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The Management of the British Economy†

By Roy Harrod

Christ Church, Oxford

This is certainly a monumental work. It is based on massive research, well documented and well written. It is prevailingly sceptical in attitude, as befits its subject, but it is judicious and well balanced. One has the impression of a very fine mind at work, and there is no doubt that this book will establish the author as one of our foremost economists. Indeed, the book should itself be quite a landmark, by the thoroughness of the research that lies behind it and by its relevance to the matters in which economists of to-day are most interested.

The author proceeds by bringing to bear on his central themes many considerations, some theoretical, some pertaining to common sense, some drawn from statistical data. He keeps many balls in the air. It is difficult for him to reach clear-cut conclusions and maxims. If the reader is inclined to wish for more of these, he will none the less console himself for having been given a very thorough survey of the territory and for having been taken into its problems in depth. The book should be a precedent for more work of the same kind. Doing justice to the complexities of the problem, it none the less always strives to throw light upon them. It does not follow that all work should be of this kind. We may still look to the genius, like Keynes, who, by a judicious selection of what is most relevant, can get a simple, memorable conclusion, which is worth having, even if it does involve oversimplifications at certain points.

There is a very interesting chapter on the forecasting methods that have been officially adopted (Chapter 5) and their inevitable limitations, partly owing to the insufficiency of the materials on which they are based. The author in his survey, which is of wider ambit than official forecasting, none the less adopts the same method of relying on judgement in summing up what the bits and pieces of evidence available point to, for forecast and for policy formation. He is doubtful if a better result could be achieved by formal econometric methods, although he hints that these might be of greater service for a forward period stretching for more than a year, than they could be for the forecasts and decisions relating to a coming year. It is not certain whether even this concession is justifiable. The root trouble is that, unless we are to ignore influences or relations that we know by simple observation to be relevant, our forecasting model must have a number of adjustable parameters, and that, to make the insertion of particular values valid for prediction, we need a far greater number of observations than in fact we have. This would be so, even apart from the fact that we have no means of evaluating the consequences of unique exogenous interferences, such as the Suez crisis.

This does not mean that econometric studies are not to be encouraged, even at the cost of all the subvention that may be required for computer assistance. In this connection a point may be stressed. When official, or other, statisticians revise

† A review article of *The Management of the British Economy, 1945 to 1960. By J. C. R. Dow. Cambridge University Press*, 1964. xix, 439 p. 9″. 60*s*.

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recent figures, whether in the light of fresh information or a new conceptual refinement, they should always job back, if possible, to the beginning of the series—for which they presumably have data in their files—even if this costs them extra labour time. For the econometric studies of the future, on which in due course we may come to rely much, it is essential that there should be uniform time series, based on the same information and concepts, stretching back as far as possible. If this is not done we shall never get enough observations to validify econometric models. Meanwhile Mr Dow is fully justified in proceeding as he does, bearing in mind all the available bits and pieces and bringing his own mellow judgement to bear on them.

As well as being so judicious, he is also like a good artist (novelist); one is kept in a state of excited anticipation, which grows as one proceeds further, about whither we are being led by his narrative. The explanation of it all is not, as in a bad detective story, compressed into a final summary of a few pages. The data mount up, but the conclusions begin to emerge at a reasonably early stage, but only so as to keep the anticipation/data ratio still rising until towards the end.

For lack of space a reviewer cannot emulate this artistry, and should therefore start from the end. Because of the incomplete potency of traditional policy weapons and the uncertainties in which they have to operate, and because of the rather poor record of the period since the war, the author favours a modicum of "planning". "There seems then a logical case for the organisation of mutual discussion by private firms and public corporations of their plans for expansion." "The resurrection of the idea of economic planning, after a decade of eclipse, has been the result of a disillusion with past policies." "The constitution of the National Economic Development Council with a secretariat of its own, and an independent position half-way between the government and business, may enable it to play a positive role in the co-ordination of plans." "My own belief is that faster growth will prove possible and that the institution of planning procedures will have made an important difference." (Pages 398–9.) This is not the main theme of the book, but is a positive corollary to a largely negative appraisal of what has been done.

Mr Dow favours our having a lower average level of demand. "If the pressure of demand were kept steady at a somewhat lower level, the rate of growth would be as rapid." "If unemployment were kept at 2–2½% instead of the post-war average of 1½%, this would probably make a major difference to the rate of rise in prices." (Page 403.) As this view coincides with those of other economists of influence, who none the less are of different outlook from Mr Dow, it may be worth giving a little space to this proposition.

His main reason for this recommendation appears to be that such a policy would moderate price increases. He cites various pieces of research (especially pages 350–363) to the effect that a higher pressure of demand is positively correlated with higher wage-rate increases. Prominence is given to Mr Dicks Mireaux's equations. For reasons already stated, I doubt if the number of observations is yet sufficient to validify these or other equations. Mr Dow presents the rather surprising result that the level of wage rates is more sensitive than the wages drift to the pressure of demand (pages 355–356). My own amateurish observations, which are hardly worth a feather's weight by comparison with the statistical researches cited by Mr Dow, but which have none the less been conscientious and re-done on a number of occasions, have found no influence of the pressure of demand on the level of wage rates, but a substantial influence on the wages drift. This flimsy conclusion has at least the merit of being more in accordance with common sense. The difference between my results

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and those cited may be due to different assumptions about the degrees of pressure of demand from time to time (see below).

But let us suppose that a high pressure of demand does pull up wage rates. There are none the less two objections to Mr Dow's solution of having demand damped.

1. How do we bring to being the higher growth rate, if demand is all the time relatively slack? Growth over a period is an integration of what entrepreneurs do in placing orders on each particular occasion, day by day. If on each occasion the pressure of demand is weak, there will be an insufficient motive for placing extra orders and for ordering new equipment, preferably of a modernizing variety. A further point here is that some degree of labour shortage is probably good for getting labour-saving installations going. This would be especially important if Mr Dow's findings are true that other incentives (initial allowances etc.) have a rather weak effect towards modernization.

Presumably Mr Dow's idea is that this problem of insufficient motive for capital outlay can be solved by the planning referred to above. But the effectiveness of such planning is not certain, as Mr Dow, in accordance with his revealed mental temperament, would readily allow. To arrange for a perennially weak level of demand would be to increase the burden to be undertaken by the planners; they would have to be working against the stream. Rather one wants natural forces to be helping towards what the planners seek to get done, and not the other way round.

2. Mr Dow's solution is callous and defeatist. It means that at any one time, on average, 200,000 more families in Britain would be deprived of a breadwinner's earnings. What about their way of life and welfare? What about the harrowing anxieties that occur on such occasions? These anxieties are great even if the unemployment is for a short period only, but, if the average percentage were higher, more people would be unemployed for longer periods. How would people in the higher echelons like a scheme of this sort applied to themselves? It would imply that they would have to look forward to being without means of livelihood for a whole year on average during the normal course of their careers. And for those below the average ability, it would be for considerably more than a year. They would not like it at all. Are we then to have one law for the rich and another for the poor?

It might be urged that we could mitigate the hardship by making things nice and easy (by higher allowances etc.) during the period of unemployment. But this would be to defeat the object of the scheme. If it is true that wage rates rise less when demand is lower, this must surely be, in part at least, due to the fact that the unpleasantness of unemployment has an inhibiting effect on wage claims. It might be argued that the lower level of demand would strengthen employer resistance to wage claims, but would this really be so if there was planning machinery in existence for ensuring the future growth of demand?

The alternative to Mr Dow's gloomy proposal is an "incomes policy". There is a brief reference to Mr Selwyn Lloyd's initiative in this respect, and to the important report prepared for the O.E.E.C. on the problem of rising prices (1961).† Meanwhile things have moved further in this direction, and Mr Dow, if writing now, might modify his request for a lower level of demand, in order to reduce price increases.

† By Gilbert, Fellner, Hansen, Kahn, Lutz and Wolff.

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It is appropriate to quote Mr Dow's main pessimistic conclusion. "The analysis suggests that the fluctuations in the growth of demand in the years 1952 to 1960 were due in large part to fluctuations in policy." (Page 391.) One may cordially sympathize with his view that policy might be adapted to secure smoother growth.

The book opens with an historical narrative, proceeds to an analysis of policy and to the behaviour of the economy and finally pulls the threads together. But there is a certain admixture of history and analysis throughout the book, which is most welcome. The subject matter for discussion is vast, and the reviewer must content himself with touching on a few aspects.

It occurred to me that "productivity" might have been included among the "indicators of the state of demand" (pages 115, 337, 341, 360, *et al.*). Changes in productivity have been far greater than changes in employment (the indicator, along with unfilled vacancies, used by Mr Dow), and would seem therefore to be a more sensitive indicator of the state of demand. When, in such a period as 1955 to 1958, productivity oscillates but little, and then suddenly rises by over 10 per cent in hardly more than a year, is not this a sign that underemployment inside factories was building up in the intervening period? All through the 1955–8 period new equipment was being furnished in good measure so that production should have been increasing continuously, thereby anticipating the spurt that actually occurred in 1959. The same process was repeated in the period 1960 to 1962, which lies outside Mr Dow's survey—a period of flatness including a mild recession followed by a spurt of more than 10 per cent within eighteen months. If Mr Dow had adopted this criterion, a somewhat different pattern would have resulted, and his narrative might have had to be changed at various points.

Incidentally I have struggled hard to escape the view that the definitions of "excess demand" and "available supplies" on page 336 are circular; in vain. They might perhaps be rescued from circularity, if a reaction time were specified. Obviously if a sudden unexpected increase of demand occurs, supplies to meet it may not be immediately forthcoming, even if there is no question whatever of aggregate net demand being in excess. One perhaps needs at this point Marshallian-type concepts of short and long periods.

There is a wider question which crops up in various parts of the book relating to monetary policy, the influence of which I believe that Mr Dow greatly underrates. "If one regards the volume of money as a secondary and relatively unimportant factor. . . ." (Page 268.) One may agree that the influence of money is secondary, by comparison with the aggregate of forces that go to make up real demand, but at the same time hold that it is very important, through its influence on real demand. Mr Dow strikes me as having been too kind to the Report of the Radcliffe Committee; this Report may have influenced him too much. In reading his work, I have felt that the true doctrine of money has eluded him, as it eluded Radcliffe, and that this has important consequences. We may cordially agree with him in rejecting the quantity theory of money in its old-fashioned form. As regards the rate of interest, we may also agree that it does not, as such, have much effect on industrial investment, but Mr Dow himself allows that it may have a significant effect on house building and the local authorities, not unimportant contributors to the aggregate of investment. The influence of money on activity is betwixt and between. If the volume of money is increased relatively to the money value of the national income, this at once makes finance easier to obtain through a wide variety of channels. It is this ease of raising funds through an imperfect capital market, far more than the arithmetical rate of interest, that

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may influence entrepreneurs (other than giants, who have no financial difficulties), in whether or not to make a given capital outlay. Oddly enough, Mr Dow does think that finance has a significant influence, if it comes via super-normal profit or investment allowances (e.g. page 291). But he has ignored the all-important influence of money itself. He seems to make some sort of concession on page 325, but the "restriction of credit", there referred to, seems to be something different from a restriction, simply, of the money supply.

Thus he thinks fiscal policy more important than monetary policy; that may be true in certain conditions; the better view is that they can both play powerful parts. Incidentally he does not seem to give fiscal policy enough credit for influencing investment in a passage on page 296. He is there presumably thinking of such fiscal measures as investment allowances, but fiscal policy may influence investment via consumption, more potently than via investment allowances. Mr Dow himself says (page 286), "First, the incentive to invest must depend primarily on the prospective evolution of final demand".

Mr Dow has an interesting passage on the non-inevitability of Dalton's failure to keep interest rates low (pages 226–7). He seems predominantly in favour of low interest rates, not so much with a view to growth policy, as to ease budgetary burdens.

In various places the narrative may suffer from not drawing a strong enough distinction between personal saving and private saving as a whole. Incidentally the great upsurge of personal saving since 1959 has lain largely outside his period. If personal saving goes up strongly without being matched by a corresponding increase of investment, company saving will go down as a result. Thus private saving as a whole will have changed less than in proportion to personal saving; it is the movement of personal saving that is the causal factor. Mr Dow does have a discussion (page 331) of Keynes's *Treatise on Money*, where these relations are analysed. It is true that Keynes there thinks of changes in personal saving having an inverse effect on company saving mainly via price movements. But for this effect there need not be any price movement at all; the whole thing can happen via a change in turnover. If personal saving rises more than investment, this reduces the increase of turnover. To the extent that short-period costs are largely fixed (cf. what was said about employment above), this reduces the increase of profit, or causes a decline. To the extent that dividends are not flexible downwards (but if they are, there may be an adverse "multiplier" effect), there will be a squeeze on company saving, off-setting the rise in personal saving. It is difficult to say what effect the disaggregation of private saving would have had on Mr Dow's narrative. It obviously becomes of supreme importance for the period after 1960.

I did not find myself in agreement with Mr Dow's treatment of the convertibility problem in the 'fifties. To me it seemed to be supremely important that sterling should be made convertible. It was, as I conceive it, a race with time. If we had held out no hopes, and not eventually taken some action, as in 1954 and again in 1955, we might have encountered an avalanche of operations through free markets and been compelled to declare a moratorium, leading to a collapse of our international financial position. This does not imply that one would have agreed with the "Robot scheme" (page 84), had one known about it; that scheme implied a doctrinaire "bid for freedom", with a floating pound and all restrictions removed. This was doubtless a half-baked proposal. I always recommended that round about the time of convertibility, which seemed to me absolutely essential, we ought to have a holiday on import de-restrictions; but in fact we did the opposite.

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There is what is surely a highly confused passage at the top of page 88. "Talk of early convertibility" could not have caused a speculative crisis. Quite the contrary; it was the talk of a postponement of convertibility at the I.M.F. meeting in September 1954 that caused a flare-up of activity in commodity shunting. Actually for a number of months after we began intervening in the transferable sterling markets in February 1955, sterling was strong, because people held this to be a prelude to full convertibility. What caused the sterling crisis later in the year was talk (in Paris in June) of wider margins for sterling. This was a sort of relic, taken out of pigeon holes, of the Robot plan for a flexible sterling.

A few smaller points may be mentioned. On page 158 Mr Dow says, "By 1954 or so, one would guess, they [import controls] can have had little restrictive effect". This embodies the old fallacy of judging the proportion of trade affected by tariffs by the amount of the trade flow. In 1954 the import of finished manufactures, still largely restricted, was very low; it has quadrupled since; this extra importation has been the main cause of, or, anyhow, has been considerably in excess of, our subsequent deficits to date.

I believe that Mr Dow understresses the effects of the devaluation of sterling in 1949. He often refers to the effect of the Korean War on our terms of trade, but this was transitory and affected the United States also. One may better judge the effect of devaluation by comparing our terms of trade with those of the United States after the immediate impact of the Korean War was over.

On page 383 Mr Dow refers to credit and budgetary policy as having been clearly expansionary in 1956. There is no indication of such expansionary measures in Table 4.1, page 113.

On page 384 there are the words, "Subsequently the government felt obliged in 1961 again to restrain the growth of demand", without any reference in this passage to the strongly restraining measures of 1960. Mr Dow misses the point (page 107) that the immediate occasion of the restoration of sterling convertibility was not primarily the devaluation of the French franc, but the final failure (end of 1958) of our attempt to form a Free Trade Area covering the whole of Western Europe. The reduction of the Bank Rate in February 1957 is omitted from the table of monetary measures supplied on page 253. On page 255, Mr Thorneycroft's meeting took place in 1957, not 1956. On page 293, last line but one, "falling off in demand" should surely be "increase in demand". On page 380, for things to have gone right in the 1950 to 1952 period, the Budget of 1950 ought to have been both "tougher" and "laxer".

This review has inevitably dealt mainly in terms of criticism. It remains to repeat that the book is a most impressive one, stimulating to thought, diligent and painstaking, and very judicious.

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