Economic Advisory Council: The State of Trade*
(Excerpts)
Answers by Mr J.M. Keynes, C.B. to the Prime Minister’s Questions.

[...]

A. MEANS TO INCREASE OUR FAVOURABLE FOREIGN BALANCE

1. By decreasing our costs of production

(i) By the rationalisation of industry. This is, of course, essential to prevent retrogression relatively to other countries. How much we can positively improve the position, as distinct from preventing further deterioration, is doubtful. Moreover a considerable proportion of so-called ‘rationalisation’ is considered to deal with the problem of surplus capacity. This may reduce losses and even restore profits, but it will not increase our foreign balance. Nevertheless, we ought without doubt to press on rationalisation by all possible means.

(ii) By the reduction of taxation. If this means the reduction of aggregate taxation, it is obviously desirable; but I do not believe that any important reduction is practicable, otherwise than by suspending the sinking fund, which I would advocate in the present emergency, except in so far as it is required to effect borrowing by the Insurance Fund. If it means the avoidance of increased aggregate taxation, certainly it is important. If it means the re-distribution of taxation so as to bear less hardly on industry, the question deserves careful examination. De-rating was an effort in this direction. Increased allowance for depreciation and renewals in respect of income tax would be another. An increased liability of the state for employers’ insurance contributions would be a third (but would this be practicable without also relieving the employees’?). Decreased direct taxation of profits by means of increased indirect taxation of the consumer (e.g. by a revenue tariff) would perhaps help. At the same time I believe that most business men greatly exaggerate the effect of our taxation on costs of production. On balance, our taxation system probably increases the costs of production less than that of any of the high protectionist countries.

(iii) By the reduction of efficiency wages. This could be effected either by reducing the actual earnings of employees, or by workers making themselves more efficient for the existing wage. The almost complete rigidity of our wage rates since 1929, in spite of the great reduction of all other price levels, is very striking to the imagination. The fact that, in spite of all adverse circumstances, we have been increasing real wages faster than ever before in our history, has undoubtedly much aggravated our other difficulties. We have been going ahead-by force of circumstances rather than by any deliberate decision-rather faster than is wise. But all the same there is now, in my judgement, a very set and deliberate determination in almost all quarters of the community not to go back on this as a general policy-though in certain cases wage reductions are inevitable and are in the interests of the workers themselves-except as an absolutely last resort.

The unwillingness of employers and associations of employers, who have appeared before the Macmillan Committee to recommend this solution has been truly remarkable. In order to test this feeling, I have often in examination pressed them to fall back on this recommendation and almost always without success.

But it does seem to me to be up to the trade unions to respond to this attitude by
meeting the employers to the utmost on conditions and restrictions affecting efficiency, and that there should be a deliberate policy on the part of the workers to give greater efficiency in return for their wages. Why should not the trade unions take the initiative in approaching the employers along these lines?

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