entails —so long as the volume of capital remains what it was and the only changes are those in its distribution between home and foreign investments —a rise in the rate of interest, due to the fact that the business concerns who have been refused loans by the banks or have seen them reduced, have to seek credit elsewhere at higher rates. It is also likely to depress the activity of the business concerns who are refused the loans to which they were accustomed or who see them reduced.

But, even if we only consider the effects of the collection of capital by means of reduced consumption, the rise in interest rates will induce merchants to liquidate their stocks, will lower prices, and will facilitate larger exports of goods, services and securities to countries not inclined to raise artificial trade barriers. The larger offer of bills and favourable exchange rates will also encourage the import of those commodities whose price on the lending market was higher than that ruling on other markets. Thus, while some commodities will rise in price as a result of a smaller supply, others will be cheaper, and the collection of capital made possible by a decline in consumption will lead to changes of some importance but easily offset by the growth of exports and imports.

The collection of capital in excess of the available deposits on the lending market may be made possible by reducing imports, and it will then lead to a rise in the price of the stocks of consumption and capital goods until then imported from abroad; in the prices of substitutes for these two groups of commodities; in the prices of goods manufactured with the said imports. Here again there is danger of a business depression in the lending country affecting enterprises accustomed to work with imported goods, and in the borrowing country as a result of the new direction given to production in the lending country which may lead to the reduction or even to the abolition of the demand for its exports. It rarely occurs that the business concerns who are compelled to reduce their activity on the borrowing market are the same as those deriving a benefit from the loan which enables the lending market to reduce its imports from the borrowing market. Thus the collection of capital obtained by reducing imports does not lead to any persistent rise in the rate of interest as savings become more abundant, nor to a rise in the price of goods for home or foreign consumption unless indeed the said goods should be instrumental, supplementary to, or replace those until then imported in smaller quantities from abroad.

Of little importance are likewise the changes produced on the lending market by the collection of capital obtained by the elasticity of the credit system, *i. e.*, by credits which the lender opens in foreign countries, the use of which he grants to the borrowing country; or by the creation of credit which the banks of the lending country place at the disposal of the borrowing country. The changes brought about by such means are of little importance provided that the "new" monetary means never exceed the growth of the real income which — maybe as the result of other productive activities — the lending country expects to secure during the whole period over which those means will remain in circulation, *i. e.* the period required for the subscribers of the foreign loan to return the advances they obtained from the banks wherewith to make their subscriptions.

We must however complete our appreciation of the scanty importance of the phenomena likely to follow the collection on the lending market of capital in excess of available savings deposits, by noting the phenomena to which the *expenditure* of the amounts secured by the loan will give rise. These two sets of phenomena can be kept apart in theory but complete each other in practice. In judging whether the lending country by granting a foreign loan places restrictions on home consumption, we

should consider the effects produced not only by the collection of the capital but also by its expenditure which may take place on the lending, the borrowing, or on other markets.

35. — Phenomena produced by the expenditure of the loan on the lending market.

The expenditure of the capital collected to make the loan may take place on the lending market.

(A) The borrower wishes, for instance, to purchase capital goods, (engines, rolling stock, road building or drainage machinery, cranes and other machinery for raising weights, agricultural and industrial machines). The banks of the lending country which subscribe the loan, grant credit to the business houses of the country producing the commodities required by the borrowing country. Should the volume of consumption goods on the lending market remain what it was before the loan was granted and should the banks refuse credit to the business concerns which until then manufactured for the home market in order to grant it to those now working for the borrowing market, there will be no real restriction of consumption, immediate or proximate. As in the case in which loans are made only with savings already available, there will be some slowing down in the production of certain goods, as, for instance, of those used on the home market whose activities are now directed towards production for the borrowing country. But this pause will be followed by a revival of production as soon as the recipients of incomes distributed in relation to the production of goods for the borrower demand commodities which can be produced by the business firms to whom the banks refused credit in order to make loans to the borrowing country.

This occurs also and in a more obvious manner if the capital for the loan is supplied by the reduction of imports. The quota of national income which was sent abroad will now be used for intensifying the production of goods for the borrower, and when redistributed in the form of incomes to the several persons participating in those activities, it will enable its recipients to make new purchases of commodities which may perhaps be different from those formerly imported and have varying degrees of utility. The same thing occurs when the capital for making the foreign loan is supplied in the lending country by credit created by the banks in the interest of national business engaged in producing for the borrower those goods which represent the loan.

If we consider the phenomena connected, not with the collection by one of the means above mentioned of the capital required for making the loan, but those connected with its expenditure on the market of the lending country, we thus find instead of depressions, unemployment of the factors of production, higher interest rates, and lasting price changes,

(a) the shift of productive factors from those businesses which produce for the home market to those which produce goods, for the most part capital goods, for the borrowing or other markets ;

(b) a different distribution of capital among short and long term investments, as the banks which must finance business working for the borrower withdraw their available resources from the contango and discount markets, compelling their previous clients to seek elsewhere the capital they need, perhaps by offering a higher rate of interest and thus leading to a rise in interest rates. This rise will, however, be of little importance when the elasticity of bank credit is marked and the trade cycle is nearing the phase of depression at the time when the loan is spent on the lending market ;

(c) a decline in the production of some goods followed, however, by a recovery as soon as the participants in the activities carried on in behalf of the borrower apply the incomes they receive to the purchase of consumption goods which were produced also prior to the loan ;

(d) a rise in the prices of goods produced for the home market. In this connection it has been asserted by some (1) that even in the case of credit created by the banks, as the larger volume of monetary instruments is *offset* by the larger volume of goods produced for the borrowing market, it can never lead on the lending market to permanent and notable price rises. Undoubtedly, if the banks do not grant loans to an exaggerated extent, and if the goods which can be produced for the borrower do not represent an appreciable quota of the whole volume of goods and services existing in the country, the price rises will not be considerable. But as at the close of each cycle of production the goods produced for the borrowing leave the lending country, the excess of monetary instruments when compared to the volume of the currency in circulation before the expenditure of the loan, will affect the prices of many goods and services ;

(e) the reduction of any unemployment which may exist, especially in the post-war period ;

(1) CABIATI, A., *Op. cit.*, p. 174.

(f) prospective earnings which can be realised as interest and amortisation payments gradually enter the lending country.

On the cessation of hostilities, should a loan be very urgently required, the lending country may, within certain limits, convert munitions of war (armoured cars, mechanical devices) into peace-time machinery (tractors, machines) at a cost undoubtedly lower than that which would be entailed by the production *ex-novo* of capital goods for peace-time purposes.

Should the exporters of the lending market also obtain from their banks the means wherewith gradually to return the loans made them for the production of the goods required by the borrower, as they in their turn receive back from the latter the loans granted in the form of the capital goods, even those disturbances in the exchange rates, which begin to be felt only when the proceeds of the loan are spent in a country other than the lender, will have no occasion for making themselves felt.

Therefore, not only will the lending country suffer no drawbacks by making loans which are spent on its own market, not only will it experience no restrictions of consumption of any importance beyond those due to a possible rise in price caused by the circulation of "new" monetary instruments, but it will secure many advantages, among which the following are the more important: a larger output of production than would have been had had its capital been invested only on behalf of the original owners of the lending country and not in behalf of those who in the borrowing country have put it to more profitable use both directly and indirectly by using capital goods obtained on credit; the growth of real income; greater opportunities for consumption (1).

(B) The capital collected in the lending country may be used on its own market not only for the purchase of capital goods required by the borrower, but also in profitable transactions such as advances and even contango operations. In this case should the profits offset the interest

(1) "It is quite true that British capital has built cotton mills in India and Russia, steel mills in Canada, other industries in South America, thus leading to a competition with the similar British industries. But it is also true that by enriching her Dominions England has greatly developed her own exports and that a great part of the productive income of the remote parts of the Empire goes in the shape of dividends to British capitalists. What is altered is the geographical distribution of the industries, which by making the peoples increasingly interdependent, secures the highest degree of perfection in the territorial division of labour". CABIATI, A.: "Fisiologia e patologia economica....". *Op. cit.*, p. 178.

payments on the loan due from the borrower to the lender, the transfer of bills is avoided, the exchange rates remain unaltered, and so does the rate of interest and the volume of the factors of production. In this case even the phenomena referred to in the previous paragraph will be avoided.

36. — Advantages of borrowing in kind to the borrowing country.

The advantages the borrower receives from a loan in kind are also evident. The goods obtained may combine with the available factors existing in the country — for instance man-power, land areas — thus promoting more intensive production ; they may lower production costs ; favour exports ; increase the volume of total real income ; offer employment to unemployed masses. These are phenomena of real importance, especially when care is taken to obtain from the lender capital goods for the “ independent ” production of consumption goods which meet the demand of the home or foreign markets, or for public works typically instrumental in the production of consumption goods or whose execution cannot be deferred.

Banking activities, confined to the function of making advances, may supply most of the circulating capital. This is why the rate of interest on the borrowing market suffers no fluctuations, and why the average price levels for the chief groups of goods and services imported from abroad and assigned for consumption on the home or on foreign markets, do not fluctuate.

More accurately speaking, the larger supply of finished goods due to the greater productive activity encouraged by the loan, lowers the price of commodities for consumption on the home market and for export, but increases the demand for many other goods used in their production, without ever succeeding in depressing the prices of imports other than those in which the loan “ in kind ” is made. Thus the inflow of capital goods representing the loan does not justify the statement that by encouraging the supply of finished products such a loan lowers their price, favours exports, prepares the way for paying subsequently and more easily the interest and amortisation rates.

The fact is that an influx of capital goods which meets real needs of different branches of production undoubtedly encourages a more abundant supply of finished goods at lower prices. But the persistence of the lower price level depends on many other factors which may neutralise it or, perhaps, accentuate it. In any case, the advantages a borrower

may obtain from loans in kind cannot be measured by the price level, whether lower or higher. They are similar to the advantages we have already referred to in the case of the lender :

(a) in the first place, the employment of the factors of production which, in the absence of a loan — for instance in the absence of capital goods — would never have been secured. The pressure which masses of unemployed workers may exercise is thus relieved ; (b) the more extensive use of available factors — for instance, land, labour etc. — which together with those arriving from abroad, can enter into combinations of greater economic expediency than those which could have otherwise been arranged for on the home market, for instance, autarchic measures ; (c) a larger supply of commodities and capital goods for which there is a demand on the home and foreign markets ; (d) the growth of total real income ; (e) larger opportunities for consumption.

It would seem superfluous to illustrate these phenomena in detail. They indicate the advantages secured both by the lending and the borrowing countries. Nor could it be otherwise ; voluntary exchanges never benefit only one of the parties to the transaction.

37. — Phenomena produced by the expenditure of the loan in countries other than those which have negotiated it: (A) Phenomena which can be noted in a lending country with a gold standard currency.

The expenditure of the loan in a country other than that which makes it entails, as we have said, the consideration of exchange rates, *i. e.* of the ratio in which the monetary unit of one country can be exchanged for that of another.

Two countries *A* and *B*, — for instance, England and the United States — with a monometallic gold system and trade limited exclusively to the exchange of goods, a balance being secured by importing goods for a total amount equal when expressed in gold to their exports, agree that the former shall pay to the latter a constant amount, over specified units of time, in the form of bills drawn by exporters in the lending country on debtors either in the borrowing or in other countries.

The banks of the lending country, which underwrite the foreign loan, seek bills payable abroad wherewith to meet their liabilities. The greater demand for bills raises their price on the lending market. Should it raise it above the gold points part of the gold reserves of the lending country will migrate to the borrowing country. This will lower the prices of the

products, encourage exports to the United States and to all the other countries with whom the borrower is in trade relations; it will lead to a larger offer of foreign bills which will allow American bills of exchange to return to England at a price lower than the upper gold point, and will enable the lending country to pay the remaining instalments of the loan not in bullion but in bills of exchange, securities, or goods.

To secure a larger and more immediate outflow of exports, the Central Bank of the lending country may raise the bank rate, which in countries with a fiduciary currency is the first means used for "correcting" the exchange rates. In any case, should there be variations in the bank-rate — following a first body of bills the demand for which raises the price of American bills of exchange in England above the gold point, and after an inflow of gold which again brings the said price below the gold point — the payments of the loan may continue to be made, if advisable, by means of bills which represent exports of goods and capital from the lending country both to the borrowing country, and, as a result of the well known effects of arbitrage, to all the other countries with which it trades. Exports, therefore, of goods and securities and in the first place of the foreign securities which may be held by the lending country, as the export of securities completes that of goods, reduces the need of lowering their price and does away with the need of raising the bank rates for that purpose. In any case, all these exports will increase as compared to their previous volume to the extent required for supplying the bills needed for paying the instalment quota.

If, on the other hand, the loan be a conspicuous one and be made within relatively brief periods of time, the exchange rates in the lending country, as a result of the eager demand for foreign bills on the part of the borrower, may rise even above the upper gold point, leading to a heavy export of gold which by encouraging the fall of prices and larger exports of goods, securities, and bills, will cause the price of bills of exchange to fall below the upper gold point and will make it possible for the lending country to continue to transfer the loan in the form of bills.

It is not easy to judge of the advantages a lending country may secure by making a loan spent on another market until the loan itself has been repaid. If we only take into account the phenomena following the collection of capital on the lending market, we should have to ascertain the restrictions placed on consumption due to the fact that, as a result of the loan and of the rise in exchange rates, the nationals of the lending country are only able to acquire smaller quantities of foreign goods, while

many commodities which were previously sold only on the home market are now absorbed by the export trade which is encouraged by the rise in exchange rates. Such a notion would however be an incomplete one. As we have already shown, an examination of the phenomena produced by the collection of capital should be completed by that of the phenomena noted in the other phases of an exchange of capital rationed over time, as in the case of a foreign loan.

38. — (B) Phenomena taking place in a borrowing country with a gold standard.

The results of the influx of bills and possibly of metallic money on the borrowing country will vary with its monetary system.

In the case of a gold standard currency, an influx of gold relatively larger than the other subsequent inflow of goods, would raise the prices of goods and services; raise monetary incomes; encourage imports representing the proceeds of the loan received by the borrowing country. It would discourage exports. More precisely speaking, the prices of the goods imported from the lending country will remain at a *lower* level than those of the goods intended for home consumption; as the rise in the price of the bills of exchange of the borrowing country in the lending country — in the example under consideration, of American bills of exchange — will determine a fall in the price of the goods of the borrowing country — *i. e.* of British goods — expressed in the currency of the lending country, *i. e.* in American currency — hence the interest of British exporters to export at all costs so as to obtain American bills which can now purchase larger quantities of British bills and goods. And even should he receive gold as a result of the loan, and even should the prices of goods and services for the home market rise, the gold currency borrower profits by the full difference between monetary incomes, which tend to rise, and prices of imported goods which tend to fall with the depreciation of the pound sterling — offered in larger quantities as a result of the loan — in terms of dollars. With the same amount of work, the borrower obtains *larger* quantities of goods and services than he obtained prior to the loan.

On the other hand, the nationals of the lending country, accustomed to consume goods of the borrowing country — even should they continue to receive the same monetary incomes as prior to the loan, or should they receive smaller incomes owing to a conspicuous outflow of gold towards the borrowing country — have to pay more for the goods of this

latter and to purchase them in smaller quantities. The exports of the borrowing country tend to decrease (1) and taken as a whole the tendency of monetary incomes and of the prices of goods for home consumption to rise is paralleled by the tendency to a fall in the prices both of goods for import and for export.

39. — Advisability for the borrowing country with a gold standard to spend the loan received on its own market.

The borrower may find it advisable to spend the proceeds of the loan on his own market. It thus purchases capital goods or consumption goods, it pays wages which are converted into consumption goods, it encourages greater industrial and commercial activity.

The foreign exchange resulting from the loan, is presented to the Central Bank to be converted into notes. The Bank may make new note issues and increase the volume of money in circulation, a policy justifiable as long as the exchange thus received is paid into its reserves but a risky policy so long as the exchange remains outside the reserves as for instance when the Bank accepts it only to be carried forward and issues paper on the unchanged basis of existing reserves. In any case the notes give rise to a larger circulation of cheques of the ordinary credit banks, to a larger capacity of consumption, to an expansion of the several forms of

(1) The always valid theory of TAUSSIG, F. W. : "International Trade under Depreciated Paper. A Contribution to Theory", *Quarterly Journal of Economics*, May 1917, reproduced and developed with admirable lucidity in the volume "International Trade". Op. cit., chap. 12, chap. 25, chap. 30, is derived in this first hypothesis of a gold currency for both countries, from the standard economists but leaves room for a misunderstanding which it would seem desirable to clear up right away. The misunderstanding is that gold movements cause those currents of exports and imports of goods, securities, and services which reestablish a balance. But the fact is that, even in countries with a gold currency, price changes and changes in the direction of trade currents are due not to the flow of gold from the lending to the borrowing country, but to variations in the price of bills of exchange caused by the loan, the increased demand for foreign exchange by the borrowing country, the greater supply of foreign exchange by the lending country. It is these variations which lead to the shift of gold from one country to another. Even should these gold movements not take place because, for instance, the fluctuations in the price of American bills of exchange in London or of British bills of exchange in New York do not reach the gold points, the transfer of the loan would still give rise to the depreciation of British goods in terms of dollars, to exports from England to the United States, and to profits accruing to the latter in their quality of lenders. Should they occur, gold movements will serve to spread over all the prices of goods or services the changes which have already occurred in the price of bills of exchange as a result of the loan. But even in the hypothesis of a borrowing country with a gold currency, the *primum mobile* of commercial currents is always the variation in the price of bills of exchange of the lending country in terms of the currency of the borrowing country.

demand, to a rise in the price of goods intended for home consumption. The stimulus given to production by the loan increases the demand for labour and raises the level of wages, as in a period of prosperity. More accurately speaking, if there was unemployment money wages will rise, but if there was full employment the competition between entrepreneurs desirous of enlarging their business will lead to a rise in real wages.

After some time the rise in the price of goods and services will lead the country to make larger imports. It is indeed true that this will increase the trade deficit and raise the demand for foreign exchange. Notes are then presented to the Central Bank to be converted into gold or foreign exchange, and the proceeds of the loan tend to emigrate. But if during the period intervening between the influx of foreign exchange consequent on the loan and the demand to provide for more advantageous imports, foreign capital should succeed in *reviving* the activity of the borrowing market, it will reduce unemployment, increase the volume of production, and prepare favourable conditions for the growth of large export currents.

All these considerations relate to loans made for obviously productive purposes and granted by the delivery of foreign bills of exchange which are changed into bills of the borrowing country.

Obstacles to the success of such foreign loans — also when examined outside the classic framework of the gold standard — arise as the result of conflicting policies which the contracting countries may follow, first of all the very common one of raising customs barriers while at the same time desiring that capital should circulate freely between one's own and other countries.

The second one is this : when the loan is transferred in the form of foreign bills of exchange it inevitably gives rise to price and wage increases. It would therefore seem to run counter to this trend to require that prices should fall in the borrowing country at a time when loans are flowing in under more or less visible forms ; or that they should remain at low levels as the result of coercive measures taken by the lending country at the time when the loans are repaid. Such short-sighted manoeuvres undermine the premises and interfere with the normal working of the gold standard (1).

(1) Under exceptionally favourable conditions, which make one think of laboratory experiments WINER, J. ("Canada's Balance of International Indebtedness 1900, 1913", New York, 1924 ; see also TAUSSIG, F. W. : "International Trade" Op. cit., chap. 19, p. 258 ; HABERLER, G. : "International Trade", London, 1936,

The Central Bank may however adopt another policy. It may convert the foreign exchange or the bullion entering the country as instalments of the proceeds of the loan, into notes and it may reduce by a like amount its own business transactions, as for instance the funds for contango settlements, and those available for discounts and advances. In this case, increased productive activity will not necessarily cause a rise in the price of goods and services in the borrowing country. The influx of foreign exchange bills is followed at most by a rise in the bank rate and in the interest on short term loans, due to the fact that the capital available for discounts and forward settlements is now in demand for other purposes. Later on, the greater demand for cheques on the part of those who no longer able to obtain loans from the Central Bank have to apply for them to the deposit banks also raises the rate of interest on medium-term credit on the open market. But as the monetary resources available in the country are unchanged, the phenomena produced by the expenditure of a foreign loan on a borrowing market with a gold currency are limited to changes in some of the rates of interest and in some of the uses to which savings deposits are put.

pp. 96-101) succeeds in confirming the theory above mentioned by the examination, suggested by Taussig himself and conducted by the author with exceptional ability, of the consequences of the large loans granted between 1900 and 1913 by Great Britain to Canada. These loans were so large as to exceed in importance any other modification which might have occurred in the Canadian balance of payments. The loans were required by an economy which -- while paying interest on previous loans and presenting therefore a favourable trade balance with an excess of exports -- felt the need of new capital to complete the economic equipment of its Western provinces.

As soon as the loans started, Canada's trade balance became passive, Under a system of "triangular trade" the Dominion not only imported from England but in a still larger measure from other countries. Gold imports entered its market, affecting its monetary system which was on a narrow gold basis, producing as a special feature the expansion of credit by the deposit and discount banks which took place even before the actual arrival of the gold, on the mere news of loans granted to their respective clients. Thus with a rise in world prices as a background, prices rose in the borrowing country to a larger extent than was noted in Great Britain. The price rise affected more especially commodities produced for the home market and the monetary wages connected therewith. The rise in the price of goods for export was somewhat smaller owing to the fact that as sterling was received in exchange for these goods, and the rate of exchange had become favourable to the currency of the borrowing country, the exporters of the lending country received smaller quantities of Canadian dollars and had little incentive to export. Nevertheless export trade continued, especially exports of wheat which along with other foodstuffs were considered as the bye-products of the necessary land-developments (MARSHALL, A.: "Principles of Economics", Book V. Chap. 10, par. 2, 6th edition; BARKER, S.W.: "Flax Fibre and Flax Seed *Quarterly Journal of Economics*, May 1917, p. 500, quoted by TAUSSIG, F. W. "International Trade, p. 229). The rise in the price of imported goods is still lower; and in any case only takes place later on, allowing the borrower to take advantage of the whole difference in relation to monetary incomes.

It may even be that foreign exchange and bullion are hoarded by the Central Bank which, with the consent of the Treasury, follows a policy directed towards the increase of its reserves and the contraction of loans, with a view to avoiding inflation and restoring at least *de facto* stability to the purchasing power of the currency, as was done by many Treasuries after 1925. In this case, the above mentioned phenomena will not occur and the reasons given in support of the loans will be less well founded than those which justify loans made for really productive purposes.

40. — Phenomena taking place in a borrowing country with an inconvertible paper currency.

These references to events of past decades should not be considered as too remote. At the time of writing it is not easy to foresee whether the nations will wish to return to the gold standard or to amend it, or to give it up. In any case, a clear understanding of the difference which exists between the theories advocated and the conditions actually brought about by human action, and a study of the motives for such differences may help to avoid future errors. Lastly, the phenomena arising from the expenditure of a loan on a borrowing market with an inconvertible paper currency can never be clearly stated if those consequent on the expenditure of a loan whose proceeds are received in the form of foreign bills of exchange on a gold standard market are not first clearly understood. Therefore the examination of the phenomena attributable to the subscription and expenditure of a foreign loan on a market with a gold currency is fully justified in theory and in practice.

On a borrowing market with an inconvertible paper currency, the rise in the price of bills of exchange expressed in the currency of the lending country — in the case we have been considering the rise in the price of American bills of exchange on the London market — and the lowering of the price of British bills of exchange on the New York market will, as when both countries are on a gold currency basis, encourage exports from the lending to the borrowing country, enable the latter to deliver larger quantities of goods to the lender, put a stop to the imports of the lending from the borrowing country; on his side the lender will incur loss due to the fact that he can only obtain from the borrower a smaller

quantity of goods in return for the same quantity of exports he was accustomed to send him (1).

Thus the only difference between a borrowing country on a *gold* basis and one with an inconvertible *paper* currency will be the movement of the price of consumption goods on the home market. In the former case these prices will tend to rise, in the latter case — should the amount of paper money and the total monetary income remain unaltered — the prices of goods and services for home consumption will tend to remain at the levels ruling prior to the loan.

It is however necessary to define this point clearly. When foreign bills of exchange enter the borrowing country and are presented for conversion into notes at the Central Bank, and when these notes encourage those branches of production which are most advantageous to pursue their activities rather than to import products from abroad, the situation described when examining the situation of a borrowing country on a gold basis is likely to be reproduced.

To state it more accurately, so long as the foreign loan converted into national currency has the typical function of acting as an advance of future real income, the prices of goods and services for home consumption tend to remain at the level attained prior to the loan. At the same time, the prices of goods for export remain at a low level as many of them remain in the country. By selling them abroad the exporters of the borrowing country would secure foreign bills of exchange which, as a result of the loan and of the consequent larger offer not only of sterling but owing to the action of arbitrage of other valuta also, have a lower purchasing power than those of the borrowing country. At the same time, the prices of

(1) It would be more accurate to say that while the installments of the loan continue arriving on the borrowing market, the exchange rates on the borrowing market fall as a result of the larger available number of bills drawn on foreign countries and this holds good not only of the exchange rate on the lending country but also of those with other countries with which the borrower trades, and to much the same extent, as a result of the well-known phenomena of arbitrage which tend to level the price ruling for bills drawn on several countries.

Should the rate of exchange have been very high before the loan was made, now that the rate is falling it may go below the upper gold point. In this case the borrowing country which has to make payments for heavier imports will not find it advantageous to make them with the gold which may be available on its own market or which may have entered the country with the loan installments. It will pay with foreign bills of exchange, and if it has received small quantities of gold it will preserve them. But in a borrowing country with an inconvertible paper currency the fall in the exchange rates may still leave them at a level higher than the upper gold point. In this case, either the gold still available on the home market or the gold which may have entered with the loan installments, will emigrate, as offering a means of payment preferable to bills.

imported goods also remain at a low level because the interest of exporters of the lending country to procure foreign bills of exchange of the borrowing country which, as a result of the loan, now have a higher purchasing power than that of the national and other currencies, induces them to be satisfied with lower prices provided they can export.

It would thus seem justifiable to state, as does Taussig (1), that while in a borrowing country with a gold currency the level of prices for large groups of goods and services, mainly intended for consumption on the home market, tends to rise, in a borrowing country with an inconvertible paper currency they tend to fall below the level ruling prior to the loan. Nor is this surprising, as with the same volume of money circulating on the home market, the borrowing country disposes of larger quantities both of goods which are not exported in the same quantities as before and are therefore available for home consumption, and of goods which it can advantageously purchase abroad favoured by the exchange rates. All income holders benefit by the difference between their income, which remains the same, and prices which are falling.

But when the part of the loan spent on the borrowing instead of on the lending market is so considerable that it is not adequately offset by consumption goods or goods used in processes leading to the production of consumption goods which can be made by national concerns, the prices of the goods and services intended for home consumption tend to rise in the borrowing country to the same extent, neither more nor less, in which gold circulates there. And the only difference which can be noted between the phenomena attending the expenditure of a foreign loan in a borrowing country with an inconvertible paper currency and in one with a gold currency, *disappears*.

Another difference however emerges ; in the borrowing country with an inconvertible paper currency the expenditure of the loan may endanger the successful stabilisation of the purchasing power of the currency which the monetary authorities may wish to secure by stopping the issue of notes and controlling the circulation of cheques. This could not occur under the gold standard because the inward or outward movement of gold would automatically regulate any excess or deficit in credit expansion. Evidently the authorities of the borrowing country with an inconvertible paper currency cannot but be concerned with the possible excesses of cre-

(1) TAUSSIG, F.W. Op. cit., pp. 349, 398, 404.

dit expansion attributable to the expenditure of a foreign loan on the market on which they are endeavouring to stabilise the purchasing power of the currency.

41. — Phenomena arising from the expenditure of a loan on markets other than those of the lending and borrowing countries.

The borrowing country in which a fall in the price of the bills of exchange of the lending country is noted as a result of the loan, may use the foreign bills of exchange and bullion or the credit accounts opened in its behalf, on other markets instead of on its own; and it may promote a demand for foreign goods to the loss of its business activities just at the time when the rise in the price of the bills of the borrowing country induces the lending country which pays the instalments of the loan to curtail its imports from that market. In such cases two forces converge to restrict the productive activity of the borrower and to lead him ever further from the situation in which the whole foreign loan is spent on his own market, whether the country be on a gold basis or have an inconvertible paper currency.

But — even in the less favourable hypothesis that the foreign loan be spent on another market — as the instalments of the loan gradually cease and imports at more advantageous conditions than those ruling on the home market continue, the exchange rate will again rise, the price of national goods in terms of foreign exchange will fall, exports which tend to offset the downward trend of home production will be encouraged. The intensity and duration of this trend will be the less perceptible the smaller the instalments of the loan and the more regular the intervals at which they are paid to the borrowing country which spends them on other markets.

42. — The case of a country which can process raw materials and semi-manufactures at a lower cost.

A case in which a foreign loan is spent on markets other than those of the lending or borrowing countries is afforded when a country lacking capital applies to countries possessing it for loans in kind. The country willing to conform with this request but deficient in adequate supplies of labour at a low cost, or else a third country which has an excess of labour and is desirous of employing it at a low cost in the production of capital goods, may agree that the expenditure of the loan granted to the appli-

cant be made in the processing country. This latter, as a result of the influx of foreign bills of exchange or of credits opened in its favour by the lending country, witnesses the appearance of all the phenomena consequent on the expenditure of the loan in a borrowing country with a gold currency or an inconvertible paper currency, *i. e.*, increased production, fuller employment, larger real income, increased consumption, higher prices for goods and services.

Indeed, with a view to accentuating these phenomena, the country which has inserted itself between the two parties to the contract for a loan in kind, may, if until then engaged in the production of consumption goods, now concentrate all its factors of production on the manufacture of capital goods for the real borrower, and should the lender be engaged — perhaps at a lower cost — in the production of consumption goods required by the processing country, this latter will now import them, thus increasing the advantages it may obtain from its insertion between the two parties to the loan agreement. It will indeed profit by the reception of commodities at a lower cost.

On the other hand, the position of the lender will remain unaltered except for the fact that while making loans in the form of foreign bills of exchange or by opening credit accounts in favour of the country producing the capital goods for the real borrower, it will on its side be producing consumption goods to allow the processing country to devote all its energies to the production of capital goods. In this way, it saves the whole difference between the lower cost of producing consumption goods and the higher cost which it would have had to meet had it manufactured the capital goods, the delivery of which was required by the loan in kind. Taken as a whole, the insertion of a processing country between the lender and the borrower assures to *all* concerned much greater advantages than those arising from mere exchanges spread over a period of time between the original parties to the agreement.

This may be described as the indirect financing of a borrower by a lender through the agency of a third party (1). The lender's loans in dollars, marks, sterling, etc., enter the borrowing country in the form of essential goods. As a matter of fact, they pass through the banks of a

(1) In the period immediately prior to the first world war, the British banks opened large credits to the German banks to enable them to finance sales of machinery and finished products sold on long deferred payment terms by German manufacturers to British colonies. At the same time they encouraged, by acceptances, large exports from India to Germany. CABIATI, A. Op. cit., p. 180.

third country, which make possible the financing of productive business engaged in manufacturing goods essential to the borrowing country. The phenomenon may be rendered more complex by the intervention of yet other countries. But each additional intervention will dilute or disperse the advantages obtained by the country which endeavours to insert itself between the original parties to the agreement for a loan in kind.

43. — Interest payments and repayment quotas tend to invert the situations of the lending and borrowing countries which we have examined.

The situation of two countries which arrange a loan tends to be inverted when the payments of the instalments cease and the borrower begins to repay them, or at least to pay interest which he may indeed have done ever since the receipt of the first instalments. To follow in detail this process of inversion does not seem necessary, as all that need be done is to replace the phenomena above mentioned by their opposites.

For instance, exchange rates depressed in the borrowing country by the receipt of loan instalments, will again rise as soon as interest and amortisation payments begin. The excess of imports which characterises the trade balance of the borrowing country during the first period will give way to an excess of exports during the second. In a borrowing country with an inconvertible paper currency the prices of *domestic* goods, higher than those of imported goods and of goods for export during the period of loan instalment receipts, will now be *lower* than the prices of goods for *export* — for which the demand is heavier, now that exports are encouraged and can not always be secured by reducing home consumption — and than the price of goods *imported*, now that the payment of interest and amortisation rates raises the price of bills of exchange of the lending country. So again, money wages — which were higher in the industries working for the home market during the first period — will tend to fall during the second, and so on (1).

(1) Minute enquiries made both by GRAHAM, F. D. : "International Trade under Depreciated Paper: the United States, 1862-1879" *Quarterly Journal Economics* February 1922 — a study of the phenomena which occurred in the United States from the end of the Civil War to the resumption of gold payments, an example of issues of paper money stabilised at a given level, of a decisive growth in population and of business turnover, of noticeable price falls and of large loans for railway construction — and by WILLIAMS, J. H. : "Argentina International Trade under Inconvertible Paper Money" 1880-99, *Harvard Economic Studies*, 1920 — a study of phenomena which occurred in Argentina offering an example of growing issues of paper money, rising pri-

Ultimately, the situation of a country which pays interest on and returns loans is similar to that of one paying tribute to a foreign country and in search of capital wherewith to do so by one of the means above mentioned, *i. e.*, the combing out of available liquid resources, the reduction of home consumption, the reduction of imports, the creation of credit, larger exports.

Just as it may suit the lender to deliver in kind the instalments of a loan he has agreed to make, so it may suit the borrower to pay interest and redemption quotas by the delivery of goods. In such cases the phenomena we noted on the lending and borrowing markets as the result of loans in kind will occur; only they will be reversed. More frequently, however, the exchanges of the borrower with other markets may attain such intensity as to make it advisable to pay the interest and the redemption instalments falling due not by the direct delivery of goods and services, but by bills of exchange which, in their turn, are evidence of exports made to a great variety of markets.

In conformity with the principles already noted, in the case of a borrowing country with a gold currency, the rising price of bills of exchange payable in the lending country will depress the prices of goods, services and securities; and should the rise in exchange rates exceed the gold point, the consequent exodus of gold will accentuate the fall already produced by the mere rise of exchange rate and spread it to all prices. Thus, for instance, the fall in wage-rates noted at first in the export industries will spread to many other industries. On the other hand, in a lending country with a gold currency the inflow of gold, if it be not "sterilized", will tend to raise the price of domestic goods inclusive of labour, while

ees, large loans also made for railway construction spent to a large extent on the lending market — confirm the theory and place it on positive foundations.

One may object, as HABERLER does (*Op. cit.*, p. 92), that not only the receipt or the repayment of a foreign loan but also many other factors tend to modify the prices of bills of exchange, domestic goods, labor, goods for export, and imported goods. Such for instance may be inflation, deflation, economic fluctuations, secular trends, improvements in the systems of production, improvements in the means of transport, changes in demand, market alterations, trade policies. But undoubtedly the phenomena brought about by foreign loans remain, even if it be not easy each time to supply inductive confirmations of their presence. Whoever enquires into the means best suited for the transfer of large bodies of capital from one country to another, whoever desires to ascertain the advantages conferred thereby on the parties to the agreement, cannot fail to take them into consideration.

For a criticism of the theory of TAUSSIG, and of the criteria followed by GRAHAM to confirm them, especially by calling attention to the premium on gold — unnecessary and susceptible of giving rise to confusion — I may be allowed to refer to my report "Prestiti esteri e commercio internazionale in regime di carta moneta", Rome, 1923.

the price of imports — now favoured by the lower rates of exchange — will fall, as will also that of exports now that the lending country finds it less advantageous to receive bills of exchange which, as a result of the larger offer brought about by the repayment of the loan, now purchase less in terms of the national currency.

In the case of a borrowing country with inconvertible paper money, the transfer of gold will not have a “spreading” effect. All the phenomena arising from the variations in the price of the bills of exchange of the lending country in terms of the currency of the borrowing country will, however continue to be felt.

But whatever be the method chosen for the payment of interest rates and for the redemption of loan instalments, the borrower — as had previously occurred in the case of the lender when paying the instalments of the loan — is compelled to deliver larger quantities of his own goods to secure the same or even a smaller quantity of the goods he previously secured by his trade with the lending country (1). The amount of the loss will depend on the contemporary “elasticity” both of the demand of the lending country for goods which the borrower produces and of the demand of the borrower for those produced by the lender. Should the borrower export, for instance, citrus fruit for which the demand in the lending country is inelastic — so that the demand for citrus fruit will not increase should its price fall as a result of higher exchange rates — and should he import, say, flax from the lending country for which the demand is elastic shrinking as soon as higher exchange rates cause the price to rise the borrowing country paying interest rates and redemption quotas will suffer the full loss incurred. The loss will be reduced should the demand on the lending market be elastic and that on the borrowing market inelastic. It will be still further reduced should both demands be elastic. It will however continue even then as the exchange will still be due to causes less favourable to the borrower than those existing before the payment of interest rates and redemption quotas on the loan began.

44. — Example of loans between Governments.

During and after the first world war there were many examples of loans between private persons and between governments. Among the latter, mention may be made of the loan granted towards the close of 1915, known as “A. Fr.” abbreviated into “Africs”, on the basis of bonds

(1) TAUSSIG, F. W. *Op. cit.*, chap. 12, p. 113.

jointly issued by the British and French governments. It was floated by the J. P. Morgan Co of New York, underwritten in full by banks and investment trusts on the American market, and redistributed by them among investors whose capital, through the agency of the Morgan Co., was used ultimately to pay for a great variety of goods purchased in the United States to meet war needs, ranging from munitions to foodstuffs.

Subsequent loans succeeded in attracting capital only by the offer of the collateral security afforded by American bonds previously issued by American nationals or groups on behalf of European creditors.

Several governments which had to incur indebtedness towards the United States and provide collateral security anxiously called on the holders of American securities to sell or even loan them, when they did not succeed in requisitioning them. Under such conditions, the loans granted after the return to the United States of American securities issued in preceding periods, were more in the nature of the redemption of loans previously obtained from European countries than of a real export of capital (1).

The redemption was effected by American investors who subscribed the foreign loans. Consequently the interest on the bonds and debentures formerly held in Europe, ceased to be an item on the debit side of the American balance of payments, and became a book debt (*partita di giro*) between American citizens, *i. e.*, American debtors on account of the bonds issued to European creditors and American holders of the new government bonds to which collateral security was afforded by bonds previously issued by Americans.

But when the war was prolonged, even the collateral security offered by securities issued by Americans was found insufficient to attract capital. The financial agents of foreign governments were replaced by those of the the government of the United States itself who, to attract the capital available in the country issued their own "Liberty bonds". In practice, the governments concerned notified the Treasury of the amounts they had to pay for the purchase of goods in America. The Treasury ordered the Federal Reserve Bank of New York to open credits for those amounts in favour of those governments, who utilised them by drawing cheques which they offered in payment to their American suppliers.

The public did not understand the essence of these transactions. It believed the United States were exporting for cash. They did not rea-

(1) TAUSSIG, F. W. *Op. cit.*, p. 313.

lise that by subscribing government loans it was always Americans who were granting their capital to other Americans producing commodities for foreign governments (1). For the time being at least there was nothing real to offset these commodities ; the producers were satisfied with scraps of paper on which each government making purchases in America recognised its debt.

What the public in such cases does perceive is the rise in prices due to credit inflation. To float the government bonds the banks open credits to their respective clients thus supplying them with the means for subscribing the loans. On the credits thus opened the clients draw cheques in behalf of the Treasury and purchase government securities. The Treasury deposits in the same or in other banks the cheques received in payment of the bonds, and draws other cheques with which it pays the suppliers of the goods sold to the allied governments. The result is that until the subscribers of the government loans return the advances made by the banks, a "new" mass of monetary instruments — in substance, cheques — is added to that already in existence and remains in circulation.

The presence of great quantities of gold — for the most part sterilised, thus preventing the action of the corrective measures regulating price fluctuations, the exodus and inflow of gold, — seems to justify the opening of lines of credit and the creation of an unlimited number of deposit accounts. In spite of these phenomena, large export currents and the constant importation of gold and securities from all sorts of countries rather curiously characterised the first post-war years in America.

45. — Capital movements due to private initiative and the migration of labour.

We have tried to conduct this examination of the consequences of foreign loans — whether collected and spent on the lending market, on the borrowing market, or on third markets, either with a gold or an inconvertible paper currency, and on the supposition of the return of the loan from the borrowing to the lending market with a gold or inconvertible paper

(1) One group of Americans produced goods which were exported, another group supplied funds for paying them. During the first stage the funds were supplied by the investors who bought the "Africs" and the subsequent issues floated by Morgan's. During the second stage they were provided by those who took the several issues of Liberty bonds. At a still later stage and indeed during the later phases of the second stage itself, something came from income taxes and excess profits taxes". TAUSSIG, F. W. Op. cit., p. 315.

currency — on simple lines with the comments suggested here and there by experience and deeper enquiries, with a view to deducing therefrom some lines of conduct should foreign loans be made — and it is to be hoped that they will be — in the approaching post-war period. Undoubtedly, “ independent ” productive activities are those best in a position to make a free choice between recourse to national savings or foreign capital. They reckon more rapidly the respective burdens and profits and if they make a mistake it is they themselves who suffer the consequences of the error. All however perceive that, considered in relation to the whole productive activity of a country, the influx or exodus of capital in its various forms — and the same holds good for the influx or exodus of working-energies — tends to moderate surpluses, smooth out deficiencies, and permit more profitable combinations of any existing factors. Thus in each country the initiative of individuals or of groups suitably supplemented by the activities of the State, is entrusted with the task of examining to which of the two movements above mentioned — that of capital or of labour — precedence should be given in the first post-war years, not only in consideration of the fact that one is seen to be less costly than the other, but in view of a whole series of other considerations, demographic, social, and ethnical.

It would seem however that if there be a superabundance of workers accompanied by a lack of capital, before allowing this labour to emigrate from its own to other countries, no effort should be spared for securing the productive factors required for utilising as many of these workers as possible in their home country ; and for this purpose everything possible should be done to promote the formation of large currents of export to markets likely to afford steady outlets, as such currents are always less costly than some forms of emigration. Indeed, as already stated, exports increase the total real income of a country and offer to all business concerns which may have incurred foreign indebtedness for the purpose of promoting their own growth, an easier means for settling the interest and sinking fund instalments of their debts.

Preceded by a careful study of the possibilities of developing the economic structure of a country and of securing openings for those goods and services which it can produce at a relatively low cost, embodied in a minutely studied system of commercial agreements entered into with a large number of countries (*see p. 104*) foreign loans afford the country which makes them a means for avoiding, amongst other things, the loss of large bodies of labour. Anyhow, the problem of emigration will concern

only that part of the labour forces which, notwithstanding all the efforts of the responsible authorities, cannot find steady employment in their native country without recourse to those artificial forms of protection to which reference has been made on (*see p. 112*). Far from excluding one another, the migration of capital and the migration of labour *complete* each other, and tend to graduate themselves in time in conformity with the economic and technical conditions of each country. Among the advantages offered by recourse to foreign capital that of affording steady employment to large numbers of unemployed cannot be neglected.

46. — The preference for loans in kind in the post-war period. The problem of imports for the creditor country.

We have seen that loans in kind are advantageous to the lending country. Except for a few price rises, they neither alter exchange rates nor disturb price and wage levels, and they do not lead to a lasting rise in the rate of interest.

Now, on the cessation of hostilities, the huge redistribution of incomes which, as a result of the great mass of government expenditure, will have occurred on those markets which, thanks to natural conditions and the ability of their population enjoyed, even before the war, ample supplies of commodities, will have led to a marked increase in the average available funds in the hands of individuals — even though huge and spectacular fortunes may be lost — and the habit of investing will have spread to all groups of the population. Thus, with the help of improved banking facilities, the collection of capital on markets naturally inclined to lend will meet with little difficulty at the end of the war. Moreover, should the loan granted to a foreign country be spent on the lending market, this will help the lender to avoid the spread of unemployment which threatens even the richest countries in the first postwar years, and will secure all the advantages we have mentioned (*par. 35*) in addition to those which will accrue when the loan will be repaid.

It will also be in the interest of the borrowing country to obtain a loan in kind at the end of the war. The arrival from abroad of some of the factors of production will allow of more economical combination: with the factors available in the country — land, for instance, and labour — it will reduce costs, increase total real income, facilitate exports, prepare the way for exports of commodities which at the date agreed on will in

their turn facilitate the payment of interest and the redemption of the loan. A loan in kind helps to reestablish in the borrowing country those ratios between the available supplies of the various factors of production which are required by technical conditions. This object however can only be attained if, in the post war period, some of the factors of production are allowed to move freely between the several countries.

It is also in the interest of the borrower that the payment of interest and amortisation quotas be made in kind. This is the only way in which they can be paid by countries with a low average income level, few raw materials, and which have suffered severely from the war. But payment in kind is also preferable for any country which with the help of foreign capital succeeds in setting up flourishing industries for supplying the demand of foreign markets and in processing raw materials or semi-manufactures at lower cost thanks to the fact that it is better suited than the lending markets themselves to supply commodities required by countries with scanty or anyhow costly labour (1).

But loans between several countries — more especially loans in kind — require as a premise that the lending country should agree to be repaid in the goods produced by the borrowing country, at least for so long as the creditors shall desire that the amounts loaned be returned in full. The more the war will have crushed certain countries which, on the cessation of hostilities, will urgently request countries less severely affected to provide them with the means for reconstructing what has been madly destroyed, the less will it be possible for the countries which, in their own interest or in the fulfilment of a moral obligation may have undertaken to act the part of creditors to disclaim the responsibilities arising from their privileged situation; advantages due to the abundance of their natural resources, or to their good fortune in having escaped equally heavy losses. It will not be possible for them to take up a negative position towards the organisation of international life on lines designed to enable the debtors to meet the liabilities incurred for the loan by exporting goods and services, either directly to the markets of the lending country, or to other markets.

(1) As a country with traditional handicrafts which can give a personal character even to the products of large scale industry, and with relatively cheap labour, the name of Italy comes spontaneously to the lips as that of a typical processing country, with the help of course of indirect financing. The reduction of unemployment and the increase of real income are results common to all countries participating in indirect exchanges of capital distributed over time.

Should the creditor country refuse to receive goods and services from the borrowing country ; and should it, in the second place, fail to make use of its factors of production for indirectly financing other markets ; should it not accept a spread between its own price level and that of the borrowing country — whose prices must be lower so as to allow it to export on a larger scale — foreign loans will be impossible, however much the creditors before granting them may enquire into the present and future possibilities of the debtor.

47. — Plans concerning foreign exchange and foreign loans designed to set going machinery by which the balance of the economic system is to be restored.

It is anyhow difficult that a loan should be granted and repaid entirely in kind. A more or less conspicuous part is always spent on markets other than those of the lending country, for the borrowing country is not only in need of capital goods. It must purchase goods on its own market, pay wages, obtain short term credits. For all these purposes an influx of means of payment is almost always required.

In conformity with the monetary system of the lending country, the phenomena ascribed in the course of these studies to variations in the price of bills of exchange will make themselves felt as soon as the borrower receives gold, foreign bills of exchange, the opportunity of using credit accounts opened in his name, or when in payment of the interest matured or in redemption of loan instalments received, the borrower sends the lender gold, foreign bills of exchange, or the authorisation to use credits opened in his name in the banks of the borrowing country. In the post-war period the notion of "foreign exchange" will also come again to the fore, *i. e.*, the ratio in which the monetary unit of a given country can be exchanged for that of another, a notion which cannot be suppressed so long as the several countries continue to have different currencies.

At the time of writing, uncertainty still prevails as to the exchange regime which the agreements that it is to be hoped will be extended to the largest possible number of countries, will set up. Will it be a system of freedom or of control ? Will each country be directly anchored to gold or will plurilateral clearings lead to a system of exchange manipulation ? The large number of writings on those valuta plans which have claimed most public attention (par. 13 of the Study I) would seem to dispense us

from reexamining this matter. Objectively considered, valuta plans tend to secure at least approximately, the stability of the foreign purchasing power of the currency of each country adhering to them, while on the home market prudent credit policies should coordinate more or less approximately this aim with the stability of the purchasing power of each currency on its own market.

But ingenious as they may be, these valuta plans, as we have said, will always prove inadequate to solve the problem unless they make it possible to secure more extensive ends which might be described as preliminary, *i. e.*, the free operation of devices truly capable of rebalancing the economic structure of the several countries, of which the currency, in its functions both on the home and foreign market, is an emanation but not a conditioning factor. Let it not be thought superfluous to insist here on the fact that the balance of the economic structure of each country — or at least the trend to secure a balance between needs which cannot be postponed and the means for satisfying them, — is the premise of all attempts at stabilising, in conformity with all prevailing conditions, the purchasing power of any currency on the international market. Now, stable purchasing power on the international market can only be secured as the result of currents of exports and imports set going by a comparison between the production costs current in the several countries for goods, services and capital, available for exchange with those which other countries can produce (1). The valuta plans will either succeed in making means available for setting these currents going in each country, securing the free movement of goods, services and the factors of production from one country to another, thus giving each the possibility of spreading to others any benefits secured by the use of certain factors in developing some of the processes of production, and in that case they will be useful; or these valuta plans, abstracting from realities, will not enable the countries accepting them to develop those currents of imports and exports

(1) It is true that in the course of these inquiries we have described as the *primum mobile* of the export and import currents of each country the variations in the price of the means of international payments. But we were then trying to distinguish between monetary phenomena — gold movements and foreign exchange movements — and to establish between them a "prius" and a "post". As a matter of fact, the fundamental phenomenon is not that of valuta; it is the dynamic factor of the production cost of goods, services, and capital. That alone sets exchanges of an enduring kind going; that alone by intensifying them tends to rebalance the economic structure of each country.

which could promote for each a balanced economic situation, and in that case they will be found inadequate.

Foreign loans in themselves, in so much as they permit of active commercial relations, help to reestablish the equilibrium of each country in contact with others. The valuta plans can also provide for loans between countries, but as they refer implicitly to more or less normal periods, when laying down certain limitations of a general character, they do not take exceptional needs into account (those exceptional needs which may be felt in every country at the end of the war) and therefore the machinery they provide is inadequate for re-establishing under all circumstances the equilibrium of the economic structure. In the first post-war period loans will be better suited to this purpose, while affecting matters which escape the action of the generic machinery of valuta plans, they take advantage of the latter as of a co-operative premise.

48. — Stricter control of the recourse of public bodies to foreign capital.

We have deemed it advisable to deal at some length with a rather long series of definitions of the possibility and consequences of recourse to foreign capital for two chief reasons.

The first is that only by acquiring an accurate notion of the phenomena involved is it possible to judge within what limits and on what foundations the State and other public bodies will be able to avail themselves of foreign capital in the immediate post-war period. In the case of a public body, a foreign loan which curtails the capital and income of a country not only in the present but also in the future and until its extinction, can only be justified when the reasons for it are more serious than in the case of private loans, such for instance as the exhaustion of all other sources from which the financial means needed for carrying on State activities can be drawn; the impossibility of postponing certain expenditures such as those for public works of a typically instrumental character for the production of consumption goods, which private enterprise, either individual or associated in legally formed groups, could never think of undertaking; the certainty that the means will be available for returning the loan at the dates fixed for its maturity, for instance 5 to 10 years from the date of the agreement, so as to enable real income to increase and produce the available funds required.

The justification of a foreign loan is related to the problem of the limit to which the State or other public body may carry its indebtedness. In the case of loans raised on the home market, this limit is set by the elasticity of the fiscal system, *i. e.*, by the possibility of levying taxes to meet the service of the debt without reducing tax yields. In its turn, this limit is in function of the growth of total real income over specified periods of time and of the consequent possibility of subjecting it to heavier taxation.

The limit to which the State and other public bodies can carry their indebtedness towards foreign countries is identical. Both in the case in which the payment of the annuities, inclusive of interest and amortisation quotas, is made in kind, as in that in which it is made by opening credits in the borrowing country in favour of the lending country, or by sending the lending country bills and remittances, — all means which imply heavier exports from the borrowing country — the borrower will always have to levy taxes to an extent which will enable him to count on a yield sufficient for the purchase of the goods for transfer to the lending country in payment of interest and redemption of loan quotas, or the corresponding means of international payment.

It is certainly not easy to make such provisions at the time of arranging a foreign loan, especially if, in order to allow the real income of a country to grow to the extent required for meeting taxation, it be desired that the payment of interest rates be deferred to *future* years, for instance 5 or 10 years from the date of the agreement. In any case, the lower the rate of interest and the longer the time allowed for the payment of the redemption quotas, the smaller will be the taxes the borrowing country will have to levy. In view of the urgent character of the reasons leading to the request, post-war loans do not differ from those required during the period of hostilities. Therefore, the privileges granted in the case of the latter, and a broad minded understanding of the situation by the lending countries (1), may rightly be solicited in the case of some of the

(1) An eloquent example is found in Section 3 (b) of the so called "Lease-Loan Act" "An Act to Promote the Defense of the U.S.A. (Public Law 11-77th Congress, Chapter 11, 1st Session, H.R. 1776)": "The terms and conditions upon which any such foreign government receives any aids authorized under subsection (a) shall be those which the President deems satisfactory and the benefit to the U.S. may be payment or repayment in kind or property, or any other direct or indirect benefit which the President deems satisfactory".

loans which will be required in the immediate post-war period for use in that part of the work of reconstruction which really does not admit of delay.

49. — Need of the economic structure of a country being equipped for exporting. Necessity of avoiding conflicts with the general direction of the country's economic policy.

A foreign loan agreement therefore requires that the whole economic structure of the borrowing country be organised, under the careful and constant supervision of the responsible government, in such wise as to encourage or at least not hinder active currents of export trade. As the cost of drawing on the capital of other countries is determined by the cost of the exports which will provide the payment of interest and ammortisation, the lower the costs of production in the country, the more numerous and substantial the active items of the balance of payments, the less will be the need of levying taxes and the more willing will be the lending country to loan its capital, the return of which will be effected without difficulty. Apart from considerations of a political nature, a government will be able to draw on foreign capital with greater facility when it is well equipped for exporting on its own account or on that of the lending country because it is the country which can process to best advantage raw materials or semi manufactures thanks to the qualities of its labour, its natural characteristics, its proximity to the purchasing markets, and so forth. The whole of our study confirms the intrinsic nature of these conditions.

But this study also serves to show that the government of a country which receives foreign loans arranged by private parties — whether the government itself be indebted or not to foreign countries — is in duty bound to follow attentively the reactions of such indebtedness, even if limited to individuals or to groups ; it must examine the extent to which the reception or repayment of foreign loans hinders or favours monetary and credit policies ; it must take measures for avoiding any neglect or possible surprise which might compromise the aims the community has in view.

If arranged with caution and parsimony and used for meeting expenditure which cannot really be delayed ; if accompanied by measures for enabling the whole productive activity of the country to work on a large scale for abroad ; if a whole system of exchanges be arranged with other

countries as the result of suitable agreements and if the various policies adopted with a full knowledge of the situation in the home country be co-ordinated with them, the foreign loans obtained by a country in need of capital at the close of the war may afford one of the most effective means for solving the innumerable problems which the war will bequeath, for pushing forward the work which will occupy for decades to come present and future generations of willing workers, for reconstructing, with confidence in the work undertaken, a whole world materially and morally devastated by collective insanity.

Appendix

ON SOME FORMS OF FINANCING PUBLIC WORKS

I. — It is not our intention to set forth here plans for reconstruction which can only be devised in relation to the needs of each country by persons in possession of all the essential data required for forming a judgement. With a view to lending a more present and concrete interest to some of the views expressed in the preceding study, especially as regards recourse to national and foreign capital, we only wish here to refer to the Italian legislation on public works of the last few decades which will be more or less closely adhered to in the first post-war years.

There would seem to be no need to insist on the fact that in the war devastated districts the premise to all subsequent works of reconstruction will be the restoration of the means of communication and transport. Whatever criteria may be adopted for distributing between the State and other public bodies — Provinces, Communes, Associations — the cost incurred for building roads, bridges, railways, ports and the settlement of sea-shore zones, whether such works serve the general national interest or that of certain regions only, it seems likely that in the first post-war years it will be left to the government to take the initiative and to the national budget to meet the cost of drawing up plans in due time and carrying out all the works required for providing once more those essential means of transport required for enabling the population to secure food supplies, capital goods, and the requisites for public health services. It seems likely that the budget will also have to meet the cost of purchasing abroad, for cash or credit or in the form of loans in kind, the capital goods required for providing a system of transports, which alone can afford the basis of all work of reconstruction.

It would therefore seem superfluous to recall, for instance, that first category works connected with harbour construction and the regularisation of the shores, such as those port facilities required, for shipping in general and for the purposes of national defence, and shore-regulation works of importance for defence purposes, will have to be carried out by the government and exclusively at its expense, while works belonging to the second category — divided into four classes classified according to the average tonnage of the goods laden and disembarked — will be carried out in the case of the first three classes by the Government, the Treasury contributing to the cost to the extent of 80 %, 70-60 % and 40 % respectively, while the remainder will be met by the Provinces and Associations concerned; as regards the 4th class, which covers harbours doing but little business, the works will be carried out by the Associations concerned and the government contribution to total cost will be at the rate of 50 %. In the first post-war years the Government, after graduating the urgency of the works required for reestab-

lishing trade currents and after making the plans for their execution, will not be able to avoid the need of carrying them out entirely at its own expense. The question of the distribution of the total cost will only become important, under the provisions of the existing law, when the time comes for recovering the quotas for which the Provinces, Communes and Associations are responsible.

What we have just said of the harbours can be repeated almost in full for the roads, which are also classified in various categories, and for other public works. The building of railways is, on the other hand, an expense which the law places exclusively on the Government.

II. — The notions suggested by the many measures taken for repairing the damages caused by earthquakes floods, and land-slips — all too frequent in Italy — are perhaps yet more instructive. When stripped of superfluous details and adjusted to the much greater proportions of the losses to be repaired, some of these measures may afford a starting point for those which will have to be taken to meet the consequences of the war.

After the earthquake which devastated Sicily and Calabria on December 28, 1908, and which is associated with the names of two cities, Messina and Reggio, the Government undertook to meet the whole cost of rebuilding public buildings and a large part of the cost, rising to 92 % in some cases, of rebuilding churches and buildings used for charitable purposes. The residual expenses were debited to a fund provided by a surtaxes which local government bodies, — Provinces, Communes and Associations — were empowered to add to the government taxes.

This fund, administered by a Committee set up under the Ministry of the Interior, was debited also with part of the expenses incurred for rebuilding works of importance to the Communes and Provinces, such as administrative offices, hygienic works, water supply services and schools. As a matter of fact, the Communes were empowered to arrange for loans with the *Cassa Depositi e Prestiti*, a State Bank which receives legal security deposits, the Post Office Savings Bank deposits and the funds of the State insurance institutes, and which makes loans to public bodies, in the first place to the Government. The loans had to be amortised within a period not exceeding 50 years. The Government contributed to the cost of works of local interest to an amount equivalent to half the annuities, inclusive of interest and sinking fund payments. The local government bodies concerned could secure the other half by applying for assignments on the fund provided by the sur-taxes.

By this means the legislator tried to meet at least part of the cost of reconstruction out of taxation. When however it proved impossible to levy the sur-taxes and it was impossible to count on income of a steady description, the local government body or church was empowered to cover the share of the costs devolving on it by securing a loan of which the repayment only was guaranteed by the fund provided by the sur-taxes. Much the same principles were followed by the Government and other bodies in providing for the cost of preparing and carrying out town-planning schemes in the Communes affected by earthquakes.

The cost of rebuilding dwelling houses belonging to persons in the government service and workmen's dwellings was met by the Government. To well-off persons in receipt of incomes who had sustained losses the Government recognised the right to obtain from a special banking consortium loans at favourable interest rates, extinguishable in 30 years with the help of a government contribution. The right to such loans found its expression in negotiable securities and amounted to a form of indemnity for the losses suffered.

The costs met by the State in connection with the earthquake of December 28, 1908, during the twenty years preceding 1942 — *i.e.* thirteen years after the tragic event — can be summarised in the following figures :

(1) Public buildings	Lire	120,000,000
(2) Churches and buildings for charitable purposes	»	290,000,000
(3) Buildings of interest to Communes and Provinces	»	250,000,000
(4) Town planning expenses	»	220,000,000
(5) Workmen's dwellings and houses for government employees	»	750,000,000
	Lire	<u>1,630,000,000</u>
Subsidies in aid of private buildings	»	240,000,000
	Lire	<u>1,870,000,000</u>

III. — The regulations issued on the occasion of that earthquake were subsequently modified as the result of other events, as for instance the Marsica earthquake of January 13, 1915. The amendments did not affect the basic principles, but they emphasised the trend to place most of the burden of expenditure on the shoulders of the State. Thus the expenditure for reconstructing public edifices required by the Communes and the Provinces was met by government subsidies to the extent of 50 %, increased to 75 % in the case of works which had to be completed within a fixed time limit. And the bodies which had to meet the residual amounts were given the right to secure loans at specially low rates of interest. Here again the State came to their assistance, lightening the weight of the debt by paying half of the annuities, inclusive of interest and amortisation. Thus the cost of building and equipping schools was met in full by the State in those Communes which had been destroyed by the earthquake and to the extent of one half in those which had only been damaged. For the other half, the local governments were empowered to secure loans bearing no interest from the *Cassa Depositi e Prestiti*.

On the other hand, as incomes rose the government contributions to the cost which the well-to-do owners of destroyed or damaged houses had to meet, declined. These contributions took the form of percentages ; or of the right to secure a loan enjoyed by all such house owners ; or of annuities to meet interest and amortisation on loans extinguishable in a specified period of time. Thus, for instance, persons with an income exceeding fifteen thousand lire per annum received State contributions equivalent to 60 % of the interest on loans at 4.50 % extinguishable in a period of not more than 20 years. This brought the State contribution — even in the case of persons with means — up to 22 % either of the cost of rebuilding, or of the loan to which the owner was entitled.

Subsequent provisions (1916-1925), and those taken in connection with the earthquake in the Carnia district (1928) and in the province of Bologna (1929) confirmed the principle that with a view to avoiding regrettable delays the Government carries out *ex officio* the works required in the interest even of persons of means, reserving the right to recover the quota for which they are responsible. On the other hand, the measures taken in connection with the earthquake in the district of the Vulture in 1930 aimed at relieving the national budget of excessive liabilities. Thus the cost of the reconstruction of works of local interest was met by raising the sur-tax ; government subsidies were not to exceed 50 % of the cost of the works ; and the organisations concerned were empowered to secure loans on specially favourable conditions to cover

the residual amounts from a special Consortium for granting subventions on mortgage security opened by the Bank of Naples.

To sum up, in the case of compensation for damages caused by earthquakes, volcanic eruptions, floods, and landslips, the State carries out all the works immediately required, such as the removal of the wreckage, demolitions, the under-pinning of buildings which are in a dangerous condition; and all the works required in cases of urgency, such for instance as the execution of important town-planning works in the affected areas, works for removing or consolidating inhabited areas, the organisation of immediate measures of relief, the erection of dwelling houses in pleasing garden-suburbs for injured persons without means.

The expenses met in connection with all the above-mentioned calamities from 1908 to 1942 exceeded three thousand million lire, to which not less than 800 million lire must be added for subsidies to individuals. It may be objected that not all these figures have the same meaning, as the purchasing power of the lira has varied in the periods preceding and following the first world war. Nevertheless, in order of size, they show the importance of the tasks undertaken by the State.

IV. — As the result of various vicissitudes (occupation of the home territory by warring armies; displacement towards the North of the administrative departments with the inevitable deterioration of their respective services; lack of means of communication and transport), the former experience which Italian legislation had in the matter of *war losses* can now teach us but little.

The initiative for undertaking the rebuilding and repair of buildings and public works of national, provincial and communal interest, and of those used for religious purposes is left, under this legislation, entirely to the State, and undertaken at its expense; this is the case also with buildings belonging to private persons, but only to the extent of their value in the month preceding the outbreak of the second world war, reduced by the value of any part of them which has not been destroyed.

By the middle of 1943, the work done by government agencies for repairing or reconstructing public works and private buildings already amounted to over two thousand million lire. With the spread of war operations by air, sea and land, with the renewal of attacks on a vast scale against densely populated centres, the amount of the losses suffered has reached alarming figures, and should present circumstances be prolonged, it will be difficult to estimate the loss even approximately. Anyhow, it will be terrific, and the law will have to be amended to meet it. Moreover, to ensure rapid reconstruction it will be necessary to revise thoroughly the administrative and financial criteria adopted.

This is not the place for making a full enquiry into the matter. Nevertheless, the experience acquired in connection with public calamities and with the first world war shows that *ex officio* execution of the work by the Government is the means best suited for assuring the rapid reconstruction of buildings and other works needed as the indispensable premise for resettling the war-devastated districts and assuring the revival of national life. In the case of private buildings, the Government might entrust their reconstruction to the « Provincial Institutes for Peoples' Dwellings » (*Istituti Case Popolari*) organised on a uniform basis for supplying the need of possessing in each province agencies capable not only of administering their own capital, consisting of the houses they have already built, but also of erecting new ones to meet the needs of the populations returning to their home centres or else settling in others offering better opportunities for employment.

But besides the well known difficulties which always attend such assessments, the Government, should it undertake to execute all the work itself, subject always to its right to collect that share of the costs, which, under the provisions of the law, has to be met by those house-owners who possess means, would have to dispose of huge funds which it would be difficult to provide for in the budgets of the first post-war years. It would therefore seem advisable to reserve to the Government the direct execution at its own expense of all public works of national interest and of those required by local government bodies and for religious purposes, as well houses for the unpropertied classes. These might be built by the above-mentioned Institutes for Peoples Dwellings, whose balance-sheets and activities should be carefully supervised.

It would seem advisable to leave the rebuilding of houses belonging to persons of means and of business premises which may be recognised as deserving of government help, to the parties concerned and at their expense, the Government assisting them by the grant of subsidies which might perhaps be supplemented by bounties to speed up the work, granted on the basis of estimates drawn up by the Board of Civil Engineers, and of vouchers showing the progress made with the work ; affording private house-owners the possibility of obtaining loans on favourable conditions from credit institutes set up to meet that part of the cost not covered by the grants above referred to.

This huge mass of work, both complicated and delicate — extending from the restoration of innumerable public works to the reconstruction of a large part of the real estate of the country which has been destroyed or damaged, and in some cases entailing the rebuilding of whole cities — will of course centre round the Ministry of Public Works, which has many decades of experience, specialised knowledge, the habit of looking facts in the face, all qualities required for undertaking the work without delay. It will however be necessary to carry out carefully planned decentralisation and to entrust much of the work to regional offices ; the technical executive offices will have to be reorganised and reinforced ; the several problems will have to be dealt with on uniform lines ; and a thorough knowledge of all the consequences of the policies followed will be required.

V. — As regards the financial criteria which should be followed, when once the respective urgency of the works has been ascertained and the plans for the public works have been approved, the following lines suggest themselves :

(a) the cost of reconstruction cannot be charged to the national income which in countries with a low average income level, heavy inflation, and which have been severely injured by the war, has been reduced and it is to be hoped will be increased rapidly. At best, only a very small part of such cost could be charged to income ;

(b) it will therefore be necessary to have recourse to national or foreign capital to the full extent which the elasticity of the fiscal system and of the economic structure of each country will allow ;

(c) if recourse be had to foreign capital as costing less than that obtainable on the home market or for the simple reason that the country has no capital, or has only insufficient quantities ; then the borrowing country must equip itself in such wise as to encourage large export currents of goods and services, thus securing the means for settling in due time, and with less difficulty, interest and amortisation payments ;

(d) if recourse be had to foreign capital, care must be taken to coordinate carefully the influx of goods in kind and of the means of payment ; the annual charges met by the Government inclusive of annuities for public works and the annual charges for

interest and amortisation. These latter expenses can only be met by countries which make such good use of the loans that they increase their total real income and can count on it for making it possible to return them. It would be a mistake for the national budget of a country to incur liabilities for public works for sums equal to those of the instalments of the loan it is receiving, unless it can be certain that when the instalments cease and interest and amortisation payments fall due, larger exports will supply adequate means for meeting the payments it has to make;

(e) care must be taken that neither the consequences of carrying out public works, nor those of securing foreign loans, run counter to the policies the monetary authorities of the country intend to pursue.

Government activities, whether favoured or not by foreign capital, will only succeed in restoring the prosperity of the country if the government is strong enough to convert any charitable help it may receive into lasting currents of production of consumption goods.

VI.

**ELEMENTS AND GUIDING PRINCIPLES
OF ECONOMIC PLANNING**

VI

ELEMENTS AND GUIDING PRINCIPLES OF ECONOMIC PLANNING

SUMMARY

PART I: PLANNING BY INDIVIDUALS. — The notion of planning is considered with a view to defining and specifying what it implies. In drawing up an economic plan account must be taken of certain elements: marginal values, the discounting of future events, direct and indirect insurance against probable risks, market conditions. All these elements enable the individual to ascertain approximately the cost of making or revising an economic plan. In planning, the individual may be guided either by the principle of economic expediency, or by that of substitution, in substance by the prevalence of motives other than economic. The present inquiry seeks to throw light on the regulating and stabilizing function of planning by individuals in modern economy.

PART II: PLANNING BY GOVERNMENTS OR OTHER PUBLIC BODIES. — The fact, that the Government may act either in the interest of the whole community or in that of special groups of citizens justifies the distinction drawn between its intervention in the general interest or in that of certain groups. Each intervention implies a cost and a result. Consequences of interventions whose cost exceeds the value of the result obtained. Contrasting results of the several interventions lead to a rise in the cost of each. Notion and function of planning by governments or by other public bodies.

PART I.

PLANNING BY INDIVIDUALS

1. — Notion of planning.

The expression “ planning ”, “ economic planning ” is in very general use ; we come across it nearly every day. Unfortunately the meaning attached to it is still a vague one. When an economic dictionary — which it is to be hoped will be compiled with the co-operation of all students of these matters — will reach the letter P, this fact will have to be mentioned when attempting to fix for the expression a meaning, or several meanings, as accurately defined as possible. It does not seem that any really thorough scientific enquiry has yet been made with this end in view. The results of a personal enquiry are here briefly summarised.

The need of a plan and the need of properly analysing all it implies are at least as old as man’s need of acting on rational lines. Whatever be the economic system in force — ranging from *laissez faire* to collectivism (provided this leave at least a minimum amount of freedom of choice to the individual) — planning is seen to be an essential requisite for any action looking to the future. Considered as instrumental, planning is seen to be a logical category of any action having in view future developments along lines traced by the reasoning powers of the individual concerned and by the opportunities offered by his environment.

Self-examination shows that each of us is rooted in the past and bound to some extent by what we inherit from it. But day by day each of us is freed from some of these bonds — a freedom more or less fully secured at fixed periods, as, for instance, on the termination of contracts, controls, liabilities of various kinds — while at the same time new bonds are being formed, as for instance by the acceptance of new contracts, controls, or liabilities which more or less crystallise and immobilise our present and even our future activities. At every moment each individual, within the environment in which he operates, is disposing of opportunities or things which are freed from past bonds and of what still survives of present immobilisations. At any moment he can assign these available means for

purposes of consumption or investment, present or future (savings), guided by that principle of using them to the best advantage which tends to secure the best satisfaction of his needs.

The basis of this principle is the sensibility of the individual concerned, which in a first period leads him to see a situation of equilibrium or tending towards equilibrium from which he will only swerve if circumstances should allow of his improving it ; but which, in a successive phase, urge him to consider the means of preserving or if possible improving the position attained in spite of all the environmental and personal changes which tend to affect it adversely. Each individual, though quite unable to foresee the situation which will arise and still less to foresee the various reactions, direct and indirect, to which it may give rise to do so he would have to have powers of divination which, moreover, would not always make his life a happy one) — can almost always succeed in fixing a line of future conduct planned on a scale which will vary with the degree of culture and foresight he possesses which enable him to conjure up a vivid picture of the future course of events.

“Planning” may therefore be defined as the projection into a more or less distant future of the most satisfactory state possible considering the available means — or of a tendency towards such a satisfactory state — which will comprise one or more aims ; attained in the former case, to be attained in the latter. A projection which, favoured by personal experience and by that of others, subject to modifications based on forecasts which anyone can formulate, reacting with his sensibility to the stimuli and the changes of his surroundings, answers the more or less conscious need of resisting to the currents surrounding him and to the uncertainties of surrounding conditions.

Instead of breasting at each minute the waves of time by which he endeavours not to be overwhelmed, and seeking in an ever-changing environment to direct his efforts so as to procure for himself the things he needs, the individual sets himself one or more aims which he hopes to realise successively over a period of time ; he directs his efforts towards the attainment of these results, even if they be only partial and only shortly deferred ; he defends them by using the means required for neutralising any adverse influences, and gradually adjusts to changing conditions the nature of the protective means employed, at least until such time as the changes which may have occurred in the real situation as compared to that which he expected shall require him to modify the objects he originally set out to achieve.

In so doing the more earnestly he strives first to preserve and then to improve the situation he has already attained, the less will his actions be the result of the chance promptings of instinct.

This shows the intimate relation thus established between the faculty of conjuring up a vivid vision of the future — so as to provide in time against possibly unfavourable influences or take advantage of possibly favourable circumstances — and the degree of prosperity which the members of a civilized community may attain and preserve. “Planning” is therefore the instrument used by the higher faculties of man for attaining, defining, and defending a certain level of prosperity which a variety of circumstances may increase but which they more often tend to undermine.

2. — The elements required for making a plan. (A) Marginal values.

A notion of the elements required for making a plan can be readily deduced from the few points above set forth.

First of all, in arranging for conditions to be secured at a future time, the element represented by marginal values must supply the basis for securing a notion of stable, imperfectly stable, or even unstable equilibrium — as the advent of a series of disturbing causes of such violence as to make it impossible to reconstruct the previously existing equilibrium may always be expected.

Marginal considerations in using one commodity (money) for seeking another (special equilibrium) or several other commodities (general equilibrium) imply the consideration of a very small increase or decrease of the thing possessed and of the thing or things of which the possession is desired : a consideration which in each case is the only one present to our mind and capable of affecting our decision as to the expediency of continuing or stopping our work ; it is our guide to rational conduct.

Following in the footsteps of Pareto, Hicks (1) considers “old fashioned” the notion of marginal utility in the selection made by a consumer ; and applying the individual preferences and curves of indifference already drawn by the Italian economist, he has very elegantly replaced the law of diminishing marginal utility by that of the diminishing rate of substitution of one commodity by another. Undoubtedly this ample tribute paid by one thinker to another deserves our admiration. Nevertheless, mindful of the teaching of Pantaleoni, we consider that, notwith-

(1) Hicks, J. R. “Value and Capital”, Oxford, 1939, pp. 58 and 132.

standing the qualifications elaborated by keen enquirers, the notion of marginal utility still retains its function as a valuable instrument for economic enquiries, and as far as this study is concerned, as it assists in the formation of a notion of equilibrium, it must also be considered as an essential element for planning which takes as its starting point precisely the notion of equilibrium or of a tendency towards equilibrium.

As a matter of fact, it is now accepted that for the purpose of attaining the maximum possible satisfaction, a consumer distributes his income between several commodities whose consumption is governed by the law of the equality of marginal utilities divided by the price unit ; a producer distributes his income or his available means over the factors of production which he wishes to combine, in accordance with the corollary of the equality of marginal productivities divided by the price unit.

At the basis of all these distributions, of all these relations between the markets for the several commodities, including money, we always find the consideration of margins. As these margins are first secured and then developed by comparing their various utilities in time, the essential foundations are thus laid for drawing up, carrying out, and revising a plan based on a condition of stable equilibrium which the entrepreneur desires to improve in conformity with changed conditions, of an imperfectly stable or unstable equilibrium, which he wishes to change into one of stability and then to improve as circumstances and individual preferences may suggest.

3. — (B) Discounting the future.

Could a state of equilibrium when once attained, or shortly to be attained, remain unchanged thanks to the permanency of all the conditions leading to it, we should encounter no greater difficulties in "projecting it into the future" — however distant — than those represented by the above mentioned marginal distribution of incomes and savings tending towards the attainment of maximum satisfaction. As a matter of fact, however, the equilibrium attained is subject to a whole series of circumstances which may affect all the conditions which determined it, such as incomes, prices, individual tastes, the state of technical knowledge. "Projection into the future", is therefore only conceivable if the changes are not such as to endanger the position of equilibrium attained by each entrepreneur, or if, although endangering it, they are offset by other conditions which can re-establish that equilibrium.

When the individual, freeing himself from the bonds with which the past has shackled him, tries to foresee the consequences which may re-

sult from changes in a given situation, he is said to « discount the future », *i. e.*, he imagines it, and keeping in mind the ends he has in view, he acts accordingly.

In practice, this expectation of the future has a twofold effect on the individual who estimates the forecasts he draws in relation to the ends he has in view. It affects the actions he takes *at the time* forecast. There follows a redistribution of the available means differing from that which he would otherwise have attained. Some at least of the actions he would have taken after the occurrence of feared events, are taken in anticipation of these. Some at last of the consequences feared are thus distributed over the period preceding the occurrence of the events instead of being all felt simultaneously. The expectation of the future affects the individual's actions after making the original distribution of available means between consumption and savings. Even if that distribution was made in view of the aforesaid expectation, as the date foreseen for the feared events draws gradually nearer, the individual can always judge whether the original distribution and the equilibrium thereby attained can remain unaltered, or whether they must be modified because the expectation either underestimated or over-estimated the event.

But we can realize that the distribution of available means is based not only on the consideration of existing but also of future conditions, the care to see whether, under these changing conditions, the said distribution is still in keeping with the ends in view, the haste taken to alter it as soon as a change may become desirable, all this is properly described as planning to meet a situation expected to arise, and in its turn confirming or correcting that plan as these expectations gradually draw near. By inducing the individual to take in advance at least some of the measures which otherwise he would only have taken when the feared event has occurred, planning tends gradually to replace by discounted incomes, prices, and tastes: those incomes, prices and tastes which were current at the moment when the forecast was made, *i. e.*, planning tends to reduce or multiply — according to the preference shown by each individual, for present as compared to future commodities and according to the favourable or unfavourable nature of the events expected — existing incomes, prices, demand and supply. Thus these unceasing efforts secure the projection into the future of a state of equilibrium attained or to be attained as the result of events the expectation of which becomes a necessity of the intellectual activity of each individual concerned.

The difficulty of substituting discounted valuations for present valuations thus arises, as stated, not only from the many conditions which have to be taken into consideration when distributing commodities with an eye to the future. It arises also from the many changes to which all the conditions to be taken into consideration are subject in the course of time. A distribution and a plan which at the start are in keeping with the aims of the person who makes them, may well turn out in the course of time to be inadequate for securing those aims. But as the full attainment of the ends in view requires that a plan should adhere as closely as possible to real conditions, the need arises for recourse to a third element which may be described as insurance, which will make it possible from the start to introduce into the plan any modifications which may be required.

4. — (C) Direct and indirect insurance of possible risks.

It is obviously in the nature of things that events may turn out to be less favourable than had been expected. Each expectation cannot be fulfilled to the full extent desired. The measure in which an expectation can be relied on finds a limit marked by the spread of the risk that its realisation may turn out to be impossible. This limit is not an objective one. It expresses the opinion of the individual who makes the plan as to the probability of being able to carry it out, at least in its main lines. This opinion varies from one individual to another, from one time to another, and determines both the scale and the duration of the plan itself.

Nevertheless, and within the limits of scale and time which at first seemed reasonable, facts may differ from expectations in a greater or a lesser degree and, what is yet more important, they may be more or less unfavourable, as, for instance, when the event foreseen occurs on a larger or a smaller scale, sooner or later than was expected. In short, the individual who looks ahead runs many risks and consequently has recourse to many measures for meeting them. He runs the risk of events unfavourable to the enjoyment of an income he was entitled to expect at the time when the distribution of the goods was first made. A reduction of the present estimate of the value of goods from which the income is obtained on a scale *larger* than would otherwise have been adopted, is the most elementary form of insurance against such a risk and is taken at the time the expectations are formulated, and this already confers some « elasticity » on the plan.

But when the future has been discounted and the discounted incomes, prices, demand and supply have replaced, in accordance with expectations, actual incomes, prices, demand and supply, the plan is still subject to other risks arising from the fact that conditions may turn out to be *even less* favourable than had been expected. And should the plan not have sufficient « elasticity » to enable it to face these risks, recourse must be had to other forms of insurance, supplementary to the first. These, in their turn, are carried to the point at which their cost, which has to be met by the author of the plan who is exposed to the disturbances caused by the more unfavourable turn of events, equals the advantage he would secure by eliminating the risk ; a point which, in the last resort, must be determined by the opinion the author of the plan has of the losses such differences may cause him.

As the only limit placed on the insurance represented by a greater discount of future events is that placed on it by the sensibility of the person who runs the risk affecting the enjoyment of an income ; so likewise the only limit to insurance against loss caused by events more unfavourable than had been expected is that placed on it by the forecast of said loss. The limits considered are always subjective ones. An objective limit could only be approximately established if the behaviour of all persons who have had the same training, work under similar conditions, and are in a position to form an élite as regards the estimation of risks, were to be identical. Even then such a limit would be of historic interest, but could never guide the individual's action.

These limits show even more clearly the efficiency of the various forms of insurance selected. Such insurance may be made once and for all, or for a specific number of times ; it may come to an end when the events in view of which it was taken have occurred. Therefore, should facts more unfavourable than expectations persist beyond the number of times foreseen, it would seem expedient to adjust the plan to the new conditions by introducing radical alterations rather than to take out new insurances against the risks involved in the existing plan.

5. — Cost of making and revising a plan.

We are thus able broadly to define the cost of making and revising a plan. To look into the future, to make a plan, to take measures for insuring against risks related to the enjoyment of income or to the chance that events may prove more unfavourable than expectations, implies a

cost represented (a) by the renunciation of certain kinds of consumption goods and certain investments, certain savings, when making a distribution of goods other than that which would have been made but for these expectations: this represents the cost of planning as compared to the absence of cost (though only temporary) of not planning; (b) the losses and expenses incurred for imparting to the plan the elasticity required to adjust it to changing conditions until such time as the cost of the said elasticity exceeds that of the least expensive form of direct insurance; (c) the losses and expenses incurred for direct insurances when they are taken to supplement the insurance represented by the greater discount of future events which takes into consideration risks referring to the enjoyment of income or the results of a productive activity. The scale of this enquiry does not allow us to go more at length into the examination of these groups of costs.

When expectations turn out to correspond to facts in a maximum degree, or when the elasticity of the plan and the insurances arranged to compensate unfavourable differences between facts and expectations, the plan may be carried out on the lines laid down without entailing further costs for the entrepreneur. But should the several forms of insurance prove insufficient to cover the unfavourable differences between facts and expectations, or should the author of the plan perceive, when the first results are secured, that the insurance guarantees are so affected as to justify the presumption that the plan will correspond less and less to the real facts of the situation which is developing; the disequilibrium will become more apparent and the need of revision, to an extent and at dates other than those foreseen, will make itself more strongly felt. To guarantee the execution of the plan or at least of its main features, new initiatives will be needed which may entail a new distribution of available goods, supplementary insurance measures, in short a cost *additional* to that met in drawing up the original plan.

6. — Guiding principles in making and revising a plan: economic expediency and substitution.

Economic behaviour depends on the psychology of the individual which is constantly affected by his selections according to subjective criteria. But undoubtedly the more rational the behaviour of the individual is seen to be as events change, the more he shows himself inclined to assert this rationality, so much the greater will be the number of goods he will

be in a position to dispose of for the attainment of the ends in view. This means a reduction in the cost of any activity he may be carrying on. It also implies that the greater the number of persons in a community whose behaviour is guided by reason to the fullest extent possible, the smaller will be the cost of the several activities they carry on, as the means of which they can avail themselves will be used to the fullest extent allowed by the environment in which they work.

Both in making and revising a plan, the principle of economic expediency — that is of the best use of available means — can be applied. Often, however, and more especially in the case of revision, a principle comes to the fore which, in relation to the exclusive consideration of economic expediency, may be called that of *substitution*, as it suggests recourse to policies less rational than those which the principle of economic expediency would suggest, or policies which may even be irrational.

Even the principle of substitution, however, does not present features which are fixed and objective. It expresses the recognition by the individual of other than economic motives, as for instance when he imports commodities at a higher price than that at which he could obtain them from another country. It entails, for instance, selling commodities at a smaller profit than would be possible, as happens when the entrepreneur exports to countries where prices are lower than elsewhere. Perhaps the adoption of the principle of substitution even more than that of economic expediency, is left to the mutable psychology of the individual which justifies not only unfavourable differences between facts and expectations — to neutralise which insurance measures might be taken — but divergencies between his actual behaviour and that which would be prompted by strict adherence to the dictates of reason, even in the conceptual field.

The degrees in which the individual will follow the principle of substitution may differ. Policies suggested by the principle — *e. g.*, by the prevalence of motives other than those of economic expediency, may still allow the latter to exist if only in some of its manifestations. But when even a residuum of economic expediency disappears — *i. e.*, when all insurance against the more serious risks is lacking, and when the irrational behaviour is not of a provisional character which justifies the hope that compensations may arise from a revival of common sense, when no attempt is made to select the least harmful of the solutions which neglect economic considerations — then the principle of substitution takes full effect, its intensity being indicated by the difference between the results it secures and those which would have been secured by following the principle of

economic expediency. The consequence is that while the latter tends to increase the income of the individual who respects it, the principle of substitution tends to curtail it, as it secures a use of available means which is inferior to the maximum attainable. As this curtailment of certain incomes does not lead to an increase in others, it may properly be said that the principle of substitution neglects the best use of available means, causes the destruction of commodities, and in time gives rise to a smaller income available for consumption, to smaller savings, to smaller capitalisation.

Whereas the principle of economic expediency, by assuring the best use of available means and tending to reduce costs, brings into action economic forces capable of reestablishing the disturbed equilibrium such a trend is not necessarily found in activities based on the principle of substitution which, in its more typical manifestations, often hinders instead of stimulating those forces, or even paralyses them when its application is insisted on. It will be readily understood that the more closely a plan is drawn up or revised in conformity with the principle of economic expediency the more actively it will promote the recovery of equilibrium following more or less serious changes in the original situation, and its further projection into the future. On the other hand, the more closely a plan is drawn up or revised in conformity with the principle of substitution, the longer will be the duration of economic disequilibria, and the results which the plan aimed at securing will be further than ever from attainment.

7. — The function of planning by the individual.

Having defined the elements of planning, and the two principles by which planning when carried into practice, is guided — both of which may be active in varying degree, or one or other may be carried to the extreme limit to the exclusion of the other — we have in other studies tested the soundness of the propositions so far set forth by examining the motives guiding the preparation and revision of consumer and producer plans, the “uniformities” met with in their respective lines of conduct; the consequences to which they lead, according to the economic system under consideration.

Even without entering into further analyses, the following assertion can be made. The consumer makes a plan for regulating consumption so as to enjoy with greater security and at dates he foresees the income at

his disposal. This income we have identified with consumption goods which form the object of the plan, whose purpose is to protect that income and distribute it in time. In relation to this purpose, the "uniformities" in the consumer's behaviour are ascertained by the consideration of all the said elements of marginal values, discount of future events, insurance against risk, adherence to market realities (1).

The producer makes a plan to secure an income by the use of several factors whose combination in the course of time tends to be modified. While the absence of consumer plans may be conceivable, the absence of producer plans, rudimentary though they may be, is inconceivable. For the purposes of the enquiry it is advisable to divide producer plans into a "plan of costs" and a "plan of prices". Interconnected by considerations related to margins, the two plans are amalgamated into one in the intention of their author, *i. e.*, a plan for raising to the utmost the income to be secured.

The existence of plans for producing an income entails consequences much more far-reaching than those met with in the case of consumer plans. A producer's plan assures in the first instance greater regularity to the income of the entrepreneur himself, as well as to the incomes obtained by all those who collaborate with him. Secondly, it assures greater regularity in the consumption of all these persons and greater stability in the whole economic system.

These consequences tend, on the one hand, to correct the cyclical movement of economic life to an extent which increases as the habit of making and revising productive plans spreads and improves. On the other hand, the possible loss to consumers both of consumption and instrumental goods, due to a price rise which an entrepreneur may try to bring about, will be offset by advantages — greater regularity, greater stability — which are far from negligible, at least so long as the said rise is a moderate one.

In the absence of plans, or in the impossibility of revising them when they have once been made, however clumsily, human activity would be left to the mercy of events susceptible of modifying its conformity to the sensibility which inspires and directs it. But when individual or collective preferences have been accurately ascertained, as well as the action required for satisfying them to the fullest extent allowed by the obstacles

(1) "Uniformità del piano di un consumatore", *Giornale degli Economisti*, November-December 1942.

encountered the discount of future events and the resultant plan, together with the various measures of insurance, will tend to *protect* this action against possible inconsistencies to which events might try to force it, and, as far as economic activities are concerned, it will tend to protect the formation, growth and enjoyment of real income.

As regards insurance against special risks and against the more general risk of unfavourable differences between events and expectations, the *whole* plan therefore acquires the function of an insurance against the still greater and not hereby identifiable risk that individual activities may be overwhelmed by events which restrict the tastes and preferences of the individual and, in the last resort, restrict the right he enjoys in a civilised community of satisfying them. Thus as the complex relations of modern life give rise to events which may prevent the individual from devoting himself to the activity best suited to his tastes and abilities, so planning, as a means of protecting these activities and with them the personality of each individual, asserts its importance and comes to the fore in a civilised community.

We often hear it said that only a few men possess in a high degree the faculty of clearly foreseeing the future course of events; and that even these few do not all attribute the same importance to planning, in the real and proper sense of the term, in its relation to present and expected conditions. But, viewed from a practical standpoint, if notions related to plans for the main economic groups — consumers, producers, public corporations who from certain points of view are consumers and form others producers with special powers — are being ever more clearly defined and are spreading steadily we have a right to hope that the number of persons inclined to make plans will increase, and that as a result of steadily improving elaboration and the corresponding development of scientific enquiries these plans will become the expression of rationality and responsibility, inspiring the actions both of individuals and of the community.

PART II

PLANNING BY THE STATE OR OTHER PUBLIC BODY

8. — The essential features of planning by public bodies.

Of late years public bodies have taken to planning on a much more extensive scale than that noted in the case of responsible private individuals of ripe experience. They have planned not so much to meet the above mentioned needs which they should be the first to perceive in pursuing the ends they have in view, but rather with a view to lending support to interests which in some cases are so great that they can be practically identified with those of the nation, but which are more frequently restricted to those of prevailing political groups. Such action by public bodies is not always successful, but is certainly a more visible expression of the need of making plans. And on these plans, which have among other things been published if only in summary form, the public has expressed a certain number of opinions.

Now, in the plan made by a public body — a plan of production or a financial plan — let us take as an example the budget of any State — do we find those elements of marginal values, discounts, insurance, adherence to reality, which are essential elements of the logical notion of economic planning? The answer to this question is important as the actual situation under which the plans of public bodies have to be carried out is no less beset with surprises than that under which private plans are carried out, and these latter — it is well not to forget it — are always the necessary premise to public plans, as it is only from individuals who are in a position to produce an income and who for that purpose more or less consciously lay down plans, that taxes can be levied and loans obtained. Now, should the plans of public bodies lack the essential elements required for forming them, and should they consequently not possess the systematic qualities and the refinement which private plans can attain, how can we expect them to secure the purposes desired by the community? And even

should they sometimes do so yet they cannot, in the absence of these elements, afford an accurate notion of the cost of making and revising them, and therefore the public body will not be able to ascertain whether the plan has conferred more benefits than it has brought losses to individual consumers and individual producers.

The purpose of this remark is to call attention to the fact that an inquiry into public planning should be made with a thoroughness which has not always been sought for. Only if the scientific examination of private plans has first defined all the conditions required for drawing them up and all the consequences they may involve — including therefore the possibility of a conflict of interests with all the losses it may entail, and the possibility of coordinating the plans of the several groups of citizens — only then will it be possible to examine in the first place whether the plans made by public bodies originate as such thanks to the concurrence of the conditions which are in a position to determine them; and in the second place whether, superimposing themselves on the plans the individual is led to make, they can fulfil a useful economic function, *i. e.*, whether they can secure advantages exceeding the losses to which they may give rise. It is only when a public plan, conceived with a view to securing certain ends, improves a situation or at least does not aggravate it permanently, that it may be considered desirable, and its prospects will be favourable in the degree in which the State, under certain circumstances which arise more especially in a post-war period, is in a position to do better work than private individuals or groups. It must however first be shown that the plans proposed are logically consistent and can be of real use.

9. — State interventions in the general interest or in that of special groups.

It does not however seem possible to form a clear notion of economic planning by the State or other public body unless we first study the nature of the activities they display by means of their various « interventions ».

In common parlance, any action taken by the State in behalf of the community or given groups of citizens belonging thereto, is described as an intervention. This notion is a clear one if we conceive community life as one in which private activities, individual or associated, are held to be prevalent, and State activities, at least originally, are held to be limited. But as in modern life for a variety of reasons State activity

has gradually expanded, the word «intervention» has come to mean any action taken by the State in ever wider and more various fields, whatever be the form of political or economic organisation of the community. It thus seems permissible to speak of interventions in this wider meaning of the word even in the case of economic régimes which leave to individuals few important spheres of action, and in which moreover the State may yet see fit to interfere. Intervention may therefore be described as any action taken by the State to meet aims which it deems advisable to pursue.

To guide us in the examination of such a wide field of activities we may draw a distinction between State intervention in the general interest and direct intervention in the interest of special groups.

The former tend at securing purposes to which the State can never be indifferent, even if their realisation in the national interest implies a more marked advantage for some groups than for others. First of all, the production of the several public services essential to the very existence of the community are seen to be of public interest. Such, for instance, are the defence of the country, the protection of persons and property against arbitrary action of third parties, the administration of justice, and so forth. In the second place, State action taken for modifying the distribution of incomes which tends to become increasingly unequal; to improve the distribution of productive activities and population over the several regions of a country and as between town and country; to attenuate by means of protection given in view of national interests (for instance economic independence) the consequences of a marked division of labour; to correct those individual activities of entrepreneurs which are not conducive to equilibrium (for instance, the employment of women and children); to bring about an equilibrium which would not otherwise be established (for instance, by fixing a maximum limit to the fiduciary circulation); to supplement the insufficient reactions of individuals; to remove obstacles to the rapidity of others; to correct the inelasticity of the demand on the home or international markets for goods and services; to regulate the supply of credit; and so forth and so on.

The latter group of interventions tend to secure ends to which the community might be indifferent. But as their pursuit secures advantages to individual groups which may connect up with the interests of the community as a whole, the parties concerned use pressure to induce the public body to intervene. Such are certain forms of customs' protection; the fixing of the relations between capital and labour expressed in wages or

in other contractual agreements ; the assumption by the State of some of the risks incumbent on the factors of production as, for instance, social insurances ; all of which are interventions for the protection of special interests.

10. — Notion of cost ; notion of the useful result of an intervention by the State.

From an exclusively economic point of view it is in the interest of the community that all interventions in the general interest or in the interest of special groups be based on a favourable comparison of the costs they entail and the useful results they may secure.

When making or revising a plan of consumption or production a private person may do so without taking into consideration the reactions it will have on others. Thus it is hardly likely that a consumer will modify his plan because by increasing the demand for a certain commodity he may raise its price to the injury of other consumers. Nor is it likely that a producer, who is in a position to manipulate the price of a commodity he has produced, will refrain from doing so because the new price may hinder consumer plans and in some cases also those of other producers.

But the planners of State intervention can never disregard the effect each intervention may have on consumption and production, and possibly also on existing consumer and producer plans. Therefore, the " cost " of State intervention broadens out to include the expense it will place not only on the State but also on those persons who may be affected unfavourably by the reactions to which it will give rise. To ignore such costs in all their bearings is to incur the risk of following mistaken or even harmful policies.

The monetary expression of the cost of an intervention is the one which lends itself most readily and with no less useful results than others to cost comparisons. It is not however easy to express such costs in terms of money.

It would not seem impossible to express in money the passive results of an intervention by the State in the form, say, of bounties or subsidies. But it is not so easy to reckon in terms of money the loss the State may suffer by levying, for instance, a customs' duty which by reducing or stopping the importation of certain commodities either for direct consumption or for use in the production of others, will reduce revenue. Still less easy is it to define the importance of the unfavourable consequences both of bounties and duties on consumers and producers, who are often compelled to complete their plans by further measures of insurance taken to protect

themselves against the risk of a rise in costs and prices, and who are therefore the first called on to meet the heavier costs entailed in making and revising their respective plans. How reckon and express in terms of money the various reactions on individual minds, and consequently the various measures of insurance in which these reactions tend to find expression? The number of consumers and producers is enormous. The difficulty of keeping in touch with their several actions is indeed great.

No less great is the difficulty met with in an attempt to define in the case of State intervention the notion and meaning of "useful result". In the first place, the mere fact that the purpose the State had in view has been secured may be considered as a "useful result". In the second place, the immediate or mediate consequences of such action in the shape of lower prices favourable to the authors of consumers' plans, or of lower costs or higher prices for certain products, favourable to the authors of producers' plans, may be considered as "useful results". Thus the "useful result" may be logically considered as a wider category of the aims pursued either in the general or in a special interest. And here again the result attainable should be expressed in terms of money to allow of direct comparison with the cost of the intervention and with the useful result it may secure in different times and in different places.

But how is it possible to estimate in terms of money the result of the attainment of an end? To settle a dispute between consumers and producers or between the owners of various factors of production; to modify the existing distribution of incomes; to develop the resources of the national territory by carrying out public works; all these are results of interventions which do not lend themselves to rapid estimates, especially in terms of money. Moreover, what standard should we use in valuing the consequences of an intervention favourable to individuals or to groups? Still greater is the risk run of over or under estimation in planning State interventions when an effort is made to estimate their value in terms of money; and the error is likely to be greater when the person planning the intervention interprets and translates into terms of money the consequences of such action taken in the interests of certain individuals or groups.

But, in any case, the recognition of these difficulties, serious as they may be, is no reason for desisting from the attempt to ascertain *all* the consequences of each intervention by the State or other public body so as to obtain, by means of an analysis conducted on lines of increasing thoroughness, as close an idea as possible of its *cost* and *utility*.

11. — Consequences of interventions which have not in view economic expediency.

We have already noted that, in conformity with the principle of economic expediency, private activities destroy present goods with the prospect of reconstituting them in larger quantities. Should this prospect not be realised, the individual concerned will suffer a loss. No less than the action of individuals, that of the State destroys present goods, but as such action is not always governed by the consideration of the possibility of reconstituting present goods in the future, State intervention may destroy them without the certainty of replacing them, at least in like measure. The loss may be only partial and in this case it will be felt by the whole community. Or the goods may be replaced in like measure in which case there will be no loss, or they may be replaced on a larger scale.

It would be vain to disguise the fact that the complex realities of modern life have led to a confirmed habit of calling for State intervention on a large scale. This habit may perhaps be countered by the prevalence of other tendencies, but one should not illude oneself as to the possible effects of such compensatory factors.

Consequently, should the number of State interventions increase, and should their *cost* — whether accurately measured in terms of money or not — exceed any reasonable estimate of the value of their *result*, the serious loss the community might suffer must necessarily claim the attention of students and statesmen.

When, conditions being equal — *i. e.*, leaving out of consideration factors which, developing in the course of time, may offset or conceal the aforesaid loss, such as growth of population, increase in the productive efficiency of certain factors in combination with others, the more plentiful supply of credit, a reduction in the habit of saving — the flow of consumption goods — that is to say the total real income of the community — tends to decline, and with it the store of capital goods and the accumulation of capital; State intervention will necessarily, in the course of time, be led back to respect the principle of economic expediency and will therefore be limited, at least for the most part, to those interventions which allow of a *favourable* comparison between costs and results. Otherwise the prosperity of the community must suffer a regression or at best will not develop to the extent which existing conditions would allow.

Unless the sum total of the useful results of all the interventions — of those in which the comparison between costs and results is favourable

and of those in which it is unfavourable — exceed the sum total of costs met by the community to such an extent as to offset the destruction of present goods caused by those interventions in which the said comparison is unfavourable ; unless, in other words, the action of the State, considered as a whole, — action mainly instrumental for the production of consumption goods by private enterprise — becomes so efficient as to cover the losses incurred for all the other interventions entailing a cost in excess of any reasonable estimate of the value of the results attained ; unless these conditions are realised, it would seem desirable that State action should be contained within those limits which favour the production and development of total real income, or which at least do not hinder this production over considerable periods of time.

12. — Other uncovered costs of public planning.

Viewed from an economic standpoint, the conditions under which the State operates are less favourable than those under which individuals — consumers and producers — act, guided by plans the formation of which is coming more and more into general use. This inferiority of the State, proclaimed on many sides, would seem to be due in the first place to the fact that those who plan State interventions are not guided strictly by the principle of economic expediency, and do not take into consideration those factors of marginal values, discount of future events, insurance against risks, adherence to real market conditions, which are at the basis of all consumer and producer plans.

Objective and subjective difficulties hinder their consideration. Such, for instance, is the objective difficulty of calculating the risk entailed by such social phenomena as strikes or locks-out, the proportions of which are unknown when a State plan affecting private productive activities is drawn up ; such, for instance, is the objective difficulty of calculating insurance against the risk that national receipts and expenditure may not correspond to the budget estimates. Moreover, people think that if the Government makes a mistake it can always cover it by having recourse to taxation or loans ; it matters little whether these measures will make conditions worse. Subjective difficulties are, for instance, those encountered in comparing the “marginal utility” of the various actions undertaken to meet the ends the State has in view, such as heavier armaments, the stricter administration of justice, the acquisition of supplies to be secured

at a distant date, or the extension of public works for developing natural resources.

In the second place, the inferiority of State action would seem to be due to the fact that the interventions it is called on to make are many, and it may well be that they will clash with one another, thus mutually neutralising their useful results.

In such cases a new cause of uncovered costs related to the useful result of each intervention, arises and this affords a further reason for replacing the principle of economic expediency by that of substitution in the case of State action which, in securing the ends it has in view, encounters obstacles arising from the development of other State or private activities.

Thus, for instance, in the fiscal field, it is inconsistent to exempt incomes below a certain minimum level from direct taxation while at the same time levying heavy duties on staple commodities. In the field of agriculture, for instance, it is inconsistent to wish to generalise sufficient, and therefore less expensive nutrition for all, while at the same time protecting producer interests by high import duties.

13. — Notion of State planning: its function is to assist and never to hinder the formation and growth of total real income.

Hence arises the need that each intervention should be based, as far as possible, not only on a favourable comparison between costs and useful results, but should also take care to avoid neutralising in any way other interventions already taken or planned which represent, in substance, attempts to secure other ends the State has in view. Hence the need that, in wide fields of national activity, interventions which are inter-related should only be undertaken after carefully analysing all their possible consequences, after eliminating possible inconsistencies, after preparing State plans which as far as possible are guided by those same considerations of marginal values, discounting future events, insuring against risks, adherence to real market conditions, which guide private activities regulated by producer or consumer plans.

Therefore the term "planning" by public bodies, and above all by the State, implies not so much the selection of a wide field of action, not so much the preparation of vast schemes of work and the execution of large-scale productive activities, but rather the consideration of interventions whose more or less gradual realisation is projected by the planner

into the future, so that he may examine all the consequences to which they may give rise and take measures to protect them against circumstances which may endanger the results achieved, and to promote all circumstances which may favour them.

The "plan" of a public body may be limited to the consideration of one single intervention of which it is possible to estimate the cost and the useful result with some approximation to truth. But more often a "plan" coordinates several interventions which, on the basis in each case of a favourable comparison between costs and useful results, are directed in their turn to secure either one or more ends. In the latter case, a public plan should be characterised by the care taken to avoid the pursuit of conflicting aims. It thus becomes apparent that the purpose of planning is to provide an instrument of which statesmen, in the exercise of their higher faculties, may avail themselves at the time when the several purposes the community has in view are being attained to favour the growth of total real income, savings, and national wealth, *i. e.*, to favour the growth of national prosperity. A public plan achieves this by eliminating any inconsistencies firstly between the several public interventions considered; secondly, between State interventions and the plans of private producers and consumers which trust not to be wrecked by State action, and finally between the several consumer and producer plans themselves by promoting as far as possible harmonious relations between them.

It must indeed be admitted that modern life, which calls for many interventions, ends by demanding of those who make public plans a vast number of calculations and an excessively great effort of forethought. But we must remember that many individuals now make these calculations and forecasts with admirable care. Why then should the State, actuated as it is by a laudable desire to supplement and never to injure private action, be the one to disregard the consequences of its actions, excusing itself by pleading that a thorough study has not yet been made of the cost and the useful results secured by each intervention? To say that public interventions have become too numerous, only emphasises the need of limiting them as soon as it becomes apparent that the principle of substitution is likely to emerge, with the consequent curtailment of total income and total savings which the efforts of whole generations have succeeded in raising to a certain level. The effort required to elaborate more fully the plans connected with action by the State or other public bodies should not induce us to renounce this task.

The several tendencies displayed by managed, regulated, planned, manipulated, and controlled economy, — *i. e.*, by economic planning — have not always taken care to define their purpose, nor have they always taken into account the possibility that private plans may interfere with one another, and with public plans. The promotion of enquiries for securing a fuller knowledge of all these facts means for each country an attempt to protect itself against wasting its energies, an attempt to develop to the utmost its available resources, an attempt — especially for those countries possessing abundant reserves of working power — to obtain therefrom the highest returns possible for the work of reconstruction which will be carried out to a great extent according to plans. In combination with other resources, working power is creative power. Thus it is the fundamental premise for an enduringly profitable work in the interests of peace.

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OF THE SUBJECTS CONSIDERED**

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