The Postwar Business Cycle in Western Europe and the Role of Government Policy (1)

The post-war period in Europe has been remarkably free from the serious fluctuations in employment and activity which were recurrently experienced in pre-war years. The main economic problems have been predominantly those associated with high or excess demand — rising prices and balance of payments difficulties. The purpose of this article is to examine the factors which have modified the operation of the business cycle in the post-war period, to analyse the extent to which the experience of high levels of demand and employment has been due to accidental and temporary circumstances, to permanent changes in the structure and behaviour of the economy, or to improvements in economic policy. In analysing the reasons why serious recession has been avoided, one must inevitably give some consideration to the nature of postwar inflation, but this is not our major concern in this article. Nor are we primarily concerned with the reasons why postwar economic growth has been fast.

A comparison of Europe and the U.S. can help to illuminate this problem because the United States has had a greater post-war experience of recession than European countries, and there has been a considerable American literature which has attempted to assess the importance of changes in economic behaviour and government policy since prewar. Many of the " accidental " factors which have operated in Europe were not present in the United States or exhausted their effect much earlier. Several of the structural or institutional changes in the American economy have not taken

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place in Europe, and the role of government in the economy is also different.

In the first section of this paper an attempt is made to characterise the postwar record in statistical terms and to set it in historical perspective. The next two sections describe factors which have contributed to high levels of European demand, and attempt to distinguish between the temporary and more permanent changes. There are four sections on the changed role of government, and a section of conclusions.

I. A Quantitative Summary of Postwar Experience

In terms of total output, unemployment and industrial production it is clear that the postwar record has been markedly better than historical experience. It has also been much more impressive than that of the U.S. The aggregate G.N.P. of Western Europe has risen continuously and its growth averaged 4.9% a year from 1948 to 1959. Even in the " recession " years 1952 and 1958, the increase was about 2%. The European aggregate gives perhaps too favourable an impression of the average cyclical experience, as its movement is heavily influenced by a few rapidly growing countries, and there have been minor differences in the timing of the cycle in different countries. However, there are many countries where G.N.P. has never fallen in the postwar period, and even in the countries where falls in output have occurred, the declines were almost all less than 1 per cent. This is in sharp contrast to the inter-war period when G.N.P. was below previous peaks in most countries for about a third or more of the time. The inter-war years were, of course, particularly bad, but even in the 1901-1913 period, output was below previous peaks for 5 years out of 13 in the United Kingdom, 4 years in Italy, 2 years in Denmark and Norway, and 1 year in the Netherlands. The U.S. postwar record is much less favourable than that of Europe with a slight fall in G.N.P. in 1949, and a fall of about 2 per cent in 1954 and again in 1958. In terms of movements from peak to trough, the postwar U.S. recessions have involved falls in G.N.P. of 2, 4, and 4½ per cent. For most European countries, comparison is not possible on a peak

TRENDS AND CYCLES IN G.N.P. — TABLE 1

	Percentage Average Annual Growth			Number of Years Below Previous Peak			Least Favourable Annual Percentage Change from Previous Peak		
	1901-13	1925-38	1948-59	1901-13	1925-38	1948-59	1901-13	1925-38	1948-59
Austria	n. a.	n. a.	7.6	n. a.	n. a.	0	n. a.	n. a.	+ 0.5
Belgium	n. a.	n. a.	3.0	n. a.	n. a.	1	n. a.	n. a.	− 0.8
Denmark	3.4	2.6	3.0	2	4	3	− 2.3	− 6.0	− 0.9
France	n. a.	n. a.	5.2	n. a.	n. a.	0	n. a.	n. a.	+ 2.1
Germany	1.9	2.8	9.3	0	9	0	+ 1.6	−24.8	+ 2.8
Italy	2.2	1.8	5.7	4	7	0	− 5.2	− 5.4	+ 2.9
Netherlands	2.6	1.3	4.8	1	7	0	0	−12.1	+ 1.7
Norway	2.6	3.4	3.6	2	3	0	− 0.9	− 8.0	+ 0.3
Sweden	n. a.	3.0	3.6	n. a.	4	1	n. a.	−14.0	− 0.5
United Kingdom	1.5	2.5	2.5	5	2	1	− 2.9	− 0.5	− 0.5
O.E.E.C. Countries	n. a.	n. a.	4.9	n. a.	n. a.	0	n. a.	n. a.	+ 1.7
United States	3.4	1.0	3.4	2	8	3	− 8.2	−29.0	− 2.0
Canada	n. a.	0.8 (1)	4.3	n. a.	10	2	n. a.	−28.3	− 3.6

Sources: A. MADDISON, " Economic Growth in Western Europe 1870-1913 ", *Banca Nazionale del Lavoro Quarterly Review*, March 1959; *O.E.E.C. General Statistical Bulletin*, May 1960; *O.E.E.C. 11th Annual Economic Review*, p. 116; *Output Labour and Capital in the Canadian Economy*; W.C. Hood and A. Scott, Ottawa, 1957.

(1) 1926-38.

TABLE 2

TRENDS AND CLCLES IN UNEMPLOYMENT AS A PERCENTAGE OF THE LABOUR FORCE

Country	Average Annual Level			Biggest Annual Increase		
	1904-13	1925-38	1950-59	1904-13	1925-38	1950-59
Denmark	5.0	10.5	4.8	2.0	7.1	1.4
Germany	1.7	8.8	4.5	0.8	5.6	0.0
Netherlands	2.1 (1)	10.0	1.6	n. a.	5.8	1.0
Norway	1.6	11.4	1.0	0.6	5.5	0.6
Sweden	2.5 (1)	6.9	1.3	n. a.	2.8	0.5
United Kingdom	3.5	10.7	1.6	3.1	4.2	0.8

Source: A. MADDISON, *Op. cit.*, p. 34.

(1) 1911-1913.

to trough basis because of the absence of quarterly or seasonally adjusted data but in the U.K. the fall from the 1957 peak to the

1958 trough was 1.3 per cent, *i.e.* less than a third of that in the United States.

Another dramatic improvement since prewar has been the reduction in the level of unemployment and in its fluctuations. In most European countries, except Belgium, Denmark and Italy, the level of unemployment now usually lies between 1 and 2 per cent of the labour force, although it is only in the past year or so that it has fallen so low in Germany. The increase in Dutch unemployment from 1 to 2 per cent of the labour force in 1958 was perhaps the biggest increase in any European country in the recession of that year. In the interwar period by contrast, the average level of unemployment was about 10 per cent of the labour force and the range of fluctuation was very wide. Year to year changes of 4 per cent were quite common. Here again, U.S. experience in the postwar period has been less favourable than European. Year to year fluctuations have been about twice as large as in Europe, and the average level of unemployment has also been about twice as large (2).

Table 3

TRENDS AND CYCLES IN INDUSTRIAL PRODUCTION

	Percentage Average Annual Growth			Number of Years Below Previous Peak			Least Favourable Annual Percentage Change from Previous Peak		
	1901-13	1925-38	1948-59	1901-13	1925-38	1948-59	1901-13	1925-38	1948-59
Austria	n. a.	1.2	10.1	n. a.	8	0	n. a.	−34.3	+ 1.0
Belgium	3.3	1.5	2.9	2	8	3	− 3.6	−27.1	− 6.5
Denmark	n. a.	3.2	4.6	n. a.	5	2	n. a.	−12.8	− 4.0
France	4.3	0.2	6.4	0	10	1	0	−25.6	− 1.0
Germany	4.7	4.0	12.6	1	8	0	− 3.8	−40.8	+ 3.4
Italy	5.2	2.0	8.9	2	9	0	− 3.8	−22.7	+ 2.2
Luxembourg	7.3	fall	3.3	2	9	4	−10.8	−32.0	− 8.3
Netherlands	n. a.	3.7 (1)	6.2	n. a.	6 (1)	0	n. a.	−16.9 (1)	0
Norway	4.4	2.8	5.7	1	6	1	− 2.9	−20.3	− 3.1
Sweden	n. a.	5.8	3.1	n. a.	3	2	n. a.	−12.1	− 2.0
United Kingdom	2.6	2.9	3.6	2	8	2	− 7.1	−14.5	− 3.1
O.E.E.C. Countries	3.8	2.7	6.9	1	8	0	− 1.8	−23.3	0
United States	5.4	fall	3.3	3	9	3	−15.7	−45.2	− 7.7

Sources: For prewar years *Industrial Statistics, 1900-1957*, O.E.E.C.; for postwar years *O.E.E.C. General Statistical Bulletins.*

(1) Between 1926-38.

Aggregate European industrial production grew by 6.9 per cent a year from 1948 to 1959, and it has never fallen on a year to year basis. This is in strong contrast with the interwar period when it was below prewar peaks for over half the years in most countries. In the case of industrial production, it is possible to compare quarterly movements in different countries on a seasonally adjusted basis. These figures make possible a crude estimate of business cycle peaks and troughs. There was a mild and short dip in output in a few European countries in the course of the first postwar U.S. recession in 1948-49, but the downward movements were not big or widespread enough to call this a general European recession. The biggest postwar recession in Europe occurred in 1951-52, somewhat earlier than the second postwar U.S. recession. The 1951-52 recession affected all European countries. In Belgium-Luxembourg and the U.K. its intensity was similar to that in the U.S. in 1953-54, and in many cases the European recession was more prolonged than in the U.S. The 1958 recession affected all European countries, but it was generally much milder than that of 1952 both in amplitude and duration. In no country, except Belgium-Luxembourg, was the recession nearly as deep as in the U.S., and only in the U.K. was it more prolonged. In Table 5 we have attempted to compare the degree of postwar cyclical experience in different countries. It is clear that Germany and Italy have been virtually free of recession, and that their expansions have been both big and prolonged. All other countries, except Belgium, have had recessions with an amplitude only half as big as the average for the U.S., and the average duration of recessions

(2) The relative degree of unemployment in the U.S. would be exaggerated by a comparison of our figures with the American official statistics which show an average of 5 per cent of the civilian labour force unemployed from 1950 to 1959. The American figures are derived from sample surveys of the labour force rather than from unemployment insurance statistics as in most European countries. If U.S. figures were available on the same basis as those for Europe, they would probably show an average of something like 3 per cent unemployment for the period 1950-59. The British census gives a figure for U.K. unemployment which is derived by a similar process to that used in U.S. sample surveys. The April 1951 U.K. census showed 516 thousand unemployed compared with a figure of 281 thousand insured unemployed in the same month.

TABLE 4

AMPLITUDE AND DURATION OF CYCLICAL MOVEMENTS IN INDUSTRIAL PRODUCTION SINCE THIRD QUARTER OF 1948

Amplitude measured by percentage change in seasonally adjusted quarterly index of production. Duration measured in quarters.

	Recession				Expansion (1)		Recession				Expansion (1)		Recession			
	Peak	Trough	Amplitude	Duration	Amplitude	Duration	Peak	Trough	Amplitude	Duration	Amplitude	Duration	Peak	Trough	Amplitude	Duration
Austria	no recession				+ 73.8	12	III 51	I 53	− 5.0	6	+ 51.5	20	I 58	IV 58	− 2.0	3
Belgium	I 49	IV 49	− 7.2	3	+ 15.9	6	II 51	III 52	− 8.3	5	+ 16.9	19	II 57	II 58	− 10.3	4
Denmark	no recession				+ 24.4	10	I 51	III 52	− 6.8	6	+ 18.4	19	II 57	IV 57	− 3.3	2
France	II 49	III 49	− 1.5	1	+ 24.7	10	I 52	I 53	− 5.0	4	+ 53.5	20	I 58	I 59	− 2.6	4
Germany	no recession				+ 108.5	11	II 51	III 51	− 1.2	1	+ 75.4	26	I 58	II 58	− 0.7	1
Italy	IV 48	I 49	− 1.1	1	+ 41.3	9	II 51	IV 51	− 4.0	2	+ 53.8	25	I 58	II 58	− 1.4	1
Netherlands	IV 48	I 49	− 1.2	1	+ 26.2	8	I 51	IV 51	− 6.7	3	+ 36.8	21	I 57	IV 57	− 4.7	3
Norway	II 49	III 49	− 1.6	1	+ 26.2	8	III 51	III 52	− 4.1	4	+ 34.2	19	II 57	I 58	− 5.4	3
Sweden	no recession				+ 15.0	12	III 51	III 52	− 6.0	4	+ 17.5	19	II 57	III 58	− 3.3	5
United Kingdom	no recession				+ 20.1	12	III 51	III 52	− 7.8	4	+ 15.8	13	IV 55	III 58	− 1.7	11 (2)
O.E.E.C. Countries	no recession				+ 31.9	14	I 52	II 52	− 2.1	1	+ 41.1	23	I 58	II 58	− 0.7	1
United States	III 48	IV 49	− 7.3	5	+ 35.0	15	III 53	II 54	− 8.6	3	+ 9.7	10	IV 56	II 58	− 12.1	6

Sources: *O.E.E.C. General Statistical Bulletins* and *Federal Reserve Bulletin*, December 1959, pp. 1473-1474.

(1) The amplitude of expansion is measured from peak to peak, the duration is, of course, measured from trough to peak.

(2) Within this period there was a slight rise in production from IV 56 to III 57 which was followed by another fall. It could therefore be considered as two recessions instead of one.

TABLE 5

AVERAGE AMPLITUDE AND DURATION OF POSTWAR BUSINESS CYCLES
Amplitude measured by percentage change in seasonally adjusted quarterly index of production. Duration measured in quarters.

	Average of Postwar Recessions		Average of Postwar Expansions	
	Amplitude	Duration	Amplitude	Duration
Austria	-3.5	4.5	+62.7	16.0
Belgium	-8.6	3.0	+16.4	12.5
Denmark	-5.1	4.0	+21.4	14.5
France	-3.0	3.0	+39.1	15.0
Germany	-1.0	1.0	+92.0	18.5
Italy	-2.2	1.3	+47.6	17.0
Netherlands	-4.2	2.3	+31.5	14.5
Norway	-3.7	2.7	+30.2	13.5
Sweden	-4.7	4.5	+16.3	15.5
United Kingdom	-4.8	7.5	+18.0	12.5
O.E.E.C. Countries	-1.4	1.0	+36.5	18.5
United States	-9.3	4.7	+22.4	12.5

Source: Derived from Table 4.

has been smaller than in the U.S. except in the U.K. The amplitude and duration of expansions has also been more favourable in Europe than in the U.S., except in Belgium, Sweden, and the U.K.

II. The Development of Demand in the Postwar Period

(a) *The Period of Recovery and Rearmament.*

In the early postwar years overall demand was extremely high. Consumption in nearly all European countries was well below prewar levels. Stocks of consumer durables and semidurables (such as textiles) had been run down. There was a great shortage of capital equipment and inventories, as most countries were employing a much higher proportion of the labour force than before the war and capital formation during the war and pre-war depression had been low. There was also a heavy demand for housing because of war damage, lack of wartime construction, population movement, and the maintenance of low rents through controls and subsidies.

During and immediately after the war, many governments undertook a considerable redistribution of income which transferred purchasing power to those with low incomes or heavier family responsibilities. There were also substantial payments to demobilised soldiers. This was particularly true in the United Kingdom, Scandinavia, the Netherlands and France. In several countries, governments tried to keep prices down by subsidies and price controls, and these measures also contributed to demand pressure.

In some countries, special factors were operative which prolonged the post-war recovery period. In Germany, recovery was not really allowed to start on any substantial scale until the currency reform of 1948, and the recovery problem was bigger than that of most countries because of extensive war damage, the division of the economy and the influx of refugees. In the United Kingdom there were also special burdens, in the shape of foreign claims on resources resulting from the wartime accumulation of debt, sale of pre-war foreign assets, and a particularly severe deterioration of the terms of trade. The U.K. also undertook a large government programme for health which made sizeable claims on resources.

In the United States, the effect of backlogs and income transfers had been exhausted by 1948 when total output was already 64% above 1938 as compared with 1% below in Europe. U.S. consumption began to flag and personal savings rose from zero to something like the prewar relation to disposable income. There was a fall in inventories and fixed investment which created the 1948 recession. In most European countries, however, the postwar backlogs had not been fully met when the Korean war added another extraordinary wave of demand.

The impact of the Korean rearmament drive of 1950-52 was smaller in Europe than in the U.S., but it had a substantial effect on the economies of France and the United Kingdom. Other countries increased defence spending to a much smaller extent, but their economies were stimulated by the increase in U.S., U.K. and French imports and by the world-wide inventory boom set off by the rise in raw material prices. While the rearmament drive lasted, other demand pressures were partly held back by fiscal and monetary policy as well as by direct controls. Hence, it was not until about 1953 or 1954 that the backlogs of consumer demand disappeared in Europe. Consumption per head regained prewar levels in Europe as a whole in 1951, in Germany in 1953, and in the U.K. in 1954.

Significantly enough, it was at this stage that personal savings began to revive in the latter two countries.

The movement of Europe's external balance from a deficit of $7 billion in 1947 to a $1.5 billion surplus in 1953 also had a powerful impact on demand. American aid allowed most countries to consume more than they produced for a number of years, but as it was terminated a good deal of the increase in output had to be devoted to exports. Austria, Germany and the Netherlands got the biggest stimulus from trade — having moved from deficits amounting to 8%, 4% and 10% of G.N.P. respectively in 1948 to surpluses representing 3%, 4% and 6% of G.N.P. in 1953.

It is, perhaps, useful to compare the recovery period following the second world war with the years following the first world war. The first world war was followed by a boom in prices and output, but within three years there was a sharp recession in most countries which reduced European industrial output by over 10% in 1921 and caused unemployment to rise substantially. There was a recovery in 1922 but during the 1920s unemployment generally remained much higher than before the war. There were, of course, fewer autonomous factors to keep demand high at that time. The backlogs of demand were smaller because the war had been shorter, affected fewer countries and involved less physical damage. The war had been preceded by a fairly steady period of progress which compared favourably with the depressed decade of the 1930s, so that the capital stock was more adequate for postwar levels of output. Finally, there was no rearmament stimulus such as was provided by the Korean war.

However, economic policy was also quite different forty years ago. Governments at that time allowed inflation to develop rapidly so that there was a speculative inventory boom and a sharp increase in prices which reduced the purchasing power of accumulated wartime savings, and in some countries destroyed it completely. The boom was followed by a very tight monetary policy. There was no large-scale redistribution of income, and in several countries governments followed a policy of wage cuts during the 1921 recession. There was little co-operation in rebuilding the world economy. The U.S. helped to force European governments into deflationary policies in 1921 by reducing its capital outflow. Within Europe itself, the main international economic discussion was about German reparations. By contrast, monetary policy was generally easy in the period following the second world war; purchasing power was maintained longer in the U.K. and Scandinavia by suppressing demand through direct controls, and even in countries where there were currency reforms as in Germany, Belgium and the Netherlands, purchasing power was better preserved than in some of the disastrous inflations of the early 1920s. There was a massive outflow of U.S. aid to finance the European deficit, and the liberalisation of European trade and the credit provided by E.P.U. were major factors which enabled governments in payments difficulties to avoid or mitigate deflationary policies in the period following 1948.

(b) *The 1952 Recession.*

Although the backlog elements in demand had not been completely eliminated, there was a mild recession in Europe in 1952. This recession was not caused by a fall in defence production as was the post-Korean recession of 1953-54 in the U.S. In fact, it occurred whilst defence spending was still rising. It was due partly to a collapse of the inventory boom which had accompanied the Korean outbreak, but it was also due to a large extent to anti-inflationary policies of governments, particularly in the U.K. and France, and to the international repercussions of these policies. In the U.K., there was a strain on resources as production was switched from civilian to military purposes in conditions of very full employment. The authorities used fiscal measures to restrain private demand and severely restricted hire purchase and credit facilities. The situation in France was similar. Both France and the U.K. ran into considerable balance of payments difficulties which they met by imposing quantitative import controls. These import restrictions had an adverse effect on the exports of other European countries, and temporarily slowed down the general pace of European growth. The collapse of raw material prices also reduced the purchasing power of primary producers and led to a fall in European exports to these countries.

(c) *The Return to Normality.*

From 1953 to 1957 Europe enjoyed its first postwar period of " normal " expansion. Nearly all of the backlogs were gone, or were rapidly disappearing, defence expenditure was falling in most countries, and total government claims on resources grew slowly except in France where they were the major inflationary force in the economy. Europe as a whole did not have to squeeze domestic consumption in order to eliminate a payments gap as had been the case in the recovery period. At the beginning of this expansion, the main stimulus came from government measures to encourage consumption and housebuilding. This was done by reducing taxes and increasing financial aid for housing, ending the monetary restraint introduced in the Korean boom, and removing nearly all the remaining direct controls, *e.g.* abolition of rationing, building licensing, and hire purchase controls in the United Kingdom. Some of the housing growth of this period had elements of backlog because governments had restrained building in the recovery period — it is, however, doubtful whether demand would have been nearly so great if governments had not continued to stimulate it by rent controls and subsidies. Consumption also increased sharply in this period, particularly consumer durables. There was an element of backlog in demand for consumer durables, particularly in the U.K., but since demand for durables is very elastic at European income levels, the sharp increase in personal incomes and consumer credit in this period would, in any case, have led to a substantial increase in expenditure on such items.

The most striking economic development since the recovery period was the investment boom of 1954-57. Investment was already high when it started and was carried to unprecedented levels in practically all European countries (3). It was induced by high consumption demand and shortage of production capacity in the same way as many investment booms in the past, but it owed its persistence and intensity partly to elements of backlog, partly to a changed attitude to investment, and partly to government policies.

Not only was demand increasing sharply, but its pattern was also changing. The output of passenger cars rose from 1.5 million in 1953 to 3.5 million in 1958, production of many household durables rose faster and the new goods involved heavy investment requirements. The more competitive state of consumer

(3) It is noteworthy that there has been no comparable postwar investment boom in the U.S. (i.e. in the sense that the U.S. rate of investment has been no higher than the long-term historical average).

markets also made it necessary to improve the quality of many goods by replacing obsolete equipment. The liberalisation of European trade sharpened competition and provided new market possibilities for the most dynamic firms. It did, of course, discourage investment by firms which lost markets to foreign competitors, but if policy had been more protectionist these firms would probably have invested less than their more dynamic neighbours.

In earlier post-war years, certain kinds of investment had been deliberately restricted as a matter of government policy, whereas the period from 1953 was free of controls. There had also been a rather intensive use of the existing capital stock in the early post-war years in many countries because of the high levels of employment compared with pre-war years, so that there was a need to provide the additional employees with more adequate facilities, particularly factory and office space. This shortage was due not only to the war but to the depressed level of investment in the 1930s. It was reflected not only in the need for more capital but in the need to replace capital whose scrapping or demolition had been postponed.

A general stimulus to modernisation investment in the post-war period has been provided by the continuance of high levels of employment and the expectation by entrepreneurs that markets are likely to continue to grow and that labour costs are likely to continue steadily upwards. Apart from the need to substitute capital for labour, this also led to a feeling that labour had to be attracted by better working conditions — hence the interest in providing more and better factory and office space. The expectation of rising prices was another incentive to put liquid or borrowed funds into new plant and equipment. Apart from these cost considerations, the successes of the recovery period and the mildness of the 1952 recession probably gave entrepreneurs optimistic expectations about the long-term growth of markets. For these reasons, the high level of investment was not only induced by the concrete profit possibilities of the immediate demand situation, but was partly a result of the generally expansionist view of the long-term cost and profit prospect.

There were a number of special government stimuli to investment which help to explain the intensity of the investment boom. In the earlier part of the boom, governments had promoted housing investment, but this was generally curtailed after 1955, except in France and Italy. There were also other more general investment stimuli. In the United Kingdom, the excess profits tax imposed in 1951 was repealed in 1953 and "initial" allowances permitting more rapid depreciation were restored. Investment was stimulated by the introduction of investment allowances (depreciation allowances bigger than the cost of assets) in the 1954 budget. In Germany tax free status was given in 1952 to investment in certain bottleneck industries — steel, coal and electricity — under the Investitionshilfegesetz, and from 1953 accelerated depreciation was allowed in all industries. Similar fiscal encouragements to investment were introduced in other countries at about the same time. In Italy and the Netherlands accelerated depreciation was allowed, in France the switch from a production to a value added tax favoured investment and in Sweden the investment tax was abolished.

During 1955 and 1956 the pressure of demand on resources grew to be excessive in several countries, with a consequent increase in prices and serious balance of payments deficits in the United Kingdom, France and the Netherlands. The price rise received a new impetus at the end of 1956 from the Suez crisis which also exacerbated the payments problems of France and the United Kingdom. The payments problems were further complicated in 1957 by speculation on a realignment of European currency parities. For these reasons, most governments adopted restrictive policies from 1955 to 1957. In nearly all countries more emphasis was placed on monetary than on fiscal policy, but it was supplemented in several countries by a number of selective restraints. Restraints on housebuilding were imposed at an early stage in Belgium, Germany, the Netherlands, Norway, Sweden and the United Kingdom, and these proved very effective. Hire purchase controls were imposed in five countries, indirect taxes were raised, and subsidies lowered in an effort to check consumption. Private investment was checked by a temporary investment tax in Norway and Sweden, and changes in depreciation allowances in Belgium, the Netherlands and the United Kingdom also had some effect. At a later stage in the boom public investment was restrained in Belgium and the Netherlands in 1957, and the U.K. restrained both public works and nationalised industry investment in 1956 and 1957. The selective restraints applied to housing and consumer durables were most effective, as were the special Scandinavian taxes on investment. However, monetary policy was slow to take effect in checking the boom in

private non-residential fixed investment and stocks except in Germany. On the external side the most difficult problem was speculative capital movement and leads and lags in payments. In the U.K. and the Netherlands (and at an earlier stage, Denmark), the payments problems of the period were met almost entirely by internal measures of adjustment. France was the only country which adopted quantitative restrictions or changed its exchange rate to meet the payments problem. In Germany, there were unilateral tariff reductions in 1956 and 1957 in an attempt to reduce the foreign surplus, and monetary policy was also eased for this reason.

(d) *The 1958 Recession.*

In most countries restrictive measures began to show their cumulative effect on investment at the beginning of 1958. Fixed investment began to level off in most countries and towards the end of the year there was a general decline in inventories. There was also a fall in the level of trade as activity slackened, and the fall in exports was an important deflationary factor in some countries. Thus, although the 1958 recession had certain features which made it resemble an old-fashioned business cycle, it was, in fact, mainly induced by government anti-inflationary policies which had been fairly prolonged because they were intended not only to curb excess demand but to check wage increases and deal with speculative payments crises.

In the recovery from the 1958 recession, policy also played a predominant role. Monetary policy was eased after mid-1958. Housebuilding was stimulated in most countries by the reduction in interest rates, measures to increase the availability of credit and larger subsidies. Public works and nationalised industry spending were increased in Austria, France, Italy, Norway, Sweden and the U.K. As a result, the fall in private investment in manufacturing was more than compensated in most countries, and in Germany and Sweden, government stimulants succeeded in raising private investment as well. In the United Kingdom, consumption rose sharply after the removal of hire purchase restraints in autumn 1958 and the reduction of purchase tax and income tax, and the increase of transfer payments in 1959. Apart from these government stimuli, recovery was aided by a general increase in stocks and in exports.

(e) *Conclusions.*

It is clear that in the period up to 1952-53 the main forces maintaining demand were of an extraordinary nature — backlogs of demand, and military spending — although governments contributed something further by income redistribution and easy money policies and by avoiding the deflationary and beggar-your-neighbour policies which were prevalent after the first world war. The recession of 1952-53 was primarily due to a reversal of the Korean inventory boom and to government policies to restrain the inflation and balance of payments difficulties created by the Korean war. After 1953, the backlogs disappeared and military spending grew little or fell. In spite of this, demand remained at very high levels, and the 1958 recession was milder than that of 1952. Unemployment in 1958 was not much more than 2% of the labour force in nearly all industrial countries, including Germany which in the early postwar period had a level nearly three or four times as high. The expansion of demand in 1953-55 owed a good deal to government policy stimuli, and the "recession" of 1958 which was felt generally in Europe and the longer stagnation from 1955 to 1958 in the U.K. were again attributable very largely to government policies to check inflation and balance of payments difficulties. It is clear, therefore, that the European economy no longer operates as it did in prewar years.

III. Permanent Changes in Economic Behaviour

It is sometimes suggested that the post-war economy has acquired new characteristics which have brought demand to a permanently higher level or which have made it less volatile. It seems worth examining the major factors which are usually cited in support of this suggestion, before analysing the role of government.

A major reason for the buoyancy of demand is that a couple of decades of very activity levels have generated forces which tend to make such conditions self-perpetuating. Perhaps the most important change since prewar is that the "normal" situation is one of labour scarcity. Thus employers are unable to cut wage rates when demand falls off, whereas in prewar years they were able

to enforce cuts in money income which greatly added to the downward spiral of recession. Government policy has also contributed to change the attitude of employers, for the authorities no longer give a lead in cutting wages in recessions as they used to. In fact, wage rates may even rise during recessions and help sustain demand. In many industries, employers are loth to dismiss workers or even to cut hours when demand declines for fear that they might lose personnel who would be difficult to recruit again later. This tendency has, of course, been strengthened by the growth in the relative importance of white-collar workers whose jobs are more secure.

Although the strength of the labour market has helped to sustain demand, the pressure of wage claims in periods of expansion has also been an important factor in the process of inflation in the past few years. It is not, of course, clear that pressure from wages is an independent cause of inflation, and it was obviously not the major cause in the early postwar years when demand was clearly excessive, and import prices were rising sharply. However, strong wage or cost pressures have become a characteristic of the economy at high but not necessarily excessive levels of demand in many European countries and the U.S. It is difficult to measure the impact of wage pressures empirically, particularly as the abolition of price and rent controls and subsidies inherited from the period when governments tried to suppress excess demand has caused a lagged increase in wages in many countries in times when demand was no longer excessive. There are also considerable differences between different European countries. In the United Kingdom and Scandinavia, trade unions are powerful and wage pressures have been particularly strong, although they have been sensitive in some degree to the state of demand. In Germany, strong wage pressures have only arisen in the past year or so since unemployment fell to levels comparable with other countries, but there is little evidence that they have acquired the independent momentum which seems characteristic of some other countries, for wage claims abated in the production lull of 1958, and rose again only when the 1959/1960 expansion was well under way. It is also difficult to discern wage pressure as an independent element in the French economy, where the government has been the major source of demand pressure and is usually itself the key factor in setting the pace for wage increases. It is clear that strong wage pressures have become a fairly permanent feature of the postwar economy of many, if not all, countries, and the practice of cutting wage rates in recessions has disappeared practically everywhere. In the past few years, governments have been increasingly concerned with the inflationary consequences of wage pressures, but few of them have made much progress in developing policies specifically designed to moderate wage increases. It may well be that future developments in this field will lead to a weakening of the postwar pressure for higher wages, but it is unlikely that governments will revert to the wage-cutting tactics of the inter-war years, or that they will allow recessions to develop to the stage where employers are able to cut wage rates. In fact, if governments were successful in moderating inflationary wage demands, they could afford to give active encouragement to wage claims when activity began to slacken. Greater success in tackling the wages problem directly would also be an improvement on the present situation in which governments attempt rather unsuccessfully to exert indirect pressure on wages by checking demand to the point of inducing a fall in output.

It has been suggested that the experience of full employment and the explicit commitment of governments to this policy has led businessmen to make long-term investment plans and keep a steadfast nerve in time of recession. In the bigger European countries total fixed investment has stagnated rather than fallen in the two postwar recessions, but this aggregate stability usually concealed a fall in private non-residential investment offset by a rise in housing. Government policy also played a substantial stabilising role. In the Benelux countries, fluctuations in investment have been bigger, with a 10% fall in the Netherlands in 1951-52, and larger falls in Belgium and Luxembourg, and there were substantial movements in these countries in the 1958 recession. It seems therefore that businessmen are quite capable of postponing long-term investment plans when the business outlook becomes uncertain, and there is no clear evidence that private investment has acquired any greater stability than that imparted by government policy. However, the long experience of rapidly growing markets, shortage of labour and steadily rising labour costs has contributed substantially to raise the general level of investment, and the level at which the economy operates is such that business has buoyant expectations. Thus, it was very difficult for the authorities to break the investment boom

by restrictive measures in 1955-57, and in 1959 business investment was quite responsive to official stimuli. At the same time, the greater relative importance of investment means that fluctuations in investment can have a bigger impact on the economy.

As far as inventory investment is concerned, movements in demand have become, perhaps, more volatile than they used to be, although it may be simply that inventory fluctuations are more apparent now because they usually mirror the primary impact of recession, and bigger movements in other demand components are now checked before they go very far. It is difficult to be sure of this for very few countries have good figures on inventories, even for post-war years. It is clear that inventories have played a bigger role in each post-war American recession than in 1929-30, when inventories increased in the initial stages, but the 1937-38 recession was heavily affected by inventory movements, and the milder 1924 and 1927 fluctuations were inventory recessions. In Europe, inventory movements appear to have been less volatile than in the United States, although the lack of quarterly figures for Europe makes judgment difficult. It may be that American inventory movements are bigger and more rapid because businessmen are better informed about the general state of the conjuncture. Hence, we may even expect inventory fluctuations to increase as business indicators improve and businessmen become more sophisticated.

Consumption is not a volatile element of demand and has risen fairly steadily with the rise in incomes. There have been some fluctuations in European demand for consumer durables but these have been largely induced by government policy and the general trend has been one of rapid and uninterrupted growth. By contrast, U.S. demand for durables is growing less rapidly because the existing stock is much higher, but variations in demand for durables as in the boom of 1955 and the sharp fall in 1956 have been an important source of instability for the economy as a whole. It is likely that similar autonomous fluctuations will occur in Europe as incomes approach closer to American levels, and as the growth of consumer credit increases the possibilities for spending beyond current income. Durables were 8.3% of European consumption in 1957 as compared with 11.2% in the U.S., so that they are already an important factor in demand.

All European countries have a sufficient dependence on foreign trade to be seriously affected by inflationary or deflationary shocks from abroad (see Table 6). In the postwar period, most countries have received inflationary impulses from abroad at one time or another. In Germany, the large trade surplus has provided a constant stimulus to domestic activity for many years. In 1952 and in 1958,

TABLE 6

PERCENTAGE CHANGE IN EXPORTS AT CURRENT PRICES RELATIVE TO G.N.P. (1)

	Ratio of Exports to G.N.P. in 1958	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958
		Ratio of Change in Exports to G.N.P.									
Austria	25.3	4.0	8.5	5.4	2.2	4.5	4.4	2.1	5.1	3.7	−0.2
Belgium	34.1	1.1	2.3	11.8	−2.5	− 1.3	1.5	5.3	5.0	1.3	−0.9
Denmark	34.1	5.3	6.2	7.6	0.7	1.1	2.1	3.2	2.5	2.7	1.4
France	13.9	n. a.	2.9	4.0	0.3	0.1	2.3	1.0	−0.6	1.2	2.1
Germany	24.9	n. a.	n. a.	6.3	2.8	2.2	3.5	3.2	3.7	4.0	1.1
Greece	14.0(2)	0.4	1.9	0.7	1.2	5.0	3.6	3.1	0.9	2.1	n. a.
Iceland	28.8(2)	(−6.3)	(9.0)	(13.6)	(2.6)	9.0	4.4	1.1	3.4	−2.7	n. a.
Ireland	35.4	(0.7)	(2.5)	(4.1)	(4.8)	(2.1)	−0.2	0.2	−0.6	4.1	−0.4
Italy	15.2	0.9	1.9	3.1	−1.0	1.9	1.0	1.4	1.9	2.9	0.5
Luxembourg	89.2(2)	n. a.	−1.2	47.9	9.7	−28.2	−0.1	14.9	15.1	4.1	n. a.
Netherlands	49.7	8.7	10.9	12.4	4.5	1.1	4.4	5.6	3.6	5.0	0.4
Norway	42.5	1.7	9.1	16.0	0.1	− 3.7	2.8	5.2	8.0	3.7	−4.5
Portugal	18.8	n. a.	n. a.	n. a.	−1.5	− 0.9	2.4	1.9	1.8	0.1	0.3
Sweden	27.6	1.1	5.6	12.4	−2.2	− 1.3	1.8	2.3	3.4	3.5	−1.0
Switzerland	26.0	(−1.1)	(2.0)	(4.6)	(0.4)	(2.5)	0.4	1.8	2.1	1.9	0.0
Turkey	2.6	1.6	0.4	1.5	1.1	0.4	−1.1	0.4	0.7	0.0	(−0.8)
U.K.	21.7	2.3	4.7	4.0	0.3	− 0.8	1.6	1.6	2.1	1.0	−0.7
Canada	19.2	−0.2	0.9	4.3	2.0	− 0.7	−1.0	2.3	2.0	0.1	−0.3
U.S.	5.2	−0.4	−0.7	1.5	−0.2	− 0.3	0.2	0.5	0.9	0.7	−0.8

Source: *O.E.E.C. General Statistical Bulletin*, January 1960.

(1) *e.g.* The figures for 1958 show the change in exports of goods and services at current prices between 1957 and 1958 divided by 1958 G.N.P. at 1958 prices.

(2) 1957.

there were deflationary consequences for several countries as a result of the general recession and fall in the volume of trade; in both cases, Belgium, Luxembourg and Sweden suffered as exporters of industrial raw materials for which demand and prices fluctuated heavily, and Norway was hit as an exporter of shipping services. Most European countries have not, however, suffered seriously from

external deflationary forces, and most payments problems have been created by domestic inflation, although there have been important speculative capital movements which have particularly hit the U.K. The relative absence of deflationary trade impulses has been due to the widespread adoption of full employment policies, but it has also been due to an abandonment of beggar-your-neighbour remedies for meeting payments difficulties. Policy weapons such as quotas, exchange controls and even exchange rate adjustments are now rarely used to deal with such problems. These developments have been fostered by the growth of international institutions, particularly the O.E.E.C., I.M.F. and the G.A.T.T., which provide many safeguards non-existent in the 1930s and which we will analyse in greater detail later. It seems then that the economies of Europe are as vulnerable as ever to unfavourable external stimuli, and suffer less from them only because of a general improvement in domestic economic policy and in standards of international economic behaviour.

In the United States, there have been institutional changes which have strengthened the resistance of the economy and the financial structure to recession or which have, at least, provided bulwarks against a far-reaching deflationary spiral on the 1929 scale. The banking system has been guaranteed against collapse by the institution of Federal Deposit Insurance. The mortgage market has been completely changed by the disappearance of the non-amortising mortgage, the establishment by the government of a secondary mortgage market (F.N.M.A.), the creation of government insured Federal Housing Association mortgages and guarantees for Veterans Administration mortgages. The possibility of stock market speculation has been limited by the supervisory activities of the Securities and Exchange Commission and the restraints on margin trading which can be imposed by the Federal Reserve Authorities. Although these institutional changes have no European counterpart, it should be remembered that European financial institutions were generally less unstable than American in the prewar period (in spite of the bank failures in Germany and Austria) and, therefore, not so much in need of reform. These measures were, after all, meant to prevent collapse and not to promote normal ranges of stability.

Hence, it does seem true that European economies have acquired some characteristics which tend to promote high levels of activity and which are not due to government policy. However, these forces have themselves been generated by a sustained experience of high levels of demand and will not necessarily be permanent. As far as stability is concerned, the private sector of the economy does not really seem to have changed much, though governments have moderated the amplitude of fluctuations, and their character has changed because of the higher general level of activity. The difficult cyclical problems have been inflation and payments disequilibrium rather than unemployment, for downward movements are easier to check in an economy which retains the momentum of full employment than in one which is stagnating or depressed. The lesser volatility of European demand for inventories and consumer durables tends to make the European economy more stable than the American, as it has been in the past. But this European advantage may well disappear in future.

IV. The Role of Government

A major reason for the changed behaviour of the postwar European economy is that governments have acquired a much better appreciation of what they should do in business cycles and also have better information on what is happening to the economy. Generally, they now do the right thing instead of the wrong thing, and they are also better equipped to do the right thing. Government financial operations are so conducted that they correct recessionary or inflationary tendencies to an important degree intsead of exaggerating them as they did in prewar years.

It is often taken for granted that the relative size of government operations has greatly increased since prewar years. However, government expenditure on goods and services has declined since prewar for Europe as a whole, although there has certainly been an increase in transfer payments and in the control of investment. In nearly all European countries, public consumption is smaller than in the U.S. but transfer expenditures are much higher. European governments have much greater control over investment than the U.S. and do much more of the economy's saving.

(a) *The Scale of Government Operations.*

For Europe as a whole, the share of government in total expenditure on goods and services is lower than it was in 1938, *i.e.* 14%

Table 7

GOVERNMENT CURRENT EXPENDITURE (1) AS A PERCENTAGE OF G.N.P. 1938 AND 1958

	Expenditure on Goods and Services		Subsidies, Transfers and Debt Interest	Total Current Expenditure
	1938	1958	1958	1958
O.E.E.C. Countries combined	15.8	14.2	n. a.	n. a.
Austria	16.5 (2)	13.9	14.7	28.6
Belgium	n. a.	11.1	13.6	24.7
Denmark	9.3	13.0 (3)	8.3 (3)	21.3 (3)
France	13.0	14.5	14.8	29.3
Germany	23.1	13.5	17.0	30.6
Greece	14.8	13.4 (4)	5.2 (4)	18.6 (4)
Ireland	12.8	12.7	10.6	23.3
Italy	16.3	12.2	13.7	25.9
Netherlands	11.4	14.4	14.1	28.5
Norway	9.9	13.2	11.5	24.7
Portugal	11.4	11.3	3.8	15.1
Sweden	10.4 (5)	18.2	10.6	28.7
United Kingdom	13.5	16.6	12.5	29.1
United States	11.4	18.8	8.0	26.8

Source: *Statistics of Sources and Uses of Finance 1948-58*, O.E.E.C., 1960.

(1) These percentages refer to total government expenditure. A substantial proportion is not in the hands of the central authorities who have primary responsibility for anti-cyclical policies, but in the hands of local governments, whose spending or revenue collection it is often difficult for the central government to direct in an anti-cyclical way. The share of central government in total government expenditure was as follows: Austria 57%, Belgium 65%, France 87%, Germany 44%, Italy 85%, Netherlands 70%, Sweden 66%, U.K. 79%, U.S. 68%, Norway 68%.
(2) 1937.
(3) 1956.
(4) 1957.
(5) 1938-39.

instead of 16%. This drop is largely due to the substantial decline in Germany and Italy where prewar military expenditures were much higher than they are now. However, there are also some other countries where there has been a slight fall in the share of public consumption. In the U.K., France, Netherlands and Scandinavia, the proportion has risen, but in no European country except Sweden has the relative growth of public consumption since prewar been as big as in the U.S.

The growth in the relative scale of government operations has not always, in itself, contributed to economic stability, even though government spending is not subject to instability for the reasons that motivate private investment. The biggest increase in government spending has been for military purposes, and such expenditure can generate its own fluctuations in the economy, either because of variations in the degree of international tension or because of changes in technology which suddenly require large amounts of equipment to be scrapped, *e.g.* the switch from aircraft to missiles, or which may make strategic stockpiles redundant at a time when private demand is flagging.

European governments have increased their transfer payments substantially since before the war, and in Austria, Belgium, France, Germany and Italy transfer payments are actually bigger than expenditure on goods and services. In all European countries, except Greece and Portugal, transfer payments are a much bigger proportion of total government expenditure and of G.N.P. than in the U.S.

In European countries the volume of housebuilding is virtually dictated by government policy as the majority of houses are built with some kind of government financial support. The methods of providing this finance vary considerably from country to country. In the U.K. financial support is largely confined to publicly-owned dwellings. Public ownership is also important in Austria, Iceland, Italy and the Netherlands, but in these and other European countries governments give financial support of some kind (which can be varied for anti-cyclical reasons) to houses built for private ownership either by granting loans at low interest rates, or by giving interest subsidies. Several governments also give important tax remissions to housebuilders and these are most substantial in Germany where savings devoted to housebuilding have been virtually freed from tax liability. In most countries, government support for housebuilding is probably greater than in prewar years, although considerable public housing schemes then existed and cheap money policies gave housing a powerful boost in the U.K. in the 1930s. In the U.S., too, government control over housing is greater than prewar. The Government provides insurance for F.H.A. mortgages and guarantees

V.A. mortgages as well as providing a secondary mortgage market. These facilities can be varied considerably for anti-cyclical reasons, and government mortgages dropped from 51% of the total in 1955 to 30% in 1957. In practice, the U.S. government's power to influence housebuilding for anti-cyclical purposes is not inferior to that of most European countries.

TABLE 8

GOVERNMENT FINANCE FOR HOUSING

	Percentage of Housing Expenditure financed from Public Funds	% New Dwellings in receipt of public financial assistance	Year
Austria	n. a.	60–70	1955
Belgium	44	53	1956
Denmark	55	85	1955
France	46	91	1957
Germany	28	52 (1)	1957
Greece	5	27	1956 (2)
Iceland	75	97	1957
Italy	13	21	1955
Netherlands	64	95	1957
Norway	47	66	1956 (3)
Portugal	3	2	1955
Spain	55	66	1956 (2)
Sweden	49	97	1956
Switzerland	1	7	1955
Turkey	2	25–33	1955
United Kingdom	56	58	1957 (2)

Source: E.C.E., *Financing of Housing in Europe*, Geneva, 1958.
(1) Excludes dwellings built with tax concessions only, which are considerable, and cover 90-95% of total construction.
(2) First column refers to 1955.
(3) First column refers to 1957.

A big difference between the scope of government activity in the U.S. and Europe is that European countries have more publicly and municipally owned enterprises, and a substantial nationalised industry. In Austria, France and the U.K., a good deal of nationalisation has been carried out since the war, but in other countries the scope of government enterprise has not changed since prewar. In France and the U.K., public enterprises absorb about a fifth of total fixed capital formation. In other European countries the proportion is smaller, but in almost all cases there is public ownership of electricity, gas, water, railways, airlines, city transport, radio and television broadcasting, telephones and telegraph all of which are privately owned in the U.S. (4).

The proportion of total saving which is done by European governments is much higher than in the U.S. In the period 1952-58 the government current surplus amounted to more than a third of total saving in Austria, and to a quarter or more in Germany, Sweden, Portugal and Luxembourg. Only in Belgium, where the government ran a deficit, and in Greece was the share of government in savings lower than in the U.S. These government savings are used to finance capital expenditure on public works, housing and in nationalised industries (although nationalised industries also provide some of their own finance), and in Germany they have also served to finance the accumulation of foreign exchange reserves. The fact that European governments do more saving than the U.S. reflects their greater financial responsibility for housing and for nationalised industry. It is also perhaps due to the greater inflationary

(4) In France, postwar nationalisation included electricity, gas, coal, atomic energy, the Renault motor works, and 3 big banks — Crédit Lyonnais, Société Générale, and the B.N.C.I. The Government also owns the railways, airlines, some shipping lines, radio, telegraph, telephone, city transport, the tobacco industry and parts of the insurance, aircraft and petroleum industries. In the U.K. postwar acquisitions include some steel companies, electricity, coal, gas, atomic energy, railways and airlines. The Government also owns radio, telephone and telegraph. In Germany the Government owns railways, some mines, the Volkswagen motor works and telephones. Gas, electricity and city transport are under municipal ownership. In Italy a considerable portion of industry is controlled by the Government via a system of holding companies. The biggest of these is the I.R.I. which controls a good deal of engineering, steel, transport and public utility enterprises and the other large government holding company is the E.N.I. which controls the petroleum, atomic energy and chemical industries. Some enterprises are under mixed ownership. In Scandinavia, there has been no nationalisation since prewar, and the nationalised sector is smaller than in the United Kingdom or France. Nevertheless, the public sector is fairly large in Sweden and Norway. In Sweden the Government industries are railways, tobacco, wines and spirits, S.A.S., and a large iron ore mining company. The gas and electricity industries are owned by municipalities. In Norway the Government controls sales of wines and spirits, 51 per cent of hydro-electric investment, and owns the railways. Gas and electricity are under municipal ownership as in Sweden. In Denmark the Government owns the railways and municipalities own gas and electricity. In the Netherlands public enterprises consist of airlines, railways, coal mines, gas, water and electricity. In Belgium the public sector is smaller than in the Netherlands. In Austria nearly all industry is owned directly or indirectly by the government because the nationalised sector is substantial and the *Kreditanstalt* and *Länderbank* are government institutions which own a good deal of the equity capital of private industry.

state of the European economies and their weaker capital markets which make it more difficult to raise funds by borrowing. In fact, the government share in saving has fallen in recent years as private

Table 9

THE SHARE OF GOVERNMENT IN TOTAL FIXED INVESTMENT IN 1957

	Public Works	Housing in Finance of which Govt. participates	Public Enterprises and Nationalised Industries	Total Investment under Government control
France	10.5	22.4	23.0	55.9
Italy	8.4	6.0	9.6	24.0
Sweden	16.7	23.5	17.8	58.0
United Kingdom	8.3	9.8	26.1	44.2

Sources: U.K., *National Income Blue Book*; Sweden, *Konjunkturläget*, Hösten, 1958, Konjunkturinstitutet; Italy, *Relazione Generale sulla Situazione del Paese*, 1958, pp. 42 and 46; France, *Statistiques et Etudes Financières*, April 1959, p. 391, Ministère des Finances. Rough estimates for some other countries are available in the *Economic Survey of Europe in 1959*, E.C.E., Geneva, 1960, Chapter V, p. 3.

Table 10

RATIO OF GOVERNMENT SAVING TO TOTAL SAVING 1952-58 (1)

Austria	35.2	Italy	18.0 (6)
Belgium	−3.2	Netherlands	21.1
Denmark	21.7 (3)	Norway	25.3 (4)
France	17.2 (4)	Portugal	27.6
Germany	28.5	Sweden	24.5
Greece	9.5 (2)	United Kingdom	15.6
Ireland	14.6 (5)		
Luxembourg	26.1 (2)	United States	12.2 (2)

Sources: *Statistics of Sources and Uses of Finance 1948-1958, O.E.E.C.*, February 1960; and *O.E.E.C. General Statistical Bulletin*, January 1960.

(1) Arithmetic average of the savings ratio for each of the years 1952-58.
(2) 1952-57.
(3) 1952-56.
(4) 1954-58.
(5) 1954-57.
(6) 1955-58.

savings have revived. Most European governments provide some capital for private industry either to close "gaps" in the capital market, to aid in structural re-adaptation to new market conditions, or simply to give preferential treatment for weak industries such as agriculture. Such aid to private industry is no more widespread in Europe than it is in the U.S. and does not represent any basic difference in philosophy. In fact, in most European countries such aid may be smaller than in the years of depression in the 1930s. However, in France, Norway, and Sweden, the government exercises fairly substantial control over the allocation of private savings either by acting as a financial intermediary or by directing banks and insurance companies as to the allocation of their savings. In other countries, there is much less of such control, although there have been some restraints in the U.K. through the Capital Issues Committee.

(b) *Built-In Stability.*

Economic stability can be fostered to an important extent if the tax system has an automatic tendency to compensate cyclical movements in income. It has been estimated (5) that in the 1953-54 U.S. recession the potential decline in G.N.P. was offset by about 30 to 40 per cent because of the automatic compensatory variation in revenues and transfer expenditures. In the 1930s, by contrast, American government operations could actually aggravate recessionary influences by 10 to 20 per cent. In Europe, the automatic compensatory impact of the tax system has also grown since prewar, but to a lesser extent than in the U.S.

A major compensatory item in U.S. recessions is the rise in transfer payments which offsets about a fifth of the decline in income. These payments had a compensatory effect in the 1930s as well, but they are now much more important than they were then. In Europe, social transfers have increased markedly since prewar and are much more important than in the United States, particularly those which provide a *fixed* income which does not vary in recessions or booms, *e.g.* pensions and family allowances. The main transfer which is *compensatory* in the sense of varying inversely with earned income is unemployment benefit. Here again,

(5) Cf. DAVID LUSHER, "The Stabilising Effectiveness of Budget Flexibility", a chapter in *Policies to Combat Depression*, N.B.E.R., Princeton, 1956. Cf. also *National Income and Outlay*, National Income Supplement to *Survey of Current Business*, U.S. Dept. of Commerce, 1959. Unfortunately, such sophisticated studies are not available for European countries.

most European schemes are more generous than American, because they have a wider coverage, benefits last longer and are bigger in relation to normal income although U.K. benefits are only a third of normal income, *i.e.* about the same as in the U.S. Farm subsidies are important in both Europe and the U.S. and help to compensate for declines in farm income, although in some cases they are erratic in their effect. However, falls in farm income do not always coincide with moderate industrial recessions, when demand for food remains steady.

In recent years, there has tended to be some reversal of the earlier post-war redistribution of incomes as taxes have been lowered and subsidies and rent controls have diminished. However, Germany and Sweden have recently made a substantial increase in transfer payments by the introduction of generous pension schemes, and they may be followed by other countries. The long-run effects of income redistribution seem to have been negligible as a factor in maintaining demand at high levels, for the propensity to save in most countries is now as high as it ever was. There has been a tendency in each of the post-war United States recessions for savings to vary contra-cyclically, perhaps because of greater equality as well as because consumers are now used to steadily rising incomes and have confidence in the eventual renewal of expansion. But in the U.K. and Germany the increase in personal savings tended to aggravate the 1958 recession. Hence, it does not seem that greater equality has given greater stability to consumption.

In the United States, tax revenue has become much more sensitive to cyclical movements because of the enormous growth in Federal income and corporate taxes. Corporate profits — the most volatile source of income in a recession — are taxed much more heavily than in prewar years and form a bigger proportion of total revenue. As a result, the fall in corporate profits taxes in recession now tends to offset the total fall in incomes by a fifth (6). Personal

(6) A major factor stabilising incomes in U.S. recessions which is not due to the government budget is the maintenance of dividends by corporations in the face of declines in profits. The fall in total profits therefore leads to a sharp fall in the undistributed portion. This is a stabiliser which also existed in pre-war years. In Europe, data on profits are not very good but there is reason to expect that business would react in a similar manner. For most of the post-war period the margin of retained profits has probably been bigger than in prewar years so that there is a bigger potential cushion. In 1938 in the U.K. 58.9 per cent of corporate profits were distributed in dividends, 29.2 per cent retained

income tax is a less important compensatory factor and the fall in tax collections usually offsets only a twelfth or less of the decline in total income. In the U.S. direct taxes rose from 29% of total government receipts in 1937 to over half in 1957. Only in Norway and Sweden is direct taxation as important for the budget or for the economy as in the U.S. In most European countries direct taxes probably form a smaller share of total government receipts than in prewar years, both because of the increase in social security levies and, in some cases, of indirect taxes. In the U.K. for

TABLE II

CATEGORIES OF GOVERNMENT REVENUE AS A SHARE OF G.N.P. 1957

Country	Total Current Revenue	Social Security Levies	Direct Taxes	Indirect Taxes	Income from Property and Entrepreneurship and current transfers from rest of world
Austria	35.1	6.8	12.0	13.8	2.5
Belgium	23.1	6.0	7.0	9.2	0.9
Denmark (1)	25.8	1.3	11.5	11.4	1.6
France	32.7	9.3	5.7	17.1	0.6
Germany	36.9	9.4	9.5	14.7	3.3
Greece	19.7	3.7	3.4	11.7	0.9
Ireland	25.3	1.0	4.9	16.8	2.6
Italy	29.3	8.5	5.8	13.8	1.2
Luxembourg	33.3	8.0	12.8	9.4	3.1
Netherlands	32.6	7.5	12.9	10.0	2.2
Norway	31.3	2.4	14.6	13.5	0.8
Portugal	18.4	3.6	5.4	8.4	1.0
Sweden	31.7	2.8	17.4	9.4	2.1
United Kingdom	31.0	3.0	11.8	13.5	2.7
United States	27.7	3.3	13.7	8.8	1.9
Canada	27.1	1.9	9.9	12.6	2.7

Source: *Statistics of Sources and Uses of Finance 1948-1958*, O.E.E.C., 1960.
(1) 1956.

and 11.9 per cent paid in taxes. In the years 1953-57 on average 28.1 per cent were distributed, 43.8 per cent were retained and 28.1 per cent were paid in taxes. In 1952 when there was a sharp fall in corporate profits, dividends rose. Cf. *National Income and Expenditure*, 1958, Table 3.

instance, direct taxes fell from 42% of receipts in 1938 to 38% in 1957 (7). It is only in Scandinavia, the Netherlands and Luxembourg that direct taxes are higher than indirect taxes, and in other European countries indirect taxes are more important.

One of the consequences of the large European transfer payments is that social security contributions are much bigger than in the U.S., particularly in Germany, France and Belgium, where they provide more than a quarter of total government revenues. In Scandinavia and the U.K., however, such payments are less important than in the U.S. In many cases these payments are in the nature of a poll tax, do not vary in time to compensate the general cycle in incomes, nor do they vary with the level of individual income (8).

Another important change in the character of tax revenues since pre-war has been the timing of their collection. In the U.S. the bulk of taxes on personal or corporate income is now paid at or near the time that income accrues, under the pay-as-you-go and quarterly corporation withholding (self-assessment) tax systems. Taxes go down almost immediately there is a recession and vice versa in a boom, and there are also provisions for carrying over losses, whereas in pre-war years, payment in arrears often accentuated the cycle. European countries have also made substantial progress but less than the U.S. Most governments collect income tax currently from wage or salary earners, but not from other taxpayers or from companies which have the most volatile incomes. These delays are not particularly significant if tax reserves are accumulated at the time when income arises as is the case in the U.K. where companies provide the Treasury with advance revenue by buying Treasury Deposit Receipts. However, when companies are not very liquid, heavy tax obligations may well accentuate recessions, and booms may be encouraged if tax claims are low.

Thus government budgetary operations tend automatically to compensate for fluctuations in the private sector of the economy to some degree in many European countries, but there are few cases where government operations have as big an automatic stabilising

(7) It should be noted, however, that the purchase taxes in the U.K. tend to be compensatory in that demand for durables is highly elastic, although it does not always fall in mild recessions.

(8) In the U.S. the introduction of social security contributions in 1937 helped to cause a recession because the immediate obligations were not offset by benefits.

effect as in the U.S. A good many of the large social transfers in European countries are fixed rather than compensatory, and they are usually financed by fixed charges which are also insensitive to income fluctuations. A lower proportion of European tax receipts is sensitive to income fluctuations, and more European taxes are collected in arrears.

(c) *Active Government Anti-Recession Policies* (9).

There is no doubt that most European governments now accept much greater responsability for economic stabilisation than they did before the war. These commitments have been embodied in employment acts in the United Kingdom and Sweden, in the Monnet Plan in France, and in the Economic and Social Council and Central Plan Bureau in the Netherlands. Even in countries where the commitment to active economic policies is less overt, and where the main authorities responsible for economic stabilisation are still the Central banks, as in Belgium or Germany, there is by no means a policy of *laisser faire*. It is true, of course, that government policy in both Germany and Italy is much less interventionist than that of the prewar totalitarian regimes, and it is also true that even before the war, there was a sophisticated and relatively successful full employment policy in Sweden.

Most governments have to make public their view of the general economic situation in a rather formal way at least once a year in connection with the budget. In Norway, Sweden and the Netherlands, the fiscal budget is accompanied by a "national budget" which is a detailed forecast of the development of supply and demand in the coming year and an outline of proposed government policy. In France, there is something similar in the Comptes de la Nation, and there are also two "rapports de conjoncture" every year to the Conseil Economique et Sociale. In the United Kingdom, the annual economic survey is more modest. It contains a review of the recent situation and a brief outline of the economic outlook.

(9) A more detailed account of the development of economic policy instruments in European countries is contained in *Nationale Konjunkturpolitik in Europa 1954-56*, C.E.P.E.S., Frankfurt, 1958, and in the annual reviews and country reviews published by the O.E.E.C., particularly *O.E.E.C. 9th Annual Report*, Chapters I, II and V, Paris, April 1958, *O.E.E.C. 10th Annual Review*, Chapters II and III, Paris, March 1959, and *O.E.E.C. 11th Annual Review*, Chapter II, Paris, April 1960.

Similar annual surveys exist in Italy and Denmark as well as in the U.S. In Germany and Belgium, there are no such surveys, but the German central bank keeps up a constant stream of analysis in its periodic report. In all countries, these reports are discussed in Parliament, but in France they are also subject to a more general public discussion by economic experts, employers and workers in the Conseil Economique et Social. France is therefore the only European country which has a counterpart to the Joint Congressional Committee in the United States.

Most governments now explicitly recognise the function of the budget as a stabilisation instrument. However, there are only a few cases, notably Austria and Sweden, where the budget accounting procedure has been redesigned to show clearly the impact of government operations on economic activity. Powers to change taxes between budgets vary from country to country, but are nowhere very great, and it is only in very exceptional circumstances that the timing of budgets can be changed to meet new economic conditions. Apart from these technical problems, there are, in practice, limits to the amount of government freedom to vary budgets, and the almost exclusive wartime and early postwar reliance on, or claims for, fiscal policy have somewhat abated in recent years.

It has not proved too easy to vary government expenditure as a counter-cyclical weapon. Current outlays on necessary public services or social transfers are not usually the most desirable items to cut in times of inflation, and it would often be wasteful to expand them temporarily during recessions. Public capital expenditure can, in theory, be accelerated or retarded to compensate for deflationary or inflationary situations, but here again, it is not always desirable and there are often difficulties in making the necessary administrative arrangements quickly enough. It has therefore been increasingly recognised that budgetary policy should be designed to have a selective impact on particular kinds of private demand which are deficient or excessive, and there has been a smaller emphasis on the significance of the overall budget surplus or deficit. In this respect it seems that European attitudes have been more sophisticated than those in the U.S.

There have been some innovations in types of tax which are used for anti-cyclical purposes at the discretion of governments. These are peculiar to European countries and have not been used

TABLE 12

INSTRUMENTS OF MONETARY POLICY USED IN THE POSTWAR PERIOD

	Austria	Belgium	Denmark	France	Germany	Italy	Netherlands	Norway	Sweden	Switzerland	U.K.	U.S.
Bank Rate	—	—	—	—	—	—	—	—	—	—	—	—
Open Market Operations					—						—	—
Reserve Ratios	—	—		—	—	—		—	—		—	—
Obligation to hold government securities		—		—	—							
Rediscount Ceilings		—		—	—							
Gentlemen's Agreements	—		—	—	—		—	—	—		—	
Stock Market Margins												—
Consumer Credit Controls			—	—				—	— (1)		—	
Other Selective Credit Restraints		—		—	—		—	—	—	—	—	
Exchange Control	—	—	—	—	—	—	—	—	—		—	
Devaluation	—	—	—	—	—	—	—	—	—		—	

(1) Control exercised under a gentleman's agreement.

in the U.S. Several countries have attempted to influence business investment by varying the rate of depreciation allowance, or by imposing taxes or giving subsidies on investment. The degree of tax discrimination between distributed and undistributed profits has been varied as an indirect means of affecting investment. These measures have had a considerable impact but their effect was sometimes delayed so that it did not always have a compensatory influence at the right time. Changes in purchase taxes have been made for anti-cyclical purposes in the U.K. and these have had a very marked contra-cyclical influence because of the high rates of tax and the high elasticity of demand for the products. Several European governments have given special incentives to saving by the issue of tax free bonds similar to those issued by U.S. State governments.

Monetary policy is not very effective against severe recession and it fell out of favour in the 1930s. The relative quiescence of monetary policy continued well into the postwar period in spite of the prevalence of inflation and balance of payments difficulties. There were several reasons for this, apart from a general preference for budgetary policy or direct controls. The existence of large public debts would have made dear money expensive, and many of the inflationary problems were so severe in the early postwar years that direct controls were more effective than monetary policy. The return to normal conditions in the early fifties made it possible for monetary policy to be used more effectively as the liquidity of business was reduced and dependence on the banking system increased. It was recognised that monetary policy can be more flexible than fiscal policy and may be a useful expansionary weapon when the economy is suffering from mild recession as well as an anti-inflationary instrument. The greater convertibility of currencies also revived its role in influencing short-term money movements. In prewar years, the main impact of monetary policy was thought to be concentrated on business investment in inventories; more recently, monetary policy has been aimed at fixed investment or consumers' durables. The effectiveness of monetary policy has been biggest as an anti-cyclical weapon in Germany where the range of measures used has been large, and where business relies heavily on the banks for finance and has usually been less liquid than in other countries.

The range of policy weapons used under the general head of monetary policy varies considerably from country to country, but

is usually much wider in Europe than in the U.S. The traditional bank rate weapon has been used very frequently in nearly all European countries since 1954. Open market operations are a major weapon of monetary control in the U.K. and Germany, but in other European countries this weapon has not been used because the market in government bonds is not large or well organised. There has however, been considerable use of changes in reserve ratios. Most countries have also used a number of more selective weapons. This is particularly true of Belgium, France and Germany, but it is also true of the U.K. which has traditionally relied on more general weapons. These selective measures have included the obligation on commercial banks to hold government securities, the imposition of re-discount ceilings on the commercial banks with penalty rates for excess discounting, and gentlemen's agreements with the commercial banks to restrain particular kinds of credit. There have been some formal kinds of restraint on bank advances to certain kinds of borrowers, but no exact parallel to the Federal Reserve practice of prescribing stock market margin requirements. In most countries the problem of credit control is more complex than before the war because of the growth of financial institutions other than banks. As a result, there has been some extension in the scope of monetary policy. Control of consumer credit has become a major anti-cyclical weapon in the U.K. and has been used elsewhere. In Norway and Sweden official guidance has been extended to the investment policies of insurance companies.

(d) *The Impact of Policy on Different Categories of Demand.*

Investment. One of the most volatile elements of demand is investment, and control over investment adds powerfully to the stabilising potential of government. Governments can provide a good deal of stability in the economy simply by arranging their own capital spending in a relatively smooth flow. When government-controlled investment is such a large portion of the total, it is better to aim at this than to vary public spending counter-cyclically, even though the more flexible of public investment projects will have to be kept in mind as priorities for cuts or expansion if the situation requires. A good deal of nationalised industry investment is capital-intensive, and individual projects, such as power stations, railway electrification, and new coal mines, often take a long time to complete. The same is true of some public works such as roads. It may therefore be difficult at short notice to find suitable public investment projects to compensate for a flagging in private investment, and stability may be better achieved by changes in policy which are designed to influence the more flexible kinds of private investment. There have been a large number of fiscal and other policy measures specifically designed to influence private investment in the postwar period. In some countries, these measures have had a fair degree of success and in all cases they have made some impact on fixed investment even though it may have been a delayed one. It has not so far been possible, however, for governments to exercise any significant influence on inventory investment.

In fact, the investment plans of the public sector are often not co-ordinated, and different public bodies make separate investment decisions — either different ministries of the central government, different local government authorities, or the administrators of the different public enterprises. In many cases, therefore, the government's potential capacity to control public investment to promote economic stability has not been fully exploited.

In France, however, there has been co-ordinated investment planning since 1946, when the Commissariat Général du Plan was set up, and it has produced three major investment plans for 1947-52, 1954-57 and 1958-61. The plans included targets for investment in private as well as public enterprises and housing, because the Government provides finance for private industry in the form of loans, subsidies and guarantees for modernisation and re-equipment. French government investment has been designed to stimulate long-term growth rather than to offset short-term fluctuations in the private sector (10). In 1959, for instance, public investment was substantially increased in spite of the restrictive character of general government policy. The flagging of public investment in 1952-53 was also an act of policy in a period when the second plan was postponed and, although the stimulus to housing in 1953 helped recovery from the recession, the housing programme continued to expand in the inflationary years of 1955-57.

(10) In fact, the postwar business cycle in France has been dominated by the government sector both in regard to investment and consumption. For this reason, the French cycle has always been rather different in timing from that in other countries.

In the United Kingdom, it has been difficult to modify the investment of public bodies for anti-cyclical purposes because the nationalised industries are fairly autonomous. However, since 1956, the nationalised industries have been financed directly by the Government through the budget and the central government exercises fairly strong financial control over local authorities via grants-in-aid and variations in the willingness of the Public Works Loan Board to grant loans. Public works and public enterprise investment were not used to stimulate recovery in 1952, but they were restrained as part of an anti-inflationary policy from 1956 to 1958, and raised in 1959 when there was a fall in private investment.

Housing construction has been varied for anti-cyclical purposes in the U.K. although it does not always respond too quickly to policy changes as public housing is carried out by a very large number of local authorities. In 1952-53 the increase in house-building was a powerful stimulant to recovery, and at that time impetus was given by financial measures and the abolition of building licences which stimulated investment demand dammed back by previous restrictions. The housing boom went too far in 1955, when there was general inflationary pressure, and in 1958 it was difficult to restart quickly.

The United Kingdom has made frequent changes in fiscal policy which have been specifically designed to affect private investment. Changes in depreciation allowances have been made in order to restrain or to encourage investment. Investment allowances — depreciation allowances greater than the cost of the assets — have been granted and removed in order to encourage and restrain investment. The rate of profits tax has also been varied for anti-cyclical purposes. Undistributed profits were taxed at a lower rate than distributed until 1959 in an effort to stimulate the general level of investment. These measures have all undoubtedly had some effect on investment but in most cases they were slow to have their impact and therefore not entirely successful as anti-cyclical weapons.

In the U.K. there has, of course, been considerable variation in monetary policy which has had some influence in restraining investment in booms but not nearly as much as in Germany. The British government has not ordinarily extended large amounts of credit directly to private industry, although in earlier years it had a negative control over access to new capital via the Capital Issues Committee. Recently, however, it has granted financial assistance to promote investment in steel, shipping, and the relocation and reorganisation of the motor car, textile and aircraft industries. These measures had a more or less immediate impact on the industries concerned.

In Germany (11) control over State industries has not been used for anti-cyclical purposes. German fiscal policy has been used to promote a high general level of private investment rather than for anti-cyclical purposes. Until 1956 undistributed profits were taxed at a lower rate to foster investment, but they are now taxed more highly than distributed profits in order to encourage the creation of a capital market. Tax privileges have been granted for certain kinds of savings — housing bonds, shipbuilding loans and equalisation of war damage — and the government has also subsidised certain kinds of saving. Accelerated depreciation was allowed on war damage, residential property, industrial, commercial and agricultural plants, and a large number of short-lived assets were allowed to be written off in the year of purchase. The government also supplies substantial investment funds to industry via the Kreditanstalt für Wiederaufbau. The main anti-cyclical weapon has been monetary policy which has been more effective, both in checking and in stimulating investment, than in other countries, because of the wide range of monetary weapons used, the illiquidity of German business following the currency reform and the greater role of the banks in supplying funds for long-term investment than in other countries. The authorities have varied credit facilities and subsidies for housebuilding for anti-cyclical purposes but there has been some reluctance to check housebuilding in time of boom because of the serious shortage of accommodation.

In Sweden (12), government control over investment has been exercised more effectively for anti-cyclical purposes than in most other European countries. Not only have there been variations in public works and nationalised industry investment but private investment has been very powerfully influenced by fiscal policy. A 12 per cent tax on investment was levied to restrain inflation in 1951 and again in 1955, and these taxes were removed when a stimulus to investment was desired in 1953 and 1957. Firms received fiscal

(11) Cf. Henry Wallich, *Mainsprings of German Revival*, Yale, 1955, for a description of German developments.

(12) Cf. Erik Lundberg, *Business Cycles and Economic Growth*, London, 1957, for a description of Swedish policies up to 1956.

encouragement to accumulate tax-free investment reserves in boom years from 1955 to 1957, and in the 1957/58 recession they were given permission to spend them. In the early post-war years depreciation rates could be fixed freely by firms but this freedom was curtailed in 1950 and again in 1955, when there was pressure of demand. The authorities have also exercised considerable control over housing investment for anti-cyclical purposes and have given general directives to insurance companies on the allocation of their investment funds. The success of these measures may be judged by the fact that investment increased by 12% in the recession year 1958. In Norway the range of government measures to affect investment has been similar to that in Sweden.

In the Netherlands, the government has also used a large number of fiscal devices to influence private investment. Control over housing construction is very extensive (although it is diffused through many local authorities as in the U.K.), and there are licensing controls for all construction. When demand was slack in 1953, depreciation allowances were increased, corporate tax concessions were given according to the rate of investment by firms, and the general level of corporate taxes was reduced. When demand pressure increased in 1955, the rate of depreciation was substantially reduced and the timing of corporate tax collections was accelerated. In 1957, corporate taxes were raised and tax concessions for investment removed. There were also cuts in public works and in housing. In 1958 when there was a fall in activity, most of the earlier stimulants to investment were restored. In Belgium, there is less extensive control over housing, and less use of fiscal policy to influence investment than in the Netherlands. Nevertheless, there have been tax concessions to favour investment as in the Netherlands, as well as subsidies for certain kinds of investment, differential taxation of distributed and undistributed profits and changes in the period of carry-over for business losses. Public works expenditure and housebuilding have also been varied for anti-cyclical reasons.

Consumption. Consumption is not a particularly volatile element of demand and tends to increase steadily in years of boom or mild recession more or less in line with the increase in personal disposable incomes, although there was a period in all European countries when it rose more slowly due to the increase in the personal savings ratio. However, governments have often wanted to influence consumption, not only because they have considered it to be excessive or deficient, but to compensate for movements in other demand factors which they either did not want to or could not directly modify.

Governments can influence consumption by modifying the flow of personal incomes, by changing incentives to save, or by measures affecting prices. The first of these methods was the one principally considered in the early literature on anti-cyclical policy, and in recent American discussion of government anti-cyclical action. In Europe, however, the other two less orthodox methods have been just as widespread.

There are considerable difficulties in raising and lowering the general level of direct taxation. It is politically unpopular to raise taxes, and few rises in direct personal taxation as an anti-inflationary device have been used since the Korean war. In the past few years the general tendency has been for tax revenues to rise faster than G.N.P. and as the government share of total expenditure has generally fallen, an anti-inflationary effect has generally been secured simply by the absence of tax reductions. A general lowering of taxes to stimulate demand is usually popular but may create inflationary difficulties for the future. Such measures can also be thwarted by changes in savings habits. A general stimulus to consumption was given for anti-cyclical reasons by direct tax reductions (although there were also specific consumption stimulants) in the British budgets of 1953 and 1959, and the German tax reductions in 1953 served a similar purpose. Some direct tax reductions such as the Dutch or British of 1955 have not had an anti-cyclical impact, but exaggerated the inflationary problem. In general, tax cuts were more widespread in 1953 and 1954 following the cut down in armaments than they were in the 1958 recession.

In some cases, governments have attempted to affect the flow of income by trying to influence the level of wages. In nearly all cases, this has been limited to exhortation to keep wage claims in check in time of inflation. Only in the Netherlands and France has government influence on wages been used both to check inflation and to promote expansion. The Netherlands is the most open of the European economies, where there is a great public awareness of the effect of wage increases on the international competitive position of the country. In 1951 real wages were cut by 5% to meet the payments difficulties of the Korean crisis, and there was no further general round of wage increases until 1954 when they were raised twice by a total of 13% to stimulate demand. In 1955 wage increases were limited to 3% but attempts to differentiate wage increases broke down in 1956, when most wages rose by 9%. In 1957 and 1958, the unions agreed to wage restraint. In 1959 the government again tried a policy of differentiated wage increases. Apart from these general increases in wages, the government has, on several occasions, agreed to wage increases specifically designed to compensate for its policy changes, *e.g.* for increased pension contributions in 1957 or the abolition of rent controls and milk subsidies in 1959. Generally speaking, the Dutch system has not stabilised the growth of incomes, but has attempted alternately to check and boost them in an anti-cyclical manner. It is obvious that wages policy has given the government a major instrument for controlling the general level of consumption, but its control is far from complete and there have been periods of extremely favourable balance of payments alternating with inflation.

In France, there is no wages policy as in the Netherlands, but government influence on wages is larger than in most other countries. The legal minimum wage (S.M.I.G.) and indexation of wages have played a leading role because of the prevalence of inflation and the weakness of unions. Thus, an important element in French recovery in 1954 was the increase in consumption generated by the 5% increase in the minimum wage at a time when prices were stable or falling. During the inflationary period from 1955 to 1957 wage increases were combatted by manipulation of subsidies to keep the cost of living index from rising as had been the practice in many countries in the early postwar years. At the end of 1958, an important part of the stabilisation programme was the abolition of wage indexation.

Some governments have attempted to influence the general level of consumption by offering special incentives to savings. The French government has from time to time floated bonds with tax free interest payments, and savings premia were introduced in Sweden in 1955. In the U.K. a tax-free premium bond scheme was introduced in 1956 and has since been maintained. Perhaps the greatest number of fiscal incentives and subsidies to savings have been given in Germany, although they have not been used anti-cyclically. It is questionable whether these schemes have much affected the general level of saving rather than the particular channels to which savings are devoted.

In the U.K. there has been frequent use of measures to influence consumption of durables. Purchase tax was reduced in 1953, raised in October 1955, reduced in 1958 and again in 1959. Hire purchase restrictions — fixing the size of minimum deposits and the maximum maturity of debt — were abolished in 1954, reintroduced in spring 1955, tightened in the summer of that year, and again in February 1956, relaxed in the summer of 1958, abolished in October 1958, and reintroduced in a mild form in the spring of 1960.

In Sweden a 12% excise duty on cars was introduced in 1956, taxes on alcohol were raised, and conditions for consumer credit were stiffened (with differential controls for individual commodities). In January 1960 a general 4% sales tax was introduced to curtail consumption. The Dutch authorities had a tax on cars from 1951 to 1955 and have also had consumer credit controls (1956 and 1957) for anti-cyclical purposes. Consumer credit controls have also been used in Denmark and France.

Changes in purchase taxes and consumer credit have generally had a substantial and immediate impact on specific sectors of the economy where the pressure of demand was raising prices and imports. They have, of course, had certain adverse effects on the costs of the industries concerned and involve discrimination against particular consumers and producers. However, the advantages outweigh the disadvantages in cases where the measures are applied in time and in small doses, for they tend to even out demand for the producers concerned.

Foreign Trade. A major obstacle to full employment or expansionary policies in the prewar years was the fear that neighbouring countries would not move similarly, and that the expanding country would run into balance of payments difficulties. These fears were so widespread that there was a general and self-frustrating move to export unemployment by restrictive "beggar your neighbour" remedies. It is, perhaps, the biggest achievement of the postwar years that the leading economies are dedicated to full employment and there is enough mutual confidence and enlightened self-interest to face the risks of expansion together. Postwar co-operation was initially fostered by the lessons of the 1930s, by the willingness of the U.S. to act as a good creditor, and to some extent in Europe it was engendered as a response to political pressure from the East. However, constant mutual consultation, frank discussion and intimate knowledge of each other's economies and their problems have made co-operation a habit which most governments now regard as indispensable to the proper formulation of policy. Co-operation has been institutionalised by the creation of powerful international organisations of which the most important have been the O.E.E.C., the I.M.F. and the G.A.T.T. In spite of the fact they have not had supra-national powers, these organisations have had powerful sanctions and safeguards at their disposal, of which the most important have been the possibility of extending credit in time of need, and assuring reciprocity for trade concessions. Countries in a position of strength have reduced trade barriers and increased capital exports, and retaliation has not been taken against countries which have been forced temporarily to restrict trade, or which have devalued their currencies. With these sanctions they have been able to enforce good behaviour on countries in difficulties — ensuring that they took adequate stabilisation measures and that restrictions on trade were removed at the earliest possible moment.

As a result of this mutual confidence and these institutional arrangements, it has been possible for European countries to eschew most of the restrictive and discriminatory policy weapons which they acquired in the prewar and early postwar years. Countries have virtually returned to the currency convertibility which seemed so dangereous in the 1930s and they have done this with fixed exchange rates. Quantitative restrictions are rapidly disappearing and have not been used by any major country except France to meet newly emerging balance of payments difficulties since 1953. Export subsidies have been more or less abolished. Discrimination in quotas and payments regulations has also virtually disappeared. There has been a complete absence of competitive exchange rate adjustments. Tariffs have not been raised for anti-cyclical reasons; in fact, there was a unilateral lowering of tariffs by Germany in 1956 and 1957 in an attempt to reduce its payments surplus.

It is obvious that the return to open economic systems has had considerable advantages in stimulating competition and in improving the allocation of resources, but it also involves certain risks. The possibility of de-stabilising hot money movements has been greatly increased, governments have to rely on a narrower range of corrective policy instruments, and disequilibrium in the domestic demand situation is rapidly reflected in the balance of payments.

There have been periods when international equilibrium was put under very considerable strain, most notably in 1957 when a serious currency crisis arose because of the failure to take appropriate policy measures in time and because of the large potential for speculative movements. There is nothing in the present institutional arrangements to prevent a recurrence of such situations, but at least the 1957 crisis gave belated proof that governments have effective policy weapons, and that there is enough international solidarity to prevent a serious breakdown in world trade. It also showed the effectiveness of the I.M.F. resources (now greatly enhanced) in meeting major payments crises. Although considerable possibilities for short-term speculative capital movements now exist, it is clear that the international payment system is less prone to collapse than in prewar years because of the dominance of government transactions in international capital movements. These government flows of grants and loans have been much more stable than private capital and have been varied to meet longer-term needs. In the period 1953-58 more than half of the $10 billion capital flow from Europe (to the outside world) was governmental, and this was also true of the $20 billion flow from the U.S. Private capital movements are now heavily concentrated on direct rather than portfolio investment, so that even this is less volatile than in the prewar era when capital flight was a major cause of the 1931 breakdown.

In spite of the improved institutional arrangements for co-operation, however, the main safeguard is that the big countries which are capable of generating large fluctuations in the world economy have acquired good neighbourly habits. The United States gave an excellent lead to Europe in the early postwar years by providing very substantial aid and tolerating trade and payments discrimination against herself. In the past decade, the competitive position and the reserves and payments strength of Europe have grown steadily. European countries have reacted to this by reducing trade barriers and by increasing capital exports. All the major trading nations have felt the benefits of good neighbourly behaviour in times of difficulty. The U.S. has recently had a balance of payments problem for the first time since the war, the U.K. and France have frequently experienced difficulties, and even Germany had a deficit in 1951.

For these reasons, the economic warfare of the 1930s has disappeared, there has been a general return to fairly open economies and an abandonment of policy weapons which restrict trade or impede expansionary policies in other countries. It is clear, however, that there is still a great deal of instability in the international economy, that conflicts of economic interest do frequently arise, and that public and even political opinion does not fully recognise the virtues of reciprocity or the danger of destroying it by restrictive measures, even though there is sufficient understanding and solidarity to prevent a major collapse. Government policy and international institutional arrangements will need constant improvement if a reasonable equilibrium is to be preserved.

V. Conclusions

For about half of the postwar period European demand was maintained at a high level by extraordinary backlogs inherited from the war or the prewar period of depression and by rearmament. Whilst these factors were operative, the pressure of demand on resources was extremely high and prices rose more or less steadily. These forces were stronger in Europe than in the U.S., and were stronger than those felt at the end of the first world war.

These special demand factors disappeared several years ago, but it is clear that the long experience of full employment has given the economies of most countries a momentum which continues to sustain demand at high or even inflationary levels. The main forces of this nature are the tendency for wage rates to rise steadily and for entrepreneurs to keep investment on a high level.

There is little evidence that the normal functioning of the private forces within the economy is more *stable* than in prewar years, but because of government intervention the normal range of fluctuation is not now given free play. Although, governments cannot claim to have done more than moderate fluctuations, they have succeeded in ensuring that they take place at a higher level of activity, so that oscillations in the degree of inflation or payments equilibrium have been bigger than those in employment or output. The two mild postwar recessions in Europe have, in fact, been due to a considerable extent to government policies to restrict inflation or restore payments equilibrium.

Governments have found the buoyancy of the postwar economy useful insofar as it enabled them to keep output and employment at high levels and to recover fairly easily from the mild recessions which have occurred. But it has also been an embarrassment in hindering price stability or payments equilibrium, and most governments have given growing emphasis to moderating wage increases. Insofar as they succeed in doing this, they will also tend to take some of the buoyancy from investment demand — if not the part due to the anticipation of steady economic growth, at least the part due to anticipation of price increases. A smaller degree of "buoyancy" or "momentum" in the economy would require governments to take more measures to secure economic growth. In some cases, this might well produce faster growth than a situation in which governments feel that they have to lean against the prevailing winds of inflation and let economic growth take care of itself.

Apart from the impact of government policy, there may be factors which will tend to weaken the momentum of demand in the longer run. The high investment levels of the past few years have given us a capital stock with a low average age, and have reduced the need for replacement. It is also conceivable that a relaxation of international tension would lead to substantial reductions in military expenditure. However, it is easy to think of ways in which such a slackening could be compensated by public investment in roads, schools, hospitals and urban redevelopment, or by government-stimulated housing construction. There is massive scope for raising European consumption closer to American levels, and there are obvious ways in which demand for consumer goods could be stimulated by tax reductions. There is therefore no reason to assume that "autonomous" demand forces in the future will lead to stagnation, or that they could not be compensated if they did flag. The danger of serious stagnation arises only when governments let deflationary forces gain substantial momentum.

The anti-cyclical role of government has increased considerably, but developments in Europe have differed from those in the U.S. As a redistributor of income and a controller of investment, government responsibilities have grown substantially since prewar and are certainly greater in Europe than in the U.S. Direct public consumption has grown somewhat since prewar in some countries but has fallen in others — only in Sweden has the rise been as dramatic

as in the U.S. However, the increased share of government in economic activity has not, in itself, been a major stabilising factor, as government expenditure on goods and services has at times been fairly volatile, and the increased government control over investment and income distribution has not always been fully exploited for anti-cyclical purposes. The anti-cyclical influence of governments has been exercised largely by deliberate policy measures destined to influence the movement of activity in the private sector of the economy. In most countries a wide range of selective fiscal and monetary policy weapons and a few direct controls have been brought to bear on the most volatile sectors of demand. In this respect, there has been a considerable difference between the general European situation and that in the U.S. where there has been much less use of selective policy measures, and a heavier emphasis on general monetary policy and automatic budgetary stabilisers. There is, of course, some degree of "built-in stability" in most European budgets. However, it is generally less important than in the U.S., and has increased less since prewar years. Most European countries have revenue collection systems which are less progressive than in the U.S. and involve greater time lags, so that government receipts are not so sensitive to movements in private income as in the U.S. European transfer payments are generally large but they tend to be fixed rather than to compensate movements in private income.

There are a number of ways in which there is scope for governments to increase the effectiveness of their anti-cyclical policies which would be reconcileable with other major policy objectives. Better information on economic trends would help in the formulation of policy and would provide a basis for intelligent public discussion of policy issues. In this respect, all European countries lag far behind the U.S. both in the amount of useful data collected and the degree of analytical processing it receives, *e.g.* in the form of seasonal adjustment. It would also be helpful if budgets could be rearranged to show more clearly the impact of public finance on the economy, and this in turn would make it easier to vary taxes in the course of the year rather than waiting for a fixed budget day which may not be optimal for policy changes, and which often provokes adverse speculative movements. In a number of countries the timing of tax collection could be improved to vary more closely with the movement of income. There are wide variations in the range of policy measures used by different governments, and a more detailed comparison of the successes and failures of neighbouring countries would provide a fund of experience on which many governments could usefully draw. There are also measures which are relatively untried such as wages policies or control of inventory movements, and here the future may bring considerable innovations. Apart from measures to affect the private sector, governments could also make a major contribution to stability by a better co-ordination and advance programming of central and local government capital spending.

Governments have enjoyed a very large degree of international economic co-operation in the postwar period which has enabled them gradually to discard protectionist weapons and to move towards freer trade and greater convertibility. The European economies are now almost as open as they were in the 1920s. There are, of course, much greater sources of international credit than there were in the 1920s and there is a much greater common understanding of the principles of good behaviour in international economic policy. It has been worth taking the risks involved in these open policies, but the extent to which European economies depend on the goodwill and economic judgment of neighbouring countries should not be forgotten.

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