# IV

# *Investment*

THE principal urge towards planning in modern states is the desire to achieve a much higher level of investment than is likely in an unplanned society. This is often confused with planning for stability but has nothing to do with it. In early formulations of the Keynesian doctrines it was thought to be necessary to plan investment not to keep it high, but to keep it steady, because it was believed that income and employment are a direct function of investment. This is true, or true for all practical purposes, if investment is defined to include everything except consumption, as Keynesians do define it, but not if investment is meant in the narrower and everyday sense. Income and employment can be kept steady through stimulating or restricting consumption by means of budgetary deficits and surpluses, and the maintenance of full employment does not itself demand any control over investment. The reason governments plan investment, in Russia or Eastern Europe, or in the U.K., is to get a higher level of investment than would occur if investment depended solely on the voluntary savings of the public.

Investment must be matched by savings, either voluntary domestic savings, or foreign savings, or inflationary savings, or government savings. In the past the first three have been responsible for nearly all the investment that has occurred; domestic savings have seldom been sufficient, except in the richest countries, to finance the whole of domestic investment, and even they, e.g. both the U.K. and the U.S.A., were borrowers in their early days. Nowadays foreign borrowing is unpopular, mainly through fear of foreign control; the weaker countries shun it, and it is the stronger countries that resort to financing domestic investment by foreign borrowing, as we have been doing so largely in the U.K. in the past three years. Inflation (forced savings) has tended to take the place of foreign borrowing, particularly in the U.S.S.R. in the early 'thirties, and in most of Europe today. But inflation has serious evils, as we have seen in the preceding chapter. If foreign borrowing is shunned and domestic savings are insufficient, we must fall back on a large budget surplus.

Voluntary domestic savings are always insufficient in a country which seeks to achieve rapid progress, and are all the more insufficient the more there is planned equality. "Since the rich save more than the poor, countries in which the national income is very unequally distributed save much more than similar countries in which there is more equality." Accordingly the more successful are plans for equality, the more necessary become plans for investment. The planning of investment is the corollary of the planning of equality.

The alternative is to be content with a very low rate of progress. For example, in Great Britain in 1947 gross investment was about 21 per cent of national income, but 7 per cent of national income was borrowed abroad, so domestic saving was only 14 per cent; this, also, was inflated—had there been no inflation in 1947 domestic saving might only have been 12 per cent. Now it is estimated that merely to replace existing capital as it wears out requires about 10 per cent of national income. So, in the absence of inflation and foreign borrowing, net new investment in 1947 would probably not have been more than about 2 per cent of gross national income.

If net investment were kept at this level, the British standard of living would increase only very slowly, and the prospect of being able to abolish poverty and to give to everyone a reasonable standard of material enjoyment would recede into the distance. Other countries would soon surpass this country, for in other countries investment is proceeding apace. Already we are far behind the U.S.A., and for seventy years our rate of material progress has been behind that of several countries, in Europe and elsewhere. This is partly because many British investors in that time were more interested in sending their money abroad than in investing at home, so that domestic industries fell behind, and partly because, in the period between the two wars, there was so much unemployment and excess capacity in staple British industries that their owners had neither the money nor the will to re-invest. In consequence many British industries need largely to be re-equipped with modern equipment if the workers are to produce all that is possible.

The argument must not, however, be pushed too far. The claims of consumption are as real as those of investment. The purpose of present investment is future consumption, and we would be foolish to starve ourselves in the present simply to increase consumption at some later date. The Russian government, for example, imposed an immense strain on its people in the 1930's when it decided to go all for producing machinery and guns instead of butter and shoes and houses, and we should certainly not try to imitate them. In a democratic country efforts to cut consumption or to keep it low, in favour of investment, are sure to be resisted. A government may get away with planning for as much as 15-20 per cent of the national income to be used for gross investment, but if it tries to go further than this it will meet considerable resistance.

If a government wishes to carry through a large investment programme without cutting consumption, the only remedy is foreign borrowing. That is what we have been doing in this country for the past three years. For example, in 1947 national production and national consumption were just about equal to production and consumption in 1938—a little more or less. Why then did we have a large adverse balance of payments in 1947 whereas we were almost in balance in 1938? The answer is because gross investment was very much larger; in fact the increase in gross investment was just about equal to the adverse balance of payments. This is not generally realised. There are those who speak as if the adverse balance is due to riotous living by the British people; and others who allege that the standard of living is being maintained only by American charity. The truth is simply that we have been borrowing abroad to finance capital formation at home. This is a very sensible thing to do, provided that the capital is not being wasted, and that the terms on which it is borrowed are not onerous. But it is possible only so long as, and to the extent that, other countries are willing to lend. If reasonable creditors abroad cannot be found, a country cannot invest at home, beyond the point where it has exhausted its reserves of gold and foreign exchange, without cutting consumption. And since the public is certain to resist a cut in consumption, the government must limit its investment plans.

Whatever the figure at which it aims, the first principle of investment planning is that the government must have a budget surplus large enough to fill the gap between the investment that is planned and the voluntary savings that are available (including long-term borrowing from abroad). If it has not, then there will be either inflation at home, or an involuntary adverse balance of payments

(The second principle is that stocks of raw materials, work-in-progress and finished commodities are as important a part of investment as is fixed capital. For it is the existence of stocks that enables an economy to work smoothly. As soon as stocks are low productivity falls, because producers then depend absolutely on receiving a steady flow of supplies, and are held up cumulatively by chance interruptions in delivery) Normally these considerations are not important, and net investment in stocks is not required. But at the end of a war, or of an inflation, the economy is short of stocks, and a large investment in stocks is the first thing that is needed in order to get productivity as high as possible. When we remember that stocks should normally stand at between 3 and 6 months of requirements, the magnitude of the sums involved will be seen. Failure to build up stocks has been one of the principal errors of the British investment programme.

The third principle in investment planning is that investment must not be planned beyond the limits of the physical resources available, no less than the financial resources. It is no use planning for 20 per cent if the steel and timber available are enough only for 12 per cent.) By all means expand the capital goods industries as rapidly as possible, so that it may become possible soon to plan for the desired level of investment. But the starting point now must be not what is desired, or what will be possible next year or the year after, but what the existing resources in the capital goods industries now permit, after making allowance for such part of their product as has to be exported. (It is a common error of governments, including our own, to advance so many investment projects simultaneously) that the available resources of steel, machinery, cement, labour, and so on are insufficient to cope with them all. Then there is intolerable confusion. Many projects are started, and then held up at crucial points, and instead of having a substantial number of finished projects, we get instead a much larger number of unfinished projects, most of which cannot proceed because the resources they need for finishing are locked up in other unfinished projects. It is foolish to plan for more investment than the available physical resources will permit.

In our case we have added to our problems by doing what we can to encourage investment at a time when what was needed was discouragement. We came out of the war with such arrears of investment that if all the things people wanted to do were added together they would probably amount to 40 per cent to 50 per cent of the national income for some years. There were houses to be built, private industry to be re-equipped and extended, and a vast programme of governmental projects from schools and hospitals to coal and colonial development. At other times, and in other places, the problem is the reverse of this, namely, how to stimulate investment, and the government has then to mobilise its weapons, its subsidies, low interest rates, generous depreciation allowances, and the like. But in contemporary Britain what we need is to discourage investment; that is to say to find means of checking and eliminating the less urgent projects, so that the nation will not embark on more than the 20 per cent that is the financial limit, or the still smaller figure that the physical resources can support.

How is this to be done? There is the familiar choice between direction and inducement. The government can decide to license investment, so that every single project has to be examined by its officers (at one time we took this to the limit, in the building industry, of requiring a licence for decorations costing £10), or it can make new investment so costly that all except the most urgent projects, adding up to 20 per cent, are voluntarily postponed.

The method of licensing is so cumbersome that it cannot be efficient. Who is to decide between the relative urgencies of a new bridge in Basutoland, a new hospital in Aberystwyth, a new mousetrap factory in Glasgow, or a new cinema in Oxford? The answer is that nobody can decide, and that therefore conscientious officials, fully knowing that they have not the facts on which to base a judgment, will pass everything that seems on the face of it to be reasonable. The result is always that more licences are granted than the available resources can fulfil, and that there is an unholy scramble in the course of which many of the most urgent projects are held up because the promoters of the less urgent have been more skilled in the arts of acquiring scarce materials.

To say this is not to imply that the alternative, which is to make new investment very costly, gives perfect results. It knocks out all the projects that cannot afford a high price, and some of these are urgent. But it is simpler for the government to correct this error by subsidising the projects which it considers specially urgent, so that they are able to afford the high cost of investment, than it is to launch upon the meaningless and ineffective method of licensing. Neither need the method of inducement and subsidy be costly to the government, as we shall see in a moment.

The traditional way of making investment more costly is to raise the rate of interest. It is an effective way, if the rate is raised high enough. For example, if £1,000 is invested for twenty years at 10 per cent, it must yield £117 a year for interest and repayment of capital. This would also be the annual charge if the rate of interest were kept at 3 per cent, but a tax imposed bringing the cost of investment up to £1,748. That is to say, on a twenty year investment the difference between a rate of 3 per cent and a rate of 10 per cent is equivalent to as much as a tax on investment of 75 per cent.

Raising the rate of interest may also help to increase voluntary saving, but this is much less certain. A savings campaign is very necessary in these circumstances, but raising the rate of interest does not make much contribution to this.

The objection to raising the rate of interest is that it increases the unearned incomes of lenders, doing this both at the expense of private borrowers and at the expense of the government, which is frequently in the market either for new loans or for purposes of conversion. This is not an insuperable objection, because it is always possible to adjust the taxes on unearned incomes in compensation. It seems a difficult political issue only because the left does not realise that when interest rates rise capital values fall *pari passu*, and the loss inflicted upon capitalists by this is much greater than any gain that accrues from higher interest rates. Indeed, the real objection to playing about with interest rates is precisely the fact that this causes wide fluctuations in capital values which give an unfair bonus to property owners when rates fall, and impose an unfair tax upon them when rates rise (including some of those who have responded to savings campaigns).

(The alternative way to make investment more costly is to impose a tax upon it. This is not as effective an alternative in one sense. A rise in the rate of interest hits investments for long periods harder than it hits short investments. It therefore encourages people, when capital is short, to use it for purposes that yield results in the immediate future rather than for those that take time to bear fruit. And this is one of the savings that we wish to make. A tax on investment, on the other hand, hits all investments equally, irrespective of their duration, and is therefore inferior to raising the rate of interest in the sense that it does not discriminate sufficiently against investments of long duration.)

This argument is perhaps less forceful now that the majority of investments of long duration are in projects directly under government control, such as houses, communications, and fuel, for the government is less sensitive to changes in cost than is the private investor, and not therefore so easily controlled by such weapons as the rate of interest. Some would argue the other way; that since the government tends to be extravagant in its investment projects, it is all the more important to submit such projects to the test of the rate of interest. There cannot be much in this either way. The Treasury has to learn to put a global limit on government controlled investment, so that private industry shall not be starved of capital, and it has to develop its own technique (including possibly charging a high rate of interest to Government undertakings, actually or notionally) for rationing out what is available between the various government claimants. If Parliament, public opinion, and common sense will not force the Treasury to learn this lesson, then it is unlikely to let itself be forced by permitting high interest rates to be levied upon it.

We come here to a very serious problem for which no solution has yet been found. All planning governments tend to be at one or the other of two extremes. In the one case they produce vast plans for houses, schools, hospitals, civic buildings, roads, and other forms of public works, and use up so much capital for these purposes that very little is left for productive industry, which is thus starved of capital. In the other case they fix their eyes on industrial projects, while housing gets worse and worse as people crowd in increasing numbers into towns that are building nothing but factories. Democratic governments, like that of the U.K., are particularly prone to the first error, because they win elections on programmes demanding a vast expansion of social services, while asking for the re-equipment of private industry gains no votes. Dictatorial governments, like that of Russia, and governments of backward countries anxious to industrialise are prone to the other error, and neglect to provide capital for social amenities. There is indeed no simple formula that tells us how to weigh up the respective capital needs of production and of social amenities; certainly the rate of interest (which would be the *laisser-faire* answer) cannot discriminate between the social usefulness of schools, health centres, roads, houses, irrigation works, and factories. We are here in one of those spheres of public administration where no precise line can be drawn, and where we depend simply on democratic judgment to ensure that neither extreme is adopted, to the exclusion either of productive investment or of social amenities. There are two things we can do. The first is to insist that productive enterprises should all have to pass the same tests, in their demands for capital, whether they are nationalised or in private hands; that is to say, that it is wrong that nationalised industries should be able to get capital more easily or more cheaply than private industries just because they are nationalised, and without other reference to their relative urgency and productivity, e.g. as compared with industries producing for xport, or with agriculture, or with engineering. And secondly ve can insist on publication and free public discussion of the annual capital budget, which shows how the available capital is to be allocated between the various claimants; of this we shall say more in the final chapter. ✓

This digression on the control of governmental demands on capital interrupted a discussion of the relative merits of taxing investment and of raising the rate of interest as means of reducing demand to the level of supply. The first disadvantage of the taxing method, we saw, was that it does not discriminate in favour of short term investments and against long term investments, as does raising the rate of interest. The second disadvantage is the administrative problems that it raises. The simplest way to impose the tax would be to put (import or excise) duties upon those materials that are needed in nearly all investments, namely steel, timber, bricks and cement. Such a tax would be easy to collect, and though it might cause some shift to substitute materials, this would be negligible. More serious would be the fact that it would necessitate paying a drawback on exports using these materials. Exporters would find this a nuisance, and full of anomalies, but since they would be receiving money for once, instead of paying it out, they would probably bear the burden cheerfully.

Against these disadvantages must be set an important advantage. If the rate of interest is raised, investment is as it were taxed for the benefit of private lenders; but if the government imposes a tax, the proceeds go not to private lenders but into the public coffers. This has the additional advantage of providing a fund that can be used to subsidise those desirable investments which cannot afford to pay the higher cost.

To sum up, neither raising the rate of interest nor taxing investment is without disadvantage, and probably what is needed is some combination of both. Either of these is superior to setting officials to assess the merits of each project, but even this is better than to make no effort at all to keep investment projects within the limits of the available resources.

## CONCLUSION

The conclusions of this chapter are as follows:

(1) The state is justified in stimulating investment if investment would otherwise be too low; but the problem of contemporary Britain is rather to check investment.

(2) There must be a budget surplus equal to the difference between voluntary savings and investment, or there will be either inflation or an adverse balance of payments.

(3) There must be adequate provision for stocks.

(4) The sum of investment projects must not exceed the physical resources available in the capital goods industries, after allowing for exports.

(5) The licensing of investment is an inefficient way of keeping this sum within the necessary limits.

(6) The best way to achieve this purpose is a combination of a high rate of interest and a tax on some of the materials used for investment.