

Wrong Diagnosis Wrong Remedies

A. J. CARTER

Most economic policies are based on the widely held assumption that it is the prime task of government to maintain growth and full employment by positive economic planning. In this paper this assumption is questioned and a course of action is indicated that would achieve and maintain full employment and growth by a policy of *laissez faire* in the true meaning of those words.

© E S S R A 1973

The Economic and Social Science Research Association, formed in 1969, is devoted to the advancement of learning through research into economics and social science, through study classes in these subjects, and through the publication of research and discussion papers.

The views expressed by authors are not necessarily those of the Association.

Council of Management

A. Haviland-Nye

R. D. Young

V. H. Blundell

W. E. Bland

**Published by the
Economic and Social Science Research Association Ltd.
8 Hatton Garden, London, EC1 834 4979**

25p

CONTENTS

THE FALSE DILEMMA	3
THE BARREN REMEDY	7
EEC NOT THE ANSWER	13
REMOVING THE BARRIERS	17

ANTHONY CARTER, 34, is a Company Secretary with a large mining finance company. He was for two years a tutor for the ESSRA School of Economic Studies, and has written numerous articles on economic and social subjects for periodicals and the national press. In this paper he discusses the relationship between inflation, full employment, and economic growth and assesses some of the preoccupations of those who make economic policy.

The False Dilemma

"The suggestion that the economy must somehow steer a careful course between inflation and stagnation reflects a misguided and defeatist view of the situation."

THE PRESENT Conservative Government has been obliged to manage the economy in much the same way as its predecessors. Faced with the choice of stimulating economic growth and risking further inflation or of instituting stern measures of restraint, it first decided to steer a middle course. Presented with these alternatives as its advisers saw them, a sensible and humane government could probably have done little else. When it became apparent that such a course could not be held and inflation was racing ahead, the Government again bowed to the conventional wisdom by resorting to a compulsory prices and incomes policy.

The experts, however, are no longer to be relied upon. For years their remedy for unemployment necessitated an inflation of the currency. Now we have the inflation but the fall in unemployment has not yet reached an acceptable level. However it may have appeared in the past, full employment is not at first hand dependent upon monetary inflation.

Inflation properly defined is an increase in the supply of money. The responsibility for it lies with those who have control of the money supply. When a company agrees to a wage increase it does not create money with which to pay it. Nor does it apply to the Bank of England for extra cash. It may borrow from a bank, but if it does the loan has to be repaid. The odds

are that it will increase the price of its goods. If it cannot do this it must meet the cost from its own resources, by an improvement in efficiency or a reduction in dividends or in retained profits.

Are consumers responsible for inflation? Like the employer, the consumer does not manufacture money, or if he does he will soon find his consumption limited by the walls of one of Her Majesty's prisons. He does not queue at the Bank of England for a handout. If he borrows he must repay. Either he seeks to maintain his standard of living by asking for a wage increase or he must reduce the extent of his consumption.

One can see clearly enough the tendency for wage increases to lead to price increases and price increases to lead to further wage increases, or perhaps we should say (for no one can detect the start of the process) for price increases to lead to wage increases and wage increases to lead to further price increases. It is a spiral with which we are despairingly familiar, but a spiral that can continue only if new money is continually fed into the economic system. If the money supply is X, then other things being equal the *overall* level of wages and prices can increase only if the amount of money in circulation becomes more than X. Without an increase in the supply of money the wage-price or price-wage spiral must come to a halt.

Who then increases the supply of money if it is not the employers or the consumers? The banks are often looked on as the villains, for the "wide" definition of money supply includes credit and the banks are the principal lenders.

If all the banks' depositors wanted to withdraw their money simultaneously the banks would not be able to meet the demand. Because they know that in practice only a small number of depositors are likely to want their money at any one time they keep only a proportion of the deposits in cash and the rest is invested or lent. Since the depositor still has a claim to the full amount of his deposited cash "in the bank" and someone else has a claim to the amount loaned and credited to his account, it would appear that money has been created - both sums appearing as a "deposit". However, what the bank lends must be repaid, and as it is repaid so there is a destruction of money

cancelling out its "creation". As it is repaid so it can be re-lent, but this process of "creation" and "destruction" of money can continue only as long as the original deposit remains. If this deposit is reduced or withdrawn the bank's lending must be curtailed.

Commercial banks in England can no longer issue their own currency. By Act of Parliament that power is restricted to the Bank of England. Only the Bank can feed new money as note and coin into the economy, and it does so not in response to some abstract assessment of what the banking system needs, or by issuing pound notes to clamant employers, consumers, or banks, but through the monetization of government debt.

The traditional concept of a balanced budget is old hat today: it is no longer thought necessary or even desirable for governments to confine their expenditure within the limits of income they can raise by taxation and borrowing. If their proposed expenditure exceeds their estimated income from these sources, the balance - the "net borrowing requirement" - is met through the Bank of England. The government issues securities to the Bank and in return the Bank prints and supplies the government with money. The securities remain in the Bank and need never be redeemed; the money is spent into circulation by the government.

Inflation of the currency is the necessary condition for the wage-price or price-wage spiral, and to stop inflation and the spiral that embodies it, all that is required is that governments shall cease to practise it - that is, that they shall balance their budgets and not resort to deficit financing by means of the printing press.

At this point we find ourselves back with the level of employment, for inflation is not only an easy way out for spendthrift governments but also a deliberate policy, with the backing of economic theory, to help maintain full employment; and it is upon the altar of full employment that excessive and painful sacrifices are unnecessarily being offered. Inflation is a method of artificially stimulating the economy by financing public spending without the corresponding reduction in private

spending that would result from taxation and genuine borrowing. In addition, rising prices (the inevitable result of inflation) boost consumption in two other ways: first, there is a fall in the real value of saving so it is more attractive to spend than to save; secondly, because goods will cost more tomorrow than they do today there is an incentive to buy now rather than later.

Inflation seems to have been broadly successful in keeping the demand for goods buoyant and industry busy. The consequences of inflation are, however, very damaging. The cost of living goes up, the scramble for higher wages leaves some behind, and those on fixed incomes suffer most. Because saving is less worthwhile there is a shortage of investment funds. Borrowing, the longer term the better, is encouraged (for every pound borrowed will be worth less when it is repaid), and interest rates rise to compensate the lenders. Above all, there are the psychological effects - the get-what-you-can, live-now-pay-later philosophy and the deep-seated insecurity that comes from an unstable currency.

Is inflation to the extent to which it appears to work a desirable cure for mass unemployment? To believe that it is, is to make the assumption that periodic mass unemployment is inevitable in a market economy unless corrective action is taken. The soundest method of maintaining full employment is to ensure that the economy thrives and continues to thrive without recurring recessions or the paralysing contraction of a slump. If this can be achieved without resort to inflation - and I shall argue later in this paper that it can - then all justification for inflation as a cure for unemployment falls away.

There is no need for an agonized choice between growth with inflation on the one hand and stagnation on the other, and the suggestion that the economy must somehow steer a careful course between inflation and stagnation reflects a misguided and defeatist view of the situation. The opposite is true: if we can get the growth we can stop the inflation.

The Barren Remedy

"There is only one practicable criterion to establish the level of wages for any particular category of job and that is the level that will attract the number of workers required to carry it out."

THOSE WHO ARGUE about the merits and demerits of state intervention in the economy should reflect that it is often when a government fails to exercise its proper functions that it is driven to acts of interference which may be ineffective and troublesome. Inflation is an example of this. The government has a duty to manage public financing on a sound basis. Instead, it follows a policy of overspending and debasement of the currency, while at the same time preaching about the evils of inflation and exhorting everybody else to stop it. It then resorts to various measures ranging from cajolery and discussions on the need for restraint, to prices and incomes policies and ultimately a compulsory freeze, to mitigate the effects of its own policies.

The justification for this approach is the assumption that when prices and wages increase, the government is somehow obliged to finance them. This gives the impression that the government has no choice and deludes the public into mistaking cause and effect. It cannot be too strongly emphasized that control of the money supply rests with the government and with no one else. The Bank of England will not print pound notes for you or me. The government spends money into the economy and the inevitable result is that all prices rise, including the price of labour.

At the time of writing all men of goodwill are supposed to be in favour of a prices and incomes policy, just as a few years before they were supposed to be in favour of indicative national planning. Ideas of this kind all too often hold sway not because they are sound but because they are fashionable and because policies based upon them are made to appear necessary.

Prices and incomes policies may be voluntary or statutory and vary in their details, but there are a number of features common to all of them:-

◆ In seeking to restrain increases in prices and incomes, an incomes policy is dealing with the consequences of inflation, not with inflation itself.

◆ It is not enough for the government to fix overall targets. These must be applied to a large number of *specific* price and income changes.

◆ There are so many prices and incomes that an incomes policy can work only imperfectly. When compliance with the policy is voluntary even those who regard themselves as represented in the formulation of the policy, through membership of the CBI and the TUC, are free to ignore it if they please. Moreover the CBI does not speak for the whole of British industry, let alone the retail trade, and even if the TUC were to persuade all the union leaders to support the policy, and the union leaders were to persuade all their members, this would still account for less than half the working population.

When the policy is a statutory one the problems are much the same. Many of those who resent price and incomes controls will seek to get round the law, and this is not difficult, for two reasons: first, because to maintain any equity at all in the policy there have to be exceptions, which can be used as loopholes by the ingenious; and secondly because the controls have to cover so wide a range that their complete enforcement is impossible. It is generally acknowledged that a statutory policy can have hope of success only if it enjoys the support of those to whom it applies.

◆ Because an incomes policy of necessity works imperfectly its burdens always fall unevenly. The pressure to comply is greatest and the scope for evasion least in the public sector (where the government must set an example) and in the biggest, best-known companies which employ a very large work force. At the other end of the scale, the local garage or cafe in the high street is virtually immune from a voluntary policy and not so much less so from a compulsory one since it is unlikely to attract much attention from the government. Generally speaking, the smaller the unit and the less in the public eye it is the less will be the pressure put on it and the more it will be able to get away with.

An incomes policy therefore contains an inherent and inescapable element of injustice.

◆ To the extent that an incomes policy is successful, it alters the relationship between the prices of different goods and services and between the wage rates for different jobs. Even if all prices and incomes are restrained by the same amount, some would otherwise have increased faster than others. The effect of this is to modify the structure of the economy by diverting resources from one industry to another and labour from one job to another in an arbitrary way unrelated to the needs of the economy.

To sum up, an incomes policy is an attempt to cure the symptoms of inflation rather than the disease itself; it is difficult to operate, contains inevitable anomalies and injustices, and can "succeed" only at the cost of distorting the economy.

Many of these features are accepted by those who advocate an incomes policy. Their contention is that, however difficult to administer and however imperfect such a policy is, it is better than nothing and there is nothing else to be done. As there is no clear distinction in their minds between the causes and the effects of inflation, the possibility of checking inflation at its source is barely considered. The suggestion that the government stop increasing the money supply either is taboo (as changes in the exchange rate were once taboo), or elicits the instinctive response that this would lead to stagnation and unemployment. The fallacy of this is dealt with elsewhere in this paper. All that needs to be added here is that many people regard limitation of the money supply as an obstacle to expansion and full employment only because they fear the imposition of a credit squeeze which will restrict bank lending and so starve industry of one of its chief sources of funds. They fail to distinguish between bank lending and inflation.

One of the reasons why a prices and incomes policy is so popular is that it is seen not only as a method of combating inflation but also as a means of establishing a more equitable distribution of incomes. There is widespread annoyance that the most powerful trade unions are able to secure substantial increases in the wages of their members, while workers who

are less well organized become relatively worse off. Why should those who are able to put the greatest pressure on society be the ones to gain the biggest rewards?

This problem has nothing to do with inflation. If one group in the community increases its income at the expense of another group, the relationship between the quantity of money and the quantity of goods and services in the economy as a whole is not affected; purchasing power is increased for some at the expense of lowering it for others. The concern here is not with the size of the monetary product but with the way in which it is apportioned between different categories of wage earners.

It is everybody's favourite game to decide who is under-paid and who is over-paid. We all have our own ideas about the wage structure we should like to see, but no one individual's scale of values is "correct": in a democratic society everybody's scale of values has to be blended together, and the result is unlikely to be identical with any one set of personal preferences. Such a blend has also to work. However fair a wage structure may look to those who draw it up, it is ultimately dependent on the operation of supply and demand. There is only one practicable criterion to establish the level of wages for any particular category of job and that is the level that will attract the number of workers required to carry it out.

If, for example, Britain is expanding its use of computers it will need more computer programmers. Now I may feel that in equity the salary of a computer programmer should be no more than that of a sewerage worker, the one being rewarded for his skill and the other for the unpleasant nature of his job, but what has to be taken into account is not my feelings but the feelings of all the potential programmers and sewerage workers in the country. Most of them may decide, if the wage is the same, that they would rather put up with the unpleasant conditions than go through an exacting course of training. There is then only one thing to be done and that is to increase the salary of a programmer in relation to that of a sewerage worker.

Such adjustments are made continually throughout the economy, and if there were a completely free market this process would be a perfectly satisfactory way of determining wage diff-

entials: workable, because it attracts labour to where it is most wanted, and democratic, because an employee's choice of occupation reflects his assessment of the advantages and disadvantages of each job.

There are, however, two major factors which hinder the operation of a free market in post-war Britain, and which an incomes policy will not remedy.

First, a large chunk of the economy is in public ownership and not subject to internal competition. Commercial firms have to pay wages sufficient to recruit the labour they need to match the standards of their competitors, but in the public sector it is possible to skimp on the service to the public by running permanently under strength and keeping wages and often quality down.

The second and more important factor is the influence of trade unions, their method of organization and the tactics they use. It is the tactics that attract most attention. There was recently a more militant approach by a number of key trade unions which were prepared to exploit their bargaining power more fully than in the past, by threatening the economy at its most vulnerable points. Among these unions there was less readiness to compromise on wage claims and a greater resolution to get the better of the employers and the government. The economic aim to secure improved living standards for their members was combined with a political aim to gain victory for its own sake. There are now signs that their militancy is subsiding, at least for the time being. This is welcome for no government in a democratic country should be forced to bow to pressure groups, whether of the right or of the left.

The power of trade unions could not be exercised if they were not organized on a national basis, including in their membership all the members of a particular trade in the country, negotiating with all their employers simultaneously, and often controlling the supply of the labour they represent by means of the closed shop. Conditions would be very different if, without abandoning the principle of collective bargaining, the unions could be drained of their monopolistic powers.

Current attempts to regulate union activity by law have hardly

proved successful, but there is already one significant trend towards the dispersal of monopoly power and that is the development of bargaining at local and plant level. This trend was noted and approved by the Donovan commission in 1968. Its advantages would be greatest if decentralization were carried to its extreme and the national trade union organization first reduced to a supporting role and subsequently made redundant.

Bargaining predominantly at plant level would stimulate further productivity agreements in which more efficient working practices were adopted in exchange for substantial increases in wages and other benefits. This would lead to increased consultation between management and men, who would accordingly gain in responsibility and status as well as materially. Wage increases could no longer be passed on automatically to the consumer, as they are when wage rates are uniform, and only the more efficient firms could afford to pay the higher wages needed to attract more labour. This would intensify competition by encouraging the growth of the efficient at the expense of their less lively competitors. Flexibility in wage rates would also permit firms to pay lower wages in places where labour was plentiful, so giving them an incentive to move to areas of high unemployment. Finally, the attitude that all workers are in conflict with all employers could begin to break up, and the tone of industrial relations gradually change from one of hostility to one of co-operation, trust, and partnership.

Unfortunately this trend towards local autonomy is seen by many people, including members of the present government, as a transfer of authority from responsible union leadership to irresponsible shop stewards. Many would dearly like a trade union to be like a business, where the man at the top is the boss and what he says goes, but in a union the man at the top cannot impose his will on the rank and file.

The vision of a totally binding agreement between the chairman of the employers' association and the general secretary of the union, or better still between the director-general of the CBI and the general secretary of the TUC, is sheer wishful thinking, and an incomes policy is founded on the same misconception. It is not true that in these delicate matters our leaders are wiser than we are.

EEC Not the Answer

"Joining the Common Market offers no simple escape route from Britain's economic problems, which must be tackled at the roots."

ONE OF THE apparent drawbacks of pursuing a policy of economic expansion is that it leads to a rise in imports and a strain on the balance of payments. In a time of slow liberalization of world trade governments have been reluctant to act directly on imports, and prior to the devaluation of sterling in 1967 the usual method of restraining imports was by damping down overall demand. This was bad for growth and investment, a self-inflicted injury at once crude and painful. It was also fashionable to restrict overseas investment which would have yielded a return, and to borrow wherever possible. This was all necessary, we were told, to preserve the integrity of the pound whose value we must defend like the frontiers of Britain itself.

These measures were the pitiful response to pressure on the exchange rate arising from the severe balance of payments deficit. The underlying cause of the deficit was an adverse balance of "visible" trade - imports and exports of goods - combined with a level of government spending overseas which more than offset the private surplus of "invisible" items such as banking and insurance. The vulnerability of sterling as an international currency aggravated this weakness and precipitated the crisis. Holders of sterling, afraid of devaluation, began to unload their pounds and so helped to bring devaluation about.

Government spending overseas was subsequently reduced, and as a result of the devaluation Britain enjoyed a large balance of payments surplus which was used to repay its debts and augment its reserves of foreign currency. However, devaluation is not a long-term answer, a lesson that was learnt in June 1972 when it became necessary to let the pound float.

A balance of payments problem is an excess or shortage of foreign currency - really, an imbalance of payments. It arises because the supply of foreign currency is out of line with the demand for it. As long as countries go on fixing their exchange

rates there will always be balance of payments problems, both surpluses and deficits. The relationship between the economies of different countries cannot remain static and a scheme of fixed exchange rates is obsolescent the moment it is adopted. The only way in which balance of payments troubles can be eliminated is by allowing freely floating exchange rates so that the supply of and demand for foreign currency is adjusted by the movement in its price.

It is normally in a country's interest for the price of its currency to be as high as possible in the foreign exchange markets. The more foreign currency that people will offer for each pound the more foreign goods we can buy with our pound and the higher is our standard of living. With a floating exchange rate the price of the pound, like the price of tomatoes, finds its own level. The more efficient production and the less inflation there is in Britain compared with that in other countries, the higher the pound stands but it is not supported artificially, with all the evils that this can lead to.

With a floating rate any increase in imports over exports is not a threat to the balance of payments because it is reflected in the external value of the pound and this makes imports dearer and the cost of exports keener. A new equilibrium is established, and if the economy continues to expand, the imported raw materials being turned into manufactured goods for export, the rate can be expected to rise. There should be no call for the government to check the expansion just as it was getting under way. The advantages of the floating pound are evident. It is true the pound has floated downwards but this has been taken smoothly without a crisis.

Britain's economy is part of a world economy, the parts of which are interdependent and would become more so were it not for the political obstacles that are put in the way. The theory of comparative costs proves that trade between two countries is good for both, even if one is more efficient than the other at everything.

Trade arises because of the varying natural advantages of different areas and the benefits of the division of labour; it is undertaken because both parties gain an advantage from it.

Economically, international trade is merely trade in which one party happens to live in a different country from the other. It is only politically that it becomes something to be encouraged or discouraged, controlled, or decontrolled, regulated for the enrichment of whatever industry has the ear of the national government and can beg persuasively for help.

To secure the most efficient use of resources trade as well as production must be free, both internally and internationally. There must be an end to privileged monopolies, subsidies, tariffs and quotas, and any other practices restricting open competition, all of which divert resources away from their most profitable uses. The current movement towards freer international trade is welcome, but it is in danger, not only from a resurgence of protectionism, but, more subtly, from the magnetism of trading blocs.

One such bloc is the European Economic Community of which Britain became a member in January 1973. Whether joining the Community will prove a grand opportunity or an unmitigated disaster, or neither of these two things, we shall probably not know for another decade, but as a step towards freer international trade it is certainly suspect. The abolition of tariff barriers between the countries of the Common Market is fine, but all the member countries have to accept a common external tariff and so lose the power to reduce tariffs unilaterally. The trend towards liberalization of world trade should in theory include the Common Market, but it is clear from other Common Market arrangements, particularly the common agricultural policy, that the motive behind the formation of the Community is not the freeing of production and trade from restrictions but the expansion of a protected home market. Britain within a larger protected home market may be better off than a protectionist Britain alone, but better than either of these alternatives would be a Britain pioneering free trade.

However, the present government, like others before it, looks on membership of the Common Market as an answer to many of Britain's problems. The member countries' higher rate of economic growth and higher level of real wages were cited as one of the main reasons for Britain's application to join. Against

this, there will be definite costs: a burden on the balance of payments (which with a free exchange rate would be translated into higher prices for imports) and increases in the price of food. Ever since the repeal of the Corn Laws in 1846 Britain has imported food from the cheapest markets and it is retrograde to introduce import levies now, even if we have supported our own farmers by other means.

To bankrupt thinkers Britain's membership of the Common Market may appear as a way of breaking our economic deadlock, but the economic consequences of entry, though appreciable, cannot be fundamental. Joining the Common Market offers no simple escape route from Britain's economic problems, which must be tackled at the roots.

Removing the Barriers

"If natural development is checked it must be because there is a barrier between natural resources and the application to them of human effort aided by technology. The way back to economic health and expansion begins with the identification and removal of this barrier to production."

WE HAVE BECOME so used to economic stagnation or at least low rates of economic growth, that the goal of steady, sustained expansion seems remote. Wise men shake their heads and wonder how it can be obtained, while some in the Treasury find the prospect of expansion so full of dangers that they would apparently prefer a safe stagnation. It is therefore important to remind ourselves that economic growth should arise naturally and not be contrived. The waters of a river do not need to be taught how to flow. If the current is sluggish the prudent irrigator cuts the weeds and dredges the silt.

The potential increase in wealth and leisure is still enormous. Even man in his primitive state could provide himself with food, clothing and shelter. With the increase in population, the intricate division of labour, the extensive use of tools and machinery, the growth in international trade and now the arrival of computers and automation, we should marvel that our standard of living is not far higher and our economy not more robust than it is. Instead, we have had appalling industrial depressions, unemployment, poverty and squalor. What has caused the natural path of progress to be so dreadfully disfigured?

Whatever the situation may be in the future (and I pronounce no judgement on that), there has not been in the past, and is not now, a shortage of natural resources. There is no lack of the desire for more goods and services, nor of the ability and willingness of man to work. There is no lack of the technology to help him. If natural development is checked it must be because there is a barrier between natural resources and the application to them of human effort aided by technology. The way back to economic health and expansion begins with the identification and removal of this barrier to production.

In a modern industrial society the supreme importance of access to natural resources is commonly overlooked. People who work on natural resources directly, in agriculture or mining, are few. The denial of access to these resources does not, on the face of it, affect the employment of the building labourer, the man on the assembly belt, or the clerk in his office. Yet the state of the whole economy does depend on the health of the primary industries. Services are paid for out of manufactured wealth, and all phases of manufacture, including marketing and organization, are ultimately dependent on the flow and processing of raw materials. If, for example, there were an interruption in the supply of timber, this would affect not only the employment of carpenters and joiners but also that of salesmen. If there were an interruption in the supply of coal and oil there would soon be cuts in power and transport. If there were an interruption in the supply of iron, steelmaking would be curtailed and ships, aeroplanes, machinery, and much else besides could not be built. If there is an interruption in the supply of land for building, all kinds of industrial and business activity will be held up. Finally, an interruption in the supply of water would not only disrupt production but threaten human life itself.

It will be seen, therefore, that any society, however advanced, is dependent on the unhindered access of its people to natural resources and in particular to land surface which gives access to all other natural resources. It follows that systems of land tenure have an important bearing on economic development in underdeveloped and industrialized countries alike.

In an underdeveloped country where land ownership is heavily concentrated and a high proportion of the population are peasant farmers, production is low because the richest land is monopolized and the peasants are obliged to cultivate the poor land remaining. Although there may be a large area of land capable of utilization, and a large population to exploit it, the former is not accessible to the latter. The result is a considerable disparity between the wealth of the big landowners and the meagre incomes of the peasants, and an absence of economic development because the majority of the population are unable

to accumulate any surplus beyond their day-to-day needs that may be used for investment.

In Britain there was a similar situation when the cumulative effect of land enclosures deprived peasants of their land and created a rootless army which drifted to the towns and gave the industrial revolution its character of degradation. The conditions of work were unpleasant and wages minimal because the opportunity to earn a living on the land had been artificially restricted.

The same inexorable force that inhibits production and divides the rich from the poor in an agricultural economy operates less obviously, but just as comprehensively, in an industrial economy. As we have seen, land is used not only for the growing of food, it is the original source of all economic activity. Land is an indispensable factor in all forms of production, and when good land for any purpose - agricultural, industrial, or commercial - is appropriated into ownership and ceases to be available for effective use, the consequences are the same as in a peasant economy. Less suitable land has to be used, productivity is reduced, and the general wage level - the base line to which all wage differentials are related - is depressed.

The most striking example of this in present day Britain is urban building land where the scarcity arising from planning constraints and the large number of vacant and under-used sites leads to pressure on the countryside and to increases in value which enrich those who have a financial interest in land at the expense of those who have not. The lesser disparity of wealth and poverty in Britain compared with that in, say, India is due only in small part to redistribution of income: the main reason is that land ownership is much more widely spread, giving rise to a modicum of economic competition among landowners, particularly owner-users.

Throughout the nineteenth and well into the twentieth century there were periodic economic crises in which much of industry ground to a halt and millions were thrown out of work. These contractions are not adequately explained by theories which attribute them to over-production or lack of demand, since the supply of some goods and services constitutes the demand for others and over the economy as a whole the supply

and demand must be equal. Supply and demand do in fact shrink together. When factories close, the men who are laid off can no longer afford to buy so much; and when orders drop off, output is reduced and factories may have to close. This is a circular process, but like that of price and wage increases it can take place only if there is a sustaining external cause. Without that cause, men who do become redundant can obtain employment elsewhere and the downward spiral is eventually checked.

One of the most puzzling features of these slumps in industrial activity is that they invariably follow closely on periods when business is booming. It is difficult to see how these boom conditions could in themselves be the cause of the slump, but it seems that the slump in some way arises out of them. It is here that the neglected factor of land provides a vital clue.

When the economy is expanding, land prices rise steeply. Owners who might otherwise release their land for use, hold it off the market to seek a profit from the increase in its value. The more this is done the greater the shortage of available land and the faster the rise in prices which in turn makes prospects for capital gains even more attractive. The effect of high prices on manufactured goods is to call forth more production and so bring prices down again, but no one can produce more land. There is no restraint on the speculative increase in price, and this must sooner or later reach a point at which the costs of production of material goods become prohibitive. It is then inevitable that production is cut back and industry marks time until land prices fall far enough to make further production profitable again.

This explanation of the business cycle of boom and slump and the scourge of mass unemployment is consistent with all the known facts and more convincing than the Keynesian theory that the economy reaches an arbitrary equilibrium which may leave productive resources unused. The natural tendency of any economy in which there are resources unused and individual wants unsatisfied is to use the resources to satisfy the wants. If it does not do so it is because there is an outsize spanner in the works.

As for the Keynesian "remedy" of boosting demand in the

economy by use of the monetary printing press, this may for a time avert a slump by reducing the real value of the ground rents payable by leaseholders and giving them a wider margin of profit, but it also makes investment in land even more attractive as a hedge against the fall in the value of money and this drives land prices higher still. The always dubious case for deficit-financed public spending as the only known cure for the evils of the thirties can thus be seen for what it is, a palliative with illusory benefits.

Any adjustment to the system of land tenure must take account of modern needs. To hold all land in common may be fitting for a primitive hunting tribe; a more advanced community requires private rights to the use of individual plots. Many countries have plans to spread the ownership of land by dividing holdings into smaller units, but this approach, though helpful in some circumstances, is hardly conducive to the fullest economic development of an industrial nation like Britain. Does the freer availability of land therefore imply the replacement of private ownership by public ownership, and would this not give governments complete control over land and over us?

There are three principal aspects of ownership of land: the exclusive possession of a site, the choice of what to do with it, and the enjoyment of its value. It is perfectly possible to preserve the first two of these as private rights while making the third a public right. This can be done by assessing the value of all land and placing a tax on its annual rental value.

The feasibility of valuing and taxing land (by which is meant the land itself, excluding any buildings or other "improvements") was confirmed in a survey made in Whitstable, Kent, in 1963 and in a revaluation carried out there this year (1973). The value assessed is the annual value of the land on the open market, that is, the rental the owner could expect to obtain if he leased it to a tenant. The market value is the value of the land for the highest use permitted by planning regulations and is frequently greater than the value in its existing use - for example, an urban site carrying permission to build would have a market value as building land and would be valued and taxed accordingly, even if it were being used as an allotment.

It will be seen that wherever land is idle or not being put to its best use the effect of the tax would be to induce the owners either to make more productive use of their land (to meet the tax liability) or to dispose of it to others who were prepared to do so. This would ensure that the most suitable land for all economic purposes was more fully developed before less suitable land was brought into use. It would also substantially augment the amount of land available for production, particularly if it were combined with a reorientation of the planning system which currently freezes too much land for no good reason. Both these changes would become more pronounced as the rate of tax were increased.

Another major effect of taxing the value of land would be to lower its selling price. The selling price of land is the capitalized value of its annual yield in the free market plus any speculative element. The tax cannot be recovered by the owner from anyone else, and a rate of 50 per cent on the rental income would reduce the income received by him by half and the selling price probably by more than half since the speculative element would have been eliminated. (A tax of 100 per cent would reduce the price of land to nothing and sites would be leased or sold for the value of the "improvements" only.)

The full taxation of land values would secure, first, the maximum utilization of all land that was in use, and, secondly, the maximum accessibility of land that was not in use, both by making more available and by destroying the obstacle of price.

With an underlying barrier to production removed, the ordinary workings of a free market economy should ensure that when resources are available and there is profit to be derived from their use, they will be used. Returns to the passive factor land are not essential to profitable production, since land rent is a surplus - and of course many profitable businesses today pay out a full market rent to another party for the sites they use. There are, however, many interferences with the operation of a free market, one of the most important of which is taxation. Taxation can influence the use of all resources - natural, human, and capital - and to attain prolonged economic growth through the maximum use of resources, the right taxation policy is essential.

The effect of a tax on land values is to encourage the availability and more intensive use of land. The effect of taxes on wages and interest is to retard the most effective employment of labour, capital, and enterprise. Hard work, responsibility, skill and training, initiative, investment, innovation, and risk-taking are all discouraged by a decrease in the net returns they can earn. The conclusion is obvious: that the introduction of a tax on land values should be accompanied by the simultaneous reduction of taxation on labour and its products and on capital.

What is needed to restore Britain's economy to its full vigour is an atmosphere in which the economy can grow, free from the disease of inflation and the constraints of the balance of payments, with the barrier between land and labour removed, with resources put to their maximum use unhindered by repressive taxation, price and income controls, or other interference with production and trade, and with full employment and high wages assured as the natural accompaniment of expansion. There is no reason why this cannot be achieved and the British people look forward to genuine prosperity instead of an uncertain and precarious affluence or in many cases outright poverty.

The opportunity is there. If muddled thinking can be dispelled and new initiatives taken boldly the rewards will be great.