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SPECIAL SUPPLEMENT

THE INTERNATIONAL LABOUR REVIEW AND THE ILO: MILESTONES IN A SHARED HISTORY

The International Labour Review and the ILO: Milestones in a shared history

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THE INTERNATIONAL LABOUR REVIEW

The *International Labour Review* is the world's leading multidisciplinary journal of labour market institutions and economics. Its aim is to advance academic research and inform policy debate and decision-making in these fields by bringing together the original thinking of lawyers, economists, sociologists, political scientists and industrial relations specialists on a broad range of labour market policy and social protection concerns. The *International Labour Review* is committed to an editorial policy that combines accessibility with rigorous, insightful analysis and the highest scholarly standards (for information on the submission of manuscripts, see www.blackwellpublishing.com/ilr).

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Editorial Assistant: Kate Pfeifferberger

Design and production: ILO Document and Publications Production, Printing and Distribution Branch

Editorial Office: International Labour Office, 4 route des Morillons, CH-1211 Geneva 22, Switzerland. Tel: +41 22 799 7903; email: revue@ilo.org; web site: www.ilo.org/revue.

The *International Labour Organization* was set up in 1919 under the Treaty of Versailles, which ended the First World War, and has been a specialized agency of the United Nations since 1946. Its aim is to contribute to the establishment of universal and lasting peace by promoting social justice. With its unique tripartite structure and Governing Body – including representatives of government and of employers' and workers' organizations – the ILO has, over the years, adopted a widely respected code of international labour Conventions and Recommendations. It also provides expert advice and technical assistance to its member States through a worldwide network of field offices. The International Institute for Labour Studies is the research and education arm of the ILO and, in that capacity, manages the *International Labour Review* on the Organization's behalf.

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International Labour Review

SPECIAL SUPPLEMENT THE INTERNATIONAL LABOUR REVIEW AND THE ILO: MILESTONES IN A SHARED HISTORY

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Léon Jouhaux was awarded the Nobel Peace Prize in 1951. He devoted “a long life of work and struggle to elevate the working classes – and first of all to improve their conditions. [...] He is here because from his earliest years he has time after time thrown himself into the fight for peace and against war”. []

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In 1935, the world's wealthiest countries were experiencing the worst of the economic crisis, victims of deflation and mass unemployment. Yet in Sweden, the recession had been less serious, and the recovery faster. Why? This question aroused considerable interest at the time. In the article reproduced here, Bertil Ohlin, who

had written reports on the global crisis and on unemployment in Sweden – and later received the Nobel Prize for economics ...[]

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The article by Abba P. Lerner reproduced here was the first to explain Keynes' employment theory in simple and generally intelligible terms; indeed, the article had been read and approved by Keynes prior to publication. Born in Romania, Abba P. Lerner studied in Cambridge before teaching at a number of universities including the London School of Economics and the University of California (Berkeley). []

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47 [Alva Myrdal](#)

In addition to its prescient economic policy in the early 1930s, Sweden is notable for the policy of family support it adopted. Alva Myrdal – who was later awarded the Nobel Peace Prize – was closely associated with the development of a population policy in Sweden. In the article reproduced here, she explains the particular concerns in Sweden and the nature of the policy recommended and applied. []

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Michal Kalecki was a Polish economist whose contributions to macroeconomics influenced Keynesian economists. After studying civil engineering in Warsaw and Gdansk, Kalecki began his career at the Research Institute of Business Cycles and Prices in Warsaw. He later worked at the Oxford Institute of Statistics, where he developed his pre-Keynesian ideas... []

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66 [Sir W. Arthur Lewis](#)

W. Arthur Lewis was born on the island of St Lucia. He taught political economics at several universities and worked at the United Nations in the 1950s, before embarking on a career at Princeton. He was awarded the Nobel Prize for economics in 1979, jointly with T. W. Schultz, for their work on development economics. []

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74 [Jan Tinbergen](#)

At the end of 1969, Jan Tinbergen, who received the Nobel Prize for economics that same year, participated in a meeting to advise the ILO on research priorities for its newly created World Employment Programme. His presentation dealt with international trade policy and its effects on job creation. []

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81 [Amartya Sen](#)

Awarded the Nobel Prize for economics in 1998, Sen is a creative author who explores the boundaries between economics and philosophy. In 1975, he wrote a seminal study on employment for the ILO, entitled *Employment, technology and development: A study prepared for the ILO within the framework of the World Em-*

ployment Programme. This work served as the basis for his article “Employment, institutions and technology: Some policy issues”, which was published in the *International Labour Review*... []

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93 **Joseph Stiglitz**

In 2001, Joseph Stiglitz was awarded the Nobel Prize for economics. In 2002, he published an article in the *Review* (Vol. 141, No. 1–2) entitled “Employment, social justice and societal well-being” in which he proposes that the purpose of economic activity is to improve the well-being of individuals, and that employment is essential to this well-being. In this regard, his description of the negative effects of unemployment echoes that given in the abovementioned article by Amartya Sen... []

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Information on the ILO, including ILO publications, is available on the Internet at: www.ilo.org. Bibliographic references to articles in the *International Labour Review (ILR)* are included in LABORDOC, the main bibliographic database of the International Labour Office, as well as in the following databases and in their respective abstracting journals: ABI/INFORM, Book Review Index, Business Periodicals Index, International Bibliography of the Social Sciences (IBSS), Management Contents, Newsearch, PAIS International (*PAIS International in Print*), *Peace Research Abstracts*, *Personnel Management Abstracts*, *Social Work Abstracts*, *Sociological Abstracts*, *Work Related Abstracts*. The Economic Literature Index (*Journal of Economic Literature*) provides abstracts both on CD-ROM and online at www.e-JEL.org. The CD-ROM *Business Periodicals Ondisc* contains full texts of ILR articles since November 1987; H. W. Wilson's full-text CD-ROM edition of *Wilson Business Abstracts* contains full texts from 1996; bibliographic references are available on the CD-ROM *ABI/INFORM Ondisc*. The *ILR* is also available, in whole or in part, in microform, online and on CD-ROM, from the Information Access Company, 362 Lakeside Drive, Foster City, CA 94404, United States. Whole collections and back numbers in microform, as well as photocopies of separate articles, are obtainable from University Microfilms International, 300 North Zeeb Road, Ann Arbor, Michigan 48106 (United States), and 18 Bedford Row, London WC1R 4EJ (England).

The International Labour Review and the ILO: Milestones in a shared history

Patrick BOLLÉ*

Abstract. *As the ILO is approaching its 100th anniversary, so is the International Labour Review. By way of introduction to this retrospective Special Supplement, which reproduces a number of articles written for the Review by winners of the Nobel Peace Prize or the Nobel Prize for economics, the author looks back at the journal's history, recalling its early days since the 1919 Treaty of Versailles, its subsequent development, broadening international readership and adaptation to the digital age. He concludes with a brief presentation of the selected authors and their work, which is considered in the context of current research and debate.*

As the International Labour Organization approaches its 100th anniversary, the world is in the midst of an unprecedented phase of economic globalization, which calls for renewed focus on the increasingly international “social question” and for a better understanding of both the ILO’s role and the world of work today. Over the next few years, in the run-up to its centenary, the ILO will be carrying out activities to disseminate knowledge of the Organization’s history and experience and raise awareness of the need for labour issues to be taken into account to a greater extent in the process of globalization.¹ The need to draw lessons from history is even more crucial in the context of the current global crisis which has yet to run its course.

Launched by the International Labour Office (the Organization’s secretariat) two years after the establishment of the ILO, the *International Labour Review* turned 90 in 2011 and is also heading for its 100th anniversary. It therefore seemed logical that the *Review* should also contribute to this commemorative project. We have chosen to reproduce in this Special Supplement a number of articles written for the *Review* by winners of the Nobel Peace Prize

* Senior French editor, *International Labour Review*. This Special Supplement has been prepared by the editorial team of the *International Labour Review*, with the support of Raymond Torres, Director of the International Institute for Labour Studies and Matthieu Charpe (IILS).

Responsibility for opinions expressed in signed articles rests solely with their authors, and publication does not constitute an endorsement by the ILO.

¹ See the ILO Century Project at: <http://www.ilo.org/century/lang--en/index.htm>.

or the Nobel Prize for economics:² Léon Jouhaux, Bertil Ohlin, Alva Myrdal, Arthur Lewis, Jan Tinbergen, Amartya Sen and Joseph Stiglitz. We have also added articles by two other influential economists – Abba P. Lerner and Michal Kalecki, whose work would seem to be of particular relevance today. First, however, we will look back at the beginnings of the *Review*, which were closely bound up with those of the ILO itself. This section will highlight key moments in the early days of the journal.

The origins

It all began with the Treaty of Versailles in 1919, which put an end to the First World War. The Commission on International Labour Legislation was established to draft what was to become Part XIII of the Treaty of Versailles, entitled “Labour”; it had indeed been realized that “there can be no lasting peace without social justice”. And a further century of human history has only confirmed – however absurdly – the truth of this statement. Part XIII of the Treaty would become the Constitution of the ILO, to which the Commission annexed “General Principles” that have been referred to as the “‘Magna Carta’ of the working class”.³ These principles were essentially meant to serve as a roadmap for the Organization and, to this day, they have lost none of their relevance (see box 1).

Article 396 of Part XIII of the Treaty reads: “The functions of the International Labour Office shall include [...] It will edit and publish in French and English, and in such other languages as the Governing Body may think desirable, a periodical paper dealing with problems of industry and employment of international interest.”⁴ This is where the history of the *International Labour Review* begins.

The early agendas of the Governing Body and the International Labour Conference regularly featured progress reports on the ILO’s programme of publications, including the launch of an authoritative periodical about the world of work. On several occasions, Albert Thomas, the ILO’s first Director-General, reported on new developments in this area. At the Eighth Session of the Governing Body (Stockholm, 5–7 July 1921), he was able to announce the publication of the *Review*:

A considerable effort has to be made to produce the International Labour Review. As is known, material difficulties delayed the publication of the January Number until the end of March.

The Office has made every effort to make up this delay little by little. It has now almost done so, since the June Number will appear in the first few days of July and the July Number will then be in the press.

It is to be hoped that, as from the month of September, the “Review” will be able to appear regularly betwe[e]n the 7th and 10th of each month.

² The correct title of what has come to be known as the Nobel Prize for economics is the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel.

³ See “The Nobel Peace Prize 1969 – Presentation Speech”, available at: http://www.nobelprize.org/nobel_prizes/peace/laureates/1969/press.html [accessed 12 November 2012].

⁴ This is now article 10, paragraph 2(d), of the ILO Constitution.

Box 1. SECTION II GENERAL PRINCIPLES

Article 427

The High Contracting Parties, recognising that the wellbeing, physical, moral and intellectual, of industrial wage-earners is of supreme international importance, have framed, in order to further this great end, the permanent machinery provided for in Section I, and associated with that of the League of Nations.

They recognise that differences of climate, habits and customs, of economic opportunity and industrial tradition, make strict uniformity in the conditions of labour difficult of immediate attainment. But, holding as they do that labour should not be regarded merely as an article of commerce, they think that there are methods and principles for regulating labour conditions which all industrial communities should endeavour to apply, so far as their special circumstances will permit.

Among these methods and principles, the following seem to the High Contracting Parties to be of special and urgent importance:

First. — The guiding principle above enunciated that labour should not be regarded merely as a commodity or article of commerce.

Second. — The right of association for all lawful purposes by the employed as well as by the employers.

Third. — The payment to the employed of a wage adequate to maintain a reasonable standard of life as this is understood in their time and country.

Fourth. — The adoption of an eight hours day or a forty-eight hours week as the standard to be aimed at where it has not already been attained.

Fifth. — The adoption of a weekly rest of at least twenty-four hours, which should include Sunday wherever practicable.

Sixth. — The abolition of child labour and the imposition of such limitations on the labour of young persons as shall permit the continuation of their education and assure their proper physical development.

Seventh. — The principle that men and women should receive equal remuneration for work of equal value.

Eighth. — The standard set by law in each country with respect to the conditions of labour should have due regard to the equitable economic treatment of all workers lawfully resident therein.

Ninth. — Each State should make provision for a system of inspection in which women should take part, in order to ensure the enforcement of the laws and regulations for the protection of the employed.

Without claiming that these methods and principles are either complete or final, the High Contracting Parties are of opinion that they are well fitted to guide the policy of the League of Nations; and that, if adopted by the industrial communities who are Members of the League, and safeguarded in practice by an adequate system of such inspection, they will confer lasting benefits upon the wage-earners of the world.

(Treaty of Versailles of 28 June 1919, Part XIII, Annex, Section II, Article 427)

Publication of the new journal was confirmed in the Director-General's 1921 Report to the International Labour Conference, which contains a list of subject headings under which articles appearing in the *International Labour Review* were to be classified (see box 2). This Report made two interesting points. First, it explained that "very great liberty has been left to the authors" of signed articles appearing in the *Review*, a tradition which the editorial staff

Box 2. Extract from Albert Thomas' Report to the International Labour Conference in 1921

333. *International Labour Review*. This monthly publication began to appear in two languages in January 1921. There was some delay in the publication of the first numbers, but the *Review* now appears regularly. Owing to the personality and the experience of the chief of the Scientific Division, the *Review* has been modelled on the review published by the Federal Labor Department of the United States of America, the *Monthly Labor Review*, whose originality of conception as an official publication had often been commented upon. Following the example of the *Monthly Labor Review*, the International Labour Office, while devoting careful attention to the editing of unsigned articles for which the Office is responsible, has not hesitated to publish in the *Review* signed articles, in the case of which very great liberty has been left to the authors. Special articles of this kind have been solicited from well-known publicists, economists, employers, and trade union leaders, on subjects of current interest, and the *Review* has already published articles of the kind.

In addition to these articles, signed or unsigned, the *Review* includes a second and more important part, which comprises articles published regularly under certain headings. Periodical information concerning wholesale and retail prices, unemployment, emigration, etc., renders the *Review* indispensable for all who are interested in industrial conditions.

The subject headings under which the articles appearing in the *International Labour Review* are classified are as follows :

1. Special articles.
2. General industrial situation.
3. Legislation, administration and adjudication of Acts affecting labour.
4. Industrial relations.
5. Control of industry.
6. Production, prices and cost of living.
7. Employment and unemployment.
8. Migration.
9. Wages and hours of work.
10. Industrial hygiene.
- 10a. Industrial security and accidents.
11. Social prevision, including social insurance, workmen's compensation and pensions to workers and their families.
- 11a. Rehabilitation and training of disabled men.
12. Protection of women and children.
13. Co-operation.
14. Welfare of workers.
15. Workers' education:
 - (a) general,
 - (b) vocational,
 - (c) vocational guidance.
16. Agricultural workers.
17. Seamen.
18. Reports of Government offices.
19. General notes.
20. Book notes and bibliographies.

(From the *Report of the Director to the International Labour Conference*, Third Session, 1921, Vol. 2, Part 3, Annex 18, Geneva)

of the journal has continued to uphold to this day, in order to ensure the quality and credibility essential to informed international debate. Second, the *Review* was to publish member States' labour statistics. Eventually, however, these became so extensive that they were collected in separate, specialized ILO publications: the *Yearbook of Labour Statistics* and the *Bulletin of Labour Statistics*.⁵ The editorial of the first issue of the *Review* explained how it fitted into the ILO's overall programme of publications; its own specific function was to serve as an academic journal (for excerpts of the editorial, see box 3). The *International Labour Review* has been published continuously since 1921, even during the Second World War, when the ILO was transferred from Geneva to Montreal.⁶

Box 3. The International Labour Review

The INTERNATIONAL LABOUR REVIEW has been established and the first number now appears, in fulfilment of the Treaty of Peace [...].

There still remained, however, a gap in the publications of the International Labour Office. There was needed a periodical which would bring together the statistical and other briefer scientific information regarding labour and industry from all nations. The new INTERNATIONAL LABOUR REVIEW will perform internationally much the same functions as are now being performed for certain countries by their official national publications. The new REVIEW will contain brief scientific articles and important information relating to labour and industry, written in readable, non-technical language. It will occupy a place between the *Daily Intelligence* on the one hand and the more pressing and more specialized *Studies and Reports* on the other hand. [...] The matter going to make up the REVIEW will consist in part of the results and findings of independent studies and researches undertaken especially with the object of producing articles for the REVIEW, and in part of the results of collecting, sifting, correlating, analysing and compiling information already issued in official and non-official publications.

The issuing of the first number of the INTERNATIONAL LABOUR REVIEW has been long delayed because of the great difficulty in recruiting competent, well-trained editors. But in these times of stress, when labour and industrial problems are pressing for solution, the world expects the International Labour Office to issue a publication the value of which cannot be questioned, to present impartially the facts needed by Governments, employers and employees to enable them to deal with the wholly unprecedented problems of the day.

[...] Only by the co-operation of all classes and all countries is it possible to establish and continue a truly International publication dealing with all countries and all phases of industrial and labour matters.

When a staff of trained editorial specialists has been created and information flows more quickly into the Office, the REVIEW will be extended to cover more subjects and more countries, while continuing the publication each month of information and statistics presented in a uniform manner upon all the more important phases of industrial life.

(Extract from the *International Labour Review*, Vol. 1 (1921), No. 1, January, pp. 3–4)

⁵ Today, these databases are available at: <http://laborsta.ilo.org>.

⁶ Readers of the *Review* were informed of the situation as follows: "Recent circumstances have entailed some disturbance of the regular appearance of the Office's periodicals. An issue of the *International Labour Review* dated August–September has been published in Geneva and distributed from there; the present issue dated October–November is being published in Montreal, and it is hoped to resume regular monthly publication of the *Review* with the December issue" (*International Labour Review*, Vol. 42 (1940), No. 4–5, p. 174).

Broadening the journal's readership

Since then, the *Review* has continued to evolve. First, by consolidating its academic identity; second, by broadening and diversifying its readership, in particular by publishing versions in languages other than French and English – namely German, Italian, Russian and, of course, Spanish.

The publication and fate of these language editions were closely bound up with historical events, but also with the way the *Review* attracted new readers from around the world, who were interested in the journal's content and in the wide range of issues dealt with by the ILO.

The German edition was the first to appear, in 1923. In the 1920s there was no organized international system, as there is now, with specific language requirements. And, as can be seen from the minutes of the meetings of the Governing Body, “the German tongue ... was familiar to more than half the workers' associations in the world”.⁷ The ILO enjoyed the support of these associations and, in addition, the use of German was supported by several other European member States, including the Scandinavian countries, the Netherlands and Hungary. The *Internationale Rundschau der Arbeit* was initially published on a monthly basis, with the aim of “informing German-language readers of the work and research carried out by the Office”, as stated in the introduction to the first issue.⁸ While it closely mirrored the English and French editions, its contents would be geared to its potential readership across northern and eastern Europe.

The German edition continued to be published until 1940, coming to an end with the Second World War because this edition of the *Review* was prepared in Berlin and Nazi Germany had withdrawn from the ILO in 1935. After the war, the international system was restructured around the United Nations, whose official languages did not include German.

The Italian version came about differently, in 1922. “In view of the increased demand from [Italy] for some publication which would be universally available”,⁹ the ILO Director-General proposed that a special periodical bulletin should be published, which would contain appropriate extracts translated from the *International Labour Review*, *Industrial and Labour Information* and the *Official Bulletin*. The Italian periodical was published the same year with the title *Informazioni Sociali*, to which the subtitle *Rivista Internazionale del Lavoro* was added in 1928. It was published monthly until 1937, the year when Fascist Italy withdrew from the ILO.

The Spanish edition followed shortly afterwards, but with greater – and more lasting – success, since it continues to be published today as an official edition of the *Review*, alongside the English and French versions. It was first published in 1923, as a short bulletin of about 30 pages entitled *Informaciones Sociales*, containing articles likely to be of particular interest to Spanish- and

⁷ Minutes of the 14th Session of the ILO Governing Body, Geneva, October 1922, p. 26.

⁸ “Zur Einführung”, in *Internationale Rundschau der Arbeit*, No. 1, January 1923, p. 3.

⁹ Minutes of the 12th Session of the ILO Governing Body, Geneva, April 1922, p. 157.

Portuguese-speaking readers. One year later, its success led the ILO Governing Body to increase its contents to 100 pages and give it a new format. This was a reflection of the great interest shown by Latin American countries in the issues dealt with by the ILO and the increasing extent to which Latin American countries participated in the Organization's work. The publication also had subscribers in Spain and in Spanish colonial territories in Morocco. In November 1924, Albert Thomas wrote in *Informaciones Sociales* that its subscribers included "well-known figures, literary and arts institutions, major public administrations such as labour ministries, social security institutions, universities and libraries, a great many workers' unions and a number of employers' organizations". He added that "50 or 60 daily newspapers reproduce reports that we are very happy to provide them with".¹⁰

The publication was to take its definitive name *Revista Internacional del Trabajo* with the January–February 1930 issue. The number of pages was increased in order to "allow greater coverage of technical aspects" and identify it as a journal dealing with "international labour theory and legislation".¹¹

The *Revista* was then published continuously, including during the Second World War, in the same way as the English and French editions. Its contents were increasingly modelled on the latter, until the three versions became identical in 1951. The exception was the period 1978–1994, when the *Revista* was published quarterly and the other two versions were published every two months.

In 1945 the International Labour Conference adopted a resolution making Spanish an official ILO language, meaning that all official documents and a large number of publications would be systematically translated into Spanish. A year later, the recently created United Nations Organization also adopted Spanish as its fifth official language. The Spanish *Revista* was therefore put firmly on the international map even though the more fundamental reason for its success was the interest shown in the journal throughout Latin America, Spain and other Spanish-speaking territories,¹² not just in terms of the number of readers but also on account of the increasing number of researchers and experts wishing to publish in the *Revista*.

In 1994, to mark the ILO's 75th anniversary, the Labour Institute attached to the Russian Federation's Ministry of Health and Social Development launched a Russian edition of the *Review*, which published once or twice a year a selection of articles from the previous year. This publication lasted until 2009.

The Review today

In 2006, the *International Labour Review* was overhauled for "relaunch" in 2007, with the aim of broadening its readership and increasing its visibility,

¹⁰ Reproduced in "Al lector", in *Revista Internacional del Trabajo* (1930), No. 1, p. 5.

¹¹ *Ibid.*, p. 6.

¹² Interestingly, some 24 per cent of current downloads from the Spanish version are by users in the United States.

while continuing to uphold its trademark quality and editorial independence. Another aim was to broaden the geographical range of published research, while taking care to maintain a balance between the academic disciplines it represents, contributors' perspectives within each particular discipline and their regional sensitivities regarding labour issues. The idea was ultimately to strengthen the journal's function as an open-minded forum for debate.¹³

The three main features of the *Review's* overhaul were as follows:

- The editorial production team was attached to the ILO's International Institute for Labour Studies, to allow it to benefit from closer exchange with ongoing labour research.
- An Editorial Board was established, together with a new panel of editorial advisers, composed of independent scholars of various disciplines from different geographical areas, who determine the journal's editorial policy and manage its content. The Director of the Institute chairs the Editorial Board.
- The publishing partnership established with Wiley-Blackwell ensures broader dissemination of the *Review*. In 2011, in addition to the journal's free distribution to the ILO's constituents – i.e. the governments and workers' and employers' organizations of the States Members of the Organization – this publishing agreement alone extended electronic access to the *Review* to some 7,400 libraries throughout the world and, through philanthropic partnerships, to a further 6,000 institutions in the developing world. Students and researchers downloaded an estimated total of 140,000 articles in that year.

Despite the current difficult economic situation, the journal's overhaul is clearly bearing fruit. The financial and economic crisis compounded the general trend of budgetary cuts which had already affected both those buying the *ILR* – libraries and institutions – and those producing it. Another factor affecting the economic situation was more ideological in nature, namely, the sidelining of social and labour policy issues.

The journal's overhaul was also in keeping with the editorial tradition established by the first ILO Director-General, Albert Thomas, as mandated by the young International Labour Organization. This historical continuity, combined with an ongoing quest for quality, is what led us to select the articles gathered together in this Special Supplement.

¹³ “Clearly, no single academic discipline or field of research has the wherewithal to produce the right mix of policies for every situation. Only multidisciplinary analysis can provide a satisfactory understanding of the underlying trade-offs and identify the options for improving their terms. Hence ... the list of contributors features economists, sociologists, lawyers, social philosophers ... because the *International Labour Review* is multidisciplinary by nature. Being multilingual as well, the *Review* also serves as a channel of communication between researchers who do not share a common culture or common academic traditions but whose perspectives on the globalizing world of work are all the more mutually enriching when they are brought together.” (Quoted from the preface of a compilation of *Review* articles edited by Jean-Michel Servais, Patrick Bollé, Mark Lansky and Christine L. Smith: *Working for better times: Rethinking work for the 21st century*, Geneva, ILO, 2007, p. vi).

Peace, the economy and social justice

The first of these articles dates back to 1922 – when the *Review* was barely a year old – and the last was published in 2009, dealing with the recent financial, economic and social crisis. We have prefaced each of the articles with a presentation by the editorial team of the *Review*. A brief summary is set out below.

The work of *Léon Jouhaux*, who won the Nobel Peace Prize in 1951, is closely bound up with the birth and early work of the ILO. After participating in the Commission on International Labour Legislation, which drafted Part XIII of the Treaty of Versailles, as an expert representing the interests of workers, Léon Jouhaux was elected in 1919 to the ILO Governing Body, of which he remained a member until his death in 1954. The article we have reproduced here reports on the third International Labour Conference and considers the extension of international labour regulations to agricultural workers, a question that still arises in many parts of the world, notably in the broader context of protection for workers in the informal economy. In his article, the author argues that financial difficulties cannot be invoked to contest the legitimacy of labour regulations.

The article by *Bertil Ohlin* dates from 1935, when the world was reeling from the Great Depression. He explains how Sweden managed to overcome the crisis better – and faster – than other countries. One cannot help but think of the current crisis, said to be the worst the world has known since the 1930s, and to which the *Review* recently devoted a special issue.¹⁴ In the 1930s, budgetary austerity failed. Today, as Raymond Torres points out in his article in the special issue, the responses are incomplete.¹⁵ Now that private debt has been turned into public debt, pressure from credit rating agencies and financial markets has forced austerity back on to the agenda.¹⁶

Recovery from the Great Depression came about, of course, through the application of economic policies that were partly inspired by Keynesian theories. It therefore seemed appropriate to include in this anthology the article by *Abba Lerner* published in the *Review* in 1936, which has been described as “the first to make Keynes’s employment theory simple and generally intelligible”.¹⁷

Sweden was also a leading light in policies related to work–family balance and the status of women in society. In her 1939 article, *Alva Myrdal* explains the policy she helped to put in place. The role of men and women in

¹⁴ *International Labour Review*, Vol. 149 (2010), No. 2, Special issue: The global crisis.

¹⁵ Raymond Torres: “Incomplete crisis responses: Socio-economic costs and policy implications”, in *International Labour Review*, Vol. 149 (2010), No. 2, pp. 227–237.

¹⁶ On the financialization of the economy, see Richard B. Freeman: “It’s financialization!”, in *International Labour Review*, Vol. 149 (2010), No. 2, pp. 163–183.

¹⁷ See Tibor Scitovsky’s bibliographical article on Abba Ptachya Lerner in John Eatwell, Murray Milgate and Peter Newman (eds): *The New Palgrave: A Dictionary of Economics*, London, Macmillan Press, 1987, Vol. 3, p. 168.

society and equality at work – the subject of the seventh General Principle (see box 1) – have become the focus of public debate and much research, to which the *Review* has made a significant contribution. See, for example, the compendium of articles published in *Women, gender and work*.¹⁸ In a recent issue of the *Review*, Colleen Sheppard examined the concept of discrimination in international law and the reality of socio-economic inequality at work.¹⁹ As a result of population ageing in the world's richest countries, demographic concerns also feature increasingly high on the economic and social policy agenda, particularly as the retirement age is raised in order to keep pension schemes afloat.²⁰

To come back to economic theory and policy, *Bertil Ohlin* and *Michal Kalecki* both claimed to have come up with Keynesian theories before Keynes himself. Kalecki's contributions centre on aggregate demand, profit theory, business cycles and imperfect competition. The question he addresses in the article reproduced here is: What policies are likely to lead to full employment? His analysis is based on a very simple "balance-sheet" presentation of national income and on the notion of net national product. He uses these tools to ascertain what fiscal policy would bring about full employment in the post-war period.

At the end of the 1960s the ILO launched its ambitious World Employment Programme to help countries provide productive and remunerative work for their labour forces. This initiative incorporated a research programme, shaped by a November 1969 meeting of economists, the aim of which was to advise the ILO on research priorities for the Programme. The meeting was chaired by Sir W. Arthur Lewis, James Madison Professor of Political Economy at Princeton University, and future winner of the Nobel Prize for economics.²¹ Reproduced here are the findings of the meeting, as published in the *Review* in 1970.

One of the participants at the meeting was *Jan Tinbergen*, winner (jointly with Ragnar Frisch) of the first Nobel Prize for economics in 1969. In the article reproduced here, he explains that classifying industries by their relative factor endowment would encourage optimal international division of labour. His arguments, which were instrumental in bringing about less restrictive trade

¹⁸ Martha Fetherolf Loutfi (ed.): *Women, gender and work: What is equality and how do we get there?*, Geneva, ILO, 2001.

¹⁹ Colleen Sheppard: "Mapping anti-discrimination law onto inequality at work: Expanding the meaning of equality in international labour law", in *International Labour Review*, Vol. 151 (2012), No. 1–2, pp. 1–19. See also Cecilia Castaño, Juan Martín, Susana Vázquez and José Luís Martínez: "Female executives and the glass ceiling in Spain", *International Labour Review*, Vol. 149 (2010), No. 3, pp. 343–360.

²⁰ For the most recent articles published, see Martin O'Brien: "Older male labour force participation in OECD countries: Pension reform and 'the reserve army of labour'", in *International Labour Review*, Vol. 149 (2010), No. 3, pp. 239–259; and Felipe Serrano, Begoña Eguía and Jesús Ferreiro: "Public pensions sustainability and population ageing: Is immigration the solution?", in *International Labour Review*, Vol. 150 (2011), No. 1–2, pp. 63–79.

²¹ In 1979, jointly with Theodore W. Schultz, for their work on development economics.

policies, showed how employment would increase if international trade were more evenly balanced.

The issues of employment and international trade remain just as important, if not more so, today. When the ILO was established, job creation was not a concern – it was not even covered in the General Principles. But with the Great Depression of 1929, mass unemployment became the predominant social issue, which spread as developing countries acquired independence; it then became more entrenched with the oil shocks of the 1970s and the decline of the Fordist model in industrialized countries. As for trade, while recent centuries have seen periods of openness alternating with periods of protectionism, things have now taken a new turn with the globalization not only of trade but also of production itself. The *Review* has, of course, published a great deal on these two important concerns for the ILO. To quote the Preamble of its Constitution: “Whereas also the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries.”

Alain Supiot makes the same point in a recent article on how corporations engage in “law shopping”, setting up businesses in countries with the weakest and least protective laws.²² Another topic recurrently taken up in the *Review* is how changing employment relationships are affecting worker protection.²³ The boundaries of the very concept of work are becoming less clear, which is making life difficult for statisticians.²⁴

Returning to the subject of job creation, *Amartya Sen*, winner of the 1998 Nobel Prize for economics, was primarily concerned with this issue when he worked for the Organization: “My own close association with the ILO goes back much more than a quarter of a century. In the seventies, I had the privilege of advising the ILO, and doing some work for it [...] But my first working association with the ILO was in 1963...”²⁵ The *Review* has published three articles by Amartya Sen, the first two of which were on employment. We refer to them briefly in the presentation of his article “Work and rights”. In 1999, the ILO had just formulated the concept of Decent Work for All, and Amartya Sen laid out four conditions for decent work in the context of globalization. The notion of decent work was subsequently the subject of much debate and research, which was reported in the *Review*. In 2003, a special issue on meas-

²² See Alain Supiot: “A legal perspective on the economic crisis of 2008”, in *International Labour Review*, Vol. 149 (2010), No. 2, pp. 151–162.

²³ Jean-Michel Servais, Patrick Bollé, Mark Lansky and Christine L. Smith (eds): *Working for better times: Rethinking work for the 21st century*, Geneva, ILO, 2007; Antonio Ojeda Avilés: “The ‘externalization’ of labour law”, in *International Labour Review*, Vol. 148 (2009), No. 1–2, pp. 47–67; and Mark Freedland: “Application of labour and employment law beyond the contract of employment”, in *International Labour Review*, Vol. 146 (2007), No. 1–2, pp. 3–20.

²⁴ See Patrick Bollé: “Labour statistics: The boundaries and diversity of work”, in *International Labour Review*, Vol. 148 (2009), No. 1–2, pp. 183–193.

²⁵ Amartya Sen: “Work and rights”, in *International Labour Review*, Vol. 139 (2000), No. 2, pp. 119–128, quote from p. 119.

uring decent work was published.²⁶ The issue of quality – as opposed to just quantity – of work was also the subject of many articles.²⁷

A couple of years into the current crisis, *Joseph Stiglitz*, winner of the 2001 Nobel Prize for economics, published his second article in the *Review*. In the first, he had denounced the fact that in neoclassical economic policies the labour force was treated as a commodity, which went against the very first of the General Principles. In the article reproduced here, “The global crisis, social protection and jobs”, he argues for a global stimulus package and stronger social protection.

Over the years, many other topics have been taken up in the *Review*, including inequality, development, social protection, working conditions, international labour standards, migrant workers, health care and low-paid work.

In the course of the *International Labour Review*’s first 90 years the scope of the ILO’s activities has widened considerably. In 1919, there were 44 States Members of the ILO; today, there are 185. This has brought new challenges bound up with countries’ differing levels of development and – today – the expansion of the informal economy into the international value chains that constitute the very fabric of globalization.

In recent decades, job creation, social protection and efforts to address inequality have all been affected by globalization – with its requirements of fierce competition and cost reduction – and the prevailing ideology that the State is not the solution but the problem, with social justice at best a mirage and at worst the Trojan Horse of totalitarianism. Ironically, with the financial meltdown of 2008, it was suddenly fine for the problem to become the solution again, in order to salvage a deregulated international financial system.

The General Principles remain as relevant as ever to the day-to-day reality of the world of work; their scope is now simply broader and more complex. The *International Labour Review* takes this on board, exploring the issues involved and sharing the findings with its readers.

²⁶ See *International Labour Review*, Vol. 142 (2003), No. 2, Special issue: Measuring decent work.

²⁷ The most recent of which are: *International Labour Review*, Vol. 150 (2012), No. 3, Special issue: Low-paid work in emerging economies; *International Labour Review*, Vol. 148 (2009), No. 4, Special issue: Low-wage work in Europe and the United States; Konstantinos Pouliakas and Ioannis Theodossiou: “Differences in the job satisfaction of high-paid and low-paid workers across Europe”, in *International Labour Review*, Vol. 149 (2010), No. 1, pp. 1–29; Lucie Davoine and Dominique Méda: “Work more to earn less? The mixed feelings of Europeans”, in *International Labour Review*, Vol. 148 (2009), No. 1–2, pp. 15–46; Sandrine Cazes and Mirco Tonin: “Employment protection legislation and job stability: A European cross-country analysis”, in *International Labour Review*, Vol. 149 (2010), No. 3, pp. 261–285.

Léon Jouhaux

Léon Jouhaux was awarded the Nobel Peace Prize in 1951.¹ He devoted “a long life of work and struggle to elevate the working classes – and first of all to improve their conditions. [...] He is here because from his earliest years he has time after time thrown himself into the fight for peace and against war”.²

One aspect of his life is of special importance in the history of the ILO. After several years of intensive work with the international trade unions and vain attempts to prevent the First World War, Léon Jouhaux participated in the Commission on International Labour Legislation as a worker-representative expert, promoting the beginnings of the ILO’s tripartite structure. The following are excerpts from his acceptance speech at the Nobel award ceremony in Oslo on 11 December 1951:

At Leeds the idea of an international labour organization appeared in a trade-union text which also drew attention to the danger to the working classes inherent in the existence of international capitalist competition. [...] The Inter-Allied Labour and Socialist Conference which took place in London in February of 1918 was perhaps even more important. [...] The Conference requested that “at least one representative of socialism and of labour should sit with the official representatives at the official Peace Conference”. [...] This request [...] was granted by two governments; in consequence, Gompers and I were attached to the delegations of the U.S.A. and France in the capacity of technical experts. We collaborated in bringing our efforts on behalf of the trade-union movement to bear on the elaboration of the Treaty, particularly insofar as Part XIII was concerned. The working classes were becoming more and more sharply aware of the complex causes of international malaise. I shall quote two clauses from that part of the Treaty which gave birth to the International Labour Organization and to its permanent instrument the International Labour Office whose activities and tangible results I need not recall here. The two clauses of the Treaty read as follows:

“Whereas, The League of Nations has for its object the establishment of universal peace, and such a peace can be established only if it is based upon social justice; And whereas, Conditions of labour exist involving such injustice, hardship, and privation to large numbers of people as to produce unrest so great that the peace and harmony of the world are imperilled; and an improvement of those conditions is urgently required...”

¹ See his brief biography published by the Nobel Foundation, available at: http://www.nobelprize.org/nobel_prizes/peace/laureates/1951/jouhaux.html [12 November 2012]. Léon Jouhaux was also a member of the French Section of the Workers’ International and a Freemason.

² See the award ceremony speech delivered by Gunnar Jahn on 10 December 1951, available at: http://www.nobelprize.org/nobel_prizes/peace/laureates/1951/press.html [12 November 2012].

In 1919, Léon Jouhaux was elected to the Governing Body of the ILO, of which he remained a member until his death in 1954. Following his death, the *Review* published an article based on recollections of his contemporaries in the world of work.³

The article by Léon Jouhaux reproduced here is a report – from the workers’ point of view – on the Third Session of the International Labour Conference. In the wake of the First Session (Washington) and the Second Session (Genoa), which had, respectively, “defined the general character of international labour legislation” and then extended “such legislation to maritime workers”, the Third Session, held in Geneva, had on its agenda the extension of labour legislation to agricultural workers. The discussion was difficult. The subject is indeed reminiscent of the current situation of workers in the informal economy, which was recently addressed in the *Review* in terms of the challenges of extending labour administration and inspection in Africa.⁴ Labour inspection is the subject of the ninth General Principle laid down in the Treaty of Versailles (see box 1, p. 3).

In his article, the author argues that economic problems alone should not be used to contest the legitimacy of labour regulation. The “modern” avatar of this debate centres on the cost of regulating labour.⁵

³ See “Léon Jouhaux, 1879–1954”, in *International Labour Review*, Vol. 70 (1954), No. 3–4 (Sep.–Oct.), pp. 241–257.

⁴ See Philippe Auvergnon, Sandrine Laviolette and Moussa Oumarou: “Labour administration in sub-Saharan Africa: Functions and challenges in the light of ILO Convention No. 150”, in *International Labour Review*, Vol. 150 (2011), No. 1–2, pp. 81–98.

⁵ See, for example, Paul Benjamin, Haroon Borat and Halton Cheadle: “The cost of ‘doing business’ and labour regulation: The case of South Africa”, in *International Labour Review*, Vol. 149 (2010), No. 1, pp. 73–91.

The work of the Geneva Conference

Léon JOUHAUX

Originally published in *International Labour Review*, Vol. 5 (1922), No. 3, pp. 381–384.

Following on the Washington and Genoa Conferences, a further important stage in the life and development of the International Labour Organisation was marked by the Conference held at Geneva. He would undoubtedly be a bold man who would attempt to estimate its full results three months after the sessions have taken place. The precise bearing of the decisions which were taken cannot immediately be summed up, but it is at least possible to state the views of the workers' delegates on this Third Conference.

Its primary characteristic to our minds was that of being the logical continuation of the two previous Conferences. Washington was the opening. There we had to define general lines for the international regulation of labour, from the point of view both of essential labour demands and of their application to workers in industry. The importance of this initial task was considerable, but its difficulties were to some degree alleviated by the fact that the state of labour legislation in various modern countries lent itself to the generalisation of reforms already achieved, while, on the other hand, the power acquired by organised labour was such as to ensure their application.

At Genoa this principle of the general regulation of labour was extended to workers at sea. But in 1920 we were already being forced to recognise the increasing difficulty of our task. It was not so much that labour is less powerful among seamen than among workers in industry, as that the problems to be solved were becoming more complex, and above all that the Conference was required to interfere more markedly than at Washington with current conditions prevailing in the different countries.

The Geneva Conference was confronted with an even more arduous task in that it sought means to confer on agricultural labour the benefits granted to other groups of workers. It was impossible not to realise the difficulties involved even before the Conference opened. Again, the actual state of legislation in each country, in the case of the agricultural wage-earner, obviously left a much wider gap between what was being aimed at and what had already been attained than confronted the worker in industry, in commerce, or at sea. Finally, the organisation of agricultural labour is mostly of recent date, and almost always inadequate.

These factors have to be taken into account in estimating the value of the work done at Geneva. There may perhaps also be a tendency to forget that neither the Washington nor the Genoa discussions were conducted without conflict or friction; but those who have followed the work of the International Labour Organisation from its start cannot forget the sometimes sharp disagreements experienced at those two Conferences. The realisation of the proposals of Part XIII of the Treaty has not been, nor should it rightly have been, easy. Nothing is won without a struggle, and it is this continuous effort and the trouble devoted to achieving an end that very largely give the latter its value. All these general considerations are to the point if the work of the Third International Labour Conference is to be justly appraised.

Some reservations must certainly be made, if this is to be interpreted in the sense of saying that the workers' expectations were fully realised. We did not get all we wanted, all we felt to be just and necessary, on the many subjects on the agenda. But having made our reservations, having taken into account the general conditions under which the Conference worked, we cannot in the face of the decisions finally reached fail to recognise the value of its results. It is of considerable importance to us that the Geneva Conference marked a step in advance, even though one smaller than we had demanded of the International Labour Organisation. That step in advance was taken when the attempt to withdraw agricultural labour problems from the competence of the Organisation failed. We have no desire to reopen this controversy here, but we can forget neither the energy with which this attempt was made nor the arguments and pretexts brought forward in its support; still less can we forget the object pursued, which was both to reduce the authority of the Organisation and to get the Conference to declare the existence of two distinct classes of wage-earners, one with the right to receive that minimum of social justice essential—to quote the words of the Treaty—to peace, the other deprived of those rights and guarantees. A little reflection has already brought out the paradoxical character of so strange a theory, of claims so untenable. The Conference rejected them. It did not, indeed, pursue the matter to the logical conclusion demanded by the workers; but a way has been opened up, and what has already been done on behalf of agricultural labour justifies the belief that the work will be completed.

It is obvious that this first result might be a guide in judging certain other difficulties confronting us at Geneva, all of them the outcome of the general conditions of society. Representatives of the working classes could not fail to realise that they were about to be faced, in the international sphere, with the same attacks as had confronted them in their own countries. We have been told that the time is past for the sort of illusions that followed the war, that the need for international labour legislation no longer presses on governments with the urgency of three years ago. We have seen capitalism once more take the offensive, and have noted every attempt to revert to a state of affairs existing before the war. Nor can we any longer shut our eyes to the fact that in certain countries labour has gone through an internal crisis detrimental to its

power and to the interests it represents and defends. But the Geneva Conference has no more adopted the view of those who imagined these passing difficulties sufficient cause for driving the International Labour Conference to retrograde action, than of those who sought to make it forget that its duty is, not to look after individual interests, but to protect general interests and to defend a human ideal. The Conference was not to be persuaded that its work must simply be that of measuring opposing forces and of making a pronouncement in favour of those momentarily superior. This we feel to be of happy augury, showing that the Third Conference has continued the work begun two years ago.

The world of labour will not magnify these temporary difficulties, or think them a reason for withdrawing the trust it placed in the International Labour Organisation. All past experience teaches the worker what laborious and unremitting effort is needed to obtain that social justice which is his aim. There is no royal road to progress. These difficulties, which we do well to recall here, are themselves indicative of the importance of the task in which the worker is taking a hand. If it were of no value, leading to no real results, there would be nothing to excite the hostility displayed by the two extremes of society, who meet here equally determined to take refuge in denial.

Nor are the workers willing to admit that results achieved can be compromised because of any temporary difficulties. They have already passed through many crises, and have emerged from all with increased power, armed for fresh attack. The like will happen this time too; witness the power maintained by their international organisation. We are profoundly convinced that those are mistaken who count on passing difficulties to effect a permanent set-back. It is a serious miscalculation to suppose that these difficulties will lead the workers to forget the promises made to them during the war; for that is not the problem at all. It is not a case of knowing whether the sacrifices made by the masses during the world struggle are to be compensated by the recognition of some of their legitimate rights; it is a question of understanding that the masses must needs take their part in the world re-organisation on which alone peace can be established. This work is today indispensable; tomorrow its urgency will be even greater than it was immediately after the Armistice, precisely because the blunders made since then, because the policy of ignoring how indispensable it really is, have aggravated the situation to such a point that we are now forced to return to it as the sole means of restoring the world's normal activities, of re-establishing equilibrium, as the sole possibility of repairing the grievous effects of the war, or even of continuing to exist.

To our mind another result of the Geneva Conference should here be emphasised. The Conference did not merely refuse to follow those who wished to restrict the competence and action of the International Labour Organisation; on the contrary, it actually extended the duties of the latter substantially by falling in with labour views. It may be recalled that at Washington a very small majority rejected the resolution on the distribution of raw materials proposed by our colleague Baldesi and supported by us on behalf of the

workers' group. This same resolution, when brought forward at Geneva, was passed. Why should no emphasis be laid on this decision, which anticipated the concern which was shown by various governments at Cannes, and suggests how much the solution demanded by us is forcing itself upon them, if the abnormal economic situation of the world is to be remedied? We may also mention the passing of our own resolution on unemployment, supplementing that of our colleague Schürch, instructing the International Labour Office to convene an international conference. We showed at the time that the problems raised by the regulation of labour could not be considered apart from general economic problems, and that in these questions no national solutions can be adequate. As soon as any attempt is made to discover the conditions for that reconstruction which the world requires, if it is to be saved from paralysis and want, the very nature of the problems attacked forces us to admit the urgency of a world re-organisation which would constitute a 'solidarity of nations' and for which the collaboration of the workers must be asked. Nor can it be denied that it was these considerations which prompted the Allied Governments to convene the International Conference of Genoa.

It would be easy to demonstrate in the light of recent events the real character of these resolutions of the Conference and the new perspective which they open up to the International Labour Organisation. They have at least already shown the efficacy of the work begun less than two years ago, the importance and place it has already won, and the hopes it has raised. The workers, far from withdrawing their confidence, will continue to give their support, so as to secure, in their unremitting pursuit of the general interest, that peace and progress which they desire above all other things.

Bertil Ohlin

In 1935, the world's wealthiest countries were experiencing the worst of the economic crisis, victims of deflation and mass unemployment. Yet in Sweden, the recession had been less serious, and the recovery faster. Why? This question aroused considerable interest at the time. In the article reproduced here, Bertil Ohlin, who had written reports on the global crisis and on unemployment in Sweden – and later received the Nobel Prize for economics¹ – analyses the reasons for the recovery in Sweden. Basically, Sweden had applied the Keynesian model before its time, in part thanks to Ohlin's contribution to the analysis of macroeconomic policy.² A flexible exchange rate, monetary policy aimed at lowering the real interest rate and encouraging investment, an expansionist fiscal policy in which loans were used to finance high deficits, productive public spending and state agricultural subsidies all helped to reduce unemployment, increase investment and prevent a sharp fall in wages. Ohlin goes on to examine policies to deal with future problems of employment and unemployment, arguing that it is crucially important for the State and local authorities to be ready with a suitable economic policy in the event of need.

¹ Received in 1977 jointly with James Edward Meade. Bertil Ohlin received the award for his contribution to international trade theory, particularly in developing the Heckscher-Ohlin theorem. He held professorships at the universities of Copenhagen, Stockholm, California (Berkeley), Columbia and Oxford and, in Sweden, was a member of parliament, a minister and a leader of the Liberal Party.

² Bertil Ohlin and Michal Kalecki both claimed to have come up with Keynesian theories before Keynes himself (see, in this special issue, the presentation of the article by Michal Kalecki).

Economic recovery and labour market problems in Sweden: II¹

Bertil OHLIN

Originally published in *International Labour Review*, Vol. 31 (1935), No. 5 (May), pp. 670–699; this abridged version was published in *International Labour Review*, Vol. 135 (1996), No. 3–4, pp. 319–335.

Analysis of the causes of the recovery

It will be obvious that it is impossible to determine how much of the revival has been due to each of a number of “causes”. What happens is always the outcome of everything that precedes it. Had one of the preceding circumstances been absent, the subsequent course of events would have been more or less different. If an attempt is made to estimate how much lower the Swedish national income would have been in 1934 if each of the favourable circumstances had in turn been absent, in order to form an opinion as to how much each of them contributed to the recovery, it will be found that the sum total of all the “increases” in income due to all the factors taken separately far exceeds the improvement that has actually taken place. This is not only because there have also been unfavourable factors at work, which if unhampered would have brought about a decline in economic activity; it is also due to the fact that each circumstance alone, or some two or more of them, may be *necessary* for a certain development, but only all of them together may be *sufficient* to produce it.

Nevertheless, an estimate of how much lower the national income would have been if, for instance, foreign demand had not increased or if the Government had not resorted to large-scale borrowing, gives some indication of the order of magnitude of the influence of the various factors.

¹ For the first part of this article, see *International Labour Review*, Vol. 31, No. 4, April 1935, pp. 498–511. [It is largely devoted to a description of the character of Sweden's recovery in industrial production, building activity and agriculture between 1932 and 1934 – i.e. before recovery in most other countries. Sweden's expansionary fiscal policy to counter the depression and monetary policy designed to stabilize and then gradually raise the wholesale price level attracted attention. The author noted that unreliable statistics and a high incidence of seasonal employment made it hard to assess the level of unemployment, but he concluded that it had dropped sharply in 1933–34, though it had risen overall since 1929.]

An attempt will be made below to arrive at such estimates of the quantitative importance of the different “causes” of the recovery. As a background we must use the account given above [Part I] of the magnitude of the revival. A general indication of its importance is perhaps best obtained through a measurement of the percentage increase in the national income from 1932 to 1934. In the writer’s opinion this increase was round about 20 per cent. The production of manufacturing industries increased by 25 per cent. The rise in the income of the farmers can be estimated at 15–20 per cent. Turnover in retail trade rose much less than one-fifth, but this is to be explained by the fact that a large part of the increase in income was saved. It is doubtful whether in 1932 there were any net savings at all. In 1934, on the other hand, the volume of investment in Sweden was not very much lower than during the good years. As already mentioned, the consumption of ordinary iron and steel was greater than in 1929. A very conservative estimate is that total investments – measured on a 10–15 per cent lower price level – were not less than three-fourths of the 1929 figure, or about 500 million kronor. A large part of the savings went to finance public works and building and certain amounts were used for filling up depleted stocks. On the whole, the best estimate the writer can make of the national income is that it rose from about 5,000 million kronor in 1932 to 1,000 million more in 1934. About one-half of the new income seems to have gone into the production of new capital equipment, while consumption rose by something like 10 per cent. All these estimates, which are necessarily rather rough although based on knowledge derived from the Social Science Institute’s investigations into the national income during the twenties, are in terms of money. As the retail price level has been practically constant during the last three years and the wholesale prices of producers’ goods have risen by about 10 per cent, not much adjustment is needed to get an idea of the quantitative changes.

The questions now to be examined are the following and others of a similar kind: How much has the Swedish national income been raised by the increase in the total value of exports? How much by public borrowing to cover budget deficits and public works? The attempt to answer them is of course subject to the qualifications mentioned above.

The increase in foreign demand

The increase in the value of Swedish exports during the last two years cannot be attributed solely to a more intense foreign demand for Swedish commodities. Sweden continued to depreciate her currency, the gold value of which fell from 67 per cent of gold par during the first quarter of 1933 – the value was a little lower during the second half of the preceding year – to 56 per cent of gold par in the second half of 1934. If the gold value of all other currencies had remained constant, a considerable rise in Swedish export prices and export values might have been expected, even if conditions of foreign demand had not changed at all. As a matter of fact, however, the average quotations in

Stockholm of currencies of the so-called sterling group and of several of the Danube States did not rise. The only currencies that appreciated in Stockholm were those that were maintained at gold par – belonging to countries representing about half the Swedish imports and less than half her exports – and the value of the United States dollar fell by about 30 per cent. In view of the fact that all Sweden's most important competitors also depreciated their currencies, it is not certain to what extent the changes in the world's monetary situation from 1932 to 1934 made the conditions for Swedish exports more favourable and thus contributed to the increase in her export values. It seems certain that the improvement in business conditions abroad and the consequent shift in demand exercised a much greater influence.

[...]

Monetary policy

Apart from its influence on exports the currency policy of the Bank of Sweden has been a favourable factor in two ways. The depreciation of the krona has stimulated the home-market industries. Furthermore, the Bank's large purchases of gold, foreign exchange, and State securities have eased the money market and contributed towards a fall in interest rates. A third, although less important, aspect should perhaps also be mentioned. The stable relation between the pound sterling and the krona, which has been "pegged" temporarily to the pound, has helped to create a feeling of stability which Swedish business men are convinced has had advantageous effects.

The transition to a paper standard in 1931 practically ended the period of deflation in Sweden. [...]

This article, however, is concerned only with the period of recovery. It is beyond dispute that the revival in the home-market industries has been to a large extent due to the depreciation of the krona, which has raised the prices of many goods imported from gold-standard countries. Some people thought that the stimulus from the depreciation would last only a few months and would then disappear. They based this opinion on the course of events in the twenties, when cost and price levels were believed to have adapted themselves to the new foreign exchange relations after a few months, in cases where no new depreciation occurred. Be this as it may, the writer is of the opinion that the adaptation at that period would have required not months but years. During a severe depression, characterised by large surplus capacity in manufacturing industries, transport, and trade, it was in any case to be expected that this adjustment of costs and prices would come about much more slowly. These expectations were fulfilled both in Sweden and elsewhere. [...] As the preparation for the production of new qualities or new goods, formerly imported from abroad, then required considerable time, the favourable effects on Swedish production and employment were felt more in the past two years than in 1932. The general return of optimism in 1933, due probably to a multitude of circumstances, also played a certain part in this respect. Naturally, too, the new

employment came not only through the substitution of home for foreign goods but also through the investment which was needed in many home-market industries to enable them to expand their production.

[...]

So far only one aspect of monetary policy has been touched on, namely, the depreciation. It is not a mere chance that the Swedish currency has fallen to 7 per cent below the pound sterling, and has remained there since the spring of 1933. It has indeed been a managed currency. In September 1931, when Sweden followed Great Britain away from the gold standard, the principle was laid down that "the purchasing power of the krona in the hands of the consumer" should be maintained. As there was at that time a certain scare of inflation, the Bank of Sweden restricted credit severely and succeeded in checking the tendency towards rising prices on the wholesale market. In the light of later developments this proved to be a mistake. For when the monetary programme was modified so as to recommend a rise in wholesale prices – but not more than should be compatible with only a small rise in the cost of living – the depression mentality had gained so much ground that for some time no rise in prices could be brought about. In a severe depression the only method of raising prices that is as a rule likely to succeed is either to depreciate the currency or to expand internal credit to such a point that it brings about a sufficient expansion of demand and production to absorb a substantial part of the surplus producing capacity.

[... T]he wholesale price level kept a surprising stability until the spring of 1933, but [...] the downward trend was clearly noticeable, even though it was insignificant in comparison with the deflation that took place in gold-standard countries. It was only when the turn of the business cycle came in the spring of 1933 that the curve began to rise. The cost of living was practically constant all the time.

This does not signify that the course of prices was unaffected by monetary policy, or even that the ambitious declarations of the Government's financial programme had no perceptible results. These declarations undoubtedly helped to create a feeling in business circles that the risk of a large reduction in the general price level had disappeared, and thus contributed towards an increase of confidence. The stable exchange rates within the sterling group had a similar influence. Furthermore, the existence of the programme prevented the Bank of Sweden from letting the krona rise to parity with the pound sterling in 1932–1933, a course which at that time would have depressed the wholesale price level. [...] Since then, [...] the money market has become extremely liquid. There can be no doubt that this glut on the money market has been one of the chief factors in bringing about the fall in the long-term rate of interest, which has come down to 3 per cent, or at least 1 per cent below the pre-war level.

The decline in interest rates [...] is all the more striking as the policy of large-scale public borrowing might well have been expected to exercise an influence in the opposite direction. The surplus of money in the commercial

banks also made them more willing to extend credit and in that way made it easier for business men to finance new production. House building is a field where cheap capital has begun to exercise a considerable influence, and is likely to do so still more during 1935. As building activity was well maintained in most parts of Sweden up to the beginning of 1933, it is a striking fact that by the summer of 1934 it was already in full swing again.

On the whole, Sweden's monetary policy has been highly successful, in spite of the fact that the Board of the Bank did not at first realise the decisive importance of large open-market operations. Fortunately, their hands were forced by the surplus of foreign exchange, arising partly from the excess of credit items in trade and service transactions with other countries – an excess due no doubt largely to the depreciation of the krona – and partly from the export of large quantities of privately owned foreign bonds. The Bank's purchases of this foreign exchange made the money market liquid early in 1933. Since then the Bank's policy has been firm and consistent, and has been directed in various ways towards supporting the tendency towards a reduction in interest levels.

The goal of Swedish monetary policy is the stability and development of industry and trade. A certain rise in the wholesale price level – which would bring it into harmony with cost conditions – was therefore laid down as the immediate aim. The rise which has taken place in the last two years seems to have been almost sufficient for this purpose, to judge from the earnings of Swedish industry in 1934. The external value of the Swedish currency is, on the other hand, a secondary consideration. Stable relations with the sterling group are desirable and will no doubt be maintained as long as they are compatible with the desired price movement. But there can be little doubt that if wholesale prices in Great Britain should begin either to fall considerably or to rise quickly, the pegging of the krona to the pound would come to an end.

Finally, a lesson may be stressed which can be learnt from the experience both of Sweden and of other paper-standard countries. The surprising constancy of the cost of living and its decline in gold-standard countries demonstrates that gold in itself is no guarantee of stability, and that paper currency is not identical with violent inflation. Some of the countries which now cling to the gold standard in spite of the deflation it entails are apt to generalise from their own experience in the twenties in a way which recent developments in the sterling group of countries have shown to be unjustified. The adoption of a managed paper currency in Sweden has made it possible to re-establish a relation between costs and prices which is not far from enabling producers to reap a normal profit, when their productive capacity is utilised to a normal extent.

Financial policy and public works

Financial traditions in Sweden are rather orthodox and strict. Borrowing was used only for productive purposes which were expected to yield the State sufficient profit to cover interest charges. Railways constructed partly for military

purposes, office buildings, etc., were financed by means of taxation. During the good years 1927–1931 current revenue exceeded current expenditure – excluding productive investments – by something like 200 million kronor.

With the advent of the severe depression in 1931 the situation changed. The budget for the financial year July 1931 to June 1932 was balanced in less orthodox fashion; the year ended with a deficit, and not less than 70 million kronor in all had to be financed otherwise than out of current revenue. For the sake of simplicity such operations will be described below as “financed by borrowing”. In addition to this 70 million a similar sum was borrowed for productive investments, which in Sweden are entered under the heading “expenditure for the increase of capital”.

In the next budget (1932–1933), which covered the period of the depth of the depression, borrowing for productive investments was – curiously enough – reduced to 50 million, apart from a sum of money that was used simply to strengthen the financial position of the iron ore company, in which the State holds a large interest. However, the deficit in the rest of the budget rose to a sum total of about 110 million, including amounts taken from various funds. Hence borrowing for total real expenditure was about 160 million, or somewhat higher than the preceding year.

The budget for 1933–1934 was based by the new Socialist Government on new principles. To finance unemployment relief during a period of depression by means of loans was declared to be sound, as this would help to maintain purchasing power, provided that the borrowing was so effected as not to restrict the credit given to private industry. Only through such a policy would it be possible to escape not only the cutting down of desirable expenditure but also an increase in taxation that would weigh heavily on industry and trade. It would however be prudent to provide for the amortisation of such temporary borrowing over a short period of years by setting aside the income from certain taxation – an increased inheritance tax – for this purpose. In the long run, the financial position of the State would not be weakened; the heavy financial burden of the depression would merely be spread over a certain number of years.

According to this new budget, borrowing for productive public works – which had always been financed in this way – would be increased to 100 million kronor. Owing to delay in starting these works only 65 million was actually spent before the financial year ended in June 1934, to which sum should be added about 15 million remaining from the previous budget. As regards expenditure which would normally have been financed out of current revenue, it was proposed to borrow 168 million for unemployment relief – relief works, cash allowances, etc. – and for certain building purposes. Furthermore, certain kinds of “savings” which meant a hidden deficit were made; these, however, were covered by the surplus which the budget ultimately gave owing to an under-estimate of certain items of revenue. Of the proposed extraordinary loan expenditure of 168 million, which was accepted by the Riksdag, only 98 million was actually spent. In addition, extraordinary amortisation amounted to 24 million, so that the sum total of expenditure financed by borrowing must

have amounted to about 155 million. This sum was about the same as the corresponding sum for the preceding year, 1932–33. As more than half the money was spent in the first half of 1934, there was certainly no increase – perhaps even a small reduction – in the rate of loan expenditure in the second half of 1933 as compared with the preceding budget, which had in theory been based on the old financial principles. On the other hand, 1934 saw a decided speeding-up of loan expenditure for public works, in particular after the end in February of the labour dispute in the building trades in the towns. As some of the State money was used as subsidies to municipalities to cover a part of the cost of public works and some more was used as subsidies for the improvement of private houses in country districts, it seems certain that the total loan expenditure due to State action during the first half of 1934 much exceeded the sums borrowed by the State; it is probable that it was not far short of twice the corresponding expenditure in the first half of the preceding year.

[...]

It should be added that Sweden's financial position has not been seriously damaged by the borrowings of the last four years. This is perhaps most clearly seen from a comparison of the interest payments on the State debt, which will be less than 100 million during the next budget year, with the expected revenue from productive investments and funds, which amounts to over 130 million. Thus no taxation is required for the interest service.

While it seems to be beyond dispute that the policy of budget surpluses during good years and deficits during the depression had a stabilising influence on economic conditions, it is also evident that the concentration of the loan expenditure in 1934, when industry and trade were well on their way out of the depression, was unfortunate. The new policy should have been begun two years earlier and preparations made for it in advance. In 1934 the time was ripe for a gradual reduction in public works rather than for an increase.

In any case the influence of the new financial policy on economic conditions in 1934 must have been considerable. State and municipal loan expenditure must have been somewhere between 150 and 200 million kronor more than it would have been under the old policy, and was at least 100 million kronor higher than it was in 1932; the national income was therefore increased by more than this amount. While these are important sums, they are far below the increase in the value of Swedish exports, which reached almost 350 million; it is probably safe to conclude, therefore, that the increased borrowing was a much less important factor in promoting the general recovery. There is also no reason for assuming that the secondary demand arising from income due to the new financial policy was relatively greater than that brought about through export revival. On the contrary, the influence of the latter on the balance of payments and the purchases of foreign exchange by the Bank of Sweden, and thereby and in other ways on the capital market, has no parallel among the indirect effects of the new financial policy.

The amount of employment given by public works is of course partly dependent on the level of the wages paid. Before 1933 the practice in Sweden

was that wages paid for relief work – road construction, forest clearing, etc. – were about 15 per cent lower than the open-market wages of unskilled labour in the district concerned. No unemployed worker, skilled or unskilled, obtained help of any kind unless he was willing to accept work on that condition. In 1933 two fundamental changes were made in this policy. A large part of the public works that were started to reduce unemployment was to be handled in the same way as ordinary productive works, and thus naturally paid at regular tariff wage rates; on relief works proper, on the other hand, the wage was to be equal to the open-market wage of unskilled labour in the district. Some people feared that this would cause a flow of labour from agriculture, where wages are lower than the lowest unskilled wage in many manufacturing regions. Up to the end of 1934, however, these tendencies seem to have been insignificant, and agriculture has on the whole not had serious difficulties in getting sufficient labour. The Unemployment Commission, which organises the State relief works and supervises the municipal relief works which receive State subsidies, naturally has its attention on these and similar difficulties,² and tries to restrict employment on relief works when dangers of this kind arise. It is still too early to say whether the new system has given rise to any serious disadvantages. Against such possible disadvantages must be set the gain that the relief works are now not so unpopular as they used to be.

The employment directly created on these various public works during 1934 reached very great proportions. During the second half of the year the number employed on the new “regular” public works – not ordinary productive investments in electrification of railways, etc., and not relief works – and in private building activity dependent upon official subsidies was estimated at 34,000. This is a considerable part of the total reduction of 70,000 in the number of applicants for unemployment assistance that took place from the second half of 1933 to the same period in 1934. Almost certainly, however, some of the 34,000 were not among those receiving assistance in 1933. Relief works, for their part, employed almost 40,000 persons, or about half the number seeking unemployment assistance. (It should be noted that workers on relief jobs are counted as unemployed.) Apart from the number who are without work but fail to report as unemployed, the total number of workers with no jobs of any kind was therefore not more than 40,000 in the autumn of 1934. The winter of 1934–35 brought with it a seasonal increase of about 20,000.

[...]

Nothing in Swedish experience – either with regard to production or with regard to interest rates – contradicts the opinion that in financially strong countries it is sound and practicable to resort to large-scale borrowing during periods of depression. The idea that the budget must be balanced each year, and that otherwise inflation is bound to ensue, is one of those popular maxims which are true in certain circumstances but not in others. The fact that they have been preached as a general gospel without qualifications, especially by

² The case of seasonal work in agriculture and forestry is also referred to below.

bankers, has done much harm. For if an economic policy is believed to be unsound the practice of it cannot fail to call forth certain unfavourable “confidence reactions”. In Sweden, fortunately, influences of this kind have been very slight. It is time to learn the lesson of recent experience that intelligent and sound public finance does not require the budget to be balanced each year but only over a number of years, including both good and bad business conditions.

Agricultural policy and good crops

[The author devotes two pages to the improvement in the agricultural situation. The main factors were a succession of good crops and regulation of the milk and butter market. Farmers’ incomes had also been raised by the State’s undertaking to buy each summer all wheat and rye of the previous year’s crop at a fixed price.]

These measures, combined with the effect of unusually large crops of bread cereals and good crops in general in the autumn of 1932, 1933, and 1934, have brought about the substantial increase in farmers’ incomes referred to above. A very large part of this extra income, however, has been at the expense of the consumer, who has had to pay increased prices for butter and some other products and therefore, presumably, has bought less of other goods. To what extent such a change in the direction of demand contributes to a general economic recovery is an open question, the answer to which would seem to depend on the special circumstances in each case; closer analysis is beyond the scope of this article. The transfer of money from one group of producers to another group can lead to a rise in the total volume of purchases over a certain period of time on two conditions: (1) if the people receiving the money so transferred spend a larger part of it on consumption during the period or if the individuals selling to these people do so; (2) if the improved profitability of production and the greater credit available to the producers receiving the transferred money leads to an increase in investment which is greater than the reduction suffered by the other producers. In view of the fact that the financial position of many Swedish farmers was very weak in 1932 and that this had unfavourable reactions on business sentiment and turnover in the country districts, it is not improbable that the rise in the prices of farm products to some extent satisfied these conditions.

However, a considerable part of the new income accruing to the farming community was derived, not from higher prices paid by the Swedish consumer, but from increased production and consumption of animal foodstuffs in Sweden. One-third of the new farm income was obtained at the expense of other countries by reduced purchases from them and larger sales to them. In 1934, smaller imports of bread cereals, sugar, and maize and a higher export price for bacon gave the Swedish farmer about 40 million kronor more than in 1932. Reduced imports of oats and a small rise in the export value of butter – the quantity exported rose from 13 million kg in 1932 to 23 million kg in 1934 – and a dumping export of cereals to reduce surplus stocks together

gave more than 10 million kronor. On the whole, the increase in farmers' incomes from changes in imports and exports from 1932 to 1934 amounted to more than 50 million kronor. Finally, the semi-official purchases of wheat and rye for 35 million kronor of borrowed money, of which only a minor part was recovered through the dumping exports and through domestic sales for feeding purposes, produced a corresponding increase in incomes. The total increase in farm incomes due to borrowing and changes in imports and exports, and not arising from sales at increased prices to other sections of the population, was evidently considerable in 1934, although decidedly smaller than the figures for income increases due to the revival in export industries.

[...]

Reinvestment demand

After [...] some years of depression a feeling that the fall in prices has come to an end may be sufficient to release a demand of the former sort that has until then been dormant, and a strong recovery movement may set in quite independently of favourable changes either abroad or in domestic economic policy.

The Swedish recovery has not been of this type. During 1930 and 1931 investment activity was well maintained, although on a slightly lower level than during the boom years. Sweden experienced only twelve months of serious depression in manufacturing industries and trade – the period from April 1932 when the Kreuger concern broke down to the spring of the following year – before the revival started. This period was too short for a large reinvestment need to accumulate. Most industrial firms had a strong financial position, so that debt liquidation did not force them to restrict investment.

It will be evident that the stimulus to expansion of output from such accumulated reinvestment need, when optimism began to return, could not be expected to come so quickly or to be so strong as in some other countries which had suffered from a longer and more severe depression. This expectation was fulfilled by actual events. The considerable increase in reinvestment came much later than the psychological change, which, to judge from the stock exchange, can be placed in February 1933. The index of share quotations fell during the second half of 1932 – it had been especially low immediately after the breakdown of the Kreuger concern – and up to February 1933, when it reached 78. It then rose to 92 in May, only to remain constant until October, and it was not until January 1934 that the real upward movement began. It is worth noting that the psychological change in the spring seems to have had little influence on investment activity. During 1933, therefore, the recovery movement must have been carried chiefly by the other factors discussed above: the expansion of exports, the home market revival due to the depreciation of the currency, and the improvement in agriculture due to crisis measures and good crops. Financial policy did not affect the movement more than in the previous year, although it was all the time a favourable influence. These three factors may be called primary forces in the recovery, while reinvestment – called forth

by them, i.e. by the improvement they had caused – was a secondary tendency which gathered strength only in 1934. In that year these three primary forces, to which financial policy should now be added, were also strengthened.

Some light is thrown on the relative importance of the four factors, other than reinvestment tendencies, not only by the preceding quantitative estimates of the size of their direct effects on income but also by the following considerations. The expansion of exports during 1933 can have had only a slight influence on home-market industries in that year. There is always a considerable time-lag before the secondary reactions take place. Hence the recovery in these industries during 1933 must have been due chiefly to the other primary factors, and probably most of all to the depreciation of the currency. Yet it would not be justifiable to describe the course of events in Sweden as fundamentally an “isolation revival”, due chiefly to the stimulus given by the cutting off of international economic relations. Both the value and the volume of imports – raw materials excluded – were in fact higher in 1934 than in 1932.

As no significant changes were made in wages during the period of recovery, it has not seemed necessary to discuss this aspect of economic policy here. It may not, however, be out of place to mention that the great stability of the situation of the home market all through the depression had something to do with the wage policy pursued. Wage reductions in 1931 and 1932 brought nominal rates down by something like 5 per cent. As the cost of living fell by 10 per cent, real wages per hour were increased. When the policy of raising the wholesale price level had been accepted, the time for any considerable wage reductions was obviously over. Such reductions would have caused an expectation of lower prices in the future and have led to a decline in consumers' demand. In the situation ruling in 1932 it would have been useless to wait for an increase in investment demand to follow a fall in wage costs. It was an important circumstance that the tendencies towards deflation, which lasted, although in a weakened form, until the spring of 1933, did not get the support of large wage reductions. It is probably more than mere chance that home-market industries were able to maintain production relatively well in Sweden as compared, e.g., with Finland, where considerable wage cuts took place.

These brief observations are not meant to indicate that rigidity of wage rates always makes for economic stability. This is by no means always the case, as the effect of different kinds of wage policy depends on the character of the situation in which they are applied. A study of economic developments in various countries during “the great depression” will presumably lead to a more relativistic view of the effects of economic policy on business conditions and the standard of life.

Present and future labour market problems

Looking back at the development of Swedish economic conditions during the last two years one cannot but feel that the recovery has been remarkable. It has not been accompanied, and still less been caused, by any elements of an

inflationary character which would lead one to expect a sudden reversal of the movement. On the contrary, the adjustment of selling prices and costs to one another since the currency left the gold standard has come about as much through cost reductions as through the rise in wholesale prices. In spite of the fact that the latter are still about 20 per cent lower than they were before the depression, whereas nominal wage rates have fallen by less than half this figure, improvements in technique and organisation have made profitable production possible in most industries.

While unemployment is still somewhat greater than in the prosperous years before the depression, the difference is less significant than in most other countries. Additional unemployment of between 20,000 and 50,000 persons does not weigh heavily on an industrialised country with more than 6 million inhabitants. The quantity of resources lying idle is certainly not of such proportions as to call for any considerable and general restrictions on their use in the present situation – e.g. through a compulsory and permanent reduction of the working week.

This, however, does not mean that there are no serious problems of employment and unemployment to face, especially if attention is directed towards the future. A new depression of a more or less typical business cycle character may come any year. It is highly important that the State and the municipalities should prepare beforehand for such an eventuality, so as to be ready in time with a suitable economic policy. This will probably have to be of much the same kind as the one applied in the last few years, the chief defect of which was that it began a couple of years too late.

Perhaps not less important is the question of the so-called “permanent” unemployment, and its relation to the social policy adopted to assist the unemployed. As the problems connected with this are similar in a great many countries, it may be worth while to make them the subject of a brief analysis.

Possible dangers of social policy

At the end of September 1934, before seasonal unemployment had begun, the number of people reporting to the Unemployment Commission and applying for assistance was 79,000. Of this number 43,000 were employed on relief works and 1,000 young people on voluntary labour service. Of the rest, 10,000 obtained cash allowances, while 25,000 were considered to be not in need of assistance. It seems certain that a considerable proportion of these 79,000 represented a type of labour on which a large amount of unemployment is ordinarily concentrated. Investigations into the quality of labour employed on relief works in certain cities have shown that it was to a large extent what may be described as second quality. There is reason to suppose that the problem of how to find employment for such labour is growing more and more important.

It is of course obvious that some individuals have always fallen below the standard of quality expected of ordinary labour, usually because they lack the intelligence, energy, or health that is necessary. It seems certain, however,

that the requirements of the ordinary standard have a tendency to rise. With the growing use of machinery, often of a complicated character, and with the increasing speed of production the demands made on the workers are rising and a growing percentage of them are not able to meet these demands. This is so not only in the manufacturing industries; in recent years the same tendency has gathered strength in agriculture as well, where formerly much second quality labour was used. The rationalisation of farming, e.g. the increasing use of machinery, seems to be proceeding more rapidly than ever, with this change in the nature of the demand for labour as a consequence.

Another factor which makes the problem of second-quality labour more serious than it was a decade or two ago is the more complete organisation of the labour market. If labour of this kind is to be paid the same wage rates as ordinary labour, it will not get much employment, except during real boom periods. The organisation of the labour market means a certain rigidity of wages and incomplete differentiation of wage rates, thus making it more difficult to adapt the rates for the second-quality labour to its real usefulness.

Before the depression workers of this kind found odd jobs here and there, but they were not well paid and, owing to intermittent periods of unemployment with little or no help from the community, they led a precarious existence. As the social policy of recent years has made it much easier to obtain unemployment assistance, the stimulus to seek new jobs has been weakened. The total amount of unemployment among workers of this kind cannot fail to show an upward tendency.

The fuller utilisation of this labour power, both for the sake of the contribution it can make to the national income and – still more – to save the individuals concerned from the burden of long idleness, is indeed a serious problem, which seems unlikely to be solved without specific measures on the part of official institutions. The experiments in the employment of the disabled, e.g. in the Ford factories, have however shown that much can be done to find opportunities for the employment of labour that is below the ordinary standard of general usefulness, or useful only under certain conditions. Due consideration must be given to this problem in the construction of future social policy.

A similar problem is raised by the existence of individuals who are reluctant or unwilling to work. The possibility of obtaining public assistance inevitably makes it easier for them to remain idle. Although the cash allowances paid in Sweden are relatively low – a maximum of 3 kronor a day for man and wife, 2 kronor for a single person, and 60 öre for each child – some people prefer to accept them rather than work. To counteract such tendencies some municipalities require two days of work per week from persons receiving assistance; if they refuse to work, all unemployment assistance is withdrawn. As far as possible, however, the unemployed are offered not cash allowances but jobs on relief works. Here again refusal to accept the work offered means the end of all help from the unemployment authorities. Some municipal unemployment committees use relief works to test the willingness to work of everyone applying for assistance; others give work to those who apply for it, while the

remainder get cash allowances. The question of how to test the willingness to work without causing undue hardship to the ordinary unemployed worker obviously gives rise to difficult problems.

Seasonal employment is another case in which, failing special precautions, social policy may tend to cause or prolong unemployment. The seasonal character of Swedish industries is very marked, chiefly for climatic reasons. In the northern part of the country small farmers and farm labourers work in agriculture during the brief summer, and during the winter in the forests cutting and transporting timber. Timber floating is done in the summer half-year. It is the normal system to pass from one to another of these occupations in the course of the year, often with one or two months of unemployment in the spring and autumn. In spite of the seasonal character of the jobs, daily earnings in them are not higher than in other more regular employments in the country districts, chiefly on account of the severe competition of the very cheap labour in the Finnish and Russian timber industries, and the standard of living of this group of workers is thus relatively low. Not unnaturally, their anxiety to find jobs in private industry is reduced by the possibility of obtaining cash allowances, and still more by the relief works on which they can earn as much as on their ordinary work, and which often give longer and more secure employment.

[...]

The local adaptation of labour

In a large and scantily populated country like Sweden the problem of the geographical mobility of labour has always been important, and has become even more so during the present period of great changes in the structure of world economy and of Swedish industry. In some parts of the country employment is almost exclusively dependent on the stone quarries, whose output seems to have been permanently reduced to a fraction of the pre-war volume. In some regions in the North the supply of timber is so small that the local timber industry will in the future be much restricted. In these and other similar cases, how is the working population to be transferred to other parts of the country and employed there?

In the nineteenth century the pressure of hardship, sometimes even of starvation, made people migrate either to other districts or – more commonly – to the United States. Nowadays, fortunately, the community intervenes with aid, but sometimes with the undesirable result of reducing the mobility of labour. The same effect is sometimes produced by the form of local protection practised by many municipalities and districts, which reserve jobs as far as possible for their own inhabitants and put difficulties in the way of people coming from outside. The difficulties are increased by the efforts of trade unions to give their own unemployed members the preference over non-members coming from other districts.

Such circumstances make it important that the community should make every effort to increase the geographical mobility of labour, when this can

be done without causing any serious inconvenience in other respects. Among general measures to this effect may be mentioned the improvement of the system of employment exchanges and official subsidies to cover travelling expenses. In Sweden both these methods are at present being applied. It is also of course important that the attention of the trade unions should be directed to the important question of mobility. Special measures to organise the transfer of labour in particular cases can also be useful. In Sweden unemployed from the more seriously affected districts are given relief work in other parts of the country, where the state of the free labour market is relatively favourable, with the result that after a time some of them find regular employment there in private industry. Another measure that has been tried on a small scale and with good results is to select youths from the overpopulated districts for official training courses, e.g. in mechanical work; after training, they have been almost eagerly demanded by mechanical firms all over the country.

It is needless to say that a policy of this kind should be based on careful study of the tendencies and trends in industry by means of regular surveys. In this respect, however, much remains to be done in Sweden.

On the basis of such investigations it may also be possible to attack the problem from the opposite angle. Instead of transferring surplus labour to other regions, new industries may be found that can with advantage be established in the districts where there seems to be a permanent surplus of labour. The depreciation of the Swedish currency has opened up possibilities of manufacturing many goods within the country that were formerly imported. A Government committee is at present enquiring into the possibilities of bringing about the desired establishment of such new trades.

The need for expansion

While unemployment is not at present a very serious problem in Sweden, there is reason to fear that the problem of employment may shortly become very difficult, owing to the rapid increase in the number of persons of working age, from 18 to 65 years. The increase during the next decade may be estimated at almost 150,000 men and a similar number of women. Where are all these people to find employment?

It is at least clear that it will not be in agriculture. Swedish exports of foodstuffs are more likely to meet growing difficulties on the foreign markets than the reverse, and there is little prospect of larger sales on the domestic market. The best that can be hoped for is that the general increase in the Swedish demand for animal foodstuffs should keep pace with the rapid rise in output per farmer. If the standard of living continues to rise in the future as it has done in the past, this will result in a larger percentage of the productive resources of the country being used to produce goods and services for the satisfaction of secondary needs.

Obviously, it is to manufacturing industries, including building, and the service industries that we must look for the greater part of the necessary

expansion of employment. Public opinion in Sweden is reluctant to accept the pessimistic view that it will become impossible to create sufficient employment, and that a permanent shortening of the working week will therefore be required. History offers no evidence in support of the view that – except during special depressions – it is not possible to use the growing productive capacity of a country to satisfy the many pressing needs of a population which is still far from a desired standard of living. (It is true that when a certain standard has been reached, a shorter working day may be preferred to a higher income, but this is quite another matter.)

On the other hand, experience seems to show that during the last hundred years rapid economic progress and expansion have been connected with a large volume of new real investment. [... P]resent conditions seem to indicate house building on a large scale as a natural form of investment during the next decade, and one which might in turn stimulate a general industrial expansion. A further reason is that the standard of housing is lower in Sweden than in some other north-western European countries, where the standard of living is not higher in other respects. The low and falling birth rate also calls for measures to check its decline, and better housing accommodation may possibly have some effect in this respect. Last but not least, the interest level of 3 per cent makes it possible to provide housing more cheaply than was possible some years ago. As, however, there is no certainty of a sufficient automatic increase in building activity, it has been proposed to subsidise house building to meet the needs of poor families with more than two children. There seems to be a growing conviction in Sweden that official measures to stimulate the production of houses is a natural way of contributing towards a general economic expansion, and a necessary item in the solution of the employment problem.

[... T]he volume of employment will also depend on the level of remuneration asked for by the trade unions. Expansion in private industry depends on the possibility of making a satisfactory profit; a wage policy that prevented this would accordingly counteract the tendencies towards the desired growth in manufacturing industries and elsewhere. The goal both of the unions and of the State must be to pursue such a general policy that the standard of living of *all* classes – or at least such as are not wealthy – can be raised. This implies, first, an expansion sufficient to avoid any increase in unemployment, and, secondly, such increase in wages – an increase *all round*, and not only in certain fields – as is compatible with this rise in employment.

Abba P. Lerner

The article by Abba P. Lerner reproduced here was the first to explain Keynes' employment theory in simple and generally intelligible terms; indeed, the article had been read and approved by Keynes prior to publication. Born in Romania, Abba P. Lerner studied in Cambridge before teaching at a number of universities including the London School of Economics and the University of California (Berkeley). Lerner made major contributions in his own right, to socialist economics, trade theory and welfare economics, e.g. on the development of market pricing for a decentralized socialist economy, the symmetry of export and import taxes, factor-price equalization, and his concept of low and high full employment (which evolved into the natural rate and then non-accelerating-inflation rate of unemployment). But here he explains the nature of Keynes' influential argument. Contrasting it with the prevailing orthodoxy of the classical economists, he explains why lowering money wages would not be sufficient to achieve full employment (the absence of involuntary unemployment): costs would fall but demand would fall by more, leading to the reversal of any gain in employment, unless at the new equilibrium the rate of interest is lower than it was initially. The central contribution concerns the determinants of investment – on which the level of employment depends. It is more efficient to act directly rather than indirectly on the rate of interest and consumption. “To seek the alleviation of depression by reducing money wages, rather than by directly reducing the rate of interest or otherwise encouraging investment or consumption, is to abandon the high road for a devious, dark, difficult and unreliable path [...]”. Apart from the central message, several other fundamental Keynesian concepts are clearly defined, such as liquidity preference, the marginal efficiency of capital, and the fallacy of composition with respect to individual and collective thrift. Then, as now, the lack of flexibility versus the weakness of aggregate demand are the competing explanations for unemployment in the ongoing debate over what to do about it.

Mr Keynes' "General Theory of Employment, Interest and Money"

Abba P. LERNER

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The object of this article is to provide as simple as possible an account of the most important line of argument that runs through Mr J.M. Keynes' book *The General Theory of Employment, Interest and Money*, so that, except perhaps in some details of presentation, it contains nothing original. [...]

Keynes wishes sharply to distinguish his own system from what he calls the "classical" economics. By that he means the orthodox body of doctrine, first conceived in fairly complete outline by Ricardo, and developed by almost all economists of repute from that time on, both in England and elsewhere, which finds its present culmination in the works of Pigou. [...]

The last sentence in Keynes' preface reads: "The difficulty lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds." I would like to underline that sentence.

* * *

Keynes is concerned with the problem of unemployment. The classical view is that in the absence of State interference or other rigidities, the existence of any unemployment will have the effect of lowering wages.

This follows immediately from the definition of unemployment, for any man who is not in employment but who does not try to get work at a lower wage is no more considered to be unemployed than the man who refuses to work overtime or on Sundays. At the current wage he prefers leisure to employment. He may be idle but he is not unemployed – at any rate he is not involuntarily unemployed. If he really wanted to work, if he were really unemployed, he would offer himself at a lower wage and this would reduce the level of wages. Unemployment is incompatible with equilibrium.

The reduction of wages, the argument goes on, will make industrial activity more profitable so that business men will employ more people. As long as

there is any unemployment wages will fall, and as long as wages fall profits rise, and as profits rise employment increases until all the unemployed are absorbed in industry and we have equilibrium and no more unemployment.

Unemployment can therefore persist only if the State, or the Trade Unions, or some other institution prevents the unemployed from offering their services at lower wages and so from setting in motion the automatic mechanism which leads to equilibrium and full employment. What is necessary, therefore, is simply to remove the rigidity and allow the unemployment to liquidate itself by reducing wages.

Keynes accepts neither the definition nor the argument. Like the classical economists he is concerned only with *involuntary* unemployment, but he defines as *involuntarily* unemployed a man who would be willing to work at a lower real wage than the current *real* wage, whether or not he is willing to accept a lower *money* wage. If a man is not willing to accept a lower *real* wage, then he is *voluntarily* unemployed, and Keynes does not worry about him at all. But there are millions of people who on Keynes' definition are unemployed but who fall outside of the classical definition of unemployed, and these provide one of the most pressing of modern social problems. These are willing to work for less than the current real wage – they would be willing to work for the current money wage even if the cost of living were to go up a little – yet they cannot find jobs. What determines the number of people in a society who find themselves in this position? Or to put the question the other way round, what determines the number of people who do find employment? The object of Mr. Keynes' book is to indicate the road leading to the answer to this question.

The classical refusal to consider these men as really involuntarily unemployed resolves itself into a recipe for finding them employment. They have only to agree to accept lower wages and they will find work. Keynes objects to this procedure of economists on two separate grounds. His first objection is on the practical ground of the uselessness of tendering advice that one knows will not be accepted, even if it is sound advice. It is time for economists who wish to give statesmen practical advice to realise that money wages are sticky – that workers will, in fact, refuse to reduce money wages.

But Keynes' main objection consists of a denial of the theory which is put forward as an excuse for the treatment. If money wages are reduced it does not follow that there will be any increase in employment. A general reduction of wages will reduce marginal costs, and competition between producers will reduce prices of products. Equilibrium will be reached only when prices have fallen as much as wages, and it will not pay to employ more men than in the beginning. The workers, who are able to make agreements with their employers about their *money* wage, cannot adjust their *real* wage. If they could reduce their real wage more would be employed, but they can only attempt to reduce their real wage by reducing their money wage at the existing price level. This, however, only brings about a proportionate fall in prices so that they are in fact not able to vary their *real* wage. That is why their unemployment is

involuntary even if they refuse to accept a lower money wage. For that would not have the desired effect of reducing the real wage and increasing employment – it would merely remove a certain stability of prices.

It has hardly been disputed that a cut in money wages, by reducing costs, will have some tendency to reduce prices, but it remains to be shown why prices should fall *proportionately* to the reduction in money wages so that there is *no* fall in the real wage and so *no* increase in employment in the manufacture of consumption goods. (Employment in investment industry depends on other factors considered below. For the time being this is taken as given.)

Whether this will be the case or not cannot be decided at all by looking merely at the effect of the wage cut upon *costs*. It is necessary also to consider the effect of the wage cut upon *demand*; whether directly or whether indirectly through the change in employment that might be initiated by the first impact of the wage cut.

[...]

The essence of the analysis whereby Keynes obtains the result that there will be no change in employment [from cutting wages] comes from a consideration of demand conditions. If there is initially an increase in employment – and, since employers very often think that a wage cut is a good thing, this impact effect is very likely – the demand conditions will be such as to bring about losses which tend to induce the entrepreneurs to curtail employment until the previous equilibrium level of employment is restored. Similarly, if the impact effect is to reduce employment, this will bring about profits which induce entrepreneurs to raise employment to the previous level.

The losses that accompany an increase in employment in the manufacture of consumption goods are due to the tendency of people, whose income is increased, to increase their expenditure by *less* than the increase in their incomes. This means that the increase in revenue from the sale of the larger output of consumption goods is less than the increase in the outlay on their production so that there emerges a net loss. This loss may be mitigated, but not entirely escaped, by the withholding of stocks with the intention of selling them at a more propitious moment, but this procedure, while diminishing losses, has the effect of building up superfluous stocks. The losses and the accumulation of stocks both tend to reduce employment, and these forces must persist and accumulate as long as employment remains above the equilibrium level. The whole of this phenomenon is reserved for the case where the initial effect of the wage cut is to diminish employment.

We must now consider how all this works if items other than wages enter into marginal costs. Where this is the case these other items are payments for the use of productive resources which, in the short period, are fixed in supply. This is because they accept whatever they can get, their reward falling relatively to wages until all those that are of any use whatever are employed.

If, then, wages are reduced, the attempt to substitute labour for these other productive resources will increase employment and may reduce the earnings of these resources. As long as these earnings have not fallen in the same

proportion as wages, costs and prices will not have fallen as much as wages but will have fallen more than the rewards of the other productive resources. Real wages will be lower while the real reward to the other productive factors will be greater. More men will be employed, and the total real income will be greater; since with more men employed on the given resources a greater real product is forthcoming. The aggregate real income of the other productive resources is increased, since the quantity employed is unchanged and the real rate of reward is increased. The aggregate real income of labour may be greater or less than in the beginning, according as the increase in employment is greater or less than the reduction in the real wage.

As long as this situation remains, prices have not fallen as much as wages have been reduced; and the workers have been able to reduce their real wages by reducing their money wages and thus to increase employment. Such a position cannot be expected to persist, but contains within itself forces which will still further reduce the rewards of the factors other than labour until costs and prices have fallen proportionately to wages, and real wages and employment are back again at the original level.

In the situation we have just described total real income is greater than in the initial position, because more men applied to the same equipment produce more goods. There is an increase in the total real costs of the consumption entrepreneurs [producers of consumption goods] exactly equal to this increase in real income (since the incomes of the factors of production are the costs of the entrepreneurs). Out of this extra income some will be saved, so that the total receipts of consumption entrepreneurs increase (in real terms) less than their outgoings. Entrepreneurs make losses which cause them to restrict their (output and) demand for productive resources. This goes on as long as more men are employed than in the initial equilibrium and as long as the real reward of the productive resources other than labour is greater than in the initial position. These two phenomena disappear at the same time, since the tendency to substitute labour for other productive resources, which led to the increase in employment in the first place, disappears just at the point where the real reward to the other productive factors has fallen in the same proportion as prices and wages. A new equilibrium is reached only when employment has gone back to its original level and the reward of the other resources has fallen to their old *real* level. This will only be when their prices have fallen in the same proportion as wages. As long as these have fallen only in a smaller proportion than wages, prices will be higher than before relatively to wages and lower than before relatively to the reward of the other productive resources, and the disequilibrium described will continue.

In a longer period it will be possible to increase or decrease the supply of productive resources other than labour by varying the application of current factors of production to their manufacture, so that the above argument, which rests on the fixity of supply of productive resources other than labour, would not apply. But there will be no inducement to vary their supply since their price, determined in the longer period by their cost of production, will have

varied in just the same proportion as wages. There is therefore no point in departing – except as a temporary mistake – from the initial level of employment.

This does not mean that a reduction of money wages may not have all sorts of indirect influences which ultimately react on the level of employment. There will be effects on the demand for money, on the rate of interest, on entrepreneurs' expectations of future prices or rather of the relation of these future prices to present costs, on the distribution of wealth and spending – all these and other influences will have an effect on the number of people that entrepreneurs consider it profitable to employ – but these work in divergent directions and some of them only after a considerable interval, so that nothing can be said as to the effect of the sum of these influences on employment as a result of a reduction in wages until a complete set of assumptions have been provided as to the form and strength of these influences. Before we have all this information we must either assume them to cancel out and say that there is no effect on employment, or else, if we wish to be more realistic, we must say that what happens to employment if money wages are reduced will depend upon other conditions, so that employment might go either up or down. Anything might happen. There is no simple rule such as the classical economists envisage relating the level of employment to the money wage.

If the level of employment is not affected in any simple way by the money wage, what is it that does determine the amount of employment? Before answering this question it is useful to contemplate some very simple equations.

The income of the whole society is earned by the members of the society in producing either consumption goods or other kinds of goods. We call these other goods investment goods. This gives us our first equation. The total income of society (Y) is made up of the income earned in making consumption goods (C) and the income earned in making investment goods (I). $Y = C + I$.

Now C , which stands for income earned in making consumption goods, must also stand for the amount spent on buying consumption goods, since these two are in fact the same thing. (Similarly I stands also for the amount of money spent on investment goods.) The aggregate amount of saving in any period (S) is defined as the excess of aggregate income in the period over the expenditure on consumption goods. This, the almost universal definition of Saving, gives us our second equation $S = Y - C$ (Definition).

From these two equations it follows that saving must always be equal to investment. $S = I$.

This appears rather peculiar to many people when they first meet it, since there is obviously no mechanism whereby any individual's decision to save causes somebody to invest an exactly equal amount. Mr Keynes has ineradicably impressed that upon the mind of everyone who has read his *Treatise on Money*. And of course Keynes was right in this. Yet there is no paradox.

It is perfectly possible for any individual to save more without investing more himself. The proposition applies only to *aggregate* saving and investment. Neither is it necessary that aggregate investment should increase whenever any individual decides to increase the amount that he saves. This would be so

if an increase in an individual's saving left unchanged the amount saved by all other individuals together, so that it always meant an increase in aggregate saving. But we cannot assume that, because the individual must decrease his expenditure on consumption goods to the extent that he increases his saving. This diminution in C (if others have not changed their expenditure on consumption goods) diminishes Y (by diminishing the income of those who sell consumption goods) and therefore leaves $(Y - C)$, which by definition is S , the same as before. Others have saved as much less as he has saved more, so that aggregate saving is unchanged and equal to the unchanged I . If there is no change in I there can be no change in S .

Individuals deciding how much to spend out of their incomes seem to be able to decide how much to save, and if we consider one individual in a large society, this has sense, because the effect on his own income of an individual's expenditure on consumption goods can be neglected. But if we take society altogether and neglect the effect of changes in expenditure on total incomes, we naturally get into trouble, for we are then making the contradictory assumptions (*a*) that when people save more they spend less on consumption goods and (*b*) that the people who sell consumption goods do not receive any less. And nobody expects to get sensible results by deduction from contradictory assumptions, not even those who are most scornful of the canons of "bourgeois" logic.

[...] We always get back to this really very obvious if not very informative bit of arithmetic. It only appears strange or suspicious because of the habit of looking at the saving from the point of view of the individual who has got his income and is wondering whether to save it or not. He is naturally unable to see the whole social process. Our suspicions should vanish when we realise that all that the proposition says is that the excess of total income over income earned in making consumption goods is equal to the income earned in other ways.

[...] It is only saying the same thing in other words to show that an attempt by people to save more than they invest will diminish consumption and incomes and employment, etc., but will never succeed in making saving greater than investment.

[...] Although there is no mechanism whereby decisions about saving bring about an equal value of investment, which is what makes the equation suspicious, because of the long-standing habit of expecting the influences to work *from saving to investment*, *there is* a mechanism whereby decisions to invest bring about an equal amount of saving, which is what makes the equation true. $I = S$.

From the expenditure on consumption at this level of income we can derive the number of men employed in making consumption goods – for there is a functional relation between this number of men and expenditure on their product. Similarly, from the expenditure on investment goods we can derive the number of people at work in making the investment goods. This gives us the total number of men employed. This number is determined by the amount

of investment and the propensity to save (or its complement: the propensity to consume, which is the relationship between income and consumption). The propensity to consume may also depend upon other things, such as the rate of interest. These can be brought in and they fit quite well into the theory, but it is a reasonable simplification to assume that small changes in the rate of interest will affect different people in opposite directions; and the net effect may here be neglected.

There remains to be considered what determines the rate of investment. It is in the analysis of this that some of the more subtle and more valuable innovations in the theory are made by Keynes. Investment consists in the application of productive resources to the manufacture of capital goods. Capital goods are goods which are valuable on account of services they are expected to yield in the future. The efficiency of a capital good, or the rate of return over cost, as Irving Fisher calls this, is the rate of yield of the capital good, i.e. it is that rate of discounting the expected future yields of the capital good which makes the sum of the discounted yields equal to the cost of making it. [...] The *marginal* efficiency of any particular type of capital good is the efficiency of the marginal item of that type of capital good, in the use where its installation would show the greatest possible efficiency. The marginal efficiency of capital in general is the highest of the marginal efficiencies of all capital goods that still remain to be made.

It should be noted that the marginal efficiency of any capital good is described in the same way (has the same dimensions) as the rate of interest, so that it can be measured against it. It is a percentage of so much per annum. But it must on no account be confused with the rate of interest. The rate of interest is the rate at which money has to be paid for the privilege of borrowing money; or, from the point of view of the lender, it is the rate at which one is remunerated in money for the service of lending money.

There is, however, a certain relationship between the rate of interest and the marginal efficiency of capital. For it will pay entrepreneurs to borrow money in order to increase the rate of construction of capital goods – which is the rate of investment – as long as the rate of interest is less than the marginal efficiency of capital. As the rate of investment increases the best opportunities for investment are used up, and the marginal efficiency of capital diminishes. This happens in two ways. As the amount of capital increases, the expected values of the services of new capital goods fall as these have to compete with a larger supply of existing capital goods. This will be a very slow process since the rate at which capital is increased – the output in a short period – is small relatively to the existing stock of capital goods. But the other way in which the marginal efficiency falls is operative in the short period. As the rate of investment increases, the marginal cost of making capital goods increases, and this immediately tends to reduce the marginal efficiency of capital to the rate of interest. For each rate of interest there is a corresponding rate of investment. This relationship is the schedule of the marginal efficiency of capital.

The schedule of the marginal efficiency of capital is sometimes called the demand curve for savings because the entrepreneurs, who undertake the

investment and have to obtain the funds to finance it, are conceived to obtain them from the savings of individuals which when summed constitute the “supply” of savings. This is important in so far as it is brought in to explain the amount of investment that takes place, and upon the amount of investment depends – as we have seen – the amount of employment which is the *quaesitum* of the whole book.

It is clear that the amount of investment undertaken by entrepreneurs in any given position, given the marginal efficiency schedule of capital, will be determined by the rate of interest. The crux of the matter lies then in the theory of the determination of the rate of interest.

According to the classical theory, the rate of interest is given by the supply and demand schedules for savings. The rate of interest is the price of savings and that amount of saving and investment comes about that is indicated by the intersection of these demand and supply schedules. If the supply of savings is greater than the rate of investment the rate of interest will fall so as to bring them into equilibrium and vice versa. Savings and investment are brought into equality with each other in an equilibrium by the movement of the rate of interest.

This line of reasoning is not merely wrong – it is meaningless. The equations [given above] [...] show that savings can never be different from investment whatever the rate of interest, so that it is nonsense to say that the rate of interest brings them to equality with each other. This can be shown in another way. The supply schedule of savings in this scheme is supposed to be independent of the demand curve for saving (which is the marginal efficiency schedule of capital). This means that, given the rate of interest, the amount of saving is independent of the amount of investment and also of the size of people’s incomes. In fact of course it is ridiculous to assume that this is so, for what happens is that if there is an increase in investment, incomes increase immediately so that saving is increased by exactly the amount that investment is increased. The supply curve does not keep still. Whatever the point one takes on the demand curve the supply curve moves to the right or to the left so that it intersects the demand curve at the point taken.

[...]

There remains unexplained what it is that determines the rate of interest. The explanation of this is given by Keynes, who derives it from the inadequate theories of the Mercantilists by an easy development of a line of thought that had been shut out of economic theory for over a century. This line of thought has only recently been coming back into respectable economics under very heavy disguise in the writings associated with such esoteric concepts as the “natural rate of interest” and “neutral money”.

The rate of interest is what people pay for borrowing money. It is what people who have money – cash – obtain for lending it to other people instead of holding it themselves. It is not payment for saving, for one can save without lending the money saved; and in that case one does not get any interest payments. On the other hand one can lend money out of what one previously held;

and in that case one gets interest payments without saving. The relevant demand is then the demand to *hold* money. The supply is simply the total amount of money that there exists. This demand schedule Keynes called *Liquidity Preference*, and it is the intersection between the liquidity preference schedule and the supply of money (which is a perpendicular line if the amount of money is fixed) that gives the rate of interest upon which the whole thing depends. The higher the rate of interest the greater the cost – in terms of interest forgone – of holding money and the smaller the amount of money people will want to hold. Conversely, if there is an increase in the amount of money the rate of interest will fall until people want to hold the larger amount of money. They are induced to want to hold more money by the fall in the rate of interest, for then, to some people, the convenience and feeling of security of holding cash can be satisfied to a greater extent because the cost is less.

Our conclusion is that the amount of employment can be governed by policy directed towards affecting the amount of investment. This may be done either by lowering the rate of interest or by direct investment by the authorities. There may be difficulties for institutional or psychological reasons in reducing the rate of interest to sufficiently low a level to bring about that rate of investment which, with the existing propensity to consume, is necessary in order to bring about full employment. It is because of such difficulties that Keynes thinks that public works are necessary, and may become more and more necessary as the wealth and capital equipment of the community increase. For this means that on the one hand people wish to save more out of the larger income corresponding to full employment while on the other hand the accumulation of capital lowers the marginal efficiency schedule of capital. Equilibrium with full employment is then possible only at lower interest rates than are practicable unless either (a) investment is increased by State production of capital goods whose efficiency is less than the rate of interest or which for any other reason would not be manufactured by private entrepreneurs, or (b) the propensity to save is diminished – consumption increased – by State expenditure on social services or by redistribution of income from the rich to the poor, or by any other means.

[...]

Keynes' conclusion that the amount of employment has to be governed by operating on the amount of consumption and investment, *via* the rate of interest or otherwise, may seem at first sight to be a very small mouse to emerge from the labour of mountains. Everybody has known that cheaper money is good for business, and so is any increase in net investment or expenditure. But except for occasional lapses from scientific purity to momentary commonsense, the pundits of economic science have been declaring that people should practice more thrift. There has been a weakening of this attitude recently – I am not clear to what extent this is due to the cyclical fluctuation in the attitude of economists and how much to the influence of Keynes' ideas and some parallel development by J.R. Hicks and the Swedish writers. But we must not forget that it is not so very long ago that we had Professor Robbins

and Mr Keynes on the wireless respectively advising the world to save more and to spend more. And there is still in Milan a World Institute for the Encouragement of Thrift. It will be a long time before the view that thrift “since it enriches the individual can hardly fail to benefit the community” is seen to be an important example of the common logical error of composition. What Keynes has done is to show that what the ordinary man has often felt in his bones can be justified by a keener analysis than has so far been applied to the problem. He has shown further that it is *only* by working indirectly on these same determinants that any other remedies can ever work. Thus, even in the case when a reduction of money wages increases employment it does so only in so far as it indirectly reduces the rate of interest. The direct effect is merely to reduce both prices and money incomes, leaving the *real* situation as before. At the lower price level people find that they need less money to carry on their business, so that if there is no change in the amount of money its supply is greater than the demand to hold it, and the attempt of money holders to lend the spare money to others, or to buy other assets for money, raises the value of the other assets and reduces the rate of interest. The reduction of the rate of interest does the trick by making a larger rate of investment profitable. Incomes then increase, in accordance with the propensity to consume, until a level of income and employment is reached which induces people to save at a rate equal to the greater rate of investment. From this it follows that any objections that may be raised against the dangers inherent in lowering the rate of interest in an attempt to increase employment apply just as much or as little to the policy of increasing employment by lowering wages, since that works only *via* lowering the interest rate. It is not denied that there are any dangers, but such as they are, they are inherent in *any* successful attempt to increase employment. To run away from these is to refuse to be cured because that will make it possible to become sick again.

To seek the alleviation of depression by reducing money wages, rather than by directly reducing the rate of interest or otherwise encouraging investment or consumption, is to abandon the high road for a devious, dark, difficult and unreliable path, for no better reason than that the dangers that await one at the common destination are more clearly seen when it is approached by the broad highway.

Alva Myrdal

In addition to its prescient economic policy in the early 1930s, Sweden is notable for the policy of family support it adopted. Alva Myrdal – who was later awarded the Nobel Peace Prize¹ – was closely associated with the development of a population policy in Sweden. In the article reproduced here, she explains the particular concerns in Sweden and the nature of the policy recommended and applied. At the time (as now in some industrialized countries), there was concern with the progressive decline and ageing of the population. To design an effective family policy in a democratic society was a challenge. Given the economic burden of raising children, a key objective was to transfer part of that burden from the family to the community. In discussing means of equalizing the cost of supporting children she addresses broader social policy issues, including arguments for benefits in kind vs in cash, housing subsidies, education, the employment of married women and rural–urban inequalities. It is interesting to note the explicit link made between encouraging larger families and ensuring that married women had opportunities for remunerative work, the argument underlying the practical measures adopted to harmonize women’s productive and reproductive roles.

¹ After heading the United Nations Department of Social Affairs for a number of years, then serving in the Swedish diplomatic corps, Alva Myrdal was elected to the Swedish Parliament in 1962. She represented Sweden on the United Nations Disarmament Commission from 1962 to 1973 and was Cabinet Minister responsible for disarmament and, subsequently, church affairs. Having played an important role in the international peace movement, she received the Albert Einstein Peace Prize in 1980, followed by the Nobel Peace Prize in 1982, which she received jointly with Alfonso García Robles.

A programme for family security in Sweden

Alva MYRDAL

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Widely different experiments in population policy have been tried in Europe since the war of 1914–1918. Those of the Soviet Union and the totalitarian countries have dominated the field of interest. Recently, however, Sweden has set about the task of formulating a democratic population policy. This is not due to any desire for ideological competition. It so happened that the population problem assumed calamitous proportions in this period, and the different forms of government have given their answers to it in typically divergent ways.

The mere fact that Sweden has managed to enunciate a democratic population policy side by side with those of the Communist and the Fascist States has been found worthy of note, however, especially in view of the fact that it was necessary to break away completely from the traditional opinions on the subject of population, which, until the winter of 1934, prevailed in Sweden as in many other countries. Since about the eighties [1880s], views on population in Sweden have been divided into two characteristic groups: the conservative and the reformist. The conservatives were traditionally interested in maintaining or rather increasing the size of the population, seeking to achieve this end primarily by curtailing the spread of birth control. More often than not, they were also adverse to honesty in sexual matters. The other, Neo-Malthusian, group was reformist as far as private family regulation through birth control was concerned, and negative as to total population trend. In fact, this group usually idealised the social and economic effects of population decrease.

The new population programme of Sweden may be described as a constructive synthesis of parts of both views. It wholeheartedly accepts Neo-Malthusianism by sanctioning rational birth control, and at the same time endorses the positive interest in population of the conservative group, though only in so far as the prevention of a cumulative decline is concerned. This decline is to be checked, not by keeping people in ignorance of birth control, and not by

letting the poorer classes carry the main burden of regeneration, but by educational and social measures aimed at stimulating voluntary parenthood. A new and realistic importance is thus added to the programme by the consideration of population measures chiefly from the point of view of the interests of the masses, and by the desire to improve the quality of the population through providing better social conditions for families with children.

The terms of reference and the work of the Population Commission followed these general lines. The Commission was appointed by the Government in May 1935 at the request of Parliament and included representatives of different political parties and experts in economics, statistics, medicine, and genetics. The Commission completed its work at the end of 1938, having published seventeen reports covering practically all the branches of social legislation which affect the family. [The author was closely associated with the work of the Population Commission of which she writes, as a member of one of its subcommittees and also as principal secretary to the Royal Commission on Women's Work, the proceedings of which necessarily involved collaboration with the Population Commission. The reader is referred to the original article for references to the particular reports of the Population Commission to which the author referred.][...]

The problem of declining population

The new problem faced is clearly one of declining population. So forcefully had the recent propaganda of the Neo-Malthusian group stressed the dangers of "overpopulation", and so commonly had statisticians and economists fallen into the habit of describing the demographic effects of the decline in fertility in the euphemistic terms of approaching "stabilisation", that it has taken some years of education to bring the general public to acknowledge the fact that no increase, and not even constancy, but a rapid decline in the stock of population is facing European countries to-day. The focal point of interest in the qualitative aspect of the population problem was also new, in that preponderant importance was attached not to biological deterioration but to the neglected possibilities of raising quality by improving environment.

The Swedish birth rate began to fall in the eighties and has shown a more conspicuous drop since 1910. The replacement limit was passed in 1925, when the net reproductivity fell below 1,000. [... The] figures indicate a loss of about a quarter of the population stock in each generation – a rate of change which is likely to produce tremendous effects on the whole economic and social structure.

[...]

The present anxiety is focused not on the size of the Swedish people but on the process of incessant decline. It has finally become apparent even to those with little technical knowledge of demographic questions that the population problem is not – as was believed throughout the Neo-Malthusian era – that of reduction to a stationary condition on a higher or lower level, but

that of a cumulative self-perpetuating decline, in which the population progressively liquidates itself.

As the present birth rate of Sweden falls about 40 per cent short of maintaining any size of population constant, it has been considered futile to regard any given stationary size as desirable or undesirable. If constancy of population could be achieved, there is reason to suppose that Sweden could adjust itself to various magnitudes of population. In a country with plenty of natural resources the quantity of population cannot in itself, within relevant limits, be perceived to have any important effects on the general welfare or the standard of living of the people. Therefore no calculations of optimum size have been attempted. The crucial factors of population are direction and rate of change rather than optimum size. [See table.] [...]

The economic, social and psychological effects of such an aging of society must be considerable.

Even apart from the changes in age structure, however, a decline in population has hampering effects on economic progress, employment, and general welfare; these effects are due to influences on the relative volume and direction of consumption, production, and particularly investment. It may once more be stressed that these features of an economy in contraction are not primarily related to quantity of population but to rate of change, not to “underpopulation” but to the dynamics of decline. The “optimum population” theory has no place for these dynamic effects, and is therefore, in an industrial society, a misleading statement of the economic aspects of the population problem.

The Swedish population policy had to have a quantitative goal determined by reference to these considerations of effects as a rational basis, and with due regard to the prevalent social values of the people. This desideratum has been formulated as the attainment, if possible, of the replacement level, and at least retardation of the rapid decline in population. No increase above reproductive equilibrium has been thought desirable or even possible.

Table: Age structure of the Swedish people

Age group	Actual percentages		Forecast percentages	
	1910	1935	1985 [hypothesis I]	1985 [hypothesis II]
0–20	41	31	15	24
20–35	22	26	16	19
35–50	16	20	20	21
50–65	12	14	25	18
65 and over	9 } 21	9 } 23	24 } 49	18 } 36

[In *Hypothesis I*, fertility among married and unmarried women combined is extrapolated from the previous trend as first continuing to fall, though at a decreasing rate, and then finally reaching stabilisation on a lower level; and in *Hypothesis II*, marital fertility is assumed to remain the same as in 1933, but extramarital fertility is assumed to decline at a uniform rate to 50 per cent in 1956, and nuptiality is stabilised from 1936 onward at 150 per cent of the earlier level. In all cases the mortality rate in different age groups is assumed to remain the same as the actual rate in 1933.]

Requirements of a constant population

When this abstract goal is translated into actual demands in the matter of child-bearing, its conflict with the private interests of individual parents and generally accepted family patterns immediately springs to the foreground. A dilemma between public and private interests is created and has to be faced; the democratic structure of Swedish society, its rationalistic bent, and its reliance on free discussion, would prevent any attempt to conceal this conflict.

The number of children born annually would have to increase from about 90,000 to 120,000 in order to maintain the population at a constant size in the long run. This in itself must seem a rather unconscionable demand on individual families, since many children even now suffer from the inadequacy of family income. It appears still more so in view of the admitted fact that even the present number must include many undesired children, who would not be born if birth control were democratically available.

[...]

Another factor pointing to a greater reduction of fertility than optimistic forecasts have taken into consideration is the continued existence of very large differences between regional and social groups. [...]

These circumstances taken together indicate how unreliable the source of future generations will be when families tend to be planned rationally.

It is theoretically possible to measure the number of children required for a constant population in terms of different family sizes and so to provide a norm with which the share of individual families in the reproduction of the people may be compared. When the required distribution of children among married couples is not taken merely as an indiscriminate average for all marriages, but allows for varying degrees of sterility in a certain number of them, this becomes one of the most interesting problems of constructive population analysis.

Such a study was made under the auspices of the Population Commission. The distribution of family size in the first phases of family regulation had given a well-known picture in which oversized and underprivileged families accounted for a disproportionately large share of total reproduction. Some enlightening statistics may be compiled from this transitional era. A percentage calculation of the actual distribution of families according to size in 1930, counting all cases where the wife was living and the marriage "completed" (the wife being between 45 and 50 years of age), shows the marks of this closed era of rapidly changing family patterns. More than 50 per cent of the families were childless or did not have more than two children, but almost 15 per cent had seven or more children. [...]

[...]

Size of family and standard of living

This ideal of obtaining more medium-sized families was, however, a challenge to a democracy where birth control had to be taken for granted and where

the rearing of children at undesirably low levels of hygiene and culture could not be endorsed.

Studies were directed towards the relation between size of family and standard of living. The most vital question was not the “general” standard of living in different occupational and income classes – an abstraction which has too frequently fossilised the discussions of recent years – but the standard of living as a function of both family type and income. More concretely stated the problem was this: how much is the cost of maintaining the standard increased, or rather the standard lowered, upon the arrival of each new child? This question not only corresponds to the economic motive for family limitation; it also brings to the forefront the fact that in the most numerous social classes a normal and desirable family size endangers the health and welfare of the children.

It may have been known earlier in a vague way, but it has rarely been so evident as in the new studies of the standard of living in Sweden – the data being computed to show budgetary changes following family changes – that in an industrial society children tend to become the greatest cause of poverty of individual families, instead of being an economic asset as they were in the old agricultural economy. The result is disastrous – either for the birth of children or for the welfare of children born. When general hygienic and cultural standards are being enhanced, the differential cost of children will also be increased and the economic motive for family limitation strengthened.

Here is revealed one of the most interesting and explosive paradoxes of modern systems of industrial economy. Unproductive ages are on the whole not included in the system of human maintenance based on capitalistic remuneration according to production. The unproductive period at the end of the life span has, in most of the industrial nations, begun to be covered by special economic devices. But children simply fall into the empty and widening gap between supporters’ income and growing needs as the family increases in size.

[...]

Basic principles of population policy

It thus became apparent that if children were to continue to be born, in a country on its way to democratic equalisation, some important modifications had to be made in the social system and the structure of social reforms. The aim of these changes must be to allot to children a greater share in the resources of the nation. Part of the economic burden of bringing up children had to be transferred from the responsibility of the individual family to that of the community.

The basic principles underlying the programme for a democratic population policy in Sweden may be summarised briefly [...]. These principles can be condensed into three statements containing cumulative postulates which are elsewhere generally presented as alternatives.

(1) Individual liberty and public interest must be reconciled. Voluntary parenthood should be ensured for all families by making birth-control infor-

mation universally available. Only children who are welcomed by their parents should be desired by the nation. But the resources of the community should be utilised to remodel social conditions so that more children can be welcomed.

(2) Harmony should be established between the qualitative and quantitative goals of population policy. The quantitative goal of a population constant in the long run should be pursued only by measures that simultaneously improve the health and welfare of children and thus enhance the quality of the next generation. Such considerations necessitate as a general rule the repudiation of cash premiums for parents in favour of goods and services in kind furnished directly to children; this principle, however, is subject to some modifications, as will be explained later. In case of conflict between quantitative and qualitative effects the latter should be given priority. Quantity should never be bought by sacrificing quality, but quality and welfare of children might have to be attained at the expense of numerical results.

(3) Educational influences and economic reforms should be co-ordinated. A more positive attitude towards family values and a greater capacity for handling family relationships must be achieved through educational propaganda, utilising both the public school system and voluntary adult education. On the other hand, social reforms must be effected involving a redistribution of income in favour of families with children. Propaganda without the support of economic reform would be futile and socially wrong if directed to the masses. And economic reform would not be politically feasible in a democracy without some change of values and attitudes through education, since citizens without children constitute a strong majority in the electorate, and the fate of the whole economic programme depends on the votes of those who have personally nothing to gain by it.

[...]

Educational measures

Education for family life and parenthood calls for attention in different aspects. It is partly general, directed towards everyone and consisting of an educational preparation which helps to determine attitudes, and partly individual, arranged to give instruction regarding family regulation as the need arises. The first stage will be effected through public education of both children and adults; the second mainly through personal consultation.

[In this section, the author specifies two useful educational measures. The first would involve broadening the school curriculum to include a knowledge of sexual hygiene, information about family limitation and instruction in contraceptive technique. This recommendation had strong support from the three large organizations of housewives, wage-earning women and women teachers. The second measure concerned personal consultation on birth control with doctors, nurses and midwives. Special clinics should be restricted to large towns, since elsewhere people were shy of attending them. It was "not proposed to limit the accessibility of [advice] to married persons".]

Changes in the laws on sexual matters

[In this section the author discusses recommendations of the Commission with respect to contraceptives, abortion and sterilization.]

Equalisation of income

The main principle of the Swedish Population Commission has been equal distribution of the cost of supporting children. It should not be possible for those who have no children to avoid contributing to the necessary investment in the future generation. This far-reaching demand – together with humane legislation on sexual matters and a more practical education for family life – constitutes the very foundation of the actual population programme. The Commission was not inclined, however, to favour equalisation by direct transfer of cash to large families, but preferred provision in kind for the consumption of children.

This support of children in kind rather than in cash is not copied from old forms of charity and individual relief. It follows instead the pattern of a co-operative economy in which large schemes for providing free goods and services for children are maintained by the community on the grounds of rational organisation, expediency, and social equity. Probably the best example of such schemes in existing public activities is offered by public school systems.

There are several reasons for adopting this principle. In the first place, when help is given in kind there are better guarantees that the benefits will actually go to the children and not be engulfed in the general family budget. Offering a larger apartment at a lower rent as the family grows is more apt to raise housing standards than paying the corresponding amount in cash to parents and relying on their willingness and ability to find the larger apartment in the open market. Thus the improvement of environment which is essential from the point of view of the quality of the population will be prompted more effectively.

In the second place, direct economic advantages are to be secured through large-scale public administration of certain types of consumption. Public housing schemes for families, with their special needs as to appliances, can be carried out at less cost than similar private housing. These schemes may further be timed to fit into public works plans, permitting the release of forces to counteract the business cycle at suitable moments. In the third place, support in kind may exert a considerable educational influence generally in favour of more rational consumption habits. Community housing schemes arouse a demand for good dwelling conditions in general. Only if adequate housing facilities can be offered to those unable to pay for them will the authorities be in a position to enforce rules fixing minimum standards of quality and size of apartments for those families who have means of their own. Finally, provision in the national budget for adequate cash pensions for children would involve

a sum so large as to be practically prohibitive. A very small individual pension (such as 15 kr. a month) would soon run to a quarter of the total budget.

For these reasons, the Population Commission adopted an unfavourable attitude towards a general scheme of State family allowances of the kind frequently recommended in theoretical discussion but applied only to a small degree in certain countries. This attitude, however, was not inflexible. When practical considerations make it expedient – as is often the case, especially in regard to incidental costs at childbirth – cash benefits may be permitted. An exception was also made in one other main respect – in regard to the indirect cash equalisation to be achieved through differential taxation.

In one of its earliest reports the Commission suggested a method of appreciable levelling through the system of exemptions from municipal and State taxes on incomes and wealth. The exemption for a single person should be lowered, the exemption for the wife and for the first two children raised in each case to the same level as the exemption for single persons, and the exemption for additional children doubled. It was also suggested that the age limit for exemption in respect of children should be raised from sixteen to eighteen years.

[...]

Maternity expenses

[The author outlines other benefits recommended by the Commission with respect to attendance at delivery, health centres for mothers and infants, maternity bonuses and assistance.]

The maternity assistance thus established has turned out to be a particularly interesting social institution, not only because it is without a counterpart in other capitalist countries, but also because it has revealed a drab, silent and seldom-acknowledged poverty in large sections of the population stretching far above the poor-relief stratum. In this group any foreseen expenditure may be enough to upset completely the strained economy of the family. The advent of children often has this effect. The tragic fact that children are frequently the chief cause of poverty was perhaps not fully realised before the inauguration of maternity assistance.

[The original article contains sections with the following headings: “Economic security of orphans etc.” (children’s pensions, alimony and allowances), “Housing schemes for families with children”, “Nutrition”, “Health supervision and reduced medical costs for children”, “Education”, and “Pre-school institutions and recreational facilities”.]

Employment of married women

In this general context it must be mentioned that the prevalent zeal in Sweden for reinforcing the family as an institution and providing greater welfare resources for children has not meant a restrictive attitude towards married

women's work outside the home, but has had decidedly the opposite effect. Unless women have open opportunities and consequently free choice in the matter of remunerative work after marriage, there will most certainly be fewer marriages and also fewer children. Several reports of the Population Commission as well as the report of the special Committee on Women's Work have not only stressed the necessity for adjusting attitudes and opinions to new social conditions and new family structures, but have also proposed practical measures to restore a greater harmony between the productive activity of women and their function as mothers.

Public opinion during the last four years has largely followed the same evolution to a more liberal understanding of the changing position of married women in the world of to-day.

Adaptation of the reforms to urban and rural conditions

With due realisation of the vast regional differences in conditions of family life, the entire programme of family security has been elaborated in somewhat different detail for rural and for urban conditions.

The Population Commission made repeated efforts to elucidate these inequalities and as far as possible to create a balance by devising different forms of assistance. Thus, in the matter of delivery care, account has been taken of the different conditions of rural and urban districts. The Commission tried to create opportunities for rural women to enjoy hospital care with its advantages in difficult deliveries and in obtaining anaesthetics. The Commission also rendered more feasible the plans for small delivery homes in rural districts, and encouraged the establishment of delivery rooms in midwives' homes and also of waiting homes for expectant mothers from distant places.

A similar line was followed in the proposals relating to nutrition, in which rural districts, where children have longer distances to go to school, were given a decided preference in the competition for State grants. In the matter of pre-school care, in which various institutions provide considerable relief for urban housewives, the Commission likewise sought to discover means whereby corresponding needs in rural districts could be met: local "summer kindergartens" for the country districts, day nurseries in connection with adult education centres and girls' schools, etc. Special attention was paid also to the need for enabling over-worked rural mothers to get away for a rest for some length of time by having a so-called "home help" to replace them for the duration of the holiday.

An analysis of the entire problem of urbanisation was attempted in a special report by the Population Commission. A definite distinction was drawn between the abandonment of agricultural occupations, which was considered an economic necessity, and the general movement from the country to the towns, which was regarded as undesirable.

Conclusion

In looking back over the diversified structure of these reforms both principles and practice have to be evaluated. Unfortunately they are not identical. The principles call for such a revolutionary change that practice must be admitted to have lagged behind. The main guiding principle was equalisation of consumption. In achieving that object a general levelling of incomes might be helpful but could not suffice, since inequalities between families of different sizes would still remain. Once this fact was acknowledged, nothing less than a new economic basis for family maintenance had to be sought. As a redistribution of cash was repudiated, the demand was for a "socialised" or rather "democratised" consumption by children of essential goods and services, administered by the community on a co-operative basis. Availability of all advantages to children of all social classes must be a vital part of this new policy of child support; the middle-class family should be relieved of the cost of children just as much as the working-class family. No entanglement of population policy with poor relief should be permitted. No social stigma should be attached to those who need assistance from the community in contributing to its continued existence. It must, however, be admitted that parliamentary alterations have practically always meant restrictions, some motivated by the necessity of introducing a programme gradually, but some probably because the population argument has not been forceful enough to break down the poor-relief limitations of social vision.

Since most of the practice is of very recent date, the time has not yet arrived to judge it, and no attempt will be made here to forecast its effectiveness. The results will be especially difficult to evaluate with reference to the objective of checking the rapid decline of the birth rate, since during a period of transition they must run in two opposite directions. In the long run these social reforms are intended to reduce the economic and provident motives for extreme family limitation. In the immediate future, however, new social and regional groups will be reached by the liberation of birth-control propaganda. This stage has to be passed in order to arrive at one where voluntary parenthood is taken for granted in all social groups; only then will it be possible to build up a rational system of family support for the whole country. During the next decade, as during the last few years, some social groups will in all probability be induced to have more children as a result of the reforms and of their planning and discussion; other groups will be affected, and rightly, in the opposite way. No simple observation of movements of fertility curves will ever permit interpretation of the total effect, both because the reforms will act in two opposite directions and, more generally, because comparison would have to be made with the purely imaginary development which would have occurred if the family security policy had not been inaugurated.

Without doubt, however, there will be a considerable decline in the number of undesired and undesirable children, and there will be positive gains in the quality of the next generation. The expenditure on the reforms is ultimately

justified on these grounds: that nothing is being wasted, that the structure of the reforms calls for costs largely to be transferred from one social segment to another, that the children's share in the wealth of the nation is increased, and that health and living conditions are being improved for those who need it most.

A groundwork has also been constructed for the far more radical population programme that will certainly one day have to be applied, when the deferred full effect of decreasing fertility on population and the economic and social consequences are unambiguously visible, and when panic might otherwise overrule both wisdom and personal liberty.

Michal Kalecki

Michal Kalecki was a Polish economist whose contributions to macroeconomics influenced Keynesian economists. After studying civil engineering in Warsaw and Gdansk, Kalecki began his career at the Research Institute of Business Cycles and Prices in Warsaw. He later worked at the Oxford Institute of Statistics, where he developed his pre-Keynesian ideas, influencing many other economists, and then at the ILO where he stayed for one year (1945) before joining the United Nations Department of Economic and Social Affairs in New York. He returned to Poland in 1955, where he was appointed chairman of the Committee for the Perspective Plan. Kalecki's contributions in the areas of aggregate demand, profit theory, business cycles and imperfect competition profoundly influenced the Cambridge Keynesians and the Post-Keynesian school of economic thought. A subject of much debate is whether Kalecki actually came up with Keynes' ideas before Keynes himself.¹

The article by Michal Kalecki reproduced here looks into what kind of economic policies are likely to lead to full employment. By way of background he provides a very simple exposition of national income accounts and the concept of net national product. He uses those tools to consider the appropriate fiscal policy stance for achieving full employment in the United Kingdom and the United States, in the postwar period. By 1945 Kalecki had already established a substantial reputation through his work on business cycles and the operation of capitalist and socialist economies, and went on to make a significant contribution to growth theory. In other writings from this period, he analysed the political as well as economic aspects of achieving and maintaining full employment.²

¹ See, for example, Michaël Assous: "Kalecki était-il Keynésien avant Keynes?", in *Revue Economique*, Vol. 57 (2006), No. 2, pp. 165-183.

² See, for example, "Political aspects of full employment", in *The Political Quarterly* (London), Vol. 14, Oct.–Dec., 1943, which sets out succinctly many of the main arguments of labour and capital, albeit from the perspective of a progressive.

The maintenance of full employment after the transition period: A comparison of the problem in the United States and United Kingdom

Michal KALECKI

Originally published in *International Labour Review*, Vol. 52 (1945), No. 5 (Nov.), pp. 449–464; this abridged version was published in *International Labour Review*, Vol. 135 (1996), No. 3–4, pp. 359–365.

A number of enquiries have recently been made into the conditions necessary for maintaining full employment in the United States and the United Kingdom after the transition period. They all point to the fact that the problem of post-transitional employment is likely to be much more formidable in the former country. With rates of taxation roughly speaking midway between pre-war and wartime levels, the loan-financed Government expenditure required to maintain full employment will be much higher in relation to the national income in the United States than in the United Kingdom. The purpose of this article is to examine the factors which account for this difference. It will be convenient to compare, first, the employment situation in the United States and the United Kingdom before the war, and then to pass to an analysis of the prospective position in the two countries after the transition period. But before the examination of the relevant data (or estimates), it will be necessary to discuss briefly a few points of a general character.

Expenditure, income and employment

In order to put the problem of employment into a proper perspective, we shall have first to draw up a “national balance sheet” of income and expenditure. The expenditure on goods and services in a given country may be subdivided into four components: (1) personal expenditure on consumption; (2) gross private expenditure on investment, i.e., expenditure on new fixed capital (plant, machinery, buildings, etc., inclusive of dwelling houses), whether for the replacement or for the extension of fixed capital, plus the increase in working capital and stocks; (3) public expenditure on goods and services; (4) expendi-

ture of foreigners, i.e., exports. Now the price of any goods or services bought for personal consumption, for private investment, or by public authorities is accounted for fully by: (1) wages, salaries, rent, interest and profits; (2) depreciation; (3) indirect taxes, if any; and (4) the cost of imported commodities used in the production of the goods considered. For instance, the price of cigarettes in Great Britain is accounted for fully by: (1) wages, salaries, rent, interest and profits earned from the manufacture and distribution of cigarettes; (2) depreciation of machinery and buildings; (3) tobacco duties;¹ (4) cost of imported raw tobacco.

It follows directly that the aggregate expenditure on goods and services in a given year is equal to the sum of the following items taken for the same year: (1) aggregate wages, salaries, rent, interest and profits, which is, in fact, the national income; (2) depreciation; (3) indirect taxes; (4) value of imports. We thus have:

Personal consumption	National income
Gross private investment	Depreciation
Public expenditure on goods and services	Indirect taxes
Exports	Imports
Aggregate expenditure	Aggregate expenditure

Let us now deduct from both sides depreciation and imports. The remaining part of aggregate expenditure may be called the “net national product”: *net*, because we deduct depreciation, namely, that part of investment which serves to make good wear and tear and obsolescence; national *product*, because we deduct that part of expenditure on goods and services which is covered by imports. If we denote by net investment the excess of gross investment over depreciation, we obtain:

Personal consumption	National income
Net private investment	Indirect taxes
Public expenditure on goods and services	
Exports minus imports	
Net national product	Net national product

The national income is the sum of wages, salaries, rent, interest and profits *before* direct taxation. On the other hand, a part of the expenditure of public authorities is devoted, not to goods and services, but to so-called transfers, that is, pensions, benefits and allowances, etc. It follows that the right-hand side of the balance sheet may be represented as income net of tax (inclusive of transfers) plus direct and indirect taxes minus transfers. Taking into consideration that the item “taxes minus transfers” represents the part of tax revenue available for public expenditure on goods and services, and that a part of income net of tax is consumed and the rest saved, we can write the final result as follows:

¹ Plus, strictly speaking, employers’ contributions to social insurance.

Personal consumption	Income net of tax	Personal consumption
Net private investment		
Exports minus imports		Taxes available for public expenditure on goods and services
Public expenditure on goods and services		
Net national product	Net national product	

It should be added by way of explanation that exports and imports are meant here to include not only goods but services as well. In particular, exports include interest and dividends on capital invested abroad, and imports include interest and dividends on foreign capital invested in the country considered. Moreover, savings cover both personal savings and undistributed company profits.

The table arrived at above, which permits us to look at the national product from two different angles, provides a good starting point for the discussion of the problem of employment. On both sides of our balance sheet we see personal consumption. If the public expenditure on goods and services is equal to the revenue available for its financing, that is to say, if the combined budget of all public authorities is balanced, savings are equal to net private investment plus export surplus. It is now clear that with a balanced budget, a given level of employment can be maintained only if savings at that level are in fact “offset” by investment plus export surplus.

If, at the existing level of employment, savings are “too high”, this results in the first instance in an increase in the stocks of consumption goods. This will be included in our balance sheet in private investment; the offset to “excess savings” will thus be provided automatically. However, the accumulation of stocks will continue over a short period; firms will soon start to cut employment, which will fall to the level where savings will be fully offset by investment (which no longer includes the accumulation of unsold goods) and export surplus.

More generally, an analysis of the type of investment forthcoming in a given period and of the export surplus (if there is an export deficit, this, of course, exerts a negative influence upon employment) can shed light on the question of what chance there is that the existing high level of employment will continue. If, for instance, a large part of investment consists of an increase in stocks of a speculative character, while there is not much chance of an increase in investment in fixed capital or in export surplus,² a fall in employment may be expected in the near future. The same is true if the level of investment in fixed capital is so high that the existing productive capacity increases quickly while the national product tends to be stationary; or when the export surplus is due to some special factor which is not likely to last long.

² It should be noted that a country can maintain an excess of exports of goods and services over its imports only if other countries are willing to deplete their stocks of gold and of the currency (or securities) of that country, or if that country, by foreign lending, provides the means for purchase of its products.

So far it has been assumed that the combined budget of public authorities is balanced. It will be seen at a glance from our balance sheet that, if the public expenditure on goods and services exceeds the revenue available to finance it, savings are equal to private investment plus export surplus plus the excess of public expenditure over revenue, i.e., plus the budget deficit. Thus the budget deficit is an offset against savings also. The gap between what persons and firms choose to save at a given level of employment, on the one hand, and the offsets of private investment and export surplus, on the other, can thus be filled by a public expenditure on goods and services which has no counterpart in revenue. In other words, a given level of employment can be maintained even though private investment plus export surplus falls short of savings, provided that the difference is made up by a budget deficit.

This brief theoretical discussion provides us with a framework for a comparison between the employment situation in the United States and in the United Kingdom.

Comparison of the pre-war situation

We choose for the comparison of the employment situation the last pre-war year in the United Kingdom, namely, 1938, and 1940 in the United States. The reason for the latter choice is that, although the United States was not at war until the end of 1941, the rearmament in that year was already on a considerable scale. Moreover, just like 1938 in the United Kingdom, 1940 in the United States was a year of moderately high employment as compared with the employment levels of the late 'thirties. However, the percentage of unemployment was greater in the United States in 1940 than it was in the United Kingdom in 1938. Indeed if people engaged on public emergency projects in the former country are counted as unemployed (as is done in the Bureau of Census statistics published since 1940), the percentage of unemployed in relation to the total available labour force in 1940 was about 14 per cent. In the United Kingdom the proportion of registered wholly unemployed³ to the number of workers insured against unemployment was in 1938 about 9 per cent; there is no doubt that the unemployment percentage for the whole of the available labour force was lower. It follows that the British unemployment percentage in 1938 was substantially lower than the American figure of 14 per cent for 1940. It should be remembered here that the normal working hours were 40 per week in the United States and 48 in the United Kingdom. The actual average working hours in manufacturing were somewhat shorter: 38.5 per week in the United States in 1940; and 46.5 in the United Kingdom in 1938.

We shall show that not only was employment in the United States in 1940 lower in relation to the available labour force than it was in the United Kingdom in 1938, but that in addition its basis was more precarious. To main-

³ The "temporarily stopped" are left out of consideration because a roughly corresponding category is excluded from the U.S. statistics of unemployment.

tain the level in the longer run would require a higher budget deficit in relation to national product than to maintain the 1938 employment level in the latter country. [...]

[Using the categories he established earlier, the author compares the net national product of the United States in 1940 and that of the United Kingdom in 1938.]

* * *

The main difference in the structure of the national product in the United States and the United Kingdom is seen to be the higher percentage of income saved in the former country at the same level of employment. This percentage was substantially higher in the United States in 1940 than in the United Kingdom in 1938, although the level of employment was lower in relation to the available labour force. If employment were as high as in the United Kingdom, the discrepancy in the percentage of income saved would be even greater, since this percentage increases with the level of employment. Roughly speaking, the problem of employment is more difficult in the United States than in the United Kingdom because the percentage of income saved at the same degree of employment of the available labour force is substantially higher; and because this percentage is not normally offset by a correspondingly higher ratio of private investment plus export surplus to incomes. This situation prevailed [...] in the pre-war years; [...] this discrepancy is likely to be even greater in [the post-transition] period.

Comparison of the post-transition situation

[The author calculates post-transition net national product for the two countries on the assumption of full employment of the anticipated labour force (an estimated 3 per cent unemployment) and pre-war working hours as a basis for judging the fiscal policy stance appropriate to full employment in each country.]

[... T]he divergence between the savings ratios results in a much higher budget deficit at full employment in the United States than in the United Kingdom. The difference between public expenditure on goods and services and the tax revenue available for such expenditure is 8.6 per cent of the aggregate income net of tax in the former country, and only 2.6 per cent in the latter. It should be added that the budget deficit in the United Kingdom is due almost entirely to the expected participation of the public authorities in residential building. In the source we use, where this type of investment is included under the heading of private investment (because it is undertaken on a more or less commercial basis), the budget of public authorities is approximately balanced.

* * *

We see thus that the solution of the problem of employment after the transition will require a much more unorthodox policy in public finance in the

United States than in the United Kingdom. The latter country will certainly experience serious difficulties in the sphere of foreign trade, because it will have to increase its volume of exports considerably over the pre-war level in order to obtain means for paying for the necessary imports (mainly because of the loss of foreign investments). However, the financial problems involved in securing a national expenditure adequate to maintain full employment are likely to be of a much smaller order than in the United States.

It is true that the budget deficit necessary for the maintenance of full employment in the United States may be diminished by a variety of factors. Working time may be reduced somewhat below 40 hours per week; the system of taxation may be shaped in the future in such a way that it will redistribute income from the higher to the lower income groups to a greater extent than is done in the system assumed above, and thus will tend to increase personal consumption beyond the anticipated level; finally, a vigorous policy of foreign lending may provide a higher export surplus. But it seems unlikely that all these factors would enable the United States to maintain full employment after the transition period without a substantial budget deficit.⁴

As long as the resulting rate of increase in the interest on public debt is not higher than the rate of increase in the national income, no rise in the “burden of the debt” would take place; and there is no reason why a development of this type should be in any way harmful to the economy. If the budget deficit is so high that the burden of the debt does increase, the problem is more complicated but by no means insoluble.⁵ [...]

It should finally be added that a substantial budget deficit need not necessarily be associated with a very high level of public expenditure on goods and services; for the Government can increase its expenditure on transfers, such as old-age pensions, family allowances, etc. In our tables this will be reflected in a reduction of the item “taxes available for public expenditure on goods and services” (because this item represents the total tax revenue minus transfers). If the transfers benefit mainly people with low incomes, any addition made to them will very largely be spent on consumption, and in this way the budget deficit will contribute to the increase in national expenditure without a rise in public expenditure on goods and services.

⁴ The “gap” cannot be filled by stimulation of private investment. For if investment is above the level at which productive capacity increases *pari passu* with the expansion of full-employment output that results from increasing population and higher productivity of labour, it creates over-capacity. This tends to depress investment in the longer run; and thus stimulation of private investment above a certain level will eventually prove a self-defeating measure.

⁵ See, for instance, M. Kalecki: “Three ways to full employment”, in *The economics of full employment. Six Studies in Applied Economics* prepared at the Oxford University Institute of Statistics (Oxford, Basil Blackwell, 1945), p. 45.

Sir W. Arthur Lewis

Sir W. Arthur Lewis was born on the island of St Lucia. He taught political economics at several universities and worked at the United Nations in the 1950s, before embarking on a career at Princeton. He was awarded the Nobel Prize for economics in 1979, jointly with T.W. Schultz, for their work on development economics. His most famous and influential contribution to economics is undoubtedly the 1954 paper on development with “unlimited supplies” of labour. He presents a stylized model in which the typical poor country is divided into a “traditional” sector and a “modern” sector. The former consists of peasant agriculture as well as self-employment of various sorts in urban areas, while the “modern” sector comprises commercial farming, plantations, mines and manufacturing. This model of a “dual economy” – analysed today in terms of the formal/informal dichotomy – persists, since the anticipated transition to an integrated labour market has not materialized. Lewis was pessimistic about the possibility of international trade serving as an engine of sustained growth for the developing countries. His and Jan Tinbergen’s views¹ differed on this, as we can see in the article reproduced here. The article reports on the meeting of economists convened in 1969 by the ILO, the aim of which was to advise the Organization on research priorities for the World Employment Programme. The economists discussed the possible macroeconomic causes of unemployment in less developed countries, including overpopulation, restrictions on exports, overvalued foreign exchange rates, low levels of productivity and an excessive propensity to import. While things have changed since then, some of these issues remain in the current economic debate on development, particularly exchange rates and the role of trade. As Lewis notes in his conclusion: “Much of the problem has to do with macroeconomic policies rather than with gimmicks here and there.”

¹ See the note on Jan Tinbergen, and his article, in this Special Supplement.

The causes of unemployment in less developed countries and some research topics

W. Arthur LEWIS

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I have been asked to try to draw together the various strands which have interwoven our discussion during this week, especially with a view to emphasising the kinds of research topics in which the ILO might interest itself.

It seems useful to divide our discussion of the causes of unemployment into two chapters: one chapter divides the economic system into various sectors and is concerned primarily with disequilibria between these sectors; the other chapter deals with an economy which has no intersectoral problems since, like the typical neo-classical economy, we assume that resources flow freely between sectors in accordance with the usual principle that factors have the same marginal productivities everywhere. This chapter is therefore concerned with the macro-economic causes of unemployment.

I shall deal with it first, partly because it is the most familiar and least controversial and partly because our discussion followed this pattern.

Macro-economic causes of unemployment

In the course of the week we have mentioned five possible macro-economic causes of unemployment in less developed countries (LDCs). I shall first list them and then say a word or two on each: first is overpopulation relatively to the physical resources of capital, land and water; second is restrictions on exports to developed countries; third is overvalued foreign exchange rates; fourth is low levels of productivity; and fifth is a too high propensity to import.

A word about each. First, overpopulation. This condition exists only in a handful of countries – India, Pakistan, Java, Egypt and some small islands. The majority of LDCs are not overpopulated. On the other hand, the handful includes nearly half the population of the LDCs, so the condition is highly significant. We spent a good deal of time discussing whether the degree of capital

intensity which maximised output in these countries could also leave some labour unemployed. This is obviously so if one postulates very low elasticities of substitution between labour and capital, as the mathematical models tend to do. But we agreed that this situation is also theoretically possible even with a wide range of choice between technologies, given a large population and a small amount of capital. To which countries this applies is a question of fact which would have to be determined separately in each case. However, since these countries are mainly agricultural, what matters to employment in the first instance is how much land and water they have rather than how much capital they have. The question whether the marginal product of labour on the land is zero in these countries has not been settled and is not relevant. That it is low is certain. Low marginal productivity is enough to produce unemployment if it is less than the marginal disutility of labour or less than the traditional subsistence wage.¹ Most students of this subject agree that there is considerable underemployment for at least ten months of the year in all the countries I have listed as overpopulated.

Professor Tinbergen introduced a second macro-economic cause: restrictions on exports from LDCs to the developed countries. His argument was that since LDCs have abundant labour relatively to capital such restrictions disadvantage labour relatively to capital. The argument is seductive when one remembers how at the end of the Middle Ages the conversion of English arable lands to sheep farming for the export of wool caused great unemployment and distress. Nevertheless, Heckscher-Ohlin theory² by itself is not sufficient to produce unemployment since, if price relations are appropriate, one will have full employment whatever the level of foreign trade may be. Professor Tinbergen must be presumed to have been saying that if a tendency towards unemployment already exists for the first reason then trade restrictions will make it worse.

The third macro-economic explanation – the overvaluation of foreign exchange rates – seems to me to be a sufficient explanation of most of the Latin American cases if one adds to it the inappropriate relative prices of labour, land and capital. World trade has for two decades been expanding at the unprecedented rate of about 7 per cent per annum, not in coffee or cocoa but in cereals, livestock products, minerals and manufactures. Very few Latin American countries permitted themselves to participate in this expansion because their exchange rates made their products too dear for foreign markets. Their growth rate of exports was therefore very low; lacking the stimulus of export markets, investment was low; and as part of the same vi-

¹ Put in simple terms, the self-employed may remain idle if what they could produce by working is worth too little to compensate them for their efforts; and they will not be taken on as wage earners if what they could produce is worth less than the wage an employer would be obliged to pay them. –Ed.

² The theory that countries should specialise at producing goods whose production requires large amounts of the factors of production that are plentiful in the countries concerned, and small amounts of those that are scarce. –Ed.

rious cycle incomes, and accordingly local markets, grew slowly, and therefore industrialisation for import substitution was rapidly exhausted. This narrowing of opportunities aggravated existing tendencies towards unemployment. Because world trade was so depressed during the 1930s, most LDCs entered the 1950s determined to neglect exports and to minimise their dependence on foreign trade. But one of the most important lessons we have learned during the last two decades is that overvalued foreign exchanges can be fatal to economic growth.

The fourth macro-economic explanation of unemployment, the low productivity of labour in LDCs, is irrelevant except in so far as it merely restates what has gone before. A neo-classical economy, which is what we are still talking about in this chapter, will find full employment at any level of productivity if its price relations are appropriate and especially its foreign exchange rate.

Fifth and last, the too high propensity to import is invoked by those who say that industrialisation creates less employment in an LDC than in a developed country because the machinery has to be imported or by those who object to the luxury imports of the rich. This again would be irrelevant in a neo-classical economy since employment foregone by importing machinery or luxuries would be compensated by employment in producing exports to pay for the imports. To validate the argument one must assume, like Chenery and the Latin Americans, that the propensity to export is fixed. Then it will follow on Keynesian lines that the amount of employment generated by investments or by exports will vary inversely with the propensity to import. But the argument that the propensity to export is fixed carries little conviction in the 1960s, except in countries which persist in inflating their domestic price level without correspondingly devaluing their foreign exchange rates.

In sum, the only macro-economic argument which explains the existence of unemployment is inappropriate price relations. Shortage-of-land-with-water in half a dozen overpopulated countries is one example of this, involving differences between earnings and marginal productivities. The maintenance of overvalued exchange rates is another and in practice probably the most common example. All the other macro-economic explanations require inappropriate internal or external price relations for their validity.

This subject presents the ILO not with an opportunity for research but with an awful warning. If it is now about to go around the world advising countries on how to reduce their unemployment, it may easily waste its time listing all sorts of possible sectoral disequilibria if it first fails to check the simple macro-economic possibility that the main cause of their unemployment is simply that the countries have priced themselves out of the world's markets.

So much for macro-economic explanations. They take us some distance, especially in the Indian subcontinent and in some parts of Latin America, but they are clearly not sufficient to explain rising unemployment in the much larger number of countries which are not overpopulated and whose exports have been growing by 5 per cent per annum or more.

Inter-sectoral disequilibria

For that we must turn to our second chapter which deals with inter-sectoral disequilibria. Professor Fei was at pains to remind us that sectoral disequilibria are at the heart of development theory, so most of what development economists have to say about unemployment comes into this chapter. Here we proceed not by looking at unemployment as a homogeneous whole but by breaking unemployment up into its various types associated with different sectors. This gives us five different sources of unemployment: (1) unemployment on the farms; (2) the excessive drift from the country to the towns; (3) the displacement of handicraft workers by machines; (4) the high capital intensity of modern industry; and (5) the services sector.

Take first unemployment on the farms. We had a good discussion of this subject. There are several possibilities for dealing with it. The first is to make more land cultivable by draining it, irrigating it, opening it up with roads, using machines extensively where labour is short relatively to land, or selectively in the opposite case where only the machine will beat the timing of the rains or the hardness of the soil. In the past two decades cultivating more land has been the principal source of increased agricultural output.

The second road is to use the land more productively; the package which makes up the Green Revolution – better seeds, more water, pesticides, fertilisers, better cultivation – is quite labour-intensive in each of the agricultural seasons. There are still areas where breaking the land into smaller units of cultivation would certainly increase employment and possibly also output, if helped with agricultural extension, though history does not always tell this tale. We did not agree on how much more labour agriculture can be expected to absorb, but we did agree that it must absorb as much as it can be persuaded to, since with populations growing at 2.5 to 3 per cent per annum there is no chance whatsoever of checking the growth of urban unemployment unless agriculture continues to take a large part of the annual increase of the population. Just as governments determined to neglect exports in the early 1950s and have now for the most part changed their minds, so also they had decided to neglect agriculture and are now beginning to mend their ways with better price policies, more widespread credit, extension services and infrastructure. But we have still a major battle to fight in the overpopulated countries, where the misery of rural underemployment is at its height, on the importance of large programmes of rural works designed partly to improve the rural infrastructure and partly to improve the lot of millions – scores of millions – who otherwise live near starvation. Such programmes are not popular with the urban types who dominate the governments of LDCs. They argue that they are unproductive or that they require too much administrative manpower or that they deflect resources from the more urgent task of creating productive capacity in the towns. This is essentially a political battle, but the ILO could help by sorting out the facts about rural works programmes in the countries which have adopted them and then giving us a manual comparing the problems, costs and

results of actual experience. I believe the population pressure in the already overpopulated countries will be so intense in the next decade that we shall be drawn willy-nilly to large-scale rural works programmes.

Our second source of sectoral unemployment is the excessive drift to the towns because the countryside is failing in its traditional function of holding the labour surplus until industry is ready to absorb it. The causes of this are well known and we covered them – a widening differential between town and country, whether in wages, social services or infrastructure; then the very fact that there is work to be had in the towns, especially casual labour, brings in more and more people, so the more jobs you offer the more unemployment there is; and, in Africa, add a sudden explosion of primary education in the villages, and so on. The phenomenon is not new. By the end of the nineteenth century 1 million people a year were emigrating from the European countryside across the Atlantic to America. Some drift is inevitable, but it can be reduced by several means: by improving infrastructure in the countryside; by building industries in small towns all over the countryside, offering work to the farmers in the off-season; by checking the rise of urban wages. These last two are well within the orbit of the ILO. We could do with some case studies of what is happening to urban wages and why; also with some surveys on why people leave the land and how they support themselves in the towns; and some studies on countries which have deliberately scattered industrial centres in the countryside. This drift is a menacing problem. In extreme cases governments have to keep people out of the towns by force, requiring residence permits. But this attitude may change. The spirit of Che Guevara hung over all our deliberations and we began to think that it may be better to have the unemployed in the towns, where we can control their rioting more easily than we can control guerilla warfare in the countryside. This change of attitude is a part of the generation gap.

The displacement of handicraft workers by machines was dear to the heart of Karl Marx since it founded the reserve army of the unemployed. In LDCs it is mainly an Asian phenomenon. Asian governments have fought it by protecting handicraft industries, by improving tools and techniques and by organising marketing and credit. It would be wonderful if the purveyors of intermediate technology could come up with simple machines which would enable the handicraft workers to undercut large-scale factory production. Even if they cannot, the handicraft workers have the economists on their side since the shadow price of their labour is zero.³ But the consumers have more votes than the economists, so unemployment will continue to grow in this sector unless we do get some technological marvels.

Our group of economists was almost unanimously against the high capital intensity of modern industry, mining and construction. We could not be

³ It is assumed that if they do not work in handicrafts they will produce nothing else instead. –Ed.

unanimous since Professor Galenson⁴ was sitting on the platform sternly reminding us that the future is more important than the present. This will be another generation gap. I have taught my children that since their income per head will rise by 2 per cent per year they are going to be twice as well off as I am. It follows that it is not I who should make sacrifices for their future but they who should make sacrifices for my present!

Here is a job for the ILO. We hear that the Russians, the Japanese and the Indians have adapted modern industrial machinery in various ways to use more labour than, say, in Germany or the United States, adapting not so much the industrial processes themselves but more the systems for moving things around. Could there be some meetings of engineers from each of these countries to discuss the adaptations actually made, bringing together different experts for textiles, steel, mining, construction and other industries? Publication of such discussions would be helpful in the engineering schools of many LDCs. Meanwhile, I do believe that shadow prices would justify putting very heavy import taxes on bulldozers, cranes, conveyor belts and other machines which simply move things around on sites.

Lastly, the services sector. This has swollen rapidly for good reasons and bad. The good reasons include the continuing monetisation of subsistence economies, the explosion of education and medical services and the great increase in the number of government administrators. The bad reasons include the numbers drifting into the towns, into petty retailing, domestic service and the like.

Karl Marx has been at work here too. The Industrial Revolution in nineteenth-century Europe brought with it a great increase in the number of clerks keeping records and of salesmen, but the typewriter began to come into use in the 1880s, then carbon paper, the cash register and now the photocopier and the computer. The vast numbers of women sitting in the market place are being driven out by more capital-intensive shops and now by supermarkets, so that clerical and selling jobs will not expand in LDCs as fast as they did in mid-nineteenth-century Europe. The demand for domestic labour is also being squeezed by vacuum cleaners, electric stoves, refrigerators, power lawn mowers and the like.

The ghost of Che Guevara does not frighten me, but I have respect for the spirit of Karl Marx which also hovers over us. He predicted that the deepening of capital would destroy more jobs than the widening would create. He was wrong for nineteenth-century Europe but he will not necessarily be wrong for twentieth-century Asia. Here, for example, are two crucial differences. At the end of the nineteenth century, German and American productivity in manufacturing was increasing by only about 2 per cent a head per year. Today typical rates of productivity increase in Europe and the LDCs are

⁴ The reference is to the article by Professors Galenson and Leibenstein: "Investment criteria, productivity and economic development", in *Quarterly Journal of Economics* (Cambridge, Massachusetts), Aug. 1955.

twice as high as this, thus demanding more investment for the same growth rate of employment. Or consider the difference in population growth rates, about 1.25 per cent a year for the Atlantic Community then, as against 2.5 per cent for the LDCs today.

I think, therefore, that we have to make superhuman efforts on the one hand to improve the countryside so that people are more willing to stay there and, on the other hand, to push up employment in the towns as fast as we can by having as high a rate of growth of industry as we can manage.

Socialist countries set themselves targets of industrial growth of around 15 per cent per annum, and some LDCs actually have achieved such rates, starting from low levels. But, of course, if we are to put more capital into the countryside and into industry simultaneously, this means higher rates of capital formation. The Atlantic Community got by in the nineteenth century with rates of investment of 10 to 12 per cent per annum net. The LDCs' problem being so much greater, they need rates of 15 to 20 per cent net, as against the current 15 to 18 per cent gross, if they are to maintain equilibrium between the demand for and supply of jobs.

* * *

We have covered a lot of ground this week. I would stress, especially, sensible foreign exchange policies, opening up new land, the political battle for rural works in a big way in Asia and the need for a significantly higher level of capital formation. But we have also talked about wages policies, education policies, upgrading of the tools of handicraft workers, import duties on bulldozers, and even perhaps, in desperation, residence permits to live in towns.

What is in it for the ILO? I do not think we have been able to suggest very much: a warning that much of the problem has to do with macro-economic policies rather than with gimmicks here and there; a comparative report on rural works programmes; some studies of the behaviour of urban wages in LDCs; some information on what is really happening to industrial productivity in some leading LDCs; studies in countries where industrial centres have been deliberately planted in the countryside; surveys of why the young are drifting into the towns and how they support themselves; a series of meetings between industrial engineers from, say, the Soviet Union, Japan, India, Germany and the United States resulting in a manual for engineering schools in LDCs; case studies of the effects of the Green Revolution on labour requirements. These are all field studies, since I feel that the ILO's comparative advantage lies rather in field studies than in making mathematical models on unrealistic assumptions; that is our kind of game.

Jan Tinbergen

At the end of 1969, Jan Tinbergen,¹ who received the Nobel Prize for economics that same year, participated in a meeting to advise the ILO on research priorities for its newly created World Employment Programme.² His presentation dealt with international trade policy and its effects on job creation. Restrictive policies – particularly with regard to agriculture and textiles – as well as the structure of import duties, which disadvantaged processed goods, went against trade based on comparative advantage, as formulated in the Heckscher-Ohlin theorem. In his article, he explains that classifying industries by their relative factor endowment could be used by policy-makers to optimize the international division of labour. While not denying that less developed countries were also guilty of erecting trade barriers, he concludes by stressing that “the biggest obstacle to the choice of the best industries for developing countries at the moment lies in the restrictive trade policies pursued by developed countries”. The strength of his arguments contributed to later progress in the removal of trade barriers and showed how employment would increase if international trade were more evenly balanced.

¹ After studying mathematics and physics at the University of Leiden, Jan Tinbergen started his career at the Central Bureau of Statistics in The Hague. He also taught economics at the University of Rotterdam and was director of the Dutch Economic Institute and chairman of the United Nations Committee on Development Planning. He was awarded the Nobel Prize for economics, jointly with Ragnar Frisch.

² Sir W. Arthur Lewis – who would also later be awarded the Nobel Prize for economics – summarized the points of view of the experts present at the meeting on research priorities. His summary is reproduced in this Special Supplement.

Trade policy and employment growth

Jan TINBERGEN

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There is an unknown but considerable degree of underutilisation of the labour force in developing countries. Apart from being bad for its own sake, this contributes to the very unequal income distribution apparent in these countries and leads to non-optimal use of their resources.

Several reasons can be given for this underutilisation of the labour force. One is the shortage of qualified persons needed to organise and supervise the work of the unqualified or less qualified. Another is the low level of technological knowledge that may help to raise employment once it has been obtained (for example, the use of the new wheat and rice varieties is expected to raise the use of manpower). A third reason may be said to be lack of capital: building activity might contribute considerably to employment, as well as to various other social objectives, but massive building programmes require capital not now available to the developing countries. A fourth reason for lack of employment is the restrictive trade policies not only of developed countries but also of developing countries among themselves.

It is to the fourth cause of the low rate of employment growth in developing countries that this paper will be mainly addressed.

Let me first recall the various types of restrictive trade policies applied by developed countries. First of all, there is the high degree of protection of agriculture in a number of these countries. I confess that from this point of view I am sorry to be a citizen of the Common Market, which has been among the worst sinners in this respect; for although I am definitely in favour of having the Common Market, I am as definitely against having it as protective as it is. In the report of the fourth and fifth sessions of the United Nations Committee for Development Planning,¹ it has been suggested that for most commodities it should be possible to eliminate impediments to imports from developing

¹ United Nations, Economic and Social Council: *Official records: Forty-seventh Session Committee for Development Planning: Report on the Fourth and Fifth Sessions (17–21 March 1969 and 7–16 May 1969)* (New York, 1969).

countries during the next ten years. This will mean an enormous internal upheaval in the Common Market and in several other developed countries as well: a figure of, say, 50 per cent of the world market price in the form of protection is not exceptional. But I think it would be reasonable, and that it is one of the most important contributions that developed countries could make and therefore should make.

Protection of agriculture is by no means the whole story. Various industries are also protected in the developed countries. Perhaps the best known case is that of the so-called long-term arrangement by GATT for textiles. This is only one example, but a very important one. Under this arrangement the door of the markets of developed countries is being opened for some types of textile products, but only very, very slowly. I think it should be opened at a much faster pace. To be sure, this will require structural changes in the developed countries. Like the agricultural problem, it is not an easy problem to solve; but I am convinced that it can be solved if the will to do so is there.

Finally there is the well-known anti-processing structure of import duties generally. It is a well-known fact that semi-finished products are protected by higher import duties than raw materials, which are very often free of import duty, and that finished products again are protected at a higher rate than semi-finished products. In both cases, these duties make it very difficult for developing countries to process the raw materials they produce. The processing of vegetable oil raw materials, cocoa, and timber are among the best-known examples. In all these cases, industries that it would be quite natural for the developing countries to have, and that would create considerable employment, are blocked for lack of opportunities to export their products.

Now I come to what I feel is the theoretical background to all this. A very long time ago, two Swedish economists formulated what is now generally known as the Ohlin-Heckscher principle of the optimal division of labour, or the optimal dispersion of industry among countries. Very briefly formulated, it states that countries should have those industries and other activities whose factor requirements correspond as closely as possible with the factor endowment of the countries. Or to put it in more everyday language, the capital intensity (whether in terms of physical or of human capital) of the industries chosen should correspond as closely as possible to the capital endowment, both physical and human, of the country concerned.

I had the pleasure recently to join a group of experts asked by the Economic Commission for Asia and the Far East (ECAFE) to check and comment on sector projections of the ECAFE region. We commented, too, on a number of calculations prepared by the ECAFE secretariat, as well as on the plans of most of the countries of the region, and our main conclusion² was that in many cases the countries of the region have been forced to choose industries that are too capital-intensive for the development of their countries in the coming

² See *Sectoral output and employment projections for the Second Development Decade*, Report of the Seventh Group of Experts on Programming Techniques (Bangkok, ECAFE, 1969).

decade or in the coming five years, simply because the expansion of the more labour-intensive industries that would be more suitable in view of their factor endowment is blocked in the way I indicated.

Here I should like to elaborate a little on a piece of work of a very provisional and crude character that has been done in the Netherlands Economic Institute, along the following lines. We felt that when most of the choice of industries in every country is made either by private initiative or, under the country's plans, by national individuals or national planners, these decisions may well in certain ways be inconsistent with each other. It stands to reason that, if there is no co-ordination of that sort of activity, inconsistencies may well result. We felt it would be of some use, therefore, if the suggestions made by planners could be checked against an optimal division of labour, showing what industries would be best established in what countries.

Now unfortunately the statistics needed to make a worthwhile exercise of this sort simply do not exist. So we regarded our paper as one, not for publication, but to be submitted to a number of colleagues – and especially to the United Nations Industrial Development Organisation (UNIDO), as well as a few other specialised agencies, perhaps including the ILO – for comment, for better elaboration, and so on. But I should like to explain what we did; for, though I have to acknowledge that the crudity of the material leads to almost ridiculous consequences in some cases, yet it is the first attempt of its kind and I feel that a few of the indications derived are of use.

What we did was to use the only statistics we could lay hands on: the Swedish production statistics covering a number of international industries, that is industries producing goods that can be traded on international markets. The number of industries covered by the Swedish statistics is about eighty-eight, which is considerable. Moreover, the statistics enabled us to estimate not only payments that can reasonably be supposed to be payments to capital but also payments to two types of labour – the more skilled and the less skilled. In this respect I think the Swedish statistics are unique, and they permitted us to obtain at least a very crude idea of the capital intensity of the various industries in accordance with two criteria: first in terms of physical capital used per less qualified worker, and second in terms of the human capital per less qualified worker. If it is assumed that the payments made to these factors represent their shares in production (a lot could be said about that), then it is possible to establish a certain ranking of industries from least capital-intensive, in both senses, to most capital-intensive. The countries of the world can be ranked in the same way, using mainly some very crude indications of the capital stock of these countries and of their stock of skills, concerning which the basic data are published regularly by the International Labour Office in its *Year Book of Labour Statistics*.

What we tried to do, then, was to establish some sort of a correspondence between these two rankings. In order to do so, we had also to know the size of industries and the size of countries. In fact, statistically speaking, what it all comes to is a sort of frequency distribution from the lowest capital inten-

sity to the highest of both countries and industries. As indicators of the size of countries we simply took the number of less qualified people available for international industries; as indicators of the size of industries we took a measure of the demand for their products. Again, demand pattern could only be based on Swedish demand, which may well of course raise serious doubts as to its representativeness, since Sweden is certainly not a country of average income. All this has to be improved, as we have indicated in our paper. Yet I feel that some of the conclusions may be of interest, if only as a starting point, and in order to stimulate constructive criticism leading to improvement.

For the ranking of countries and international industries we actually carried out three exercises; that is, in addition to ranking them separately according to the concepts of physical and human capital as already mentioned, we also ranked them according to the concept of total capital (the sum of physical and human capital). The ranking of countries according to the first two concepts, though they did not exactly coincide, showed a very high correlation and there was no need to rank countries according to each of these concepts separately. So as the criterion of ranking countries we took total capital per less qualified worker in all the international industries in the country in question, and arranged the countries in ten groups from lowest to highest. In the lowest there were some of the most important developing countries; the highest was the United States, the next highest were Western and Eastern Europe, and so on. For the ranking of international industries the three rankings according to the three criteria for measuring capital intensity, though also not very different, were retained in order to ascertain, *inter alia*, the different quantitative requirements of qualified manpower, physical capital and total capital for developing industries selected under each criterion in the developing countries. Under each criterion international industries were arranged into some ten groups or clusters in increasing order of capital intensity. It may be asked why only ten groups were chosen. This was because we wanted to introduce the element of diversification, but only up to a certain point. Though some diversification is necessary, we consider that diversification should not be exaggerated; if it is taken to the extreme the result is complete autarky and this, of course, can never be the highest wisdom in finding the best international division of labour.

The three exercises, then, took the industries according to, first, their physical capital intensity, then their human capital intensity, and finally a combination of the two. Using only the results common to the three exercises, we found that a number of industries – textiles, shoes, leather, glass, wooden furniture and a few metal industries – would typically be suitable for developing countries, ideally serving almost the whole world; which would mean, of course, an enormous increase in the demand for the products of these industries established in the developing countries.

I would like to add right away that we are aware of the fact that capital intensity, especially when measured in such a crude way, is not the only element for determining the optimal division of labour. Another element is that some-

times you may reap the advantages of large-scale production by establishing complexes of industrial production, preferably in co-operation between a number of neighbouring countries (unless, of course, the country is very large, when there is no need for such co-operation). These centres of industrial production offer considerable economies of scale, and it may well be that such a combination or industrial complex would show comparative advantages for developing countries too. But again, among the industries offering important economies of scale, it would be my suggestion that the relatively more labour-intensive ones should be the first to be tackled, whereas the relatively capital-intensive ones should be tackled later. Examples of the first could be the automobile industry and all the various component parts of it, and the machine-tool industries, which are relatively labour-intensive; on the other hand, steel and heavy chemicals, for example, should perhaps be tackled only later. So again in this group of industries, where the economies of scale are very considerable, there would be some logical order.

Turning to another point, it would be erroneous to think that labour-intensive industries should be rejected for development on the grounds that their profits are modest. What matters is not the profits, but the total income earned in them. Future development, being dependent on investments, can be enhanced most if present factors are used so as to maximise total income now; this admits of the maximum of consumption plus investment. It is only in a private enterprise economy that profits are the only source of investment. In a mixed economy, not to speak of a state-guided economy, there is another source of savings, namely government savings, which can just as well be used for investment purposes. What matters really is the total national income and not the profits, and the total national income has to be maximised even now if we want to have the highest possible rate of growth, in order to have the highest possible income ten years from now, or five years from now. Of course, this presupposes that the government is capable of raising the necessary taxes. But I think such investments can even be financed by indirect taxation, which all developing countries are capable of organising; besides, there are some types of direct taxation they are perfectly capable of organising, namely taxation on big companies and also, although this is not for the moment a very strong element, a progressive tax on land, that is one taxing large landowners much more than small landowners. If I may add a personal note, I have decided to undertake a piece of investigation on precisely this point: the contribution that a progressive land tax can make both to higher tax revenues and to better social conditions. But that is by the way.

My next point is so well known that I hardly need stress it. It is that neighbouring developing countries of smaller size would be wise to combine their markets, at least for new products that they have not so far produced or have started to produce only recently. In this way, they could also profit from certain economies of scale.

Finally, the main point I would like to make – which is also the main conclusion that we drew in the expert group in Bangkok, and to which I have

already referred – is that the biggest obstacle to the choice of the best industries for developing countries at the moment lies in the restrictive trade policies pursued by the developed countries. This is why in the proposals of the Committee for Development Planning we laid so much stress on this aspect of the contribution that developed countries would have to make. If they would abandon most of their protective policies within five years, a huge increase would be possible in employment in the more labour-intensive industries in which the developing countries already enjoy comparative advantages. And even though I admit that the bulk of employment will have to be created in agriculture and construction, I still believe that the contribution from manufacturing could be considerably larger than it has been so far.

Amartya Sen

Awarded the Nobel Prize for economics in 1998, Sen is a creative author who explores the boundaries between economics and philosophy. In 1975, he wrote a seminal study on employment for the ILO, entitled *Employment, technology and development: A study prepared for the ILO within the framework of the World Employment Programme*. This work served as the basis for his article “Employment, institutions and technology: Some policy issues”, which was published in the *International Labour Review* (Vol. 112, No. 1). He distinguishes three aspects of employment – income, production and recognition – and makes a lasting contribution to understanding the role of employment in today’s world.

In 1997, another article by Amartya Sen entitled “Inequality, unemployment and contemporary Europe”, which mostly dealt with the negative effects of unemployment, was published in the *Review* (Vol. 136, No. 2). Unemployment penalizes people well beyond the obvious financial aspect of income loss, a loss which transfer payments can offset. The unemployed are liable to suffer psychological harm, social exclusion and family breakdown, and loss of skills, motivation and political voice. These effects entail major social costs when unemployment is massive, as it is now in many European countries. Related but even less apparent costs include exacerbated racial and gender inequality, technological conservatism and the premature retirement of able-bodied adults. Thus, Sen argues, the penalties of unemployment are enormous and reducing unemployment would contribute to solving many of Europe’s ills.

After looking at the possible role played by the “self-help” culture in the United States in reducing unemployment, he concludes by stressing that encouraging people to help themselves is not enough in itself, and must go hand in hand with a policy of job creation.

Amartya Sen’s third *Review* article was published in Vol. 139 (2000), No. 2. The ILO had just launched the idea of decent work: a welcome move for someone who refuses to dissociate economics from ethics. In “Work and rights”, which is reproduced here, the author examines four conceptual features of “decent work” that are essential to its achievement in a context of globalization. First is an inclusive and universal approach, not just focusing on some categories of workers. The second feature is rights-based thinking, acknowledging certain basic rights that transcend legal recognition. The third consists in placing work within a broad economic, political and social context — one that includes democratic values. And fourth, the extension of thinking from international to the truly global.

Work and rights

Amartya SEN

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This is a crucial moment in the history of working people across the world. The first flush of globalization is nearing its completion, and we can begin to take a scrutinized and integrated view of the challenges it poses as well as the opportunities it offers. The process of economic globalization is seen as a terrorizing prospect by many precariously placed individuals and communities, and yet it can be made efficacious and rewarding if we take an adequately broad approach to the conditions that govern our lives and work. There is need for well-deliberated action in support of social and political as well as economic changes that can transform a dreaded anticipation into a constructive reality.

This is also a historic moment for the ILO as custodian of workers' rights within the United Nations system. Its new Director-General – the first from outside the industrialized world – has chosen to lead the organization in a concerted effort to achieve decent work for all women and men who seek it across the globe (see ILO, 1999). My own close association with the ILO goes back much more than a quarter of a century. In the seventies, I had the privilege of advising the ILO, and doing some work for it (see, e.g., Sen, 1975, 1981). But my first working association with the ILO was in 1963, when I was despatched to Cairo. Already in the 1970s I was trying to persuade the ILO to take a broad approach to the idea of working rights – though admittedly what I did then was rather crude and rough. I was trying to invoke ideas not only of rights but also of metarights. So I do particularly welcome this new initiative of the ILO to achieve decent work.

What, then, is the nature of this start, and where does all this fit into the contemporary intellectual discourse on economic arrangements, social values and political realities? I should like to identify four specific features of the approach which may be especially important to examine. I shall have the opportunity of scrutinizing only two of these issues in any detail, but I shall briefly comment on the other two distinctive features.

Responsibility for opinions expressed in signed articles rests solely with their authors, and publication does not constitute an endorsement by the ILO.

Objectives and goals

The first important feature in the new ILO vision is the articulation of its goal: the promotion of “opportunities for women and men to obtain decent and productive work, in conditions of freedom, equity, security and human dignity” (ILO, 1999, p. 3). The reach of this objective is indeed momentously large: it includes *all* workers, wherever and in whatever sector they work; not just workers in the organized sector, nor only wage workers, but also unregulated wage workers, the self-employed, and the homeworkers. The ILO aims to respond to the terrible fact that “the world is full of overworked and unemployed people” (ILO, 1999, pp. 3, 4).

This universality of coverage, pervasiveness of concern and comprehensive conception of goals is a well-chosen alternative to acting only in the interest of some groups of workers, such as those in the organized sector, or those already in employment, or those already covered by explicit rules and regulations. Of course universality implies facing many difficult questions which need not arise if the domain of concern is restricted to narrower groups, such as workers in the organized sector (leaving out the unorganized sector), or even all wage workers (leaving out homeworkers), or even all people actively in work (leaving out the unemployed).

The case for choosing such a broad focus rests on the importance of a comprehensive approach. There are different parts of the working population whose fortunes do not always move together, and in furthering the interests and demands of one group, it is easy to neglect the interests and demands of others. Indeed, it has often been alleged that labour organizations sometimes confine their advocacy to very narrow groups, such as unionized workers, and that narrowness of the outlook can feed the neglect of legitimate concerns of other groups and also of the costs imposed on them (unorganized labourers, or family-based workers, or the long-term unemployed, for example). Similarly (on the other side), by focusing specifically on the interests of workers in the informal sector, it is also possible to neglect the hard-earned gains of people in organized industry, through an attempt – often recommended (if only implicitly) – to level them down to the predicament of unorganized and unprotected workers.

Working people fall into distinct groups with their own specific concerns and plights, and it behoves the ILO to pay attention simultaneously to the diverse concerns that are involved. Given the massive levels of unemployment that exist in many countries of the world today – indeed even in the rich economies of western Europe – it is right that policy attention be focused on expanding jobs and work opportunities. And yet the conditions of work are important too. It is a question of placing the diverse concerns within a comprehensive assessment, so that the curing of unemployment is not treated as a reason for doing away with reasonable conditions of work of those already employed, nor is the protection of the already employed workers used as an excuse to keep the jobless in a state of social exclusion from the labour market

and employment. The need for trade-offs is often exaggerated and is typically based on very rudimentary reasoning. Further, even when trade-offs have to be faced, they can be more reasonably – and more justly – addressed by taking an inclusive approach, which balances competing concerns, than by simply giving full priority to just one group over another.

The aged and the unemployed

The need for a broad and inclusive approach can be well illustrated by referring to another issue – that of ageing and the dependency ratio – which is often juxtaposed, in an unexamined way, to the problem of unemployment and availability of work. There are two principles in some tension with each other that are frequently invoked simultaneously in dealing with these different issues in an intellectually autarchic way.

Addressing the growing proportion of the aged population, it is often lamented that since old people cannot work, they have to be supported by those who are young enough to work. This leads inescapably to a sharp increase in the so-called dependency ratio. As it happens, this fact itself demands more scrutiny. There is, in fact, considerable evidence that the increase in longevity that has resulted from medical achievements has also elongated the disability-free length of working lives over which a person can work (see, for example, Manton, Corder and Stallard, 1997). The possibility of elongating working lives is further reinforced by the nature of technical progress that makes less demand on physical strength.

This being the case, it is natural to suggest that one way of reducing the burden of dependency related to ageing is to raise the retirement age – or at least give people in good health the option to go on working. In resisting this proposal, it is frequently argued that if this were done, then the aged will replace the younger workers and there will be more unemployment among the young. But this argument is in real tension with the previous claim that the root of the problem lies in the fact that old people cannot work, and the young who can work have to support the old.

If health and working ability ultimately determine how much work can potentially be done (and certainly social and economic arrangements can be geared to make sure that to a great extent the potential is realized), then surely the trade-off with youthful unemployment is a real non sequitur. The absolute size of the working population does not, in itself, cause more unemployment; for example, it is not the case that countries with a larger working population typically have a larger proportion of unemployment (consider the United States compared to France or Italy or Spain or Belgium). There are many big issues to be faced in scrutinizing proposals for revising the retirement age, but linking unemployment to the absolute size of the working population does not enrich this discussion. Indeed, we see here a messy argument based on combining two mutually contrary gut reactions: (i) the gut reaction that the source of the problem related to an ageing population is that the old

cannot work and the young must support them; and (ii) the gut reaction that the young must lose jobs if the older people do work. The combination of these unscrutinized feelings is to produce a hopeless impasse which rides just on unexamined possibilities, based on a simple presumption of conflict that may or may not actually exist.

The practice of being driven by imagined conflicts and being led by partisan solutions is as counterproductive in dealing with issues of ageing and employment as it is in addressing the problem of working conditions on one hand and the need for employment on the other. Conflicts cannot be made to go away by simply ignoring them on behalf of one group or another. Nor need conflicts invariably arise merely because some elementary textbook reasoning suggests that they might conceivably exist, under certain hypothesized conditions. There is a need for facing empirical possibilities with open-mindedness. There is also a need for openly addressing ethical issues involving conflict, when it does arise, through balancing the interests of groups with contrary interests, rather than giving total priority to the interests of one group against another.

Child labour and its prevention

Similar questions arise in dealing with the difficult problem of child labour. It is often claimed that the abolition of child labour will harm the interests of the children themselves since they may end up starving because of a lack of family income and also because of increased neglect. It is certainly right that the fact of family poverty must be considered in dealing with this issue. But it is not at all clear why it must be presumed that the abolition of child labour will lead only to a reduction of family income and further neglect of children, without any other economic or social or educational adjustment. In fact, that would be a particularly unlikely scenario for “the worst forms of child labour” (slavery, bondage, prostitution, trafficking) which are the focus of the recently adopted Convention concerning the prohibition and immediate action for the elimination of the worst forms of child labour (Convention No. 182 (1999)).

The case for a broader and more inclusive economic analysis and ethical examination is very strong in all these cases. One must not fall prey to unexamined prejudices or premature pessimism.

Rights of the working people

The second conceptual feature that needs to be stressed is the idea of rights. Along with the formulation of overall objectives, the domain of practical reasoning extends beyond the aggregative objectives to the recognition of rights of workers.

What makes this rights-based formulation particularly significant is that the rights covered are not confined only to established labour legislation, nor only to the task – important as it is – of establishing new legal rights through

fresh legislation. Rather, the evaluative framework begins with acknowledging certain basic rights, whether or not they are legislated, as being a part of a decent society.¹ The practical implications that emanate from this acknowledgement can go beyond new legislation to other types of social, political and economic actions.

The framework of rights-based thinking extends to ethical claims that transcend legal recognition. This is strongly in line with what is becoming increasingly the United Nations' general approach to practical policy through rights-based reasoning. The framework of rights-based thinking is thus extended from the pure domain of legality to the broader arena of social ethics. These rights can thus be seen as being *prior* (rather than posterior) to legal recognition. Indeed, social acknowledgement of these rights can be taken to be an invitation to the State to catch up with social ethics. But the invitation is not merely to produce fresh legislation – important as it is – since the realization of rights can also be helped by other developments, such as creation of new institutions, better working of existing ones and, last but not the least, by a general societal commitment to work for appropriate functioning of social, political and economic arrangements to facilitate widely recognized rights.²

There are really two contrasts here: one between legal rights and socially accepted principles of justice, and another between rights-based reasoning and goal-based formulations of social ethics. In scrutinizing the approach, we have to ask how well rights-based reasoning integrates with goal-based programming. These two basic precepts have sometimes been seen, especially by legal theorists, as providing alternative ethical outlooks that are in some tension with each other (see, for example, Dworkin, 1977). Are we to be guided, in case of a conflict, by the primacy of our social goals, or by the priority of individual rights? Can the two perspectives be simultaneously invoked without running into an internal contradiction? I believe that the two approaches are not really in tension with each other, provided they are appropriately formulated. However, the underlying methodological question has to be addressed, and I shall briefly examine the reasons for thinking that there is no deep conflict here.³

Rights and goals

The question that has to be faced is this: why cannot the fulfilment of rights be among the goals to be pursued? The presumption that there must be a conflict here has indeed been asserted, but the question is why we should accept this claim. There will quite possibly be a real impasse here if we want to make the fulfilment of each right a matter of absolute adherence (with no room for give

¹ A key instrument that reflects this is the ILO Declaration on Fundamental Principles and Rights at Work. For the full text of that 1998 Declaration and for helpful discussion, see the special issue of the *International Labour Review* on “Labour Rights, Human Rights” (Vol. 137 (1998), No. 2, pp. 253–257 and pp. 223–227 respectively).

² This and related issues are discussed in Sen, 1999a.

³ I have discussed these issues in Sen, 1982a, 1985 and forthcoming.

and take and no possibility of acceptable trade-offs), as some libertarians do. But most rights-based reasoning in political debates, for example on human rights, need not – and indeed does not – take that form.

If the formulation is carefully done to allow trade-offs that have to be faced, then it is indeed possible to value the realization of rights as well as the fulfilment of other objectives and goals. The rights at work can be broadly integrated within the same overall framework which also demands opportunities for women and men to obtain decent and productive work, in conditions of freedom, equity, security and human dignity. To pay attention to any of these demands does not require us to ignore – or override – all other concerns. For example, the rights of those at work can be considered along with – and not instead of – the interests of the unemployed.

Rights and obligations

There is a different type of question that is sometimes raised, focusing on the relation between rights and duties. Some have taken the view that rights can be sensibly formulated only in combination with correlated duties. Those who insist on that binary linkage tend to be very critical, in general, of any discussion of rights (for example, invoking the rhetoric of “human rights”) without specification of responsible agents and their duties to bring about the fulfilment of these rights. Demands for human rights are then seen just as loose talk. And similar scepticism is aimed at such statements as “all those who work have rights at work”.

A basic concern that motivates some of this scepticism is: how can we be sure that rights are, in fact, realizable unless they are matched by corresponding duties? Indeed, some do not see any sense in a right unless it is balanced by what Immanuel Kant called a “perfect obligation” – a specific duty of a particular agent for the actual realization of that right (Kant, 1788).

This presumption can be the basis of rejection of rights-based thinking in many areas of practical reason. Indeed, aside from general scepticism that tends to come from many lawyers, there are also distinguished philosophers who have argued in favour of the binary linkage between rights and exact duties of specified individuals or agencies (see, for example, O’Neill, 1996).

We can, however, ask: why this insistence? Why demand the absolute necessity of a co-specified perfect obligation for a potential right to qualify as a real right? Certainly, a perfect obligation would help a great deal towards the realization of rights, but why cannot there be *unrealized* rights? We do not, in any obvious sense, contradict ourselves by saying: “These people had all these rights, but alas they were not realized, because they were not institutionally grounded.” Something else has to be invoked to jump from pessimism about the *fulfilment* of rights, all the way to the *denial* of the rights themselves.

This distinction may appear to be partly a matter of language, and it might be thought that the rejection can be based on how the term “rights” functions in common discourse. But in public debates and discussion the term

“rights” is used much more widely than would be permitted by the insistence on strict binary relations. Perhaps the perceived problem arises from an implicit attempt to see the use of rights in political or moral discourse through a close analogy with rights in a legal system, with its demand for specification of correlated duties. In contrast, in normative discussions rights are often championed as entitlements or powers or immunities which it would be good for people to have. Human rights are seen as rights shared by all – irrespective of citizenship – advantages that everyone *should* have. The claims are addressed generally (and as Kant might say, “imperfectly”) to anyone who can help, even though no particular person or agency may be charged to bring about single-handedly the fulfilment of the rights involved. Even if it is not feasible that everyone can have the fulfilment of their rights in this sense (if, for example, it is not yet possible to eliminate undernourishment altogether), credit can still be taken for the *extent* to which these alleged rights are fulfilled. The recognition of such claims as rights may not only be an ethically important statement, it can also help to focus attention on these matters, making their fulfilment that much more likely – or quicker.

This is indeed the form in which many major champions of rights-based thinking have tried to use the idea of rights, going back all the way to Tom Paine and Mary Wollstonecraft.⁴ The invoking of the idea of rights is neither in tension with a broadly goal-based ethical framework, nor ruled out by some presumed necessity of perfect obligations allegedly needed to make sense of the idea of rights. The broad approach can be defended not just in terms of good commonsense appeal, but also in terms of capturing the variety of values and concerns that tend to arise in public discussions and demands.

Social and political broadening

Another distinguishing feature of the approach is that it situates conditions of work and employment within a broad economic, political and social framework. It addresses, for example, not merely the requirements of labour legislation and practice, but also the need for an open society and the promotion of social dialogue. The lives of working people are, of course, directly affected by the rules and conventions that govern their employment and work, but they are also influenced, ultimately, by their freedoms as citizens with a voice who can influence policies and even institutional choices.

In fact, it can be shown that “protection against vulnerability and contingency” is, to a great extent, conditional on the working of democratic participation and the operation of political incentives. I have argued elsewhere that it is a remarkable fact in the history of famines that famines do not occur in democracies. Indeed, no substantial famine has ever occurred in a democratic

⁴ Tom Paine’s *Rights of man* and Mary Wollstonecraft’s *A vindication of the rights of woman* were both published in 1792.

country – no matter how poor.⁵ This is because famines are, in fact, extremely easy to prevent if the government tries to prevent them, and a government in a multi-party democracy with elections and a free media has strong political incentives to undertake famine prevention. This would indicate that political freedom in the form of democratic arrangements helps to safeguard economic freedom (especially from extreme starvation) and the freedom to survive (against famine mortality).

The security provided by democracy may not be sorely missed when a country is lucky enough to be facing no serious calamity, when everything is running along smoothly. But the danger of insecurity arising from changes in economic or other circumstances (or from uncorrected mistakes of policy) can lurk solidly behind what looks like a healthy state. This is an important connection to bear in mind in examining the political aspects of the recent “Asian economic crisis”.

The problems of some of the east and south-east Asian economies bring out, among other things, the penalty of undemocratic governance. This is so in two striking respects, involving the neglect of two crucial instrumental freedoms, viz. “protective security” (what we have been just discussing) and “transparency guarantee” (an issue that is closely linked with the provision of adequate incentives to economic and political agents). Both relate directly or indirectly to safeguarding decent work and to promoting decent lives.⁶

Taking the latter issue first, the development of the financial crisis in some of these economies was closely linked with the lack of transparency in business, in particular the lack of public participation in reviewing financial and business arrangements. The absence of an effective democratic forum has been consequential in this failing. The opportunity that would have been provided by democratic processes to challenge the hold of selected families or groups – in several of these countries – could have made a big difference.

The discipline of financial reform that the International Monetary Fund tried to impose on the economies in default was, to a great extent, necessitated by the lack of openness and disclosure, and the involvement of unscrupulous business linkages, that were characteristic in parts of these economies. The point here is not to comment on whether the IMF’s management of the crises was exactly right, or whether the insistence on immediate reforms could have been sensibly postponed until financial confidence had returned in these economies. No matter how these adjustments would have been best done, the contribution of the lack of transparency and freedom in predisposing these economies to economic crises cannot be easily doubted.

The pattern of risk and improper investments, especially by politically influential families, could have been placed under much greater scrutiny if democratic critics had demanded this in, say, Indonesia or South Korea. But of

⁵ I have discussed this in Sen, 1982b and 1984; and jointly with Jean Drèze in Drèze and Sen, 1989.

⁶ I have investigated these connections in Sen, 1999a.

course neither of these countries then had the democratic system that would have encouraged such demands to come from outside the government. The unchallenged power of the rulers was easily translated into an unquestioned acceptance of the lack of accountability and openness, often reinforced by strong family links between the government and the financial bosses. In the emergence of the economic crises, the undemocratic nature of the governments played an important part.

Second, once the financial crisis led to a general economic recession, the protective power of democracy – not unlike that which prevents famines in democratic countries – was badly missed. The newly dispossessed did not have the hearing they needed. A fall of total gross national product of, say, even 10 per cent may not look like much, if it follows the experience of past economic growth of 5 or 10 per cent every year for some decades. And yet that decline can ruin lives and create misery for millions if the burden of contraction is not shared together but allowed to be heaped on those – the unemployed or those newly made economically redundant – who can least bear it. The vulnerable in Indonesia may not have missed democracy acutely when things went up and up, but that very lacuna kept their voice muffled and ineffective as the unequally shared crisis developed. The protective role of democracy is strongly missed when it is most needed.

The comprehensive view of society that informs the approach adopted in the ILO vision of decent work (ILO, 1999) provides a more promising understanding of the needs of institutions and policies in pursuit of the rights and interests of working people. It is not adequate to concentrate only on labour legislation since people do not live and work in a compartmentalized environment. The linkages between economic, political and social actions can be critical to the realization of rights and to the pursuit of the broad objectives of decent work and adequate living for working people.

International versus global

I turn now to the fourth and final distinctive feature of the approach under discussion. While an organization such as the ILO has to go beyond national policies (without overlooking the instrumental importance of actions by governments and societies within nations), there is a critical distinction between an “international” approach and a “global” one. An *international* approach is inescapably parasitic on the relation between nations, since it works through the intermediary of distinct countries and nations. In contrast, a truly *global* approach need not see human beings only as (or even primarily as) citizens of particular countries, nor accept that the interactions between citizens of different countries must be inevitably intermediated through the relations between distinct nations. Many global institutions, including those central to our working lives, have to go well beyond the limits of “international” relations.⁷

⁷ I have discussed the distinctions involved in Sen, 1999b.

The beginnings of a truly global approach can be readily detected in the analysis underlying the new directions of the ILO. The increasingly globalized world economy calls for a similarly globalized approach to basic ethics and political and social procedures. The market economy itself is not merely an international system; its global connections extend well beyond the relation between nations. Capitalist ethics, with its strong as well as weak points, is a quintessentially global culture, not just an international construct. In dealing with conditions of working lives as well as the interests and rights of workers in general, there is a similar necessity to go beyond the narrow limits of international relations.

A global approach is, of course, a part of the heritage of labour movements in world history. This rich heritage – often neglected in official discussions – can indeed be fruitfully invoked in rising to the challenges of decent work in the contemporary world. A universalist understanding of work and working relations can be linked to a tradition of solidarity and commitment. The need for invoking such a global approach has never been stronger than it is now. The economically globalizing world, with all its opportunities as well as problems, calls for a similarly globalized understanding of the priority of decent work and of its manifold demands on economic, political and social arrangements. To recognize this pervasive need is itself a hopeful beginning.

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Joseph Stiglitz

In 2001, Joseph Stiglitz was awarded the Nobel Prize for economics. In 2002, he published an article in the *Review* (Vol. 141, No. 1–2) entitled “Employment, social justice and societal well-being” in which he proposes that the purpose of economic activity is to improve the well-being of individuals, and that employment is essential to this well-being. In this regard, his description of the negative effects of unemployment echoes that given in the abovementioned article by Amartya Sen on unemployment in Europe. While such assertions may seem obvious, economic policy often runs counter to the interests of workers. In addition to generalized market imperfections, the under-representation of workers and the infatuation with neoclassical policies purporting to separate efficiency issues from equity, Stiglitz blames the fact that neoclassical economics treats labour like a commodity. It is up to governments – and more generally to the international community – to ensure that development does not become merely a matter of capital accumulation. Thus, 80 years later, he denounced disregard for the first of the ILO Constitution’s General Principles: labour is not a commodity.

And then came the crisis in 2008. In 2009, Stiglitz published another article in the *Review* (Vol. 148, No. 1–2) entitled “The global crisis, social protection and jobs”. This article, which is reproduced here, notes that the policy responses to the global financial meltdown and the collapse of aggregate demand had largely been driven by domestic interests. Resurgent protectionism, bank bail outs and national stimulus packages were distorting competition and incentives, to the detriment of developing countries, much-needed spending on social protection and, ultimately, rapid global economic recovery. Warning against underestimation of the job-destruction potential of the current crisis, Stiglitz argues for a truly global stimulus package, together with a rethink of economic paradigms and regulatory policies, financial assistance to developing countries, a less constraining IMF, and stronger social protection as an automatic stabilizer of economies.

The global crisis, social protection and jobs

Joseph STIGLITZ

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The most engrossing topic of the day is obviously the question of the global economic crisis. This article begins by addressing some of the broader issues, and then turns to particular aspects relating to decent work and social protection.

A global crisis “Made in the USA”

The current crisis is touching every country in the world, including the developing countries. For a while there was a myth that there would be decoupling – that the crisis, which began in the United States, would leave Europe and the developing countries untouched. It is very clear that this is not the case. Globalization has meant that the world economy has become integrated, that there cannot be a major downturn in the world’s richest country without implications for every other country.

Moreover, the way globalization has been managed allowed the United States to export its toxic mortgages all over the world. Had the rest of the world not bought as many of them as it did, the downturn in the United States would have been much worse. This crisis has a very clear “Made in the USA” label on it. Not only did the United States export its toxic mortgages, but it also exported the deregulatory philosophy that allowed others to buy these toxic mortgages and ensured that regulators abroad did not stop it.

The economic downturn is affecting even those developing countries which had succeeded in managing their economies well, those that had sound monetary policies and regulatory frameworks. In fact, as we looked at the monetary and regulatory policies of various countries, one of the observations made by the Commission of Experts of the President of the United Nations

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General Assembly on Reforms of the International Monetary and Financial System, which I am chairing, was that some of the developing countries really did a much better job than the United States. The United States should go and study what good central banks do, in India and elsewhere, because they actually did avoid the excesses that marred American financial markets. When American banks wanted to sell complex, risky derivatives, one of the central bankers in South-East Asia said, “Can you explain that?” They said, “No, we can’t.” She responded, “Well, if you can’t explain it, you can’t sell it.” Thus, they were protected against the ravages of the derivatives which have had such a negative effect on the United States and Western Europe.

There are multiple channels through which this crisis is affecting all the countries of the world. The most direct channel through which it began was, of course, financial markets. Financial flows, which were so strong in good years, are now reversing, meaning that access to finance is becoming a problem in many developing countries. A dramatic fall in the flows to developing countries is projected; in some cases, there may actually be reverse capital flows. Another channel is the unprecedented fall in exports. The declines are of a magnitude that no one ever expected to see. Furthermore, there are impacts through remittances and labour flows. Inevitably, when employment goes down, immigrant labourers are among those first hurt. In the United States, the banks that are getting bail-outs were told that they could not hire immigrant workers, so there have been restrictions on hiring workers from abroad, no matter how qualified they are. Job offers have had to be rescinded, and immigration is being affected.

Resurgent protectionism and other distortions of trade and investment

In November 2001, during the last global economic downturn, Mr Juan Somavia, the Director-General of the ILO, made a statement in which he decisively rejected protectionism. This time again, we have made that statement, but it has not been followed through. Protectionist measures are being taken all over the world. It was a good thing that the members of the G-20, at their meeting in November 2008, committed themselves not to engage in protectionism, but it is a sad thing that they did not honour their promise. The protectionism that has occurred has been both direct and indirect, intentional and unintentional, but it has been pervasive. For example, the United States’ stimulus package included a “Buy American” provision. Clearly, this is a violation of the spirit of “no protectionism”. The Government then said this provision would be suspended to the extent that it violates international World Trade Organization (WTO) agreements. That sounded good, but the WTO agreements on government procurement are in fact between the United States and other advanced industrial countries. The message behind that language was in effect: “We will continue to buy goods from the other advanced industrial countries, from the

rich countries, but we will discriminate against goods from poor countries.” This is even more invidious than an across-the-board protectionist policy.

The spirit of international trade agreements recognizes that tariffs are a trade distortion, but so are subsidies. That is why there are general restrictions on subsidies except in agriculture – and we know that agricultural subsidies help to create an unlevel playing field and distort the patterns of trade. During the current crisis, however, the advanced industrial countries have been providing massive subsidies to their enterprises, including their financial enterprises. Thus, even if there may once have been a level playing field, no one can claim that this is so today. How can a bank, a financial institution, or an automobile company from a developing country compete with an automobile company or financial institution from the United States that received tens of billions of dollars of assistance?

It is not only the financial institutions that have received aid. The fact is that the United States and Western Europe have signalled to big companies that if they have problems, they will be bailed out. Or at least, they may be bailed out. This has changed the propensity of these companies to undertake risk, because if they undertake big risks and lose, taxpayers pick the losses up. If they win, they get the profits. The level playing field has thus been destroyed for years to come, and we should recognize that the old trade and investment regime has been – intentionally or unintentionally – altered in a fundamental way.

Take the issue of guarantees provided to banks. Even if the developing countries reciprocated and provided guarantees to their banks, symmetric policies can have asymmetric effects. A guarantee by developing countries to their banks does not have the same weight as a guarantee from the United States. This is part of the reason for the anomaly of reverse capital flows. Money is going to the United States, which is the source of the original problem. The United States caused the global financial crisis by bad regulation and bad financial practices, but money is going into these bad financial institutions because the United States Government has provided a guarantee.

A global crisis calls for global remedies

Clearly, the current crisis has really altered the nature of global competition in profound ways, and we will need to rethink all the elements of the rules of the game in order to move forward. It is a truly global crisis, and within a globally integrated economy, a crisis of this kind can only be addressed globally.

We need a global stimulus package for the world economy, but the locus of decision-making remains at the national level. Thus, there is a disjunction between what is needed, which is global action, and the locus of decision-making, which is national. This is important because each country weighs its benefits and its costs, including the cost of things like the increase in the national deficit, as it looks at a stimulus package. The benefits each country looks at are the benefits only to its own economy, not the global economy. The result

is that there will be insufficient global stimulus unless it is provided in a globally coordinated way.

To put it another way, in terms of macroeconomics, we usually talk about “multipliers”: how much extra GDP is generated, or how many jobs are generated, by each dollar of government spending or stimulus? However, there is a very big difference between the national multiplier and the global multiplier, especially in small, open economies. Economists call this difference “leakage”, whereby some of the money spent does not stay in the national economy. If all the money stayed in the economy, it would recirculate and keep boosting the economy. In an open economy, some of the money that is spent goes to other countries but stays within the global economy. We are not part of a galaxy, and we still trade only within the world, so the world is a closed economy. There are no leakages within the world, and the global multipliers are very large. As the global economy has become more integrated, the national multipliers have become relatively small, and the net result is that there will be an incentive not to have a large enough stimulus.

Furthermore, as each government thinks about how to design a stimulus package, the question it is asking is: “How can my country get the most benefit?” – not how the world can get the most benefit. It is focusing on stimulus spending that does not leak out but instead stays within the country. However, because governments are thinking nationally, the global impact is reduced, and the benefit from the stimulus is smaller than it otherwise would be. This is obviously of great concern because the current crisis is likely to be the deepest and longest economic downturn since the Great Depression.

Social protection, automatic stabilizers and jobs

The particular problem in the United States is that the stimulus is not only too little but also too late, and it has not been well designed. In looking at the size of the stimulus, one has to look at what else is going on in the economy. Are there automatic stabilizers or automatic destabilizers? When the economy gets weaker, spending on social protection and unemployment schemes should automatically go up, helping to stabilize the economy. However, at least in the United States and some other countries, one of the sad facts of the so-called reforms in recent decades is that we have been weakening these important automatic stabilizers. The extent of progressivity in tax systems has been lowered, and we have moved from defined benefit systems to defined contribution retirement systems, again weakening the automatic stabilizers of the economy and in some cases converting them into automatic destabilizers.

If one compares the situation when the United States had good social protection, with defined benefit pension programmes, and the situation that country has been moving into, with weak social protection, with defined contribution pension programmes: what has happened to most Americans? They have seen their retirement accounts devastated at the same time as the value of their house has fallen dramatically by 20–30 per cent, in some cases 50 per

cent. The money that people put away to pay for the education of their children or for their own retirement has been wiped out. The country used to have a system that would protect them against these kinds of risks, but mistakenly it got rid of it.

As Americans see their savings and retirement accounts eroded, they will realize that they have to save more. In many ways, in the long run, this is a good thing for the American economy: the household savings rate had gone down to zero, and that was not sustainable. In the short run, however, it is a real problem. Already, there are indications that the savings rate in the United States may have gone from zero all the way up to 5 per cent, and it is still increasing. This is a massive change in aggregate demand: if people are saving more, they are spending less. It is this reduction in spending that is weakening the global economy, leading to a lack of aggregate demand.

The weakening of the United States' automatic stabilizers is compounded by the further problem that the states have automatic *destabilizers*. They have balanced budget frameworks, which means that when revenues go down, they either have to cut back expenditures or raise taxes. The magnitude of these destabilizers is enormous. A few months ago, before the downturn got much worse, it was estimated that the shortfall in state taxes would be around US\$150 billion a year. Now it is probably much larger than that, perhaps US\$200 billion a year. This means that over a two-year period, the negative stimulus from the reduction in state revenues offsets 40 or 50 per cent of the total federal stimulus. From this perspective, one realizes how small the United States stimulus package really is – and that it clearly is not up to the task lying ahead.

To put it another way, in terms of jobs, the stimulus package was supposed to create or save about 3.6 million jobs. However, the United States has already lost upwards of 2.5 million jobs, and it is still losing 600,000 per month. This rate is likely to continue. Meanwhile, there are almost 2 million new entrants into the labour force every year. Thus, at this juncture, there is already a job shortfall of 5 million, and there will be a shortfall of another 2–3 million jobs over the next two years. The creation or saving of 3.6 million jobs is inadequate relative to the need. By 2010, there will be a very large job deficit in the United States. And I think these problems are being replicated, in some cases even more dramatically, in other countries around the world.

The crisis and the developing world

That brings me to looking at this crisis and the stimulus from the perspective of the developing countries. There is agreement that we need to have a global stimulus, but countries in the developing world do not have the resources to finance a stimulus package. The United States can spend US\$700–800 billion on a stimulus package, but most developing countries do not have the resources to do so. Unless they receive substantial assistance, these countries will not be able to engage in counter-cyclical policies, and there will thus not be a quick, robust recovery in a large part of the world that is being most affected by the

crisis. These countries are innocent victims of bad regulatory policies in the United States, but they will not be able to engage in the counter-cyclical policies to save themselves unless something is done to help them. However, this is more than a question of responsibility or even humanitarianism; it is a question of self-interest, because there cannot be a robust recovery for the global economy if there is a significant part of the world that remains weak. It is imperative that assistance be given.

The Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System is going to recommend that at least 1 per cent of advanced industrial countries' stimulus packages be allocated to developing countries. We should realize how small the numbers are: 1 per cent of a US\$700 billion package is US\$7 billion divided among the developing countries. It is not going to be enough, but it is better than nothing. The real point is that we have to explore a whole variety of innovative ways of bringing finance to the developing countries, and in the Commission's extended report, we will develop several ideas on how this might be done.

However, there is another problem, in addition to the lack of resources: the lack of policy space. If we go back to 1997–98 and the last financial crisis in East Asia, the IMF came to the help of the countries affected, but the assistance it provided came with conditions which made the downturns worse. The downturns became recessions, and recessions became depressions.

Some people might say that we will not have another Great Depression because today we know what to do and are so much smarter than we were in the 1930s. We should remember that, a decade ago, we were almost as smart as we are today, but the IMF and the United States Treasury went into Indonesia, gave advice about what to do with its financial system, and managed to destroy it. They imposed conditions that led to a deep depression in Indonesia: the unemployment rate in the central island of Java went up to 40 per cent. Anybody who thinks we are so smart today that we can avoid a depression should remember what happened in Java just a decade ago. Some of the same people who were in policy-making positions then may still be in policy-making positions today. Maybe they have learned their lesson, but maybe they have the same mental framework. We do not know, but we should obviously be concerned.

What happened ten years ago has another important implication. Because the countries in East Asia were so deeply affected by the IMF's mismanagement of these crises, many countries in that region – and, actually, many countries all over the developing world – have said they would never let this happen to them again. I was talking to the Prime Minister of one of the countries and he said, "We were in the class of '97. We learned what happened if you do not have enough reserves." The class of '97, and those who studied the lessons of the class of '97, have accumulated huge amounts of reserves, in the trillions of dollars. That is good for them and means that they are more protected. However, this presents a problem for the global economy because

these people are receiving income which they are not spending. It is like burying income in the ground, which is exacerbating the lack of global aggregate demand. The lack of global aggregate demand is, in a sense, one of the fundamental problems underlying this crisis.

Market failures and the role of government

I think it is important, as we think about this crisis, to keep in mind the underlying problems. At the beginning of the crisis, a reporter asked President Bush what the problem was. His reply was, "Well, we built too many houses." It was true that we had built too many houses, but market economies are not supposed to build too many houses in the wrong places and beyond people's ability to afford them. The question we need to ask is: why did the market economy fail? People are now saying that there was excessively lax monetary policy and weak regulation. But then one has to ask, why were there these excessively lax monetary policies and weak regulation? Unless we ask those questions, we will not understand what to do about the current crisis.

One of the reasons that there were lax regulations was the misguided economic philosophy that said unfettered markets are the best way of running an economy, since markets are self-adjusting. Fortunately, almost everybody recognizes that this market fundamentalist view is wrong. Even Alan Greenspan, the former Chairman of the Federal Reserve, who is viewed as the high priest of market fundamentalism, has said, "I made a mistake." He learned this lesson at a great cost to everybody in the world, but at least he learned it. Some people have not quite learned. Markets are not self-regulating; there is an important role for government to try to make the market economy work. Markets are at the core of a well-functioning economy, but, by themselves, they are not enough. There needs to be a balance between the role of the market and the role of the government. Understanding when markets work and when they do not, and the limitations of markets as well as the limitations of government, is an essential part of developing appropriate policy frameworks.

The second question is why monetary policies were so lax. Why did Greenspan create a bubble? Again, there is a very simple answer: in the absence of lax monetary policy, there would have been insufficient aggregate demand in the United States and in the world. Greenspan allowed this in order to keep the American economy going. But why was there insufficient aggregate demand? In a globalized economy, we can only really answer these questions at the global level. Again, there are two answers. One is that, over the past 30 years particularly, there has been an increase in inequality. In effect, we have been transferring money from the poor to the rich, from people who would spend the money to people who do not need to spend the money, and the result of that is weaker aggregate demand.

The United States thought it could solve the problem: Americans who had no money were told to keep spending as if they had it. They enjoyed it for a while. A massive debt finance bubble enabled them to continue to

spend. The richest country in the world was living beyond its means. When the United States was criticized, the Secretary of the Treasury said that the world should be thankful, because if Americans were not spending so much, the global economy would be weak. There was a sense in which he was right, but if it is true that the global economic system requires the richest people in the world to spend beyond their means, there is a fundamental flaw in the global economic system.

The problem is that the system is now broken, because it was based on American consumers spending beyond their means by borrowing and borrowing and borrowing; it was based on a bubble and house prices that were out of line. But the bubble has broken, and people now know they cannot continue to finance consumption in this way. One might say that the engine of global economic growth has been taken away.

Global inequality was one of the reasons that monetary policy was weak, but the other reason was the massive build-up of reserves that countries engaged in to protect themselves from having to turn to the IMF in case of economic volatility.

The reason I emphasize these more fundamental problems is that in the current discussions in the G-20 and other forums there is a lot of focus on trying to fix the regulatory system and a lot of attention to providing some short-run stimulus. The question is, what is going to happen in two or three years' time? What is going to replace the sources of aggregate demand that fuelled the global economy in the period 2003–07, or even before that? We have gone from one bubble to another, from one unsustainable basis to another unsustainable basis, and unless we make more fundamental reforms, we will not be able to return to sustainable, robust economic growth. That is why I have tried to emphasize here some of the more fundamental problems underlying the current crisis.

Competing paradigms, aggregate demand and wages

I now turn to some of the underlying ideas and economic paradigms, which are important in order to understand the requisite policy responses. For the past several decades, there have been two paradigms that have been waging war with each other for the hearts and minds of people all over the world. One was the “market-fundamentalism” model, which I have referred to above, based on rational individuals with rational expectations, acting in perfectly competitive markets with profit-making competitive firms. The view was that unfettered markets were sufficient to ensure economic efficiency. The best role for government was a limited one, and somehow the benefits of the growth that this would engender would trickle down to everybody in society.

The other model was based on a set of ideas that has many sources and many strands. I will pick up one of them, emphasized by Keynes, which held that markets do not always work well or self-correct. After all, the Great De-

pression did happen. There are two separate strands of Keynesian economics, one of which has been more influential but, unfortunately, largely wrong. It goes back to John Hicks and was disseminated most effectively by Paul Samuelson. This strand argued that the problem in the market economy was rigid wages, and that if it were not for wage rigidities, the economy would work in the way that classical economics predicted: markets would clear, everything would be fine, and Adam Smith would be in heaven. (Yet, Adam Smith actually understood Adam Smith much better than his modern descendants. He understood that markets do not always work well. He understood the importance of competition in ensuring efficiency, but that firms always try to restrict competition, and that you need to have competition. But the modern descendants of Adam Smith only read the parts of Adam Smith that they like.)

Modern economics explains why that tradition of Adam Smith was wrong. My own work on asymmetric information – simply the notion that some people know things that other people do not – showed that the reason why the invisible hand of the market often seems invisible is that it is not there. Markets are not, in general, efficient. This important idea is a very simple one, but it has not been taken fully on board by those who believe that markets are always efficient.

Many adherents of the rigid-wage Keynesian view argued for what was called the neoclassical synthesis, which said that the economy had two regimes, one in which things worked perfectly and in which Adam Smith was right, and another regime in which there was unemployment. All that was required was to ensure the economy was at full employment in order to ensure that markets work perfectly.

This conclusion is not based on economic science. It is neither a theorem nor an empirical “finding”. It is an article of faith. A moment’s reflection suggests that the underlying logic is very peculiar. It is much more reasonable to say that a complete breakdown of the economy, like we are seeing today and saw in the Great Depression, is symptomatic of a market failure so large that it cannot be ignored. Even market advocates say that something is wrong today. There are many other circumstances where markets are not perfectly efficient, where things are not working well, but the failures are harder to detect or predict. What we are seeing is the tip of the iceberg, but underneath there are smaller market inefficiencies on a massive scale that we ought to be aware of. In my own work I have tried to expose a number of these.

The implication of the Keynesian rigid-wage theory was very invidious but very pervasive: if rigid wages are the reason the economy is not working as well as Adam Smith said it should, what is the solution? Get rid of the rigid wages, and let labour markets be more “flexible”. That has been the basis of a whole set of doctrines undermining job protections and labour rights.

Another strand that has grown out of Keynes, which I believe is much more fundamental, is due to Irving Fisher and Hyman Minsky (who has become much more fashionable). Much of my work during the past quarter-century has been in this tradition. Part of the motivation of our work was a

simple observation: wages are not rigid. In the Great Depression wages fell by about one-third. How can anyone say that wages are rigid when they are falling, and by that amount?

The problem that Keynes recognized was that wages can be too flexible. Indeed, when wages fall, people's income falls and their ability to demand goods falls as well. Lack of aggregate demand was the problem with the Great Depression, just as lack of aggregate demand is the problem today. Imposing more wage flexibility can result in exacerbating the underlying problem of lack of aggregate demand.

Because of this current crisis, it is clear that almost no one today can believe in the rational expectations model and the efficient markets model. I say "almost no one" because there are a number of American academics who seem impervious to what has happened; no evidence will change their beliefs. They continue to believe that markets are fully efficient, even as unemployment goes up and as symptoms of irrationality become so evident. Yet once we reject the market fundamentalists, the question now is to try to understand the ways in which markets fail. The two contrasting Keynesian views – the rigid wage versus the problem of excessive flexibility – give two different ways of thinking about what is wrong and two very different policy responses.

Downward flexibility of wages or, to put it another way, deflation is a concern partly because of the loss of aggregate demand, as I have emphasized, but there is also another reason. The presence of deflation when debt contracts are nominal, not indexed, means that there will be problems of bankruptcy. Bankruptcy is costly and disruptive. Periods of deflation have historically been very difficult periods, with weak growth. Deflation was a problem in the United States and Japan in the late 1990s, and there is a worry about it being a problem today.

Bankruptcy is a concern because you can lose organizational capital if it is not well managed. If it is well managed, it is just a financial reorganization, which is an important point to realize. A lot of people today are *excessively* afraid of bankruptcy because it has been, in some instances, very badly managed. However, well-managed bankruptcies – as provided for under Chapter 11 of the United States Bankruptcy Code, for example – can maintain the integrity of the firms and be an effective way of going forward. One should not be afraid of it, though, to be sure, it is not costless.

The nature of the problem that we face today can be put in the following way. The people in the global economy have the same skills as before the crisis, and the machines and real resources are the same as before the crisis. The problem is that there is an organizational failure, a coordination failure, and a macroeconomic failure. We are failing to put to work these human and physical resources to produce output. What this highlights is the importance of economic policy and organization. It is not our resources that have disappeared. It is the way we organize those resources to create jobs and to create value. The challenge, in going forward, is to try to create the aggregate demand that will put those resources back to work. The question is: what kinds of policies and reforms are likely to do that? If we start asking that question,

we realize that many of our policy frameworks in recent decades have been making things worse. I have already mentioned that we have weakened our automatic stabilizers by weakening social protection, and we have destabilized the economy by making wages more flexible rather than providing job security. We have created greater anxiety, which, in times like this, increases savings rates and weakens consumption. All of these so-called reforms have made our economic system less stable and less able to weather a storm.

The lending crunch, bank bail-outs and the social consequences of skewed incentives

In addition to the inadequacies of the stimulus, which I have already mentioned, another big problem facing the United States today in designing an effective recovery programme to address the economic crisis has been figuring out what to do with the failed banking and financial system. We all know what needs to be done, but it will be a challenge. We want to restart lending in a way that puts the least burden on the government deficit and debt. Unfortunately, the bank bail-outs have done just the opposite: hundreds of billions of dollars have been spent, increasing the national debt but with no increase in lending. If the United States had taken US\$700 billion and created a new bank, unburdened with the past, and allowed it to leverage 12 to 1 – which is very modest compared to the risky 30 to 1, 50 to 1, and up to 100 to 1 leverage that the banks being bailed out had – at just 12 to 1 that 700 billion would have created US\$8.4 trillion of lending capacity. That US\$700 billion could thus have been used to generate all the lending capacity required, including loans for small businesses and to maintain enterprises. The profits from the new bank would have paid back the Government. Instead, it was decided to spend the money in ways that protect some existing vested interests.

It is simple to understand what has happened: banks in the United States created some toxic assets. Some of them were sold to Europe, but a lot of them are still held back in the United States. The mistakes have been made, and a basic law in economics is to let bygones be bygones. The losses are there. The banks loaned on the basis of a bubble, and the bubble has broken. Nothing is going to change that. A lot of people, in the financial sector and elsewhere, want everyone to believe that somehow if there were just a restoration of confidence, the losses would disappear. I wish that they were right, but they are wrong. There was a bubble that was apparent at the time and is doubly apparent now. Now the question is: who bears the losses? This is close to a zero sum game. What do the banks want? It is very easy: the banks want the American taxpayer to take up those losses. If I were a banker, I would want it too. No one likes to bear the losses or consequences of their mistakes. They are trying, in one surreptitious way or another, one non-transparent way or another, to force those losses onto the American taxpayer. The irony is that a lack of transparency got us into this mess, and now some people are trying to use a lack of transparency to get us out of this mess.

An example of a non-transparent way of doing this is to insure the losses. You take a bundle of toxic assets, and you say, I will insure the loss. But that does not make the loss go away: it just puts the loss onto the balance sheet of the United States Government. However, there is a difference between the accounting frameworks. Moving the losses off the bank's balance sheet shows up as a gain to the bank, so it looks better. However, the United States Government does not keep its books in a way that shows the expected losses, as the losses are not recorded until they occur. We can all go through the fantasy of saying, look, we solved the problem, but only because we were being non-transparent. It is a good trick, but it does not solve the problem because in a few years' time the national debt of the United States is going to be larger, possibly much larger.

In fact, it is worse than a zero sum game, it is a negative sum game. If you do not get incentives right, you get bad behaviour, and part of the problem of the financial sector is that incentives have consistently been bad. As the United States was pouring money into the banks, and the banks were taking money out in bonuses and paying dividends, people looked at this behaviour and said: are these bankers not terrible? Everybody says, yes, American bankers are ethically challenged. That may be true. However, the main problem is that they were responding to perverse incentives, just as earlier they responded to incentives which encouraged them to act in a short-sighted way and engage in excessive risk-taking. In both instances, they behaved in the way that incentives drove them. In fact, I was worried as I looked at the behaviour of the banks in the years leading up to this crisis, because I believed very strongly that we should be seeing serious problems. When we did not see those problems, I worried that my theory was wrong. But the problems that were predicted have now become manifest.

The insurance scheme also gives rise to perverse incentives. The losses of Citibank, for instance, have been insured. They pick up 10 per cent of the loss, and the Government picks up 90 per cent. Mortgages are a key part of the problem, and they ought to be resolved. Even if a house is "underwater", meaning that the value of the mortgage is much greater than the value of the house, it would be better for everybody if people got to stay in their homes. It does no one any good to throw people out of their homes: the house gets wrecked, and the community is weakened. Millions of Americans are losing their homes, and with their homes their life savings. The United States has a social problem, not just an economic problem.

We need to do something about this, but the provision of insurance to the banks against losses makes it even worse. For example, take a mortgage that ought to be resolved. There is a small probability that the price of the house goes up. If it is not resolved and the price goes up, Citibank gets to keep the gain. If the price goes down, which is very likely, the American taxpayer bears the loss. It is a heads-I-win, tails-you-lose situation. This has created a situation where banks have an incentive not to resolve these mortgages and to engage in excessive risk-taking behaviour. It has created asymmetric incentives. That is why this is a negative sum game.

More broadly, the United States Government has provided most of the capital for several of the major banks, but it does not have control of decision-making in these banks. This is true not only in the United States but also in other countries – wherever there is a disparity between who provides the capital and who is making the decisions, there are perverse incentives. These are the first laws of economics. Perverse incentives produce bad behaviour, which destroys wealth. In other words, these countries have created incentives for wealth destruction rather than wealth creation.

These budget deficits will have long-term effects. A few years ago, President Bush said to the American people: “We have a problem. Our social security (which is America’s old-age public pension programme) is broken. If we do not do something about it, we will have to break the covenant, the social contract. It will also break our economy.” At that time, the size of the deficit in social security – known as the 75-year deficit – was about US\$560 billion. For less than what was spent on bailing out the sick banks, which are still sick, the United States’ social security system could have been put on a sound financial basis for generations to come. All the retirees for the next 75 years could have been told that they do not have to worry about their retirement. Now President Obama is also saying that social security has to be re-examined because the funds are not available.

Resources are limited – which is the subject of economics – so choices must be made about how to use those limited resources. Some poor choices have been made in how to bail out ailing banks. And those choices have social and economic consequences, one of which is that there will be elderly people whose retirement benefits will be put in jeopardy.

Concluding remarks

As we approach the problems posed by the current crisis, it is imperative to keep in mind the importance of maintaining the automatic stabilizers and the social protections. For a robust and sustained recovery, we must also address the underlying problem of insufficiency of aggregate demand, caused by global inequality as well as inequality within countries, and the build-up of excessive reserves, which is related to the global imbalances that have been a cause of growing concern in recent years. Unless the problems in developing countries are addressed in a more effective way than they have been in the past, the inequality will increase and the demand for excessive reserves will grow even greater.

We have to have a better way of managing global risks – including a new global reserve system to replace the dollar reserve system, which is fraying. While we all work hard to fix the problems and reform the regulatory system, we have to recognize that these actions only fix the plumbing. Of course, it is important to have good plumbing. However, if we do not address these more fundamental problems, we will not be able to restore our global economy to sustainable, robust and equitable growth.