SUMMARY

CHAPTER 1

THE CONTRIBUTION OF ECONOMIC ANALYSIS TO THE DESIGN OF ECONOMIC POLICY

1.1. Objective of this Study; (1) to describe the process of economic policy; (2) to judge the consistency of its aims and means; (3) to indicate the optimum policy for attaining given aims; (4) to make suggestions as to aims. Explanation of structure of book.

1.2. Summary Description of the Economic Process and Its Determinants

Data and economic phenomena; policy-makers; available means, and other data; foundations and structure of an economy; instruments of economic policy. Foundations referring to spiritual aspects and to qualitative relations between human beings. Examples of foundations: existence or absence of certain freedoms and rights, of certain opportunities for education, the degree of specialization and division of labour. Structure referring to the details of the organization and the quantitative aspects of an economy. Examples of elements of structure: number of social groups and institutions and their behaviour, number of goods, system of exchange (free or rationed), degree of monopolization, numbers of policy-makers. Foundations and structure, as a rule, change gradually; certain other data subject to frequent changes: crops, technical factors, "world market data". Definition and examples of instruments of economic policy: tax rates, items of public expenditure, rate of discount, reserve ratios, wage rates, rates of exchange. Variables and constants; various degrees of constancy; economic relations or equations, and models.

1.3. The Logic of Economic Policy; the Contribution of Economic Analysis to the Design of Economic Policy

Economic policy consists in the deliberate variation in means in order to attain certain aims. Such changes in means may be used to offset the effect of changes in other data. In particular, changes in instrument variables are meant to offset rapid changes in other data, which continuously tend to disturb short-term equilibrium. If these changes in other data have

undesired effects on the economy it may be desired to "cure" the "evil", and the "causes" of it may be seen in these changes in other data. The cure cannot consist, however, in reversing the change in the other data, since these latter cannot deliberately be changed. There need not therefore be any correspondence between causes and "cures", and the causes may even be irrelevant to the indication of "cures".

The economic policy of a certain area may be in the hands of one, or of several, policy-makers; to begin with the case of one policy-maker will be considered. According to the nature of means involved, policy may be "reform" (change in foundations), "qualitative policy" (change in structure) or "quantitative policy" (change only in values of instrument variables). Qualitative policy may consist of a change in the number of policy-makers themselves. Also, according to the nature of the aims, a distinction may be drawn between qualitative and quantitative policy; quantitative policy being mainly directed towards a change in the numerical values of some of the economic variables, to be called targets. Distinction between policy of fixed targets and one of flexible targets.

Necessity of considering economic policy at any moment as a coherent whole; possibility of "partition" only exceptional. "Range" of economic policy: number and nature of aims and means involved. Logic of economic policy an inversion of the logic of economic analysis. Logic simplest with quantitative policy and fixed targets: target values are given, instrument values are "unknowns". Problem with flexible targets a maximum problem: to find values of instrument variables rendering some welfare function a maximum. Qualitative policy problems usually of the "trial and error" type, i.e. optimum has to be found by trying alternative solutions. Contribution of economic analysis may be (*a*) to judge consistency of aims, and of aims and means as a combination; and (*b*) to find optimum policies where aims and means are given and consistent.

Procedure of policy-making: planning, i.e. making a forecast and considering consequences of conceivable changes in means; appraisal of possible consequences and making a choice; all this to be called "design". The final stage is that of the execution of the policy chosen. Planning of a policy has nothing to do with the particular policy sometimes called "planning", i.e. one of centralized production decisions.

1.4. Aims of Economic Policy

Policy-makers base their acts, consciously or unconsciously, on preferences, which, when consistent, may be represented by some welfare or utility concept. This welfare concept will coincide largely, but not neces-

sarily completely, with a representative individual welfare concept; it will depend on quantitative and qualitative elements that also enter into these individual utility functions; in addition, collective preferences will come in. The elements entering into the policy-maker's welfare function refer to (*a*) elements determining individual material and spiritual well-being, such as the quantity of food and shelter available, the efforts needed, the opportunities for education, the right to take part in decisions; (*b*) elements determining relations between individuals, such as (i) the degree of freedom, (ii) the frequency of conflicts (or the degree of social and international peace) and (iii) the positive elements in social relations (e.g. justice). Some of these elements will be specified later on; sometimes they assume special legal forms, at least in the short run, as e.g. the maintenance or introduction of a number of constitutional rights. For each quantitative element not only the average value, but also various "distributions", are important, as e.g. the distribution over groups of the population or the distribution over time.

Policy-makers' "social welfare functions" are often streamlined by political parties emphasizing certain "principles" of economic (and general) policy; liberals stressing freedom since they rely on the self-adjusting forces in economy, communists stressing certain aspects of equality, nationalists stressing national interest etc.

"Similarity" between various social welfare functions defined for certain variables. Similarity between individual and social welfare functions; in the latter, collective needs and adjustments for inconsistencies in individual preferences may come in (among other things, corrections against human "vices"). Should social welfare functions be derived from individual ones and can they?

Historically the aims of economic policy have been influenced by some development in general individual aims, but much more by fluctuations in what was believed to be the possibility of self-adjustment of the economy. Liberal policy believed in it to the greatest extent and this consequently reduced the range of aims of policy-makers. In recent decades this belief has fluctuated and, on the whole, diminished. According to circumstances (normal or extreme scarcity, wealthy or poor regions) a narrower or a wider range of aims is now accepted.

Aims of modern economic policy may be summarized as (*a*) maintenance of international peace; (*b*) maximum real expenditure per capita with "full" employment and monetary equilibrium; (*c*) improvement of distribution of real expenditure over social groups and countries; (*d*) emancipation of certain underprivileged groups; and (*e*) as much personal freedom as is compatible with the other aims. Qualifications as to the meaning of "maxi-

mum" real expenditure if development in time is considered; limits to human needs.

1.5. Inconsistencies in Individual and Collective Aims

Inconsistencies in the aims of economic policy will to some extent derive from inconsistencies in the aims of individuals. Aims are called inconsistent if their ultimate consequences are incompatible. They may be regarded as due to imperfections in the human mind and are most likely to occur when great distances between cause and effect are involved. Inconsistencies in individual behaviour are often to be found in decisions as to education and the creation of a family. Lack of concern for other people's well-being is another example and this is connected with the belief in the unlimited needs of man. In the collective sphere this lack of concern is reflected in the doctrine that every country should use its own resources for its own well-being only.

The most appalling inconsistencies in collective aims are those responsible for the outbreak of war. Further inconsistencies are to be found in aims relating to the size of population, to the facilities for education and to social and geographic inequality. In certain countries inconsistencies in aims with regard to development exist, leading to inflation. Foreign assistance may reduce these inconsistencies.

1.6. Some Suggestions as to Aims

Suggestions as to aims may be meant to take account of new facts or new insights, as e.g. the situation created by atomic weapons, or the insight that human needs have a ceiling.

Further suggestions concerning aims may be made in order to remove inconsistencies. On this basis more family planning and more education may be suggested as aims. In some countries more orthodox financial aims need to be suggested. Finally, suggestions may be made in order to give shape to aims so far only vaguely felt. A sharper definition of social justice would be one of the most important contributions that could be made. Such a definition depends, essentially, on the comparison of the satisfaction of different individuals. Such comparisons are declared impossible by many economists. Nevertheless they seem to be the basis for many decisions taken by family heads as well as organizers, judges, etc. Furthermore, individuals who have undergone a "transformation" such as training or a medical treatment seem to be able to make comparisons. Finally it would sometimes seem possible to determine, with the help of medical and similar standards,

the compensations needed to neutralize certain "handicaps" and by so doing to find a method of making different individuals "equally happy".

1.7. Means of Economic Policy

The means of economic policy used also affect welfare, by material and immaterial costs (sacrifices in resources or in friction and conflicts). The range of socially and politically acceptable means may be wider and narrower, and during the liberal era was narrowed down. During the great depression and in war time the range widened quickly, and narrowed down afterwards. Various political parties have pre-conceived ideas about the desirable range. Such ideas may represent side conditions to the problems of economic policy as e.g. a restriction on the type of instruments to be used (no nationalization; no price control; no increase in working hours). Choice of means should be based on their probable effects, i.e. their efficiency. It follows that a wider range of means will be needed, the more difficult is the situation. The disadvantages connected with an intensive use of certain means may impose limitations (i.e. boundary conditions) on their use (limit set to tax increases, or wage reductions). Certain sets of aims and means may appear inconsistent, i.e. that the aims cannot be attained by the means proposed or admitted. Or it may be that long-term effects are unfavourable to the aims.

CHAPTER 2

ECONOMIC MODELS

2.1. Scope of Models

To specify assumptions as to foundations and structure of economy, i.e. natural, technical and legal data and behaviour of subjects. Such specification—usually meaning strong simplification—enables the economist to give precise answers to precise questions and clarifies discussion. Applications to real situations are bound to introduce divergencies. "Micro" and "macro" models, for closed and open economies, static or dynamic. Complete description of model requires a large number of details; systematic survey of all conceivable models difficult. Important features: as to "actors" considered: (*a*) number, (*b*) nature and behaviour of their income, (*c*) spending habits, (*d*) nature and origin of wealth, (*e*) investment habits; as to "markets" considered: (*a*) number, (*b*) stock or flow character of commodity; as to

technical relations (in the widest sense, including legal): (*a*) number, (*b*) nature of phenomena involved, (*c*) mathematical shape.

Logical structure of model may show a certain "ordering", different for analytical and political problems.

2.2. Some Conclusions from Models

Danger of aprioristic propositions in economics. Under specified conditions total value of production at free-market prices will be a maximum if free pricing and production is applied. This presupposes, however, the full use of all factors of production, and the non-interruption of exchange possibilities. Free pricing impossible, too, with decreasing marginal costs. It has further to be assumed that productivity does not depend on the time the technique of production has already been in use, and maximum production may be at variance with maximum real expenditure or with optimum distribution. "Dynamic" features such as lags, speculative attitudes and the role of stocks may make the adjustment to a changed situation an unstable process. Changes in the annual flow of production of a commodity of very long lifetime cannot be important for the market of such a commodity. Therefore short-term changes in the rate of savings are not important for the rate of interest. Changes in the price of a commodity or service which is only a minor factor in the production of a certain product will not influence the supply of that product very much; hence the restricted importance of the short-term interest rate for general activity.

Statistical inference is bound to yield only conditional results: If profits and equipment prices are the most important variables affecting investment fluctuations, the influence of the rate of interest on investment activity has been only weak. If income is the most important factor influencing demand, price elasticity for most goods has been only low. If product prices are primarily dependent on costs, their flexibility has been rather high. If incomes and prices are the most important factors in demand, short-run elasticities of substitution in international trade have been moderate.

2.3. Survey of Models Used as Examples in this Book, indicating variables occurring in them (cf. Appendix 3). Notations used.

2.4. Closed Static Models

Macro-models: (01) money-flow model: simplest Keynesian model; (02) money and product flow; specifies quantity and price components; (03) money, product and factor flow: distinguishes between product and factor

market (labour); (04) money flow and public finance: introduces government decisions; (05) money flow, public finance and assets: introduces complications caused by liquidation and formation of assets.

Micro-models: (06) horizontal money and product flow: introduces multiplicity of final products; (07) horizontal money and product flow with monopolies: introduces monopolistic price formation; (08) income distribution: a model introducing personal abilities and other attributes making for income inequality.

2.5. Closed Dynamic Models

(09) development: specifies interaction between income, savings and capital in the process of long-term development; (10) cycle (money flow, paper profits): one of the simpler models of the busines cycle, with the emphasis on lags in income spending and the role played by paper profits in overspending and underspending.

2.6. Open, Static Macro-models

Models (11)–(15) correspond to models (01)–(05) with the only difference that they all refer to open economies; meaning that imports and exports are among the variables. Public finance has not, however, been introduced explicitly in these models, as was the case in (04) and (05); instead the rate of exchange is introduced as a separate variable in model (14).

2.7. Open, Static Micro-models

(16) money, product and factor flow and public finance: here public finance is introduced again; (17) money-flow and banking: introduces a more complete description of monetary aspects; (18) horizontal money, product and factor flow: a model illustrating complications of fostering isolated increases in productivity in open economies: (19) horizontal money and product flow: being a combination of (03) and (06) for an open economy.

2.8. Open Dynamic Micro-models

(20) investment project appraisal: a model to be used for the explanation of certain methods of "project appraisal" (priority calculations).

2.9. Group of Economies Model

(21) money and product flow: a model thought appropriate for dealing with short-term adaptations in employment and balance of payments between several countries.

CHAPTER 3

QUANTITATIVE POLICY: REGULATING THE POSITION WITHIN A GIVEN STRUCTURE; (I) CLOSED ECONOMY

3.1. Nature of Problem; Practical Approach so far Mostly Used

Quantitative policy, leaving structure unchanged, mainly short-term policy, but not always. Often takes form of trial and error. Tendency to incoherent treatment based on supposed one-by-one correspondence between targets and instruments. Choice often made on qualitative arguments. Interrelation should not be neglected; requires simultaneous consideration of all targets and instruments. Formal versus material aspects.

3.2. The Logic of Quantitative Economic Policy

Distinction should be made between problems with fixed or flexible targets, those with many or only few instruments and according to the possibility of boundary conditions intervening. Basis for design to be initial situation, or forecast, and effects of changes in "other" data to be expected. Criteria for policy to be found in divergency between "actual" and most desirable situation (targets). Choice of instruments should be a question of efficiency. Model should be realistic and "manageable". Stochastic nature of problem.

3.3 Provisional Solution; Efficiency of Instruments

Optimum values of instrument variables to be estimated with help of model. In case of fixed targets and an equal number of instrument variables, without boundary conditions, the solution will as a rule be unique. It the number of instruments is larger, some degrees of freedom will remain; if it is smaller, there will, as a rule, be no solution (inconsistency of given combination of aims and means). In the case of flexible targets, there will be a solution irrespective of the number of instrument variables; but it may depend on boundary conditions. The efficiency coefficient of a certain instrument, with respect to a certain target variable, may be defined as the ratio between the change obtained in the target variable and the change needed in the instrument variable; it depends on side conditions as to the other variables. For a comparison between various instruments and targets, their changes have to be valued. The final measures of efficiency then boils down to the net increase in social welfare obtainable.

3.4. Appraisal and Amendment of the Solution

The provisional solution found in 3.3 may be inacceptable because of too large changes in certain instrument variables, deemed to be impossible physically (e.g. capacity limit to production), or for psychological or political reasons (wage reduction or tax increase). "Conditional" targets may have to be dropped or additional instruments have to be introduced. Where degrees of freedom were left, a closer study of alternative instruments and their influence on social welfare are in place.

3.5. Methods to regulate employment and monetary equilibrium

Discussion of meaning to be attached to expressions "full employment" and "monetary equilibrium". Problems 011–061 (cf. Appendix 2). Money flows (government expenditure or taxes) more reliable instruments for regulating employment than factor prices (wage rates or interest rates). Choice between tax reduction and increase in government expenditure should depend on marginal utility of private and public expenditure and on delays involved. Multiplier for taxes lower than that for expenditures. Possibility of increasing total demand by expanding balanced budget. In depression, indirect taxes more efficient than direct taxes. Banking system may influence money flows mainly by restriction of credits. Financing of government deficit by loans to be preferred to credit creation with a view to avoiding future inflation; but credit creation not to be excluded for that reason, since loans may be impossible.

Monetary equilibrium may be maintained by the regulation of money flows, or of wage rates; but two simultaneous targets can be attained only if two instruments are applied. Apart from indirect taxes, wage rates seem to be the most appropriate instrument to be applied in addition to public finance.

Long-term targets may be added to the short-term ones; in particular the avoidance of future inflation. And the number of short-term targets may be increased by requiring "full" employment in a number of industries.

Indirect taxes or subsidies most efficient instrument for short-run regulation of employment in separate industries.

3.6. Main Problems of Development Policies

Investment the key to increased production. Problem 091. Fundamental choice of rate of development. Desirability and possibility of foreign aid, in order to reduce divergence in standards of life.

CHAPTER 4

QUANTITATIVE POLICY (II) IN AN OPEN ECONOMY; AND IN SETS OF ECONOMIES

4.1. Methods of Regulating Employment, Monetary Equilibrium and Balance-of-payments Equilibrium in an Open Economy

Open countries are dependent, for the volume of demand as well as for their price level, on the world market. They may be forced to "import" inflation from abroad but are sometimes able to "export" their own inflationary tendencies. Importance of ample reserves. Definition of monetary equilibrium "as the realization of the most desirable price level", to be distinguished from balance of payments equilibrium. Dependence on policies followed in other countries. Problems 111–152 (cf. Appendix 2). Policy requirements depend on the degree of similarity between the targets set abroad and at home. Necessity, in the long run, to maintain balance of payments equilibrium. In addition, nowadays, the further goals of "full" employment and monetary equilibrium will be maintained. Most efficient single instrument again public expenditure, although its multiplier is lower in an open country than in a closed one and varies according to the cyclical position. Together with money flows, price levels will now also have to be used as instruments; either exchange rates or the internal price structure, i.e. wage rates and commodity prices; perhaps both exchange rates and the

3.7. Example of Sector Policy in a Closed Economy: Transportation

Sector policy requires, among other things, decisions as to position with regard to other sectors. Characteristics of transportation: (*a*) low elasticity of demand; (*b*) bulky investment in some and (*c*) small units in other sub-sectors, implying high fixed cost leading to unstable prices in the former and a tendency towards over-investment in the latter: (*d*) a large number of partly noncompeting market compartments. Aims of policy: maximum contribution to national income, continuity and stability of facilities, income reasonable in comparison to other sectors. Instruments: price regulation, restrictions on entry to market, formation or control of monopolies. Price regulation may be needed to avoid both too low and too high prices; restrictions to entry of market in order to avoid over-investment in small units; formation of monopolies in order to prevent cut-throat competition; control of monopolies to avoid too high prices.

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internal price structure. Both will be needed if it is desired to maintain stable internal prices as well as balance of payments equilibrium. Efficiency of devaluation very different in different phases of cycle, and according to structure of country; the "critical elasticity" issue. Short-term and long-term effects; differences between wage policy and exchange-rate policy. Exchange-rate policy usually will not leave wages unchanged. Isolated wage policy tends to place the full burden of a difficult position on the workers, and a wage-adjusted devaluation tends to place the full burden on the other groups; sharing the burden is preferable. The interest rate only represents a weak instrument of regulating activity.

4.2. Multiple-target Policies for Open Economies

This represents the general type of quantitative policy for most countries. International ties in some respects reduce, but in others increase, freedom. "Imported inflation" as an example of reduced, and the possibility to "export inflation" as an example of amplified, freedom. Advantages of increases in productivity may have to be handed over to the other economies. Problems 161–191 (cf. Appendix 2).

Formal and material aspects (cf. 3.1.). Numerical combination of targets relevant. As long as each instrument acts on the various target variables in different ratios, any combination of targets may be obtained. Usually a problem of simultaneous algebraic equations. Sometimes the set of instrument values may be obtained by consecutive arithmetical operations. The target of full employment determines level of production, and hence imports; the target of balance of payments equilibrium then determines exports and these again determine the country's price level in international currency. With given exchange rate the wage level can be determined. With the internal price level as a further target, the exchange rate or the wage level will follow.

There may be inconsistencies in targets in that they are contradictory irrespective of the instruments used (i.e. since they do not obey a structural equation); or in that they are not attainable with the instruments admitted. This may be due to the fact that, even if the number of instruments is equal to the number of targets, some instruments are relevant to some targets, in a fixed combination only, so that other instruments will have to "do two jobs at the same time".

Also, boundary conditions on some of the instruments may reduce the possibility of solving a problem in economic policy. Importance of using a larger number of instruments than is strictly necessary in order to distribute pressure. Conflicts between short-term and long-term aims may be solved

by the use of more instruments. For reasons of short-term employment it may be desirable to increase taxes, whereas for reasons of long-term development their reduction would be needed. If no other instrument is used, a compromise has to be made; but both targets may be served at the same time if two instruments are used, e.g. taxes and investment subsidies. "Trial-and error" policy usually requires a succession of steps whereas systematic policy tries to attain the target in one step; trial-and-error policy will not always be successful, but systematic policy will not always be possible.

Materially, this section confirms some of the conclusions as to the relative efficiency of wage rates, indirect taxes and credit policy. It is difficult to present general statements; one specific conclusion refers to the feasibility of "directed productivity increases".

4.3. Example of Sector Policy in an Open Economy: Agriculture

Most agricultural products have international markets. Foreign policies therefore influence national agriculture; home price policy only possible if trade impediments are accepted. Foreign policy may or may not be in accordance with home policy. Characteristics of agriculture: (*a*) random fluctuations in production; (*b*) low elasticity of supply; (*c*) low elasticity of demand; (*d*) a time-consuming production process; (*e*) seasonal fluctuations; (*f*) agriculture well organized in a number of countries; (*g*) land in short supply; (*h*) for Holland: land very fertile. Aims of Dutch policy: maximum contribution to national income; stable income, reasonable in comparison with other industries, regionally well distributed; seasonal pattern in labour demand with not too wide fluctuations. Instruments: import duties or subsidies, export duties or subsidies, price subsidies to consumer, quantitative restrictions, regulation of production, periodic stock accumulation and liquidation, and rent and wage control. Policy has to be flexible, adapted to changing circumstances; complicated. Only a few examples can be given; maximum contribution to national income fundamentally requires free trade pattern. Modifications: rather less production of commodities whose labour requirements are subject to overlarge seasonal fluctuations. If because of exceptional world crops prices are temporarily abnormal, normal prices may be maintained at home by duties or subsidies—on the import side for deficit products, on the export side for surplus products. A regulation of production will be usefull for products with a long period of production (pork); seasonal levelling out of prices by stock manipulations is another contribution to stability. To the extent that incomes of farmers are high in comparison to other industries (because of fertility

of soil) reduced prices to consumers and rent control may be appropriate. If a certain region, largely dependent on one product, suffers from incomes which are too low, special regulations for that product may be appropriate.

4.4. Quantitative Economic Policy where Policy-makers are Many: (1) International Quantitative Economic Policy

Represents a case of decentralized policy. Introduces complications since policy also influences others' welfare and policy of other policy-makers influences welfare at home. Assumptions will have to be made about other countries' policy. Similarity with the problems of polipoly. Problem 211. Better results will be obtained if it can be assumed that other countries will follow a similar policy than if this is not the case.

4.5. Quantitative Policy where Policy-makers are Many: (2) Pressure Groups

Pressure groups are "states within the state" and their behaviour may be contrary to the general interest. Example of employers and workers.

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CHAPTER 5

QUALITATIVE POLICY: CHANGING THE STRUCTURE WITHIN GIVEN FOUNDATIONS

5.1. Qualitative Policy consists of changing the less fundamental elements of social organization, those not affecting spiritual aspects or essential relations between individuals. Sometimes changes in quantitative data may bring about circumstances that require another type of organization (extreme scarcity, changing cost structure, better administrative techniques, etc.), but new ideas about organization may also come up spontaneously. No systematic way of summing up conceivable alternatives. Less knowledge available to make precise statements. Discussion of means one by one and an attempt at a synthesis at the end of Chapter 6.

5.2. Quantitative Restrictions (Q. R.) are an efficient means in the short run to attain the aims of equilibrium and equitable distribution under circumstances of extreme scarcity in markets showing a low elasticity of demand. Examples are food rationing and quantitative restrictions on imports if elasticities of demand for imports and exports are low. In the

longer run the necessity to make the systems increasingly complicated makes them less attractive and freedom, partial at least, is preferable.

5.3. Built-in Stabilizers represent a structure of public expenditure that automatically counteracts cycles and hence to some extent replace *ad hoc* adjustments as discussed before (3.5 and 4.1). Problem 101.

5.4. Changes in Pricing and Taxation Schemes

Non-flat-rate charging an example of an efficient change in pricing techniques; it should, however, be based on correct cost calculations. With full use of capacity, marginal costs become high. Sliding scales for wages and other incomes lessen flexibility of economy; dangerous unless they would make financial authorities and organized income recipients more conscious of necessity to avoid inflation. In a well-administered state *direct taxes* are an indispensable instrument for influencing the rate of investment and for redistributing income. *Import duties* may increase a country's welfare (*a*) if they reduce unemployment; (*b*) because of the "infant-industry" argument and (*c*) because of the "optimum-tariff" doctrine. The same results for the country concerned may be obtained with less sacrifices from others by the use of subsidies in the case (*a*) and (*b*) and international redistribution of income instead of optimum tariffs.

5.5 Monopolies

Monopolies are an instrument to compensate for cut-throat competition in cases of over-capacity and high fixed costs. Their prices should not exceed long-term competitive prices; if they do, welfare is below optimum. Problems 071–074. Cumulative monopolies appear to be much more restrictive than vertically integrated monopolies.

5.6. Decentralization or Centralization in Administration may refer to geographical as well as to institutional decentralization or centralization; there are stronger and weaker forms of centralization. Supporting, conflicting, neutral and mixed means of economic policy. Decentralization likely to lessen the use made of supporting and increase the use made of conflicting means. Decentralization to be recommended for means whose handling does not show economies of scale and whose affects are nearly neutral. *Centralization* to be advocated for clearly supporting or conflicting means. Trade impedimets, rates of exchange or wage rates and public finance surplus or deficit important examples of instruments to be centralized. Negative and positive integration.

5.7. Appraisal of Investment Projects to be based on net increase in real national product or expenditure they create (with possible modification for effects on income distribution), taking account of indirect and secondary effects and using equilibrium prices for products and factors. Problem 201. Priority figures cannot, strictly speaking, be calculated for separate projects, with a view to select some and rejecting others; among alternative sets of projects, requiring the same sacrifices of factors, the set has to be chosen which yields the maximum net increase in real income. Possible simplifications of procedure. Estimation of accounting prices. Labour-intensive industries as a rule more attractive to countries with little capital and much labour. "Industries" to be considered as technically inseparable combinations of complementary industries; "labour" to be understood as unskilled labour.

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CHAPTER 6

REFORMS: CHANGES IN FOUNDATIONS

6.1. Reforms

Reforms are changes in the more fundamental features of social organization, affecting spiritual aspects and essential relations between individuals. Still less known about effects of these changes.

6.2. Social Security Schemes are important instruments of social justice, especially for the handicapped. Distinction to be made between formal and factual contributors to a scheme. Except when financed out of profit or income taxes most of the benefits are in the long run paid out of wages, since market forces determine the total of wages and benefits. Beyond a certain limit social security may lessen incentives to produce.

6.3. Minimum Incomes and Guarantees for Minimum Employment work the same way; minimum incomes cannot be an important portion of wages without endangering incentives to produce.

6.4. Equalization of Opportunities by cheap education, apart from being very important from a spiritual and social viewpoint, will raise the supply of qualified workers (in all ranges) in relation to non-qualified. Problem 081. Education will raise production and lessen inequality. Little is known about the distribution of desired and factual abilities, and about the possibilities of raising the quality of abilities.

6.5. Monetary Reforms may eliminate some of the instabilities, or unnecessary complications, of the present monetary system. Aim of "100% money", meant to reduce violent expansion of circulation, may be attained by a wise monetary policy under present regulations as well. Problem 102. The "raw material standard" will reduce fluctuations in raw material prices in a much simpler way than would a set of commodity agreements.

6.6. Centralization of Production Decisions may avoid certain inconsistencies (over-production), but would require a very complicated technique and would lead to power concentration, with dangers for individual freedom. Such centralization may recommended for industries with a long period of production and in a situation of extreme scarcity.

6.7. Industrial Democracy may be the best means to satisfy the need for self-respect and dignity with those occupying modest jobs. Important possibilities explored in European countries; need for further experimenting.

6.8. Nationalization

Nationalization is one of the most controversial subjects in economic policy, partly because of the vested interests involved. Nationalization may avoid over-production and eliminate unearned income, but it may endanger efficiency and lead to a dangerous concentration of power. Scientific comparisons between nationalized and private industries are difficult because of non-comparable situations. Such restricted evidence as is available suggests that the differences in efficiency are not large. Since there are other means to obtain the advantages claimed for nationalization, its importance seems to have been over-estimated. There are some secondary advantages to be found, however, in the control of certain vital national interests and the possibility to carry out an anti-cyclical policy in the field of investment.

6.9. Summary and Conclusion

A coherent treatment as recommended for quantitative policy is hardly possible yet for qualitative policy and reforms. The author tries to summarize his views on the probable effects, in an "average" country, of the policies discussed, in Table 6.9. Recommendations: to devote more effort to international integration, including income transfers, stabilizing devices (including the raw-material standard), family planning, industrial democracy and the equalization of opportunities.

CHAPTER 7

UTOPIAS: MISCONCEPTION OF HUMAN NATURE?

7.1. Certain reforms have proved to be inefficient, mostly because a misconception of human nature was involved. They indicate certain limits set to reforms. These limits need not be lasting.

7.2. Complete Freedom means the jungle: the rule of the strong and brutal. Regulation of freedom by law recognized by all to be necessary. Even the regulated freedom of the 19th century led to unacceptable exploitation and inequality.

7.3. Complete State Regulation is inefficient and hence only acceptable in extraordinary circumstances. War economies have to some extent been abolished everywhere.

7.4. Productive Co-operatives (Associations) are attempts to replace hierarchy in productive organization by cooperation on an equal footing. The attempts have failed almost completely.

7.5. Abolition of Money as a means of saving, a proposal repeatedly made, is closest approximated by war-time rationing and inflation, when money loses its meaning. The attempts to "monetize" rationing coupons as well as the success of monetary purges illustrate the usefulness of money for accumulating reserves.

7.6. Complete Equalization of Incomes was attempted in Russia and Israel and appeared not, or not yet, to be possible. It disturbs the equilibrium between demand and supply of different types of labour, since it reduces the willingness to perform hard jobs.

7.7. Completely Free Services seem to be insufficiently appreciated by most people and are wasted therefore. Moderate charges even for vital services would seem to be a better device.

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CHAPTER 8

SOME REMARKS ON THE ORGANIZATION OF ECONOMIC POLICY

8.1. Number and Nature of Agencies and Their Tasks

Economic policy, being a complicated activity, is divided over a large

number of agencies, and requires deliberate organization. Organization dependent on type of policy and quality of officials. Since the handling of instruments is the task to be performed, executive agencies should be organized according to means. Coordinating and supervising agencies have to consider all the means and all the aims together. Means should be clearly allocated to the various agencies. The phases of planning, co-ordination and decision, execution and supervision. Time lags involved.

8.2. Planning of Economic Policy

The underlying principles are formulated by political parties; actual policy is planned by government agencies; such planning should already be based on provisional directives. Role of "declarations of intent"; desirability of contacts with private sector already in planning phase.

8.3. Co–ordination and Decision

Co-ordination commences with the issue of directives and ends with decision as to aims and means to be used and to what extent. Co-ordination requires the existence of inter-departmental bodies and staff organs and its general design should be a well-defined task of a well-defined unit. There will have to be clarity about the division of tasks between Parliament and Government. There should be a simultaneous proposal, at regular intervals, about important changes in policy, preferably on Budget Day.

8.4. Execution

The execution of economic policy is distributed over a large number of agencies, which partly have a certain autonomy and then have to be guided in an indirect way, e.g. by grants in aid. Numerous smaller decisions have to be taken in accordance with the general policy. Large numbers of non-economic factors, rightly or wrongly, influence the execution.

8.5. Supervision

Supervision of economic policy not only a means of control for Government, Parliament and citizens, but essential also to future planning and decisions. Largely a question of good statistics and analytical studies.

8.6. International Economic Policy

In the international field economic policy is scarcely organized at all. Responsibilities are often ill-defined. A large role is played by negotiations between autonomous governments. There is scope for more co-ordination and integration.