## CHAPTER SEVENTEEN

# INTRODUCTION

PART III will be devoted to a discussion of the ways in which economic movements may be influenced, in other words to a discussion of economic policy. We define "economic policy" as the activity of the government in the economic field. We use the term, therefore, in a somewhat more limited sense than it is sometimes used; in particular, we do not include a discussion of the economic policy of individuals, enterprises, labor unions, etc. Thus, we shall not deal with any measures of business-cycle policy that may be adopted by individual enterprises. With respect to the economic behavior of the individual subjects, we shall in general assume that no differentiation can be made between political and nonpolitical motives. In the activity of the government, on the other hand, a distinction can be made between its normal objectives and the corrections of the consequences of individual economic activities which it wants to make. Such corrections may be necessary because (1) the government may sometimes be able to achieve what individuals cannot achieve; (2) the government may enforce a certain behavior on individuals or groups of individuals who do not know what is best for them; and (3) the government may give particular attention to the interests of the economically weak.

The ultimate objective of economic policy is the same, therefore, as that of economic activity in general but is directed toward the welfare of the community, that is, the population as a whole; the interests of the different groups are weighted against each other, and the government endeavors to achieve the general objective in a better way than the activities of the individual economic subjects could achieve it. The objective may be defined as the maximum possible welfare for the population as a whole. This concept, which cannot be discussed in full detail here, has many different aspects or components; it is a many-dimensional magnitude. For practical purposes, these aspects may be grouped into a few global aspects, the most important of which are (*a*) a maximum total production, (*b*) a satisfactory distribution of total production over the different commodities, (*c*) a satisfactory distribution of total production over the different persons, and (*d*) a satisfactory distribution of production over time.

One might indicate (*c*) and (*d*) as economic justice and economic stability, respectively. We shall give prominence in our discussions to aspects (*a*) and (*d*) because they touch most directly on the movement of the main economic variables. One of the most important elements of economic justice under (*c*), full employment, practically coincides with the first objective of a maximum volume of production.

With respect to the distribution of production over time, the following observations are pertinent. The ultimate purpose of all economic policy should be, as we have said, a situation of a maximum satisfaction of the community. It is a debatable question how the concept of maximum satisfaction of the community should be linked to that of the satisfaction of individual persons (an important problem which falls outside the scope of our treatment); but it can hardly be doubted that the satisfaction of the great majority of people would be larger if the total supply of goods and services they enjoy during the period of a cycle were distributed more equally over time. A simple example: the total satisfaction of an income of ten each year is greater than the total satisfaction of a fluctuating income which is eleven one year and nine the next. The increase in satisfaction when income goes from ten to eleven will be smaller than the decrease in satisfaction when income declines from ten to nine. For this reason a change from a stable income of ten to an alternating income of nine and eleven means a loss in total satisfaction. Only extremely adventurous natures might find in the mere fact of change a satisfaction that would outweigh the loss mentioned.

Against this argument that a stable income is preferable to a fluctuating income with the same average, the proposition has been advanced that in a stabilized economy progress would be less rapid: each boom, it is said, stimulates new inventions which lead to a rate of progress greater than that which would prevail in a society without business cycles. The weak point in this proposition is that no attention is given to the setbacks resulting from a depression. It would seem more reasonable, therefore, to take the position that the rate of progress would be as large in a stabilized society as in one which is subject to cyclical fluctuations; it is true that some new inventions may not be applied, but those are likely to be the ones which in our present society would ultimately prove to be unprofitable. We would believe, therefore, that the maintenance of the business cycle could hardly be defended on these grounds. For this reason we assume in what follows that stabilization should be considered a desirable objective of economic policy.

## OBJECTIVES, CRITERIA, AND INSTRUMENTS

These few words may have served to indicate the general direction of the ultimate objective of economic policy. As the more immediate objective of each part of that policy or of each single form of economic policy, one may indicate the change which each form is to achieve in the level or the movement of certain specific economic variables, e.g., reduction of the level of unemployment or reduction in the fluctuations of employment. According to whether the objective of a certain element of economic policy is a change in the average level, in the trend movement, or in the cyclical movement of a certain variable, we may distinguish structural policy (in the more limited sense of the word), trend policy, and cycle policy. Structural policy in the broader sense of the word may also be used to include both the structural policy in the narrower sense and the trend policy.

A distinction should be made between the objective and the criterion of economic policy. We consider as the criterion of economic policy that variable by which the execution of economic policy is guided. If, in executing a policy of public works, the policy is continued until unemployment has reached a certain level, then the level of unemployment is the criterion of the policy followed. Criterion and objective may coincide, especially if the objective is a relatively narrow one. They coincide in the case just mentioned. But the criterion may also be different from the objective; for instance, it may be more symptomatic in character. A monetary policy that has as its objective the stabilization of the business cycle may use as its criterion a certain price-index number. Generally speaking, it is desirable that criterion and objective coincide, but this is not always possible. If, as for instance in our first example, one were to consider stabilization of employment as the objective, but available unemployment statistics were incomplete and referred, say, to union members only, then it might be necessary to use these limited unemployment statistics as the criterion.

In order to define a particular form of economic policy completely, it is not sufficient to indicate the criterion; a quantitative indication of the policy to be undertaken will also be required. In other words, it is necessary to indicate with what intensity one intends to respond to a certain deviation of the actual from the desired value of the criterion. Suppose that the criterion chosen is the volume of unemployment, which it is desired to stabilize at 5 per cent, if necessary by the execution of public works. This policy is fully defined only if one indicates at the same time to what extent public works will be undertaken in a particular month at the beginning of which unemployment might, for instance, be at 6 per cent. All too frequently, economic policy is discussed without such exact indications. It need hardly be said that this does not promote the clarity of the discussion. Much, indeed, depends on whether the government responds weakly or with great intensity to a certain deviation of the criterion.

Using another expression, one might also describe a certain specific form of economic policy as a change in one of the relations (indicating a certain reaction) of the economic structure of the economy.

Next to the criterion of economic policy, we want to mention the instrument of that policy. We define the instrument as that variable which is manipulated in order to achieve the objective. In the execution of public works we consider these works as the instrument; in credit policy the volume of credit is the instrument; etc.

It will prove to be convenient in our further treatment to distinguish the different forms of economic policy from a number of other points of view, admitting at once that the exact lines of demarcation between the various categories are not always clear or simple and may require a fuller description. We shall give these descriptions later, as far as necessary.

A first distinction may be made between direct and indirect policies. We define as direct policies all those which use as their instrument the volume of production, consumption, any part of production or consumption, or an intermediate stage between production and consumption; we consider as indirect policies all those which use other instruments. In the category of indirect policies we include in particular all forms of economic policy which change one or more of the prices (in the broadest sense of that word) and thereby the incentive to produce and thus affect indirectly the volume of production. In a more theoretical sense of the word, direct policies are those which employ quantities as the instrument, rather than prices, and in particular stream and flow quantities rather than stock quantities.[1]

A second distinction is that between global and detailed policies. Detailed policies are those which require a large administrative apparatus controlling the behavior of individual enterprises. Price policy, performed by government intervention in the market as a supplier or demander, would be a global policy; but a price policy performed by the exercise of control over individual suppliers or demanders would be a detailed policy. The execution of public works is a global policy, the control of investment plans of individual enterprises a detailed policy. Clearly, a global policy is preferable to a detailed policy if the former can achieve the objective set.

A third distinction is that between incidental and systematic policies. This distinction is of importance particularly with respect to forms of economic policy that are calculated to affect the cyclical movements of economic variables. A systematic policy is a policy that leads to systematic changes in the movements, for instance, to an increase in the rate of damping of a wave movement or to the total elimination of cyclical fluctua-

1. Cf. p. 31, *supra*.

tions. We would consider as an incidental policy, on the other hand, measures against unemployment taken during a short crisis period and abandoned shortly thereafter. All sorts of measures of a transitional character also constitute incidental policies. The result of a systematic policy may be described as a permanent change in a certain relation, for instance, in a demand or supply relation in a certain market. If, for instance, the government were to accept the execution of public works as a definite policy in any depression period, followed by its withdrawal from the market in boom periods, then the demand for certain types of investment goods would depend on fluctuations in national income in a different way than before. Similarly, the institution of a legal floor under farm prices would make the movement of farm prices different from what it would have been otherwise. In these cases there is a permanent systematic change in a certain relation which is quite different from occasional government intervention by the exercise of some additional demand for certain commodities.

## MEASUREMENT OF EFFECTS

In order to determine the effects of a certain economic policy, it would be necessary, in principle, to compare the development of the economy in question under this policy with the development which would have taken place without the policy. This implies, first of all, that one cannot simply observe what has happened after the introduction of the policy and attribute it entirely to the policy. Thus, it would be inaccurate to say that the recovery in production in the United States after the introduction of the New Deal was the result of the New Deal; an appraisal of the policy would require a comparison of the recovery observed with what would have happened without the New Deal policy. Second, our statement implies that one should observe the level of economic activity not only at one moment but the whole movement during a certain period. This is of importance in particular whenever a certain policy would lead initially to a reduction of production but at a later stage to a more rapid growth of production. This might be plausible, for instance, with respect to the Russian economic policy of forced investment. Generally speaking, an increase in savings may have this effect. And it will be necessary to take into account the effects in all sectors of the economy, not only those effects which are obvious but also those which are not so readily seen. The well-known example of import duties may be quoted in this connection: the beneficial effect on the industries which are directly protected is usually easy to observe; but one should take into account also the effects on the export industries which, each perhaps in a slight degree only, but all together to a considerable extent, would be subject to the unfavorable influence of reduced imports leading via the balance of payments to reduced exports.

In practice, it is often far from easy to determine the effects of a certain economic policy because it is usually extremely difficult to state what would have happened without this policy. Sometimes, however, it is possible to have a definite opinion concerning this hypothetical development. It may happen, for instance, that measures of economic policy have not been taken in another country which is in a similar position to the country under consideration; by comparison of the economic development in the two countries certain conclusions may be drawn. Thus, in the period 1924–26 Denmark and Norway appreciated their currencies greatly, while Sweden and the Netherlands did not follow this policy. The currency of Belgium was depreciated in 1935 but not those of the Netherlands and France.[2]

Second, it is sometimes possible to draw conclusions concerning the effect of certain forms of economic policy when similar situations have occurred in the history of the country itself. Thus it might be possible to compare events in or after the first and the second world wars. Or one might make a comparison of what has happened in successive depressions or in successive ascending or descending branches of the "long waves" or in corresponding seasons.

Finally, it may actually be possible to calculate what would have happened without certain measures of economic policy. In order to do this, it will be necessary to know accurately and quantitatively the way in which the economic mechanism (or, if one prefers, the economic organism) operates. In other words,

2. See p. 86, *supra*.

all coefficients (elasticities, etc.) have to be known. Thus, for instance, in order to compute the effects of the restriction measures in the international tin market, one would want to know how production would respond to prices, costs, and productive capacity "in normal times," that is to say, without a restriction policy; this would permit an estimate of the volume of production without these restrictions. It would further be necessary to know how demand depends on the international business cycle, the price, and, possibly, certain other factors, as well as on the development of stocks under the influence of prices and other factors, in order to compute the hypothetical development of prices and stocks. It may sometimes be possible to come to a conclusion as to the effect of a certain economic policy, along these lines. The method indicated, scientifically the most desirable one, has been applied to the example just quoted[3] and also to the measurement of the effects of the agricultural policy of the American government after 1933.[4]

Only after ascertaining the effects of various economic policies will it be possible to formulate a comparative judgment regarding these policies and hence to decide which are the more desirable.

In the chapters that follow we shall discuss only those elements of economic policy which aim at changing the movements of economic variables. Accordingly, we shall primarily discuss business-cycle policy and trend policy. As has been said, we shall not deal with the policies of the individual enterprise or (with a few important exceptions closely related to our subject) with structural policy in the more limited sense of the word, policy whose objective is to change the equilibrium level.

Before we start the discussion of the various types of measures of economic policy, it will be necessary to elaborate somewhat further the objectives of economic policy (chap. xviii).

We shall divide our discussions of cycle policy further into a treatment of indirect policies (chaps. xix and xx) and one of di-

3. M. J. Schut, *Tinrestrictie en Tinprijs* (Haarlem, 1940).

4. U.S. Department of Agriculture, *Agricultural Adjustment 1937–38* (Washington, D.C., 1939), chap. v; Geoffrey S. Shepherd, *Agricultural Price Control* (Ames, Iowa), 1945.

rect policies (chaps. xxi and xxii). As to the indirect policies, we devote an entire chapter to the most important among them, namely, tax policies (chap. xix). Other forms of indirect policy (interest policy, wage policy, price and exchange-rate policy) are discussed in chapter xx. Among the direct policies, the expenditure policies of the government are again dealt with in a separate chapter because of their eminent importance (chap. xxi).

With respect to each form of economic policy we first give a description and justification and then analyze the effects of the policy. This analysis is followed by a discussion of practical experience with that policy, in so far as such experience is available and has been studied. In our final chapter (chap. xxiii) we shall endeavor to draw some general conclusions.