CHAPTER 6

REFORMS: CHANGES IN FOUNDATIONS

6.1. Reforms

6.11 We defined reforms as changes in the more fundamental features of social organization: those affecting spiritual aspects of society and essential relations between individuals. The changes we call qualitative policy are more superficial: quantitative restrictions, changes in taxes or in pricing schemes, changes in the organization of marketing, and even international integration, have no immediate importance for spiritual values such as the access to education or the change in conditions of employees by social security schemes or institutions of industrial democracy. Nor do these more superficial changes affect the essential relations between men, such as the relation of employee to employer, or the relation between citizen and government official. The changes to be discussed in this chapter do all affect spiritual values and essential relations to a greater or lesser extent. They are all somewhat concerned with attempts to eliminate fears that have governed the outlook and the attitudes of millions of people for long periods: fears of want, fears of lack of freedom; fears which have led to tensions and to opposition which cannot lead to an attractive pattern of social organization. In the minds of very many, these tensions have centered around the feeling of social injustice, a concept so far scarcely used in official welfare economics but, however vague it be, very important for the understanding of social policy. This feeling is a corollary of the fact that people's happiness is not only determined by the absolute level of their own physical situation, but also by the relative level in comparison to other individuals, a fact gradually recognized by economists but not yet given its full place in welfare economics.

6.12 The reforms to be discussed should be seen as attempts to
weakens the social tensions existing in most economies. These reforms very often have both quantitative and qualitative aspects, and their aims are to be found equally in the quantitative as well as the qualitative elements of welfare. Social security schemes, for example, affect the quantitative distribution of income but, at the same time, also affect the degree of freedom of individuals and the feeling of social justice. Much the same is true of improved access to education, of industrial democracy and of nationalization. All of these and various other proposed reforms should be considered as experiments—actual and theoretical—for approaching, by trial and error, a more satisfactory social organization. "More satisfactory" either in the sense of increasing welfare as seen by large numbers of citizens and as seen by a number of policy-makers—mostly the representatives of these citizens—or in the sense of some more objective criterion still to be discovered. The problem before us is, in its widest version, thus the central problem of long-run economic policy, the problem, par excellence, of welfare economics. As already stated in Chapter 1, economic analysis is able, in principle, to make various contributions to the solution of this central problem. It may judge the degree of inconsistency in the set of aims and means proposed by certain politicians or political groups. It may also indicate the optimum policy for attaining given aims. And it may make fresh suggestions as to aims, based on the consistency analysis. Some attempts in each of these directions will be made in this chapter. For reasons to be set out below, these attempts will have to be very modest, however.

6.13 The economist needs, in order to make the contributions just mentioned, a large number of behavioural data. In order to determine the consequences of certain reforms he needs to know how people will react, not only to the quantitative changes involved, but also to the qualitative changes. This knowledge has to be taken from experience or from inquiries about expected behaviour; both sources of information are scarce, however. They will be replaced, to some extent, by deduction which, unfortunately, is a less reliable source. It will be clear that this state of affairs is a considerable handicap to economic analysis in making the contribution that it can to this important subject. Nothing more than rather sketchy (and in many respects subjective) contribu-
tions can therefore be expected. The author has tried to round off in a more or less harmonious picture the elements of contributions derived from discussions in which he participated and from experiences known to him.

As previously announced in § 5.1, the method to be followed in this chapter will be the analytical rather than the synthetic method followed in Chapters 3 and 4. The reforms selected will be discussed one by one and a provisional appraisal will be given. In a final section an attempt is made to test the consistency of certain policies, to indicate an optimum policy and to make some suggestions as to aims.

6.2. Social Security Schemes

6.21 The essential feature of social security schemes is that part of the national income is distributed to categories of citizens who have not contributed to the productive effort made during the time period considered. Benefits are being paid to the sick, the unemployed, to old people, and so on. These benefits are financed out of contributions made by the other groups, either by premiums paid by employers and employees or by government contributions themselves collected out of indirect or out of direct taxes. They may also be financed partly out of "funds", meaning that they are again financed out of contributions to such funds, or out of interest collected. Interest itself will as a rule be obtained from government securities and then is financed out of general public revenue; or it may be obtained on mortgage loans or private bonds and then also originates, in one way or another, from the general production process, as part of overhead cost. The questions to be considered are, which are the consequences of the imposition of such schemes and how far should they be extented?

6.22 Of course, the outstanding consequence which needs first mention is the improvement in the situation of many of the "handicapped" mentioned above. As a rule, they will not be able to take care of themselves, even if they try to do so by saving in more fortunate periods or circumstances; and it should be borne in mind that the distribution of these handicaps over different groups is very unequal. Some might, therefore, have taken care of themselves, others definitely not. The elimination of much fear and risk of this kind not only makes a direct
contribution to material welfare of those concerned, but also an indirect contribution to welfare in that it may favourably affect people's attitude towards the society in which they are living.

6.23 On the other hand, there will be consequences for those who are paying. They will receive a smaller income, implying, among other things, that the relation between effort and income will be a weaker one than would be the case without social insurance. Both aspects, a redistribution of income and a redistribution of stimuli to produce, are important for an appraisal of social insurance schemes.

In order to appraise the redistribution involved we need to know from whose income the contributions are made. It would be an error to assume that those who formally pay the contribution also pay it in fact. In order to determine the true contributors we have to ask ourselves, what would incomes be without the insurance scheme. In fact, the introduction of such a scheme produces shifts in incomes which will be more important the longer the time period that has elapsed since the initiation of the scheme.

Immediately after introducing the scheme, the formal contributors will coincide with the true ones. But soon there will be shifts. A distinction should be made between (i) contributions, to be called "premiums", which are proportional to the wage rate paid, (ii) contributions to be paid out of profit taxes and (iii) contributions to be paid out of general public revenue.

6.24 Premiums will directly affect marginal costs whereas the other types of contributions will only do so indirectly. Premiums will therefore affect prices; to what extent, depends on the elasticities of demand and supply. If prices are increased by the full amount of the premium, it is the consumer who, at that stage of development, pays the contribution. If prices are only increased by a small portion of the premium, it is the producer who pays. Since consumers are, at the same time, either employees or employers, it will be clear that these two groups will, in an unknown proportion to each other, be the true contributors. This part of the analysis holds as long as no new wage negotiations occur. When such negotiations enter the picture, the burden may be shifted again. There is a general argument in favour of the idea that most of the burden of premiums will, in the long run,
rest on the employees. The argument is that the subject negotiated in this bargain, and finally determined by the market and power position of the two parties, is the total amount to be paid to the marginal worker; this total amount includes direct (disposable) wage rate as well as premiums and other proportional additions. If a higher premium is established by legal provisions this can only mean, therefore, that the direct wage rate will be lowered. It is only to the extent that the market and power position are themselves influenced by the insurance scheme that this argument does not apply.

6.25 A different conclusion applies in the case of contributions made out of taxes on profits. These do not directly influence marginal cost, since the marginal producer is not affected. It is only to the extent that the changed position of intra-marginal employers or taxpayers affects income requirements of marginal employers that marginal costs are affected. Prices are therefore virtually unaffected and, in this stage, employers and taxpayers are the true contributors. Since, in possible wage negotiations, the payment made to the marginal wage earner is not affected either, the conclusion is that the present type of contributions is paid by the intra-marginal employer and the taxpayer.

6.26 Contributions made out of general public revenue will be of an intermediate type, the exact nature depending on how revenue is increased. If it is increased by an increase in profit or income taxes, more or less the same conclusions apply as in the case of contributions made out of profit taxes. If public revenue is increased by an increase in indirect taxes, the effects will be about the same as for premiums: marginal cost will be affected.

6.27 The redistribution of income caused by an insurance scheme therefore boils down to a redistribution of labour income only in the case of premiums and of financing out of indirect taxes; in the other cases it is a redistribution between labour and non-labour income. In the former case, stimuli to workers’ productivity will be somewhat lowered and in the latter cases stimuli to employers’ productivity and to capital formation may be involved. Our knowledge concerning these matters is restricted, and it would be difficult to draw clear-cut conclusions. The present author feels that certain handicapped groups
are still neglected, even in Western European countries, and that some expansion of social insurance in these directions is justified (old age pensions, widows’ and orphans’ benefits). Some of the usual types of social insurance (sickness, unemployment, accidents) are, in his opinion, at their optimum levels and caution is called for with regard to their expansion. In many other countries much remains to be done in this field, however.

6.3. Minimum Incomes; Guaranteed Minimum Employment

6.31 Various other proposals have been made to reduce the feeling of social insecurity caused by low wages, unemployment and the other risks of life. They have in common that some “bottom” is provided for, either as to income or as to the opportunity to earn an income.

A well-known first proposal, already carried through in a number of countries, is the institution of minimum wages for a number of low-wage occupations. They may be compared to price regulations; and in principle they have the same consequences, namely to disturb the equilibrium between demand and supply unless further measures are taken. If the wage rates of the lowest-wage jobs are regulated, that is, fixed at a level above their equilibrium level, demand will decline somewhat and supply increase. At the same time demand for and supply of jobs in the “neighbourhood” (i.e. slightly better paid jobs) will be affected in the opposite way and hence tend to raise wages there also. Minimum wages will therefore support the lower part of the wage structure as a whole: but, at the same time, they will create some unemployment. As long as minimum wages apply to a small portion of the labour market they will not do much harm of the latter type and therefore probably cause more good than bad effects. They cannot, however, be applied to large portions of the labour market without causing considerable unemployment. Other, and more complicated measures will be required if a general increase in wages in the low-wage sectors is aimed at (cf. § 6.4).

6.32 A second proposal of this type refers to the establishment of a “basic income” to certain groups of the population especially exposed to risks of poverty. Such a basic income should not necessarily be a sufficient income, but it might be a contribution to it, to be supple-
mented by other incomes dependent on the individual's activity or savings, or on other provisions of a less general character. A good example is offered by the Dutch proposal to establish an old age pension to everybody who reaches the age of 65; the level of the pension being about $400 for a married couple. Groups other than the old might be treated similarly, for example, certain sick or disabled. The proposals are not very different from social insurance proposals; but the link between contributors and recipients is a looser one. Economically speaking, the proposals are the same; and, in accordance with our analysis of § 6.2, the conclusion might be that such measures are to be recommended if they refer to recipients who otherwise would be very badly off in comparison with other groups of the population. At the same time it will be clear that a basic income of any importance (say 50% of normal wages), and given to an important part of the population, would meet with unsurmountable difficulties of the kind set out in § 6.27: stimuli to productivity and saving would be reduced to an appreciable extent.

6.33 Proposals have also been made to create a guarantee to a certain minimum employment. They are, in principle, equivalent to creating a "right to employment". Such proposals are related to the ideas incorporated in the "ateliers nationaux" a century ago in Paris. The necessary corollary would be either the creation of an obligation for employers to engage a certain number of workers, or the creation of government plants with such an obligation. The difficulties involved are serious: the volume of employment required would probably vary, making it difficult to organize production in an efficient way. In addition, the quality and the qualifications of the workers offering themselves would probably vary considerably and not necessarily fit the requirements. A modern production process has to be so complicated in order to be efficient that considerable freedom has to be left to its organizers. If the requirement of efficiency were neglected only poor wages could be paid which was probably not the intention of those who made the proposal. The author's conclusion is that in matters of employment a policy of high and stable employment as discussed in Chapters 3 and 4 is all that can be done; something, to be sure, of the utmost importance. The nature of the modern production process,
however, makes it difficult to impose—except for short periods of emergency—on its organizers an obligation to engage workers.

6.4. Equalization of Opportunities

6.41 The reforms so far discussed have all been proposed as a reaction to the widespread feelings, already referred to in § 6.1, that the distribution of individual welfare in the nineteenth century was very unsatisfactory and that many in the low-income groups suffered badly as a result of their economic handicaps. Various well-known theories have been put forward to prove that the distribution of income was largely a question of power and that once power was attained by the suppressed groups, incomes could be made more equal, so to speak, "by decree". Experience since has shown (cf. § 7.6), and theory explained, why this is so much less simple than it seems to many at first sight. Income distribution cannot easily be detached from a complicated and refined system of stimuli to production which are vital to present-day economies. The theory of income distribution has been, it is true, a neglected part of economic science; but many elements are present. The author believes that they could and should be integrated into another "econometric model" outlined in model 08 (cf. Appendix 3). The essence of the mechanism of income formation is to be found in the supply of jobs offered by the organizers of production and depends, in a large degree, on the capital available, the state of technology and that of organization. This supply may be regarded as a long list of numbers of people wanted to fill the jobs created, each job characterized by a number of "required qualifications". On the other hand there is the demand on the part of citizens, for jobs, which, in their turn, may be characterized by the qualifications actually present. These qualifications should be interpreted in a wide sense, so as to include not only physical and mental characteristics, but also the individuals' wealth, their family size and other factors influencing their willingness to accept a certain job. Income formation has the economic function to fit supply and demand. If, for certain difficult jobs, there are few persons willing to accept, incomes connected with those jobs will have to rise in order to attract them; this is the only way if freedom of occupation is required. Incomes may be said, in this
sense, to be the expression of the tension between supply and demand. And if we want to equalize incomes we will have to influence the factors behind them so as to change supply or demand without disturbing their balance. One of the most promising approaches then seems to be—our knowledge on these matters unfortunately is very restricted—to increase the possibilities for those who want more training and education, of being educated or trained according to their abilities. The problems connected with this well-known device of equalization of opportunities are presented in schematic form in problem 081.

6.42 PROBLEM 081. MODEL 08.

Aims: the general aims, described in Chapter 1. These may be symbolized by a welfare function

\[
\Omega\left(\frac{P}{M}, \sigma_{\log 1}, \ldots; \gamma, L_1, \varphi \ldots\right)
\]

where

- \(P/M\) is production per head,
- \(\sigma_{\log 1}\) a measure for income inequality,
- \(\gamma\) the rate of taxation,
- \(L_1\) the piece rate coefficient in general wage policy,
- \(\varphi\) the family allowance level. For more detailed definitions model 08 should be consulted.

Means: the instruments of policy have already been included in the list of arguments of the welfare function. The tax rate is intended to finance education and thereby to influence the average degrees \(t_4\) of "changeable" properties; the rate \(L_1\) is intended to influence the intensity of work \(t_4\), whereas \(\varphi\) represents a redistribution device in favour of "handicapped". Comments: The intention of model 08 and problem 081 is to present a clear-cut and therefore precise treatment of some of the problems of influencing the income distribution. A more general and therefore necessarily more vague treatment will be given in the general text. The numerous simplifications introduced into model 08, which are, in many respects, artificial, are necessary to obtain a model that can be used for explicit calculations about the income distribution. Even then, the full treatment of our policy problem cannot be given in an explicit way. All this is illustrative of the complicated nature of these problems. An additional feature is that very little is known about many of the coefficients of the functions that play an integral part in the process, including the coefficients of the welfare function.

We will assume e.g. that \(\sigma_{\log 1}\) has a negative coefficient, meaning that
an equalization of income distribution will be appreciated; but this may not be so in certain economies. The velocity with which the average degree of changeable properties can be increased, if a given amount is spent on education, is not known either, and is illustrative of further difficulties.

From formulae (19) and (20) of model 08 some conclusions can nevertheless be drawn.

1. An increase in \( t_i \) without a change in \( r_1 \) will raise \( \frac{M}{P} \) without changing \( \sigma_{\log 1} \) and hence increase \( \Omega \). We should be careful, however, not to overlook two points. An increase in \( t_i \), while raising production also raises disutility as represented by \( \varphi \) in formula (2). It is not, therefore, correct, to conclude that every increase in \( t_i \) is an advantage. We will not go into the details; they could be dealt with on the basis of our assumptions. The other point is that piece rates should reflect the real increase in product obtained by an increase in \( t_i \); i.e., the most natural form for piece rates to take would be \( l(t_i) = \hat{P}(t_i) \).

2. Increases in \( h_i \), the average degree of properties \( i \) present with the population will both increase \( P \) and decrease \( \sigma_{\log 1} \); and hence increase \( \Omega \). The reasons are that an improvement in average skill will increase production of the individual and at the same time make it less necessary to have wage differentials between less skilled and more skilled jobs.

3. While increases in \( \varphi \) do not influence total production, they do influence distribution. It might seem that \( \varphi = 0 \) would correspond to the smallest dispersion in incomes, but this would only be true for the dispersion in family income, not for income per head. The best measure for distribution evidently would be the dispersion in satisfaction \( \omega \); leaving apart the other factors influencing \( \omega \) we have, according to (1) and (10):

\[
\omega = \log t_0 - \log t_0 + \varphi (\log t_0 - \log t_0) \ldots \\
= (\varphi - 1) (\log t_0 - \log t_0) \ldots
\]

This component of the dispersion of incomes will therefore be least for \( \varphi = 1 \), i.e., for family allowances just covering the disutility of the size of the family.

Having thus considered the simplified model we will now summarize and at the same time generalize our argument without the use of formulae.

6.43 Starting again from the interpretation of incomes as the expression of the tensions between supply of jobs and demand for them, we have to ask whether we can influence the supply or demand factors, or both, with a view to allowing supply and demand to approach each
other. Generally speaking there appears to be a relative scarcity of qualified people; relative in comparison to what is required by the organizers of production. It would not be very attractive, even if possible, to clamp down on the requirements, since our general level of well-being is directly connected with the capital-intensity of production and the technology used. The better approach therefore seems to be to change people's qualifications. There is scope for making a distinction here between qualifications that can be changed and qualifications that cannot be changed at all; and between those that can be changed easily or rapidly, and those that can be changed only slowly. A good example of an easily changeable qualification is a man's speed of work which can be influenced by such simple devices as the introduction of piece rates. Training and general education are lengthier processes that may change some of his more fundamental qualifications; and some of these, say innate intuition, may hardly be changed at all, or only be changed from one generation to the other. Our problem then becomes: is it possible to find modes of changing some of the qualifications of the population in such a way as to maximize general welfare? The problem can only be solved if (i) general welfare is specified and (ii) if a large number of data are available, exemplified by the data in our simplified model. If we take general welfare to depend positively on the two broad aims, size of national income on the one hand and the degree of equality in income distribution on the other, we will find that some means of economic policy will affect one of the aims positively but affect the other negatively. This applies, for example, to changes in income or inheritance tax. Increases in these taxes, or increases in the progression of their rates, will increase equality but may damage productivity as well as the rate of investment. A number of "social measures", as previously discussed (§§ 6.2 and 6.3), have the same consequences. As long as we do not know the relative weight given to the two aims and the relative effect of these means on the two aims, it will be difficult to indicate where the optimum level of the intensities of the means is to be found. Measures, however, which lead to improved education and training, will have a tendency to further both aims at the same time. Increased supplies of qualified workers, in all ranges, will tend to increase productivity as well as equality. Again, it will depend on many more
numerical data which of the many conceivable measures of education and training will be the most attractive, and in what intensity they should be applied. Extensive research programs may have to be developed in order to answer these important questions.

6.5. Monetary Reforms

6.51 Among those proposals for changing the social structure which have been launched and discussed in the past century, monetary reforms form a separate class. Many social and economic philosophers have looked at our monetary system as the root of many evils. The quality of the philosophies, as well as of the proposed reforms, has varied widely. They range from the superficial and naive to penetrating and practical theories and proposals. Some of the superficial proposals either fail to look behind the outer form of social phenomena or neglect some fundamental psychological truth. Those who hold money responsible for the large power that one group of society can exert over other groups and hence want to “do away with money” seem to confuse the outer form of wealth with its deeper causes. Those who, in other proposals, wish to abolish bank secrecy and to concentrate all transactions in one centralized administration seem to underestimate the significance of that secrecy.

6.52 Among the less radical and ambitious proposals are several more promising ones. The sponsors of these proposals seem to have understood well that money, although only an auxiliary instrument of economic activity, occupies a strategic place in the organization of the economy and may be the medium of important policies provided that its character is not changed too much. In fact, during the last century, a number of changes have already been made and have been proved to work well. We still do consider changes in the monetary system as “reforms” since the features of the monetary system are felt, by many citizens, to be fundamental. Often these reforms were changes in the relation between the circulating medium and its “cover”. The introduction of paper money and of bank debits, implying a loosening of the tie between medium and cover have been an important means of enlarging circulation and simplifying its technique. No doubt
they have also led to abuse in isolated cases, but nobody would advocate their elimination in order to prevent these abuses. The suggestion of requiring a 100% gold cover ("100% money") has been made in order to avoid excessive expansion of monetary circulation. The same effect may be obtained by a wise monetary policy as discussed in previous chapters and the 100% money proposal would seem to be too rigid.

6.53 In fact, the necessary improvement should not be looked for in such a rigid quantitative tie between circulation and the existing traditional reserve material. A more promising approach would seem to be contained in the proposed "raw material standard", where the nature of the reserve material would be changed. Instead of only gold, a combination of gold and a certain raw material "cocktail" would be accepted as legal cover. The cocktail should have a fixed composition, which might be gradually changed according to the changing significance of certain raw materials. A unit would consist of a given quantity of wheat, another quantity of rye, given quantities of barley, corn, rice, steel, copper, lead, zinc, and so on. Such units should be bought and sold by the Central Bank at fixed prices, the selling price some 5 or 10% higher than the purchasing price, which would have the effect of virtually stabilizing a certain average price of raw materials. The stabilization would be subject to certain conditions, to be sure: it would not work when the demand for some of the raw materials was so large as to deprive the Central Bank of its entire stock. Such a situation would call for some of the other means of restricting demand. Generally the establishment of a raw material standard would not imply that other means of economic policy, and particularly of stabilization policy, would be excluded.

The effect of a stabilization of raw material prices may now be considered with the aid of our simplified model 10.

6.54 PROBLEM 102. MODEL 10.
Aim: stabilization of general cycle
Means: stabilization of raw material price level
Comments: As in problem 101, § 5.32, the effect of this structural change will be studied by comparing cyclical movements that would occur without this change with those to be expected in its presence. The method has in
fact been demonstrated already in section 5.32, where we found that the movements of national expenditure $X_t$ in the absence of changes in data, will be determined by equation (5322). The resulting movements appeared to be the well-known cumulative movements characteristic of both the upturn and the recession in business cycles.

The change that will be introduced by the raw material standard consists of a considerable reduction in the coefficient $\pi$, indicating the change in general price level caused by a unit change in national expenditure. The reduction will be considerable since most of the price changes in finished products are due to changes in raw material prices, which are far the most flexible component. Assuming that $\pi$ will be reduced to one tenth of its original value, i.e. to 0.05, equation (5322) now becomes:

$$X_{t+1} = X_t + 0.08 (X_t - X_{t-1})$$  \hspace{1cm} (6541)

This equation expresses that a rise in $X$ between $t - 1$ and $t$ will be almost stopped the next time unit, when the further rise will only be 0.08 times as large. This comes to saying that incidental movements in national expenditure, caused by changes in data, will almost immediately be “nipped in the bud”: a perfect method of stabilizing cyclical movements. The main reason, evidently, is that a stabilization of raw material prices will considerably reduce the occurrence of any paper profits, which, according to several writers, played an important part in historical business cycles.

6.55 It should be added that our model 10 somewhat overstates this phenomenon perhaps; and that problem 102, therefore, may also overstate the importance of stable raw material prices for the general cycle. This latter may be considerably damped down by other measures also, in particular by compensatory public expenditures in leading countries. The question arises whether the raw material standard is not superfluous.

The best answer to this question would seem to refer to two principles: the technological principle of two- or threefold security and the principle, recommended for economic policy (cf. § 4.2), of “distributing pressure”. Put more directly, it would seem wise to have a separate and direct regulator in the sector of raw material prices because of the vital importance of these prices to a number of under-developed countries. Such a regulator would eliminate one source of instability which continuously threatens these economies and makes the difficult problem of their monetary policy still more difficult.

The necessity of introducing some such direct regulator has been stressed by large numbers of experts and several other forms have been advocated
which, from an economic point of view, are far less attractive. The best known proposals are those on commodity agreements. These are meant to regulate individual prices by contracting minimum and maximum prices. It is evident that they can only work if supply is regulated in order to smooth out excessively violent fluctuations. The regulation of the supplies of a number of individual raw materials is, however, a far more cumbersome affair than anything like a raw material standard, where only the average or total supply is regulated by the purchases or sales of units by the Central Bank. The decision as to which of the two types of regulation should be chosen should not be made by authorities with a vested interest counter to the introduction of the raw material standard, but by authorities who must compare the troubles involved with the alternative troubles of establishing and maintaining a set of some twenty commodity agreements.

6.6. Centralization of Production Decisions

6.61 One of the far-reaching reforms that have been applied by the communists may be formulated as centralization of production decisions. An often used phrase is “planning” in its widest sense, including both the preparatory calculations about the most desirable levels of production and the decisions themselves, with control of their execution. The reform means that such planning should not be applied in a decentralized way of planning firm by firm, but in a completely centralized way, as it is done in the communist countries. The figures computed should be based on the “real needs” of the economy, defined in some way or another, and not to be left to the “anarchy” of the individualistic system of production.

6.62 What could no doubt be avoided would be typical “over-production”, that is a volume of production larger than can be sold at reasonable prices. Such over-production may occur and has occurred as a consequence of a lack of co-ordination between producers in those industries where the process of production either takes a long time or the outcome of the process is fluctuating. Examples of the former are all construction processes, in building as well as in metal trade (houses, other buildings, ships, machinery etc.) and some processes in the cattle industry: raising of hogs or beef cattle. The difficulty only faces those producers whose production is “for the market” and not “to order”. Indeed, the size of the market may change considerably
during the period of construction or animal raising, and one producer will not know the others' supply until the end of the process. Serious overproduction may be the consequence, as has been usual on hog raising, and it could only be avoided by centralized decisions about the volume of production. Examples of production processes with fluctuating outcomes include almost all agricultural processes and fishery; here centralization of the production decisions could not help very much but centralized selling could.

6.63 A complete centralization would mean, of course, a considerable concentration of power at the same time. The disadvantages for political and spiritual freedom are evident and are a major factor in the appraisal of the proposal.

Another disadvantage is the loss of efficiency which results. The processes involved are very complicated. The demand for a large number of products, particularly intermediate products in manufacturing industry, depends on technical factors which change continuously as a consequence of technical development. In countries with a high standard of living, further complications are created by rapid changes in the tastes of the consumers, particularly in the field of textiles, and so on. Decisions about changing production programmes will need to be very frequent, and no one decision is of great importance to the economy as a whole. There is little scope for taking these decisions in a centralized way, and, if centralization is nevertheless maintained, there will be an unavoidable loss of time and energy. The alternative is that production fails to fit demand; this is no serious problem as long as there is a shortage of most goods—but in a wealthy community this is not likely to be the case.

6.64 We met a similar problem, but on a smaller scale, when discussing quantitative restrictions (§ 5.2). We then tried to enumerate the conditions under which such restrictions are efficient. Similar conditions might be formulated as to centralized production decisions. From the preceding argument it follows that for a few industries they will be efficient, namely where market production takes places, and requires time; also trade in agricultural products may sometimes be better based on centralized decisions. Complete centralization of all decisions could only be efficient in poor communities with simple
patterns of production, and implies a danger to political and spiritual freedom. It is, moreover, scarcely necessary in industries where the period of production is short.

6.7. Industrial Democracy

6.71 By industrial democracy we will understand the participation, by workers' representatives, in discussions, and in the taking of certain decisions, in industrial life. It may take various forms; it may be practised at the enterprise level or at higher levels: those of the industry or those of economic life as a whole. It may refer to social questions only, including or excluding wage levels, or it may refer to economic questions as well. It may be chiefly in the sphere of discussions and less in that of decisions; or imply decisions to a larger extent. There may be a gradual development from one form to the other. In certain forms it already exists in various European countries, either in the form of works committees or of working parties for an industry as a whole, or, finally, because part of the board of directors is nominated by workers' organizations. In several countries trade union representatives are members of an Economic Council which advises the government on important problems of general economic policy.

6.72 The common element in all these forms of industrial democracy lies on the psychological side. The material side is much less important. Changes in the distribution of income can be brought about in much simpler ways. The social problem will not be solved, however, by mere changes of income distribution in favour of the simpler jobs. The need for self-respect and dignity is one of the basic human needs. It is continuously being suppressed in those living in the lower regions of some hierarchy unless counteracting forces are introduced. Industrial democracy is one of these counteracting forces, supplementing the regular, but often very restricted, possibilities of "climbing" on the "social ladder". Industrial democracy is probably the best way of satisfying the needs just mentioned. It is so because it has, at the same time, some natural functions to perform in a democratic society where the enterprise is gradually becoming an institution of public interest, instead of an institution to serve private interests only. The interests that an enterprise has to serve include those of consumers as
well as those of the various types of producers involved, and, among the latter, the workers are one type. The fact that capital and labour, and as may be the case, land, are all factors of production supposed to co-operate in the productive process, should find its expression in the organization. The same applies for the industry and for economic life as a whole.

6.73 This does not mean that there are not also certain dangers involved. If workers or workers' representatives were inclined to use their influence in the interest of their own group only, they might threaten the sound development of the enterprise or the industry. They might claim wages too high to be borne by the enterprise or they might undermine labour productivity. Their sense of responsibility should, of course, prevent them from doing so, and usually will. But this sense is not always sufficiently developed, especially with the "rank and file". This point illustrates very well the educational side of the institution of industrial democracy. This is not restricted to the requirements necessary for the workers; very often the owners and managers are also in need of some further education. But, as in the case of every process of education, it will need to be gradual and carefully devised.

6.8. Nationalization

6.81 The most far-reaching reforms that have been proposed, and carried through in a number of countries (but to varying degrees), are those of nationalizing certain enterprises or industries. Strictly speaking, it is in their political consequences that they have been far-reaching; it does not necessarily follow that they have also been the most far-reaching reforms in terms of their economic and social consequences. Nationalization is usually taken to mean the handing over, to a country's government, of the ownership of an enterprise, or an industry's capital or its assets. This transition may be, but need not be, accompanied by the introduction of some forms of industrial democracy (cf. § 6.7). The immediate consequences of nationalization, irrespective of its precise form, are twofold: private profits are eliminated as a source of income and the possibility is opened for a centralization of production decisions (cf. § 6.6).
The reform under discussion is one of the most controversial ones, partly because of the large vested interests involved. These interests create a possible source of bias in the opinions of the interested groups. The traditional arguments in favour of, and against, nationalization may be summarized very briefly as follows. In favour of it are the arguments that the elimination of unearned income increases social justice, and that the possible centralization of production decisions may be used to avoid over-production or, more generally, economic fluctuations. Against nationalization are put the arguments that efficiency will decline because of the elimination of direct private interest in the profits to be obtained, and that dangerous concentrations of power may result.

As previously stated at the beginning of this chapter, a scientific test of these arguments is difficult to perform because of lack of precise observations. It is true that nationalization has already been carried through in a number of countries and industries; in order to determine, however, the impact on efficiency, one should be able to make comparisons between nationalized and private situations. Comparisons between the communist and non-communist countries are very difficult because a large number of other factors in economic life also differ. The simple fact that Russia’s standard of life is lower than that of the United States does not, of course, prove anything at all. The fact that Russia’s rate of expansion is higher than that of the U.S. does not prove anything either. Both facts are characteristic of a less developed country. Much more refined comparisons would be needed, including other relevant factors as well.

Comparisons, inside western countries, of nationalized and private industries are difficult if the nationalized industries are monopolistic, which they are, almost by definition. This means that the test of competitive power cannot be applied; in addition the question may, of course, be raised whether this test can be applied at all in “a world ofopolies”.

In very few cases do nationalized enterprises compete with private ones. The Netherlands coal mining and steel industries are two cases in point. Coal mining, however, is always an industry that depends so much on geological data peculiar to each individual enterprise that comparisons are again difficult. The competition of the government-
owned Dutch steel industry in the Coal and Steel Community is again complicated by Dutch wage policy.

6.83 These circumstances do not permit any definite conclusion; if the author, nevertheless, tries to formulate some tentative appraisal, he is quite aware of the reserves that have to be kept in mind. His tentative conclusion is that there are no marked differences in efficiency. This is subject to some conditions referring to other factors which seem to be more important to efficiency, such as the quality of management and the relations between management and workers. These factors should not differ too much between the enterprises compared.

The argument of power concentration does hold, of course, to some extent, but would seem to depend on other factors as well. Nazi Germany did not nationalize industry, but its political system represented much more a dangerous concentration of power than has ever been the case with the Swedish or British Labour governments.

The force of the social justice argument has also been somewhat impaired, by the invention of numerous other means of increasing social justice, particularly direct taxation and education. In addition, there is a well-known process in development which tends to reduce the importance of the shareholders as a recipient of profit income: only small percentages of total profits are nowadays paid out to these “owners”.

In summary, it must be said that the significance of nationalization as a means of increasing welfare is less than its sponsors have thought.

6.84 This does not imply that there are not secondary arguments in favour of nationalization in specified circumstances. There are a number of basic activities which are so fundamental to a country’s existence that they will be considered a matter of direct government responsibility everywhere. These range from defence and flood control to public utilities, transportation, and, in some countries, coal and steel. The border-line between the government sector and the private sector may be chosen differently under different circumstances. It may happen that the private capital supply is insufficient to finance the investments in these capital-intensive activities. Several of these activities, in addition, can only be carried out with heavy fixed costs, implying the tendency towards monopoly. It would not be attractive
to leave such important key industries to private monopoly without control. Control may, however, require a more complicated organization than public ownership. Finally, the existence of a public sector of some size is a favourable basis for anti-cyclic policies in the field of investment.

If our analysis is correct, that is, if, on the one hand, our exact knowledge on the consequences of nationalization is restricted, whereas, on the other hand, there are some secondary arguments in its favour, all that can be recommended is to make further experiments, but carefully and gradually.

6.9. Summary and Conclusions

6.91 In the preceding chapters and sections we have discussed the various means of economic policy and their probable effects on welfare. Although we have emphasized the necessity of considering, as far as possible, economic policy as a coherent whole, we were forced to split up the discussion into a discussion of quantitative policy and one of the other types; and in the latter a further subdivision, according to the means used, was applied. The separate discussion of quantitative policy was defended by the argument that this type of policy is largely one of short-term adaptation to small current disturbances of equilibrium. The treatment, one by one, of the means of qualitative policy, and some types of reform, was defended with a reference to our lack of exact knowledge. Here the stage of analysis still cannot be concluded. Nevertheless it is necessary, in order to design these types of long-term changes, to consider them also in their mutual relations. In this section an attempt will be made to summarize the conclusions so far reached as to the probable effects of these policies.

6.92 The task which is set is a difficult one, and only a first step can be made. The subject is crowded with uncertainties. It is, moreover, almost impossible to discuss the effect of reforms in a general way, without reference to the particular situation of an individual country. The needs of one country are very different from those of other countries. The meanings of the terms used to indicate some of the most important types of reforms are vague, only; some specification will be found in the sections dealing with them. Many of them can
be applied with different intensities and, in almost all cases, "too much" will do harm. The appraisal to be attempted will apply to reasonable doses applied to the average country; in a few cases some specification as to the type of country implied will be given.

Again, the meaning of the terms used to indicate certain elements of welfare is vague. We have already discussed the need for a definition of "social justice". The term "freedom" covers a wide variety of phenomena, and one man's freedom may be another man's slavery. "Cultural development" needs only to be mentioned to remind the reader of the different interpretations which are possible.

Finally, the roles these various elements have to play in welfare and, consequently, the choice to be made with regard to the intensity with which a certain reform or structural change should be carried out, are, to a large extent, of a subjective character.

6.93 The table below should, therefore, be considered with the utmost reserve and very critically. It should only be considered as an invitation to the reader to choose this form of summarizing his own appraisal of the means of economic policy considered.

Only those influences have been indicated which, in the author's opinion, are more or less clear. Their intensity is not further specified; the influences indicated by + are, however, supposed to be more intensive than the influences to which no sign has been given. A few cases of influences which are, in the author's opinion, clearly negative have also been indicated in the table. One may wonder why the number of positive signs is so much larger than the number of negative signs. This is due to the fact that, where two opposite varieties of a same policy exist, the one has been chosen with the larger number of positive signs. Instead of integration one could, for example, have chosen decentralization of international economic policy; instead of equalization of opportunities the introduction of privileges; or instead of family planning the stimulation of population increase. The appearance of relatively many + signs is also due to the exclusion of certain measures such as "quantitative restrictions", which, in the author's opinion, would have shown mainly — signs.

6.94 The author appreciates that he is expected to draw some conclusions. While doing so he wants to repeat the reservations made in
**Table 6.9 Survey of probable effects of some reforms or minor structural changes on welfare as understood by the author.**

<table>
<thead>
<tr>
<th>Reforms or other Structural Changes</th>
<th>Production per Capita</th>
<th>Social Justice</th>
<th>Cultural Development</th>
<th>Freedom</th>
<th>Stability</th>
<th>Internat. Peace</th>
<th>Social Peace</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Economic Integration</td>
<td>+</td>
<td>+</td>
<td>-</td>
<td>+</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>International Income Transfers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Raw Material Standard</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Built-in Stabilizers</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equalization of Opportunities</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial Democracy</td>
<td>+</td>
<td>+</td>
<td></td>
<td>+</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Family Planning</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td></td>
<td>+</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social Security Schemes</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td></td>
<td>+</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nationalization</td>
<td>+</td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Centralization of Production Decisions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct Taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

+ signs denote that more or less clearly positive influences on the various elements of welfare are to be expected from the application of the structural changes listed; the — signs negative influences.

This section as well as those already made, in the sections dealing with each of the reforms or other measures separately. It is his belief that some of the reforms listed should rank high in economic policy programs, and should be pursued with more energy than is the case at present. These are international integration, the international transfer of incomes, the introduction of built-in stabilizers and the raw material standard in the international field, and the application of family planning, of industrial democracy and the equalization of opportunities, in the national field. Social security schemes as well as direct taxes are in need of expansion in a number of less developed countries;
nationalization and the centralization of production decisions are of a less general relevance; they may be useful in isolated cases. Generally speaking the need for, or feasibility of, any of the national measures mentioned will vary greatly between individual nations. In addition, some of the simpler devices from the quantitative realm are still so much needed in a number of countries that they deserve first attention.