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NATIONAL AND INTERNATIONAL MEASURES FOR FULL EMPLOYMENT

Report by a Group of Experts
appointed by the Secretary-General

UNITED NATIONS

National and International Measures for

Full Employment

(E/1584)

Errata

Page 9. The document references in the footnote should read "E/1111 and E/1111 Addenda 1-8".

Page 33, line 8. The word "depreciation" should read "appreciation".

Page 33, paragraph 68, line 5. The paragraph references should read "45-47".

Page 103, line 14. The sentence beginning "These are mentioned" should follow immediately after the previous passage ending with the word "investment" without a break.

NATIONAL AND INTERNATIONAL MEASURES FOR FULL EMPLOYMENT

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UNITED NATIONS
Department of Economic Affairs
Lake Success, New York
December 1949

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This unanimous report on national and international measures required to achieve full employment was prepared by a small group of experts whom I appointed at the invitation of the Economic and Social Council. The group was composed of the following: John Maurice Clark, Professor of Economics at Columbia University, New York, who worked in association with Arthur Smithies, Professor of Economics at Harvard University; Nicholas Kaldor, Fellow of King's College, Cambridge; Pierre Uri, Economic and Financial Adviser to the *Commissariat général du Plan*, Paris; E. Ronald Walker, Economic Adviser to the Australian Department of External Affairs. At the invitation of the group, E. Ronald Walker acted as Chairman.

During the preparation of the report, the experts were informed of work already done or currently being undertaken on problems of full employment by the secretariats of the United Nations and of the specialized agencies. In preparing the report the experts acted in their personal capacities and their recommendations are put forward on their own responsibilities. These recommendations are set out in part III of the report.

In accordance with the Economic and Social Council's resolution 221(IX) E, adopted on 11 August 1949, copies of the report have been transmitted to all Member Governments. Copies have also been made available to the Economic and Employment Commission, which was invited by the Council to examine the report and to transmit to the Council any comments and recommendations for action which seemed appropriate.

On behalf of the United Nations, I wish to express appreciation to the experts for the contribution which they have made in regard to one of the outstanding economic and social problems of our time. I also wish to thank the institutions with which the experts are associated for their willingness to release them from their normal duties so that they might be free to undertake this highly important task.

TRYGVE LIE

Lake Success, New York
22 December 1949

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LETTER OF TRANSMITTAL TO THE SECRETARY-GENERAL

We have the honour to submit herewith the report on "national and international measures to achieve full employment" which, in pursuance of a resolution of the Economic and Social Council, we were invited to prepare. The limited time at our disposal, from 22 October to 16 December 1949, has obliged us to concentrate upon those aspects of the problem of full employment that are of greatest urgency in the light of the current world economic situation.

We are happy to be able to present for the consideration of Governments a unanimous report, including a set of recommendations on which we are all agreed. These recommendations cover action in both the national and the international field, and we would hope that they might be considered together, since they make up a comprehensive programme.

Two members of the group, John Maurice Clark and Arthur Smithies, have worked in association with each other in accordance with the arrangements made for their participation in the preparation of the report, and both have signed it. J. M. Clark has added a personal concurring note, which is annexed to the report. While this concurring note is a personal statement by Professor Clark, the other members of the group desire to place it on record that they are in general agreement with it.

At the request of the group, E. Ronald Walker served as Chairman.

We desire to express our gratitude for the valuable assistance rendered by members of the United Nations Secretariat.

We have the honour to be, Sir,

Your obedient servants,

J. M. Clark

Nicholas Kaldor

[illegible]

[illegible]

E. Ronald Walker

Lake Success, N. Y.
16 December 1949

Part I

THE NATURE OF THE FULL EMPLOYMENT OBLIGATION

Part I

THE NATURE OF THE FULL EMPLOYMENT OBLIGATION

The Full Employment Pledge

1. The full employment pledge embodied in the United Nations Charter[1] marks a historic phase in the evolution of the modern conception of the functions and responsibilities of the democratic State. With other international agreements and declarations of national policy by individual countries it reflects the fundamental importance of the promotion of full employment from two distinct points of view: first, as a condition of economic and social progress and an essential factor in human rights—a goal adopted by each State in the interests of its own citizens, irrespective of any international repercussions; and, secondly, as a necessary prerequisite for the maintenance and smooth working of an international economic system and "the achievement of a stable and expanding world economy".[2]

2. Although "the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment", as embodied in the Universal Declaration of Human Rights adopted by the United Nations General Assembly on 10 December 1948[3] has often been asserted by and on behalf of workers, its recognition as a practical objective of national policy in all countries arises from the contrast between the depression of the 1930's, with its wide-

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[1] *Article 55:* With a view to the creation of conditions of stability and well-being which are necessary for peaceful and friendly relations among nations based on respect for the principle of equal rights and self-determination of peoples, the United Nations shall promote:

a. higher standards of living, ***full employment*** and conditions of economic and social progress and development;

b. solutions of international economic, social, health, and related problems; and international cultural and educational co-operation; and

c. universal respect for, and observance of, human rights and fundamental freedoms for all without distinction as to race, sex, language, or religion.

Article 56: All Members pledge themselves to take joint and separate action in co-operation with the Organization for the achievement of the purposes set forth in Article 55.

(We have italicized the full employment pledge, which should, however, be read within the context of Articles 55 and 56 as a whole.)

[2] Resolution 308 (IV) of the General Assembly of the United Nations, adopted on 25 November 1949.

[3] Article 23.

spread suffering due to mass unemployment in many countries, and the full employment obtaining in those same countries during and immediately after the war, whether they have retained the system of private enterprise, or turned, in greater or lesser degree, to a system of planned economy. At the same time, the acceptance of the full employment objective reflects the progress achieved in our understanding of the causes of unemployment and of the conditions necessary for the maintenance of full employment; an understanding rooted in practical experience and in a growing insight into the mechanics of economic systems.

3. Measures to achieve full employment should be conceived as forming part of a general economic policy which has as its objective the threefold goal set by the United Nations pledge—"higher standards of living, full employment, and conditions of economic and social progress and development". Any successful full employment policy must be carried out with due regard to the preservation of incentives for progress and the capacity to adapt to change, which are essential conditions for continued increases in productivity; to the maintenance of a stable price level; to the need to avoid conflict with the full employment policies of other countries; and to the need for all countries to obtain the benefits of a stable and expanding world economy. It should include any special measures required to reach these ends.

4. The full employment pledge of the Charter is based on the conviction that full employment can and must be maintained within each of the different economic systems under which countries have chosen to live, although the free play of economic forces may not be sufficient to bring about this result. There is now in many countries a recognition both of the compatibility of full employment with the essential principles of any economic system and also of the need for a conscious and constant correction of tendencies that are capable of causing unemployment. The full employment pledge does not impose upon any country the obligation of altering the basic features of its economic system, but it does imply a willingness to "take action, as the need arises, designed to promote and maintain full and productive employment, through measures appropriate to its political, economic and social institutions".[4]

5. In countries in which there is a considerable degree of central direction of the economic system, the mechanism of planning and con-

[4] Resolution 308 (IV) of the General Assembly of the United Nations, adopted on 25 November 1949.

trol can be used to ensure that all available labour is in fact employed. In countries which rely primarily on the system of private enterprise, concern is sometimes expressed lest a policy of full employment may entail the introduction of controls of a type considered foreign to their economic institutions. In our view, however, the steps required to promote full employment in free enterprise economies are fully consistent with the institutions of such countries. The measures recommended in the present report to sustain effective demand do not involve any basic change in the economic institutions of private enterprise countries. At the same time, it is clear that a full employment policy could not be pursued if the principles of any particular system were to be construed so rigidly as to rule out any and every kind of government action that might be required to achieve the desired goal.

6. The importance of full employment policies among the conditions necessary for the smooth working of an international economic system, for the attainment of convertibility of currencies, and for the development of multilateral trade, was clearly recognized in the Articles of Agreement of the International Monetary Fund and in the Havana Charter for an International Trade Organization, as well as in the United Nations Charter. Yet it is necessary continually to emphasize the lessons of past experience on which this recognition was based. The contraction of world trade in the 1930's arose primarily from the decline of international demand; new restrictions on trade emerged out of the efforts of governments to maintain employment in the face of a collapse in the external markets for their products, which had its roots in the contraction of effective demand. Any premature attempt to free the channels of world trade again before establishing the conditions necessary to sustain international demand would consequently be doomed to failure.

7. Moreover, the whole case for international specialization in accordance with the conditions of comparative advantage as indicated in relative prices can be undermined by the prevalence of unemployment. The conclusion that a country can increase its real income by importing even those goods which it can produce more efficiently than external suppliers, if by so doing it can specialize on other lines of production in which its advantages is even greater, loses its validity when the choice for a country is not between more or less efficient uses of available resources but between employing some resources or leaving them idle.

Thus the successful working of the international mechanism cannot be ensured when countries, according to their stage of development, suffer either from unemployment or from under-employment of resources: that is, the more advanced countries from unemployment which is due to an insufficiency of effective demand, and the underdeveloped areas from unemployment which is only concealed by keeping more people at work than contribute effectively to production. The maintenance of international equilibrium requires sustained action, and the international interest commands that all countries fulfil their full employment obligations in such a way as to help others to fulfil theirs.

The Present Setting of the Problem

8. The full employment objective, as embodied in international agreements, has been established against the background of pre-war experience, in order to avoid the recurrence of such major depressions and breakdowns in international trade as beset the world in the 1930's. Since the beginning of the war full employment has been continuously maintained in most countries. Not only did unemployment disappear but the war effort led simultaneously to an increase in hours of work and to an increase in the labour force. After the war, there were widespread inflationary pressures, and such threats to full employment as occurred arose from shortages of essential materials and from crises in international payments.

9. The year 1948 brought an important change in the situation and outlook. Reconversion was virtually complete and consumers' goods were coming on to the market in increasing quantities. Production had expanded well beyond the pre-war levels in many parts of the world. Good crops in the latter part of the year checked the rise in food prices, and inflationary pressures were relaxed in a number of countries. The growth in production was beginning to level off in many industries, and in a few countries unemployment began to increase somewhat above previous low levels. It became apparent in the second half of 1948 and the beginning of 1949 that the post-war inflation on a worldwide scale was over, and that countries needed to concern themselves once again with the problem of unemployment.

10. International concern was naturally centred on the 12 per cent fall in industrial production in the United States and on the increase in unemployment of over one-and-a-half million between June 1948 and

June 1949. Substantial unemployment in Belgium, Italy and Germany added to fears that the world might be on the brink of a post-war depression.

11. In recent months, it appears that the decline in activity in the United States has been arrested, and industrial production and employment have both turned upward. We shall not attempt to predict the course of events over the next few months, but the essential fact remains that the international scene is clouded with uncertainty concerning levels of economic activity and employment in major industrial countries of the world. That uncertainity can be removed only if governments can assure the world that they are in a position to deal with a recession if it occurs.

12. The replies of the governments[5] to the questionnaire submitted to them by the United Nations indicate that there are considerable differences in the promptness and effectiveness with which governments would be able to act in the near future to correct a substantial decline in effective demand. This is partly due to the fact that many governments have not yet settled on the course of action they propose to take. But in many cases, there remains the danger that, even if governments had decided on their policies and knew precisely in what circumstances they should be put into effect, there would be serious delay in the actual adoption of the measures required. Some governments have drawn attention to the fact that certain measures, such as additional public works expenditure and changes in tax rates, would require enabling legislation, and this might take considerable time.

13. In addition, unless detailed plans and technical preparations have been made in advance, additional delays are likely to arise after the necessary legislative authority has been obtained. It seems probable that unless advance planning is carried a good deal further, effective action will be held up in many countries.

14. The events of the first half of 1949 demonstrated how even a moderate decline in activity in one major industrial country can have serious dislocating effects on the entire world economy. Between the fourth quarter of 1948 and the second quarter of 1949 United States imports fell by 15 per cent, or by an annual rate of over one billion

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[5] See *Maintenance of Full Employment* (U.N. Sales No. 1949 II.A.2) and documents E/1111 and E/1111 Addenda 1-8.

dollars. Over the same period its imports from western Europe fell by over one-third. Thus the increase in dollar exports that several of the European countries had managed to achieve in 1948 was sharply reversed. Furthermore, there was a serious decline in United States imports of certain primary commodities, notably cocoa, rubber, wool and wood products, which are the main source of dollar earnings for the countries that produce them. We draw attention to these facts because they illustrate the urgent need for national and international action to permit the international flow of trade and payments to continue in the face of fluctuations in the effective demand in particular countries. Experience has shown that the functions of the International Bank for Reconstruction and Development and of the International Monetary Fund must be enlarged if they are to play their proper roles. To this end, we are submitting concrete recommendations which we believe will provide a basis for international consideration.

15. The difficulties that many countries have experienced in 1949 also bring emphasis to the fact that the dollar and non-dollar countries of the world are still in a state of chronic unbalance with each other. Had the countries of the world possessed adequate dollar reserves they could have sustained, at least partially, their rate of imports, despite the fall in their exports. As it was, they had to deprive their economies of needed imports through imposing additional restrictions. If the larger part of Europe's imports from the United States had not, in fact, been financed by loans and grants of the United States Government, the disruptive effect of the fall in United States imports on the world economy would have been considerably greater.

16. We can envisage no satisfactory solution of the world full-employment problem and no real improvement in the world trading system unless the chronic dollar shortage is attacked at its roots. Although substantial progress has already been made by the European countries, we are convinced that, to find a complete solution, the problem must be dealt with on a world basis, rather than on a European basis. There can be little doubt that Europe's ability to achieve balance-of-payments equilibrium would be facilitated to the extent that it could earn dollars in countries outside the United States. This will depend heavily on the international flow of capital. Finally, much depends on the internal policies of the United States—particularly its policies with respect to maintaining full employment and its policies with respect to tariffs. We

have reached the conclusion that the United Nations should undertake to arrange for consultation and negotiation between all interested governments for the establishment of a consistent pattern of world trade, and we have included in our recommendations our suggestions as to how these negotiations might be carried out.

17. The developments in employment and trade, reminiscent of past disturbances, which took place in the second quarter of 1949, have inspired the resolution passed by the Economic and Social Council inviting the Secretary-General of the United Nations to arrange for the preparation of this report. We have not interpreted our terms of reference as involving any attempt at forecasting what the short-term development of the world economic situation may be. Rather we felt it our duty to point to the necessary steps which should be taken so that efficient national policies for the maintenance of full employment may be promptly implemented as the occasion arises, and so that a stable framework of international economic relations may be established.

The Practical Meaning of Full Employment

18. The term "full employment", taken literally, defines a situation in which there are no unemployed persons. Even under this definition, however, full employment must be related to the size of the wage-earning labour force—that is, to the number of people able, willing and seeking work for wages, and to the normal hours of work; these in turn vary with the social framework, the incentives provided and the stage of development of countries. Any practical definition of full employment, moreover, must in addition take account of the various types of unemployment which exist in the real world, some of which cannot be completely eliminated even though much may be done to alleviate them.

19. Unemployment is of three main kinds. The first results from a lack of the complementary resources necessary to keep wage-earners at work; the second arises from certain structural factors in the economy; and the third is engendered by the insufficiency and instability of effective demand.

20. Unemployment resulting from a lack of capital equipment or other complementary resources required to keep the wage-earners at work is a characteristic phenomenon of underdeveloped countries. It may also arise in industrially advanced communities as a result of an

interruption of the supplies to which the system of production has adapted itself—for example, as a result of natural phenomena such as an unusually severe frost, or a lack of essential raw material imports caused by balance-of-payments difficulties. Such interruptions of supplies are usually of temporary duration in the highly developed countries. In the underdeveloped countries the lack of capital equipment is a crucial factor in large scale underemployment, which, although it may not emerge in the form of urban unemployment, is nevertheless reflected in the fact that a large part of the population could be diverted from agricultural occupations without any decrease in agricultural output. The only remedy for this form of disguised unemployment is economic development, which constitutes the major economic problem of the world. We are of the view that the problem of full employment cannot be solved except in the context of an expanding world economy of which the economic development of underdeveloped countries would form the most important single element.

21. We believe, moreover, that policies of economic development and policies of full employment are essential complements of each other. Thus the pursuit of full employment policies by the industrialized countries should in itself be of great benefit to the underdeveloped countries, since it is the underdeveloped countries which, as a rule, suffer most during worldwide depressions. On the other hand, one of the greatest needs of the underdeveloped countries is for the capital and techniques which they require to provide productive employment for their populations. In this connexion, we consider a stable flow of foreign investment to these countries to be of great importance.

22. We understand that the Economic and Social Council has made separate provision for extensive studies of the problem of economic development. While, therefore, we have had this problem continuously in mind in framing our recommendations with respect to policies of full employment, we did not consider it appropriate to attempt to deal extensively with the problem of economic development as such.

23. The second main cause of unemployment arises from certain structural features of the economy, such as seasonal fluctuations in activity, particularly in agriculture, declines in particular industries and irregularities in certain types of occupation. Frictional unemployment, moreover, occurs when workers, for whatever reason, leave one job and seek another. While policies designed to increase effective demand will

themselves substantially reduce these kinds of unemployment, it is most important that governments adopt measures designed directly to improve the organization of the labour market, to reduce seasonal and casual unemployment (for example, by providing alternative employment during slack periods), to facilitate the transfer of workers to new jobs, and, where necessary, to promote the international migration of labour. We wish to draw attention to the technical advice and assistance which the International Labour Organisation provides to governments on these matters. We understand that the International Labour Organisation is itself preparing a report on these aspects of employment policies in the near future. Although investigation of these problems is outside the scope of our own report, we wish to call attention to their importance.

24. Finally, the major cause of unemployment in industrialized countries is the insufficiency and instability of effective demand. In the light of present uncertainties in the world economic situation, we felt that it was this problem with which our terms of reference required us most particularly to deal. For the practical purpose of this report, full employment may be considered as a situation in which employment cannot be increased by an increase in effective demand. Under normal conditions, any unemployment exceeding the amount which is due to the frictional and seasonal factors to which we have referred above is a clear indication of a deficiency in effective demand. To put the problem in another way, we define full employment as a situation in which unemployment does not exceed the minimum allowances that must be made for the effects of frictional and seasonal factors.

25. There has undoubtedly been a tendency in the past to exaggerate the quantitative importance of the minor causes of unemployment, and to overlook the fact that the main reason why seasonal and other intermittent workers are not absorbed during the slack periods, and why workers displaced from their regular work remain unemployed, is the lack of alternative employment opportunities, which in turn is due to a deficiency of effective demand. This was proved by British experience during the war, when large-scale so-called "structural" unemployment, which had previously been attributed mainly to lack of mobility of labour, melted away, leaving an acute labour shortage. Similarly, the large-scale "transitional" unemployment that was expected in many countries after the war simply failed to materialize, because as people

were displaced from war jobs they were immediately absorbed into other employment.

26. These empirical observations are quite consistent with what one would expect from an analysis of the possible effects of these minor causes of unemployment. In the case of frictional unemployment, for instance, if as much as one-half of the total number of wage-earners were to lose their jobs each year and to remain idle for one week each, on the average barely 1 per cent of the total would be unemployed for this reason. In the United States the average rate of labour turnover—"separations"—in 1948 was between 4 and 5 per cent per month. Of these workers more than half left of their own accord, presumably with other employment in view, and it is probable that many of them were not out of work for any length of time. Even if we assume that all of those who left, whether through dismissal or of their own free choice, were idle for two weeks on an average, this would result in unemployment of about 2 per cent of the total number of wage-earners. In the case of seasonal unemployment, if there is a seasonal movement affecting several industries in the same direction simultaneously the unemployment resulting from this cause will vary throughout the year. Suppose that 20 per cent of the workers are in occupations subject to a 20 per cent fluctuation at the same period of the year, then seasonal unemployment will vary from zero to 4 per cent of the total number of wage-earners. Since in practice the seasonal fluctuations would not occur at the same time in all industries, the amount of seasonal unemployment would in fact fluctuate within a narrower range than the above. It would, therefore, not be surprising if a number of countries found that the level of unemployment resulting from both seasonal movements and labour transfers was no more than 2 to 4 per cent of the total wage-earners. In the United States in 1947 approximately 4 per cent of the total wage-earners were unemployed. In addition there were at that time about a million persons working short time but willing and able to work full time. In the United Kingdom from 2 to 3 per cent of insured workers were unemployed in 1947. In Australia, about 1 per cent of trade union members were unemployed in that year.

27. The percentage allowance for seasonal and frictional unemployment may be expected to vary to a limited degree from season to season and from year to year, depending on the nature and extent of economic change and on other circumstances. Thus, for the purposes of our defin-

ition of full employment, as described in paragraph 24 above, we prefer to use a range of percentages, rather than a single percentage figure, for the allowance for seasonal and frictional factors.

28. We believe that the first requirement for a successful full employment policy is that governments establish a full employment target that will provide a guide-post for their policy. This target should be expressed in terms of percentages of wage-earners out of work and seeking work; with proper allowance for the full time equivalent of the hours of work lost by persons who are working on short time but who are willing and able to work full time.

The Scope of the Report

29. Our assignment has been to report on national and international measures required to achieve full employment. In view of the history of the full employment pledge and the circumstances that gave rise to our assignment, we have confined ourselves to considering unemployment resulting from a deficiency of effective demand. Although there is scope for much further investigation into this problem, there is sufficient agreement to provide a firm base for our recommendations.

30. In the following sections of the report, we analyse the ways in which a deficiency in effective demand may arise, the causes underlying fluctuations in effective demand, and the manner in which fluctuations that originate in one country tend to be propagated to others. This is followed by a general review of the domestic and international aspects of the full employment problem, thus setting out the considerations leading up to our recommendations.

31. In view of the wide differences in the economic organization of various countries, it is, of course, impossible to lay down a uniform domestic full employment policy that all countries should follow. But there should be one common feature of all stabilization policies. Action to offset economic fluctuations should be prepared in advance and should come into effect without delay, as soon as the actual course of events shows that action is needed. It is with that requirement particularly in view that we have prepared our recommendations. At the same time we are convinced that full employment policies increase the general responsibility of governments for maintaining the stability of the price level. In our view, therefore, governments can and should take steps to secure stability of prices and avoid inflation at the same time as they can and

should take steps to avoid unemployment. While international measures of the type we propose are in our opinion necessary to enable the industrial countries and the underdeveloped countries to solve their problems of unemployment and underemployment, they will also permit the international trading system to withstand the minor fluctuations that are inherent in any country's full employment policy, however successful.

32. Such measures would also provide the conditions which we believe to be essential for the establishment of an international economic system in which the full benefits of multilateral non-discriminatory trade and the convertibility of currencies would be enjoyed by all countries.

33. Our recommendations for national and international action are designed to provide a framework within which the countries of the world can obtain the advantages of both full employment and an expanding volume of world trade. We believe that many of our recommendations, taken separately, are fully susceptible of successful implementation by governments. We do consider, however, that our recommendations should be examined as forming an interrelated whole, and that, taken together, they are sufficient to achieve full employment, both in its national and international aspects.

Part II

THE MAINTENANCE OF FULL EMPLOYMENT

Part II

THE MAINTENANCE OF FULL EMPLOYMENT

The Problem of Effective Demand

The Circulation of Income and Expenditure

34. In any community which provides for the satisfaction of wants through specialization and exchange, the prices received by the sellers of goods and services constitute at the same time the incomes of the enterprises—individual or corporate—which produce them; and thus provide the source of the remuneration of the individuals who share the income of the enterprises, whether as workers, employers or suppliers of productive resources. From these incomes comes the demand for commodities and services, to keep the circulation moving.

35. Commodities and services flow in one direction till they reach the final consumer, and money flows in the opposite direction. If the whole of the price received from the sale of goods and services were turned into income, and all the incomes were fully and regularly expended on the purchase of goods and services, the aggregate price at which sales had been made would always generate an equal volume of aggregate demand to maintain the circulation undiminished. Production in the aggregate could not, in that case, be limited by an insufficiency of purchasing power, since productive activity itself would necessarily generate sufficient buying power to absorb all the goods and services produced.

36. In fact, however, some of the buying power automatically generated by productive activity is not spent on the purchase of goods and services but is diverted partly to "capital accounts", as the savings of individuals and corporations and amortization payments with respect to the use of capital goods, partly to the government in taxes, and partly to the purchase of imported goods. On the other hand, the current demand for goods and services does not consist solely of the spending of current personal incomes. It is supplemented partly by expenditures on goods and services which are charged to capital accounts (investment expenditures), partly by the expenditures of the government, and partly by the demand of foreign countries.

37. The key to an understanding of the problem of effective demand lies in the recognition of the fact that in a private enterprise economy the decisions to save and the decisions to invest are to a considerable extent independent of each other; this is also true of the current revenue and expenditure of the government, as well as of the level of exports and imports. Thus the rate of investment depends heavily on the extent to which existing capital equipment is utilized, and the expectations of the rate of profit that can be earned in the future with the aid of new equipment. Decisions to save, on the other hand, maintain a fairly stable relation to current income, this relation depending on the habits of individuals, and on the share of business profits ploughed back into industry. In the same way, government tax revenue is highly dependent on the level of income, since a change in the community's income will affect government tax receipts (at given rates of taxation) more than proportionately. Government expenditures, on the other hand, do not necessarily vary with income, and may even vary in a contrary direction. Finally, the level of imports varies with the level of incomes of the importing country, while exports depend largely on the incomes of other countries.

38. These factors and their interaction explain why at times the community is unable to secure full utilization of its resources. Assuming for the moment that taxation is equal to government expenditures, and that imports are equal to exports, the principle can be illustrated by the interaction of decisions to save and decisions to invest. When savings decisions exceed investment there is a deficiency in the aggregate demand for goods and services, and some of the output currently produced will remain unsold (or sold at unremunerative prices), which, in turn, will necessarily cause a tendency towards contraction in the level of production and incomes. Since, however, savings largely depend upon the level of incomes, the contraction of incomes in itself tends to reduce savings, and thus to eliminate the excess of supply over demand. When, conversely, the decisions to invest exceed current savings, the aggregate demand for goods and services will exceed the current supply and incomes will tend to rise. This in turn will tend to increase savings until the rise in incomes reaches a point at which the excess of demand for goods and services over the supply is eliminated.

39. Similar forces of contraction and expansion in the economic system result also from the activities of the government and the movements of foreign trade. A change in the rate of government expenditure

at given rates of taxation, or a change in exports relatively to imports at given rates of exchange, sets up the same forces of expansion or contraction in the economic system, as a change in investment decisions relatively to savings.

40. In all these matters—private saving and investment, government revenue and spending, and the balance of foreign trade—there are both tendencies towards balance and possibilities of unbalanced movement. The objective of full employment can be maintained only if balance is achieved at levels at which effective demand is adequate to provide full employment. If balance is achieved at less than full employment, a full employment policy requires an unbalanced movement which expands aggregate effective demand, and continues to expand it until full employment is reached, when a balance must again be established between the several factors, in order to maintain employment at the full employment level. The condition necessary for balance is that the sum of factors having a plus effect on expenditure—private investment, government expenditures and exports—shall equal the sum of the minus factors—savings decisions, taxes and imports.

41. There is no reason to assume that the full employment level will be reached automatically or that, if it is reached, it will be maintained at that level. The attainment of full employment and its maintenance may therefore require sustained action, purposively directed to that end; and while numerous agencies may co-operate, the central role must be assumed by governments. While the main impact of government programmes is likely to be found in the direct effects of government fiscal and international policies, hardly less important may be their indirect effects on the attitudes of individuals and corporations whose decisions to save and invest are crucial in the private sector of the economy.

42. This account of the principle of effective demand reveals the way in which the economic system responds to financial stimuli, but, in itself, it is a drastic simplification of reality. At a time when there are unemployed resources of all kinds available at prevailing prices, an increase in effective demand expressed in money will normally result in a corresponding increase of production and employment. On the other hand, if some resources are scarce, or immobile in varying degrees, an increase in money demand will result partly in an increase in output and employment, and partly in an increase of prices. The same result

would follow even in the absence of any such physical limitation on the increase of output, if the sellers of goods or productive services held out for higher prices in response to an increase in demand. A further complication is that an analysis in overall financial terms ignores the possible effect of changes in price relationships. Changes in the prices of consumer goods relative to those of investment goods may have an important bearing on investment decisions, and changes in the prices of domestic goods relatively to foreign goods may have an important bearing on the foreign balance.

43. Finally, the liability to unemployment in different countries varies considerably with their stage of economic development; and it is particularly great in industrially advanced countries with high per capita real incomes. In such countries, a large proportion of consumption consists of durable consumers' goods, the purchase of which can be easily postponed; in addition, the highly variable items of investment expenditure constitute a large proportion of the total national expenditure. In underdeveloped countries, where the amount of capital equipment is relatively small and per capita real income is low, investment expenditure is only a small fraction of the total national income, and there is correspondingly small scope for a decline in internal effective demand. The potential importance of the problem of effective demand from the point of view of the more highly developed industrialized countries with a high per capita income is indicated by the experience of the 1930's, when, over sustained periods, employment and real income in the United States and in many of the industrialized countries of western Europe—with due allowance for the impossibility of exact measurement—was some 20 to 40 per cent below the levels that could have been attained if existing resources had been reasonably fully utilized.

Fluctuations in Production and Employment

44. The problem confronting us is not merely that of an insufficiency of effective demand but its inherent instability, which gives rise to fluctuations of a cyclical character in income and employment. Industrial countries with a predominantly private enterprise system are regularly subject to a complex pattern of recurrent fluctuations varying in duration. These cycles affect most sectors of the economy and appear to have the common feature that original or primary expansions or contractions are diffused in a cumulative and self-reinforcing fashion. On different occasions, the cyclical movement may go to varying lengths

before it reaches its limit and is reversed. The nature of the disturbing forces and of their cumulative action is well understood. There is more uncertainty as to the factors determining the amplitude and duration of particular cyclical movements and the actual factors responsible for the turning point, especially their timing. The latter kind of knowledge is important for any policy which depends on forecasting and anticipating a turning point, but the former kind of understanding is sufficient for a policy which is designed to check deflationary or inflationary tendencies and to reverse them before they have proceeded far.

45. There is general agreement that the primary factor responsible for cyclical fluctuations is the instability of the level of private investment, including investment in plant and equipment, business inventories and residential construction. These investment fluctuations are to be explained partly by self-generating processes, and partly by active disturbing factors. In both cases, the process of expansion and contraction, once started, is similar.

46. As regards the self-generating factors, there is reason to believe that a given rate of capital expenditures, unless it happened to be delicately adjusted to the trend of income and technical change, would not tend to maintain itself in time, even if income and technical change were maintained at a steady rate. In highly industrialized countries, the expansion of capital expenditures in the course of past cycles has generally resulted in a more rapid increase in the stock of capital equipment than in investment opportunities. In such circumstances, there tends to be a decline in the rate of profit, and a consequent reduction in the rate of capital outlays, which in turn reduces total income and causes the reduction in the rate of investment to be intensified. Thus a cumulative downward spiral may be initiated.

47. Such a cumulative process of contraction may be fairly rapid; it will not, however, proceed indefinitely but will come to a halt at some point. This is partly because investment reaches a minimum limit; and partly because, with the fall in income, savings will be more than proportionately reduced. Some kinds of investment, including certain public works and public utilities, are planned on a long-term basis and will not be significantly reduced as a result of a fall in current income. As incomes fall, savings will be reduced more than proportionately and possibly to a net minus quantity—partly because personal consumption tends to be maintained relatively to incomes, partly because unemployed per-

sons spend out of past savings as well as out of unemployment compensation, and partly also because corporations may pay dividends in excess of current earnings. The tax revenue of governments will decrease, while the expenditure of governments will decrease less, and some types of expenditure, such as unemployment compensation, will even increase. Hence the government may find itself borrowing to meet current expenses without necessarily intending this as a deliberate act of expansionist fiscal policy. Finally, imports may fall relatively to exports. All these reactions tend to damp down the contraction. Ultimately, these or other active factors bring it to a halt. Once the downward process has been arrested, the under-maintenance and obsolescence of current business capital tend to reduce excess capacity and this, or other active factors, in time initiates a revival of investment from its drastically reduced level. Once started, the revival proceeds cumulatively in the same way as the process of contraction.

48. Other elements in investment fluctuations consist of such active initiating factors as inventions and innovations which produce spontaneous increases in investment at an irregular rate. In addition, many extraneous and accidental factors affect the actual course of business cycles. Thus the occurrence of major wars and major changes in social and political institutions have a decisive influence on the course of economic activity. Such extraneous changes may for a time suspend entirely the operation of the normal cyclical process or they may alter the character or the timing of the fluctuations. The normal sequel of war is an investment boom, and unless new external influences prevent it, this boom can be expected to be followed by a decline in investment after it has brought the country's stock of capital into line with current needs. Finally, the course of cyclical activity will also be affected by the character of the responses which the ocurrence of economic fluctuations evokes in the field of governmental economic policy. This factor has grown in importance in recent years, since the large extension of governmental activities has introduced an important new element of potential stability into the economies of most countries.

49. The duration of an investment cycle depends on factors related to the construction period and the service life of capital goods. The former affects the rapidity with which investment overtakes investment opportunities, while the latter affects the rate at which an excess supply of equipment will liquidate itself. Since there are many kinds of capital goods with differing lengths of service life, the investment cycles of

various industries could be expected to be of unequal duration and differently phased. On the other hand, investment in most industries is strongly influenced by aggregate demand, and this responds to aggregate investment rather than to investment in a particular industry. Hence, the investment cycles of different industries tend to be synchronized in time: in effect, the investment cycles of the major industries can be said to influence the timing of investment in the minor industries. Nevertheless, certain industries (such as shipbuilding or residential construction) tend to have cycles of their own, differing in length and phasing from the general business cycle, though influenced by it. In addition, there may be inventory cycles, shorter in duration than the investment cycles for fixed capital.

50. Fluctuations in economic activity, and recurrent economic crises, have been observed for well over a hundred years. Their duration and severity have varied from time to time, the depression beginning in 1929 being probably the most severe on record. In 1932, the year of deepest depression, the volume of industrial production, measured in real terms, was little over half that of the previous peak period in the United States; while in a number of other countries, such as Austria, Belgium, Czechoslovakia, Germany, and Poland, it varied between 60 and 70 per cent of the 1929 level. The fluctuation in the national income, expressed in terms of national currencies, was in many cases even greater than that of industrial production, despite the fact that the national income includes sectors of economic activity which are less exposed to fluctuations than industry. The relatively greater fluctuation in national incomes is due to the fact that, in the course of a cyclical movement, not only production and employment but also the levels of prices and wages tend to vary. These associated changes in prices aggravate the effects of fluctuations in that they cause haphazard changes in the distribution of real income between different sections of the community and different areas of the world. The most important of such changes are those caused by the movements in the prices of primary products (i.e. the products of agriculture, forestry and mining) relatively to those of secondary products (i.e., the products of manufacturing industry). Owing to differences in the organization of production and marketing, the supply of primary products is less responsive to changes in effective demand than the supply of secondary products, with the consequence that the prices of primary products are far more unstable. Hence an economic depression is likely to cause less unemployment among producers of food and

raw materials than in manufacturing industries, but the impact of falling prices hits the former more severely. Primary producers, therefore, experience the effects of an economic depression more in the form of a severe reduction in real income than in the form of unemployment.

51. Fluctuations in economic activity have usually been worldwide in their effects. The depression which began in 1929 was reflected in reductions in industrial production and national income in almost every country in the world. The economic fluctuations in individual countries were, moreover, synchonized to a considerable extent. The reasons for this are analogous to those mentioned in connection with the synchronization of the investment cycles of different industries. While any country, if isolated from the rest of the world, might be expected to experience a cyclical movement of its own, the cyclical fluctuations of the leading industrial nations have, in effect, a determining influence on the timing and character of the fluctuations in the others, so that locally generated fluctuations tend to be displaced in time, and synchronized with those emanating from the leading industrial countries. With respect to economic fluctuations, therefore, some countries have a leading role and others more nearly a passive one, their economies tending to fluctuate in response to impulses received from outside. From this standpoint the course of economic activity in the United States has an influence in the world's economy which is not shared by that of any other country. To understand the character of this influence, it is necessary to examine in some detail the nature of the international propagation of cyclical fluctuations.

International Propagation of Changes in Effective Demand

52. To understand the ways in which the level of effective demand and its fluctuations in one country influence the economic position of other countries, it is necessary first of all to describe the means whereby the international transactions of any one country are ordinarily brought into equilibrium. Under a regime of fixed exchange rates, equilibrium in the balance of payments on current account—i.e. a state of affairs where the value of goods and services exported during any period is balanced by the value of the goods and services imported—presupposes a particular relation between the price levels in terms of the different national currencies and also a particular relation between the levels of effective demand in the various currency areas. A rise in the price level in any one country or currency area, relatively to others, will, other

things being equal, encourage imports and discourage exports. Similarly, an increase in effective demand in one country in relation to others will tend to increase imports and, if it absorbs some of the goods that would otherwise be available for export, it will also tend to reduce exports. The balance of international transactions is thus affected both by changes in the relative price levels and by changes in the relative levels of employment in the different countries.

53. In the past, it was generally supposed that under the regime of the international gold standard—in so far as short-term credit movements could not offset the effect of temporary fluctuations in trade—the balance of international transactions was secured through movements in relative price levels which were brought into operation automatically through the movements of gold that took place whenever the international balance of payments was disturbed. It is doubtful, however, whether, even in the heyday of the international gold standard, induced movements in relative price levels had any major regulatory influence on the balances of international transactions. The internal price level of any one country largely depends on the level of money wages; and it is questionable how far the inflow or outflow of gold exerted any significant influence on the level of money wages even though it may have affected the quantity of money in circulation. A more powerful and more direct effect on the balances of international transactions was exerted by the changes in the levels of production and employment which occurred either in direct response to changes in the international balance, or as a result of the restrictive credit policy introduced by countries suffering from a loss of external reserves.

54. Whenever a particular country experiences a reduction in its exports due to a fall in the foreign demand for its products, its internal level of activity tends to fall, both as a result of the reduced demand for the products of its export industries and also as a result of the reduction in the demand for the products of other industries, which the reduced level of incomes in the export industries brings about. This consequent fall in the level of production and incomes of the exporting country has the effect of reducing its demand for imports (even without any associated changes in relative price levels) and thus tends to correct the disequilibrium in the balance of international transactions.

55. It should be noted, however, that the resulting movements in the level of economic activity may not by themselves be sufficient to

restore equilibrium in the balance of payments on current account unless accompanied by deliberate credit restrictions ostensibly introduced in order to lower the price level, but, in effect, reducing the level of home investment. Unless domestic investment is reduced by restrictive policies, the reduction in incomes generated in the economy of any particular country (as a result of a fall in exports) may not proceed far enough to reduce imports by the full extent of the fall in exports and may thus leave a residual deficit in the balance of payments on current account.

56. The above propositions can be summarized by saying that any country which permits a fall in its effective demand will tend to create a favourable balance in its foreign transactions, since the consequent reduction in the level of effective demand of other countries will not normally be sufficient to reduce its exports by the same rate as its imports. Conversely, if a country takes steps to increase the level of employment in its own territory through the stimulation of demand, it will face an unfavourable balance in its foreign transactions, since the stimulation which its own expansion of employment extends to the level of economic activity of other countries will not normally be sufficient to raise the level of its exports by the same rate as its imports have risen in consequence of the increase in domestic demand.

57. It is evident from the above that, from the point of view of any single country, there may be a serious conflict of interest between the requirements of domestic prosperity and stability and the requirements of maintaining an international balance. Countries which allow the level of their effective demand and the level of their employment to fall, or which pursue restrictionist monetary and financial policies, will exert a depressive influence on the level of activity in the rest of the world; but at the same time they will tend to accumulate claims against the rest of the world and thus augment their own financial strength. Conversely, countries which pursue expansionist policies and raise the level of employment in their own territory will exert a stimulating influence on the level of activity in the rest of the world; but at the same time they are likely to face deficits in their international balance and thus to weaken their external financial position. The very policies, therefore, which lead to internal economic weakness may lead to external financial strength, and vice versa.

58. The possibility of maintaining a relatively free system of inter-

national trade may be compromised not only by the failure of some countries to pursue full employment policies, but also by the failure of others to avoid inflationary tendencies. Expansionary policies that are carried beyond the requirements of full employment will impair a country's export capacity and, unless offset by currency devaluation, will necessitate the adoption of specific measures to protect its balance-of-payments position.

59. It is the nature of these international repercussions which makes the question of domestic economic policies a matter of international concern. While the maintenance of full employment in any one country is primarily to be secured by domestic measures, it cannot be a matter of indifference to other countries whether a particular country maintains its effective demand at a satisfactory level or not. For failure to maintain economic prosperity in one part of the world makes it more difficult to pursue policies aimed at economic expansion in other parts; and may, in addition, force other countries to adopt restrictionist measures in international trade, which react unfavourably on the prosperity of the countries whose exports are thereby reduced. The pursuit of policies aiming at economic prosperity and stability is consistent with a relatively free system of international trade only if, in pursuing full employment policies, all countries keep in step, so that the efforts of some are not frustrated by the failure of others. The primary responsibility in this matter necessarily lies with those nations which, by virtue of their size, their share in world production and world trade, and their financial strength, are able to initiate policies of world economic expansion in a manner that is not open to smaller or less favourably situated nations.

60. The influence which the level of effective demand in one particular country exerts upon the prosperity of others depends essentially upon two factors: upon its share in world trade, and upon the extent to which its purchases of goods and services from other countries are likely to vary as a result of changes in its domestic economic situation. On both these counts the United States of America occupies a unique position in the world economy. Its share in world industrial production, which was about one-third before the war, now accounts for nearly one-half, and its share in the total value of world exports, which was around 12 per cent before the war, is now around 20 per cent. Its imports consist largely of commodities in which the bulk of requirements is satisfied out of domestic production, so that its import requirements

are peculiarly sensitive to changes in total domestic consumption. Between 1929 and 1932, while the United States national income fell by 52 per cent, the dollars supplied by the United States to foreign countries through purchase of goods and services and new investments abroad fell by 68 per cent. This implied a reduction in the dollars available to foreign countries after meeting fixed debt service obligations of no less than 77 per cent.[1] Between 1937 and 1938 the United States national income declined by some 10 per cent, while the dollar value of commodity imports fell by 35 per cent. Between the fourth quarter of 1948 and the second quarter of 1949, the United States national income fell by 5 per cent, the value of imports by 15 per cent.

61. Under the system of mutually convertible currencies that existed in the world before the great depression of the 1930's (and, to a more limited extent, up to the Second World War), and in the absence of import restrictions, the freedom of any individual country to stimulate the level of employment within its own territory in the face of declining world demand was extremely limited. Unless it responded to the decline in its exports by deliberate measures to contract its home demand, and particularly its home investment, it was faced with an unfavourable balance in its international transactions which could be sustained only at the cost of liquidating its international currency reserves (unless it could offset this by borrowing from abroad). Any attempt by a country in such circumstances to offset the decline in foreign demand for its products by stimulating home demand tends to impair its international financial position to an even greater extent, thus causing a more rapid depletion of currency reserves. The maintenance of a balance in international accounts in these circumstances requires a policy of internal deflation which reduces imports by the full extent of the fall in exports. This in turn enhances the fall in demand for the products of other countries, which are then similarly faced with an adverse balance in their international accounts. Under a regime of fixed exchange rates and convertible currencies, the necessity for maintaining an international balance will thus tend to force each country to adopt measures of contraction until the level of effective demand, and the volume of international trade throughout the world, has fallen to a similar degree in all trading countries. During the great depression of the 1930's an important initiating cause in the contraction of world employment and

[1] Cf. *United States and the World Economy*. United States Department of Commerce, table, page 6.

trade was the fall in prices and the fall in demand for imports in the United States. This resulted in a fall in prices and a contraction of production and trade in other countries, which, in turn, had further repercussions on the United States economy itself. In this way, by a process of chain reaction, the depression was spread and further intensified throughout the world.

62. The fall in world production and employment was not nearly as large as the fall in world trade, since in the face of the balance of payments crises the countries of the world, one after the other, adopted measures to restrict imports (in the form of higher tariffs, quantitative import controls or currency devaluation), by means of which they were able to raise their home production and consumption relatively to international trade. They were thus able to mitigate the effects of world depression only at the cost of foregoing some of the advantages of the international division of labour.

63. The policy of non-discriminatory import restrictions offers, however, a remedy of only limited efficacy, since in most countries imports cannot be restricted beyond a certain point without causing production to be restricted as well: industrial production cannot be carried on without the importation of essential raw materials. From this dilemma the policies of selective import control and bilateral trading (introduced by certain countries before the war and since practised on a wider scale) offer lines of escape. In the case of bilateral agreements, trade can be expanded between pairs of countries which are willing to settle their accounts directly and without the medium of international convertible exchange.

64. Through this system of bilateral trade and exchange control it is possible for any particular group of countries to maintain effective demand in the territories under their own control in the face of declining demand and employment elsewhere in the world. It must be realized, however, that the system of bilateral trading can never afford complete protection from economic instability: so long as major trading nations remain outside the system, the impact of outside fluctuations must inevitably have their effect on the export industries and on international liquidity, and thus on the ability of these countries to obtain essential raw materials from countries outside the bilateral trading system. The system of bilateral trading involves, moreover, continued discrimination between different sources of imports and thus militates against the

optimum allocation of the world's resources. It was for these reasons that the majority of the nations proclaimed their support of a return to a system of convertible currencies and multilateralism in the Bretton Woods Agreement and in the Havana Charter.

65. While the return to multilateralism and currency convertibility is the declared aim of the great majority of nations—alongside the policy of internal stability and full employment, as laid down in the Charter of the United Nations—it is important to realize clearly how far these aims are complementary and how far one is a pre-condition of the other. The system of bilateral trading and exchange control is undoubtedly a most powerful weapon for maintaining full employment and a high level of production within the countries participating in such a system, in the face of serious fluctuations emanating from non-participating countries. It is not, however, in itself a major source of economic instability and cannot therefore be regarded as an obstacle to the successful pursuit of domestic full employment policies by any country. The justification for bilateral methods of trade will undoubtedly disappear once the present structural disequilibrium in international trade has been removed and countries have succeeded in eliminating major fluctuations in their balances of payments arising from inadequate or unstable effective demand. However, in the successful attainment of the twin goals of full employment and the creation of a relatively free multilateral trading system, the former must certainly take precedence over the latter: while countries can pursue full employment policies even without a multilateral trading system, the restoration of multilateralism without the attainment of internal economic stability in the trading countries is impossible.

66. As will be argued later in this report, the essential prerequisites for a sound international system are the successful pursuit of domestic full employment policies, and the adoption of special measures for stabilizing the international flow of payments. Only if these conditions were fulfilled would each country be in a position to maintain a stable and prosperous economy and at the same time enjoy the benefits of a free multilateral and non-discriminatory trading system. This is not to imply that under such conditions balance-of-payments disequilibria would not arise, or that the maintenance of equilibrium would not require continued adjustment. In these circumstances, however, balance-of-payments disequilibria would emerge mainly as a result of structural changes; and exchange rate adjustments would provide the appropriate

method for dealing with them, once the fact of the structural change was clearly established. Primary producing countries, which are subject to great changes in their trade as a result of instabilities in the conditions of supply at home or abroad, would naturally require more time to determine whether an exchange adjustment was in fact called for. Countries would devalue in order to reduce import surpluses and appreciate to reduce export surpluses; with appropriate internal policies currency appreciation need not reduce effective demand in the appreciating countries, and currency depreciation need not reduce effective demand in other countries.

Full Employment Policies

The Domestic Aspects of Full Employment Policies

67. The problem of maintaining effective demand has two main aspects: how to secure stability, and how to secure an adequate level of spending. The problem of stability, in principle, could be tackled in two different ways: (1) by stabilizing the level of demand directly in those sectors of the economy which are primarily responsible for the fluctuations; (2) by neutralizing the effect of such fluctuations through compensating variations in the rate of expenditure on other goods and services. In both cases, the problem of ensuring stability of demand inevitably merges into the problem of ensuring an adequate level of demand. In the following section these two major methods of dealing with the problem will be treated in some detail.

Stabilizing the level of investment

68. Apart from cases in which the originating impulse of fluctuations is transmitted from abroad, the proximate cause of instability in the level of economic activity is the fluctuation in the level of capital expenditure, particularly of business investment in fixed capital or in inventories which, as was shown in paragraphs 45-47 above, may be of a self-generating character. The problem of instability could therefore be largely solved if adequate measures could be devised to stabilize the rate of investment. Even investment stabilization may not, however, solve the problem entirely, since the expenditure of consumers on durable goods may exhibit features analogous to the expenditure on capital goods in the usual sense of the term. Nevertheless there can be little doubt that the fluctuations in business investment represent the major primary cause of economic instability.

69. Spontaneous tendencies to fluctuations in the level of productive investment may be regarded as inevitable so long as the decisions to invest are made by private business firms acting independently of each other. In a socialist state such fluctuations may be avoided by stabilizing investment though a government budget, though even in a socialist state irregularities in the investment process may arise as a result of the intricate problem of dovetailing a succession of specific investment projects, each of which is of limited duration. In economies in which production is carried on by private enterprise subject to direct government controls, stability in the level of investment may be secured by means of quantitative restrictions (such as building permits, allocation of basic materials, etc.) provided the current demand for capital goods of all kinds exceeds the effective supply. During the period of post-war reconstruction, this was generally the case in a number of industrial countries, so that the level of investment could be more or less effectively controlled by the government—the actual stability of investment depending on the practical effectiveness of the control measures. But while such measures of quantitative restriction may be effective enough in times when investment demand tends to be excessive, they are unavailing to maintain the level of investment once demand falls below the limit set by the supply of labour and basic materials.

70. In private enterprise economies, which operate with a free price mechanism, stability in the level of private investment could only be promoted by methods of indirect control. Such indirect control operates traditionally through the banking system, i.e., through the variation of interest rates and other conditions of credit. Past experience has shown that such monetary methods of control (like the methods of quantitative control discussed above) are more effective in placing an upper limit to investment than in preventing downward movement. But apart from monetary and credit measures, there may be at least two other ways in which the government can influence the rate of investment. One consists in influencing the timing of private investment projects through special tax incentives—the government offering special tax concessions or subsidies to firms which are willing to postpone or ante-date their particular investment projects, so as to fit them into a more stable general pattern. This would require that the government obtain information on the investment plans of the individual firms for a sufficient time ahead to be able to exert an influence on the actual timing of their execution. It would also involve a highly complicated

system of tax legislation and tax administration in order to devise and administer inducements that would exert a major influence on the timing of investment projects.

71. The second method of stabilizing the rate of investment consists in offsetting the fluctuations in private investment by countervailing fluctuations in public investment. The effectiveness of this method clearly depends on the size of the public sector of the economy which determines the scope for public investment. In economies where the only type of public investment consists of public works (such as the building of highways, dams, bridges, navigation and irrigation works, etc.), the possibilities of stabilizing the rate of investment in this manner will obviously be smaller than in economies where housing, transport, public utilities or other basic industries are also under public control. It must be remembered, of course, that not all types of public investment can be timed in such a way as to fit in with the requirements of the general economic situation. In order to be effective, such a stabilizing policy would also require (*a*) that the public authorities prepare in advance an adequate reserve of suitable public investment projects which could be put into operation as and when required; (*b*) that the government obtain advance information on the investment plans of private firms, so as to be able to dovetail public investment with private investment effectively.

72. Economies that make widespread use of central planning and control are obviously in a better position to undertake the direct stabilization of investment than private enterprise economies relying on a free price mechanism. There can be little doubt, however, that with properly thought out methods and sufficient preparation, private enterprise economies could also accomplish far more in this direction than was thought feasible in the past. A number of countries have adopted new methods for the purpose of forecasting the movement of each strategic component of the national expenditure, and are building up regular channels of advance information on private business investment plans. Some countries are also accumulating a reserve of properly elaborated public investment projects which could be put into operation fairly quickly in case of need. These methods are as yet in their infancy and only experience will be able to show to what extent they will succeed in imparting a greater degree of stability to the economic system.

73. If the level of investment were effectively stabilized by any of the methods outlined above (or some combination of them), economies might still be faced with the problem of ensuring that the total demand for goods and services generated in the economic system was adequate to ensure full employment. If investment were stabilized at its long-term trend level (which may be put somewhere mid-way between the boom level and the depression level of investment), no special problem need arise in maintaining that level over longer periods, but the total demand for goods and services generated at that level of investment would also be somewhere mid-way between the boom level and the depression level, so that it would not suffice to ensure full employment. On the other hand, if an attempt were made to stabilize investment at levels approaching the peak periods of activity, the continued high rate of investment would lead to a growing over-capacity of plant and equipment, and would thus require more and more compensatory public investment to maintain it (or increasing subsidies to private investment), which in turn would be likely to cause an exhaustion of useful investment opportunities. In both cases, therefore, once the stability of investment is assured, there is the additional problem of adapting the structure of the economy to a higher ratio of consumption demand to investment demand which may be necessary in order to secure adequate total demand at a level of investment that is no higher than can be sustained under conditions of stability. This, of course, does not apply to underdeveloped or partially developed economies whose stock of capital equipment is inadequate.

Stabilizing aggregate demand

74. The alternative approach to the problem, and one which may yield more effective results in highly industrialized countries, is that of influencing the general level of consumer demand rather than attempting to control investment demand directly. The most promising methods of doing so are through the revenue or expenditure programmes of the government, both central and local. Certain kinds of government expenditures (e.g. consumers' subsidies, or transfer payments such as family allowances and payments to the unemployed) directly affect the purchasing power of consumers relatively to the level of incomes. Similarly, changes in the level and structure of taxation directly affect the purchasing power of consumers. Hence, consumers' expenditure can be raised or lowered by changes in taxes or in certain kinds of gov-

National and International Measures for Full Employment

(E/1584)

Errata

Page 9. The document references in the footnote should read "E/1111 and E/1111 Addenda 1-8".

Page 33, line 8. The word "depreciation" should read "appreciation".

Page 33, paragraph 68, line 5. The paragraph references should read "45-47".

Page 103, line 14. The sentence beginning "These are mentioned" should follow immediately after the previous passage ending with the word "investment" without a break.

ernment expenditure. In this way, total effective demand could be stabilized even though fluctuations in investment demand itself were not eliminated. The counter-cyclical variation in consumers' demand would, moreover, in itself exert a stabilizing influence on the level of investment, and this in turn would further stabilize consumption so that fluctuations of both would be reduced to a radically lower order of magnitude. Furthermore, a sustained policy of raising consumers' demand in the face of declining investment demand would lead to a gradual adaptation of the industrial structure to a higher level of consumption and thus reduce the scope for instability emanating from the side of investment.

75. The activities of governments, as was indicated in paragraph 47 above, will tend to exert a certain stabilizing effect on the economic system even in the absence of deliberate measures to raise consumers' demand in the face of a declining investment demand or vice versa. If the actual rates of taxation are not increased when the revenue of public authorities declines with a decline in income, the forces of contraction in the economic system will be weaker than they would be otherwise, and the downward spiral in production and incomes will come to a halt more quickly. If, furthermore, a decline in production and incomes itself leads to a rise in public expenditures (on account of unemployment compensation, for instance), the automatic stabilizing influence of governmental activities will be even greater. Looked at in another way, this means that if the fiscal policies of the state involve a growing budgetary deficit (or a declining budgetary surplus) in times of declining income, and vice versa, the actual fluctuations in income will be confined to narrower limits than if the public authorities attempted to achieve a balance between current revenue and current expenditure in each period. This stabilizing influence, moreover, will be all the greater, the larger the normal share of governmental expenditure in the total national expenditure. Such "built-in" stabilizing effects are, of course, far more effective in countries which have adopted a social security system and which, as a matter of policy, refrain from raising tax rates in times of declining national income. It would be desirable if governments reviewed their existing structure of social expenditure and their tax structure with a view to reinforcing the operation of such "built-in" stabilizers. It must be remembered, however, that such stabilizers, by the nature of the case, can only have the effect of dampening the range of economic fluctuations. They can

mitigate the fall in consumers' demand that occurs in response to a fall in investment demand; they cannot conjure up an actual *rise* in consumers' demand that would be needed to offset the fall in investment demand.

76. A rise in consumers' demand could, however, be secured through budgetary measures if governments did not content themselves with the "built-in" stabilizers described above, but undertook positive counter-measures through counter-cyclical variations in the rates of taxation in force. If the rates of taxation were lowered in times of declining demand, and raised in times of rising demand, the purchasing power in the hands of consumers could be altered sufficiently to maintain total demand at a stable level. (A similar result could be achieved, of course, if instead of varying the rates of taxation, governments varied the rates of certain types of expenditure in a counter-cyclical manner —e.g. if the level of consumers' subsidies, or of family allowances, were raised in times of declining demand or lowered in times of rising demand.) Though this policy aims at stabilizing the total demand for goods and services and not the demand for each major component separately, it is not expected that any major fluctuations in employment would occur as a result. The recent experience of industrialized countries has shown that, provided total effective demand is maintained, the economic system is capable of dealing with considerable shifts in the distribution of demand without involving transitional unemployment.

77. Variations in the rates of taxation in force thus appear to offer for many countries a most effective and prompt method for maintaining the level of effective demand in the economy. The leading industrial nations of the world possess methods for estimating the effects of particular changes of tax rates on consumer demand with a sufficient degree of reliability to warrant the application of these methods; they also possess general taxes which could be altered at short notice and the effects of such changes would be transmitted fairly promptly. The most suitable taxes for such purposes are general sales taxes, social security contributions, or personal income taxes which in a number of countries are now collected on a "pay as you earn" basis. Though the income tax is normally an annual tax, we do not envisage any serious difficulties in introducing the adjustments required to make it possible for tax rates to be changed at more frequent intervals. In the leading industries countries, the income tax is the most universal tax and

is probably best adapted for this purpose. However, the use of social security contributions for this purpose would have the advantage of distributing the benefit of increased purchasing power over a wider range of the community than is possible through a reduction in personal income tax. Indirect taxes levied on particular commodities are less suitable: in addition to changing the general purchasing power, variations in such indirect taxes may also create undesired variations in the consumption of the commodities affected. On the other hand, in countries which maintain a general sales tax on a sufficient scale to permit adequate variations, this tax could be used for the purpose of economic stabilization just as effectively.

78. If the future course of demand for goods and services could be forecast with sufficient accuracy, the necessary changes in taxation to maintain demand at a stable level could be planned ahead and, theoretically, put into effect simultaneously with any change in the level of national expenditure emerging from other causes, so that the actual level of expenditure could be kept stable. However, with the present knowledge of economic forecasting it would be utopian to expect that the necessary counter-measures to prevent fluctuations in national expenditure would generally be taken sufficiently early to prevent any actual variations from taking place. Though some governments do make regular forecasts of the trend of national expenditure and take these into account in determining the scale of taxation in connexion with the annual budget, it may be inevitable that the major counter-measures intended to check a decline in production and employment should be taken in the light of actual events rather than on the basis of forecasts of future tendencies that have not yet materialized. Some decline in demand is therefore bound to occur before effective measures can be taken to check and to reverse the movement. In present circumstances this may be inevitable; what is essential is to ensure that such counter-measures are not taken too late, and that when they are taken they should be adequate for dealing with the situation. If the nature and timing of counter-measures are left entirely to the discretion of the executive organs of the government, there is a strong presumption that the uncertainties of the future will generally weigh the scales in favour of inaction rather than action, and the adoption of positive counter-measures will be delayed until a downward movement in production and employment is well under way. Effective stabilization policies require, therefore, that positive counter-measures, the nature of

which is announced beforehand, be designed which automatically come into operation in certain clearly defined eventualities. Specific recommendations to this end are put forward in this report. Their adoption would not guarantee the complete elimination of fluctuations in employment, but they would give an assurance that effective countermeasures against cyclical instabilities would be taken early enough to prevent such fluctuations from exceeding certain moderate limits.

79. The basic principle underlying these recommendations is that compensatory measures aimed at producing an expansion of effective demand should be brought into operation automatically whenever the actual level of unemployment (as a percentage of wage-earners) exceeded a pre-announced level by a stated percentage, for three successive months. In our view, while the influence of chance factors would make it unreasonable to base policies on the actual record of any particular month, the record of three successive months should give sufficient indication of a trend to bring counter-measures into operation. The counter-measures could take the form of a stated reduction in taxation (whether of income tax or of a general sales tax) which, together with the secondary effects of the resulting increase in consumer expenditure, would generate an expansion of effective demand sufficient to bring unemployment within the full-employment target level.

80. Although the level of unemployment which gives the signal for the automatic measures must bear a definite relation to the full-employment target, it is not essential that it be calculated on exactly the same basis. For instance, the full-employment target might be defined in terms of percentages of the number of wage-earners who are unemployed; but the signal level for the automatic measures might be defined as a percentage of unemployment in the sensitive industries in which unemployment fluctuations are normally concentrated, such as manufacturing, mining and construction.[2]

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[2] If the number of wage-earners in the sensitive industries were, for instance, half of the total number of wage-earners, a change of 5 in their percentage of unemployment would be equivalent to 2½ in the percentage for the total number of wage-earners. Suppose the unemployment target were set at 2 to 4 per cent of the total wage-earners, then the mean percentage would be 3 per cent. If it were desired to apply automatic compensatory measures as soon as the percentage of total wage-earners unemployed exceeded this mean percentage by 2½, it might be preferable to set the actual signal, not at 5½ per cent of the total wage-earners, but at 8 per cent of the wage-earners of the industries that are particularly sensitive to employment fluctuations. The action taken should in any event have

81. To give positive and definite content to the full-employment obligation assumed by Members of the United Nations, the first requirement is that they should define their full-employment objective in the manner described in paragraph 28 above. The second requirement is that nations should determine the counter-measures which they intend to put into effect automatically whenever the level of unemployment exceeds a stated percentage for three consecutive months. Such an undertaking is not, of course, intended to replace other policies which governments should pursue to maintain their economies in a stable and prosperous condition. According to the nature of the political, economic and social institutions of each country, governments should exert a regulatory influence on economic life through fiscal, monetary or credit policies, or the use of quantitative controls, various kinds of anti-monopoly controls, and the general planning of investment or the deliberate variation of the public sector of investment. Many of these measures must by their very nature be discretionary in character: they need to be shaped in the light of each particular situation, as it discloses itself, and no detailed concrete obligations as to the manner of their operation could be assumed beforehand. The present proposal is intended as an assurance that, if and when other methods for maintaining effective demand in an economy clearly fail over a definite period, effective counter-measures will be brought into operation auto-

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the effect of reducing unemployment to the mean of the full-employment target.

The automatic compensatory measures may be operated in a more flexible manner by setting more than one signal level; so that certain expansionary action is taken at the first signal, further action if unemployment continues to grow until a second signal is reached, and so on. But there are obvious objections to making the system too complicated; and since these measures are complementary to a general policy of employment stabilization, it should be possible to adjust one or more of the factors in that general policy if unemployment continued to grow above the signal level.

To calculate the necessary reduction of the rate of taxation governments would have to estimate (*a*) the effect of any given reduction in tax rates on consumer spending power, (*b*) the effect of any given increase in consumer spending power on actual expenditure of goods and services, taking into account both primary and secondary effects. The first calculation requires translating a change in tax *rates* into the resulting change in the level of consumer income after tax. The second calculation would take into account the extent to which a given rise in consumer income causes a primary increase in spending and in addition the extent to which a primary increase in spending causes secondary increases of spending by persons whose incomes have been augmented in consequence of the primary increase. Though the exact nature of this relation would vary in different countries and different times, it has been estimated that in leading industrial countries, there is in normal circumstances a rough 1:2 relation as between primary and total effects, i.e. that the primary injection of one unit of money per unit of time causes a net increase of approximately two units in the level of expenditure.

matically to restore the situation. The greater the success of governments in stabilizing their economies at high levels of employment by other methods, the less will be the need to bring these measures into actual operation. Indeed, the mere fact that the precise nature of these counter-measures and the exact circumstances in which they are to be brought into operation are clearly announced beforehand will in itself have a considerable stabilizing effect on economic life. Uncertainties concerning governments' intentions are in themselves a major factor making for economic instability; once economic stabilization becomes the settled policy of governments and the mode of operation of this policy becomes known and understood by the community, the decisions of economic units which ordinarily give rise to fluctuations will themselves show a more stable pattern.

Full employment and budgetary policy

82. It remains to examine some of the main problems that may arise in private enterprise economies in connexion with a full-employment policy such as is outlined here. The first of these refers to the basic principles of governmental budgetary policies. In the past, government budgeting was operated on the principle that in ordinary times expenditure must be covered out of ordinary tax revenue and borrowing should be resorted to only in times of emergency, or for specified purposes. Though this principle was not always followed, the history of the public debt of many countries shows that borrowing was largely concentrated in times of war, while in times of peace the revenue raised in taxation normally exceeded current expenditure and was sufficient to make some provision for the reduction of the public debt. These debt repayments during periods of peace were, however, insignificant in comparison with the vast borrowings in times of major wars, so that in many countries (except in those where the debt was periodically wiped out through a major inflation) the size of the national debt showed a strong secular growth, even in relation to the national income. On the other hand, the vast increases in debt that occurred in connexion with the two world wars have also shown that past fears concerning the harmful economic effects of a large public debt were very much exaggerated. The economic effects of the debt depend on the annual interest charges that have to be paid, and not on the principal amount of the debt. The payment of interest on the debt represents a transfer largely from productive to unproductive sections

of the economy. Its effect on real income must be measured in terms of the nature of that transfer and the process of effecting it. The burdensomeness of that transfer will depend on the size and growth of the debt in relation to the size and growth of the national income. If policies which involve an increase in public indebtedness enlarge the national income, the burden of transfer payments may actually be reduced in consequence, even though the size of the debt and the annual interest charge on it are larger.

83. It is necessary, however, in substituting a flexible fiscal policy for the principle of an annually balanced budget, to ensure that the ordinary principle of economy in public expenditure—the proper weighing of costs against returns—is not sacrificed at the same time. The stabilization policy outlined above does not exempt governments from the obligation to raise new taxes in order to meet additional expenditures, except where special budgetary action is required to increase effective demand.

Full employment and inflation

84. A second problem which requires examination is the relation of a full-employment policy to the stability of the price level. In the past, inflation or inflationary pressure generally occurred during periods in which there was also full employment. This has given rise to widespread apprehensions lest full employment policies could be pursued only at the cost of continued inflation. Although serious inflations in industrialized countries in the past have generally resulted from disturbances caused by wars, it is nevertheless true that the governments' general responsibilities for maintaining the stability of the price level are enhanced by their adoption of full-employment policies.

85. Inflation may arise for several reasons. First, it will arise if the stimulation of effective demand to maintain full employment is carried to excess. In that case prices will tend to rise in relation to consumer incomes until, as a result of the rise in prices, consumer demand in real terms is reduced to the level of supply. This rise in prices, however, may lead to a demand for higher money wages, which in turn may cause a further rise in prices. To avoid such a wage-price spiral it is essential that steps should be taken to ensure that the stimulation of effective demand is carried only to the point required to maintain full employment and not in excess of this amount. Hence, the policy of employment

stabilization must also be effective in preventing an excess of effective demand which would be reflected in an inflationary rise in prices in relation to consumer incomes.

86. Secondly, it is possible for sectional inflationary pressures to develop as a result of "bottlenecks" in the supply of specific commodities, even in the absence of a general excess of effective demand. In times when the structure of demand is changing rapidly, output may be inelastic in some sectors of the economy while considerable unemployment persists in other sectors. However, we do not believe that, in ordinary times of peace, this need present serious difficulties to an effective full-employment policy. The economic system ordinarily shows a high degree of adaptability to changes in the structure of production caused by changes in demand or in technology; and it is the function of inventories to serve as a buffer when increased demand cannot be met immediately by increased output. Bottlenecks in the productive structure are likely to arise only in times of large-scale and rapid changes in the structure of demand such as occur in connexion with the conversion of an economy from peace to war or from war to peace. In such times inflationary pressures may exist side by side with considerable unemployment, though the recent experience of highly industrialized countries has shown that even large-scale transitions can be carried through with less disturbance than might have been expected. In any case, the inflation of the war and the immediate post-war years—when vast transfers of labour between industries and occupations were necessary—is not really relevant from the point of view of the relationship of inflation to a peace-time full-employment policy.

87. Finally, an inflationary price spiral could also occur if labour unions, farmers' groups, trade associations, cartels or business monopolies pressed for increased earnings in such a way as to produce a continuous upward pressure on prices. Although the bargaining power of any organized group may be sufficient to cause such pressure, even in times of insufficient effective demand, it must be recognized that such a risk may be increased by the temptation to exploit a situation in which demand is abundant and employment high and stable. The proper way for dealing with such inflation is not to reduce the aggregate volume of effective demand—which may create unemployment and may not even reduce prices—but to take steps which will ensure that price stability can be maintained at full-employment levels. If the various

economic groups do not exercise sufficient self-restraint to assure the maintenance of price stability, the government can take a wide variety of measures to prevent prices from rising without reducing the volume of effective demand below full-employment levels. Where the upward pressure on prices is due to attempts to increase profit margins, such measures might include qualitative or quantitative credit controls, direct controls over inventories, and selective controls over prices. If there is an upward pressure on prices, resulting from attempts to increase wages substantially more than the rate of increase in productivity, it might be necessary for governments, jointly with labour unions and representatives of management, to take action so as to ensure that such wage increases as may be granted will not lead to an inflationary price spiral.

88. A persistent upward pressure in the general level of wages could also result from continuing attempts to adjust *relative* wages to reflect differences in skill, in training, and in relative attractiveness of different occupations. Clearly, the efficient distribution of resources within an economy will greatly depend on the appropriateness of the scale of relative wages; such an appropriate wage scale, however, could not be expected to emerge automatically from the uncoordinated wage-bargains of different industries. One remedy may be to improve existing systems of wage-bargaining, so that wages applicable in different trades and crafts and in different industries could be settled simultaneously. It would, however, clearly lie beyond the scope of this report to examine the various ways in which improvements could be made in the existing arrangements for the settlement of wages. Our task here is mainly to call attention to this aspect of the problem and to urge that it would be inappropriate for any country to pursue policies having the effect of raising unemployment above the level resulting from seasonal and frictional causes, merely in order to restrain upward pressures on prices. If it appears in practice that the maintenance of full employment involves problems of maintaining the general stability of efficiency-wages (i.e. of the rates of wages in relation to efficiency) governments should seek ways of settling such problems, in co-operation with labour and management, rather than abandon the full-employment objective.

89. While a rise in unemployment in excess of the limits set by the full-employment target may generally be taken as a clear indication of an insufficiency of effective demand, a rise in prices, as we have

seen, may be due to a number of causes calling for different types of remedies and is not necessarily indicative of an excess of effective demand. In consequence it would not be appropriate to employ automatic compensatory measures to deal with inflationary problems in ways analogous to the automatic measures we recommend for dealing with situations of insufficient effective demand. The main reason for this is that there is no single criterion (the behaviour of some price index, for instance) that would make it possible to distinguish situations which call for general counter-measures to curb demand as distinct from situations which call for other types of measures to deal with the rise in prices, either sectionally or generally. In our view, therefore, in dealing with a rise in prices, governments must be left free to adapt their counter-measures to the needs of particular situations, rather than be obliged to institute automatic counter-measures of a pre-determined nature.

Full employment and the export industries

90. So far we have reviewed the problem of domestic full-employment policies only in those cases where insufficiency of effective demand is of domestic origin, i.e. when it is due to insufficiency in the level of home investment. For certain countries, however, insufficiency of effective demand in the domestic economy may be mainly the result of an economic depression generated elsewhere, manifesting itself in a fall of export prices, or a reduction in the volume of exports, or both. The balance-of-payments aspects of this problem will be examined in a later section of this report (see paragraphs 119-122). From the point of view of domestic employment, a reduction in demand for the products of the export industries has much the same consequences as a reduction in home investment, in the sense that unless counteracting measures are taken, the total fall in production and employment is likely to be considerably greater than the primary reduction due to the fall in the proceeds of exports.

91. However, the problems posed by a fall in exports are different from those resulting from a decline in domestic investment in two major respects. In the first place, while fluctuations in domestic investment may be eliminated by means of measures designed to stabilize internal aggregate demand, such measures could not prevent fluctuations in foreign demand for exported goods. Secondly, while it may be in the interests of long-term internal equilibrium to adapt the indus-

trial structure to a higher level of consumption and a reduced level of domestic investment, it may not be desirable, for balance-of-payments reasons, to employ measures which might have the effect of transferring labour and other resources away from the export industries.

92. It should be emphasized that the above considerations do not constitute any justification for failing to take measures to deal with unemployment in export industries. If unemployment were allowed to continue in these industries, labour and other resources would tend in any case to be drawn off to other industries, unless, indeed, there were general unemployment in the economy, which governments are committed to prevent. Moreover, any explicit or implied policy on the part of a government not to take action against any unemployment which might arise in the export industries would itself cause a deterioration of the morale of the labour force in these industries; it would cause workers to shun such industries as subject to special risks and induce them to seek employment elsewhere at the first available opportunity, even while foreign demand was at a high level.

93. Therefore, where unemployment is due to a fall in exports, a full-employment stabilization policy requires that governments maintain employment in the export industries, or at any rate provide alternative employment in the districts in which the export industries are located, so that when foreign demand for exports revives, workers will be able to return to their normal occupations. To these ends, specific measures should be introduced having the effect of stimulating domestic demand for the products of the export industries. Such measures might take the form of subsidizing the prices of the export goods in the domestic market. These subsidies could be progressively withdrawn to the extent that foreign demand was restored. If such measures proved insufficient, the government should introduce public works programmes in the areas affected so that workers in the export industries could be absorbed in remunerative employment, while remaining available to the export industries when foreign effective demand for the country's exports increased once again.

94. If exports fail to revive, so that there is evidence that the fall in exports of any particular industry is the result of a long-term downward trend in foreign demand, the government should consider making the necessary structural adjustments.

95. To the extent to which governments took action along the above lines to deal with the problem of unemployment in the export industries, there would be no need to bring into actual operation the automatic compensatory measures to raise effective demand in general.

96. In countries whose exports consist largely of primary products, a fall in foreign demand will generally take the form of a fall in the prices of such products and a consequent fall in the incomes of primary producers, rather than of unemployment. The most suitable method of dealing with this problem would be to enter into specific international agreements with a view to stabilizing the prices of staple commodities in world markets. Such agreements could either take the form of guaranteed purchases or sales, with prescribed price ranges, as laid down in the International Wheat Agreement; or the creation of international buffer pools, either for particular commodities taken separately, or for a combination of such commodities. However, there are many serious obstacles to the institution of such arrangements on a wider scale: obstacles arising partly out of the inherent conflict of interests between producers and consumers, and partly out of the difficulty of financing international commodity reserves in the absence of general currency convertibility.

97. Failing such international agreements, substantial stability in the world prices of staple commodities could still be achieved by the national commodity stabilization schemes of those countries which, either as exporters or as importers, control a substantial part of total world trade in particular commodities. In addition, each country could introduce a stabilization scheme for the benefit of its own producers, provided that it was prepared to incur losses resulting from differences between the guaranteed prices which it would pay to the domestic producers, and the prices for which it would sell the commodities at home or abroad. Since, however, such a scheme if adopted by a particular country in isolation, and in the absence of other related measures, would be bound to weaken its balance-of-payments position, the general solution of this problem along national lines can be contemplated only in conjunction with the adoption of special arrangements for the general stabilization of external currency disbursements on current account, such as are recommended in this report.

INTERNATIONAL ASPECTS OF FULL EMPLOYMENT POLICIES

98. The objective of full-employment policy in its international aspects is to create conditions under which any particular country will so behave in its international economic relations as not to prevent other countries from maintaining the stability and prosperity of their economies. Attainment of this objective requires both the achievement of over-all equilibrium and the maintenance of stability in international economic relations. These two aspects, though distinct, are closely related. Stability in international trade cannot be maintained when the balances of payments of individual countries are in serious disequilibrium; and balance-of-payments equilibrium cannot be maintained if the demand or supply of individual countries for internationally traded goods is unstable.

99. In our view, there are three major requirements for the establishment of the kind of over-all international economic equilibrium and stability which would enable countries successfully to maintain their economies at a stable and prosperous level. The first requirement is that some method be devised for ascertaining the general policies of countries with respect to the ways in which they intend to re-establish balance in their international transactions, so that all countries may be enabled to envisage the kind of economic adjustments which they will need to make in order to bring themselves into line with the future pattern and structure of world trade. The second requirement, which is closely associated with both the first and the third, is that lending countries should stabilize the flow of their international investment over considerable periods, and that appropriate international measures be taken for facilitating this process. Finally, the third major requirement for the establishment of sound international economic relations is that some procedure be introduced whereby the international propagation of cyclical fluctuations and a consequent cumulative contraction in world trade may be most effectively prevented.

Maintenance of over-all international equilibrium

100. The essential condition for the creation of a workable international system that is consistent with the prosperity and stability of the world economy is that each country should individually strive to attain a balance in its international transactions, and should therefore avoid policies which involve persistent surpluses or deficits in its bal-

ance of payments. Deficits and surpluses in the balances of payments are, of course, merely two different aspects of a single situation; deficits in the balances of some countries necessarily involve surpluses in the balances of others, and vice versa. It is important to recognize, however, that both deficits and surpluses in the balances of payments of particular countries may simply be a reflection of the economic conditions obtaining in, or of the policies pursued by, other countries, rather than of inadequate or inappropriate policies of their own. Thus a particular country may have a tendency towards an export surplus, owing to the fact that its own demand for foreign products is limited in relation both to its own exportable surpluses and to the size of the world demand for its products. In that case the inability of deficit countries to balance their accounts may be largely a reflection of certain structural features in the economy of the surplus country. On the other hand, if certain countries pursue domestic policies of expansion which leave insufficient resources available for the purpose of exports, their own inability to avoid deficits in their balances of payments will also reflect itself in surpluses in the balances of payments of other countries. Though no hard-and-fast rules can be laid down which would make it possible to determine how far, in any particular case, the cause of international disequilibrium originates in the deficit country or in the surplus country, it is clear that the restoration and maintenance of international equilibrium requires a co-operative effort by both sides, and the adoption of policies that are mutually consistent.

101. The acute underlying disequilibrium in international transactions which has persisted throughout the post-war period overshadows all other international economic problems and remains by far the most disturbing feature of the current situation. Until this disequilibrium has been eliminated, world prosperity and stability cannot be assured; nor can any substantial progress be made towards freer and less discriminatory trading conditions.

102. This chronic imbalance in international trade is of profound significance for the problem of maintaining full employment in many areas of the world. Unless the deficit countries succeed in paying for their essential imports out of current earnings, their ability to import the raw materials essential for their industries will be seriously endangered; and present development programmes in many underdeveloped countries designed to enlarge employment opportunities for their peoples will be compromised. Moreover, the extremely precarious level

to which the monetary reserves of many countries have fallen in consequence of persistent deficits over a number of years render them highly vulnerable to even small disturbances in international trade. Without the restoration of over-all equilibrium in balances of payments, it will be impossible to achieve the kind of stable international framework within which full employment policies can succeed.

103. The present disequilibrium in international economic relations has three main aspects. The first is the inability of western European countries to finance their imports by current earnings and, in particular, to pay for their imports from the dollar area, which at present are only temporarily assured through the aid furnished by the United States under the European Recovery Program. The second is the large import surpluses of a number of underdeveloped countries in Latin America and in the Far and the Middle East, financed, in greater part, by the drawing down of balances accumulated during the war in western European countries and in the United States. The third is the large export surplus of the United States both in transactions with Europe and with other areas. The universal character of this export surplus makes it very difficult for any country to cover a deficit with the United States through surpluses earned in other countries.

104. The magnitude of this imbalance can be gauged from the fact that in 1948 current earnings paid for only 43 per cent of Europe's imports of goods and services from the United States and for only 90 per cent of her imports from other non-European countries; that non-European countries as a group paid for only 74 per cent of their imports from the United States by current earnings; finally, that only 62 per cent of the current earnings of the United States in foreign transactions was covered by imports of goods and services. The elimination of this disequilibrium will require a large increase in Europe's overseas exports or a large reduction of her imports, or some combination of both methods. It will also require a similar adjustment by the non-European deficit countries, unless their current import surpluses can be sustained over longer periods through long-term borrowing for purposes of economic development. Finally, it will require a large increase in United States imports or a large reduction of United States exports, or some combination of both—except in so far as the United States wishes to continue to provide for an excess of exports over imports through long-term international lending. It is clear that these various adjustments are interdependent; thus, for example, the type

of adjustment which Europe should undertake, i.e. the extent to which it should raise its exports rather than lower its imports and the character and destination of such exports, will be closely related to the corresponding adjustments that the United States is prepared to make in its balance of payments.

105. The size of the adjustments required in the structure of world trade in order to re-establish world financial equilibrium is a sufficient indication that the solution of the problem requires a degree of international co-operation which would make it possible for countries to pursue policies of adjustment that are consistent with one another. To this end, there is a need for a procedure whereby countries would make known to one another the character of the international economic policies they intend to pursue, and would consult together concerning the means for harmonizing such policies. Such a procedure would involve, as a first step, that both deficit and surplus countries should set "targets" for the main constituent items of their balances of payments indicating the adjustments by means of which they hope to restore over-all financial equilibrium within an agreed period. Deficit countries should declare the amount by which they intend to raise the proceeds of their exports, or to reduce their disbursements on account of imports. Surplus countries should declare the amount by which they wish to raise their disbursements for imports, the extent to which they contemplate reducing their exports, and the amount of long-term lending which they wish to undertake on a continuing basis. These "targets" would not be in the nature of binding obligations on the countries concerned, but should provide a quantitative expression of the rate and direction of economic adjustment to be fostered by government policies. Nevertheless, they might be immensely helpful in facilitating the task of international economic adjustment. An analysis and comparison of these targets would reveal the nature of the inconsistencies in the policies and aspirations of the different countries and would provide a means for adjustment of these policies through consultation and negotiation between governments. In our view, such an analysis would reveal the specific trading relationships in which major adjustments are required. It would also reveal the nature of the adjustments in international trade required to secure financial equilibrium at the level of international investment which lending countries are prepared to provide (and to stabilize, along the lines suggested in paragraphs 111-

114 below). In this connexion, consideration should be given not only to new international lending but to the rate at which debtor countries are able to repay their existing debts.

106. We have given careful thought to the character of the machinery which would be most suitable to achieve the objectives which we have in mind. In our view, there is a need for all interested governments to meet together under the auspices of the Economic and Social Council in order first to exchange information along the lines we have suggested, and secondly to establish the character of a consistent pattern of international economic relations through a process of mutual consultation. If such a meeting or series of meetings were successful in working out a programme for the establishment of a new structural equilibrium in world trading relationships within a few years, there would still, in our opinion, be a need for the interested governments to continue to meet together at frequent intervals in order to adjust their targets on a continuing basis in the light of actual progress made; they should keep each other informed of the policies they are following in order to achieve a speedy realization of their goals; and they should, where possible, make specific agreements regarding major factors in these policies which are of common concern.

107. By these means governments would be enabled to make such modifications in their own national policies as would bring them into harmony with the over-all pattern of international economic relations upon which agreement had been reached. The main obligation of deficit countries in this connexion is to pursue policies aimed at reducing internal inflationary pressures which may compromise their ability to export and aggravate their need to import and to adjust their exchange rates in cases in which the expansion of their exports is hampered by the overvaluation of their currencies. They should also be prepared to adjust their production structures to the needs of those potential markets which, in the light of the prospective situation, are necessary for the achievement of balance-of-payments equilibrium. The main obligation of surplus countries is to take the internal measures necessary to ensure that any decrease in their exports or rise in their imports does not involve a reduction in their internal production and income and thereby generate again export surpluses in their own balances of payments. The surplus countries should also take steps to facilitate the necessary adjustments in trading relationships by reducing or removing restrictions on imports, in so far as they contemplate an increase in imports; and by refraining

from giving any direct or indirect encouragement to exports through governmental policies, in so far as they contemplate a reduction in exports.

108. Negotiations and consultations of the kind we envisage evidently require much technical preparation and assistance if they are to succeed. We therefore consider it desirable that the Economic and Social Council should appoint an Expert Advisory Commission, responsible to the Council, to work out the detailed procedures which will be required for the formulation of the over-all programme, including targets and the technical means for the co-ordination of national policies; to call the attention of governments to the problems that arise in the process of co-ordination of their individual programmes; and to report at regular intervals to the Economic and Social Council on the progress made and on any emergent problems requiring the attention of the United Nations or of the specialized agencies. In the course of its work the Expert Advisory Commission should maintain close contact with the interested specialized agencies and should make full use of their facilities.

109. We do not underestimate the difficulties and technical complexities involved in the far-reaching proposals we are making, and we are conscious that it is only too easy to suggest international conferences as a panacea for resolving all problems. But we consider that the procedure we are suggesting follows inescapably from the character of the economic disequilibrium with which the world is confronted. Only the governments themselves, by acting together in agreement with one another, can take the steps necessary to eliminate conflicts between their national economic policies and thus lay the groundwork for a consistent and self-sustaining pattern of trading and financial relationships, for the achievement of which all countries could work both individually and collectively.

110. It is a fundamental purpose of the United Nations, under the Charter, "to be a centre for harmonizing the actions of nations" in the attainment of common ends. In our view, the creation of a sound framework of international economic relations along the lines we have suggested constitutes, in the economic sphere, one of the most important of these common ends.

Stabilization of the flow of international investment

111. The second major requirement for the establishment of a sound basis for international economic relations is the creation of conditions

under which the flow of international investment could be stabilized over substantial periods. This is essential both for the attainment of structural equilibrium in international trade and for the efficient development of the world's under-utilized resources. As to the first of these aspects, if governments are to make a rational and co-ordinated approach to the adjustments required for the achievement of international financial equilibrium, it is essential that they should be able to foresee the level of external currency disbursements of the major lending countries for a considerable period ahead. Only if they are in possession of adequate information in this regard can they take appropriate action with respect to the future volume and direction of their exports, and determine the extent (if any) to which they will need to restrict the volume of their imports. From the point of view of the underdeveloped countries, the character of the development programmes which they will be able to plan and execute will depend in large part upon the extent to which they can anticipate a steady flow of capital from the lending countries.

112. From both points of view, it appears necessary that, in the field of foreign investment, the industrially advanced countries should undertake a far more conscious direction of policy than has yet been attempted. Past experience has shown that foreign investment, if left to private initiative, tends to be extraordinarily unstable: it tends to dry up in periods of depression—at the very time when its cessation does the greatest damage to the maintenance of world prosperity. It is hard to see how this could be prevented without direct government action. Furthermore, the conditions for a revival of private foreign investment on any large scale have become less favourable. Quite apart from the political instability that is inimical to a revival of private lending, the underdeveloped countries themselves have strong feelings on the conditions under which they will admit foreign capital. Quite understandably they do not want a repetition of the policies of the nineteenth century, and they want to retain a substantial amount of control over the capital invested in their territories. Thus, while private foreign investment can continue to play an important role, its extent is likely to be limited. It is evident, on the other hand, that the interests not only of the underdeveloped countries but of the world economy at large depend heavily on a substantial and steady outflow of capital from the leading industrial countries. The only practicable solution of this problem is to organize a large part of long-term foreign lending

through an international organization. The International Bank for Reconstruction and Development is soundly conceived from this point of view. By placing an international buffer between the lending countries and the borrowing countries, it can achieve the economic advantages of foreign investment and at the same time avoid its disadvantages.

113. However, the International Bank, if restricted to its present functions, would be unable to act as the main channel of international lending and to bring about a stable flow of international investment of major dimensions, for two reasons. The first is that its resources are far too small to meet the needs of such a long-term investment programme. It has very limited funds for direct lending and must rely largely on borrowing from private investors; and its ability to borrow is likely to vary with the state of the capital markets of the lending countries. The second reason is that, except in special circumstances, the Bank is now restricted to lending on a specific project basis. While such loans make important contributions to economic development, it is extremely unlikely, as the Bank itself recognizes, that they will result in a total flow of the magnitude required. We therefore believe that, in addition to its present functions, the Bank should be empowered to obtain funds by borrowing from governments; and to lend to governments for general developmental purposes not only in special circumstances but generally. With these powers, the Bank could serve as the international agency through which governments could stabilize their international investment programmes.

114. We believe that governments of lending countries should take direct responsibility for a considerable volume of future international investment and in particular that they should make known in advance the total annual volume of international investment which they consider appropriate in the light of the lending capacity of their countries. Having thus established their targets for future international lending, the lending governments should put at the disposal of the International Bank at six-monthly intervals an amount equal to the total foreign investment planned for the period less the amount expected to be lent through private investors or national public bodies, including the International Bank's issues on national markets, or through other channels. If the amounts actually lent in any period fall short of the target level, the amounts put at the disposal of the International Bank in the following period should be so adjusted as to stabilize as far as possible the total amount of net lending at the target level. Thus governmental

loans to the Bank would consist of two parts: a predetermined amount depending on the long-run lending programmes; and a (smaller) fluctuating amount that would offset fluctuations in private investment.

115. Inasmuch as the Bank would act as an intermediary between lending and borrowing governments, its functions would amount to creating a pool of lending resources to be allocated among the different countries according to the merits and requirements of particular developmental programmes. It would be the responsibility of the Bank to investigate the programmes for which loans were requested and to follow their execution. It would borrow from lending governments by issuing securities to them on the terms on which they themselves were able to raise funds on their own markets. It would lend directly to the borrowing governments at uniform rates of interest (as at present), and at rates no higher than required to cover the cost of the loans, the Bank's operating expenses and a fixed allowance for the risks of default. For such operations, the Bank would need no capital of its own. Losses would be met in the first instance out of the reserves set up for the purpose (which should be kept separate from the capital and reserves set up by the Bank within the framework of its present operations); for the balance, losses would be apportioned among all lending governments by a proportionate writing down, to the necessary extent, of their outstanding loans. Such an arrangement would provide for a spreading of risks among lending countries and would thus reduce the losses which individual countries might have sustained by direct lending.

116. During the course of its development, it is appropriate for an underdeveloped country to run a balance-of-payments deficit on current account. Provided it executes a well-conceived development programme, it can afford to borrow on a long-term basis to meet this deficit. When loans are granted for general development purposes instead of for specific projects, the restriction on the use of the funds to specific purchases from abroad loses its validity; and the funds provided should be made available for the financing of any imports that are directly or indirectly necessary for the execution of an over-all developmental programme. This means that, while the Bank must necessarily continue to seek the maximum possible safeguards for its loans, it should be enabled to change the criteria applied in making them. To ensure that the funds are in effect applied to the realization of the development programme, borrowing countries should be required to set up separate

capital budgets which would show in detail the disbursements under the programme so that they could be followed in detail. If governments so desired, such budgets could be prepared side by side with their budget as it is at present constituted. No basic changes in executive and legislative procedures may therefore be required. The United Nations should also use every endeavour to provide the technical assistance which countries will require in framing their development programmes and in making their loan applications to the Bank, in accordance with the policies approved by the General Assembly.

Stability in international trade

117. The third major requirement for full employment in its international aspects is that measures be taken to assure stability in international trade. Instability in international trading conditions can be due to many causes, some of which are the result of deliberate policies pursued by governments; others are the result of changes in the general economic situation which could (to a greater or lesser extent) be prevented by appropriate government policies; yet others are of a kind for which the governments concerned could in no way be held responsible. Instabilities of the first type can be exemplified by changes in tariffs, import restrictions or the buying policies of public trading corporations. Instabilities of the second type are those caused by deflationary or inflationary tendencies in the domestic economy and the consequent changes in the demand for imports or in the supply conditions for exports. Instabilities of the third type are those due to crop failures, etc.

118. It is clear that instabilities of this last type could never be eliminated—though national or international policies may be designed to mitigate their effects on the exporting or on the importing countries. Instabilities of the first type—those resulting from deliberate action by governments in the field of international economic policy—could clearly be prevented; and the new international institutions created or projected since the war, such as the International Monetary Fund, and the proposed International Trade Organization, were set up to establish and to follow the observance of a body of rules designed to prevent countries from pursuing policies that are incompatible with good international behaviour. There can, however, be little doubt that present international arrangements are least adequate where they are most required—namely in respect of instabilities which

result from fluctuations in effective demand in particular trading countries. The only positive contribution so far in this field is the commitment of governments to pursue full-employment policies. No doubt, if policies of domestic economic stabilization were one hundred per cent effective, so that both inflationary and deflationary tendencies could be entirely avoided, international economic stability of the second type would also be assured—though even in that case, there would be need for a specific policy, on the lines suggested in paragraphs 112-114 above, for stabilizing the flow of international lending. However, no assurance can be given that domestic policies of stabilization will fully succeed, in the coming years, in eliminating all fluctuations in income and employment. There is every likelihood that even if governments take all practicable action for stabilizing their internal economies, considerable fluctuation might still occur in a country's external balance of payments on current account as a result of internal causes. This is particularly probable in those countries whose demand for imported goods is highly sensitive to changes in the level of incomes.

119. As was explained in paragraphs 54-56 above, a deflationary tendency in any particular country will reduce that country's imports from the rest of the world and, to the extent that it leads to an internal fall in prices or an easing of supply conditions, it will also tend to augment its exports. This will adversely affect the economies of other countries both by reducing their international monetary reserves through the adverse movement in their balances of payments and also by reducing their internal employment. Conversely, an inflationary tendency in any particular country will increase its demand for imports and may also tend to reduce its exports. It will therefore raise effective demand in other countries and may generate inflationary tendencies there; it will also tend to strengthen the liquidity position of other countries through the favourable movement in their balances of payments. It should be noted, however, that the effects of deflationary and inflationary tendencies emanating from any particular country on the economies of other countries are not symmetrical. Since inflationary tendencies cause an adverse movement in the balance of payments of the country concerned, disturbances of this type would sooner or later compel the country affected to take some kind of remedial action—as otherwise its currency reserves would become exhausted. There is no such compulsion, however, in the case of disturbances resulting from deflationary tendencies, since a country

may be willing to augment its international monetary reserves indefinitely.

120. This asymmetry was recognized in the Articles of Agreement of the International Monetary Fund and in the Charter of the proposed International Trade Organization, which explicitly permit countries that encounter balance-of-payments difficulties resulting from deflationary pressures emanating from abroad to waive the ordinary rules concerning commercial and exchange policy and to introduce measures for quantitative restriction and trade discrimination, while no analogous provisions were made in the case of countries whose economies might be affected by inflationary tendencies emanating from abroad. Thus, under the Articles of the International Monetary Fund, a deficit country has a certain freedom to devalue its currency which a surplus country does not possess. A deficit country would also be free, under the ITO Charter, to impose quantitative import restrictions which would not be open to other members of the organization whose balances of payments were favourable. Finally, if the currencies of surplus countries became scarce and a declaration were made to this effect by the International Monetary Fund, countries would be free to restrict imports from such scarce-currency countries without the need of imposing similar restrictions in regard to imports from other countries. These provisions constitute powerful safeguards for the protection of domestic employment policies in times of world depression. However, these measures in themselves could not prevent economic depression in one particular country from affecting adversely the economies of other countries, since these other countries would still be compelled to forego their normal imports from the depressed country, and—depending on the character of these imports—this would involve a loss in real income and might also affect their ability to carry out domestic full-employment policies. Discriminatory import restrictions would, moreover, disrupt the normal channels of trade and the institutional framework within which international trade should be carried on—and, as past experience has shown, it is difficult to re-establish the normal trading patterns and institutional arrangements once they have been disrupted. Finally, these restrictions, while they could minimize or even prevent the adverse effects of deflationary pressures on the balances of payments of other countries, would be bound to aggravate the internal position of the country suffering from a depression, by reducing its exports. In addition, a restriction of

imports designed to protect the balance of payments would, to the extent that it was non-discriminatory, aggravate the position of other countries and thus magnify the effects of the decline in effective demand. Therefore, both from the point of view of countries suffering from a decline in effective demand and also from the point of view of the world at large, it is eminently desirable that countries should not be placed in the position of having to restrict imports in order to offset a fall in their exports caused by deflationary pressures abroad; and, in our view, specific international action for maintaining full employment should explicitly be based on the recognition of this principle.

121. If countries possessed international currency reserves that were large in relation to the magnitude of fluctuations in international demand, they would be able to maintain their imports, and thus the stability of their whole economy, in the face of export fluctuations, by drawing upon their currency reserves in times of low foreign demand, provided they could be certain of replenishing them at a later period. However, the large uncertainties that are always associated with international trade would make countries unwilling to allow their reserves to fall for the purpose of stabilizing their imports, even if they possessed adequate reserves to do so. In the present situation most countries possess only a minimum of currency reserves and have no early prospect of restoring them. The International Monetary Fund was created during the war as a means of enlarging the international reserve available to all countries. It is very doubtful, however, that, even if the present fundamental disequilibrium in international transactions were removed, it would be capable of dealing with the problems that are likely to arise in the event of any sizeable fluctuations in the currency disbursements of the leading industrial countries. The International Monetary Fund, in answer to the United Nations questionnaire on full employment, itself stated that it considers its present resources wholly inadequate for dealing with the effects of an economic depression. Under present circumstances, moreover, a major increase in the Fund's resources could hardly be envisaged, since creditor countries would have no assurance that the added resources of the Fund would be used for stabilization purposes and not for the purpose of maintaining or even aggravating the fundamental disequilibrium in the balance of international transactions.

122. Since a reduction in exports of a country suffering from a decline in effective demand is a direct or indirect consequence of the

reduction in its external currency disbursements (i.e., of a reduction in the value of its imports or a reduction in its net foreign lending, or both) it could be prevented if that country took steps to maintain both its foreign lending and its external disbursements on current account. One method of achieving the latter would be the adoption of special measures to maintain imports. Such measures could take the form of government purchases of imported goods for stockpiling or for public use; the inclusion of purchases of imported goods within existing commodity stabilization schemes in the importing country; tariff reductions and the removal of other restrictions on imports; and finally, outright import subsidies. International commodity schemes designed to stabilize the prices of basic commodities would, of course, have an automatic stabilizing effect on the value of imports in such circumstances. In the absence of international schemes of commodity price stabilization, each country could take independent measures for stabilizing the value of its imports in the face of internal fluctuations in demand if it were prepared to hold stocks of such imported commodities. However, the extent to which individual countries would be prepared to go in maintaining imports is clearly limited. The greater part of a country's imports is not suitable for stockpiling purposes; and governments would clearly be unwilling to undertake measures of import stimulation that would directly or indirectly weaken their internal economic situation. It could hardly be expected that governments would undertake positive measures of stimulating imports—in the form of tariff reductions or even outright subsidies—in times of falling domestic demand.

123. It is therefore necessary to find some means whereby countries suffering from a decline in exports resulting from a reduction in external effective demand could maintain their imports without a corresponding depletion of their international currency reserves so that a cumulative contraction in the volume of world trade would not ensue as a by-product of the attempts of countries to maintain their international currency reserves in the face of a decline in external demand. In our view this could be achieved if a mechanism could be created whereby countries which unintentionally syphon off currency reserves from the rest of the world through an undesigned export surplus generated by a fall in their employment, took steps to replenish these reserves on a continuing basis. This would enable other countries to maintain their current purchases from the country suffering from a

fall in demand, thereby lessening the impact of that fall in the country involved and also preventing it from affecting adversely the real income of other countries.

124. Since the International Monetary Fund is the international institution primarily concerned with maintaining international currency reserves, the most appropriate solution of this problem would be an arrangement whereby the Fund would act as an agent for the provision of temporary accommodation to countries confronted with a loss of monetary reserves as a result of deflationary tendencies in other countries. Under such an arrangement, any country whose external disbursements on account of imports fell as a result of a fall in internal effective demand would put at the disposal of the Fund such sums in its own currency as were necessary to make up for the deficiency; these sums would, in turn, become available for purchase by other countries against their own currencies, in proportion to the losses which they had sustained in the currency of the depositor country as a result of the fall in their exports to that country. For this process to be self-liquidating, a further provision would be required whereby the depositor country would, in some subsequent period, be able to replenish its own monetary reserves by drawing upon such other currencies as had been deposited with the Fund under the above purchasing arrangements.

125. The scheme we recommend, and set out in detail in paragraph 205 below, has as its objective the maintenance of the world's currency reserves, in the face of deflationary pressures, without aggravating the disequilibrium in the international balance or creating new sources of disturbance by stimulating inflationary tendencies in deficit countries. By making a contingent provision for the replenishment of currency reserves on a continuing basis, this plan avoids the problems that would be encountered in any once-and-for-all increase in the resources of the International Monetary Fund or in any scheme aimed at redistributing the world's gold reserves. In conjunction with the arrangements suggested above for adding to the functions of the International Bank, it would enable the Fund to fulfil the functions for which it was originally created and would provide one of the basic requirements for the early restoration and maintenance of international currency convertibility. The plan would also enable the Fund to carry out its other functions in the manner originally envisaged, and in particular to act as the central international agency responsible for providing

such financial facilities to its members as would enable them to tide over temporary maladjustments in their balances of payments.

126. The elaboration of such a plan calls for a clear definition of the circumstances in which compensatory deposits would be made with the Fund and of the amount and timing of such deposits; of the methods for satisfying claims upon these deposits; and of the circumstances in which a country which had been required to supply its currency to the Fund should be able to draw upon the currencies against which its own deposit had been sold.

127. It is an essential requirement of the plan that, while it should compensate for a decline in the external disbursements on current account of a given country which was traceable to a decline in domestic demand, it should not serve to enable other countries to make net additions to their monetary reserves nor to increase their imports from the depressed country above the level which would have prevailed had the decline in internal demand not occurred. These objectives are ensured, in the scheme put forward in paragraph 205, by a provision which limits the amount of currency to be deposited with the International Monetary Fund of a country suffering from a fall in internal demand to an amount equal to the fall in its imports less the fall in its exports as compared with some suitable reference year; and by a further provision which limits the amount of such currency which can be made available to any one country to the fall in its exports to, less the fall in its imports from, the depositor country as compared with the same reference year. The scheme does not provide finance for any increase in either the volume or value of the exports of a country suffering from a decline in internal demand, nor would the scheme deal with the case in which a depletion of reserves was due to capital flight.

128. Two main considerations enter into the determination of the "reference year" against which changes in imports and exports should be measured. First, allowance must be made for the fact that the level and composition of imports and exports are likely to change gradually with the progressive changes in the structure of world trade. This consideration alone would argue in favour of a changing reference year. The plan proposed in this report therefore provides that in normal circumstances the reference year should be the year previous to the year in which a decline in imports by a country suffering from

recession took place. Secondly, it is important to ensure that the reference year itself should not reflect a fall in imports caused by a decline in internal demand since otherwise the main purpose of the plan would be frustrated. For this reason, it is necessary to provide that in cases where a country has been suffering from unemployment in excess of the target level during an extended period, the reference year should be regarded as the last year in which the full-employment target was achieved.

129. The scheme thus provides finance for the net increase in a country's export surplus (or the net fall in its import surplus) caused by a fall in its demand for imports as a result of a decline in internal demand—in other words, it takes into account the extent to which exports have fallen as well as imports. An alternative method for dealing with this problem would have been to provide finance for an amount corresponding to the reduction in imports without any allowance for changes in exports. Assuming that all trading countries entered the scheme, these two methods would yield the same results. There are several reasons, however, why the provision of finance on a net basis is preferable to the alternative of providing finance on a gross basis. The first is that if only a limited number of countries enter the scheme, provision of finance on a gross basis might result in some countries' having to make deposits although their export surplus had actually diminished (or their import surplus had actually risen) as compared with the reference year. This would present an obstacle to the introduction of the plan unless all trading countries could be induced to enter the scheme simultaneously and could be relied upon to carry out their obligations under it. On a net basis, on the other hand, it would be feasible to introduce the scheme even if at the start only a limited number of trading countries agreed to put it into effect. Secondly, if deposits were made on a gross basis, countries which, in spite of the plan, restricted their imports from the depositor country, would be able to increase their monetary reserves through such a restriction; in some circumstances, therefore, they might be tempted to do so, which would be contrary to one of the basic purposes of the plan. Finally, it should be emphasized that, apart from the factor mentioned above, countries would have the same inducement to maintain imports from a prospective depositor country whether the scheme operated on a gross or on a net basis. In both cases, countries would be in a position to obtain

sufficient finance to purchase the same volume of imports as in the reference year if they chose to do so.

130. The plan proposed in this report is designed to enable countries to maintain their imports from the depositor country without a reduction in their currency reserves provided that those imports in real terms are no higher than in the reference year, and provided also that the amount of finance, if any, furnished by the depositor country through long-term lending has not changed in comparison with the reference year. If the volume of long-term lending is stabilized, the formula described in paragraph 127 above will provide finance for the same amount of exports in real terms, irrespective of whether prices as compared with the reference year remain unchanged or have generally fallen and irrespective of whether import prices have fallen in greater or less proportion than export prices. The single exception to this rule arises in the case where the value of exports of the depositor country falls as a combined result of an increase in the volume of exports and a decline in prices. In this case, the application of the above formula would result in the financing of a higher volume of exports than in the reference year. In such a case, therefore, for the purpose of this scheme, the fall in the value of exports should be calculated as if the volume of exports had remained unchanged as compared with the reference year.

131. Evidently, a fall in imports by a particular country may be due to factors other than a fall in internal demand or a restriction of imports not made necessary by an adverse balance of payments. Such a fall might, for example, occur if a particular country was unable to obtain the imports it required from other countries, either as a result of general shortages in these countries, or on account of inflationary policies pursued in such countries. It is, therefore, necessary to give discretion to the International Monetary Fund to waive the requirements of the scheme in such circumstances.

132. It would, in our view, be reasonable to prescribe that compensatory deposits, where required, should be made at annual intervals and not later than six months from the beginning of each calendar year. This means that reserves would be replenished with a one-year lag on the average. In our view, this would not cause any special difficulty in the operation of the scheme. Countries would either be able to tide over intervening periods with the aid of their own reserves (i.e., would allow their reserves to be depleted in the knowledge that

they would be replenished later on) or could turn for short-term accommodation to the ordinary facilities provided by the International Monetary Fund.

133. The manner in which the claims of other countries upon a deposit made by the depositor country with the Fund should be satisfied follows simply from considerations symmetrical with the requirements under which the deposit is originally made. Thus a country experiencing pressure on its monetary reserves resulting from a decline in its exports to a depositor country should be entitled to purchase the currency of that country from the International Monetary Fund against its own currency in an amount equal to the fall in the value of its exports to that country, net of any fall which may have occurred in the value of its imports from that country. The sum of all such claims should theoretically be exactly equal to the deposit made, though, in practice, statistical discrepancies may arise and the Fund may be called upon to adjudicate the claims in such cases. The Fund may also be called upon to adjust claims in cases where the depositor country made partial use of the waiver clause referred to in paragraph 131 above. Claims might be filed at any time up to eight months from the beginning of the calendar year, thereby providing a margin of two months beyond the time limit for the making of the required deposit by the depositor country. All outstanding claims should have been satisfied by the end of the year, and at that time any unutilized portion of the original deposit should be refunded to the country making it. This plan should, in our view, apply to all countries which desire to avail themselves of its benefits, whether members of the International Monetary Fund or not; provided, of course, that they undertake the corresponding obligation to make a deposit with the Fund whenever the occasion so requires, in accordance with the provisions of the scheme.

134. A depositor country should be able to draw upon the currencies standing to its credit with the International Monetary Fund as a result of the sale of its own currency, to the extent to which its own monetary reserves fall during a subsequent period. In calculating the change in monetary reserves of a depositor country for this purpose, no account should be taken of the "normal" increase in reserves resulting from the absorption of new gold production, since the absorption of new gold does not result in any corresponding depletion of the reserves of other countries. There are obvious conceptual difficulties in deter-

mining how much of the actual increase of a country's monetary reserves in any given period should be attributed to its purchase of a share in the world's current gold production. The criterion suggested in this scheme is that the "normal" accretion of reserves should be calculated on the basis of the depositor country's share in the world's monetary gold reserves.

135. If general currency convertibility were restored, no restriction would be necessary on the drawings of the depositor country upon any particular currency standing to its credit with the International Monetary Fund. Pending the establishment of currency convertibility, however, it would be necessary to restrict drawings by depositor countries on any particular currency to the amount by which the monetary reserves in gold and convertible currencies of the country which had sold that currency to the Fund had risen during the period in question. If this limitation were not imposed, it would evidently be possible for particular countries to be exposed to the same kind of pressures, in connexion with the release of their currency, as arise whenever, under conditions of bilateral trading and non-convertibility, deficits incurred in certain trade relations cannot be offset by surpluses earned in others.

136. The scheme should clearly provide for the protection of a depositor country against the consequences of exchange depreciation of any currency standing to its credit with the Fund. The provision would be that purchasing countries should maintain the value of the Fund's holdings of their currencies in terms of the depositor country's currency, in accordance with the official rate of exchange.

137. In reviewing the costs and benefits of the scheme it should be borne in mind that the scheme requires deposits to be made only at times in which their social cost is in fact negative, that is, when the sums put at the disposal of other countries will serve to maintain employment in the depositor country and prevent a secondary deflation due to a fall in exports. Conversely, depositor countries may draw upon the counterpart in other currencies of their deposits at times of rising home demand, thus enabling them to finance an increase in imports without current cost, at the time when imports are most needed.

138. It is, of course, true that compensatory financing arrangements do not in themselves entirely solve the problem of a country confronted with difficulties resulting from a fall in its exports to a depressed country. This is particularly serious for primary producing countries

which are unable to absorb commodity surpluses in the domestic market. In such cases additional measures might be required either to stockpile commodity surpluses, or so to change the structure of production and trade as to permit of greater stability in trading relationships. At the same time in so far as primary producing countries might decide to stockpile commodity surpluses, the finance provided under the scheme would serve to offset the additional investment thus required.

139. It will be noted that the scheme has been so arranged as to reduce the possibility of the accumulation of idle balances in the currencies of purchasing countries to the credit of depositor countries, to the maximum extent possible. To be allowed to draw on the balances held by the Fund in its favour, a depositor country need only lose reserves to other countries. This does not require the emergence of an import surplus, but only that the export surplus should fall below the volume of foreign lending plus the normal accretion of new gold. Such a position might arise even when a country had a considerable surplus on current account. Moreover, it is to be expected that the secular trend of imports by the present surplus countries is likely to be upwards, and this trend reduces the probability and scope of a net accumulation of idle balances by the surplus countries over extended periods. These considerations suggest that the danger of an undue accumulation of idle balances in favour of a particular country would only arise if that country suffered a prolonged and persistent depression which it failed to offset by appropriate domestic measures.

140. The scheme recommended in this report provides a powerful and flexible weapon for offsetting the effects of fluctuations in economic activity and employment in any one country upon other countries which are themselves maintaining full employment; and at the same time for easing the difficulties of the country suffering a decline in internal demand. It should be emphasized, however, that measures designed to maintain international demand and thus prevent the international propagation of economic recessions must be regarded as supplementary to domestic policies for ensuring full employment and not as substitutes for them. To the extent that domestic full-employment policies are effective, the maintenance of international demand would be virtually assured without specific international measures. On the other hand, measures for maintaining international trade and liquidity could never, in the absence of domestic full-employment policies, ensure that mass unemployment is eliminated in all parts of the world.

Part III

RECOMMENDATIONS

Part III

RECOMMENDATIONS

1. Domestic Measures

141. In order to give better effect to the fulfilment of the full employment obligation assumed by Members of the United Nations, we recommend that each government should take early action on the following lines:

(i) It should adopt and announce a full employment target which will define the meaning of full employment in the country concerned in operational terms, and constitute the standard to the attainment of which the national employment stabilization measures will be directed;

(ii) It should announce a comprehensive programme for directing its fiscal and monetary policies, its investment and production planning, and its wage and price policies (including anti-monopoly policies) to the continuous achievement of its full-employment objective;

(iii) It should adopt and announce an appropriate system of compensatory measures designed to expand effective demand which would be prepared in advance for automatic application in case its general programme for maintaining full employment, indicated above, fails to prevent unemployment from exceeding the limit prescribed by the full-employment target by a pre-determined amount for three successive months;

(iv) It should announce the nature of the policies which it will adopt in order to maintain the stability of the price level and to combat inflationary tendencies in a manner consistent with the maintenance of its full-employment target;

(v) It should adapt its legislative procedures, its administrative organization and its statistical services to the implementation of its full-employment programme.

142. We believe that, while the adoption of these recommendations will not necessarily prevent the occurrence of some fluctuations in employment, it will go a long way towards the practical realization of the

general full-employment objective. We explain them in more detail below.

A. Fixing a Full Employment Target

143. We believe that fixing a full-employment target is a most important step in the practical implementation of full-employment policies: both in providing an operational standard for the application of such policies, and also as an earnest of each government's intention to fulfil its full employment pledge.

144. In industrialized countries, targets should be defined in terms of unemployment rather than employment, and they should be expressed in terms of the smallest percentage of unemployment of wage-earners which the country in question can reasonably hope to maintain in the light of seasonal movements and in the light of structural changes in the economy, which inevitably give rise to some temporary unemployment that could not be eliminated through public policy.

145. According to the circumstances of each country, this target may be defined as a range (e.g. from 2 to 4 per cent or from 3 to 5 per cent of wage-earners) rather than as a precise figure, owing to the fact that the unemployment resulting from the above-mentioned causes may not be measured with complete accuracy and may in itself be subject to small variations. We recognize that the percentage of unemployment thus defined would, within limits, vary with the circumstances of each country—in particular with the rate of technical progress and the relative importance of seasonal industries—and therefore no specific range can be set down as uniformly applicable to all countries, though, in the light of recent experience, the target in most countries can be set in terms of a much smaller percentage of unemployment than was regarded as normal before the war. In each country, however, the target should be so set that any growth in unemployment beyond the limit of the range could be regarded as evidence of an inadequacy of effective demand so that the government's employment stabilization policy could be directed towards maintaining effective demand at the level necessary to keep unemployment within the target.

146. For the purposes of the definition of the full-employment target, "unemployment" should include all workers without work and seeking work as wage-earners irrespective of the type of industry or occupation and irrespective of whether or not they are classified as unemployed

for the purpose of social insurance schemes. In addition, the definition of unemployment should include an allowance for the full time equivalent of time lost by all wage-earners working short time but willing and able to work full time.

147. In industrially less developed countries, where workers who lose their jobs in industry are absorbed into agricultural pursuits, it may be desirable to define the target in terms of the volume of industrial employment rather than in terms of a percentage of unemployment. In that case the target figure should be raised year by year in accordance with the growth in industrial capacity.

B. The Continuing Programme for Full Employment and Economic Stability

148. Since almost all activities of governments in a modern state affect the general level of employment in the country, a comprehensive government programme for the maintenance of full employment cannot be looked upon merely as a set of measures designed solely to deal with the employment problem. To a large but varying extent, the full-employment programme of any particular country consists in the adaptation of its ordinary activities to the over-all objective of maintaining full employment and economic stability rather than in the adoption of new kinds of activities, introduced specifically for the purpose.

149. In view of the large expansion of governmental activities since the war in most countries, the influence of public activities on the general state of the economy of each country is, in any event, far greater than in the past; and consequently, the co-ordination of governmental activities and programmes in the interests of a full-employment and stabilization policy would in itself exert a far more powerful effect on the economy than before the war, while the absence of such co-ordination would have a far more disturbing influence.

150. We recognize that most governments have in recent years become aware of this fact, and have already undertaken far-reaching steps to co-ordinate their activities in the interest of full employment and economic stability. We believe, however, that the time is opportune for a review and public restatement by governments of the whole range of measures which they intend to take to promote full employment and to maintain their economy in a stable and prosperous condition.

151. We recognize also that the main features of the full-employ-

ment programme would vary from country to country, both according to the nature of the political and social framework and according to the stage of the economic development of the country concerned. Socialist countries or countries which have adopted a widespread system of central planning and control may promote full employment and stability as part of their general economic planning; private enterprise economies would wish to rely to a far greater extent on the adaptation of general fiscal and monetary policies to serve this end. We believe, however, that the objective of full employment can and should be realized, irrespective of the political and social institutions of each country. Similarly, the problem of insufficient effective demand may take different forms and call for different kinds of remedies in less developed economies than in industrially advanced countries. We believe, however, that countries with both types of economies can and should pursue effective full-employment policies.

152. According to the varying interests and circumstances of the different countries, full-employment policies may be made to serve different social ends and may be pursued by different methods or combinations of methods. Thus, in some countries, the rate of economic development may be accelerated as part of the full-employment programme; in others, the realization of full employment would call for structural changes associated with an increase of the share of consumption in the national product. Some countries may wish to make wide-spread and continued use of direct and selective controls over the economy—such as price controls, rationing and allocations—while others may wish to rely on methods of indirect control to permit the operation of a free price mechanism. Finally, there are differences in the technical and administrative efficacy of various kinds of controls in the different countries. It is not practicable, therefore, to make detailed or concrete recommendations in this report with regard to the particular ways in which full-employment policies should be applied in particular countries. Paragraphs 153-164 are merely intended as a brief review of the various kinds of measures that predominantly private-enterprise economies could adopt as parts of a comprehensive programme.

(i) *Fiscal policy*

153. The adaptation of the fiscal policy of the state to the needs of full employment will undoubtedly be one of the principal vehicles for stabilizing effective demand at the full-employment

level in private-enterprise economies. The means for such an adaptation consist of changes in the level and kinds of expenditure, changes in the level and kinds of taxation, as well as changes in the relations between these two; and finally, in the adaptation of both taxation and expenditure to increase their flexibility in response to fluctuations in effective demand.

154. The budget reflects the entire programme of the government in so far as it involves expenditures and taxation; and in view of the changing nature of government requirements, calls for revision from year to year. Where effective demand is deficient, it can be augmented by increased government expenditure or reduced taxation (provided the existing tax structure is large enough to furnish a base from which adequate reductions can be made). The course that is pursued should depend on the social needs of the country. Where government programmes of high social priority await realization, it would be appropriate to raise expenditures rather than reduce taxes. On the other hand, where the government's expenditure programmes are adequate, but tax rates are felt to be high, a country may decide to stress tax reduction in the event of deficient effective demand. In the contrary case where effective demand is expected to be excessive, the same kind of choice will have to be made between reductions in expenditures and increases in taxation. The degree to which reliance is placed upon changes in taxation or in expenditure will depend also on the extent to which the ordinary expenditure programmes of the government are capable of being accelerated or retarded and the extent to which changes in the rates of taxation are administratively feasible. Though the method of forecasting is as yet inadequate for laying down precise rules for the budget structure in each particular set of circumstances, certain general principles could undoubtedly be established. Thus in times when the outlook for the future involves no likelihood of inflation and some possibilities of deflationary tendencies, it would be prudent to give the annual budget an anti-deflationary slant. If there were signs of serious depression commencing, there would be imperative reasons for including vigorous anti-depression measures in the budget. The opposite kind of policy would be called for if the dangers were on the inflationary side.

155. Apart from those changes in taxation and expenditure that require deliberate and continued action by governments to maintain effective demand at full-employment levels, it is also desirable in the interests of economic stability to incorporate into the fiscal system such

features as would automatically dampen the amplitude of economic fluctuations. The recent changes introduced in the interests of social progress, such as the adoption of widespread social security measures and progressive income taxation, already have the effect of ensuring some degree of automatic stabilization. While the basic decisions to adopt such programmes will presumably continue to be taken on political and social grounds, governments should make full use of their stabilizing effects.

156. Fiscal policy may also be adapted to the needs of full employment through the co-ordination of fiscal programmes at the central and local government level. In the nature of the case, local governments have less fiscal freedom than central governments, and unless deliberate measures are taken to assist them, local governments may find it necessary, for purely financial reasons, to contract their expenditures at times when they should really be expanding them in the interests of economic stabilization.

(ii) *Control of the volume of private investment*

157. There are various ways in which effective government action can be taken to control the rate of private investment. Governments can provide special credit facilities or give guarantees or special tax inducements to private investors when it is desired to promote the expansion of investment in the private sector of the economy. On the other hand, restrictive credit controls, controls over capital issues, and, in some cases, control and allocation of materials can be used when there is a danger that private investment is expanding too rapidly.

158. It may also be feasible for governments to co-operate with the private industries concerned in the establishment of long-range investment programmes in well-established industries, such as the railroads or the steel industry, designed to meet the future needs of the economy regardless of short-run business fluctuations. Some countries may wish to undertake measures of control designed to integrate private investment into an over-all national development programme.

(iii) *Planning of public investment*

159. In those cases in which the public sector of the economy includes certain basic industries such as mining, steel production and public utilities, and a substantial part of transport, housing and industrial

construction, which together account for a large proportion of total investment expenditure, the level of investment could largely be stabilized as a result of a co-ordinated public investment programme. The stabilization of the total volume of investment could further be ensured by timing the execution of postponable public investment projects so as to dovetail with the fluctuations in private investment. This can be done also in those countries in which public works constitute the main or only form of public investment. It is to be noted, however, that specific governmental action is required to ensure that the total volume of public works projects is varied in such a manner as to offset fluctuations in private investment, since the bulk of investment in public works is normally under the control of local authorities who are frequently compelled to vary their expenditures in a cyclical rather than a contra-cyclical manner.

160. The co-ordination of the public works programmes of central and local governments and of other quasi-autonomous public bodies, and the necessary financial plans to make such co-ordination effective, would thus be an essential requirement for effective full-employment policies.

161. We would also stress the importance of governments making advance legislative, administrative and technical preparations for reserve programmes of public works expenditures so that they will in fact be able to put such programmes into effect at the shortest possible notice whenever the occasion requires.

(iv) *Stimulation of consumption*

162. While the measures outlined above for the control of public and private investment should serve to reduce or eliminate spontaneous fluctuations in investment, advanced industrial countries may not wish to rely on the stimulation of investment, public or private, to achieve an adequate level of effective demand. The rate of investment should be geared to the requirements of a steady and balanced rate of expansion of the economy; and this rate, in advanced industrial countries, could normally be expected to be in the neighbourhood of the average level of investment over the cycle as a whole and thus considerably less than the actual rate of investment experienced in the past at full-employment levels. For the maintenance of an adequate level of effective demand, such countries would therefore place their main reliance upon the expansion of consumer demand. In many countries a long-term programme for the expansion of consumption could be carried out by employing the

instruments of fiscal policy discussed above: i.e., by changing the incidence of taxation and lowering its level; by expanding programmes of social security and transfer payments; by raising the standards of social expenditures generally, for education, health, etc.; and by means of other supports to personal consumption. Furthermore, the control of monopoly prices may serve the purpose of increasing consumer demand through the reduction of profit margins. Some countries may wish to extend this principle further and use price control more generally in order to effect a more equitable distribution of income.

(v) *Domestic aspects of international measures*

163. The international measures we are recommending, while primarily designed to prevent the spread of depressions, to promote economic development of the underdeveloped countries, and to maintain a workable international economy, would furnish important support for the economies of countries in which depressions may originate. The plan outlined below for achieving a stable level of long-term foreign investment also has the effect of maintaining the level of effective demand in the lending countries; while the plan for stabilizing external disbursements on current account would help to sustain employment in the export industries of a country in the event of depression.

(vi) *Stabilization of incomes of primary producers*

164. In addition to measures for maintaining employment in industry, most countries recognize the need for supplementary measures for maintaining incomes in agriculture where fluctuations in effective demand tend to affect the level of prices rather than levels of production and employment. This is particularly important for underdeveloped countries in which the greater part of the population obtains its livelihood from agriculture. The most suitable method for maintaining agricultural incomes is the stabilization of the prices of staple commodities in the world market, either through international commodity stabilization schemes, such as the International Wheat Agreement, or through the national commodity stabilization schemes of those countries which control a substantial part of total world trade in any particular commodity. In addition, each country could introduce a stabilization scheme for the benefit of its own producers, provided it were prepared to incur losses resulting from the difference between the guaranteed prices which it would pay to its domestic producers and the prices for which it would sell the commodities in the world market. Since, however, such a policy

would be bound to weaken the balance-of-payments position of the country concerned, we can only recommend it as a general policy in conjunction with the particular recommendations set out below for the stabilization of international trade.

C. Automatic Compensatory Measures in the Event of Unemployment

165. We believe that the adoption by each country of a system of automatic compensatory measures which would come into operation in clearly defined circumstances announced beforehand is a most important element in a successful full-employment policy. While each country's employment stabilization policy should be continually directed towards keeping unemployment from exceeding the limit of the target, we believe that, in the present stage of economic forecasting, major counter-measures intended to reverse a decline in production and employment may inevitably have to be taken only in the light of actual events rather than on the basis of forecasts. It is, therefore, all the more essential to devise methods whereby counter-measures come into effect at an early stage on an automatic basis. If the nature and timing of counter-measures is left entirely to the discretion of the executive organs of the government there is a serious danger that the uncertainties of the future will generally weigh the scales in favour of inaction rather than action, and the adoption of positive counter-measures will be delayed until a downward movement of production and employment is well under way. Furthermore, assurances given by the very adoption of a system under which counter-measures will automatically come into effect would in itself have an important stabilizing influence both on the domestic economy and on the world economic situation.

166. We suggest that the automatic counter-measures should be so constructed as to produce an expansion of effective demand whenever unemployment exceeds the range defined in the full-employment target by some pre-determined amount for three consecutive months. The increase in the unemployment percentage necessary to bring the automatic measures into operation may vary with the circumstances of different countries, but in each country it should be no higher than is necessary to give a clear indication of deflationary tendencies in the economy; and it should be high enough to make it possible for measures for expanding effective demand to be undertaken on a scale sufficiently large to make an immediate and substantial impact on the employment situa-

tion. The counter-measures should be designed so that their operation should in no case be delayed by more than three months once unemployment has reached or exceeded the signal level, since this, in our view, can be regarded as unambiguous evidence that the general employment stabilization programme is proving ineffective whether as a result of imperfections in the programme or of unforeseen developments. To increase the efficiency of the scheme, it would be preferable to take as the signal level of unemployment a certain percentage of unemployment in the sensitive industries, such as manufacturing, mining and construction, rather than a percentage of wage-earners as a whole. In countries where the rate of unemployment is subject to strong seasonal influences, the signal level of unemployment should be seasonally adjusted. It is also necessary to provide for a suspension of action taken under the scheme, which should come into effect when the percentage of unemployment in the sensitive industries has remained below the mean of the full-employment target for a specified period.

167. The automatic compensatory measures should embody the following necessary features: first, they should be capable of raising effective demand promptly and throughout the economy; secondly, they should be of a quantitative nature so that their effect on demand and employment could be estimated with a fair degree of reliability; thirdly, their quantitative magnitude should be sufficient to reduce the level of unemployment (taking into account both primary and secondary effects) to the mean percentage of the full-employment range.

168. The detailed design of automatic compensatory measures should be undertaken by each country in the light of its own economic structure and the possibilities afforded by its fiscal and administrative systems. In industrially advanced countries the most appropriate method would be to make advance legislative provisions for alternative tax schedules, the lower of which could come into operation in circumstances defined in the legislation and determined on the principles indicated above. The most suitable tax for this purpose, in those countries, is the personal income tax on earned incomes which, under the pay-as-you-earn system, is deducted on a current basis; and the legislative provision should provide either for alternative rates of such taxation or for alternative levels of exemptions. Similarly, the social security contributions could be varied and advance legislative authorization could be given for their complete suspension in prescribed circumstances.

169. If neither the personal income tax nor social security contributions offer adequate scope for reductions designed to raise purchasing power, countries may find it possible to enact legislation under which the ordinary social security contribution is automatically reversed and replaced by periodic payments to both employers and employees on a pre-determined basis. The incorporation of the social security system into the scheme would have the advantage of distributing the benefit of increased purchasing power over a wider class of the community than is possible through a reduction in personal income tax.

170. In countries where neither the personal income tax nor the social security system are widely developed, an analogous system could be introduced in the form of pre-determined variations in the general sales or purchase taxes. In some countries, moreover, compulsory savings arising out of the war or compensations for war damage could be legislatively so adapted that their release is made dependent on similar pre-defined circumstances.

171. We therefore believe that it is possible to devise adequate measures in most countries for the operation of some such scheme. The requirements of clarity, definiteness and promptness of operation, noted above, can normally be satisfied only by changes in taxes or contributions, or the introduction of cash payments such as bonuses or subsidies. Many countries rely heavily on a counter-cyclical public works programme as part of their anti-depression policy and some of them may find it possible to incorporate a counter-cyclical public works programme into an automatic compensatory scheme. In general, however, public works can not, in our opinion, be varied rapidly enough to fulfil the necessary criteria for such a scheme by themselves, though we recommend that appropriate changes in public works should be a highly important part of a government's general and continuing stabilization programme.

172. The legislation authorizing the automatic compensatory measures should be so framed as to make it mandatory on the government to put into effect the measures contemplated in the eventualities defined in the legislation. However, the executive organs of the government should have the power to waive the obligations under this legislation with respect to automatic compensatory measures when there is clear evidence that a rise in unemployment is due to causes other than a fall in effective demand and cannot be cured by a stimulation of effective demand. If, in any particular case, the executive organs of the government wish to

make use of this waiver, they should announce the precise reasons for their action.

D. Ensuring the Stability of the Price Level and the Prevention of Inflationary Tendencies

173. The general responsibilities assumed by the government for the maintenance of full employment also enhance the government's general responsibilities for maintaining the stability of the price level. It is essential, therefore, that effective and continuing action to preserve general price stability should be undertaken by governments, side by side with their full-employment policies. We recognize that if such measures are not taken, and if persistent price inflations do occur, governments may be tempted to abandon their full-employment obligation.

174. The need for specific action to preserve the stability of the price level may arise for a number of reasons. It may arise because government action to expand effective demand combines with other unforeseen factors to raise the aggregate demand beyond the level necessary for full employment and thus generates excess demand. It may also arise if, in the course of an expansion of employment, temporary shortages and bottlenecks are encountered which bring speculative price increases in their trail. Finally, it may arise if organized groups within the community, such as trade unions, farm organizations, trade associations, producers, cartels or industrial monopolies take advantage of the high and stable level of demand that tends to go with full employment and press for increased earnings in such ways as to give rise to a continuing upward movement of prices.

175. The government has, at all times, a variety of means at its disposal to combat and check an upward movement in prices. Indeed, measures to curb inflation are likely to be more effective in operation than measures that have ordinarily been taken in the past to reverse deflationary trends. It is essential, however, that governments should take positive action appropriate to the particular situation which arises. While inflationary pressures which result from a general excess in effective demand must be counteracted by general measures to curb excessive demand, a rise in prices provides no necessary evidence of a general excess of demand. And if attempts were made to curb such price increases by restrictions of demand, they might only lead to reductions in employment and production even without a reduction in prices. Price

increases resulting from factors other than a general excess of demand require selective measures of a direct or indirect nature, rather than measures which are the inverse of measures taken to stimulate demand. They should take the form of qualitative or quantitative credit control (introduced in particular threatened sectors of the economy), direct controls over inventories and selective controls over prices.

176. If there is evidence of a continuous general upward pressure of money wages exceeding substantially the rate of increase of productivity and leading to offsetting price increases, the situation requires such action by the government, jointly with organized labour and employers' associations, as would ensure that any wage increases that may be granted will not result in a general price inflation. The character of the action to be taken would naturally depend on the conditions ruling in each country.

177. If price stabilization policies are to be effective, and the general full-employment objective preserved, it is essential that the government be ready to employ a wide variety of measures for dealing with price inflation. According to their political and economic institutions, some countries may wish to rely more on indirect types of control, while others would make a more widespread use of direct controls. In both cases, the measures need to be adapted to the particular cause of the rise in prices, and it would not therefore be possible to legislate in advance for any general measure that should automatically come into operation in the case of inflation. It is essential, however, that the government should take such action, appropriate to each particular situation, for the preservation of price stability, as will check inflationary tendencies without allowing an increase in unemployment above the limit of the full-employment target.

E. Governmental Machinery

178. The implementation of a full-employment policy along the lines of these recommendations does not require any alteration in the political system and institutions of any country, but each government should review its organization and procedures with a view to adapting them, where necessary, to facilitate the preparation and execution of the measures recommended. Such modifications will be required, to a varying degree in different countries, within the fields of legislative procedure, administrative organization and statistics.

(i) *Legislative procedures*

179. We realize that in some countries the adoption of a comprehensive full-employment programme will require enabling legislation setting standards for the exercise by the executive organs of such discretionary powers as are involved in certain features of the programme. We stress the importance of the early introduction of the necessary legislation. It is equally urgent that the financial relations between central and local governments be reviewed, and any necessary legislation enacted, to permit the appropriate co-ordination of expenditure programmes and to provide the requisite finance.

(ii) *Administrative organization*

180. We recommend that all countries review their administrative organization in order to ensure that all government programmes are co-ordinated in such a way as to contribute to achieving the full-employment objective; and to prepare special measures that are required in particular circumstances. Governments must have at their disposal analyses of the trends in the economic situation. It is essential that responsibility for full-employment policies be clearly concentrated in the appropriate executive organ of the government and that adequate staff be provided for that purpose.

(iii) *Statistics*

181. Although the adoption of full-employment policies cannot await the perfecting of statistics, we draw the attention of all governments to the need to improve the collection and analysis of the statistical material necessary for the guidance of such policies. Certain of our recommendations require the preparation of monthly figures of total unemployment and also unemployment in certain sectors of the economy. If adequate figures of short-time work are not collected regularly, estimates should be made, by sample studies at appropriate intervals, to permit the calculation of the full-time equivalent of partial unemployment. Governments should also work towards the objective of publishing, at regular intervals, comprehensive figures showing employment and unemployment by major industrial groups, by areas, and by categories of workers (e.g. skilled, unskilled, white-collar employees, etc.). In addition, the effective planning and operation of most of the measures envisaged also require the regular collection and interpretation of a wide range of

statistics relating to the level of economic activity in different branches of the national economy, and the preparation of estimates of the principal aggregates that together determine the level of effective demand (including national income, private and public investment, private and corporate saving, government revenue and expenditure, imports, exports and other items in the balance of payments).

(iv) *Technical assistance*

182. In view of the difficulties that may be encountered by some countries in equipping themselves with the necessary governmental machinery and statistical services, the United Nations and the specialized agencies should provide such technical assistance as may be requested by governments.

2. International Measures

183. The particular recommendations set out below serve three main purposes:

(i) To create a workable system of international trade for a stable and expanding world economy and thereby provide the conditions required for the elimination of undue trade barriers and for the restoration of the convertibility of currencies.

(ii) To accelerate the orderly economic development of the underdeveloped areas of the world.

(iii) To prevent the international propagation of fluctuations in effective demand.

For these purposes we recommend that governments should take early action on the following lines:

(i) To establish a programme, through consultation among governments under the auspices of the Economic and Social Council, to eliminate the present structural disequilibrium in world trade.

(ii) To create a stable flow of international investment at a level appropriate to the needs of the underdeveloped areas of the world and to the capacity of the lending countries.

(iii) To stabilize international trade by maintaining external disbursements on current account in the face of internal fluctuations of effective demand.

184. We believe that our recommendations are interdependent, that they need to be pursued simultaneously but separately and that their implementation would be adequate for the realization of the main objective set out above.

185. These recommendations include certain changes in the constitution of the International Bank for Reconstruction and Development and the International Monetary Fund. We have felt that the most effective way to present them for international consideration is to put them forward in fairly concrete form.

A. A Programme to Establish a New Equilibrium in World Trade

186. The present chronic imbalance in international trade is of profound significance for the problem of maintaining full employment in many areas of the world, and its removal is an essential condition for a stable and expanding world economy and for the restoration of freer and less discriminatory trading conditions. We therefore recommend that the Economic and Social Council convene a meeting of the governments of interested countries in order to develop a joint programme designed to establish, at a reasonably early date, a new structural equilibrium in world trading relationships; and to consult together on the adjustments in domestic and external policies that are required to this end. This programme should aim at removing the existing lack of balance and at establishing structural equilibrium in world trade within the space of three or four years.

187. Such a programme would involve extensive consultation and exchange of information among governments, leading to the formulation of national policies and possibly international agreements. It would call for a procedure whereby countries would make known to one another the character of the economic policies they intend to pursue, and would consult together concerning the means of harmonizing such policies. This would require, as a first step, that both deficit and surplus countries should set "targets" for the main constituent items of their balances of payments indicating the adjustments by means of which they hope to restore their over-all financial equilibrium within the agreed period. Deficit countries should declare the amount by which they wish to raise the proceeds of their exports or to reduce their disbursements on account of imports. Surplus countries should declare the amount by

which they wish to raise their disbursements for imports, the extent to which they contemplate reducing their exports and the amount of long-term lending which they wish to undertake on a continuing basis. These targets would not be in the nature of binding obligations on the countries concerned but should provide a quantitative expression of the rate and direction of economic adjustment to be fostered by government policies. An analysis and comparison of these targets would reveal the nature of the inconsistencies in the policies and aspirations of the different countries and would provide a means for adjustment of these policies through consultation and negotiation between governments. In our view such an analysis would reveal the specific trading relationships in which major adjustments are required and would thus be immensely helpful in facilitating the task of economic adjustment. Assuming that long-term capital flows can be stabilized along the lines recommended in this report, one of the essential steps is to ascertain the annual amount of new lending and the annual rate of repayment of debts which are basic factors in determining the nature and extent of the trading adjustments required.

188. We recommend that, after the initial programme has been established, the interested governments should continue to meet at frequent intervals in order to adjust their targets on a continuing basis in the light of the actual progress made; they should keep each other informed of the policies they are following in order to achieve a speedy realization of their goals; and they should, where possible, make specific agreements regarding major factors in these policies which are of common concern. The main obligation of deficit countries in this connexion is to pursue policies aimed at reducing any internal inflationary pressures which may compromise their ability to export and aggravate their need to import, and to adjust their exchange rates in cases in which the expansion of their exports is hampered by the overvaluation of their currencies. They should also be prepared to adjust their production structures, where necessary in co-operation with each other, to the needs of those potential markets which, in the light of the prospective situation, are necessary for the achievement of balance of payments equilibrium. The main obligation of surplus countries is to take the necessary internal measures to ensure that any decrease in their exports or rise in their imports does not involve a reduction in their internal production and income and thereby generate again export surpluses in their own balances of payments. The surplus countries should also take steps to

facilitate the necessary adjustments in trading relationships by reducing or removing restrictions on imports, in so far as they contemplate an increase in imports; and by refraining from giving any direct or indirect encouragement to exports through governmental policies in so far as they contemplate a reduction in exports.

189. We further recommend that, with a view to assisting governments in the realization of this programme, the Economic and Social Council should establish an Expert Advisory Commission, responsible to the Council, and acting in close co-operation with the specialized agencies concerned, with the following functions:

(*a*) To work out, for the consideration of interested governments, detailed procedures for the formulation of the programme including the setting of targets and the choice of technical means for the co-ordination of national policies; (*b*) to take the initiative in calling the attention of governments to the problems that arise in the process of co-ordination of their individual programmes; (*c*) to report at regular intervals to the Economic and Social Council on the progress made and on any emergent problems requiring the attention of the United Nations or of the specialized agencies.

190. Without under-estimating the difficulties involved in the preparation of such a programme and in making the necessary domestic adjustments, we believe that it should be possible, by a determined effort on the lines indicated, to remove the present structural disequilibrium in international trade within the space of a few years, and to ensure the maintenance of equilibrium in the light of changing conditions. Without such a plan, we would see little hope of the world emerging from its present difficulties in the international economic field, even over a very long period of time.

B. Stable International Investment for Economic Development

191. Both from the point of view of the efficient development of the world's under-utilized resources and the achievement of a stable international trading system, it is essential that in the field of foreign investment the industrially advanced countries should undertake a far more conscious direction of policy than has yet been attempted. It is only through the rapid growth of the capital equipment of the underdeveloped countries that the vast problem of disguised unemployment in agriculture

can be overcome; and it is only through the rapid growth of production and real income of the underdeveloped areas that the world economy as a whole can attain that steady rate of growth that would permit the needed structural adjustments to be brought about without a contraction of world trade. To this end, it is necessary that the outflow of capital from the industrially advanced countries to the underdeveloped areas should be both adequate and stable. It is further necessary—in order to satisfy both the legitimate desires of the borrowing countries to limit the extent of foreign influence in their territories, and the legitimate requirements of the lending countries to obtain adequate security and a reasonable return on their loans—that the bulk of international investment should be channelled through an appropriate international organization. The International Bank for Reconstruction and Development is soundly conceived from this point of view, provided that adequate resources are put at its disposal, and its present constitution is amended, so as to permit the Bank to lend to underdeveloped countries for the general purposes of over-all development programmes not only in special circumstances but generally.

192. We therefore put forward the following recommendations for creating a stable and adequate flow of international investment.

(i) *Establishment of foreign lending programmes by governments*

193. We recommend that lending countries should fix annual targets for long-term international investment for five-year periods, and that they should make the necessary legislative and institutional arrangements to enable them to stabilize the total flow of lending at the planned level. The total to be thus fixed should comprise both private investment and public lending, and should take into account the rate of amortization and repayment on past debts. It is envisaged that the greater part of governmental loans would be channelled through the International Bank, in connexion with the plan for the reorganization of the Bank's operations presented below, and that the governments of the lending countries would undertake to place funds at the disposal of the International Bank directly, on a current basis. This would mean that in any particular year, the lending governments would put at the disposal of the International Bank at six-monthly intervals an amount equal to the total foreign investment planned for the period less the amount expected to be lent through private investors or national public bodies, including the International Bank's issues on national markets, or through other chan-

nels. If the total amounts actually lent fall short of the target level, the amounts put at the disposal of the International Bank by lending governments in the following period should be so adjusted as to stabilize, as far as possible, the total amount of net lending at the target level.

(ii) *Addition to the functions of the International Bank for Reconstruction and Development*

194. We recommend that the Articles of Agreement of the International Bank be amended so that, without prejudice to the discharge of its existing functions and obligations, it be enabled on the one hand to borrow from governments and, on the other, to lend to governments for general developmental purposes not only in special circumstances but generally. The plan which we recommend would embody the main features described in the following paragraphs.

195. *Organization of a department for general developmental lending*

(*a*) A new department of the Bank should be set up to conduct general developmental lending to governments and to raise the funds required for such lending by borrowing from governments.

(*b*) The new department should be under the management of the Bank, but, apart from that, it should be entirely distinct from the Bank as at present constituted. In particular, the new department should have no recourse to the Bank's capital or other resources arising from the performance of its present functions. It should therefore operate with no capital of its own, but should rely entirely on borrowed funds.

(*c*) Funds borrowed by the Bank from lending governments should be paid into a general loan fund out of which the Bank would make loans to borrowing governments. There should therefore be no direct relation between specific lending by the Bank and specific borrowings by it.

196. *Relations of the Bank with lending governments*

(*a*) The Bank should borrow from governments on a long-term basis on the same terms as those governments themselves can borrow in their own markets.

(*b*) The extent to which governments lend to the Bank should derive in general from the nature of their long-term foreign lending programmes and from the requirement that they stabilize their volume of foreign investment in the manner outlined above.

(*c*) The Bank should normally repurchase securities issued by it to lending governments as it receives repayment from borrowers. However, if in the opinion of the Bank, developmental needs are not being adequately met, it should, in agreement with lending governments, relend funds received by it in repayment of loans. In that case the lending governments would agree to the refunding of their loans when they became due.

(*d*) Loans to the Bank should be made in the currency of the lending country, and should normally be available for expenditure by borrowers from the Bank in any country. However, pending the establishment of general currency convertibility, exceptions to this rule should be permitted to such lending countries as are still encountering balance-of-payments difficulties.

(*e*) Losses by the Bank arising from default on any loan made by it should, in cases where they cannot be met from the department's reserves, be apportioned by the proportionate writing down of outstanding loans to the Bank.

197. *Relations of the Bank with borrowing governments*

(*a*) The Bank should make developmental loans to the central governments of the borrowing countries.

(*b*) The Bank should make such loans on the basis of general developmental programs submitted to it by borrowing governments. The criteria for the worthwhileness of such loans should be their effect on national income, taxable capacity and export capacity. While the effects of a developmental programme cannot be calculated with precision, the Bank should not, in general, lend unless it is convinced that, in consequence of the loan, the borrowing country's current balance of payments will improve sufficiently to permit interest and amortization payments to be made.

(*c*) Borrowing governments should be required to set up separate capital budgets[1] for their development programmes which should show,

[1] If governments so desired, such budgets could be prepared side by side with their budget as it is at present constituted. No basic changes in executive and legislative budgetary procedures may therefore be required.

in detail, all disbursements under those programmes. While the capital budget would normally be financed, in part, by funds raised locally in addition to those raised by foreign borrowing, its use would permit the Bank to survey the entire development programme and to ensure that its funds were not being used to finance the current expenses of the borrowing government.

(*d*) Developmental loans should be made at interest rates uniform for all borrowing countries as is the Bank's present practice. The rate charged should be the average rate at which the Bank borrows plus a fixed allowance of 1 per cent to cover the operating expenses and the risk of default.

(*e*) Loans should be amortized over as long a period as is consistent with the Bank's obligations to make repayments of its own borrowings. Where appropriate, amortization payments should be deferred for the initial period that must elapse before the effects of the developmental programme are felt on the borrowing country's national income.

(iii) *Technical assistance by the United Nations*

198. In order to obtain a larger range of suitable funds for international investment, the technical assistance programme of the United Nations should be developed and applied energetically to help underdeveloped countries in framing and operatng their general development programmes.

C. A Plan for Stabilizing the Flow of International Trade

199. Apart from the need for removing the structural disequilibrium of foreign trade and for assuring a stable flow of international lending, the most urgent requirement for a workable international system is the adoption of procedures whereby the international propagation of deflationary pressures and the consequent tendency towards a cumulative contraction of world trade may be effectively prevented. If domestic policies of stabilization were fully successful in eliminating all fluctuations in income and employment in every country, the maintenance of international demand would be assured without specific measures. There is every likelihood, however, that even after all practicable action on the lines we have indicated is taken, a country's external balance of payments on current account might still be subject to considerable fluctuations as a result of internal causes. Such fluctuations might have

serious disturbing effects on the stability of the world economy and on the ability of certain countries to maintain their national economies in a stable and prosperous condition. While no international device can serve as a real substitute for the successful execution of domestic full employment policies, there is a legitimate need for countries to be protected against the possible failure of other countries to carry out their full employment obligation effectively. Indeed, it is in the interests of those countries whose full employment policies may temporarily fail, to protect the world economy against the consequences of their failure.

200, The effects of internal deflation in a particular country will normally be communicated abroad through a fall in the exports of other countries relatively to their imports with a resulting loss in their monetary reserves. This loss of monetary reserves will sooner or later compel countries to restrict their imports. At the present time the monetary reserves of most countries would almost certainly prove inadequate for withstanding the shock of serious losses resulting from deflation abroad unless they promptly introduced restrictions on imports. Such restrictions, however, would certainly involve a further disruption in the normal channels of international trade, deprive the importing countries of needed goods and aggravate the deflationary pressures in the countries where they originate through the consequent fall in their exports.

201. The only possible way of preventing this cumulative process of contraction, and of enabling countries to maintain their imports and their real income in the face of fluctuations in foreign demand, is for each country to stabilize its own external currency disbursements on current account in the event of a decline in its own demand for foreign goods and services. This could be achieved in one or both of two ways. One way consists of the adoption of special measures to maintain imports. Such measures could take the form of government purchases of imported goods for stockpiling purposes as part of more general national schemes adopted by particular countries for stabilizing the prices of staple commodities in terms of their own currencies. We recommend that countries should take all practicable steps in this direction, but we recognize that such action can make only a limited contribution to the solution of the problem since, in any event, such action could only be applied to a restricted number of commodities.

202. We therefore recommend that each government should accept the responsibility, within a permanent and systematic international

scheme, of replenishing the monetary reserves of other countries concurrently with, and to the extent of, the depletion of those reserves which results from an increase in its own reserves induced by a fall in its demand for imported goods and services, in so far as this fall is caused by a general decline in effective demand within its own country.[2] We believe that the adoption of such a scheme would be the most important single contribution that could be made in the international sphere towards protecting the world economy against the spread of recurring deflationary influences.

203. In formulating our recommendations we have endeavoured to construct an international scheme that would satisfy six basic requirements:

(i) It should provide for the replenishment of international reserves, but should not finance any increase in reserves.

(ii) It should not be capable of being misused by countries as a device for financing an increase in their volume of imports.

(iii) It should provide for the repayment, as soon as conditions permit, of the temporary financial accommodation provided.

(iv) It should not retard the normal process of adjustment of international trade to structural changes in the world economy.

(v) It should operate on principles that are simple, clear and definite so as to make the operation of the scheme as smooth and predictable as possible.

(vi) It should be operated by an appropriate international agency.

Addition to the functions of the International Monetary Fund

204. Since the International Monetary Fund is the agency primarily concerned with maintaining international currency reserves and with movements in the balances of payments, we recommend that the scheme be operated by the International Monetary Fund, side by side with the functions that it now performs. We recommend that the Articles of Agreement of the International Monetary Fund be amended, so that

[2] A decline in effective demand can also induce a decline in monetary reserves as a result of a decline in foreign investment. We assume, however, that the possibility of this would be excluded by the adoption of our recommendations with respect to the stabilization of foreign investment.

without prejudice to the discharge of its existing functions and obligations, it be enabled to operate the scheme along the following lines:

205. (*a*) If, in any given year, the value of imports of goods and services by a particular country falls as a result of a fall in effective demand within the country, and this fall is not fully offset by a decline in the value of its current exports of goods and services, that country (hereinafter deferred to as the "depositor country") should make a deposit in its own currency with the International Monetary Fund of an amount equal to the fall in its imports less the fall in its exports in the given year, as compared with a reference year. In calculating the amount thus to be deposited, the change in the value of exports should be taken into account only if their value has actually fallen in relation to the reference year; no account should be taken of the change in exports if their value has risen in relation to the reference year.[3] Such deposits, where required, should be made at annual intervals, and not later than six months from the beginning of each calendar year.

(*b*) The reference year, against which the changes in imports and exports in any given year should be measured, should normally be defined as the year previous to the given year. If, however, in that previous year, unemployment in the country concerned had already exceeded the range defined in its full employment target for a period of three months or more, the reference year should be taken as the last year in which the full employment target was achieved for a period of more than nine months. If there was no recent year in which the full employment target was thus achieved, the reference year should be taken as the year previous to the introduction of the scheme.

(*c*) The International Monetary Fund should be empowered to waive the deposit requirements under (*a*) above if the country concerned can show, to the satisfaction of the Fund, that the fall in its external currency disbursements on current account was due in part or in whole to factors other than a reduction in its import demand caused by a fall in effective demand within the country or other than a restriction of imports that was not made necessary by an adverse balance of payments.

(*d*) The International Monetary Fund should be empowered to sell

[3] If the volume of exports of the depositor country rises, while the value of exports falls, as compared with the reference year, the change in exports for the purposes of the scheme should be calculated as if the volume of exports had remained unchanged.

the currency of the depositor country, made available to it in accordance with the provisions of (*a*) above, against the currencies of member and non-member countries. Any country (hereinafter referred to as a "purchasing country") wishing to purchase the currency of a depositor country should file a claim with the Fund to that effect not later than eight months after the beginning of the calendar year. Purchasing countries should be entitled to buy the currency of a depositor country in an amount not exceeding the fall in the value of their exports to, less the fall in the value of their imports from, the depositor country, as compared with the reference year[4] defined above with respect to the depositor country. If the amounts thus claimed exceed the amount of the depositor country's currency made available to the International Monetary Fund, the Fund should be empowered to make the appropriate adjustments on the basis of the best statistical evidence available or on other appropriate grounds in cases in which, in accordance with the provisions of (*c*) above, the depositor country's obligation was partially waived. Any balance in the depositor country's currency remaining after all outstanding claims have been dealt with should be refunded to the depositor country at the end of the year in which the deposit was made, or as soon thereafter as practicable.

(*e*) The currencies of purchasing countries received by the International Monetary Fund in accordance with the provisions of (*d*) above should be deposited to the credit of the depositor country concerned. These deposits should be made freely available for the finance of current transactions of the depositor country in subsequent periods, to the extent to which its own monetary reserves are diminishing. To this end, the depositor country may file a claim with the International Monetary Fund at six-monthly intervals for the release of currencies to an amount not exceeding the fall in its monetary reserves during the previous six months. In calculating the change in monetary reserves, the depositor country's "normal" accretion of reserves due to absorption of new gold production should not be taken into account. This "normal" accretion of reserves should be calculated on the basis of the depositor country's share in the world's total monetary gold reserves. Until general currency convertibility is re-established, the amounts thus released in any particu-

[4] If the volume of imports of the purchasing country rises, while the value of imports falls, as compared with the reference year, the change in imports for the purposes of the scheme should be calculated as if the volume of imports had remained unchanged.

lar currency should not exceed the increase in monetary reserves in gold and convertible currencies of the purchasing country concerned over the same period and calculated in an analogous manner.

(*f*) If the official rate of exchange (as communicated to the International Monetary Fund) of the currency of the purchasing country against the currency of the depositor country is reduced subsequent to the purchase of the depositor country's currency under paragraph (*d*) above, and prior to the release of the purchasing country's currency under paragraph (*e*) above, the purchasing country should deposit such additional amounts of its own currency with the Fund as are necessary to maintain the value of the deposits in terms of the depositor country's currency.

(*g*) Deposits and withdrawals, sales and purchases, of currency made under the above arrangements should be operated by the International Monetary Fund independently of its other transactions and the rules governing such transactions.

Separate Concurring Statement by J. M. Clark[1]

1. The writers of this report have commendably striven to produce positive analyses and recommendations, and to avoid a report consisting largely of pointing to unsolved problems, and recommending that further study be given to them. In this I believe they have succeeded well enough to be able to afford to recognize one important area where it is not possible to make a finding at once positive and simple, where competent study is in its infancy—especially organized study—and where further study is the first need. I refer to the area of problems which includes the effect of the wage-price structure and behaviour on aggregate effective demand and employment, and ramifies out to raise the same question with respect to numerous other matters of the sort roughly indicated by the term "structural".

2. This is in addition to whatever is said about inflation: a distinct though related problem. It concerns the understanding of what is required to give us a type of economy which may spontaneously tend to maintain a high average rate of operation, and thus minimize the burden imposed on devices of fiscal policy. The two are co-ordinate and complementary, and it is possible that fiscal policy may succeed or fail, according as the economy, and its constituent parts, work with it or against it. It is "structural" features in this sense on which, in the United States, the President's Council of Economic Advisers has laid major stress in those parts of its reports dealing with long-run conditions. Since the United States bears such a major part in the programme envisaged in this committee's report, its complete omission of this area is conspicuous, despite the reasons that lie behind it.

3. One key problem in this area, but only one, is that of the effect of a high or low general wage-level, or of increases or decreases of wages, on the volume of employment. On this, nineteenth-century economics assumed without warrant that reducing wages was the all-sufficient way to increase employment, while numerous modern theorists make an

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[1] This note was written to repair what seemed to the writer a substantial omission in the report, and with the hope that there might turn out to be a fair measure of agreement as to the actual views here expressed. This hope has been justified; all members of the committee have expressed general agreement.

equally sweeping and equally unwarranted assumption that the way to increase employment is to raise wages. So far, few have suggested the startling idea that the answer may depend on how high wages were to start with, relative to prices. With such rival theories in the field, there is value in a negative conclusion: neither increased nor decreased wages, with or without corresponding price adjustments, can be relied on *a priori* as dependable remedies for under-employment. Probably no wage-price behaviour is a sure cure for this ailment. But some features of wage-price structure and behaviour may make it worse: a good structure may be necessary, though not sufficient. All of which points to the need of better understanding of what a good wage-price structure is.

4. Perhaps the chief difficulty is the fact that wages are at once a major source of spending-power and a cost to the employer—the cost of the act of employing labour. Thus high or low wages have both plus and minus effects, with a presumption that these largely cancel. In attempting to judge whether there is a net balance in one direction or the other, the various factors that may affect the outcome appear to come to a head in the effect of the high or low level on the total spending disposition of the economy: the amount it will spend for consumption plus investment, out of a given antecedent income. This may depend on various structural characteristics and accompanying features. The effect of a movement, up or down, may depend on where the initiative comes from and on matters of timing, leads and lags in responses, and expectations created. Does the initiative come from prices or from wages? If from wages, are prices free to adjust or not, or can they adjust only subject to some limitations on the capacity of total monetary demand to move proportionately with prices (as when a price-inflation in one country restricts foreign demand for its goods)? Is the answer different for capital goods and consumer goods, or for different classes of consumer goods?

5. From the standpoint of employment, the optimum adjustment is one in which wage-earners receive as income the largest fraction of the total product consistent with adequate incentive to invest. More precisely, the optimum comes when the net increase in consumer-spending, resulting from a high fraction going to wage-earners, fails to offset the effect of narrowing profit-margins in reducing incentives to autonomous investment. In that connexion, countries that favour the competitive

system believe that a limitation of profit-margins by competitive pressure is likely to be consistent with a more vigorous flow of investment than an equal limitation of profit margins brought about by direct public controls.

6. Where particular prices are put excessively high (implying monopoly power) this may reduce employment in the monopolized industry, without in itself doing anything to open up added demand elsewhere sufficient to reabsorb the displaced workers, if they were to seek other jobs. Thus it is inherently likely to impose a burden of demand-creation, if these workers are to be reabsorbed, which would be unnecessary in the absence of such excessive prices. If the reabsorption were not successfully carried out, the resulting reduction in income would naturally have cumulative effects.

7. It is also possible for extra-high wage-rates to attract or retain more workers in an industry than can be given full employment there. There may also be an obstacle to full employment where standard wage-rates do not differentiate between better and poorer workers, making the "last 5 per cent" of poorer workers less profitable to employ. In booms they are profitable to employ because the employing industries are making sufficiently high profit margins to absorb the high marginal cost of some workers (premium pay for overtime is a more important form of increased marginal cost). But this means that profits absorb so large a part of the national income that adequate demand requires an investment component too large to be enduringly maintained; the consumption-component is not as large as it needs to be to render this level of employment stabilizable—as is indicated elsewhere in the report (see paragraph 73 of part II). With profits at a level moderate enough to be stabilizable, the less profitable character of the poorest workers may become a bar to employment where employers select freely on a basis of profitableness. This might affect some industries, or some countries, more than others.

8. These examples are intended to illustrate that the wage-price structure, while it may neither bring on great mass-unemployment nor cure it, can place obstacles in the way of a successful outcome. With an unfavourable structure, it may be impossible to set as high an employment target as with a favourable structure, or may be possible only at the cost of price inflation, or an increase in the real burden of public debt

or both. Improvements in the structure may be necessary for attaining a fully satisfactory employment-target; and in countries attaching importance to voluntary methods, this may take time.

9. Other features of similar import include the following

—the character and structure of the tax system as affecting the distribution of disposable income and incentive to investment, especially equity investment;

—institutions making equity investment suitable and attractive to the great new class of small savers;

—the character of the permanent financing of social security as affecting the balance of saving and investment;

—attempts to bring about counter-cyclical timing of private business investment. These are mentioned in paragraph 70 of part II; but it might be appropriate to add, among the incentives, a place for price-flexibility in capital goods, which would presumably be ineffective if it stood alone, but might possibly be effective as part of a well co-ordinated project.

To repeat, these are matters suitable for further study. They are also matters in which the active co-operation of private economic groups may be of vital importance.

As to fiscal policy, I agree entirely with its dominant importance as a means of stabilizing cyclical fluctuations, and would also be prepared to lean heavily on it for long-run purposes of maintaining a high level or trend of income and employment, though lacking in complete confidence in its capacity to maintain any desired level of national income, under any and all conditions. In that matter, as already stated, I regard it as one of two co-ordinate areas of effort, each of which may be necessary.

We are probably taking some chances if we try to do too much with fiscal policy. But we are also taking chances if we do too little to stabilize income and employment at a high level. In terms of fluctuations, the United States might be inclined to accept a moderate amount of irregularity, and rely on its social security system to provide for the resulting unemployment. But the impact of our fluctuations on other countries will not allow us, as good citizens of an interdependent world, to decide the question in the same terms that might govern us if we were isolated.

I recognize that the world situation, analysed in this report, imposes an obligation on countries that rank as industrial leaders, and makes it to their interest to demand a higher performance from themselves than they might be inclined to do on domestic considerations alone. To put it in what may be a more pertinent light, this world situation warns us to take very seriously—more so than we otherwise might—the risks of doing too little, as against the risks of using imperfectly tested fiscal devices.

In view of the world situation, I am prepared to take considerable risks of the latter sort, and it is in that light that I am signing this report.

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